Investor view

Insights from the investment community

Issue 8 - Cash flow disclosures

Cash flow disclosure: is there enough?

Cash flow disclosures, including the cash flow statement and supporting notes, are clearly important to investment professionals. However, investors tell us that the existing requirements do not provide a full picture. Both the cash flow statement and the supporting notes are frequently cited as areas in which additional information would be useful. This 'Investor view' looks at areas in which disclosure of cash flow information could be improved.

Why is cash flow important?

Reported profit is important to investors, but so is cash flow. What enables an entity to survive is the tangible resource of cash – not profit, which is merely one indicator of financial performance. Historical cash flows are not necessarily a good indicator of future cash flows, but trend data often provides a base for assessing future cash flow performance and liquidity.

How can disclosures be improved?

Disclosure requirements for cash flow information are primarily governed by AS 3 'Cash Flow Statements' (IAS 7 'Statement of cash flows' under IFRS). The standard seeks to require disclosure of information that provides investors with a basis for assessing an entity's ability to generate cash and its needs to utilise that cash. Nevertheless, investors have cited the following areas in which disclosure could be improved.

Cash flow statement – investors tell us that they would like more meaningful descriptions of the adjustments made to derive operating cash flow so that these can be related to items on the balance sheet. For example, it would be useful to separate changes in working capital assets and liabilities by balance sheet line item.

Investors also tell us they would find it more helpful for the reconciliation of profit or loss to operating cash flow to start at the operating profit line (or pre-tax profit line) rather than at net income. This would simplify the disclosure and remove the need for spurious reconciling items, which may need to be both eliminated and then added back to arrive at a total for operating cash flow.

Net debt reconciliation – investors tell us they need reconciliations of net cash flow to the movement in net debt. A net debt reconciliation provides useful information about changes in liquidity on a broader basis rather than solely movements in cash balances. It allows investors to see how business financing has changed over the year and whether an entity that on the surface looks to have had a significant increase in cash has, for example, achieved this only by taking on a corresponding increase in debt.

Capital expenditure – most entities disclose one number for capital expenditure in the investing section of the cash flow statement (albeit split between tangible and intangible elements). Investors would like disclosure of capital expenditure to be separated into 'maintenance' and 'growth' spends. Many investors would also like to see capital expenditures for core businesses included in operating cash flows but with capital expenditure for acquisitions remaining in investing, although it is accepted that that is not permitted by the current standard.

Non-cash transactions – investors would like clearer descriptions of non-cash transactions and how they affect the cash flow statement, such as information about new finance leases, non-cash contributions to pension trusts or non-cash consideration in a business combination.

This information is also useful to investors in that it enhances cohesiveness across the primary statements. Investors like information that links the movement in working capital to revenues and expenses in the income statement.

Segments – segment reporting is very important to the investment community, so providing more segmental cash flow information would be valued. Many investors believe that multi-segment entities should use the reportable segment as the unit of analysis for providing cash flow information.

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