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Use of and issues with the statement of cash flows

Issues Paper

Objective

- 1 The purpose of this session is to receive input on what improvements users of financial statements consider could be made to IAS 7 *Statement of Cash Flows*. This is done by asking:
 - (a) how the statement of cash flows would be most useful (what should be the purpose of the statement of cash flows);
 - (b) how users (currently) use the statement of cash flows; and
 - (c) what issues users encounter with how statements of cash flows are currently prepared/the current requirements.

Background

- 2 Following the 2021 consultation on EFRAG's research agenda, EFRAG [decided to include on its research agenda](#) a project on the statement of cash flows. EFRAG FR TEG and the EFRAG FRB will discuss the scope of the project at future meetings. The project should provide input to the IASB's research project on the statement of cash flows and related matters. The IASB prioritised the project as a result of the feedback received in response to the [IASB's Third agenda consultation](#) and may start working on in 2024.
- 3 During the agenda consultation many considered it a high priority to solve existing deficiencies. However, mixed views were provided about the nature and extent of those deficiencies. Some respondents supported a comprehensive review of IAS 7, while others were in favour of a targeted approach on specific issues. As part of its initial work, the IASB will consider whether the project should aim to review IAS 7 comprehensively or, instead, to make more targeted improvements.
- 4 For EFRAG's discussions on the scope of the project, input is warranted from users on what the purpose of the statement of cash flow should be, how it is currently used and issues with current requirements/practice.

The purpose of the statement of cash flows

- 5 IAS 7 currently lists several objectives of the statement of cash flows. Paragraphs 4 and 5 of IAS 7 thus state:

A statement of cash flows, when used in conjunction with the rest of the financial statements, provides information that enables users to evaluate the changes in net assets of an entity, its financial structure (including its liquidity and solvency) and its ability to affect the amounts and timing of cash flows in order to adapt to changing circumstances and opportunities. Cash flow information is useful in assessing the ability of the entity to generate cash and cash equivalents and enables users to develop models to assess and compare the present value of the future cash flows of different entities. It also enhances the comparability of the

reporting of operating performance by different entities because it eliminates the effects of using different accounting treatments for the same transactions and events.

Historical cash flow information is often used as an indicator of the amount, timing and certainty of future cash flows. It is also useful in checking the accuracy of past assessments of future cash flows and in examining the relationship between profitability and net cash flow and the impact of changing prices.

- 6 Changes, if any, to IAS 7 should reflect how the statement of cash flows would be most useful – that is what the main purpose/the added value of the statement of cash flows should be. Should the purpose, for example, be:
- (a) to provide information for estimating future cash flows/assessing the value of an entity (for example, by providing information useful for estimating free cash flows);
 - (b) to provide information for assessing the management of working capital;
 - (c) to assess the liquidity of an entity; or
 - (d) perhaps be different for different types of entities?

Questions for EFRAG User Panel and EFRAG FR TEG

- 7 What should be the primary role/purpose of the statement of cash flows?
- 8 Is this primary role/purpose of the statement of cash flows relevant as well for Financial Institutions or do you see a different purpose for Financial Institutions?

Use of the statement of cash flows

- 9 To examine how changes, if any, should be made to current requirements in IAS 7, information on the manner the statement of cash flows is currently used (including any 'corrections' made to reported figures) would be beneficial. Information on the manner the statement of cash flows is used, includes identification of the information that is used and how this is utilised - directly or in combination with information from other statements and the notes.

Questions for EFRAG User Panel and EFRAG FR TEG

- 10 How do users use the information currently provided in the statement of cash flows? (If you think it would be useful to illustrate the use, the Appendix includes the statement of cash flows of a pharmaceutical company to which references can be made).

Issues with how statements of cash flows are currently prepared/current requirements

- 11 Issues with current practice/current requirements on the statement of cash flows that have been brought to the attention of the EFRAG Secretariat include:
- (a) There are differing views/unclear requirements on what is cash and cash equivalents (e.g., in relation to certain crypto currencies (stable coins pegged to fiat currencies), demand deposits with restrictions, cash pool arrangements including multi-currency arrangements).
 - (b) There are differing views/unclear requirements on what should be considered cash transactions and what should be considered non-cash transactions. For example, if a bank is instructed to purchase a particular asset for an entity and the entity will pay the bank an amount at a later date (which is higher than the price of the asset), should only the cash payment to the bank be reflected in the statement of cash flows – or should cash flows related to investment activities (as if the entity had bought the asset) and financing activities (and

taken up a loan at the bank) be reported? The issue is also relevant for leases, factoring/reverse factoring arrangements.

- (c) There are differing views/unclear requirements and options on how certain transactions are classified into operating activities, investing activities and financing activities (e.g., interests, dividends, taxes, payments for contingent consideration in a business combination).
- (d) The statement of cash flows less useful for financial institutions.
- (e) There is a lack of useful information (e.g., which cash flows that may relate to cash inflows in the future (capital maintenance versus capital growth), supply chain financing and future payment and unusual items).
- (f) It can be difficult to reconcile cash flows with other primary statements and the notes (e.g., because of non-cash transactions).
- (g) There is no net debt reconciliation which, among other things, could provide information about the entity's sources of finance and how those sources have been used over time.
- (h) Some information presented in the statement of cash flows should be disaggregated—for example, net cash flows attributable to the operating, investing and financing activities of discontinued operations.
- (i) There are no definitions of some commonly used cash flow measures, such as free cash flows.
- (j) The direct method of presenting cash flows from operating activities is seldom used, but would (sometimes) result in more useful information.
- (k) The consistency with the new content and structure of the statement of financial performance could be enhanced.

Questions for EFRAG User Panel and EFRAG FR TEG

- 12 Do users have other issues with how statements of cash flows are currently prepared/the current requirements on the statement of cash flows than those listed in paragraph 11 above?
- 13 Which of the current issues with the statement of cash flows are most urgent to consider? Should some of the topics be more specific? Are there some of the items listed in paragraph 11, that should be removed from the list of issues (e.g., do users generally prefer cash flows from operating activities to be presented using the indirect method and/or do users consider that some flexibility in what is considered 'cash and cash equivalents' and how cash flows are categorised is warranted?

Appendix 1: Example of statement of cash flows

Cash flow statement from 2022 Annual Report of Novo Nordisk:

Cash flow statement

for the year ended 31 December

DKK million	Note	2022	2021	2020
Cash flow statement				
Net profit		55,525	47,757	42,138
<i>Adjustment of non-cash items:</i>				
Income taxes in the income statement	2.6	13,537	11,323	10,992
Depreciation, amortisation and impairment losses	3.1, 3.2	7,362	6,025	5,753
Other non-cash items	4.7	22,310	13,009	7,849
Change in working capital	4.8	(5,336)	(8,656)	(4,353)
Interest received		276	241	100
Interest paid		(272)	(261)	(422)
Income taxes paid	2.6	(14,515)	(14,438)	(10,106)
Net cash generated from operating activities		78,887	55,000	51,951
Purchase of intangible assets	3.1	(2,607)	(1,050)	(16,256)
Proceeds from sale of property, plant and equipment		—	—	7
Purchase of property, plant and equipment	3.2	(12,146)	(6,335)	(5,825)
Cash used for acquisition of businesses	5.3	(7,075)	(18,283)	—
Proceeds from other financial assets		—	—	12
Purchase of other financial assets		(169)	(4)	—
Purchase of marketable securities		(9,566)	(7,109)	—
Sale of marketable securities		6,645	1,172	—
Investment in associated companies	5.4	—	—	(392)
Dividend received from associated companies	5.4	—	4	18
Net cash used in investing activities		(24,918)	(31,605)	(22,436)
Net cash generated from activities				
		2,172	(2,098)	(2,729)
Cash and cash equivalents at the beginning of the year		10,719	12,226	15,411
Exchange gains/(losses) on cash and cash equivalents		(238)	591	(456)
Cash and cash equivalents at the end of the year	4.6	12,653	10,719	12,226

The full 2022 annual report of Novo Nordisk can be found here: https://www.novonordisk.com/content/dam/nncorp/global/en/investors/irmaterial/annual_report/2023/novo-nordisk-annual-report-2022.pdf