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# Staff paper

Agenda reference: 5

# Capital Markets Advisory Committee meeting

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| Date | **8 November 2024** |
| Project | **Statement of Cash Flows and Related Matters** |
| Topic | **Assessment of potential key topics identified** |
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# Purpose of this session

- Gather member views on the issues raised during the joint CMAC-GPF meeting in June 2024.
- Seek to better understand members views on the issues raised, including their prevalence.
- The input from members will contribute to the IASB deciding on the scope of the project.

# Information for CMAC members

# Background of the project

- In its September 2024 meeting, the IASB moved the project on Statement of Cash Flows and Related Matters from the research pipeline to the research work plan.
- The IASB also sought feedback at the joint Capital Markets Advisory Committee and Global Preparers Forum meeting in June 2024 before starting the project.
- The IASB will now conduct initial research, including meetings with stakeholders and review of existing academic studies, to gather evidence on the nature and extent of perceived deficiencies in current reporting and the likely benefits of developing new financial reporting requirements.
- The project team plans to report the results of initial research into the issues raised by stakeholders to the IASB in Q1 2025 to help the IASB decide on the project scope.

# Follow up questions on key messages from the June 2024 joint CMAC-GPF meeting

# Summary of the key issues on statement of cash flows

- The following slides summarise the feedback from CMAC members on issues discussed during the June 2024 joint CMAC-GPF meeting.
- For each topic we pose specific follow up questions for discussion. During the discussion we would also like to understand your views on which topics are the highest priority and why.

The key topics include:

1. Disaggregation requirements for information about cash flows
2. Information about commonly used cash flow measures
3. Effects of non-cash transactions
4. Requirements for classifying cash flows
5. Statement of cash flows for financial institutions
6. Definition of cash and cash equivalents
7. Reporting cash flows from operating activities

# 1. Disaggregation requirements for information about cash flows

**What we heard from CMAC members**

- Some said that more disaggregated information would be useful on:

  a) capital expenditures—specifically split between growth and maintenance expenditure;

  b) changes in working capital; and

  c) cash flow information related to different business segments.

**Questions for CMAC members**

1. Given the information in points a) and c) is encouraged disclosure in IAS 7 (see slide 15), do you see that companies provide this disaggregated information? If so, how much detail is usually provided?
2. When the information in points a) to c) is provided, how do you use it in your analysis? When it is not provided, what information do you use instead?
3. Are there other cash flow items for which you would expect more disaggregated information?

# 2. Information about commonly used cash flow measures

**What we heard from CMAC members**

- Most members said that it would be useful to have a standardised definition of 'free cash flow'.
- Some others said it might not be necessary to have a standardised 'free cash flow' if entities disclosed transparent information for understanding and calculating individual measures.
- Some members said it would be useful to have a reconciliation between operating cash flow and free cash flow.

**Questions for CMAC members**

1. How do you use free cash flows in your analysis? For example, forecasting future cash flows, comparing companies' performance, or a combination?
2. Do you have an internally standardised definition of free cash flow or are company specific circumstances important? For example, do you use company disclosed free cash flows and/or do you make different adjustments for different uses of the measure?

# 3. Effects of non-cash transactions

**What we heard from CMAC members**

- Reconciling the statement of cash flows to the statement of financial position is sometimes difficult and there is a need for more information on non-cash transactions.

**Questions for CMAC members**

1. We have had previous feedback against more rigid linkages between primary financial statements. What are the benefits of being able to reconcile the statement of cash flows and statement of financial position?
2. We have had previous feedback that information would be useful on non-cash transactions that are economically similar to cash but are not reflected in the statement of cash flows. For example, leases, purchases of assets/business using own shares, or share based compensation. Do you have similar experiences and if so, what issues does it create? Are you aware of other transactions with such characteristics that would help in your analysis?

# 4. Requirements for classifying cash flows

**Stakeholder feedback from Third Agenda Consultation**

- Some stakeholders requested the IASB revisit the classification of cash flows into operating, investing and financing categories specified in IAS 7, in the light of differences in the classification requirements in Primary Financial Statements project (this classification is included in IFRS 18 *Presentation and Disclosure of Financial Statements* effective from 1 January 2027).

**Questions for CMAC members**

1. In your analysis do you make adjustments to reclassify line items in the statement of cash flows? For example, research & development expenses, factoring receivables, supplier finance arrangements, or leases. What information do these reclassifications provide?
2. Do you think that the 'cash flows from operating cash flows' category in the statement of cash flows provides useful information based on the existing practices. Please explain why and why not?

# 5. Statement of cash flows for financial institutions

**What we heard from CMAC members**

- The statement of cash flows prepared in accordance with IAS 7 has limited usefulness for financial institutions.

**Questions for CMAC members**

1. What are the ‘limited uses’ of the statement of cash flows of a financial services entity? For example, we have heard that it can provide insights into cash management & liquidity, provide validating information, or act as a control measure.
2. Do you think those uses could be enhanced by improvements to existing requirements? For example, classification, disaggregation, or more information about non-cash transactions?
3. We heard the statement of cash flows might be less useful because there is less focus on cash & liquidity, classification is not meaningful, and there are more stringent regulatory measures. Do you have any further insights to share?

# 6. Definition of cash and cash equivalents

**What we heard from CMAC members**

- Diversity in practice on what can be classified as cash and cash equivalents might lead to comparability issues between companies. Eg: The same financial instrument might be considered as a cash equivalent by one company and as an investment by another company.

**Questions for CMAC members**

1. How frequently do you observe differences in the classification of cash and cash equivalents between companies?
2. Do you experience issues with companies' classification of some investments as cash equivalents using the maturity basis (i.e. 3 months) included in IAS 7 (see slide17 for definition of cash equivalents)?
3. Are there other instruments you view as cash and cash equivalents?

# 7. Reporting cash flows from operating activities

**What we heard from CMAC members**

- Some members said that the indirect method of reporting operating cash flows provides them with useful information.
- Some others said that there are advantages and disadvantages to each reporting method

**Questions for CMAC members**

1. What is useful about the information provided using the indirect method?
2. What is useful about the information provided using the direct method?

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# Appendix—selected requirements of IAS 7 *Statement of Cash Flows*

# Requirements related to disaggregation of cash flows

- Additional information may be relevant to users in understanding the financial position and liquidity of an entity. Disclosure of this information, together with a commentary by management, is encouraged and may include:
  - a) the amount of undrawn borrowing facilities that may be available for future operating activities and to settle capital commitments, indicating any restrictions on the use of these facilities;
  - b) [deleted]
  - c) the aggregate amount of cash flows that represent increases in operating capacity separately from those cash flows that are required to maintain operating capacity; and
  - d) the amount of the cash flows arising from the operating, investing and financing activities of each reportable segments. (Paragraph 50 of IAS 7)
- The separate disclosure of cash flows that represent increases in operating capacity and cash flows that are required to maintain operating capacity is useful in enabling the user to determine whether the entity is investing adequately in the maintenance of its operating capacity. An entity that does not invest adequately in the maintenance of its operating capacity may be prejudicing future profitability for the sake of current liquidity and distributions to owners. (Paragraph 51 of IAS 7)
- The disclosure of segmental cash flows enables users to obtain a better understanding of the relationship between the cash flows of the business as a whole and those of its component parts and the availability and variability of segmental cash flows. (Paragraph 52 of IAS 7)

# Requirements related to classification of cash flows

- Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
- Investing activities are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
- Financing activities are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

(Paragraph 6 of IAS 7)

# Requirements related to the definition of cash and cash equivalents

- Cash equivalents are held for the purpose of meeting short-term cash commitments rather than for investment or other purposes.
- For an investment to qualify as a cash equivalent it must be readily convertible to a known amount of cash and be subject to an insignificant risk of changes in value. Therefore, an investment normally qualifies as a cash equivalent only when it has a short maturity of, say, three months or less from the date of acquisition.
- Equity investments are excluded from cash equivalents unless they are, in substance, cash equivalents, for example in the case of preferred shares acquired within a short period of their maturity and with a specified redemption date.

(Paragraph 7 of IAS 7)

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