

Cash Flow Accounting in Banks

–A study of practice

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After the near collapse of the global financial system in 2008, much of the debate has focused on credit and asset valuation, as well as liquidity issues in the financial sector. Emphasis has been on debt and balance sheet quality, but little focus has been on the cash flow statements of banks. The statement of cash flows is designed to illustrate financial strength and liquidity with information about operations, investment and financing. Cash flow statements generally show operational stability and funding, outflow and inflow of cash, as important factors of firm's financial resilience. In this respect banks are different and their cash flow statements are simply not used.

The aim of this thesis is to study how cash flow statements of banks are different from non-financial firms to understand why they are not used. This includes research on how the accounting standard functions for banks and identify special issues of cash flows in banks.

Four studies are used to gather evidence and evaluations of the accounting framework and the financial statements in order to describe facts and interpret bankers' opinions. The big Scandinavian banks are selected as study objects and thirty bankers interviewed. Historical comment letters are analysed as well as fourteen years of financial statements.

The accounting rules for banks and cash flow are described in the first study. The second study concerns the accounting regulation process and confirms that prior to the standard setting, bankers warned that it would not function in banks. Long-term financial statement analysis in the third study illustrates the negative operative cash flow in the banks over a decade. The final study, interviewing bankers about the cash flow in banks, confirms that none of them uses the statement and they have never been asked about it.

The main findings indicate that standard cash flow statements do not work for banks because banks' operations are different from non-financial firms with respect to cash. The reason why bankers do not use the statements is that they do not consider the information provided to be relevant. The results furthermore indicate that the cash flow statements of banks are not used because the existing accounting standard does not consider the credit creation function in banks. This is exemplified in the negative operative cash flow during periods of lending growth. Banks are different from other firms and the reporting of banks' cash flows functions differently because cash is their product and they create deposits on their balance sheet when providing loans to their customers. The accounting transaction of lending does not involve any prior funding or cash inflow, but occurs in the accounting system, creating deposit as a liability and loan as an asset of the bank.

These results contribute to the debate needed in accounting and banking about useful cash flow statements for banks and provide an overview to prepare new accounting regime.

Key words: Accounting, Banking, Cash Flow, Financial Institutions, Money View

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