IFRS Accounting

Staff paper

Agenda reference: 3

Capital Markets Advisory Committee and Global Preparers Forum

Date	**June 2025**
Project	**Statement of Cash Flows and Related Matters**
Topic	**Potential ways to improve financial reporting**
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Purpose of this session

Ask CMAC and GPF members for views on:

- potential ways to improve the information in financial statements about the types and effects of changes in the carrying amounts of assets and liabilities presented in the statement of financial position and how those changes relate to information presented in the statement of cash flows—for this purpose we use ‘working capital’ as a case study.
- improving the transparency of information about cash flow measures not specified in IFRS Accounting Standards.

Next steps

We will use the input received when developing agenda papers for future meetings of the International Accounting Standards Board (IASB)

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Background

Background information

- At the March meetings of the CMAC and the GPF we shared with you our initial research findings about seven research topics.[1] In this joint meeting we touch on three of the research topics:
  a) in our case study about working capital—effects of some non-cash transactions (particularly, non-cash remeasurements and business combinations) and disaggregation of cash flow information; and
  b) cash flow measures and other disclosures.
- At its March 2025 meeting, the IASB discussed the initial research findings. The IASB observed that it might consider different approaches, including building on the requirements of IFRS Accounting Standards, like IFRS 18 *Presentation and Disclosure in Financial Statements*.

1. See Agenda Paper 3 of the March 2025 CMAC meeting and Agenda Paper 4 of the March 2025 GPF meeting.

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Case study: working capital

Contents

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    a. questions for CMAC and GPF members slides 17 and 21

Why working capital?

We chose 'working capital' as a case study because:

- stakeholders mentioned working capital as an example to illustrate perceived shortcomings in information under a few of the seven research topics—indicating working capital is a commonly known area of concern for different types of stakeholders; and
- working capital came up as a specific example under the research topics about effects of non-cash transactions and disaggregation of cash flow information—both topics have been identified as important to stakeholders.

Note: Throughout this document, we assume that existing disclosure requirements about working capital related transactions, events or circumstances are applied. For example, we assume information is available about receivables subject to factoring arrangements in accordance with IFRS 7 *Financial Instruments: Disclosures* and payables subject to supplier finance arrangements according to IAS 7 *Statement of Cash Flows*.

Potential areas for improvement

For our case study we identified two potential areas for improvement in the information companies provide about changes during the period in assets and liabilities for which the cash flows were, or will be, classified as cash flows from operating activities[1] ('operating assets and liabilities'):

- AREA 1—the composition of operating assets and liabilities considered to be working capital; and
- AREA 2—the types of changes in the carrying amounts of operating assets and liabilities considered to be working capital.

In our case study, we will cover each area in turn, including possible ways of improving information in the financial statements.

Note 1: The possible ways of addressing AREA 1 might affect the ways of addressing AREA 2.

1. We exclude assets and liabilities for income tax and interest.

AREA 1—Composition of working capital

Background

IFRS Accounting Standards do not define working capital. The IASB decided not to explore defining working capital in this project. However, we understand companies often consider the ‘changes in inventories and operating receivables and payables’ referred to in IAS 7 as akin to its working capital. In our initial financial statement analysis, we found some companies, that used the indirect method of reporting operating cash flows in the statement of cash flows, disclosing as separate line items changes in trade receivables, changes in inventories and changes in trade payables which together make up changes in working capital. However, some companies only present or disclose a single line item for changes in working capital with no further explanation.[1]

IFRS Accounting Standards do not include requirements for a company to explain the relationship between the composition of ‘operating receivables and payables’ in IAS 7 and ‘trade and other receivables’, ‘trade and other payables’ and ‘current and non-current’ assets and liabilities in IAS 1 (IFRS 18).

1. See paragraph 19 of Agenda Paper 20C of the March 2025 IASB meeting

AREA 1—Composition of working capital

Possible ways of improvement

We think financial reporting might be improved if companies provide information that enables investors to understand which items or line items of assets and liabilities make up the changes in operating assets and liabilities considered to be working capital.

We think there are two alternatives that can satisfy this objective:

- **Alternative 1A—Entity-specific composition**

  Companies present or disclose changes in those items of operating assets and liabilities that it considers as working capital. See the next slide for items companies might consider working capital.

- **Alternative 1B—Specified composition**

  Companies include the changes in specified line items or items of current assets and current liabilities. The specified items might include all or some of the items listed on the next slide.

AREA 1—Composition of working capital

Research findings about the composition of working capital

We understand companies often consider the following current assets and current liabilities as working capital—we do not imply them to represent a definition or an exhaustive list:

a. inventories under IAS 2 *Inventories*;

b. contract assets, assets for contract costs, right of return assets and contract liabilities under IFRS 15 *Revenue from Contracts with Customers*;

c. trade receivables and trade payables under IFRS 9 *Financial Instruments*, sometimes including receivables subject to factoring arrangements and payables subject to *supplier finance arrangements*;

d. current liabilities arising from employee benefits under IAS 19 *Employee Benefits*;

e. some provisions under IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*, like provisions for warranties and product returns; and

f. other current assets (like prepayments) and current liabilities (payments received in advance) not included under a–e.

Questions for CMAC and GPF members (1 of 3)

1

AREA 1—Composition of working capital

To improve information about the composition of operating assets and liabilities[1] considered to be working capital, would you prefer:

- Alternative 1A—an entity-specific composition of such assets and liabilities. If you prefer Alternative 1A, are there minimum items we should specify (or not specify), and why? In this case, would further information be required?
- Alternative 1B—specified items of assets and liabilities? If you prefer Alternative 1B, which items should we specify (or not specify), and why?

In answering this question, please consider the items mentioned on slide 14.

1. We exclude assets and liabilities for income tax and interest.
2. Specifying line items does not mean developing a definition of working capital. It means we list items which investors find useful and which companies can provide information for.

AREA 2—Types of changes in the carrying amounts of items

Background

IFRS Accounting Standards include many requirements that enable investors to understand the types and extent of changes in the carrying amounts of operating assets and liabilities. We think, however, the requirements do not result in information about the different types and extent of changes in a single location.

We also note that there are differing levels of aggregation and disaggregation of disclosure requirements across IFRS Accounting Standards—some requirements are in aggregate (for example, exchange differences and translation adjustments) and others are by 'class' or 'category' of assets or liabilities (for example, disclosures required for business combinations).

The above-mentioned requirements—even though extensive—might not enable investors to link the various disclosures to the line items of assets and liabilities and, therefore, to the part of the changes in those assets and liabilities included in the statement of cash flows.

AREA 2—Types of changes in the carrying amounts of items

Possible way of improvement

We think financial reporting might be improved if companies provided information that enable investors to understand how different types of changes in the carrying amounts of operating assets and liabilities, that are considered to be working capital, effect its calculation of cash flows from operating activities.

We think a way to address this objective could be to require disclosure of reconciliations of the opening and closing carrying amounts of each of the items of the operating assets and liabilities determined under AREA 1 (that is, either an entity-specific composition or a specified composition):

Benefits of reconciliations	Costs of reconciliations
Reconciliations are structured disclosures that enable investors to reconcile the primary financial statements and other disclosures in the notes.	Reconciliations would, most likely, require companies to prepare direct cash flow information. Our initial research identified that most companies use the indirect method and preparing direct cash flow information would be costly.

AREA 2—Types of changes in the carrying amounts of items

Illustration of reconciliations

Reconciliations of the opening and closing carrying amounts of each of the items [1] of the operating assets and liabilities that are considered to be working capital might look as follows:[2]

DT / (CT)	Inventory	Trade receivables	Trade payables	Net working capital
Opening carrying amount	xx	xx	(xx)	xx
Amounts recognised in profit or loss	(x)	x	(x)	(x)
Cash receipts or payments	x	(x)	x	x
Translation adjustments (OCI)	(x)	(x)	(x)	(x)
Business combinations	x	x	x	x
Closing carrying amount	xx	xx	xx	xx

1. Paragraph 41 of IFRS 18 states an item is an asset, liability, equity instrument or reserve, income, expense or cash flow or any aggregation or disaggregation of such assets, liabilities, equity, income, expenses or cash flows.
2. We assume inventory, trade receivables and trade payables are the only items this company considers to be working capital or have been specified as items for which disclosures are needed (see AREA 1).

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Questions for CMAC and GPF members (2 of 3)

2

AREA 2—Types of changes in the carrying amounts of items

We understand from our initial research that investors might find useful reconciliations of the opening and closing carrying amounts of each of the line items of the operating assets and liabilities[1] that are considered to be working capital. We also understand that companies might have difficulty in obtaining the information that would be needed to prepare such reconciliations—particularly direct cash flow information or for assets like inventory.

Is our understanding correct? Do you think the benefits of this alternative would outweigh the costs, and why? Note: if in the light of your discussion you think this alternative would not be feasible, we consider adaptations to this alternative in the next slides.

1. We exclude assets and liabilities for income tax and interest.

AREA 2—Types of changes in the carrying amounts of items

Potentially less costly ways of improvement

Reconciliations illustrate two dimensions to the information: (i) the items of assets and liabilities (the columns); and (ii) the types of changes in the carrying amounts of the assets and liabilities (the rows). We think possible ways of reducing the costs of potential improvements is to move along a spectrum of aggregating one or both of these dimensions. We list a few examples on the next slide.

		Items of assets and liabilities			
	DT / (CT)	Inventory	Trade receivables	Trade payables	Total working capital
Types of changes	Opening carrying amount	xx	xx	(xx)	xx
	Amounts recognised in profit or loss	(x)	x	(x)	(x)
	Cash receipts or payments	x	(x)	x	x
	Translation adjustments	(x)	(x)	(x)	(x)
	Business combinations	x	x	x	x
	Closing carrying amount	xx	xx	xx	xx

AREA 2—Types of changes in the carrying amounts of items

Examples of potentially less costly ways of improvement

The table lists examples of how the level of aggregation of both dimensions can be adjusted to possibly improve the cost-benefit balance:

Level of aggregation going from highest (Level I) to lowest (Level IV)	Items of assets and liabilities	Types of changes
Level I	Single line item—working capital	Single change—change in working capital
Level II	Current assets Current liabilities	Changes in the statement of cash flows[1] Other changes
Level III	Line items in the statement of financial position that includes working capital	Some specified types of changes. The balancing figure is one amount. See next slides for possible types of changes to specify.
Level IV	Items of the operating assets and liabilities determined under AREA 1 (that is, either an entity-specific composition or a specified composition)	All types of changes need to be separately disclosed.

1. We refer here to the amounts presented in cash flow from operations under an indirect method of reporting.

AREA 2—Types of changes in the carrying amounts of items

Research findings about the types of changes

We understand the types of changes investors often might want information about include—this is not meant to be an exhaustive list:

a. obtaining or losing control of businesses;

b. non-cash remeasurements—for example, translation adjustments, exchange differences and any write-down (or reversal of any write-down) of inventory to net realisable value; and

c. reclassifications in the statement of financial position of assets and liabilities, including due to factoring and supplier finance arrangements.

Note: the balancing figure might then be disclosed as a single amount.

Questions for CMAC and GPF members (3 of 3)

3

AREA 2—Types of changes in the carrying amounts of items

Which combination(s) of the examples of the levels of aggregation of both dimensions (the line items of assets and liabilities and the types of changes in the carrying amounts) do you think optimises the costs and benefits of the information, and why?

(For example, you might consider Level III for the items of assets and liabilities and Level II for the types of changes to be an optimal combination.)

Are there additional levels of aggregation for one or both dimensions you would consider preferrable, and why?

1. We exclude assets and liabilities for income tax and interest.

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Commonly-used cash flow measures

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2. Potential approach to improve transparency about cash flow measures — slide 25-28
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3. Suggested disclosure requirements on cash flow measures — slide 29-30
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4. Appendix 1 – MPMs and related IFRS 18 requirements — slide 31-34

1. Recap of previous feedback on information on common cash flow measures

Feedback from CMAC members	• Most said having additional information about 'free cash flows' is important, and they use diverse definitions for 'free cash flow'. • Some suggested that the IASB apply a similar approach to management-defined performance measures (MPMs) in IFRS 18 to performance measures relating to the statement of cash flows, such as 'free cash flow'. • Some said having a consistent definition of free cash flow would be challenging and some other suggested to require entities to disclose transparent information to facilitate calculation of individual measures. • Some members said it would be useful to require companies to reconcile free cash flow to a consistent starting point.
Feedback from GPF members	• Many said they provide a non-GAAP cash flow measure labelled as 'free cash flows. • However, some said having a standardised definition for 'free cash flow' would not add any value because there is no consensus on how it should be calculated. • Some suggested that the IASB apply a similar approach to 'free cash flow' as MPMs in IFRS 18. • Some suggested specifying a measure that varying definitions of 'free cash flows' could be reconciled to would be useful and provides users with the information needed for their analyses.

Both CMAC and GPF members supported an approach to improving the transparency of information about cash flow measures not specified in IFRS Accounting Standards, particularly focussed on the measure 'free cash flow'.

2. Potential approach to improve transparency about cash flow measures

MPMs in IFRS 18 require information about measures based on the statement of profit or loss not defined in IFRS Standards to be disclosed in the notes to the financial statements. (Please refer appendix 1)

Many stakeholders suggested applying a similar approach to improve transparency about cash flow measures. Accordingly, we have set out examples of 2 types of cash flow measures that reconcile back to IFRS subtotals based on the statement of cash flows with the objective of understanding:

- the potential benefits to investors and any perceived challenges to preparers regarding the different scopes captured in these suggested cash flow measures, which are computed based on operating and investing activities; and
- the potential benefits to investors and any perceived challenges to preparers regarding the possible disclosures on cash flow measures.

TYPE 1 – Cash flow measures relating to operating activities

TYPE 2 – Cash flow measures relating to investing and financing activities

Type 1 – Cash flow measures relating to operating activities

Free cash flows

Calculation of the measure - In this example we have computed a free cash flow type cash flow measure, adjusting the operating cash flows for:

- capital expenditures
- repayment of principal portion of the lease liabilities
- cash flows from restructuring expenses

	CU
Net operating cash flows	2,500
Net capital expenditure	(1,000)
Repayment of lease liabilities	(400)
Cash flows relating to restructuring expenses	1,200
Free cash flows	2,300

Type 2 - Cash flow measures relating to investing and financing activities

Adjusted investing cash flows

Calculation of the measure - In this example we have computed a cash flow measure based on the investing activities which focuses:

- an entity's total cash flows on investment in capital assets specifically including only the growth capital expenditure (excluding maintenance capital expenditure) and
- repayment of principal portion of the lease liabilities.

	CU
Net investing cash flows	(1,000)
Maintenance capital expenditure	300
Repayment of lease liabilities	(400)
Adjusted investing cash flows	(1,100)

Questions for CMAC and GPF members

For CMAC members

1. Do you find it is useful to have cash flow measures only relating to operating activities similar to type 1 (slide 26) or is it beneficial to have cash flow measures relating to investing and financing activities similar to type 2 (slide 27) as well, when companies provide such measures?

For GPF members

2. Do you see any potential challenges regarding the 2 types of cash flow measures?

3. Do you provide any measures that adjust investing or financing cash flows or only free cash flow type measures?

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3. Possible disclosure requirements on cash flow measures

IFRS 18 MPM disclosure requirements	Application to cash flow measures
Descriptions required	
i. the aspect of financial performance that, in management's view, is communicated by the MPM	Applying these requirements to common cash flow measures would be useful to investors.
ii. why the MPM provides useful information about the entity's performance	
iii. how the MPM is calculated	
Reconciliations required	
iv. between the MPM and the most directly comparable subtotal specified in IFRS Accounting Standards, including tax and non-controlling interest (NCI) effects for each reconciling item	Providing reconciliations as illustrated in slide 26-27 would provide useful information. But the tax and NCI impacts would not be applicable for measures reconciled to a subtotal in the statement of cash flows.
In addition, for each reconciliation item, disclose:	
v. the amounts related to each line item in the income statement; and	Providing relevant line items in the statement of cash flows might be impracticable when using indirect method as the adjustments might be shown as direct cash flows. E.g. in the example in slide 26, disclosing the line items relevant for restructuring might require listing the amounts included in the operating profit and changes in working capital (if using indirect method)
vi. how the reconciling item is calculated and contributes to the MPM providing useful information	Providing explanations on how the reconciling items are being determined would be useful information to investors.

Questions for CMAC and GPF members

For CMAC members

1 What are your views regarding the MPM disclosure requirements discussed in slide 29 as being applicable to cash flow measures? Do you have any other suggestions for information that might be useful about cash flow measures?

For GPF members

2 Are there any potential challenges that might arise when providing these suggested disclosures?

Appendix 1 – MPMs and related IFRS 18 requirements

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What are management-defined performance measures?

Performance measures

Financial performance measures

Subtotals of income & expenses

MPMs

- Adjusted profit or loss
- Adjusted operating profit
- Adjusted EBITDA

IFRS-Specified

- Operating profit
- Operating profit before depreciation amortisation and specified impairments

Subtotals of cash inflows and outflows (Suggested)

MPMs (Suggested)

- Free cash flow
- Adjusted operating cash flows
- Adjusted investing cash flows

IFRS-Specified (Suggested)

- Operating cash flows
- Investing cash flows
- Financing cash flows

Other measures that are not subtotals of income and expenses or cash inflows and outflows

- Return on equity
- Net debt

Non-financial performance measures

- Number of subscribers
- Customer satisfaction score
- Store surface

Key aspects of IFRS 18 requirements on MPMs

Subtotals of income and expenses not required or specifically exempted by IFRS Accounting Standards

Included in **public communications outside financial statements**

Measures that communicate **management's view** of a company's financial performance

Disclosures for MPMs

IFRS 18 introduces requirements to disclose in a single note

- **Reconciliation** back to IFRS-defined subtotal
- Explanation of **why** the MPM is reported
- Explanation of **how** the MPM is calculated
- Explanation of any **changes** to the MPM

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