EFRAG

European Financial Reporting Advisory Group

EFRAG Short Discussion Series

The Statement of Cash Flows: Issues for Financial Institutions

Feedback statement

May 2016

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Introduction

Objective of this feedback statement

Objective of this feedback statement is to describe the main comments received on the discussion paper *The Statement of Cash Flows: Issues for Financial Institution*s published in the EFRAG Short Discussion Series ('discussion paper'). This feedback statement should be read in conjunction with the discussion paper, which is available on EFRAG's website here.

EFRAG discussion paper

The discussion paper was published on 15 July 2015. The EFRAG Short Discussion Series addresses topical and problematic issues with the aim of helping the IASB to address ways to improve financial reporting after having stimulated debate among European constituents and beyond. Views of constituents were requested by 31 March 2016.

IAS 7 *Statement of Cash Flows* applies to all entities reporting under IFRS. However, there have been claims that its relevance for financial institutions, such as commercial banks and insurance companies, is limited, due to the particular nature of their business activities.

Chapter 1 of the discussion paper illustrates the general requirements in IAS 7 and the intended benefits of the statement of cash flows. Chapter 2 illustrates the requirements that more specifically apply to financial institutions and investigates the arguments in favour and against the relevance of the statement in its current form for banks and insurance companies.

Chapter 3 assesses how the nature of the business activities of some entities may affect the statement of cash flows, identifies a defined population of entities and for these entities discusses two alternatives:

(a) To replace the statement of cash flows with other disclosures.

For banks EFRAG identified that disclosures replacing the statement of cash flows or could be provided in the areas of:

(i) Information on liquidity – such as information on highly liquid assets, on maturities and on encumbered assets where indicators already used for regulatory purposes might provide help in developing the disclosure requirements.

(ii) Information on changes in assets and liabilities – statement of changes of some other aggregation of assets than cash and cash equivalents, such as highly liquid assets, might be provided. Valuable information could also be brought by a reconciliation of flows to capital.

For insurance companies EFRAG concluded that it might be premature to suggest changes while the outcomes of the insurance contracts project were still unclear.

(b) To modify some of the requirements in IAS 7.

EFRAG suggested that improvements could be considered in following areas: removing the categories, reporting separately tax cash flows and disclosing some flows on gross basis.

Comments received from constituents

Eight comment letters were received in response to the discussion paper. All comment letters received are available on EFRAG's website here. The comment letters received came from preparers' organisations, national standard-setters and a regulator. List of respondents can be found in the Appendix 1.

EFRAG also obtained input in some meetings with the European Banking Federation, ESBG, European Association of Public Banks and CRUF Insurance and Banking Group.

General comments

All respondents shared concerns about the relevance of the statement of cash flows for financial institutions and thus were supportive for the EFRAG's proactive initiative. However, the views on how this issue should be addressed diverged significantly among respondents. Nevertheless the comments received provide valuable inputs for further research.

Questions and analysis of comments

EFRAG's questions	Constituents' comments
Usefulness of the statement of cash flows (Question 1)	
The DP discusses the claim that, for some entities, the statement of cash flows in its current format has limited relevance. Do you think the claim is legitimate? If so, do you think that paragraph 3.12 appropriately identifies these entities?	All respondents shared concerns about the relevance of the statement of cash flows for financial institutions. Thereof, in line with the industry which they cover, two respondents provided this view specifically for banks and additional two respondents for insurers. One respondent referred particularly to situations where the underlying activity is based on transfers of cash and cash equivalents (e.g. deposit taking). Four respondents made comments regarding insurance companies and all of them advocated for addressing the need for changes only when new accounting requirements and disclosures for insurance contracts are known. This was in line with the view taken in the discussion paper. One respondent confirmed that a dedicated working group including both preparers and users concluded that the statement of cash flows neither is used as a management tool nor allows to assess liquidity risk in banks, solvency in insurance companies and capital adequacy constraints and their impact on dividends. One respondent noted that the sources and background of changes in total cash position, which is crucial in reading, understanding and analysing a financial institution's financial position, are not currently easily identifiable in the cash flow statement. One respondent commented that the limited relevance would depend on the business model of a bank. They also referred to the fact that the frequency of publishing the cash flow statement contradicts the fact that solvency of banks is challenged daily by the market. The purpose of the

EFRAG's questions	Constituents' comments
	statement and different banking models should be discussed before the changes are considered. Regarding identification of entities for which the statement of cash flows has limited relevance one respondent commented that paragraph 3.12 appropriately identified the entities. Two respondents commented that the definition of the entities that are subject to the proposals in the discussion paper was too narrow. One of them noted that there are other entities, such as leasing companies, whose statements of cash flows are subject to the same issues. The other respondent considered that financial institutions may consist of multiple business models and for some of them the cash flow statement may provide relevant insights, for example an asset management-type business. One respondent noted that the lack of relevance was not limited to banks collecting deposits but rather is the case for all entities with an established asset and liabilities management process including entities involved in non-life insurance business.

EFRAG's questions	Constituents' comments
Possible alternatives (Question 2)	
Chapter 3 discuss two alternatives: replacing the statement of cash flows for the identified entities with other requirements, or retain it with targeted improvements. Do you support any of these two proposals? If not, do you have other suggestions?	Three respondents favoured the approach to retain the statement of cash flows for financial institutions but improve its content and presentation accompanied by appropriate disclosures. One of the respondents recalled their opposition against industry-specific standards and noted that the statement of cash flows has been for a long time one of the primary financial statements and the information which it provides is valued by investors across various industries. Another respondent did not support removal as a first step but believed that a major overhaul to the cash flow statement would most likely be required. In their view, it would also be worthwhile to analyse the replacement with possibly an alternative primary statement. They encouraged alignment to existing disclosure initiatives of the IASB but also to non-IASB activities such as the recommendations of the Enhanced Disclosure Task Force. Two respondents preferred the alternative of replacing the statement of cash flows with other requirements. One respondent did not support either of the proposals. In their view more robust evidence is needed for gaining an understanding as to 'what is broken', before alternative paths can be explored. One possibility could be an in-depth analysis of several financial institutions' cash flow statements. One respondent stated that they generally continue to prefer the abolishment of the statement of cash flows for insurers, but refrained from commenting on the alternatives questioned by EFRAG due to the ongoing development in insurance contracts accounting.

EFRAG's questions	Constituents' comments
Replacing the statement of cash flows (Question 3)	
Assuming the statement is replaced by the identified entities, do you support the introduction of the new disclosures discussed in paragraphs 3.14 to 3.37? If not, what other requirements would you suggest to replace the statement of cash flows with?	One respondent suggested replacing the statement of cash flows with ratios designed to monitor liquidity risk by banking authorities. On the other hand, two respondents had concerns to base accounting requirements on prudential information. Also, the scope of consolidation for supervision purposes may be different as well as the distinction between debt and equity. One respondent suggested to consider information on the funding structure and key sources of funding, which some banks already address by providing so-called 'cash balance sheets' reconciled to the reported accounting figures. This could be complemented by narrative or quantitative information on how the structure has evolved during the period to provide a dynamic view. The constituent also noted that the information on liquidity interacts with the interest rate management performed through the Asset and Liability Management. Since the IASB has decided to focus on disclosures as a first step of its research project on dynamic interest rate risk management (macro-hedge accounting), the constituent suggested that EFRAG takes an active part in defining them so that they could be consistent with cash flow disclosure. One respondent noted that the proposed disclosures based on liquidity ratios as designed by banking authorities would provide information about a bank's liquidity and liquidity risk at a certain point in time which may be subject to huge fluctuations. To mitigate the volatility requiring time series of a particular ratio, e.g. the asset encumbrance might provide more useful information. This should supplement rather than replace the statement of cash flows.

EFRAG's questions	Constituents' comments
	One respondent which did not see the replacement as the first step but asked for considering a major overhaul generally supported the proposed disclosures – mainly the breakdown and movements in the stock of highly liquid assets and the breakdown of maturities of both assets and liabilities into maturity buckets.

EFRAG's questions	Constituents' comments
Targeted improvements (Question 4)	
Assuming that the statement is retained for the identified entities, do you support the targeted improvements in paragraphs 3.38 to 3.47?	One respondent presented different approaches which could be further analysed regarding preparation of the statement of cash flows for financial institutions: (a) management approach on liquidity management; (b) considering access to central bank financing and asset encumbrance in defining cash and cash equivalents; (c) hybrid method of presentation (combination of elements of direct and indirect methods); and (d) relevance of regulatory disclosures. Two respondents deemed the proposal to require certain cash flows to be reported gross, instead of net, as worth considering. However this might not be useful for cash flows from short term business, such as revolving loans where gross presentation would result in huge numbers that may distort important information. The dividing line should be carefully considered. One respondent which otherwise supported replacing the statement of cash flows commented that should the statement be retained the best way to improve the information would be to remove the categories. Two respondents believed that that the limited improvements proposed by EFRAG would not result in enhanced relevance of the statement and one of them added that, should the IASB decide to maintain the statement in its current format, they would prefer keeping the current requirements unchanged. One respondent believed that targeted improvements were not expected to

| | effectively address all concerns and proposed considering a major overhaul. |

EFRAG's questions | **Constituents' comments**

Separate financial statements (Question 5)

The DP discusses general issues with the statement of cash flows for the identified entities. Do you think that there are other issues specific to their separate financial statements? If so, what are they?

Two respondents stated that all aspects regarding liquidity and liquidity risk would have to be discussed first for separate financial statements before addressing other issues specific to the consolidated financial statements.

In this respect, one of the respondents explained that liquidity and liquidity risk are related to contractual rights and obligations and involve the transfer of cash. Only legal entities can be contractual parties to any transaction. Following this logic a number of issues would have to be addressed including the scope definition for conglomerates and knock-on issues such as:

(a) additional liquidity disclosures for the whole group or for a defined part that meets the scope definition;

(b) usefulness of cash flows between the group's segments; or

(c) whether a consolidated statement of cash flows provides information value at all, or should the statements of cash flow be provided on segmented basis.

Another respondent noted that the issues would depend on the nature of the entity that prepares the separate financial statements. For example, if this was a typical holding company this would likely provide more insight, since the investment and financing categories are relatively more important for the performance on the entity.

One respondent noted that they had no issue to raise in respect of the separate financial statements since in their jurisdiction they are not required.

Appendix 1 – List of respondents

Respondent	*Category*	*Nationality*
ESMA	Regulator	Europe
German Insurance Association	Preparers’ organisation	Germany
German Association of Cooperative Banks	Preparers’ organisation	Germany
Accounting Standards Committee of Germany	National Standards Setter	Germany
Dutch Accounting Standards Board	National Standards Setter	The Netherlands
Insurance Europe	Preparers’ organisation	Europe
Association of German Public Banks	Preparers’ organisation	Germany
Autorité des Normes Comtables	National Standards Setter	France