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# THE USEFULNESS OF CASH FLOW STATEMENTS IN BANK LENDING DECISIONS: INSIGHTS FROM BULGARIAN PRACTICES

## ABSTRACT

This study examines the role and utility of the Statement of Cash Flows in the credit decision-making process from the perspective of Bulgarian banks. The main purpose is to evaluate how banks use the Statement of Cash Flows to assess the creditworthiness and financial health of the enterprises. A survey of leading Bulgarian banks reveals differences in how they understand and use this information in credit analysis. The findings reveal that, although banks acknowledge the importance of the Statement of Cash Flow for assessing liquidity and risk, it is often overshadowed by other financial reports such as the Balance Sheet and Income Statement. Common issues identified include improper classification of cash flows and lack of clarity in the regulation of non-cash transactions, which hinders the full utility of the Statement of Cash Flows in the credit evaluation process. Although the Statement of Cash Flows is useful for evaluating credit risk, the research identifies limitations in its current use by banks. Recommendations to improve Cash flow statement structure and credit assessments using cash flow information are provided.

**Keywords:** accrual accounting, cash accounting, Statement of cash flows, usefulness of the information in cash flow statement, bank scoring

**JEL Classification:** M41

## INTRODUCTION

Discussions about the usefulness, merits, shortcomings, purpose, and future of information from financial statements do not stop. In Bulgaria, a more active part of them is the accountants, and only some of the other authorities and regulators; the academic accounting community; and accounting practitioners. It seems as if the direct users of the information from the financial statements (investors, creditors, including banks; tax and statistical authorities; regulators; trade unions, traders and entrepreneurs, and other interested parties) are too passively related to this debate. Such behaviour may have different explanations, but the objective analysis and the credibility of the conclusions require serious research. This is the foundation of the purpose of this research to try to find out how useful the information from the Statement of Cash Flows is, focusing on one leading user - the banks as creditors of the business.

It is known that the Statement of Cash Flows (CFS/SCF), as a mandatory component of the public annual financial statements of enterprises, appeared much later than the balance sheet and the income statement - in the 1980s of the 20th century (Filipova et al., 2023). The Statement of Cash Flows remains in the shadow of these two flagship reports, even though it provides information about one of the most important driving forces in business – THE CASH. Confirmation of a certain neglect of this report in Bulgaria is the fact that according to Art. 29, para. 3, 4, and 5 of the Accounting Law, the Annual reports of certain sole traders and micro and small enterprises may not contain a Cash Flow Statement. On the other hand, the listed categories of enterprises are the most numerous in our country according to National Statistical Institute data (NSI, 2024), and as of 30.08.2024, micro and small enterprises represent 98.87% of all enterprises, based on the number of persons employed in them. At the same time, these enterprises often and preferentially use bank lending to finance their activities. How and from where (what source) can banks as creditors get reliable information about the

enterprise's ability to generate money, its liquidity, and its ability to return the received loans? This is a question to which, as far as we know, there is no in-depth and reasoned answer in the Bulgarian specialized literature. For this reason, the present study is motivated to pose it and try to answer it based on a study of the Bulgarian practice.

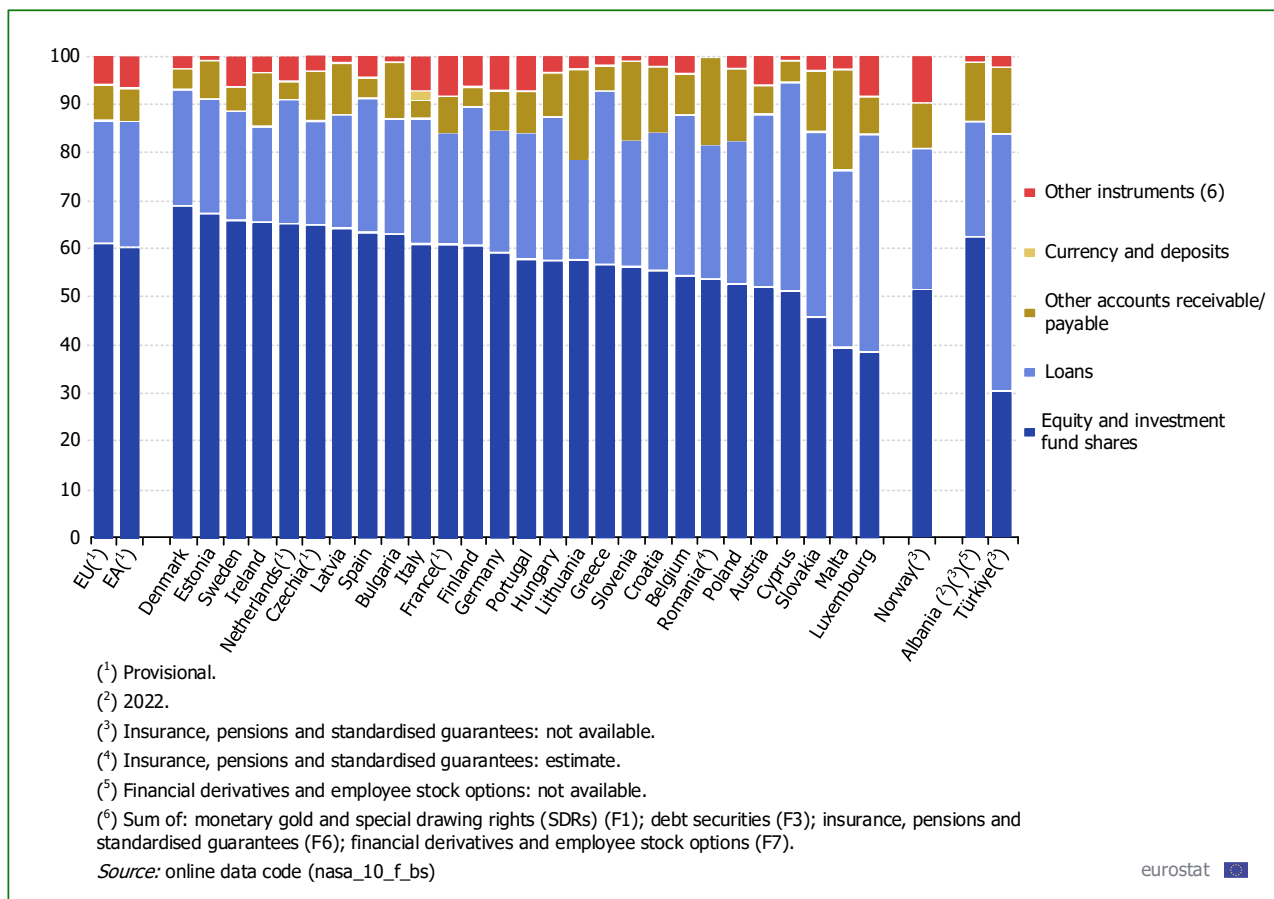
The debate related to the accrual principle and the cash flow principle, which has been going on for decades, has led to the fact that since the 1930s the accrual principle has dominated financial accounting. This determines the dominant role of the two statements in which it is applied: the balance sheet and the income statement. In the 1980s, however, the leading accounting legislators (in the USA, Great Britain, etc.) accepted that useful company financial information should also give a concrete idea of cash flows (incoming and outgoing), including the change in cash and cash equivalents during the reporting period. The introduction of the Statement of Cash Flows is a kind of homage to the cash principle, which has been pushed to the background until now. Why does this happen in this particular period? One of the leading assumptions is that then the cases of manipulation of financial information by company management, especially that related to the amount of accrued income and the financial result, become more frequent and more large-scale. By introducing the Statement of cash flows as a mandatory component of the financial statement, especially when it is prepared using the indirect method, it can be established whether there is a significant (and illogical, unfounded) discrepancy between the accrued financial result and the movement and amount of company cash.

Therefore, the benefit of the Statement of Cash Flows can be sought in several directions:

1. Provides information on the movement of the company's money - on incoming and outgoing cash flows, including and by types of activities (operational, investment, financial).
2. The change in the money supply at the end of the year compared to the beginning of the year is tracked, and the type of activity from the above that has the most significant effect on it is also tracked.
3. Provides information for analysis of the company's liquidity and its solvency, including using information from the other elements of the annual report; - Assesses how management manages its liquid resources.
4. The relationship between revenues, profit/loss, and cash flow is tracked.
5. The enterprise's ability to generate cash is assessed and its future amount is predicted.
6. Free cash flow is calculated as an important indicator for the evaluation of company capital securities.
7. An assessment is made regarding the eventual fall of the enterprise into insolvency and bankruptcy.

We find support for the usefulness of Statement of Cash Flows in the bank lending process, taking into account the size of loans as a form of business financing in the Eurostat data for 2023: the share of loans in the structure of the liabilities of Bulgarian non-financial enterprises is about 25 %, which is close to the average rate for EU (25.8 %), while in some EU countries, this share reaches 45.7% (Figure 1). According to the same data, loans made up 25.8% of the liabilities of non-financial corporations (EUROSTAT, 2024).

Using data from the Bulgarian National Bank Economic Review (BNB, 2024) in the first eight months of 2024, the annual growth of loans to non-financial enterprises followed an accelerating trend, reaching 9.5% at the end of August and 8.4 % at the end of September 2024 (7.3% as of December 2023). According to data from the quarterly bulletin of the Bulgarian National Bank (BNB), as of June 30, 2024, loans represent 62.2% of all bank assets. For this period, according to BNB statistics, the gross credit portfolio of the banking system grew by 4.0% (BGN 4 billion), with loans to non-financial enterprises increasing by BGN 1.4 billion, i.e., 2.4%. Of all the loans provided, the largest share is the loans for non-financial enterprises, representing 44.4% of all loans provided by the banking system in Bulgaria (BNB, 2024).



**Figure 1. Share of type of liabilities of non-financial corporations, 2023.** Note: % share of total financial liabilities of non-financial corporations. (Source: EUROSTAT, Non-financial corporations - statistics on financial assets and liabilities - Statistics Explained)

The data presented above show growth in lending both in the EU and in Bulgaria. This circumstance should be seen in the context of the European Court of Auditors' special report on EU supervision of banks' credit risk, which states that the ECB needs to do more to achieve greater safeguards for good credit risk management and coverage. In this regard the European Court of Auditors recommends improving risk assessments, optimizing the process of supervisory review and assessment, and improving supervisory measures in order to effectively manage risks (European Court of Auditors, 2023).

The statement of cash flows provides crucial information about a company's financial health, enabling stakeholders to understand its cash inflows and outflows. Recognizing the importance of this information, the International Accounting Standards Board (IASB) announced on September 16, 2024, the launch of a research project aimed at reviewing and enhancing the requirements for the statement of cash flows and related matters (IASB, 2024).

This initiative is driven by stakeholder feedback, which highlights the need for improvements to the IAS 7 Statement of Cash Flows. Stakeholders have indicated that the current requirements could be refined to deliver more meaningful and actionable insights for users of financial statements. The project seeks to address these concerns and ensure that the statement of cash flows remains a vital tool for assessing an entity's liquidity, creditworthiness, and overall financial performance.

The cash flow statement (CFS) is an essential financial document that provides critical insights into a bank's financial health and operational efficiency. For banks, the CFS serves multiple purposes, including liquidity management, risk assessment, and aiding in strategic decision-making. The usefulness of cash flow statements for banks can be understood through various dimensions, including their role in evaluating financial performance, informing lending decisions, and enhancing transparency in financial reporting.

The arguments presented above highlight the need to examine the content, structure and use of the Statement of Cash Flows, emphasizing its significance as a source of valuable information. Additionally, its application in the lending processes of banks warrants further study to fully understand its role and impact.

All this is equally important for the management of large, medium, and small enterprises, as well as for users interested in information about their activities. Therefore, according to the authors of the present study, there is no logical explanation for why the information from the CFS is ignored in Bulgaria, including by the banks (as creditors), which dominantly finance Bulgarian enterprises?! The authors' observations of the practice in our country indicate that the banks as creditors usually require the CFS from their corporate clients once a year but in shorter periods (quarterly) they are only interested in the balance sheet and the income statement. Is this due to neglecting the information from the Statement of Cash Flows? Or because in our country lending is based on assets as collateral (asset-based lending) and not based on cash flows (cash-based lending)? Or because creditors (banks) make it a condition for businesses to open their accounts with them, and in this way, they have daily information about their incoming and outgoing cash flows and stocks? An unequivocal answer, without a thorough study of practice, could not be given.

The underestimation and neglect of the Cash Flow Statement by the users, including banks as creditors (which the authors observe in practice), righteously raises the question of the real usefulness of the information from this statement. This necessitates reference to the more conceptual principles and understandings of the notion of "usefulness of financial statement information" presented in the Conceptual Framework to IAS/IFRS (IASB, 2018). According to the latter, usefulness is based on the following qualitative characteristics:

1. Relevance.
2. Faithful representation.

The above two, in combination with the rest of the quality characteristics (timeliness, materiality, comparability, verifiability (possibility of checking), and comprehensibility), create and define the usefulness of the information from the financial statements, including from the Cash flow statement. All this is briefly regulated in par. 2.4 to 2.43 of the Conceptual Framework to the IAS and we will not dwell on it here, being notoriously known to professionals.

## LITERATURE REVIEW

In Bulgaria, a relatively small number of studies (Luchkov, 2020), (Genov, 2009), (Veysel, 2014), (Petrova, 2015), (Dimov, 2013), (Filipova & Georgiev, 1995) related to the Cash Flow Statement limited to clarifying its essence, purpose, structure, preparation features and the requirements in this regard of IAS 7 Cash Flow Statement and the IAS 7 of the same name. There are also publications (Ivanova, 2016) presenting the main financial indicators that can be calculated based on the Cash Flow Statement database, including in combination with information from the other statements of the financial statement (Balance Sheet, Statement of revenues and Expenses/Statement of Comprehensive Income and Statement of Changes in Equity). In-depth studies regarding the real use and usefulness of the information from this report in practice, as well as the need for possible changes to it, are lacking. Among the foreign studies devoted to the Statement of Cash Flows, the above questions are also represented, but also several others such as:

1. Use of information from financial statements, including the Statement of Cash Flows: S. Cascino et al. (2013) strongly support the understanding that information from financial statements is useful both for investors, as well as for creditors, and devotes space to the question of what financial information influences the conditions in credit agreements. But here again, researchers mainly rely on information from the balance sheet and the Statement of Comprehensive Income, but not that of the Statement of Cash Flows. They emphasize the central role of accounting information in loan negotiation, but point out that research in this area is scarce due to a lack of publicly available information on loan contracts. However, scientists believe that these contracts are also bound by financial conditions, values, and indicators such as net assets, working capital, "equity - debt capital" ratio, interest coverage, and cash flows, citing Citron (1992b); Bradley and Roberts (2004), Garleanu and Zwiebel (2009). Also, they cite a study by Demerjian (2011), for the period 1996 to 2007, the use of financial indicators from balance sheet data significantly decreased, compared to those from the Income Statement, which they explain by the wider use of fair value in valuing balance sheets. This leads more conservative lenders to make many adjustments to accounting estimates and prefer to tie loan terms to performance indicators rather than balance sheet items and net worth. Cheri L. Reither's dissertation "Process analysis of lenders' use of FAS 95 cash flow information" (Reither, C., 1994) is also interesting as a study because it is entirely focused on how lenders use the information from the report for the cash flows of its customers. The same author summarizes that the research regarding the use of the information from the cash flow statement is in three directions: to determine the market prices of capital instruments, related to the capital markets (the relationship of cash flows, income and return on investments in securities); to forecast the future cash flows of the enterprise; to predict possible company bankruptcy. The author cites highly influential studies such as those of Ball and Brown (1968), Beaver and Dukes (1972), which argue that cash flow information is less predictive

of stock returns than with information on net financial results and yield per share. However, subsequent studies, e.g., Wilson (1986, 1987), Bowen Burgstahler, and Daley (1987), Bernard and Stober (1989), Livnat and Zarowin (1990), are no longer so emphatic about the dominant role of financial performance in predicting stock returns, compared to the information and indicators based on the Statement of Cash Flows. Scholars such as Bowen, Burgstahler, and Daley (1987) as well as Greenberg, Johnson, and Ramesh (1986) argue in their research that accrued income and financial performance (the opinion of the American Accounting Standards Board, FASB) have a greater impact on forecasting future cash flows compared to current cash flows. Authors such as J.D. Neill and colleagues in "The Usefulness of Cash Flow Data: A Review and Synthesis" (Neill, J. D. et al., 1991) found that there is a closer, stronger relationship between cash flows related to investments and dividends paid and eventual firm bankruptcy than between cash flow from operating activities (as a summative magnitude) and the future liquidity of the enterprise.

Such an analysis, in all its depth, would also be useful for creditor banks. J. D. Neill et al. also cite a study by Kemp and Overstreet (1990) who, through questionnaires, attempted to ascertain the information needs of merchant lenders. In this regard, Kemp and Overstreet point out that lenders also have specific informational needs. For them, the current credit exposure of the client, the use of working capital and the company's cash are the leading factors. Therefore, the assessment of the borrower's liquidity, the value of supplies and raw materials, the amount of hard-to-collect receivables, and their depreciation are very important indicators. Also, for the correct analysis of all this, the accounting policy followed by the enterprise is decisive, and from here - creditors try to assess how adequate it is and whether it is applied consistently and correctly. A particularly important conclusion made by Kemp and Overstreet is that, unlike investors, lending institutions place less importance on income and financial performance (Kemp and Overstreet, 1990). Examining a sample of Italian public companies for the period 2008-2017, S. Ferri and colleagues (Ferri, S., et al., 2020), found that based on the use and analysis of indicators from the Statement of Cash Flows, possible company insolvency was foreseen in about 80% of the cases. Moreover, the obtained results indicate that there is no difference (or dominance) in predicting company bankruptcy based on information from the Cash Flow Statement and that from the Income Statement. But it is important to emphasize that if the enterprise can continue to exist in the face of declining profits, then in the absence of money it cannot continue its activities. In the article "The Ability of Cash Flows to Predict the Earning: Evidence from Jordan" Mohammad Fawzi Shubita (Shubita, 2021) examines a sample of 77 industrial public companies listed on the stock exchange in Amman (Jordan) for the period 2006-2019 Empirical data show that for large companies with a short operating cycle, the ability to predict future revenues and profits using indicators from the cash flow statement is greater than for small enterprises with a long operating cycle.

2. Research on the ability of revenue analysis (compared to cash flow analysis) to predict companies' future cash flows: S. Supriyadi (2018) investigates the issue in Indonesia based on a sample of 61 manufacturing companies listed on the Jakarta Stock Exchange, for the period 1990-1997. According to the obtained results, information on current cash flows is more suitable for forecasting future ones than on accrued income and financial results. But the combination of current cash flows, earnings, and bottom line, in predicting future cash flows and the market price of shares, would give very good results.
3. Studies on the advantages and disadvantages of the two approaches to preparing the Statement of Cash Flows (direct and indirect), as well as discussions on the criteria for classifying the information in them by activities (operational, investing, and financing) to increase its usefulness for users: in this direction, the study of H. Nurnberg "Perspectives on the cash flow statement under FASB Statement No. 95" (Nurnberg, H., 2006) should be noted. In it, he defends the understanding that the direct method of preparing the Statement of Cash Flows (based on gross inflows and outflows), accompanied by additional information with recalculation and transformation of the net financial result to net cash flows from operating activities, are more the useful and informative way for users to present information related to company cash and cash flows. The same author insists on a stricter definition of the concept of "free cash flow", including considering whether the enterprise is from the financial sector or a non-financial institution. For the purpose of analysis, especially in the estimation of company value, H. Nurnberg recommends that the Statement of Cash Flows be adjusted with all items (cash flows) that are not expected to occur in the future forecast periods, as well as with those that are missing among current cash flows but expected to occur in the future.

According to Perry Fisher (2022), if the individual elements of the financial statement and the information they provide were to be ranked according to their importance to banks as lenders, this ranking would look like this: first Cash Flow Statement; then the Balance Sheet and finally Statement of Comprehensive Income. But is it really so? And above all - is it the same for the banks in Bulgaria?

Dung Duc NGUYEN and Anh Huu NGUYEN (2020) analyze the impact of information from the Statement of Cash Flows of a sample of listed companies in Vietnam on the lending decisions of lending banks. Data were collected from 160 bank loan officers. It has been established that information on cash flows and relevant indicators related to them significantly influences both short-term and long-term credit granting. The lack of information related to the borrower's cash flows negatively affects the banks' confidence in granting loans. The above brief review of research related to the Statement of Cash Flows, mostly focused on the problem of the usefulness of the information in it, shows the differences in the understandings of individual researchers, as well as mixed, conflicting empirical results. All this provides an opportunity and occasion for new research.

## AIMS AND OBJECTIVES

As it was mentioned before the ongoing discussions around the relevance, benefits, limitations, purpose, and future of information from financial statements remain active and vital. The apparent lack of active involvement from direct users may stem from various factors, but thorough research is necessary to objectively analyze the situation and provide credible conclusions.

The purpose of this research is to try to find out how useful the information from the Statement of Cash Flows is, focusing on one leading user - the banks as creditors of the business. It will help us to evaluate how banks use the Statement of Cash Flows to assess the creditworthiness and financial health of the enterprises.

The review of studies related to the usefulness of the information in the Statement of Cash Flows shows the differences in the understandings of individual researchers, as well as mixed and contradictory empirical results. All this provides an opportunity and occasion for new research. Based on the studied literature and observations in Bulgarian practice, the authors formulate the following working hypotheses:

- *Hypothesis 1:* The usefulness of the information from the cash flow statement is difficult to understand and is not adequately evaluated by the banks in Bulgaria (it is even neglected), due to the peculiarities of preparing this statement.
- *Hypothesis 2:* The usefulness of the information from the Statement of Cash Flows is not manifested in its full capacity due to the frequent incorrect preparation of this statement.
- *Hypothesis 3:* The imprecise regulation of the requirements for the preparation of the Cash Flow Statement both in National Accounting Standard 7 and in International Accounting Standard 7 (NAS 7 and IAS 7) often leads to unreliable information and low usefulness of the information for users.

## METHODS

The research methodology is based on the results of an online survey containing twelve questions, the purpose of which is to investigate how banks use the information from the Statement of Cash Flow in the lending process, and how they evaluate the usefulness of this information. However, for the needs of the current study, because of the volume limitations, only the answers to six of the questions posed to the respondents are presented and discussed: those that are directly aimed at the judgment of the respondents - banks regarding the usefulness of the information in the Statement of Cash Flows (Appendix 1). The rest of the collected answers and empirical data are the subject of a separate paper.

The scope of the study includes a sample of banks that have a license issued by the Bulgarian National Bank. The formed sample covers a total of 10 banks, to which a link to the survey was sent with a request to fill it out: 1. The banks from the first group, which consists of the 5 largest banks based on their total assets according to BNB data as of 30.06.2024, namely: DSK Bank, United Bulgarian Bank, UniCredit Bulbank, Eurobank Bulgaria and First Investment Bank; 2. Three banks from the second group, selected by random non-repeating selection - Allianz Bank Bulgaria, Tokuda Bank, and Central Cooperative Bank; 3. Two banks from the third group, according to BNB data as of June 30, 2024 - Citibank Europe - Bulgaria branch and ING Bank N.V. - Sofia branch. The representativeness of the formed sample is determined not by the number of participating banks, but by the value of the loans provided by the surveyed banks. The loans provided by the banks of the first group, according to BNB data, represent BGN 88,550,537 thousand or 79.82% of the total amount of loans and advances and 74.32% of all loans granted to non-financial enterprises as of 30.06.2024. Banks from the second group have a relative share of 18.27% of all granted loans and advances, and banks from the third group - 1.91% (BNB, 2024).

Responses were received from seven banks, which included all five banks in the first group, one bank in the second group and one bank in the third group. This determines a total Response rate of 70 % (RR = No of Responses / No of Invites). The anonymous nature of the survey does not allow identification of the responding banks with the specific answers received, apart from their belonging to the relevant group, according to the BNB, but the significance of the answers received based on the value of the loans provided by the surveyed banks, allows us to accept the results of the study as significant regarding the assessment of the role and importance of the information from the Cash Flow Statement for Bulgarian banks. The survey questions in this study are six in total, five of which are multiple-choice, and one of the questions requires participants to provide an answer by ranking the usefulness of the information from the Statement of Cash Flows. This question was constructed using a modified Likert scale with only extreme scale values assigned. All participants declared that they were aware of the purpose of the study, their participation in the study was voluntary and was not stimulated by monetary and/or material incentives. The participants agreed that the data and information they provided would be used in scientific publications for the purposes of the implemented project, being presented in a summarized form without indicating any identifying information.

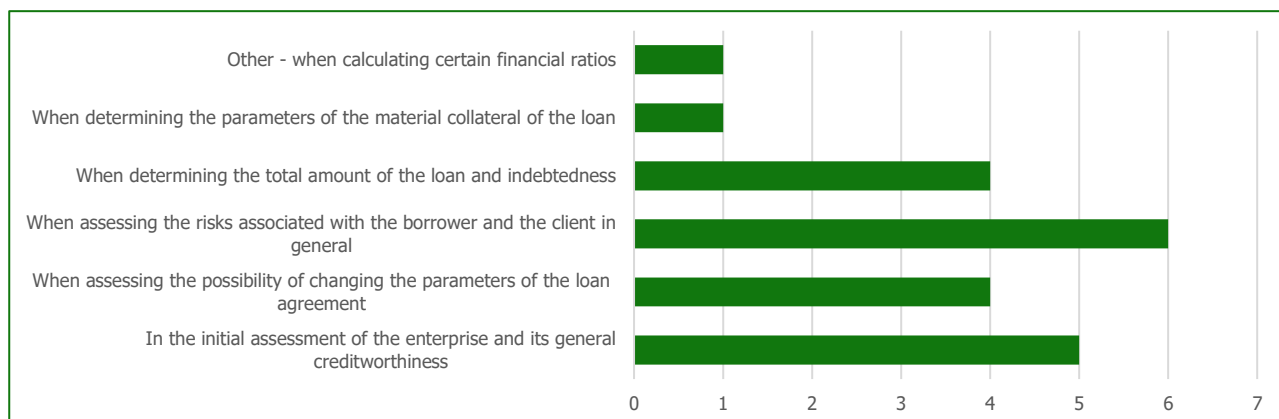
## RESULTS

The research results identify the most serious weaknesses of the information from the borrowers' Cash Flow Statements found by the banks when assessing the creditworthiness of the enterprises. They also indicate the banks' attitude to the usefulness and use of the information from the Cash Flow Statement in comparison with the other elements of the annual financial report in the business lending process. Below are the questions in the survey and the processed information based on the answers received.

**Question 1:** Please express your opinion on the usefulness of the information from the annual financial report in connection with the analysis of the financial position and the assessment of the creditworthiness of enterprises, incl. the determination of credit risk.

Six respondents (85.7%) indicated that all elements of the financial statement were equally useful, and only one respondent (14.3%) indicated the Income Statement/Statement of Comprehensive Income as the most useful. These results suggest that Bulgarian banks rely not only on the Income Statement or Cash Flow Statement individually but on a comprehensive set of financial reports for a complete view of a company's financial stability. The lack of emphasis on the Income or Cash Flow Statements alone could imply that these banks view credit analysis as a multi-dimensional assessment requiring data from various sources within the financial report. It is noteworthy that the majority of respondents believe that information from all statements (Balance Sheet/Statement of Financial Position, Income Statement/Statement of Comprehensive Income, Statement of Cash Flows, and Statement of Changes in Equity) is equally useful for analyzing the financial status and creditworthiness of enterprises. The standard deviation of 0.35 in responses to Q1 indicates little dispersion in opinion, with only one respondent veering towards another view.

**Question 2:** In which cases do you use information from the Statement of Cash flows and for what? (more than 1 answer is possible). The results are shown in Figure 2.



**Figure 2. Using the information from the Cash flow statement.** (Source: Authors' elaboration based on questionnaire processing)

The frequency analysis of the responses shows that the highest percentage (85.7%) of banks use the Cash Flow Statement to assess the risks associated with the borrower, which highlights the role of cash flows as an important indicator of

financial health and whether the customer can cope with his current obligations. Despite the fact that 85.7% of banks use the Cash Flow Statement to assess the risks associated with the borrower 71.4% of the banks use information from the Cash Flow Statement already in the initial assessment of the enterprise and its creditworthiness, and 57.1% of the answers, it is stated that the Cash Flow Statement is useful in assessing the possibilities of changing the parameters of the loan, for example in refinancing or restructuring. Only one bank uses the information from the Cash Flow Statement to assess the collateral parameters and to calculate financial ratios. This indicates that these aspects of the analysis are less dependent on cash flows and are linked to other data and reports. The answers to this question show that Bulgarian banks use the information from the cash flow statement mainly to assess the risks related to the borrowers and for an initial assessment of their creditworthiness. Although there are various use cases, the most important are assessing the risk and liquidity of the client. Less often, the Statement of Cash Flows is used for the assessment of material collateral and the calculation of financial ratios, which indicates that other analytical tools are used for these purposes. Of interest is the fact that 57.1% of banks believe that the Cash Flow Statement is useful when evaluating the possibilities of changing the loan parameters. For example, in cases of refinancing or restructuring, which can be interpreted that cash flows play an important role in assessing the possibility of changing the terms of the contract. I.e., banks analyze whether the client will be able to cope with the new conditions. The author's opinion is that it means that if the borrower has stable cash flows, a change in the contract parameters is more likely to be approved, as the bank sees the capacity to service these new conditions. The standard deviation is 1.83, indicating moderate variation in the use of the Statement of Cash Flows for different purposes. This highlights that banks have varied approaches to using information from the Statement of Cash Flows, but risk and initial valuation are among the leading factors.

*Question 3:* What information from the Statement of Cash Flows do you use most often in your work?

According to the answers received, banks in Bulgaria prioritize the use of information on the net change in cash flows in the three activities (operational, investing and financing) - 71.4%. Two of the banks (28.6%) only use information on changes in cash flows/operations in operational activity. Banks in Bulgaria prioritize the use of information on the net change in cash flows in the three activities (operational, investing and financing). This information should be considered in the context of the answers to the next question, according to which most of the surveyed banks (71.4%) use the overall information on cash flows and their net change in the three main activities (operating, investing and financing), which shows, that this data is most useful and common for credit analysis and scoring. The median value is 3.5, which reflects the fact that information from the three activities of the Statement of Cash Flows is preferred by banks. There was some variation in responses, with a small number of banks preferring only operational data. These results suggest that complete information from all activities in the Statement of Cash Flows plays a critical role in cash flow analysis, while information from operating activities is important for some banks but not sufficient for most of them.

*Question 4:* What gaps and weaknesses do you find in the current regulation of the Statement of cash flows reference (both in NAS 7 and IAS 7)? (more than 1 answer is possible).

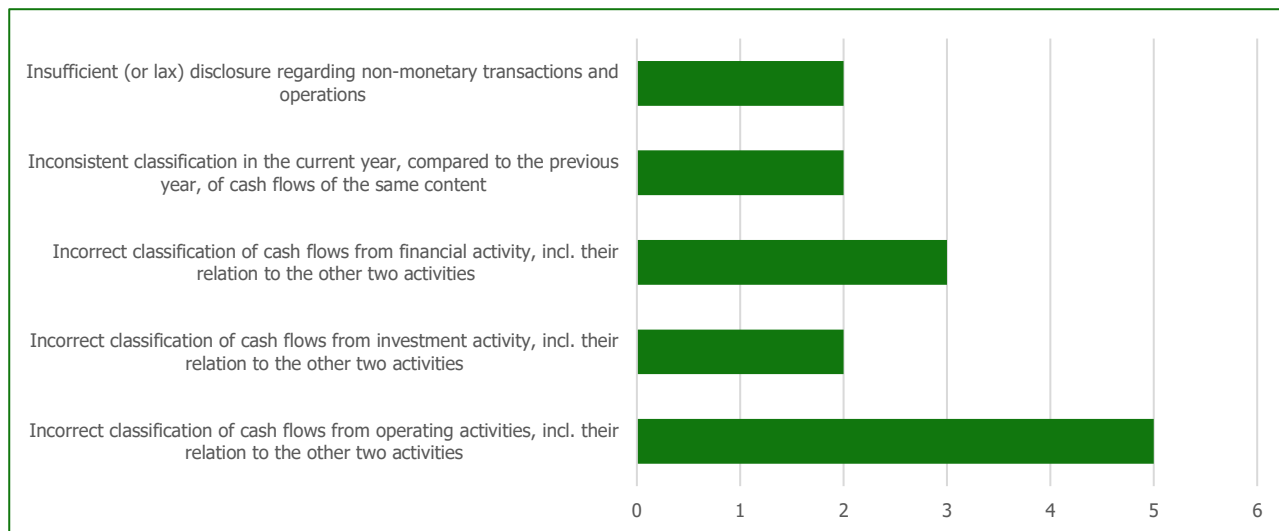
"Uncertainty about the purpose and usefulness of the information from the Statement of Cash Flows" was the most common answer (57.1%), indicating that more than half of the respondents believe that the current regulation of the Statement of Cash Flows does not provide sufficient clarity about its purpose and utility. Three answers are indicated with a significance of 42.9%: Limited/incomplete regulation regarding the variety of non-monetary operations, incl. non-cash financing (contributions, transformation of debt into property, barter, etc.), and their effect on the Cash Flow Statement; Ambiguities in the presentation in the Statement of Cash Flows on a net basis as "other" and incompleteness in NAS 7 and IAS 7 regarding disclosures of the significant information related to the Statement of Cash Flows.

The answers of Q4 show that the main gaps and weaknesses that banks define in the current regulation of NAS 7 and IAS 7 are related to the lack of clear guidelines and ambiguities regarding the purpose and usefulness of this statement. The greatest attention is paid to the ambiguities in the presentation of cash flows, especially concerning non-cash transactions and information on a net basis as "other". Disclosure requirements are also considered incomplete, which can create difficulties for users of financial statements. All this indicates that the responses are not very spread out around the median. This suggests that banks' responses are relatively close to each other and that there is general agreement on the main regulatory issues. The lack of significant variance between responses suggests that banks have similar perceptions and experiences in working with the Statement of Cash Flows. The answers obtained allow the following conclusions:

1. The most significant issue relates to the lack of clarity about the purpose and usefulness of the Statement of Cash Flows information, which highlights the need for better definition and communication of the statement's objectives.
2. The lack of clear guidelines for the classification of cash flows and the limited regulation of non-cash transactions are important areas for improvement.

3. Incompleteness in the disclosure of significant information and ambiguity in the presentation of cash flows are also issues that require attention.

*Question 5:* What are the most common deviations you have noticed in the Cash Flow Statements of the enterprises financed by your bank? (more than 1 answer is possible). The results are shown in Figure 3.

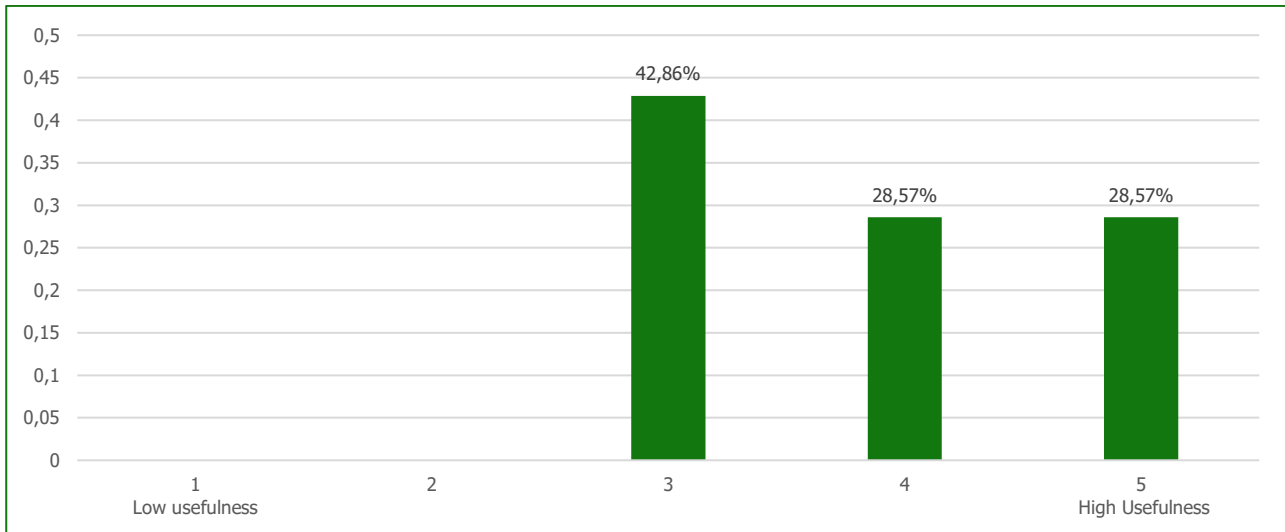


**Figure 3. Most common deviations in the Cash flow statements.** (Source: Authors' elaboration based on questionnaire processing)

The most common deviation when preparing the Statement of Cash Flows (71.4%) is the incorrect classification of cash flows from operating activities. This emphasizes the importance of the correct classification of operating cash flows, as they represent the basis of the financial sustainability of the enterprise. Rarer, but significant deviations are related to the incorrect classification of cash flows from investing and financing activity (with a frequency of 28.6% and 42.9%, respectively). The lack of disclosure of non-cash transactions and operations can lead to uncertainty about the true financial position of the entity. This omission, although less common (28.6%), is essential for properly understanding liquidity. In the analysis of Q5 answers, it should be noted that the main problems highlighted in the analysis of these responses are related to the incorrect classification of cash flows and the lack of consistency in classification across different reporting periods. The inconsistency in the classification of cash flows across years leads to difficulties in data comparability and cash flow analysis. This makes it difficult to perform correct analyses of trends in cash flows and the sustainability of the enterprise. This above can distort the analysis of the liquidity and financial stability of the enterprise, making the reports difficult to interpret. Also, the lack of adequate disclosure of non-monetary transactions, such as barter transactions or the transformation of debt into property, leads to gaps in the understanding of the overall financial position of the company. Without clear disclosure, investors and analysts may underestimate or overestimate the entity's actual liquidity and cash flows. These inaccuracies can distort the analysis of the liquidity and financial condition of the enterprise since the operational activity is a main indicator of the sustainability of the business. The elimination of identified inaccuracies is essential to improve the quality of financial statements and to provide more accurate information to investors and analysts.

*Question 6:* How do you rate the overall usefulness of the information from the Statement of Cash Flows for the purposes of credit rating and credit risk assessment? The last question (Q6) aims to find out how banks perceive the general usefulness of the information from the Cash Flow Statement in the lending process. Frequency analysis shows that the majority of respondents find the information in the Statement of Cash Flows moderately to highly useful. The question was constructed on a modified five-level Likert scale, with 1 corresponding to "low utility" and 5 corresponding to "high utility". The values of the intermediate evaluation levels from 2 to 4 are not indicated, but it is assumed that level 3 expresses the average value, i.e., "neither low nor high utility".

There are no respondents who consider the information to be of low utility, which highlights the importance of this report in the process of assessing creditworthiness and credit risk. The median shows that the central tendency of the responses is around the value 4. This means that half of the respondents rate the usefulness of the information in the Statement of Cash Flows as 4 or higher (see Figure 4). The median is less prone to extreme values than the mean. In this case, the median indicates that most respondents find the information quite useful, even if some rate it lower or higher. The indicated results allow us to conclude that regardless of the identified problems, the banks consider the information from the Cash Flow Statement to be highly useful in assessing creditworthiness and credit risk.



**Figure 4. Rating of the information usefulness of Cash flow statement.** (Source: Authors' elaboration based on questionnaire processing)

The largest percentage of respondents (42.86%) gave a rating of 3. This means that the majority of respondents consider that the information from the Cash Flow Statement is moderately useful for assessing creditworthiness and credit risk. This assessment may indicate that while the information is useful, it may not be comprehensive or clear enough for all analyst needs. Grades 4 and 5 are evenly distributed, each with 28.57%. This shows that a significant proportion of respondents find the information very useful or extremely useful. These estimates suggest that for some banks the Statement of Cash Flows provides important and valuable information for assessing creditworthiness and credit risk.

## DISCUSSION

The findings of this study underscore both the recognized value and practical challenges of using the Statement of Cash Flows (CFS) in Bulgarian banks' lending decisions. This study aligns with the observations of other researchers who affirm the utility of the CFS in evaluating borrower liquidity and credit risk, as well as predicting potential insolvency (Ferri et al., 2020; Kemp & Overstreet, 1990). These studies, along with findings from Cascino et al. (2013) and Citron (1992), highlight that while banks often rely on balance sheets and income statements, CFS data is increasingly essential for assessing a borrower's cash generation capacity—a critical factor in sustaining loan obligations.

### ***Alignment and Divergence with Previous Studies***

In line with Cascino et al. (2013) and Citron (1992), this study finds that Bulgarian banks still predominantly focus on traditional financial reports (i.e., balance sheets and income statements) in credit evaluations. This reliance aligns with historical trends observed in various studies that report the CFS often receives secondary attention compared to other financial statements. However, this study adds to the literature by identifying a shift in perspective within some Bulgarian banks, which now recognize the CFS as a critical tool for assessing liquidity risk and evaluating potential loan restructuring options.

Further reinforcing previous findings by Reither (1994) and Demerjian (2011), the study's results support the argument that the CFS provides unique insights not captured by the balance sheet or income statement. Respondents indicated that they use the CFS primarily to assess liquidity risks and borrower creditworthiness, showing that the CFS is vital to initial credit evaluations and decisions about loan restructuring. These applications suggest an evolving perspective that places greater emphasis on cash flow-based analysis, potentially indicating an emerging shift towards more cash flow-centric lending models, which remains less common but is gaining traction as a more resilient approach to credit assessment.

### **Regulatory Challenges and Methodological Limitations**

This study highlights several critical regulatory challenges that restrict the effective use of the CFS, particularly ambiguities within NAS 7 and IAS 7, which are consistent with critiques by Nurnberg (2006). Bulgarian banks in this study echoed concerns from Ferri et al. (2020) and Nguyen & Nguyen (2020), noting that the lack of clear guidelines in cash flow classification—especially regarding non-cash transactions—limits the reliability of the CFS in credit assessments. These regulatory limitations reduce CFS's utility in credit assessments, underscoring a need for more detailed guidelines, a recommendation shared by studies like Wilson (1987) and Neill et al. (1991). Respondents identified frequent misclassifications, inconsistencies across reporting periods, and insufficient disclosure of non-monetary transactions as significant issues, which hinder accurate assessments of borrowers' cash flow sustainability. Such limitations underscore the need for regulatory bodies to improve clarity and comparability in CFS standards to enhance its reliability in lending decisions.

### **Practical Implications and Areas for Further Research**

The practical implications of these findings are substantial, especially in the context of Bulgarian banking, where asset-based lending is the norm. The emphasis placed on cash flows for certain types of credit assessments, as noted by Fisher (2022), suggests that more banks might benefit from incorporating detailed CFS analyses as part of their credit evaluation process. While banks currently obtain daily cash flow information through other means (such as account monitoring), the CFS offers an independent, holistic view of cash flow sustainability and liquidity that remains underutilized.

Despite this growing interest, Bulgarian banks still encounter challenges in effectively using the CFS. Previous studies by Kemp and Overstreet (1990) and Reither (1994) indicate that lenders seek specific types of information from the CFS, such as cash flow trends that affect liquidity and debt repayment capability. However, ambiguous guidelines in NAS 7 and IAS 7, highlighted by this study, limit the utility of the CFS for these purposes, as noted by Nurnberg (2006) in his work.

This study also identifies several promising areas for further research. For example, future studies could explore how cash flow-centric lending models affect credit risk profiles over time, particularly in Eastern Europe where regulatory structures and banking practices share similarities with Bulgaria. Additionally, examining the potential benefits of CFS-focused credit assessments in small and medium enterprises (SMEs) could yield insights, as SMEs often rely heavily on bank financing but lack comprehensive financial statements.

The study's hypotheses on the use and usefulness of the Cash Flow Statement (CFS) in Bulgarian banks' lending decisions are assessed through survey results from major banks in Bulgaria. Here's a summary of how these hypotheses are either supported or refuted:

1. *Hypothesis 1* predicted that Bulgarian banks undervalue the CFS due to its complexity and preparation specifics. This hypothesis is partially supported. While banks recognize the CFS as useful for risk assessment, they often prioritize other statements, like the Balance Sheet and Income Statement, suggesting that its value is sometimes overlooked compared to these reports.
2. *Hypothesis 2* suggested that the utility of CFS is compromised by frequent errors in its preparation. The data supports this hypothesis, as banks noted common issues with the misclassification of cash flows and inconsistent reporting across periods, affecting the statement's reliability for credit assessments.
3. *Hypothesis 3* posited that ambiguous guidelines within NAS 7 and IAS 7 diminish the CFS's effectiveness. The findings support this hypothesis, as banks reported that unclear regulations and incomplete guidance, especially concerning non-cash transactions, limit the CFS's clarity and usability.

In conclusion, the study underlines that while Bulgarian banks do see the CFS as a useful document, especially for assessing liquidity, existing limitations in preparation and regulatory guidelines reduce its practical impact. This calls for regulatory improvements to better support banks in leveraging the CFS effectively, echoing calls from prior studies by Neill et al. (1991) and Wilson (1987) to refine cash flow reporting for clearer, more reliable financial analysis.

The results of the study have to be analysed and discussed with a focus on the limitations of the study:

1. **Focus on Leading Banks:** The study is primarily focused on larger banks, which may have different practices and perspectives compared to smaller or more specialized institutions, potentially skewing the results.
2. **Geographical Scope:** The study is focused only on Bulgarian banks. As a result, the findings may not apply to banks in other countries or regions with different regulatory frameworks or banking practices.

3. **Survey-Based Data:** The reliance on survey responses introduces potential biases, such as subjective interpretations of the usefulness of the Cash Flow Statement and how banks use it in practice. The respondents may also not fully represent all decision-makers within the banks.
4. **Limited Exploration of Non-Financial Factors:** The study is heavily focused on the financial aspects of credit assessment, potentially overlooking qualitative factors such as management quality or market conditions, which could also influence the use of CFS in lending decisions.

These limitations suggest that while the study provides valuable insights into the use of the Cash Flow Statement by banks in Bulgaria, further research with broader samples, geographical diversity, and inclusion of other financial and non-financial factors would strengthen its findings.

## CONCLUSIONS

Our study establishes several important aspects regarding the use of the Cash Flow Statement in the credit process of Bulgarian banks. Although most banks recognize the importance of the Cash Flow Statement for assessing the liquidity and financial condition of enterprises, it remains less used compared to the Balance Sheet and the Income Statement. Key findings from the study include:

1. **The usefulness of the Cash Flow Statement for Creditworthiness Assessment:** While the majority of banks state that all major financial statements are equally useful, the Cash Flow Statement is often viewed as less important than other financial statements. The statement is mainly used to assess the credit risk related to the liquidity of enterprises, and less often to assess capital collateral or financial ratios.
2. **Limited use of the Statement of Cash Flows in practice:** Data shows that banks in Bulgaria usually require the Statement of Cash Flows once a year, focusing mainly on changes in cash flows in operating, investing, and financing activities. However, for quarterly or short-term statements, banks rarely pay attention to the Statement of Cash Flows, preferring information from the Balance Sheet and Income Statement.
3. **Problems in the regulation and presentation of the Cash Flow Statement:** The study found several weaknesses in the current regulation of this statement. Lack of clarity about the purpose and usefulness of the report, as well as insufficient guidance on the classification of non-monetary transactions (such as barter, debt-to-property transformations, etc.), lead to difficulties in its use. This limits banks' ability to derive maximum utility from the creditworthiness analysis report.
4. **Misclassification of cash flows:** The most common problem identified by banks is the misclassification of cash flows, especially in operating activities. This makes it difficult to analyze the liquidity and finances of enterprises and can lead to distorted assessments of their financial condition.
5. **Risk Assessment and Loan Restructuring:** While the Cash Flow Statement is primarily used to assess credit risk, banks also use it in making decisions to change loan parameters, such as restructuring or refinancing. This highlights the importance of stable cash flows to approve changes in credit terms.

In conclusion, the study highlights the need for better regulation and clear guidelines for the preparation and use of the Statement of Cash Flows. Although banks recognize the importance of this statement, its limited use and shortcomings in its current form prevent its full integration into credit analysis. Improvements in the classification of cash flows, as well as better disclosure of non-cash transactions, could increase its usefulness in the lending process. The findings and conclusions of this study can serve regulatory, and standardizing bodies, as well as the enterprises and banks themselves in the preparation and analysis of the Cash Flow Statement.

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## ADDITIONAL INFORMATION

### AUTHOR CONTRIBUTIONS

*All authors have contributed equally.*

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## CONFLICT OF INTEREST

The Authors declare that there is no conflict of interest.

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## КОРИСНІСТЬ ЗВІТІВ ПРО РУХ ГРОШОВИХ КОШТІВ ПРИ УХВАЛЕННІ РІШЕНЬ ЩОДО БАНКІВСЬКОГО КРЕДИТУВАННЯ: ПОГЛЯДИ З БОЛГАРСЬКОЇ ПРАКТИКИ

У цьому дослідженні розглянуті роль і користь Звіту про грошові потоки в процесі ухвалення кредитних рішень із погляду болгарських банків. Основна мета – оцінити, як банки використовують Звіт про рух грошових коштів для оцінки кредитоспроможності та фінансового стану підприємств. Опитування провідних болгарських банків виявляє відмінності в тому, як вони розуміють і використовують цю інформацію в кредитному аналізі. Результати показують, що, хоча банки визнають важливість Звіту про рух грошових коштів для оцінки ліквідності та ризику, він часто затьмарюється іншими фінансовими звітами, такими як Баланс і Звіт про фінансові результати. Одна з виявлених поширених проблем – неправильна класифікація грошових потоків та недостатня чіткість регулювання безготівкових операцій, що перешкоджає повній користі Звіту про рух грошових коштів у процесі оцінки кредитоспроможності. Хоча Звіт про рух грошових коштів є корисним для оцінки кредитного ризику, дослідження має обмеження в поточному використанні банками. У статті надано рекомендації щодо вдосконалення структури звіту про рух грошових коштів та кредитних оцінок із використанням інформації про рух грошових коштів.

**Ключові слова:** облік за методом нарахувань, облік грошових коштів, звіт про рух грошових коштів; корисність інформації у звіті про рух грошових коштів; банківський скоринг

**JEL Класифікація:** M41

### Questionary

**Q1: Please express your opinion on the usefulness of the information from the annual financial statement in connection with the analysis of the financial situation and the assessment of the creditworthiness of enterprises, incl. the determination of credit risk.**

- The most useful is the information from the Statement of profit and loss/Statement of Comprehensive Income
- The most useful information is from the Balance Sheet/Statement of Financial Position
- Equally useful is the information from both the Balance Sheet/Statement of Financial Position and the other 3 statements Statement of profit and loss/Statement of Comprehensive Income, Cash Flow Statement, and Statement of Changes in Equity.
- Information from the Statement of Cash Flows (CFO) is most useful
- I can't judge

**Q2: In which cases do you use information from the OPP and for what?  
(more than 1 answer is possible)**

- In the initial assessment of the enterprise and its general creditworthiness
- When assessing the possibility of changing the parameters of the loan agreement
- When assessing the risks associated with the borrower and the client in general
- When determining the total amount of the loan and indebtedness
- When determining the parameters of the material collateral for the loan
- Other, please specify

**Q3: What information from the Statement of Cash Flows do you use most often in your work?**

- Only the information related to the total net change in cash during the reporting period
- Information related to the change in cash in operating activity
- Information related to the inflows and outflows of cash from the investing activity
- Information about cash flows and their net change in all three activities: operating, investing and financing activity
- I can't judge
- Other, please specify

**Q4: What gaps and weaknesses do you find in the current regulation of the Statement of Cash Flows (both in National Accounting Standard (NAS) 7 and in IAS 7)?**

*(more than 1 answer is possible)*

- Ambiguity about the purpose and usefulness of information from the Cash flow statement
- Lack of clear guidelines in NAS 7 and IAS 7 regarding the classification of cash flows related to interest, dividends, bank service charges, etc.
- Limited/incomplete regulation regarding the variety of non-monetary operations, incl. non-monetary financing (contributions, transformation of debt into property, barter, etc.), and their effect on Cash flow statements
- Ambiguities in the presentation of cash flows on a net basis as "other" in the Cash flow statement
- Incompleteness in NAS 7 and IAS 7 regarding the disclosures of the material information related to the Cash flow statement
- Other, please specify

**Q5: What are the most common deviations you have noticed in the Cash Flow Statements of the enterprises financed by your bank?**

*(more than 1 answer is possible)*

- Incorrect classification of cash flows from operating activities, incl. their relation to the other two activities
- Incorrect classification of cash flows from investing activity, incl. their relation to the other two activities
- Incorrect classification of cash flows from financing activity, incl. their relation to the other two activities
- Inconsistent classification in the current year, compared to the previous year, of cash flows of the same content
- Insufficient (or lax) disclosure regarding non-monetary transactions and operations
- Other, please specify

**Q6: How do you rate the overall usefulness of the information from the Statement of Cash Flows for the purposes of credit rating and credit risk assessment?**

	1	2	3	4	5	
Low usefulness	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	<input type="radio"/>	High usefulness