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EFRAG's proactive project on the statement of cash flows

Cover Note

Objective

- 1 The objectives of this session are:
 - (a) To introduce the contractor (Zielke Research Consult GmbH) that will assist EFRAG on its proactive research project on cash flow reporting and inform about the delivery of the outsourced work.
 - (b) To confirm the approach of issues to be identified in the first phase of the Discussion Paper.
- 2 For information purposes the appendix to this paper includes an overview on the initial feedback on the objectives/uses of and the issues with the statement of cash flows.

Background

- 3 Following the 2021 consultation on EFRAG's research agenda, EFRAG decided in June 2022 to include on its research agenda a project on the statement of cash flows (see [EFRAG feedback statement](#)).
- 4 The reasons for adding this project to the EFRAG proactive agenda were that:
 - (a) the project could be useful for the IASB, since the IASB has also decided to include a project on the statement of cash flows and related matters as research pipeline projects following its Request for Information (RfI) on its Third Agenda Consultation; and
 - (b) the project could encompass supply financing arrangements, which was deemed as a suitable EFRAG proactive project.
- 5 EFRAG will issue a Discussion Paper for public comments that will:
 - (a) list and briefly discuss different alternative objectives/uses of the statement of cash flows. This will include considering whether the statement should reflect changes in cash, changes in cash and cash equivalents, or changes in working capital or net debt;
 - (b) list the issues with current requirements/practice. The issues would be categorised/labelled according to which use/object of the statement of cash flows (in (a)) they would be related to;
 - (c) discuss whether the IASB could consider the issues by targeted amendments, or a comprehensive review would be necessary to deal with the issues in a satisfactory manner.

- 6 As approved by the EFRAG FRB in its June 2023 meeting, EFRAG outsourced parts of the project listed in 5(a) - 5(b).
- 7 The contractor's report should be written and structured in a way that is most useful for the publication of EFRAG's Discussion Paper.

Timeline and scope of the outsourced work

- 8 The milestones of the outsourced work are listed below:
 - (a) November-December 2023: The EFRAG Secretariat organised roundtables for different stakeholder groups¹ to collect input for the outsourced parts of the project.
 - (b) 19 December 2023: Input from EFRAG FR TEG and EFRAG FRB on the first part of the report will be collected by the contractor.
 - (c) 30 January 2024: The final version of the first part of the report will be submitted to EFRAG by the contractor.
 - (d) 28 March-4 April 2024: Review and revision of the second part of the report.
 - (e) W/c 15 April 2024: Input from EFRAG FR TEG and EFRAG FRB on the second part of the report will be collected by the contractor.
 - (f) 3 May 2024: The final version of the report will be submitted to EFRAG by the contractor.
- 9 A more detailed overview of the different phases of the project, including deliverables and timelines, can be found in the [open call for tender](#) (part A.3.1), as issued by EFRAG.

Issues to be addressed in the Discussion Paper

- 10 In previous meetings, the FRB highlighted that the project should focus on the fundamental issues as this was considered to be most useful for the IASB. The IASB, has subsequently informed the EFRAG Secretariat that a comprehensive list of issues would be most useful. Consequently, the EFRAG FR TEG in its [October 2023](#) meeting discussed the topic and considered that the contractor should provide a comprehensive list of the issues with the statement of cash flows, rather than focusing on specific issues only. EFRAG FR TEG members noted that in order to identify and focus on the fundamental issues, a comprehensive list should be provided as a basis.
- 11 Therefore, the EFRAG Secretariat seeks for EFRAG FRB's views on the structure of the report and on what the contractor should emphasize on so that it is most useful for EFRAG's Discussion Paper.

Initial feedback received

- 12 Thus far, EFRAG has collected initial feedback on the objectives/uses of and the issues with the statement of cash flows, which can be found in the **Appendix** of this cover note.
- 13 The initial feedback and any additional inputs received during this meeting will be considered by the contractor when conducting the work.

¹ There are three different types of roundtables, focusing on different stakeholder groups: [Financial Institutions and auditors of financial institutions - 17 November](#), [Corporates and auditors of corporates - 27 November or 4 December](#), [Users and Academics – 1 December](#).

Questions for EFRAG FRB

- 14 Does EFRAG FRB has any questions or comments on the outsourced work?
- 15 Does EFRAG FRB has any comments on the outreach approach of the first phase of the project? Is EFRAG FRB aware of other industry specific issues to be addressed besides the ones of financial institutions? Does EFRAG FR Board consider necessary to reach out to other industries to properly reflect their issues in EFRAG's Discussion Paper?
- 16 Does EFRAG FRB agree with EFRAG FR TEG's proposal to include a comprehensive list of issues in the Discussion Paper, but focusing on the description on the fundamental issues?
- 17 Does EFRAG FRB have inputs to provide to the contractor on the structure of the report, focus points and relevant literature that can be used for the project?

Next steps

Outreach

- 18 The EFRAG Secretariat will organise roundtables for corporates, financial institutions and users/academics to allow the contractor to collect inputs from the roundtables for their report.
- 19 The contractor will organise additional interviews with relevant persons to obtain information about the objectives/uses of and the issues with the statement of cash flows in practice.

Contractor's report

- 20 The first draft of the report on input for EFRAG's Discussion Paper on objectives/uses of the statement of cash flows will be submitted to EFRAG FR TEG and will be discussed in the December 2023 EFRAG FR TEG-FRB joint meeting.

Information exchange with the contractor

- 21 The EFRAG Secretariat will ensure the on-going information exchange with the contractor and will be reviewing the progress of the report.

Appendix: Identified objectives/uses of and issues with the statement of cash flows identified by EFRAG FR TEG and EFRAG working groups

Objectives of the statement of cash flows

- 22 The following views have been expressed:
- (a) there is no primary objective for the statement of cash flows. It shows where an entity got its money from and what it did with the money;
 - (b) the objective is to explain why cash has not changed with the net profit of the period;
 - (c) the objective is to provide information on liquidity (specifically insurance companies);
 - (d) the objective is to depict the 'rhythm' of the operating, investing and financing cash flows;
 - (e) the objective is to offer a collection of information that can be used by users in their own analyses on e.g., credit worthiness; and
 - (f) for financial institutions (banks), the objective should be to provide information on liquidity risk (as the statement of financial position may not reflect problems with liquidity).
 - (g) the interaction with the other primary financial statements is not clear.

How the statement of cash flows is used

- 23 The following uses were mentioned:
- (a) to assess management's stewardship — how the management is dealing with the cash the entity is generating (CapEx policies, capital policies, what is financed, impact on statement of financial position, free cash flow generated compared to invested capital);
 - (b) to help reconcile movements in net debt (e.g., what is repayments and what is interest) to calculate cash yield numbers);
 - (c) to help reconcile cash movements;
 - (d) to assess liquidity;
 - (e) to understand working capital dynamics (e.g., how much working capital is absorbed as the entity grows);
 - (f) to compare CapEx with depreciations (to assess whether entities are growing – and for corrections to discounted cash flows projections). It is used to assess what profit is realised (and not e.g., changes in fair values); and
 - (g) it is currently not used much for banks.

Issues with the statement of cash flows

- 24 The following issues/views have been mentioned:
- (a) The statement of cash flows is prepared very differently from one entity to another (different layout and different categorisation of cash flows). Comparability is an issue.
 - (b) Dividends to non-controlling interests are often included in the same figure as dividends to the entity's shareholders.
 - (c) Business combinations complicate the interpretation of the information in the statement of cash flows.

- (d) It could be more useful to reconcile net debt (net financial obligation or net interest-bearing instruments or something similar).
 - (e) The usefulness for assessing liquidity could be improved (see also point on restrictions on cash).
 - (f) It might not be possible/useful to achieve 'cohesiveness' with the labelling in the statement of financial performance. For example, operating income is after depreciations, but cash flows from operating activities is before CapEx - and analysts did not want to change that.
 - (g) The current disclosures around the statement of cash flows are insufficient (e.g., on non-cash transactions, working capital, covenants, restrictions on cash (e.g., in the consolidated statement of cash flows). Disclosures could also be improved on liquidity (which would be relevant for banks) by providing e.g., Liquidity Cover Ratio (LCR) and the Liquidity Mismatch Index (LMI) and for insurance companies maturity analyses of insurance liabilities and CSM.
 - (h) Cash is not defined and it is unclear what cash equivalents comprise (i.e., there are different views on what 'cash equivalents' consist of).
 - (i) The exclusion of certain transactions/classification of certain transactions including an intermediary is not useful (e.g., investments made by share-based payments, supplier finance arrangements, leases and purchase of an asset with deferred payment terms).
 - (j) The statement is not useful for banks (as it does not focus on providing information on liquidity risks) and to some extent also not for insurance companies (but the issues for banks and insurance companies are not completely the same (insurance companies can be illiquid but solvent) – and there may also be differences between non-life and life insurances). The issue may be further complicated by the existence of conglomerates including both banking and insurance businesses.
 - (k) The reasons for the differences in presentation between the statement of cash flows and the other primary financial statements is partly unclear. To use the same labelling (operating, investing, financing) as in IAS 7 within the expected IFRS 18 might be confusing.
- 25 The indirect method to present cash flows from operating activities was generally considered most useful by the (European) EFRAG working group members. Cases where the direct method was most useful included when there were significant business combinations. The direct method would also provide more granular information about the differences between operating cash flows and the related items in the statement of performance.

Background of the IASB project

- 26 In April 2022, following the Third Agenda consultation feedback received, the IASB added the project *The statement of Cash Flows and Related Matters* to the research pipeline of its 2022-2026 workplan.
- 27 In the [Feedback Statement](#) on the Third Agenda Consultation, published in July 2022, the IASB noted that, as part of this project, the IASB will consider whether the project should aim to review IAS 7 comprehensively or make more targeted improvements. The IASB's feedback statement referred to the issues identified by the respondents to the RFI as issues that could be considered in the project.
- 28 Many respondents to the IASB's RFI considered that it was a high priority to solve existing deficiencies, although they had mixed views about the nature and extent of those deficiencies. For instance, some supported a comprehensive review of IAS 7, while other

respondents were in favour of a targeted approach on specific issues. These issues included both presentation issues (such as the classification of cash flows into operating, investing and financing activities) as well as other issues (including improving disclosures about non-cash movements, such as factoring of trade receivables and reverse factoring of trade payables). Additionally, the project may address some issues that arose in the Primary Financial Statements project but were outside its scope.