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**A Roadmap to the Preparation
of the Statement of Cash Flows**

2019

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Preface

May 2019

To our friends and clients:

We are pleased to present the 2019 edition of *A Roadmap to the Preparation of the Statement of Cash Flows*. This Roadmap provides Deloitte's insights into and interpretations of the accounting guidance on the statement of cash flows, primarily that in ASC 230.¹

The accounting principles related to the statement of cash flows have been in place for many years; however, errors in the statement of cash flows continue to be one of the leading causes of restatements and registrants continue to receive comments from the SEC staff on cash flow presentation matters.

While ASC 230 provides some guidance on cash payments and receipts that are classified as either operating, investing, or financing activities, it does not provide consistent principles for evaluating the classification of cash payments and receipts in the statement of cash flows, which has led to diversity in practice.

To address these concerns, the FASB issued ASU 2016-15 and ASU 2016-18, which clarify guidance in ASC 230 on the classification of certain cash flows² and apply to all public business entities and many private entities. The 2019 edition of this Roadmap reflects the amendments to ASC 230 made by these ASUs and includes some of Deloitte's interpretive views on them.

The 2019 edition also incorporates interpretations and guidance related to the new leasing standard, ASU 2016-02 (codified in ASC 842; see [Section 7.6](#)). ASU 2016-02 amended the leasing guidance in U.S. GAAP — notably by requiring lessees to recognize liabilities for lease payments and right-of-use assets — and became effective for calendar-year-end public business entities on January 1, 2019.

Subscribers to the [Deloitte Accounting Research Tool \(DART\)](#) may access any interim updates to this publication by selecting the document from the "Roadmaps" tab on DART's home page. If a "Summary of Changes Since Issuance" displays, subscribers can view those changes by clicking the related links or by opening the "active" version of the Roadmap.

We hope that you find this publication a valuable resource when considering the accounting guidance on the statement of cash flows.³

Sincerely,

Deloitte & Touche LLP

¹ For the full titles of standards, topics, and regulations, see [Appendix F](#). For the full forms of acronyms, see [Appendix G](#).

² See [Chapter 1](#) for each ASU's effective date and transition provisions.

³ Although this Roadmap is intended to be a helpful resource, it is not a substitute for consulting with Deloitte professionals on complex accounting questions and transactions.

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Chapter 1 — Overview

ASC 230 contains guidance on reporting cash flows in an entity's financial statements. The primary objective for presenting a statement of cash flows under ASC 230 is to provide details on the changes in an entity's cash and cash equivalents during a period. In accordance with this objective, cash receipts and payments are classified as operating activities, investing activities, or financing activities in the statement of cash flows and noncash investing and financing activities are separately disclosed.

ASC 230-10

10-1 The primary objective of a statement of **cash** flows is to provide relevant information about the cash receipts and cash payments of an entity during a period.

10-2 The information provided in a statement of cash flows, if used with related disclosures and information in the other financial statements, should help investors, creditors, and others (including donors) to do all of the following:

- a. Assess the entity's ability to generate positive future net cash flows
- b. Assess the entity's ability to meet its obligations, its ability to pay **dividends**, and its needs for external financing
- c. Assess the reasons for differences between net income and associated cash receipts and payments
- d. Assess the effects on an entity's financial position of both its cash and noncash investing and financing transactions during the period.

ASC 230 provides general guidance on the classification of cash receipts and payments as operating, investing, or financing activities. Under ASC 230, cash receipts and payments that are not defined as financing or investing should be classified as operating activities. Although ASC 230 provides some guidance on identifying cash flows from operating activities, it points out that such cash flows are generally the cash effects of transactions or events that enter into the determination of net income. Because ASC 230 did not previously contain clearly defined principles for evaluating the classification of all cash payments and receipts in the statement of cash flows, diversity in practice had evolved with respect to the classification of certain cash receipts and cash payments.

To address diversity in practice related to certain matters associated with presentation in the statement of cash flows, the FASB issued **ASU 2016-15**¹ and **ASU 2016-18**² in 2016. Both of these ASUs are codified in ASC 230 and contain amendments that are effective for all public business entities and many private entities. This Roadmap reflects the updates to ASC 230 made by these ASUs.

¹ For public business entities, the guidance in ASU 2016-15 is effective for fiscal years beginning after December 15, 2017, including interim periods within those fiscal years. For all other entities, it is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted for all entities. However, an entity that early adopts ASU 2016-15 must adopt all of the ASU's amendments. Entities must apply the guidance retrospectively to all periods presented but may apply it prospectively if retrospective application would be impracticable.

² For public business entities, ASU 2016-18 is effective for fiscal years beginning after December 15, 2017, including interim periods therein. For all other entities, it is effective for fiscal years beginning after December 15, 2018, and interim periods within fiscal years beginning after December 15, 2019. Early adoption is permitted for all entities, which must apply the guidance retrospectively to all periods presented.

Chapter 2 — Scope

Although entities are required to present a statement of cash flows, there are certain exceptions (identified in ASC 230). ASC 230 also defines the periods for which an entity is required to present a statement of cash flows.

ASC 230-10

15-2 The guidance in the Statement of Cash Flows Topic applies to all entities, including both business entities and not-for-profit entities (NFPs), with specific exceptions noted below. The phrase *investors, creditors, and others* includes donors. The terms *income statement* and *net income* apply to a business entity; the terms *statement of activities* and *change in net assets* apply to an NFP.

15-3 A business entity or NFP that provides a set of financial statements that reports both financial position and results of operations shall also provide a statement of cash flows for each period for which results of operations are provided.

A statement of cash flows should be presented for each of the periods in which a statement of operations (or statement of activities for not-for-profit entities (NFPs)) is provided. For example, if a statement of operations is provided for the most recent three periods, a statement of cash flows should also be provided for the same three periods. However, certain types of entities are exempt from the requirement to present a statement of cash flows under ASC 230 when they are presenting a complete set of financial statements.

ASC 230-10

15-4 The guidance in this Topic does not apply to the following entities:

- a. A statement of cash flows is not required to be provided by a defined benefit pension plan that presents financial information in accordance with the provisions of Topic 960. Other employee benefit plans that present financial information similar to that required by Topic 960 (including the presentation of plan investments at **fair value**) also are not required to provide a statement of cash flows. Employee benefit plans are encouraged to include a statement of cash flows with their annual financial statements when that statement would provide relevant information about the ability of the plan to meet future obligations (for example, when the plan invests in assets that are not highly liquid or obtains financing for investments).
- b. Provided that the conditions in (c) are met, a statement of cash flows is not required to be provided by the following entities:
 1. An investment company within the scope of Topic 946 on investment companies
 2. Subparagraph superseded by Accounting Standards Update No. 2013-08.
 3. A common trust fund, variable annuity account, or similar fund maintained by a bank, insurance entity, or other entity in its capacity as a trustee, administrator, or guardian for the collective investment and reinvestment of funds.

ASC 230-10 (continued)

- c. For an investment company specified in (b) to be exempt from the requirement to provide a statement of cash flows, all of the following conditions must be met:
 - 1. Subparagraph superseded by Accounting Standards Update No. 2013-08.
 - 2. During the period, substantially all of the entity's investments were carried at fair value and classified in accordance with Topic 820 as Level 1 or Level 2 measurements or were measured using the practical expedient in paragraph 820-10-35-59 to determine their fair values and are redeemable in the near term at all times.
 - 3. The entity had little or no debt, based on the average debt outstanding during the period, in relation to average total assets. For the purpose of determining average debt outstanding, obligations resulting from redemptions of shares by the entity from unsettled purchases of securities or similar assets, or from covered options written generally may be excluded. However, any extension of credit by the seller that is not in accordance with standard industry practices for redeeming shares or for settling purchases of investments shall be included in average debt outstanding.
 - 4. The entity provides a statement of changes in net assets.

Entities that are not required to present a statement of cash flows include defined benefit pension plans that prepare financial information in accordance with ASC 960, certain investment companies within the scope of ASC 946 that meet all of the conditions in ASC 230-10-15-4(c), and certain funds described in ASC 230-10-15-4(b)(3).

Chapter 3 — Format and Presentation

This chapter provides guidance on the format and presentation of changes in cash and cash equivalents, focusing on actual cash flows during the period.

3.1 Form and Content of the Statement of Cash Flows

The statement of cash flows should report the cash effects of operations, investing transactions, and financing transactions during a period. An entity can use the indirect method¹ or the direct method² to present the operating section of the statement of cash flows. ASC 230 contains examples illustrating the preparation of the statement of cash flows under both methods. ASC 230-10-45-25 encourages entities to use the direct method in presenting the operating section of the statement of cash flows and to report major classes of gross cash receipts and gross cash payments for operating cash flows. Further, entities are encouraged to use the direct method to include a detailed breakdown of operating cash receipts and payments to the extent that providing such detail is feasible and financial statement users find it helpful.

Although use of the direct method is encouraged, many entities apply the indirect method to present operating cash flows. However, entities employing the indirect method should consider the direct method when evaluating proper classification of operating cash flows.

ASC 230-10

45-28 Entities that choose not to provide information about major classes of operating **cash** receipts and payments by the direct method as encouraged in paragraph 230-10-45-25 shall determine and report the same amount for net cash flow from **operating activities** indirectly by adjusting net income of a business entity or change in net assets of a **not-for-profit entity** (NFP) to reconcile it to net cash flow from operating activities (the indirect or reconciliation method). That requires adjusting net income of a business entity or change in net assets of an NFP to remove both of the following:

- a. The effects of all deferrals of past operating cash receipts and payments, such as changes during the period in **inventory**, deferred income, and the like, and all accruals of expected future operating cash receipts and payments, such as changes during the period in receivables and payables. Adjustments to net income of a business entity or change in net assets of an NFP to determine net cash flow from operating activities shall reflect accruals for interest earned but not received and interest incurred but not paid. Those accruals may be reflected in the statement of financial position in changes in assets and liabilities that relate to investing or **financing activities**, such as loans or deposits. However, interest credited directly to a deposit account that has the general characteristics of cash is a cash outflow of the payor and a cash inflow of the payee when the entry is made.

¹ Under the indirect method, net cash provided or used by operating activities is determined by adding back or deducting from net income those items that do not affect cash (e.g., noncash transactions).

² Under the direct method, major classes of gross cash receipts and payments and their arithmetic sum are reported to determine net cash provided or used by operating activities.

ASC 230-10 (continued)

- b. All items that are included in net income of a business entity or change in net assets of an NFP that do not affect net cash provided from, or used for, operating activities such as depreciation of property, plant, and equipment and **amortization** of finite-life intangible assets. This includes all items whose cash effects are related to investing or financing cash flows, such as gains or losses on sales of property, plant, and equipment and discontinued operations (which relate to **investing activities**), and gains or losses on extinguishment of debt (which relate to financing activities).

Regardless of which method is used, an entity must present a reconciliation of net income (or changes in net assets for NFPs) to net cash flows from operating activities. All major classes of reconciling items must be separately reported; further breakdowns of categories are encouraged if doing so would result in more meaningful information for users.

ASC 230-10

45-29 The reconciliation of net income of a business entity or change in net assets of an NFP to net cash flow from operating activities described in paragraph 230-10-45-28 shall be provided regardless of whether the direct or indirect method of reporting net cash flow from operating activities is used. That reconciliation shall separately report all major classes of reconciling items. For example, major classes of deferrals of past operating cash receipts and payments and accruals of expected future operating cash receipts and payments, including, at a minimum, changes during the period in receivables pertaining to operating activities, in inventory, and in payables pertaining to operating activities, shall be separately reported. Entities are encouraged to provide further breakdowns of those categories that they consider meaningful. For example, changes in receivables from customers for an entity's sale of goods or services might be reported separately from changes in other operating receivables.

Pending Content (Transition Guidance: ASC 958-10-65-1)

45-29 The reconciliation of net income of a business entity to net cash flow from operating activities described in paragraph 230-10-45-28 shall be provided regardless of whether the direct or indirect method of reporting net cash flow from operating activities is used. However, NFPs that use the direct method of reporting net cash flows from operations are not required to provide a reconciliation of change in net assets to net cash flow from operating activities. Additional guidance for NFPs is found in Subtopic 958-230. The reconciliation shall separately report all major classes of reconciling items. For example, major classes of deferrals of past operating cash receipts and payments and accruals of expected future operating cash receipts and payments, including, at a minimum, changes during the period in receivables pertaining to operating activities, in inventory, and in payables pertaining to operating activities, shall be separately reported. Entities are encouraged to provide further breakdowns of those categories that they consider meaningful. For example, changes in receivables from customers for an entity's sale of goods or services might be reported separately from changes in other operating receivables.

45-30 If the direct method of reporting net cash flow from operating activities is used, the reconciliation of net income of a business entity or change in net assets of an NFP to net cash flow from operating activities shall be provided in a separate schedule.

Pending Content (Transition Guidance: ASC 958-10-65-1)

45-30 If an entity other than an NFP uses the direct method of reporting net cash flow from operating activities, the reconciliation of net income to net cash flow from operating activities shall be provided in a separate schedule.

ASC 230-10 (continued)

45-31 If the indirect method is used, the reconciliation may be either reported within the statement of cash flows or provided in a separate schedule, with the statement of cash flows reporting only the net cash flow from operating activities.

45-32 If the reconciliation is presented in the statement of cash flows, all adjustments to net income of a business entity or change in net assets of an NFP to determine net cash flow from operating activities shall be clearly identified as reconciling items.

At the 2005 AICPA Conference on Current SEC and PCAOB Developments (the 2005 AICPA Conference), SEC Associate Chief Accountant Joel Levine suggested that it is not appropriate to reconcile an amount other than net income (e.g., income from continuing operations) to net cash flows from operating activities in the statement of cash flows.

ASC 230-10-55-7 through 55-21 contain examples illustrating the presentation of the statement of cash flows under both the direct method and the indirect method.

Presentation requirements related to NFP financial statements are discussed in ASC 230-10-45-29 and 45-30. NFPs have the option of presenting their statement of cash flows by using either the direct method or the indirect method. However, an NFP that chooses to use the direct method of cash flow reporting is not required to present or disclose (e.g., in a separate schedule) the indirect method reconciliation.

3.2 Gross and Net Cash Flows

Generally, cash payments should not be presented net of cash receipts in the statement of cash flows. ASC 230-10-45 provides guidance on presenting gross and net cash flows in the statement of cash flows.

ASC 230-10

45-7 Generally, information about the gross amounts of cash receipts and cash payments during a period is more relevant than information about the net amounts of cash receipts and payments. However, the net amount of related receipts and payments provides sufficient information not only for [cash equivalents](#), as noted in paragraph 230-10-45-5, but also for certain other classes of cash flows specified in paragraphs 230-10-45-8 through 45-9 and paragraph 230-10-45-28.

45-8 For certain items, the turnover is quick, the amounts are large, and the maturities are short. For certain other items, such as demand deposits of a bank and customer accounts payable of a broker-dealer, the entity is substantively holding or disbursing cash on behalf of its customers. Only the net changes during the period in assets and liabilities with those characteristics need be reported because knowledge of the gross cash receipts and payments related to them may not be necessary to understand the entity's operating, investing, and financing activities.

ASC 230-10 (continued)

45-9 Providing that the original maturity of the asset or liability is three months or less, cash receipts and payments pertaining to any of the following qualify for net reporting for the reasons stated in the preceding paragraph:

- a. Investments (other than cash equivalents)
- b. Loans receivable
- c. Debt.

For purposes of this paragraph, amounts due on demand are considered to have maturities of three months or less. For convenience, credit card receivables of financial services operations — generally, receivables resulting from cardholder charges that may, at the cardholder's option, be paid in full when first billed, usually within one month, without incurring interest charges and that do not stem from the entity's sale of goods or services — also are considered to be loans with original maturities of three months or less.

The netting criteria in ASC 230-10-45-8 (turnover is quick, the amounts are large, and the maturities are short) must be met for an entity to present investing and financing activity on a net basis, regardless of the classification of the asset or liability in the balance sheet (i.e., current or noncurrent). For example, in some cases, provided that certain conditions are met, it may be appropriate to present debt-related activity (e.g., withdrawals and repayments) on a net basis in the statement of cash flows even though the debt is presented as noncurrent in the balance sheet. This could be the case, for example, if debt (1) meets all of the conditions for net presentation in ASC 230-10-45-8 and 45-9 and (2) is appropriately presented as noncurrent in the balance sheet because it meets the criteria in ASC 470-10-45-14.

3.2.1 Situations in Which Net Presentation May Be Appropriate

ASC 942-230-45-1 and 45-2 state:

45-1 Banks, savings institutions, and credit unions are not required to report gross amounts of cash receipts and cash payments for any of the following:

- a. Deposits placed with other financial institutions and withdrawals of deposits
- b. Time deposits accepted and repayments of deposits
- c. Loans made to customers and principal collections of loans.

45-2 When those entities constitute part of a consolidated entity, net amounts of cash receipts and cash payments for deposit or lending activities of those entities shall be reported separate from gross amounts of cash receipts and cash payments for other investing and financing activities of the consolidated entity, including those of a subsidiary of a bank, savings institution, or credit union that is not itself a bank, savings institution, or credit union.

Example 3-1

On January 1, 20X1, Entity A enters into a three-year revolving line of credit with a maximum borrowing capacity of \$300 million. Under the terms of the line of credit, each borrowing or draw is considered due on demand. On June 30, 20X1, A borrows \$150 million against the line of credit. On August 1, 20X1, A draws against the line of credit again, borrowing an additional \$120 million. On August 31, 20X1, A borrows another \$30 million from the line of credit. On September 30, 20X1, A pays \$200 million of the outstanding balance. Assume that the turnover of borrowings and payments is quick and that the amounts borrowed and paid are large. Because the original (contractual) maturity of the borrowings is due on demand (i.e., three months or less), A may present the borrowings and payment on a net basis (\$100 million) as a financing cash inflow in its statement of cash flows for the period ended December 31, 20X1.

Example 3-2

On January 1, 20X1, Entity A enters into a three-year revolving line of credit with a maximum borrowing capacity of \$300 million. On June 30, 20X1, A borrows (1) \$200 million from the line of credit and signs a note to pay the amount borrowed in three months and (2) \$100 million from the line of credit and signs a note to pay the amount borrowed in four months. On September 30, 20X1, A pays \$200 million related to the first note. On October 31, 20X1, A pays \$100 million related to the second note. Assume that the turnover of borrowings and payments is quick and that the amounts borrowed and paid are large. In A's statement of cash flows for the period ended December 31, 20X1, only the borrowing and payment related to the first note may be presented on a net basis within financing activities because the original (contractual) maturity of this note is three months or less. The borrowing and payment related to the second note should be presented on a gross basis (i.e., borrowing of \$100 million as a financing cash inflow and payment of \$100 million as a financing cash outflow).

Example 3-3

On January 1, 20X1, Entity A enters into a three-year revolving line of credit with a maximum borrowing capacity of \$300 million. The agreement does not set maturity dates for each borrowing other than the expiration of the line of credit at the end of December 31, 20X3. In this case, all borrowings and repayments made before October 1, 20X3, should be presented on a gross basis because the original (contractual) maturity of each borrowing is not three months or less. Provided that the turnover of borrowings and payments is quick and that the amounts borrowed and paid are large, amounts borrowed or paid after October 1, 20X3, may be presented on a net basis because the original (contractual) maturity is within three months. It may, however, be impractical to separate the borrowings and repayments into those that must be presented on a gross basis and those that may be presented on a net basis. Accordingly, A could present all borrowings and repayments on a gross basis.

3.3 Presentation of Discontinued Operations

A disposal of a component or group of components of an entity must be reported in discontinued operations if the disposal meets the criteria in ASC 205-20. [ASU 2014-08](#) changed the requirements for reporting a discontinued operation under ASC 205-20 and introduced new disclosure requirements for discontinued operations, including certain cash flow disclosure requirements.

ASC 205-20

50-5B An entity shall disclose, to the extent not presented on the face of the financial statements as part of discontinued operations, all of the following in the notes to financial statements: . . .

- c. Either of the following:
 1. The total operating and investing cash flows of the discontinued operation for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity)
 2. The depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity). . . .

During deliberations of the guidance in ASU 2014-08, some Board members noted that disclosure of investing and operating cash flows is more meaningful than disclosure of depreciation and amortization, capital expenditures, and significant noncash items. However, the cash flow disclosures could present a significant challenge for entities that have a centralized cash management process (since these entities do not typically segregate their invoices or purchase orders at the business unit or operating unit level) and may be difficult to provide in a timely manner and without undue effort. Therefore, the Board decided to give entities the option of providing the above alternative disclosure in the notes to the financial statements. The Board also decided not to require entities to disclose the financing cash flows of a discontinued operation because financing transactions are often conducted at the parent level rather than within each subsidiary.

Before the adoption of ASU 2014-08, entities were not required to separately disclose — in the statement of cash flows or in the notes to the financial statements — cash flows pertaining to discontinued operations reflected in operating, investing, and financing activities. However, in his 2005 AICPA Conference speech, Mr. Levine stated that if an entity chooses to separately present cash flows pertaining to discontinued operations in the statement of cash flows, such presentation should be in line with the basic principle of ASC 230 (i.e., all cash flows must be reported as operating, investing, or financing activities, as applicable). Therefore, although they are not required to do so, some entities have chosen to separately present the cash flows pertaining to discontinued operations on the face of the cash flow statement or to disclose such information in the notes to the financial statements, classifying cash flows pertaining to discontinued operations within operating, investing, and financing activities.

Under ASU 2014-08, if an entity chooses to separately disclose cash flows pertaining to discontinued operations in the notes to the financial statements, the entity is only required to provide the minimum disclosures described in ASC 205-20-50-5B(c), including either (1) total operating and investing cash flows of the discontinued operation or (2) depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation.

However, ASU 2014-08 states that “[a]n entity shall disclose, to the extent not presented on the face of the financial statements as part of discontinued operations, all of the following in the notes to financial statements.” From this wording, it is not clear whether, (1) if an entity elects to provide these minimum disclosures on the face of the statement of cash flows (in particular the option to only disclose depreciation, amortization, capital expenditures, and significant operating and investing noncash items), such disclosures would represent the required minimum cash flow information about the discontinued operation to present in the statement of cash flows or (2) an entity would nonetheless be required to comply with the principles of ASC 230 and provide total operating, investing, and financing information for the discontinued operation to the extent applicable. On the basis of informal discussions with the FASB staff, we do not believe that ASU 2014-08 amended the principles of ASC 230, specifically those related to providing total operating and investing cash flows for a discontinued operation. We therefore believe that if an entity elects to provide the ASU 2014-08 cash flow disclosures pertaining to a discontinued operation on the face of the statement of cash flows, the entity would need to comply with the principles of ASC 230. Given the lack of clarity discussed above, entities are encouraged to consult with their accounting advisers if they are considering an alternative presentation of cash flows related to discontinued operations on the face of the cash flow statement.

The following table illustrates one acceptable presentation for reporting cash flows from discontinued operations on the face of the cash flow statement:

Categories Related to the Statement of Cash Flows	Presentation
Operating	Continuing
	Discontinued (in detail or net)
	Total operating cash flows
Investing	Continuing
	Discontinued (in detail or net)
	Total investing cash flows
Financing	Continuing
	Discontinued (in detail or net)
	Total financing cash flows

An alternative to the above presentation is to disclose cash flows pertaining to discontinued operations for each of the categories (either in detail or net) below the section for cash flows from financing activities pertaining to continuing operations:

Categories Related to the Statement of Cash Flows	Presentation
Operating	Continuing
Investing	Continuing
Financing	Continuing
Operating	Discontinued (in detail or net)
Investing	Discontinued (in detail or net)
Financing	Discontinued (in detail or net)

When using this presentation, preparers should be aware that the approach does not provide a total for each of the three categories (although a user could compute these totals by adding the net cash flow for continuing operations and discontinued operations for each category). Accordingly, when using this alternative approach, captions related to any totals presented must clearly reflect the category to which the total is related (continuing vs. discontinued).

Entities should provide separate disclosures consistently for cash flows pertaining to discontinued operations for all periods affected and should continue to do so until there are no longer material cash flows related to the discontinued operation. In addition, ASU 2014-08 requires entities that have significant continuing involvement with a discontinued operation after the disposal date to disclose the amount of any cash inflows or outflows to or from the discontinued operation and any revenues and expenses with the discontinued operation presented in continuing operations after the disposal transaction that were eliminated in the consolidated financial statements before the disposal. SEC registrants should also consider discussing in MD&A the impact of the discontinued operations on future cash flows.

The proceeds from the sale of discontinued operations should be presented as cash associated with investing activities of discontinued operations. Although neither ASC 230 nor ASC 360-10 provides explicit guidance on the presentation of proceeds from the sale of discontinued operations in the statement of cash flows, this presentation is consistent with the concepts in those standards.

ASC 230-10-10-1 states that “[t]he primary objective of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an entity during a period.” Some preparers have included the proceeds from the sale of a discontinued operation in cash flows from continuing operations since these proceeds will be used to fund outflows of continuing operations. However, in commenting on the proper classification of insurance proceeds in the statement of cash flows at the 2005 AICPA Conference, Mr. Levine clarified that the SEC staff does not believe that the classification should be affected by how an entity intends to spend such proceeds. Further, the SEC staff’s view is consistent with ASC 230-10-45-21B, under which entities are required to classify proceeds from insurance settlements on the basis of the underlying loss (see [Section 6.3.2](#) for additional information). This view would also apply to reporting the proceeds from the sale of a discontinued operation.

Although ASC 360-10 does not provide explicit guidance on the presentation of discontinued operations in the statement of cash flows, ASC 205-20-45-3 requires that gains or losses from discontinued operations be presented separately from gains or losses from continuing operations in the income statement. Likewise, in the statement of cash flows, proceeds from the sale of assets that are associated with discontinued operations should be presented separately as cash related to investing activities of discontinued operations.

However, the allocation of taxes associated with the sale of a discontinued operation to investing activities would not be appropriate. ASC 230-10-45-17(c) requires that cash flows associated with cash payments to governments for taxes be included as a component of operating cash flows. Further, in the background information in paragraph 92 of FASB Statement 95, the Board indicates the following:

[A]llocation of income taxes paid to operating, investing, and financing activities would be so complex and arbitrary that the benefits, if any, would not justify the costs involved. This Statement requires that the total amount of income taxes paid be disclosed for reasons discussed in paragraph 121.

On the basis of this wording and the guidance in ASC 230-10-45-17(c), the Board decided not to permit the allocation of income taxes to the various cash flow components.

Example 3-4

Company P sold its international business to Company J for \$12 billion and will be required to pay approximately \$3 billion in taxes related to the gain on the sale. Company P has appropriately decided to report the sale of the international business as a discontinued operation in its income statement. In addition, P has elected to present the discontinued operation separately in its statement of cash flows. The proceeds from the sale of the business should be presented separately as cash related to investing activities of discontinued operations. The taxes related to the gain on the sale of the international business should be presented in operating activities in P’s statement of cash flows.

[Section 3.4 has been deleted.]

Chapter 4 — Cash and Cash Equivalents

This chapter provides guidance on the determination and presentation of cash and cash equivalents in the statement of cash flows. In accordance with ASC 230-10-45-4, when the total amounts of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are presented in more than one line item within the statement of financial position, an entity must provide additional disclosures to reconcile (1) the amounts disaggregated by line item, as reported in the statement of financial position, to (2) what is shown in the statement of cash flows.

4.1 Definition of Cash and Cash Equivalents

ASC Master Glossary

Cash

Consistent with common usage, cash includes not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty. All charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. For example, a bank's granting of a loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made.

While the definition of cash is fairly straightforward, the determination of cash equivalents may not be as clear. The ASC master glossary defines cash equivalents as follows:

ASC Master Glossary

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that have both of the following characteristics:

- a. Readily convertible to known amounts of cash
- b. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year U.S. Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an entity with banking operations).

Maturity is a critical component in the determination of whether short-term investments, such as certificates of deposit, time deposits, and other temporary investments, can be combined with cash and classified as cash equivalents or presented separately as short-term investments in an entity's balance sheet and statement of cash flows.

Example 4-1

Entity A invests excess funds in short-term (less than three months) bank repurchase agreements. The underlying securities in the transaction may have maturities greater than three months. Entity A may classify these repurchase agreements as cash equivalents in its balance sheet and statement of cash flows. The investment (the repurchase agreement), in substance, meets the criteria in ASC 230. The critical factor is the maturity of the repurchase agreement itself, not the underlying securities that serve to secure the investment.

ASC 230-10

45-6 Not all investments that qualify are required to be treated as **cash equivalents**. An entity shall establish a policy concerning which short-term, highly liquid investments that satisfy the definition of cash equivalents are treated as cash equivalents. For example, an entity having banking operations might decide that all investments that qualify except for those purchased for its trading account will be treated as cash equivalents, while an entity whose operations consist largely of investing in short-term, highly liquid investments might decide that all those items will be treated as investments rather than cash equivalents.

In accordance with ASC 230-10-50-1, an entity should disclose its policy for determining which items are treated as cash equivalents. Changes to an entity's policy represent changes in accounting principle for which preferability must be established in accordance with ASC 250.

4.1.1 Restricted Cash

4.1.1.1 Balance Sheet Presentation of Restricted Cash

Cash available for general operations is distinguishable from cash restricted in accordance with third-party special-purpose agreements. When a cash account is restricted, the ability of the account's owner to withdraw funds at any time is contractually or legally restricted. Since an entity cannot withdraw restricted cash without prior notice or penalty, the entity should not present such cash in cash and cash equivalents. While the terms "restricted cash" and "restricted cash equivalents" are not defined in U.S. GAAP, SEC Regulation S-X, Rule 5-02(1), requires registrants to separately disclose account balances whose withdrawal or usage is restricted. As a result, registrants typically present restricted cash and restricted cash equivalents separately from cash and cash equivalents on their balance sheet, and many nonpublic entities elect similar balance sheet presentation. However, entities may include restricted cash and restricted cash equivalents in other balance sheet line items. Accordingly, an entity's definition of restricted cash and restricted cash equivalents is typically an accounting policy matter. Such a policy should be applied consistently and will need to take into account the nature of both the financial instruments and the restrictions.

Paragraph BC9 of ASU 2016-18 indicates that the Board's clarifications related to presenting restricted cash and restricted cash equivalents in the statement of cash flows were not intended to change an entity's practice for identifying and reporting restricted cash or restricted cash equivalents. Specifically, paragraph BC9 states:

Although the Master Glossary does not include specific definitions of restricted cash or restricted cash equivalents, some Task Force members believe that only those financial instruments that first meet the definition of cash or cash equivalents before considering the restrictions that exist in a separate provision outside those financial instruments should be included in the beginning-of-period and end-of-period reconciliation of the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents on the statement of cash flows. Other Task Force members believe that the nature of the restrictions on cash or cash equivalents should be considered and that in certain cases the restrictions could be so severe that the financial instrument would not meet the definition of cash or cash equivalents, thereby preventing those balances from being included in the beginning-of-period and end-of-period reconciliation of total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents on the statement of cash flows. The Task Force considered defining restricted cash; however, it ultimately decided that the issue resulting in diversity in practice is the presentation of changes in restricted cash on the statement of cash flows. The Task Force's intent is not to change practice for what an entity reports as restricted cash or restricted cash equivalents.

Further, paragraph BC19 of ASU 2016-18 notes that (1) an entity should apply the guidance on a change in an accounting principle in ASC 250 "if [the] entity is considering changing its accounting policy for determining restricted cash and restricted cash equivalents" and (2) "[s]uch evaluation would be separate from adoption of the amendments in [ASU 2016-18]."

In addition, in accordance with ASC 230-10-50-7, an entity should disclose information about the nature of restrictions on its cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. Further, when cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are presented in more than one line item in the statement of financial position, an entity should also apply the requirements in ASC 230-10-50-8, as discussed below.

4.1.1.2 Presentation of Restricted Cash in the Statement of Cash Flows

ASC 230-10

45-4 A statement of cash flows shall explain the change during the period in cash and cash equivalents. The statement shall use descriptive terms such as cash or cash and cash equivalents rather than ambiguous terms such as funds. The total amounts of cash and cash equivalents at the beginning and end of the period shown in the statement of cash flows shall be the same amounts as similarly titled line items or subtotals shown in the statements of financial position as of those dates.

Pending Content (Transition Guidance: ASC 230-10-65-3)

45-4 A statement of cash flows shall explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. The statement shall use descriptive terms such as cash or cash and cash equivalents rather than ambiguous terms such as funds. When cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are presented in more than one line item within the statement of financial position, an entity shall provide the disclosures required in paragraph 230-10-50-8.

ASC 230-10 (continued)

45-5 Cash purchases and sales of items commonly considered to be cash equivalents generally are part of the entity's cash management activities rather than part of its operating, investing, and **financing activities**, and details of those transactions need not be reported in a statement of cash flows.

Pending Content (Transition Guidance: ASC 230-10-65-3)

45-5 Cash purchases and sales of items commonly considered to be cash equivalents generally are part of the entity's cash management activities rather than part of its operating, investing, and financing activities, and details of those transactions need not be reported in a statement of cash flows. In addition, transfers between cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are not part of the entity's operating, investing, and financing activities, and details of those transfers are not reported as cash flow activities in the statement of cash flows.

50-8 When cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are presented in more than one line item within the statement of financial position, an entity shall, for each period that a statement of financial position is presented, present on the face of the statement of cash flows or disclose in the notes to the financial statements, the line items and amounts of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents reported within the statement of financial position. The amounts, disaggregated by the line item in which they appear within the statement of financial position, shall sum to the total amount of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents at the end of the corresponding period shown in the statement of cash flows. This disclosure may be provided in either a narrative or a tabular format.

An entity should include in its cash and cash-equivalent balances in the statement of cash flows those amounts that are generally described as restricted cash and restricted cash equivalents. Accordingly, changes in restricted cash and restricted cash equivalents that result from transfers between cash, cash equivalents, and restricted cash and restricted cash equivalents should not be presented as cash flow activities in an entity's statement of cash flows. This stipulation is consistent with paragraph BC8 of ASU 2016-18, which states, in part:

The Task Force believes that internal transfers between cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents do not represent a cash inflow or outflow of the entity because there is no cash receipt or cash payment with a source outside of the entity that affects the sum of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents.

Example 4-1A

Company A enters into an agreement with Company B under which A will operate and maintain a desalination plant owned by B. In accordance with the contract:

- Company B will transfer a fixed amount of cash into an account in A's name at the beginning of every month to fund the cost of repairing and maintaining the plant.
- The account is segregated from A's general operating account.
- Company A obtains approval from B before performing any repair and maintenance work, and available account funds cannot be withdrawn without B's approval.
- Any funds remaining upon the expiration or termination of the agreement will be returned to B.

Because of the contractual restrictions associated with the use of the cash deposited into A's account, whenever B funds the account, A immediately recognizes restricted cash and a contract liability (i.e., deferred revenue).

In accordance with ASC 230-10-45-4, A includes the restricted cash balance with cash and cash equivalents in the reconciliation of beginning and ending cash, cash equivalents, restricted cash, and restricted cash equivalents, instead of separate cash flows (for each period for which the cash amounts are restricted).

[Example 4-1B has been deleted.]

4.1.2 Classification of Interest Earned on Restricted Funds

As noted in [Section 4.1.1](#), entities must include in their cash and cash-equivalent balances in the statement of cash flows those amounts that are generally described as restricted cash and restricted cash equivalents. Entities must also provide certain disclosures about the amounts and nature of restricted cash included in their cash and cash-equivalent balances. Under ASC 230, an entity should classify interest earned on restricted funds in the statement of cash flows in a manner consistent with cash and cash equivalents that are not restricted and should also include such amounts in disclosures about restricted cash.

[Examples 4-1C and 4-1D have been deleted.]

4.2 Book and Bank Overdrafts

4.2.1 Balance Sheet Considerations

4.2.1.1 Book Overdrafts

A book overdraft represents the amount of outstanding checks in excess of funds on deposit for a particular bank account, resulting in a credit cash balance reported on an entity's balance sheet as of a reporting date. For financial reporting purposes, an entity should reinstate a liability (e.g., accounts payable) to the extent of the book overdraft in such a way that the cash balance is reported as a zero balance.

When an entity maintains separate funding and disbursement accounts with the same bank, it may not be as easy to determine the amount of the book overdraft. For example, an entity may have a cash management arrangement with a bank in which checks written are issued from a dedicated disbursement account that is funded from a separate deposit account as the checks are presented for payment to the bank. In such a scenario, the disbursement account may be designed to maintain a zero balance. Further, it is not uncommon for a bank to have the contractual right and ability to automatically sweep cash from the funding account to cover checks presented for payment from the disbursement

account. Because of timing differences between when checks are written by an entity and when they are funded by the bank, the disbursement account may reflect a book overdraft as of a reporting date, which by design would represent the entire population of outstanding checks.

In practice, questions have arisen regarding how an entity should determine the book overdraft in such an arrangement to reinstate accounts payable. Two alternative approaches to making this determination have emerged:

- *The single account approach* — The deposit and disbursement accounts with the same bank would be viewed as a single account in the determination of the book overdraft.
- *The liability extinguishment approach* — The book overdraft with the same bank would be determined independently from any funds held in the deposit account, resulting in the reinstatement of the entire population of outstanding checks.

4.2.1.1.1 The Single Account Approach

The balance sheet offsetting guidance in ASC 210-20 focuses on whether a “right of setoff” exists. A right of setoff is defined as “a debtor’s legal right . . . to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor.” However, ASC 210-20-55-18A states that “[c]ash on deposit at a financial institution shall be considered by the depositor as cash rather than as an amount owed to the depositor.” Because cash on deposit is held by the bank for the entity in a fiduciary capacity, the cash on deposit would not be considered an “amount owed” to the entity. Although the offsetting guidance in ASC 210-20 would not apply to the separate deposit and disbursement accounts in the above scenario, we nonetheless believe that it would be acceptable — to the extent that the following conditions are met — for entities to analogize to the offsetting guidance in deciding whether to view the disbursement and deposit accounts as a single bank account in the determination of the book overdraft:

- Under the terms of the depositor relationship, the financial institution has the right, ability, and intent to offset a positive balance in one account against an overdrawn amount in the other.
- Amounts in each of the accounts are unencumbered and unrestricted with respect to use.

Further, we believe that the single account approach is also consistent with the nonauthoritative guidance in AICPA Technical Q&As Section 1100.08, which states:

Inquiry — Should the amount of checks that have been issued and are out of the control of the payor but which have not cleared the bank by the balance sheet date be reported as a reduction of cash?

Reply — Yes. A check is out of the payor’s control after it has been mailed or delivered to the payee. The balance sheet caption “cash” should represent an amount that is within the control of the reporting enterprise, namely, the amount of cash in banks plus the amount of cash and checks on hand and deposits in transit minus the amount of outstanding checks. Cash is misrepresented if outstanding checks are classified as liabilities rather than a reduction of cash.

Under the single account approach, a book overdraft would not exist to the extent that the funding account has sufficient funds to cover the amount of outstanding checks. Therefore, to the extent that outstanding checks exceed the amount in the deposit account, this excess would be considered the book overdraft and should be presented as a liability for financial reporting purposes.

4.2.1.1.2 The Liability Extinguishment Approach

Under the liability extinguishment approach, the disbursement account is viewed independently from the deposit account in the determination of the amount of the book overdraft. The accounting basis for this approach is that the liability (e.g., accounts payable) that will be settled through the issuance of the outstanding checks has not been legally extinguished as of the reporting date in accordance with ASC 405-20. Therefore, under the liability extinguishment approach, a book overdraft represents what is, in substance, a payable to the original creditor.

Accordingly, the existence of a deposit account with the same financial institution is not relevant to the accounting analysis. Specifically, ASC 405-20 indicates that a liability is not extinguished until a creditor is paid. Under this view, payment to the creditor occurs when the counterparty presents the check to the bank for payment rather than when the entity issues the check from the disbursement account. In addition, proponents of the liability extinguishment approach note that even if one were to support the view that book overdrafts are within the scope of ASC 210-20, offsetting is not required when the right of setoff exists. Instead, as noted in ASC 210-20-45-2, offsetting is permitted, but not required, provided that the right of setoff exists.

Consequently, under the liability extinguishment approach, the entire population of outstanding checks (i.e., all checks written from the disbursement account) would represent the book overdraft as of the end of the reporting period. Therefore, although there may be funds in the deposit account, accounts payable would be reinstated for such an amount. Further, while the liability extinguishment approach is based on a situation in which the separate disbursement and funding accounts are maintained with a bank, we believe that an entity would reach the same view when it uses one bank account for deposits and disbursements. That is, if an entity's policy is that the liability derecognition guidance in ASC 405-20 does not apply until the counterparty presents the check to the bank for payment, we think that such a policy should be neutral regarding whether there are separate accounts (that are linked) or whether a single account is used for both funding and disbursements.

Regardless of whether an entity elects the single account approach or the liability extinguishment approach, we believe that the entity should consistently apply and transparently disclose the approach it uses.

4.2.1.2 Bank Overdrafts

A bank overdraft represents the amount by which funds disbursed by a bank exceed funds held on deposit for a given bank account. Therefore, a bank overdraft represents a loan from the bank to an entity and, for financial reporting purposes, the bank overdraft should be classified as a liability. There may be situations in which an entity maintains several bank accounts held by its subsidiaries at the same financial institution. Such subsidiary bank accounts are contractually linked, and the bank will allow the subsidiary cash accounts to be in a bank overdraft position, as long as sufficient funds are held on deposit at other subsidiary bank accounts that are part of the linked arrangement. Although the offsetting guidance in ASC 210-20 would not apply to such an arrangement (for the same reasons noted in [Section 4.2.1.1](#)), we nonetheless believe that for financial reporting purposes at the consolidated/parent level, the parent would be permitted but not required to offset bank overdraft balances in subsidiary bank accounts against positive cash account balances maintained in other subsidiary bank accounts with the same bank that are part of the contractual arrangement. For such offsetting to be acceptable, however, the following conditions would need to be met:

- Under the terms of the depositor relationship, the financial institution has the right and ability to offset a positive balance in one account against an overdrawn amount in the other.
- Amounts in each of the accounts are unencumbered and unrestricted with respect to use.

In addition, when a subsidiary prepares financial statements on a stand-alone basis, the presentation of the subsidiary's bank accounts in the stand-alone financial statements should reflect the individual subsidiary's facts and circumstances (i.e., in presenting bank accounts with the same financial institution, the subsidiary should not consider how the bank accounts are presented in the parent company's consolidated financial statements).

4.2.2 Considerations Related to the Statement of Cash Flows

AICPA Technical Q&As Section 1300.15 stipulates that a net change in overdrafts should be classified as a financing activity in the statement of cash flows. Because this guidance appears to address only bank overdrafts, an entity that is in a bank overdraft position must show the net change in liability related to the bank overdraft as a financing activity.

However, we believe that if an entity is in a book overdraft position, it is acceptable for the entity to show the net change in the liability related to the book overdraft as either an operating activity or a financing activity in the statement of cash flows. This position is supported by the fact that at the time of the book overdraft, the entity has no financing activity with the bank (i.e., the bank has not extended credit, as would be the case if the bank account were overdrawn). The presentation of book overdrafts as either operating or financing activities is an accounting policy decision that the entity should apply consistently.

4.3 Centralized Cash Management Arrangements (“Cash Pools”)

A parent company and its subsidiaries may have centralized cash management arrangements in which excess cash is invested in a cash pool. Subsidiary cash requirements are met through withdrawals or borrowings from the pool. The pool is invested in assets (e.g., deposits at banks) that are in the parent company's name. Under this type of arrangement, the parent company and its subsidiaries have sweep arrangements with their respective banks in which cash is transferred between the parent's and subsidiaries' bank accounts daily. This arrangement reduces lending costs and yields higher rates of return on investments (by allowing an entity to invest larger “blocks” of cash).

Generally, funds deposited by a subsidiary in its parent company's cash account under a centralized cash management arrangement should not be classified as cash or a cash equivalent in the subsidiary's separate financial statements if the subsidiary does not have legal title to the cash on deposit. For a subsidiary to classify funds on deposit with its parent as cash and cash equivalents in the balance sheet, the deposit in the cash pool would need to meet the definition of cash or a cash equivalent.

Because the deposit in the cash pool is not a demand deposit in a bank or other financial institution, it would not meet the definition of cash. Generally, legal title in a cash account is demonstrated by the deposit of the cash or cash equivalent in a demand deposit account at a bank or other financial institution in the subsidiary's name.

A deposit in the cash pool would also not be considered a cash equivalent under ASC 230. As defined in ASC 230-10-20, cash equivalents are “short-term, highly liquid investments.” Such investments are made available to a broad group of independent investors and are commonly recognized in markets as vehicles for investing funds for future benefit. Accordingly, the deposit in the affiliate cash management pool is generally a receivable from an affiliate and not an investment as contemplated in ASC 230.

Receivables from an affiliate resulting from a cash pooling arrangement are generally considered loans and, correspondingly, changes resulting from such deposits should be presented as investing activities in the statement of cash flows. ASC 230-10-45-12 and 45-13 state that cash flows from investing activities include payments and receipts related to making and collecting loans. Payables due to an affiliate in these situations are considered borrowings and, correspondingly, changes should be

presented as financing activities in the statement of cash flows. ASC 230-10-45-14 and 45-15 state that cash flows from financing activities include proceeds and payments related to borrowings and repayments of amounts borrowed.

Example 4-2

Parent A maintains a centralized cash management program in which Subsidiary B participates. Subsidiary B issues stand-alone financial statements that reflect a \$100 receivable from A as of December 31, 20X6, in connection with cash deposited by B into the centralized cash management program. During 20X7, B withdraws \$200 from A as part of the centralized cash management program, resulting in a \$100 payable to A as of December 31, 20X7. The statement of cash flows in the stand-alone financial statements of B for the 12 months ended 20X7 would report a \$100 investing cash inflow and a \$100 financing cash inflow related to the activity associated with the centralized cash management program.

ASC 230-10-45-8 and 45-9 indicate that payments and receipts in these situations should be presented in the statement of cash flows on a gross basis, except when “the turnover is quick, the amounts are large, and the maturities are short.” In addition, if the receivable from or payable to affiliates is due on demand, net presentation of payments and receipts is acceptable. In most centralized cash management arrangements in which funds are due on demand, the parent acts as a bank to the subsidiary in that it holds and disburses cash on the subsidiary’s behalf; correspondingly, such related transactions may be presented net in the statement of cash flows. See [Section 3.2](#) for further discussion of reporting cash flows on a gross or net basis.

The principles above also apply to condensed consolidating information for guarantor subsidiaries under SEC Regulation S-X, Rule 3-10. In a manner consistent with cash pooling arrangements, intercompany transactions settled on a net basis between entities with cash flow information reported in different columns in the condensed consolidating information in a guarantor footnote should be recorded separately in each entity’s column as if the columns were reported on a stand-alone basis. Therefore, the classification of intercompany funding activity between entities whose cash flow information is separately reported in each column should reflect cash payments and receipts in investing and financing activities.

4.4 Money Market Funds

Money market funds (MMFs) are investment funds that maintain a constant per-share net asset value (NAV) by adjusting the periodic interest rates paid to investors. The NAV is usually set at \$1 per share. Generally, investors can make withdrawals from MMFs on short notice without incurring a penalty. However, as a result of the most recent credit crisis, certain money market mutual funds incurred losses on their investments, causing some of the funds to “break the buck” when the NAV fell below the constant per-share amount. As the fair values of MMFs declined as a result of deterioration in the creditworthiness of their assets and general illiquidity conditions, redemptions by investors increased. Accordingly, some funds were forced to impose limits on redemptions, liquidate their assets, or obtain support from related entities.

In July 2014, the SEC issued a [final rule](#) that amends the rules governing MMFs under the Investment Company Act of 1940. The final rule requires certain MMFs to “sell and redeem shares based on the current market-based value of the securities in their underlying portfolios rounded to the fourth decimal place (e.g., \$1.0000), i.e., transact at a ‘floating’ NAV.”¹ In addition, the final rule gives the boards of directors of MMFs the “discretion to impose a liquidity fee [or] suspend redemptions temporarily” (i.e., gate) if a fund’s weekly liquidity falls below the required regulatory threshold. Further, the rules require

¹ The requirement to transact at a floating NAV applies to institutional prime MMFs but not to government or retail MMFs.

nongovernmental MMFs to impose a liquidity fee or gate if a fund's weekly liquidity deteriorates below a designated threshold.

The definition of “cash equivalents” in the ASC master glossary indicates that MMFs are often included within its scope. Under normal circumstances, an investment in an MMF that has the ability to impose a fee or gate does not prevent the MMF from being classified as a cash equivalent. Further, the requirement for certain MMFs to transact at a floating NAV does not prevent an investment from being classified as a cash equivalent. However, if events occur that give rise to credit and liquidity issues for an investment and result in the imposition of redemption restrictions (e.g., liquidity fees or gates) or a planned liquidation, it would generally not be appropriate to continue to classify the investment as a cash equivalent.

Example 4-3

An MMF imposes a restriction on redemption before the balance sheet date to prevent an investor from converting its investment into cash as of the balance sheet date. It would not be appropriate to classify the fund as a cash equivalent since it is no longer “[r]eadily convertible to known amounts of cash” in accordance with the definition of “cash equivalents” in ASC 230.

Implicit in the definition of a cash equivalent is the assertion that an MMF is, in substance, cash or near cash. Therefore, a restriction on an MMF would contradict the definition of cash and therefore the intent of classification as a cash equivalent. Further, when an MMF has imposed redemption restrictions or is liquidating its investments over a period and is distributing the proceeds, an investor should not record any portion of its investment as a cash equivalent unless the entire investment is considered a cash equivalent in accordance with ASC 230. It would not be appropriate to look through the investment to the underlying securities and classify a portion of the investment as a cash equivalent.

Example 4-4

An MMF imposes an “insignificant” penalty on redemption, and an investor concludes that the imposition of this penalty causes the fund's fair value to fall below the investor's cost/par. Therefore, the MMF no longer qualifies as a cash equivalent.

Example 4-5

A redemption restriction is imposed on an MMF on or before the balance sheet date but is lifted after the balance sheet date and before the financial statements are issued or available to be issued. As a result, an investor is able to withdraw funds from the MMF without prior notice or penalty. The subsequent change to lift the redemption restriction should be accounted for as a nonrecognized subsequent event.

If a redemption restriction is imposed on January 15 for a calendar-year-end entity, we would expect the entity to reconsider the classification of the MMF and evaluate whether credit and liquidity issues existed as of the balance sheet date. Even if the redemption restriction is not imposed until after the balance sheet date, it may be appropriate to reclassify the MMF in the prior period depending on whether such conditions existed as of the balance sheet date.

4.5 Variable-Rate Demand Notes

Variable-rate demand notes (VRDNs), also called “low floaters” or “seven-day floaters,” generally have long-term stated maturities. However, they also have certain economic characteristics of short-term investments, such as their rate-setting mechanism and their liquidity provisions. These notes are normally secured by a letter of credit. The rates on VRDNs are reset periodically (e.g., daily, weekly, monthly) through an auction process. If there is a failed auction, the VRDNs can be tendered (i.e., put) by the investor for par plus accrued interest. The counterparty to the put may be the third party that provided a letter of credit or, in certain cases in which no letter of credit is involved, the issuer of the VRDN itself.

VRDNs may be classified as cash equivalents in an entity’s balance sheet and statement of cash flows if the instruments are puttable back to the original issuer (or to the issuer through the issuer’s agent) within three months. An entity should also consider the creditworthiness of the issuer before classifying VRDNs as cash equivalents.

VRDNs that are puttable to parties other than the original issuer (e.g., insurer, remarketing agent, bank, dealer, or other third party) should be accounted for under ASC 815-10-15-6, which states that a “put or call option that is added or attached to a debt instrument by a third party contemporaneously with or after the issuance of the debt instrument shall be separately accounted for as a derivative instrument under this Subtopic by the investor (that is, by the creditor).”

Therefore, if a VRDN is puttable to a party other than the original issuer, the put option should be accounted for separately from the note in accordance with ASC 815. The note would not be considered a cash equivalent unless it is acquired within three months of its maturity and there is no concern about the issuer’s creditworthiness.

4.6 Auction Rate Securities

Auction rate securities (ARSs) are distinct from other, more traditional securities. ARSs generally have long-term stated maturities; the issuer is not required to redeem the security until 20 to 30 years after issuance. However, for the investor, these securities have certain economic characteristics of short-term investments because of their rate-setting mechanism. The return on these securities is designed to track short-term interest rates through a “Dutch” auction process, which resets the coupon rate (or dividend rate).

Generally, ARSs cannot be classified as cash equivalents in an investor’s statement of cash flows. Because ARSs have stated maturities of more than three months, investments in ARSs do not meet the definition of a cash equivalent in ASC 230-10-20 unless the ARSs are purchased very near their contractual maturity (i.e., three months or less). This conclusion is consistent with the views expressed in Section II.H.3 of the SEC’s *Current Accounting and Disclosure Issues in the Division of Corporation Finance* (updated November 30, 2006).

Chapter 5 — Noncash Investing and Financing Activities

Investing and financing activities that affect recognized assets or liabilities but that do not result in actual cash receipts or payments should be disclosed as noncash investing and financing activities. Such disclosures should be summarized in a schedule or in narrative form on the face of the statement of cash flows or in another section of the financial statements that refers to the statement of cash flows. Some examples of noncash investing and financing activities include:

- Converting debt to equity.
- Acquiring long-lived assets through the assumption of directly related liabilities (e.g., purchasing a building by incurring a mortgage to the seller).
- Obtaining an asset through a capital lease (under ASC 840) or a finance lease (under ASC 842) and sale-leaseback transactions, when less than the full amount of the consideration is paid/received as of the closing date. (See [Sections 7.6.1.1, 7.6.1.3, and 7.6.3](#) for further discussion of seller financing and lease transactions.)
- Receiving a building or other asset as a gift.
- Exchanging noncash assets or liabilities for other noncash assets or liabilities.
- A transferor's beneficial interest obtained in a securitization of financial assets.

Example 5-1

Company A acquired 100 percent of the common stock of Company B in exchange for issuing 10,000 shares of A's stock. Because the acquisition of B involved no cash consideration, the transaction should be disclosed as a noncash investing (acquisition of B) and noncash financing (issuance of A's stock) transaction. Disclosure may consist of a narrative or be summarized in a schedule.

In addition, A would generally classify B's acquired cash and cash equivalents, if any, as an investing activity in the statement of cash flows. In certain circumstances, however, the predominant source of cash acquired in a business combination may be more appropriately characterized as financing (e.g., if B had recently issued debt and the acquired cash balance largely comprised the proceeds from that borrowing). See [Section 6.4](#) for a discussion of transactions with more than one class of cash flow.

To the extent that a transaction includes both cash and noncash components, an entity should disclose the noncash component of the transaction and present the cash component in the statement of cash flows.

As discussed above, acquisitions paid for by stock that are accounted for as business combinations under ASC 805 are considered noncash investing and financing activities and should be disclosed in a narrative or summarized in a schedule in the financial statements. Correspondingly, acquisitions paid for in part by cash and in part by stock are split between the cash and noncash aspects of the transaction. Only the cash portion is reported as an investing activity in the statement of cash flows. The

stock portion is disclosed in a manner consistent with that discussed above. The amount of cash paid, net of the acquiree's cash and cash equivalents, is presented as an investing cash outflow. Consider the following examples:

Example 5-2

Company A acquires Company B for 10,000 shares of A's stock (fair value of \$100 per share) and \$150,000 of cash. Company B's net assets have a fair value of \$1.15 million, which includes \$50,000 of cash and cash equivalents. Company A reflects the transaction in its statement of cash flows and related disclosures as follows:

- Noncash investing and financing activity of \$1 million.
- Investing cash outflow of \$100,000 for cash paid in acquisition, net of cash acquired.

Example 5-3

Company A divests one of its subsidiaries (Subsidiary B) to Company C in exchange for all shares that C owns in A. The fair value of C's shares owned in A is \$300 million, and B's fair value is \$150 million. Because the fair value of the treasury stock reacquired is greater than the fair value of the disposed-of business, A infuses an additional \$150 million in cash into B before ownership of B is transferred to C. When combined with \$10 million in cash already held by B, the total amount of cash transferred as part of B's divestiture is \$160 million. The \$10 million of cash held by B before the \$150 million cash infusion represents a normal level of (or regular) working capital cash used in B's operations. Therefore, the substance of this transaction essentially consists of (1) an exchange of A's shares held by C for the \$150 million in cash (i.e., the amount of the cash infusion) and (2) the divestiture of B in exchange for the remaining shares of A's stock held by C.

As a result, A would generally reflect the transaction in its statement of cash flows and related disclosures as follows:

- The \$150 million in cash that is infused into B is considered a share repurchase of A's stock from C and thus should be classified as a financing activity.
- The \$10 million in regular working capital cash held by B before the cash infusion and transferred to C in the divestiture should be classified as an investing activity.
- The remainder — namely the noncash net assets of B transferred to C in exchange for the remaining number of A's shares owned and held by C — should be treated as a noncash investing and financing activity and disclosed.

Chapter 6 — Classification of Cash Flows

ASC 230 requires entities to classify cash receipts and cash payments as operating, investing, or financing activities on the basis of the nature of the cash flow. Grouping cash flows into one of these three categories enables investors and creditors to evaluate significant relationships within and between those activities. Such presentation also links similar cash flows (e.g., cash proceeds from and repayments of borrowings), facilitating further analysis of the reporting entity's activities.

The most appropriate classification of a particular cash flow may not always be clear because, as indicated in ASC 230, “[c]ertain cash receipts and payments may have aspects of more than one class of cash flows.” Paragraph BC39 of ASU 2016-15 states that, in such circumstances, entities must determine the appropriate classification by considering when to (1) “separate cash receipts and cash payments and classify them into more than one class of cash flows” and (2) “classify the aggregate of those cash receipts and payments into one class of cash flows based on predominance.” See [Section 6.4](#) for more information about when cash payments and receipts have more than one class of cash flows.

This chapter provides an overview of the three cash flow categories as well as guidance on how to apply the cash flow categorization principles in a number of situations.

6.1 Investing Activities

ASC 230-10-20 defines investing activities, in part, as follows:

Investing activities include making and collecting loans and acquiring and disposing of debt or equity instruments and property, plant, and equipment and other productive assets, that is, assets held for or used in the production of goods or services by the entity (other than materials that are part of the entity's inventory). Investing activities exclude acquiring and disposing of certain loans or other debt or equity instruments that are acquired specifically for resale.

ASC 230-10

45-12 All of the following are **cash** inflows from **investing activities**:

- a. Receipts from collections or sales of loans made by the entity and of other entities' debt instruments (other than **cash equivalents**, certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21, and certain donated debt instruments received by not-for-profit entities (NFPs) as discussed in paragraph 230-10-45-21A)
- b. Receipts from sales of equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-19 and certain donated equity instruments received by NFPs as discussed in paragraph 230-10-45-21A) and from returns of investment in those instruments
- c. Receipts from sales of property, plant, and equipment and other productive assets
- d. Subparagraph not used
- e. Receipts from sales of loans that were not specifically acquired for resale. That is, if loans were acquired as investments, cash receipts from sales of those loans shall be classified as investing cash inflows regardless of a change in the purpose for holding those loans.

For purposes of this paragraph, receipts from disposing of loans, debt or equity instruments, or property, plant, and equipment include directly related proceeds of insurance settlements, such as the proceeds of insurance on a building that is damaged or destroyed.

Pending Content (Transition Guidance: ASC 825-10-65-2)

45-12 All of the following are cash inflows from investing activities:

- a. Receipts from collections or sales of loans made by the entity and of other entities' debt instruments (other than cash equivalents, certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21, and certain donated debt instruments received by not-for-profit entities (NFPs) as discussed in paragraph 230-10-45-21A)
- b. Receipts from sales of equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-18 and certain donated equity instruments received by NFPs as discussed in paragraph 230-10-45-21A) and from returns of investment in those instruments
- c. Receipts from sales of property, plant, and equipment and other productive assets
- d. Subparagraph not used
- e. Receipts from sales of loans that were not specifically acquired for resale. That is, if loans were acquired as investments, cash receipts from sales of those loans shall be classified as investing cash inflows regardless of a change in the purpose for holding those loans.

For purposes of this paragraph, receipts from disposing of loans, debt or equity instruments, or property, plant, and equipment include directly related proceeds of insurance settlements, such as the proceeds of insurance on a building that is damaged or destroyed.

ASC 230-10 (continued)

Pending Content (Transition Guidance: ASC 230-10-65-2)

45-12 All of the following are cash inflows from investing activities:

- a. Receipts from collections or sales of loans made by the entity and of other entities' debt instruments (other than cash equivalents, certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21, and certain donated debt instruments received by not-for-profit entities (NFPs) as discussed in paragraph 230-10-45-21A) and collections on a **transferor's beneficial interests** in a securitization of the transferor's trade receivables
- b. Receipts from sales of equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-18 and certain donated equity instruments received by NFPs as discussed in paragraph 230-10-45-21A) and from returns of investment in those instruments
- c. Receipts from sales of property, plant, and equipment and other productive assets
- d. Subparagraph not used
- e. Receipts from sales of loans that were not specifically acquired for resale. That is, if loans were acquired as investments, cash receipts from sales of those loans shall be classified as investing cash inflows regardless of a change in the purpose for holding those loans.

For purposes of this paragraph, receipts from disposing of loans, debt or equity instruments, or property, plant, and equipment include directly related proceeds of insurance settlements, such as the proceeds of insurance on a building that is damaged or destroyed.

45-13 All of the following are cash outflows for investing activities:

- a. Disbursements for loans made by the entity and payments to acquire debt instruments of other entities (other than cash equivalents and certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21)
- b. Payments to acquire equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraphs 230-10-45-18 through 45-19)
- c. Payments at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets, including interest capitalized as part of the cost of those assets. Generally, only advance payments, the down payment, or other amounts paid at the time of purchase or soon before or after purchase of property, plant, and equipment and other productive assets are investing cash outflows. However, incurring directly related debt to the seller is a financing transaction (see paragraphs 230-10-45-14 through 45-15), and subsequent payments of principal on that debt thus are financing cash outflows.

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 825-10-65-2)**

45-13 All of the following are cash outflows for investing activities:

- a. Disbursements for loans made by the entity and payments to acquire debt instruments of other entities (other than cash equivalents and certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21)
- b. Payments to acquire equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-18)
- c. Payments at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets, including interest capitalized as part of the cost of those assets. Generally, only advance payments, the down payment, or other amounts paid at the time of purchase or soon before or after purchase of property, plant, and equipment and other productive assets are investing cash outflows. However, incurring directly related debt to the seller is a financing transaction (see paragraphs 230-10-45-14 through 45-15), and subsequent payments of principal on that debt thus are financing cash outflows.

Pending Content (Transition Guidance: ASC 230-10-65-2)

45-13 All of the following are cash outflows for investing activities:

- a. Disbursements for loans made by the entity and payments to acquire debt instruments of other entities (other than cash equivalents and certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21)
- b. Payments to acquire equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-18)
- c. Payments at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets, including interest capitalized as part of the cost of those assets. Generally, only advance payments, the down payment, or other amounts paid at the time of purchase or soon before or after purchase of property, plant, and equipment and other productive assets are investing cash outflows. However, incurring directly related debt to the seller is a financing transaction (see paragraphs 230-10-45-14 through 45-15), and subsequent payments of principal on that debt thus are financing cash outflows.
- d. Payments made soon after the **acquisition date** of a **business combination** by an **acquirer** to settle a **contingent consideration** liability.

6.1.1 Restricted Cash**6.1.2 Classification of Interest Earned on Restricted Funds**

Sections 6.1.1 and 6.1.2 and their examples have been moved to [Chapter 4](#); see [Sections 4.1.1](#) and [4.1.2](#).

6.1.3 Securities Lending

Many entities with significant investments in marketable securities engage in securities-lending transactions. In one form of securities-lending transaction, the transferor relinquishes securities and agrees to repurchase them for a fixed amount on a specified future date. The transferee, to secure its obligation to return the securities (or similar securities), posts cash collateral in an account that is inaccessible to the transferor unless the transferee fails to deliver the securities.

Assume that the transaction fails to satisfy the derecognition criteria of ASC 860 and that the transferor and the transferee record the transfer as a secured borrowing. The transferor classifies the amount provided by the transferee as “collateral received” or “restricted cash” rather than including it in “cash and cash equivalents.” ASC 860-30-45-1 states that if the transferee “has the right by contract or custom to sell or repledge” the transferred securities, the transferor reports the transferred securities “in its statement of financial position separately . . . from other assets not so encumbered.”

The transferor is entitled to earnings on the cash in the restricted account and is obligated to pay the transferee (i.e., the borrower of the securities) a rebate, representing a portion of those earnings.

The sale and repurchase of the securities are noncash transactions (i.e., an exchange of investments) unless the transferee fails to deliver the securities and the transferor obtains access to the cash in the account.

6.1.4 Distributions From Equity Method Investments

ASC 230 distinguishes between returns of investment, which should be classified as cash inflows from investing activities (see ASC 230-10-45-12(b)), and returns on investment, which should be classified as cash inflows from operating activities (see ASC 230-10-45-16(b)). Accordingly, to make the appropriate classification in the statement of cash flows, entities must determine whether distributions received from an equity method investee represent a “return on” or a “return of” the related investment.

ASC 230-10-45-21D indicates that there are two acceptable methods for determining whether distributions from equity method investments are returns on investment or returns of investment. Under the first method (the “cumulative earnings” approach), distributions are presumed to be returns on investment. When classifying the related cash flows under this approach, an entity should compare cumulative (i.e., since inception) distributions received by the investor, less distributions received in prior periods that were determined to be returns of investment, with the investor’s cumulative equity in earnings. Cumulative distributions received that do not exceed cumulative equity in earnings represent returns on investment and should be classified as cash inflows from operating activities. Cumulative distributions received in excess of the investor’s cumulative equity in earnings represent returns of investment and therefore should be classified as cash inflows from investing activities.

Under the second method (the “nature-of-the-distribution” approach), an entity evaluates the specific facts and circumstances of each distribution to determine its nature. Unlike the cumulative earnings approach, the nature-of-the-distribution approach does not presume that a distribution is a return on investment; rather, an entity using this approach must conduct an analysis to determine the nature of each distribution and may be required to use significant judgment in making this determination. Examples of distributions that may represent returns of investment include, but are not limited to, liquidating dividends and dividends representing proceeds from the sale of property, plant, and equipment. These distributions should be classified as cash inflows from investing activities to the extent that they are considered to represent returns of investment.

An entity can elect to apply either of these approaches as an accounting policy and must select a single method for all of its equity method investments. Under either approach, an entity should comply with the disclosure requirements in ASC 235-10-50-1 through 50-6. However, if an entity selects the nature-of-the-distribution approach for its equity method investments but cannot obtain the information it needs to evaluate the nature of the distributions for any individual equity method investment, the entity must report a change in accounting principle retrospectively by applying the “cumulative earnings” approach to any such equity method investment. In other words, an entity is not required to apply the cumulative earnings approach to all of its equity method investments when it is unable to obtain adequate information for certain equity method investments; rather, this approach must only be applied to the equity method investments for which the information could not be obtained.



Connecting the Dots

Although entities are permitted to elect the approach under which distributions may be evaluated, it does not remove the requirement for entities to evaluate whether each distribution from an equity method investment represents a return on investment or a return of investment, particularly when entities elect the nature-of-the-distribution approach. In other words, because the nature-of-the-distribution approach does not presume that a distribution is a return on investment, it requires that an entity analyze each distribution to determine its nature. Further, entities that elect the cumulative earnings approach may generally presume distributions to represent a return on investment, unless such distributions represent returns of investment (i.e., they exceed the investor’s cumulative equity in earnings).

In addition, because the ASU does not provide guidance on how much information (e.g., the type and sufficiency of investee information) an entity needs to determine the nature of a distribution, an entity that applies the nature-of-the-distribution approach will most likely need to use significant judgment in making this determination. We generally believe that such information should be sufficiently reliable and that the degree of reliability is likely to increase in proportion to the materiality of the distribution.

[Examples 6-1 through 6-3 have been deleted.]

Example 6-4**Cumulative Earnings Approach: Return of Investment Versus Return on Investment**

Company A is a calendar-year-end company that has a 20 percent equity investment in Company B but no other equity investments. On January 1, 20X7, A made an initial \$10,000 cash investment in B. Company A accounts for its investment in B as an equity method investment and has elected to use the cumulative earnings method to determine the classification of distributions from B in its statement of cash flows. Further, there are no basis differences between A's equity investment and the underlying assets in B.

Company A's share of income or loss in the equity of B and A's related share of dividend distributions for the last six and five years, respectively, are as follows:

Year Ended	Company A's Share of Income or (Loss) in the Equity of B	Company A's Cumulative Share of Income or (Loss) in the Equity of B	Company A's Share of Distributions (e.g., Dividends)
12/31/20X7	\$ (1,000)	\$ (1,000)	\$ —
12/31/20X8	(400)	(1,400)	200
12/31/20X9	200	(1,200)	200
12/31/20X0	4,000	2,800	3,000
12/31/20X1	2,600	5,400	1,600
12/31/20X2	(6,000)	(600)	1,000

Classification of B's distributions in A's respective annual statements of cash flows is as follows:

Year Ended	Company A's Cumulative Share of Income or (Loss) in the Equity of B	Company A's Share of Distributions	Classification in the Statement of Cash Flows	
			Operating	Investing
12/31/20X8	\$ (1,400)	\$ 200	\$ —	\$ 200
12/31/20X9	(1,200)	200	—	200
12/31/20X0	2,800	3,000	2,800	200
12/31/20X1	5,400	1,600	1,600	—
12/31/20X2	(600)	1,000	—	\$1,000

Under the cumulative earnings approach, because the distributions that A received for the years ended December 31, 20X8, and December 31, 20X9, are in excess of A's cumulative share of earnings in the equity of B for these same years, such distributions received represent a return of A's investment in B. Therefore, such distributions should be classified as investing inflows. In other words, the fact that A had cumulative deficits in B's earnings for both of the first two years (ended December 31, 20X9) indicates that B was funding A's share of each year's dividend through A's initial investment in B. Consequently, the dividends represent returns of A's investment in B.

Example 6-4 (continued)

As of December 31, 20X0, only a portion of the cumulative distributions received (less prior-year distributions that were returns of A's investment) was in excess of the inception-to-date cumulative earnings in B's equity. The excess portion was therefore classified as an investing activity (i.e., as a return of A's investment in B), and the remaining portion was classified as an operating activity (i.e., as a return on A's investment in B).

As of December 31, 20X1, A's cumulative distributions received, less any prior-year distributions that were returns of investment, did not exceed the cumulative earnings in equity; therefore, the entire amount of distributions received is classified as an operating activity that reflects a return on A's equity method investment in B. Conversely, on December 31, 20X2, cumulative distributions received, less any prior-year distributions that were returns of investment, fully exceeded the cumulative earnings in equity; therefore, the entire amount of distributions received in 20X2 should be classified as an investing activity that reflects a return of A's equity method investment in B.

6.1.5 Property, Plant, and Equipment Acquired on Account

ASC 230-10-45-29 states that the reconciliation of net income to net cash flows from operating activities must separately report all major classes of reconciling items, "including, at a minimum, changes during the period . . . in payables pertaining to operating activities." Therefore, the change in accounts payable included in this reconciliation should exclude changes in payables related to investing or financing transactions (e.g., the change in payables incurred in the current and previous reporting periods to acquire or construct property, plant, and equipment and other productive assets).

Furthermore, the noncash investing activity disclosed by an entity should be limited to the amount of the liability incurred for assets acquired during the current reporting period that remains unpaid as of the end of the reporting period; it should not merely be the period-to-period change in the liability account used to track productive assets purchased on account. Noncash activity should be disclosed separately in a schedule or described in a narrative disclosure.

In the period in which the liability is settled, the amount paid should be classified as a cash outflow for investing activities or financing activities, depending on the payment terms of the transaction. Specifically, ASC 230-10-45-13(c) characterizes payments "at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets" as cash outflows for investing activities. The SEC staff has informally interpreted the term "soon" in this context as indicating a period of three months or less, which is consistent with the period used for other ASC 230 considerations (e.g., the definition of cash equivalents in ASC 230-10-20 (see [Chapter 4](#)), the determination of net or gross presentation in ASC 230-10-45-9 (see [Chapter 3](#)), and contingent consideration classified as a liability (see [Chapter 7](#))).

Therefore, if an entity purchases property, plant, and equipment and other productive assets and the terms of the transaction require payment within three months of the transaction date, the payment would be classified as an investing outflow. Generally, if the payment terms of the transaction extend beyond three months, any payment made after three months would be classified as a financing outflow. However, there may be limited circumstances in which payments made after three months (but less than one year) could be classified as investing outflows — for example, if payment terms extend beyond three months but such terms are consistent with standard industry practice as well as with terms that are customary for the vendor. Entities are encouraged to discuss these circumstances with their accounting advisers. Payments made in connection with terms that require discounting under ASC 835 (i.e., generally more than of one year) should be classified as financing outflows even if the payment terms are consistent with industry practice and considered customary for the vendor.

Example 6-5

In December 20X4, Company A purchased equipment from a supplier on account for \$500,000, which was included in the total year-end accounts payable balance of \$4 million. Company A paid the \$500,000 payable due to the supplier in January 20X5. In December 20X5, A purchased equipment from a supplier on account for \$1 million, which was included in the total year-end accounts payable balance of \$6 million. Company A paid the \$1 million payable due to the supplier in January 20X6.

In preparing its 20X5 cash flow statement, A would (1) reduce the total \$2 million increase in accounts payable by the \$500,000 change in nonoperating accounts payable (which increased from \$500,000 to \$1 million) and report a total increase in operating accounts payable of \$1.5 million; (2) present an investing cash outflow for the \$500,000 payment made in January 20X5; and (3) disclose a noncash investing activity of \$1 million, representing the unpaid liability that was incurred during 20X5 to acquire the equipment.

In preparing its 20X6 cash flow statement, A would reflect the \$1 million decrease in accounts payable as an investing activity outflow for the acquisition of the equipment.

Example 6-5A

Company A, a telecommunications company, enters into a contract with Vendor B to receive equipment, construction, and installation services for a network build-out with payment terms of 270 days for the equipment and 90 days for construction and installation services. These payment terms are consistent with industry practice for similar equipment and services and are customary for B. Vendor B bills A for the equipment, construction, and installation of the network build-out on January 31, 20X6. In accordance with the payment terms, A pays B for the construction and installation services at the end of April 20X6 and the equipment at the end of October 20X6. Because the payment terms are consistent with industry practice, are customary for B, and do not need to be discounted under ASC 835, it would be appropriate for A to classify both payments to B as investing outflows even though the payment terms for the equipment extend beyond three months. In determining whether a period of more than three months but less than a year is in accordance with ASC 230-10-45-13(c) — which indicates that “[p]ayments at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets” are investing activities — A must use judgment and consider its specific facts and circumstances.

6.1.6 Securities**ASC 320-10**

45-11 Cash flows from purchases, sales, and maturities of **available-for-sale securities** and held-to-maturity securities shall be classified as cash flows from investing activities and reported gross for each security classification in the statement of cash flows. Cash flows from purchases, sales, and maturities of **trading securities** shall be classified based on the nature and purpose for which the securities were acquired.

ASC 321-10**Pending Content (Transition Guidance: ASC 825-10-65-2)**

45-1 An entity shall classify cash flows from purchases and sales of equity securities on the basis of the nature and purpose for which it acquired the securities.

ASC 230-10

45-19 Cash receipts and cash payments resulting from purchases and sales of securities classified as trading securities as discussed in Topic 320 shall be classified pursuant to this Topic based on the nature and purpose for which the securities were acquired.

Pending Content (Transition Guidance: ASC 825-10-65-2)

45-19 Cash receipts and cash payments resulting from purchases and sales of securities classified as trading debt securities accounted for in accordance with Topic 320 and equity securities accounted for in accordance with Topic 321 shall be classified pursuant to this Topic based on the nature and purpose for which the securities were acquired.

Debt securities are accounted for in accordance with ASC 320, while equity securities (with certain exceptions) are accounted for in accordance with ASC 321. In accordance with ASC 230-10-45-19, for trading debt securities and equity securities, an entity is required to present the related cash receipts and payments in the statement of cash flows in a manner consistent with the nature and purpose for which the entity acquired such securities.

6.1.6.1 Debt Securities

In accordance with ASC 320, an entity is required to initially recognize purchases of debt securities as trading, available for sale, or held to maturity. An entity that actively and frequently purchases, sells, or trades securities with the intent to sell them in the near term (e.g., hours or days) to generate short-term profits should classify such purchases as trading securities. However, ASC 320-10-25-1(a) indicates that “[c]lassification of a security as trading shall not be precluded simply because the entity does not intend to sell it in the near term.” In addition, as noted in ASC 320-10-25-1(b), a debt security that is not classified as trading or held to maturity must be classified as an available-for-sale security.

Investments in debt securities classified as trading and available for sale are initially recognized at fair value in the statement of financial position, with subsequent changes in fair value recognized in net income and other comprehensive income, respectively, in each reporting period. Further, cash flow activity associated with debt securities classified as available for sale and held to maturity is classified as investing activities, while cash flow activity associated with trading securities is classified on the basis of the security’s nature and the entity’s intent to sell or hold the security.

However, while an entity’s election to classify a debt security as trading results in income statement recognition of subsequent changes in the security’s fair value — not unlike the recognition of financial assets and liabilities for which an entity elects the fair value option under ASC 825 — entities that elect to classify securities as trading have questioned whether cash activities related to such securities should be presented as operating or investing activities.

An entity’s election of the fair value option for financial assets and liabilities under ASC 825 does not affect its cash flow statement classification of receipts and payments associated with financial assets and financial liabilities. Specifically, ASC 825-10-45-3 states, “Entities shall classify cash receipts and cash payments related to items measured at fair value according to their nature and purpose as required by Topic 230.”

Accordingly, we believe that an entity should assess why debt securities are classified as trading. In other words, an entity should assess whether it is **required** to classify debt securities as trading in accordance with ASC 320 (i.e., because the securities that are acquired are intended to be sold within hours or

days). We believe that if an entity is required to classify debt securities as trading securities, the related cash flow activities should be presented as operating activities in the entity's statement of cash flows. Our view is based on ASC 230-10-45-20, which contains a general principle under which cash flows pertaining to securities or other assets acquired principally for resale in the near term must be classified in operating activities.

We believe that when an entity elects to classify debt securities as trading, the frequency of purchases and sales of securities should be assessed as a basis for determining an entity's intent. For example, we believe that daily trading is analogous to trading securities under ASC 320 and that the related cash flows therefore should be presented as operating cash flows. Conversely, and in the absence of the intent to trade to generate short-term profits, nondaily trading may not reflect trading activities and, therefore, presentation of related cash flows as investing activities would be required in such cases.

6.1.6.2 Equity Securities

In accordance with ASC 321, equity securities (except those accounted for under the equity method or those that result in consolidation of the investee) are measured at fair value, with changes in fair value recognized through net income.

As with debt securities classified as trading, an entity needs to consider the nature of the equity securities, and why they were acquired, to determine the appropriate presentation in the statement of cash flows. That is, an entity that actively and frequently purchases, sells, or trades equity securities, intending to sell them in the near term (e.g., hours or days) to generate short-term profits, would generally present such cash flow activity as operating activities; otherwise, presentation within investing activities would generally be required.

6.1.7 Company- and Bank-Owned Life Insurance Policies

ASC 230-10

Pending Content (Transition Guidance: ASC 230-10-65-2)

45-21C Cash receipts resulting from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, shall be classified as cash inflows from investing activities. Cash payments for premiums on corporate-owned life insurance policies, including bank-owned life insurance policies, may be classified as cash outflows for investing activities, operating activities, or a combination of cash outflows for investing and operating activities.

Entities purchase life insurance policies for various reasons (e.g., to fund employee benefit costs and protect against the loss of key persons). Such policies are typically described as company-owned life insurance (COLI). ASC 230 addresses cash receipts (and premium payments) related to COLI, including bank-owned life insurance (BOLI) policies. The guidance in ASC 230-10-45-21C, which is predicated on a notion that COLI policies, including BOLI policies, are purchased primarily as investment vehicles, requires that an entity classify cash proceeds received from the settlement of COLI policies, including BOLI policies, as cash flows from investing activities.

In addition, entities are permitted, but not required, to align the classification of premiums paid with the classification of proceeds received. Therefore, cash payments for premiums may be classified as cash outflows for investing activities, operating activities, or a combination of cash flows for investing and operating activities.

6.2 Financing Activities

ASC 230-10-20 defines financing activities as follows:

Financing activities include obtaining resources from owners and providing them with a return on, and a return of, their investment; receiving restricted resources that by donor stipulation must be used for long-term purposes; borrowing money and repaying amounts borrowed, or otherwise settling the obligation; and obtaining and paying for other resources obtained from creditors on long-term credit.

ASC 230-10

45-14 All of the following are cash inflows from **financing activities**:

- a. Proceeds from issuing equity instruments
- b. Proceeds from issuing bonds, mortgages, notes, and from other short- or long-term borrowing
- c. Receipts from contributions and investment income that by donor stipulation are restricted for the purposes of acquiring, constructing, or improving property, plant, equipment, or other long-lived assets or establishing or increasing a permanent endowment or term endowment
- d. Proceeds received from derivative instruments that include financing elements at inception whether the proceeds were received at inception or over the term of the derivative instrument, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments
- e. Cash retained as a result of the tax deductibility of increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services that is recognizable for financial reporting purposes. For this purpose, **excess tax benefits** shall be determined on an individual **award** (or portion thereof) basis.

Pending Content (Transition Guidance: ASC 718-10-65-5)

45-14 All of the following are cash inflows from financing activities:

- a. Proceeds from issuing equity instruments
- b. Proceeds from issuing bonds, mortgages, notes, and from other short- or long-term borrowing
- c. Receipts from contributions and investment income that by donor stipulation are restricted for the purposes of acquiring, constructing, or improving property, plant, equipment, or other long-lived assets or establishing or increasing a donor-restricted endowment fund
- d. Proceeds received from derivative instruments that include financing elements at inception, whether the proceeds were received at inception or over the term of the derivative instrument, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments
- e. Subparagraph superseded by Accounting Standards Update No. 2016-09.

Pending Content (Transition Guidance: ASC 958-10-65-1)

45-14 All of the following are cash inflows from financing activities:

- a. Proceeds from issuing equity instruments
- b. Proceeds from issuing bonds, mortgages, notes, and from other short- or long-term borrowing
- c. Receipts from contributions and investment income that by donor stipulation are restricted for the purposes of acquiring, constructing, or improving property, plant, equipment, or other long-lived assets or establishing or increasing a donor-restricted endowment fund
- d. Proceeds received from derivative instruments that include financing elements at inception, whether the proceeds were received at inception or over the term of the derivative instrument, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments
- e. Subparagraph superseded by Accounting Standards Update No. 2016-09.

ASC 230-10 (continued)

45-15 All of the following are cash outflows for financing activities:

- a. Payments of **dividends** or other distributions to owners, including outlays to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.

Pending Content (Transition Guidance: ASC 718-10-65-8)

45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by an employer when withholding shares from an employee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 230-10-65-2)**

45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by an employer when withholding shares from an employee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed, including the portion of the repayments made to settle zero-coupon debt instruments that is attributable to the principal or the portion of the repayments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to the principal.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.
- f. Payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-17(ee).
- g. Payments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders that are directly related to the debt prepayment or debt extinguishment, excluding accrued interest.

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 718-10-65-11)**

45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by a grantor when withholding shares from a grantee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed, including the portion of the repayments made to settle zero-coupon debt instruments that is attributable to the principal or the portion of the repayments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to the principal.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.
- f. Payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-17(ee).
- g. Payments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders that are directly related to the debt prepayment or debt extinguishment, excluding accrued interest.

The sections below discuss certain types of financing cash flows.

6.2.1 Debt Extinguishments and Modifications

If a borrower settles a debt financing arrangement before the maturity date, a lender may include a prepayment penalty in the financing agreement, often on the basis of a number of factors, such as an approximation of remaining interest that will not be paid given the early extinguishment.

ASC 230-10-45-15(g) notes that cash outflows for financing activities include “[p]ayments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders that are directly related to the debt prepayment or debt extinguishment, excluding accrued interest.” Further, paragraph BC7 of ASU 2016-15 notes that the EITF concluded that debt extinguishment costs “should include all costs for the prepayment or extinguishment of debt (that is, third-party costs, premiums paid to repurchase debt in an open-market transaction, and other fees paid to lenders).”

Although ASC 230 does not address debt modifications,¹ we believe that when debt is restructured and is accounted for as a modification rather than as an extinguishment, an entity should follow the principles in ASC 230 and classify the fees paid to the creditor on the modification date as a financing cash outflow. Our view is based on the fact that, in accordance with ASC 470-50-40-17(b), fees paid to the creditor on the modification date are “associated with the . . . modified debt instrument” and (1) capitalized on the balance sheet as a reduction to the modified debt and (2) “amortized as an adjustment of interest expense over the remaining term of the . . . modified debt instrument using the interest method.” Since the fees paid to the creditor to modify the debt reduce the liability on the balance sheet, such fees are akin to the payment of principal (or a debt discount, which, on the balance sheet, is netted against the proceeds from the debt issued); accordingly, such payments would be presented as financing cash outflows in the statement of cash flows.

Further, we believe that any fees paid to a third party other than the creditor in connection with a debt modification should generally be classified as operating cash outflows because, in accordance with ASC 470-50-40-18(b), the payment must be expensed. Therefore, since such fees enter into the determination of net income, they would be presented as operating activities. See [Section 6.3](#) for further discussion of operating activities.

¹ While ASU 2016-15 clarified the presentation of certain payments related to debt extinguishments in the statement of cash flows, the ASU did not address the cash flow presentation related to fees a debtor pays to the creditor when the debt is modified in accordance with ASC 470-50.

6.2.2 Transactions With Noncontrolling Interest Holders

ASC 810-10-45-23 indicates that “[c]hanges in a parent’s ownership interest while the parent retains its controlling financial interest in its subsidiary shall be accounted for as equity transactions (investments by owners and distributions to owners acting in their capacity as owners).” Accordingly, payments to acquire noncontrolling interests in a subsidiary, or those associated with the sale of noncontrolling interests in a subsidiary, should be classified as financing activities in the statement of cash flows.

Direct costs of purchasing or selling noncontrolling interests in a subsidiary, when control is maintained, should generally be recorded as an adjustment to additional paid-in capital (APIC) and be classified as financing cash outflows in the statement of cash flows. However, indirect costs of purchasing or selling noncontrolling interests in a subsidiary, when control is maintained, should generally be reflected as an expense in the income statement and should be classified as operating cash outflows in the statement of cash flows. These conclusions are supported by analogies to ASC 810, [SAB Topic 5.A](#), and AICPA Technical Q&As Section 4110.09.

SAB Topic 5.A provides guidance on accounting for costs related to the issuance of equity securities, stating that “[s]pecific incremental costs directly attributable to a proposed or actual offering of securities may properly be deferred and charged against the gross proceeds of the offering.” Therefore, direct costs of issuing equity securities are generally reflected as a reduction of the amount that would have otherwise been recorded in APIC. SAB Topic 5.A further states that “management salaries or other general and administrative expenses may not be allocated as costs of the offering and deferred costs of an aborted offering may not be deferred and charged against proceeds of a subsequent offering.” These indirect costs are generally reflected as an expense in the income statement.

In addition, AICPA Technical Q&As Section 4110.09 states that although there is no authoritative literature on costs entities incur to acquire their own stock, some “believe that costs associated with the acquisition of treasury stock should be treated in a manner similar to stock issue costs.” Under SAB Topic 5.A, direct costs associated with the acquisition of treasury stock may be added to the cost of the treasury stock.

Distributions to noncontrolling interest holders (in their capacity as equity holders) are considered equity transactions and should be reflected as cash outflows for financing activities in accordance with ASC 230-10-45-15. Entities that determine that it is appropriate to classify the cash outflows associated with these distributions outside of financing activities in the statement of cash flows are encouraged to consult with their accounting advisers.

6.3 Operating Activities

ASC 230-10-20 defines operating activities as follows:

Operating activities include all transactions and other events that are not defined as investing or financing activities (see paragraphs 230-10-45-12 through 45-15). Operating activities generally involve producing and delivering goods and providing services. Cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income.

ASC 230-10

45-16 All of the following are cash inflows from **operating activities**:

- a. Cash receipts from sales of goods or services, including receipts from collection or sale of accounts and both short- and long-term notes receivable from customers arising from those sales. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash receipts from returns on loans, other debt instruments of other entities, and equity securities — interest and dividends.
- c. All other cash receipts that do not stem from transactions defined as investing or financing activities, such as amounts received to settle lawsuits; proceeds of insurance settlements except for those that are directly related to investing or financing activities, such as from destruction of a building; and refunds from suppliers.

Pending Content (Transition Guidance: ASC 230-10-65-2)

45-16 All of the following are cash inflows from operating activities:

- a. Cash receipts from sales of goods or services, including receipts from collection or sale of accounts and both short- and long-term notes receivable from customers arising from those sales. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash receipts from returns on loans, other debt instruments of other entities, and equity securities — interest and dividends.
- c. All other cash receipts that do not stem from transactions defined as investing or financing activities, such as amounts received to settle lawsuits and refunds from suppliers.

45-17 All of the following are cash outflows for operating activities:

- a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash payments to other suppliers and employees for other goods or services.
- c. Cash payments to governments for taxes, duties, fines, and other fees or penalties.²
- d. Cash payments to lenders and other creditors for interest.
- e. Cash payment made to settle an asset retirement obligation.
- f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

² **ASU 2016-09** removed from ASC 230-10-45-17(c) the notion that “the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services recognizable for financial reporting purposes also had not been deductible in determining taxable income. (This is the same amount reported as a financing cash inflow pursuant to paragraph 230-10-45-14(e).)”

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 718-10-65-8)**

45-17 All of the following are cash outflows for operating activities:

- a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash payments to other suppliers and employees for other goods or services.
- c. Cash payments to governments for taxes, duties, fines, and other fees or penalties.
- d. Cash payments to lenders and other creditors for interest.
- e. Cash payment made to settle an asset retirement obligation.
- f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

Pending Content (Transition Guidance: ASC 230-10-65-2)

45-17 All of the following are cash outflows for operating activities:

- a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash payments to other suppliers and employees for other goods or services.
- c. Cash payments to governments for taxes, duties, fines, and other fees or penalties.^[3]
- d. Cash payments to lenders and other creditors for interest, including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to accreted interest related to the debt discount. For all other debt instruments, an issuer shall not bifurcate cash payments to lenders and other creditors at settlement for amounts attributable to accreted interest related to the debt discount, nor classify such amounts as cash outflows for operating activities.
- e. Cash payment made to settle an asset retirement obligation.
- ee. Cash payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability that exceed the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-15(f).
- f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

³ See footnote 2.

ASC 230-10 (continued)

45-18 Banks, brokers and dealers in securities, and other entities may carry securities and other assets in a trading account. Characteristics of trading account activities are described in Topics 255 and 940.

45-19 Cash receipts and cash payments resulting from purchases and sales of securities classified as trading securities as discussed in Topic 320 shall be classified pursuant to this Topic based on the nature and purpose for which the securities were acquired.

Pending Content (Transition Guidance: ASC 825-10-65-2)

45-19 Cash receipts and cash payments resulting from purchases and sales of securities classified as trading debt securities accounted for in accordance with Topic 320 and equity securities accounted for in accordance with Topic 321 shall be classified pursuant to this Topic based on the nature and purpose for which the securities were acquired.

45-20 Cash receipts and cash payments resulting from purchases and sales of other securities and other assets shall be classified as operating cash flows if those assets are acquired specifically for resale and are carried at **fair value** in a trading account.

45-21 Some loans are similar to securities in a trading account in that they are originated or purchased specifically for resale and are held for short periods of time. Cash receipts and cash payments resulting from acquisitions and sales of loans also shall be classified as operating cash flows if those loans are acquired specifically for resale and are carried at fair value or at the lower of cost or fair value. For example, mortgage loans held for sale are required to be reported at the lower of cost or fair value in accordance with Topic 948.

Pending Content (Transition Guidance: ASC 825-10-65-2)

45-21 Some loans are similar to debt securities in a trading account in that they are originated or purchased specifically for resale and are held for short periods of time. Cash receipts and cash payments resulting from acquisitions and sales of loans also shall be classified as operating cash flows if those loans are acquired specifically for resale and are carried at fair value or at the lower of cost or fair value. For example, mortgage loans held for sale are required to be reported at the lower of cost or fair value in accordance with Topic 948.

Pending Content (Transition Guidance: ASC 326-10-65-1)

45-21 Some loans are similar to debt securities in a trading account in that they are originated or purchased specifically for resale and are held for short periods of time. Cash receipts and cash payments resulting from acquisitions and sales of loans also shall be classified as operating cash flows if those loans are acquired specifically for resale and are carried at fair value or at the lower of amortized cost basis or fair value. For example, mortgage loans held for sale are required to be reported at the lower of amortized cost basis or fair value in accordance with Topic 948.

45-21A Cash receipts resulting from the sale of donated **financial assets** (for example, donated debt or equity instruments) by NFPs that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash shall be classified as operating cash flows. If, however, the donor restricted the use of the contributed resource to a long-term purpose of the nature of those described in paragraph 230-10-45-14(c), then those cash receipts meeting all the conditions in this paragraph shall be classified as a financing activity.

The sections below address certain types of operating cash flows.

6.3.1 Long-Term Trade Receivables

As indicated above, ASC 230-10-45-16 states that cash collections from sales of goods or services on account are cash inflows from operating activities. Further, at the 2004 AICPA Conference on Current SEC and PCAOB Developments, Todd Hardiman, associate chief accountant in the SEC's Division of Corporation Finance, emphasized that all cash collections stemming from the sale of inventory are operating cash flows, regardless of whether the cash flows represent:

- Immediate cash collections from customers.
- Collections of cash from receivables obtained in exchange for inventory (short-term or long-term).
- The proceeds of the sale of customer receivables (originated in exchange for inventory) to third parties (e.g., in a securitization accounted for under ASC 860).

In addition, during the conference, Craig Olinger, deputy chief accountant in the SEC's Division of Corporation Finance, indicated that this classification is required in situations in which the extension of credit is provided by a captive finance subsidiary.

Example 6-6

Company A sells a product for \$500. The customer finances its purchase with a loan from Company B (a captive finance subsidiary of A). When B makes the loan to the customer, it remits \$500 to its parent (A) on behalf of the customer.

For A, the initial transaction (sale of the product) is a noncash transaction. However, when B receives a payment on the loan from the customer, the payment should be treated as an operating cash flow in A's consolidated financial statements because the payment is related to sales of A's inventory.



Connecting the Dots

One of the topics addressed by the FASB in ASU 2016-15 is a transferor's beneficial interest obtained in a securitization of financial assets (e.g., trade receivables). The ASU notes that the transferor's initial receipt of the beneficial interest in a securitization of trade receivables should be disclosed as a noncash activity. Subsequent cash receipts from payments on such beneficial interests should be classified as investing activities. We believe that, before the issuance of ASU 2016-15, many entities classified subsequent receipts of the beneficial interest as operating activities. As a result, the ASU has resulted in a change in practice for some entities.

6.3.2 Cash Proceeds From Insurance Claims

ASC 230-10-45-21B states that "[c]ash receipts resulting from the settlement of insurance claims, excluding proceeds received from [COLI] policies and [BOLI] policies, shall be classified on the basis of the related insurance coverage (that is, the nature of the loss)." In addition, for lump-sum settlements, "an entity shall determine the classification on the basis of the nature of each loss included in the settlement." The purpose of such clarifications is to provide financial statement users with more relevant information.

For example, insurance settlement proceeds received as a result of a claim made in connection with the destruction of productive assets should be classified as cash inflows from investing activities because the settlement proceeds could be analogous to proceeds received on the sale of such assets. However, proceeds received as a result of claims related to a business interruption should be classified as operating activities.

6.3.3 Planned Major Maintenance

Transportation assets in certain industries (e.g., the airline and shipping industries) may be subject to major maintenance activities at specified intervals in accordance with regulations applicable to the industry. These activities are known as planned major maintenance activities. For example, vessels participating in the United States Coast Guard's alternate compliance program with the American Bureau of Shipping must meet specified "seaworthiness" standards to maintain required operating certificates. To meet such standards, vessels must undergo regular inspection, monitoring, and maintenance, referred to as "dry-docking." Typical dry-docking costs include costs for blasting and steel coating as well as steel replacement.

When determining an accounting policy for dry-docking costs, many shipping entities apply ASC 908 for analogous guidance on overhaul costs. ASC 908-360-25-2 provides three alternatives for accounting for overhaul costs:

- *Direct expensing method* — Actual costs are expensed as incurred.
- *Built-in overhaul method* — The costs of components subject to overhaul are segregated at purchase and are amortized to the date of the initial overhaul. The process is repeated thereafter.
- *Deferral method* — Actual costs are capitalized and amortized to the next overhaul.

Informal discussions with the SEC staff have revealed that an entity should classify dry-docking expenditures in operating activities in the statement of cash flows, regardless of the method the entity uses to account for these expenditures.

However, classification of these expenditures as operating activities is not limited to dry-docking costs for shipping vessels and thus would apply to planned major maintenance activities in other industries.

6.3.4 Employee Benefit Plans

When an employer makes contributions (discretionary and nondiscretionary) to an employee benefit plan in connection with employee services rendered, such payments, although perhaps initially contributed to a trust, will ultimately be paid to employees. Therefore, the employer should classify those payments as cash flows for operating activities in the statement of cash flows, regardless of whether such payments are voluntary or are required by ERISA.

Further, when an entity files for bankruptcy, it may enter into an agreement with the Pension Benefit Guaranty Corporation regarding its employee benefit plan liabilities. Typically, such an agreement requires the entity to make payments for its employee benefit plan liabilities at the time of, or after, its emergence from bankruptcy. Although these payments may extend over a number of years, they still ultimately concern employee services rendered and therefore should be classified as cash flows for operating activities in the statement of cash flows. This classification is required even if the entity is later required to apply "fresh-start" reporting under ASC 852. This classification is also consistent with views expressed by the SEC staff.

6.4 More Than One Class of Cash Flows

ASC 230-10

45-22 Certain cash receipts and payments may have aspects of more than one class of cash flows. For example, a cash payment may pertain to an item that could be considered either **inventory** or a productive asset. If so, the appropriate classification shall depend on the activity that is likely to be the predominant source of cash flows for the item. For example, the acquisition and sale of equipment to be used by the entity or rented to others generally are investing activities. However, equipment sometimes is acquired or produced to be used by the entity or rented to others for a short period and then sold. In those circumstances, the acquisition or production and subsequent sale of those assets shall be considered operating activities.

Pending Content (Transition Guidance: ASC 230-10-65-2)

45-22 Certain cash receipts and payments may have aspects of more than one class of cash flows. The classification of those cash receipts and payments shall be determined first by applying specific guidance in this Topic and other applicable Topics. In the absence of specific guidance, a reporting entity shall determine each separately identifiable source or each separately identifiable use within the cash receipts and cash payments on the basis of the nature of the underlying cash flows, including when judgment is necessary to estimate the amount of each separately identifiable source or use. A reporting entity shall then classify each separately identifiable source or use within the cash receipts and payments on the basis of their nature in financing, investing, or operating activities.

45-22A In situations in which cash receipts and payments have aspects of more than one class of cash flows and cannot be separated by source or use (for example, when a piece of equipment is acquired or produced by an entity to be rented to others for a period of time and then sold), the appropriate classification shall depend on the activity that is likely to be the predominant source or use of cash flows for the item.

45-23 Another example where cash receipts and payments include more than one class of cash flows involves a derivative instrument that includes a financing element at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments, because the borrower's cash flows are associated with both the financing element and the derivative instrument. For that derivative instrument, all cash inflows and outflows shall be considered cash flows from financing activities by the borrower.

Certain cash receipts and payments may have aspects of more than one class of cash flows. Paragraph BC39 of ASU 2016-15 provides guidance on “when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows . . . and when an entity should classify the aggregate of those cash receipts and payments into one class of cash flows based on predominance.” The classification of cash receipts and payments that have aspects of more than one class of cash flows should be determined by first applying specific guidance in U.S. GAAP. When such guidance is not available, financial statement preparers should separate each identifiable source or use of cash flows within the cash receipts and cash payments on the basis of the nature of the underlying cash flows. Each separately identified source or use of cash receipts or payments should then be classified on the basis of its nature. Classification based on the activity that is most likely to be the predominant source or use of cash flows is only appropriate when the source or use of cash receipts and payments has multiple characteristics and is not separately identifiable.

In accordance with ASC 230, the classification of cash flows with characteristics of more than one class of cash flows is a three-step process and, as noted above, an entity should not default to classification based on predominance. Unless an entity can conclude that sources or uses of cash payments or receipts are not separately identifiable, the entity must first allocate amounts of each cash receipt or payment that has aspects of more than one class of cash flows on the basis of the nature of the

underlying cash flows for each separately identifiable source or use of cash. However, because the guidance does not define the term “separately identifiable,” entities must use judgment when applying the guidance.

The first step in the process is to determine whether there is explicit guidance in ASC 230 or other U.S. GAAP regarding the classification of the related cash flows. Example 6-7A below illustrates guidance from ASC 230 that would address the portion of the payment for long-lived assets used in operations (i.e., as investing activities) and the portion for the inventory (i.e., as operating activities).

[Example 6-7 has been deleted.]

Example 6-7A

Entity A rents office equipment to customers and separately sells supplies such as paper and ink cartridges. In 20X6, A enters into an asset purchase agreement with Entity B to purchase printers and related ink cartridges for \$1.5 million. The transaction does not represent the acquisition of a business; therefore, A accounts for the transaction as an asset acquisition. On the basis of their relative fair values, A records \$1.2 million for the purchase of the printers as investing cash outflows because the printers will be used in A's operations as rentals (i.e., equipment under operating leases). Entity A records \$300,000 for the purchase of the printer cartridges as operating cash outflows because they represent inventory that A will sell.

If no guidance explicitly addresses classification, the second step is to determine whether cash flows are separately identifiable. ASC 230-10-45-22 notes that entities should identify each separate source and use of cash on the basis of the nature of the underlying cash flows and states “including when judgment is necessary to estimate the amount of each separately identifiable source or use.” Consider the following example:

Example 6-7B

Entity A's primary operations consist of sales and rentals of commercial trucks. In 20X6, A enters into a transaction to purchase 100 trucks of the same make and model from Entity B for \$10 million. At the time of the purchase, A does not know precisely how many of the trucks will be sold and how many will be rented; however, A is able to reasonably estimate that 60 trucks will be sold (i.e., inventory) and that the remaining 40 will be rented (i.e., long-lived depreciable assets). Accordingly, on the basis of its estimate of the nature of the underlying cash flows, A classifies \$6 million as operating outflows for its estimate of inventory purchases and \$4 million as investing outflows for its estimate of purchases of depreciable long-lived assets.

In Example 6-7B, the entity purchases trucks (which are similar assets) that it regularly uses in its operations as rentals and for resale. When the entity purchased the trucks, it did not know exactly how many units would be rented and how many would be sold; however, the entity used judgment and estimated the cash flows for each category (operating and investing). In other words, at the time of purchase, the entity estimated the cash flows for each category on the basis of how it planned to use each truck.

The third step is to determine classification of cash flows on the basis of predominance in situations in which cash receipts and payments have aspects of more than one class of cash flow and the entity is unable to separately identify sources and uses of cash flows (note that this is not the case in Example 6-7B above because the entity could estimate the category, which in that case was based on the entity's intent at the time the original cash flow occurred). Such scenarios may occur when the same piece of equipment is sold but, at the time of purchase, the asset will be used in the entity's operations for a

short period before resale. In such situations, an entity may need to classify all of the cash outflows in the same category on the basis of the activity that is likely to be the predominant use of the cash flows (i.e., the investing outflows in Example 6-7C are based on predominance).

Example 6-7C

A company provides health care equipment to patients for a monthly rental fee. At times, the company may also sell the rental equipment to patients. In other words, the entity sells the same asset that it uses in its operations as rentals and classifies the cash outflows for asset purchases on the basis of the predominant source of cash flows (i.e., the entity's use of the assets as rentals). Therefore, because the purchases of health care equipment are presented as a cash outflow from investing activities upon acquisition, proceeds from the sale of the health care equipment should be presented as a cash inflow from investing activities.

Note that an entity should apply the same three-step process when the disposition of assets may have aspects of more than one class of cash flows. Consider the following example:

Example 6-7D

Assume the same facts as in [Example 6-7A](#), except that, rather than purchasing printers and related ink cartridges, Entity A is selling these items in a single transaction for \$1.5 million. Entity A accounts for the transaction as an asset disposition. On the basis of their relative fair values, A records \$1.2 million for the sale of the printers as investing cash inflows because the printers have been used in A's operations as rentals (and the presentation is consistent with the cash outflows when the printers were originally acquired). Entity A records \$300,000 for the sale of the printer cartridges as operating cash inflows because they represent inventory that A was holding for sale as part of its normal operations (and the presentation is consistent with the cash outflows when the printer cartridges were originally acquired).

In addition, an entity's intended use of an asset may change when compared with its intended use at the time the asset was acquired. Such changes in an asset's intended use may also make it challenging to determine how to classify cash inflows and outflows. Consider [Example 6-7B](#), in which the entity purchases assets, intending to use some of the assets purchased in its operations (as rentals) and resell others. The entity may purchase a piece of equipment to rent to customers but may later decide to sell the asset rather than rent it to customers. Because the entity purchased the asset while intending to use it in its operations, the cash outflows were classified as investing activities. However, because the entity also regularly resells equipment (representing a revenue transaction for the entity), a question arises regarding whether the cash inflows from the sale of the asset should be classified as operating activities. Therefore, classifying the cash outflows and inflows on the basis of the intent that existed when the respective cash flows occurred would result in the differing classification of inflows and outflows for the same asset (i.e., investing activities for the purchases of equipment to be rented and operating activities for revenue from their sales). Conversely, if cash flows for the asset's purchase and sale are classified consistently (e.g., both are presented on the basis of original intent representing an investing activity and therefore the subsequent sale would also be investing rather than operating), the cash flow presentation may not be consistent (i.e., not symmetrical) with how balances are presented in the other financial statements because presentation in other financial statements reflects the entity's change in intent.

In a manner consistent with the SEC staff's remarks at the 2006 AICPA Conference on Current SEC and PCAOB Developments and comment letters to registrants, we believe that an entity should be consistent in how it classifies cash outflows and inflows related to an asset's purchase and sale. Further, cash flow classification should be consistent even if doing so creates asymmetry with how the transaction is presented in the balance sheet and income statement. When such asymmetry exists, an entity should include appropriate disclosures that explain such differences.

6.4.1 Classification of Cash Flows for Emission Allowances and Related Transactions

Emission trading (or “cap-and-trade”) programs are administered by governing bodies (i.e., governments or governmental agencies) to control or reduce the emission of pollutants or greenhouse gases. The most common programs in the United States cover emissions of sulfur dioxide and nitrogen oxide. Outside the United States, there are similar programs to control the emission of greenhouse gases (e.g., carbon dioxide). In the current U.S. cap-and-trade programs, governing bodies typically issue rights (allowances) to participating entities to emit a specified level of pollutants. Each individual emission allowance (EA) has a vintage year designation (i.e., the year the allowance may be used). EAs with the same vintage year designation are fungible and can be used by any party to satisfy pollution control obligations for emissions from any source within the governing bodies’ associated control area during the vintage year or, potentially, subsequent years (i.e., many EA programs permit carryforward to subsequent years). EAs are generally granted several years in advance. For example, sulfur dioxide allowances in the United States have already been allocated and delivered to participating entities for the next 30 years.

Entities can choose to buy EAs from, and sell EAs to, other entities, which is typically initiated through a broker. Entities can also enter into nonmonetary exchanges of EAs of one vintage (e.g., use in 2020) for EAs of another vintage (e.g., use in 2030) — commonly referred to as vintage year swaps. At the end of a compliance period, a participating entity must either (1) deliver to the governing bodies EAs sufficient to offset the entity’s actual emissions or (2) pay a fine.

Markets to buy and sell EAs in the United States continue to develop. The extent of development depends on the type of EA and whether the EA is related to a national, regional, or state program.

Discussions with the FASB and SEC staffs have indicated that two methods of accounting for EAs are acceptable: (1) the inventory model and (2) the intangible asset model. While both are permitted, the intangible asset model is preferable. Although the FASB added a project to its agenda to address the accounting for EAs, the project was removed from the Board’s agenda in January 2014. Therefore, entities should choose one method and apply it consistently to a given category of EA. For example, an entity could hold two categories of EA, “held for use” and “held for sale,” each with its own accounting method. However, within a category, the method must be consistently applied.

Under the intangible asset model, cash inflows and outflows from sales and purchases of EAs are classified as investing activities in the statement of cash flows; however, under the inventory model, they are classified as operating activities in the statement of cash flows.

6.4.2 Classification of Cash Flows of Repayments of Zero-Coupon Bonds and Other Debt Instruments With Coupon Interest Rates That Are Insignificant in Relation to the Effective Interest Rate of the Borrowing

ASC 230-10

45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.

Pending Content (Transition Guidance: ASC 718-10-65-8)

45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by an employer when withholding shares from an employee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 230-10-65-2)**

45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by an employer when withholding shares from an employee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed, including the portion of the repayments made to settle zero-coupon debt instruments that is attributable to the principal or the portion of the repayments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to the principal.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.
- f. Payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-17(ee).
- g. Payments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders that are directly related to the debt prepayment or debt extinguishment, excluding accrued interest.

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 718-10-65-11)**

45-15 All of the following are cash outflows for financing activities:

- a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments. Cash paid to a tax authority by a grantor when withholding shares from a grantee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.
- b. Repayments of amounts borrowed, including the portion of the repayments made to settle zero-coupon debt instruments that is attributable to the principal or the portion of the repayments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to the principal.
- c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
- d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
- e. Payments for debt issue costs.
- f. Payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-17(ee).
- g. Payments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders that are directly related to the debt prepayment or debt extinguishment, excluding accrued interest.

ASC 230-10

45-17 All of the following are cash outflows for operating activities:

- a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash payments to other suppliers and employees for other goods or services.
- c. Cash payments to governments for taxes, duties, fines, and other fees or penalties and the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services recognizable for financial reporting purposes also had not been deductible in determining taxable income. (This is the same amount reported as a financing cash inflow pursuant to paragraph 230-10-45-14(e).)
- d. Cash payments to lenders and other creditors for interest.
- e. Cash payment made to settle an asset retirement obligation.
- f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

Pending Content (Transition Guidance: ASC 718-10-65-5)

45-17 All of the following are cash outflows for operating activities:

- a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash payments to other suppliers and employees for other goods or services.
- c. Cash payments to governments for taxes, duties, fines, and other fees or penalties.
- d. Cash payments to lenders and other creditors for interest.
- e. Cash payment made to settle an asset retirement obligation.
- f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 230-10-65-2)**

45-17 All of the following are cash outflows for operating activities:

- a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
- b. Cash payments to other suppliers and employees for other goods or services.
- c. Cash payments to governments for taxes, duties, fines, and other fees or penalties.
- d. Cash payments to lenders and other creditors for interest, including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to accreted interest related to the debt discount. For all other debt instruments, an issuer shall not bifurcate cash payments to lenders and other creditors at settlement for amounts attributable to accreted interest related to the debt discount, nor classify such amounts as cash outflows for operating activities.
- e. Cash payment made to settle an asset retirement obligation.
- ee. Cash payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability that exceed the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-15(f).
- f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

ASC 230-10 (continued)

45-25 In reporting cash flows from operating activities, entities are encouraged to report major classes of gross cash receipts and gross cash payments and their arithmetic sum — the net cash flow from operating activities (the direct method). (Paragraphs 230-10-55-1 through 55-4 and paragraph 230-10-55-21, respectively, discuss and illustrate a method by which those major classes of gross operating cash receipts and payments generally may be determined indirectly.) Entities that do so shall, at a minimum, separately report the following classes of operating cash receipts and payments:

- a. Cash collected from customers, including lessees, licensees, and the like
- b. Interest and dividends received. Interest and dividends that are donor restricted for long-term purposes as included in the list of financing activities and paragraph 230-10-45-14(c) are not part of operating cash receipts.
- c. Other operating cash receipts, if any
- d. Cash paid to employees and other suppliers of goods or services, including suppliers of insurance, advertising, and the like
- e. Interest paid
- f. Income taxes paid and separately, the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included as a cost of goods or services recognizable for accounting purposes also had not been deductible in determining taxable income (see Section 230-10-45-14(e))
- g. Other operating cash payments, if any.

Entities are encouraged to provide further breakdowns of operating cash receipts and payments that they consider meaningful and feasible. For example, a retailer or manufacturer might decide to further divide cash paid to employees and suppliers (category (d) in the preceding paragraph) into payments for costs of inventory and payments for selling, general, and administrative expenses.

Pending Content (Transition Guidance: ASC 718-10-65-5)

45-25 In reporting cash flows from operating activities, entities are encouraged to report major classes of gross cash receipts and gross cash payments and their arithmetic sum — the net cash flow from operating activities (the direct method). (Paragraphs 230-10-55-1 through 55-4 and paragraph 230-10-55-21, respectively, discuss and illustrate a method by which those major classes of gross operating cash receipts and payments generally may be determined indirectly.) Entities that do so shall, at a minimum, separately report the following classes of operating cash receipts and payments:

- a. Cash collected from customers, including lessees, licensees, and the like
- b. Interest and dividends received. Interest and dividends that are donor restricted for long-term purposes as included in the list of financing activities and paragraph 230-10-45-14(c) are not part of operating cash receipts.
- c. Other operating cash receipts, if any
- d. Cash paid to employees and other suppliers of goods or services, including suppliers of insurance, advertising, and the like
- e. Interest paid
- f. Income taxes paid
- g. Other operating cash payments, if any.

Entities are encouraged to provide further breakdowns of operating cash receipts and payments that they consider meaningful and feasible. For example, a retailer or manufacturer might decide to further divide cash paid to employees and suppliers (category (d) in the preceding paragraph) into payments for costs of inventory and payments for selling, general, and administrative expenses.

ASC 230-10 (continued)**Pending Content (Transition Guidance: ASC 230-10-65-2)**

45-25 In reporting cash flows from operating activities, entities are encouraged to report major classes of gross cash receipts and gross cash payments and their arithmetic sum — the net cash flow from operating activities (the direct method). (Paragraphs 230-10-55-1 through 55-4 and paragraph 230-10-55-21, respectively, discuss and illustrate a method by which those major classes of gross operating cash receipts and payments generally may be determined indirectly.) Entities that do so shall, at a minimum, separately report the following classes of operating cash receipts and payments:

- a. Cash collected from customers, including lessees, licensees, and the like
- b. Interest and dividends received. Interest and dividends that are donor restricted for long-term purposes as included in the list of financing activities and paragraph 230-10-45-14(c) are not part of operating cash receipts.
- c. Other operating cash receipts, if any
- d. Cash paid to employees and other suppliers of goods or services, including suppliers of insurance, advertising, and the like
- e. Interest paid, including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to accreted interest related to the debt discount
- f. Income taxes paid
- g. Other operating cash payments, if any.

Entities are encouraged to provide further breakdowns of operating cash receipts and payments that they consider meaningful and feasible. For example, a retailer or manufacturer might decide to further divide cash paid to employees and suppliers (category (d) in the preceding paragraph) into payments for costs of inventory and payments for selling, general, and administrative expenses.

An entity that issues zero-coupon bonds to an investor records the proceeds from the bonds' issuance as a financing cash inflow. The bonds are accreted to their redemption value in accordance with the "interest" method,⁴ as described in ASC 835 (i.e., the carrying amount of the bonds increases from issuance until maturity (or earlier if prepayment is allowed) for the accrued interest to arrive at the bonds' redemption value). On the maturity date (or earlier if prepayment is allowed), the entity repays (1) the original proceeds (the principal amount of the bonds) and (2) the accrued interest from the date of issuance. Before the bonds' maturity (or the date of prepayment, if earlier), the interest expense is presented in the statement of cash flows as a reconciling item between net income and cash flows from operating activities, since no interim cash payments are made for the periodic accrual of interest.

At redemption, the cash paid to settle the interest component is reflected as a cash outflow from operating activities in the statement of cash flows in accordance with ASC 230-10-45-17 and ASC 230-10-45-25 as the accrued interest is recognized in earnings. The cash paid to settle the principal is reflected as a cash outflow from financing activities in the statement of cash flows in accordance with ASC 230-10-45-15.

⁴ ASC 835-30-35-4 states that "[o]ther methods of amortization may be used if the results obtained are not materially different from those that would result from the interest method."

Example 6-8

On January 1, 20X2, Company A issues 1,000 zero-coupon bonds, each with a face amount of \$1,000, and A receives proceeds of \$600,000 upon issuance. The zero-coupon bonds mature in five years (on December 31, 20X6).

In fiscal years 20X2–20X6, A records annual interest expense of \$80,000 $([\$1,000,000 \text{ redemption value} - \$600,000 \text{ proceeds received}] \div 5 \text{ years})$ to accrete the zero-coupon bonds to their redemption value. Company A has determined that the amount of the interest expense accrued annually on a straight-line basis (\$80,000) would not materially differ from the amount of interest expense accrued under the interest method.

On December 31, 20X6, A redeems the zero-coupon bonds for \$1 million. Amounts that A would present in its statement of cash flows for specific years are as follows:

- December 31, 20X2:
 - The initial cash proceeds of \$600,000 received upon issuance of the zero-coupon bonds would be reflected as a cash inflow from financing activities.
 - The interest expense of \$80,000 recorded to accrete the zero-coupon bonds to their redemption value would be reflected as a reconciling item between net income and cash flows from operating activities.
- December 31, 20X3–20X5:
 - The interest expense of \$80,000 recorded to accrete the zero-coupon bonds to their redemption value would be reflected as a reconciling item between net income and cash flows from operating activities.
- December 31, 20X6:
 - Of the \$1 million of cash paid, \$600,000 represents the amount paid to settle the principal amount of the zero-coupon bonds and would be reflected as a cash outflow from financing activities.
 - The remaining \$400,000 of cash paid (i.e., the interest expense of \$80,000 recorded in each of the five fiscal years) would be reflected as a cash outflow from operating activities because the interest was recognized in earnings.

[Example 6-9 has been deleted.]

In addition to zero-coupon bonds, the guidance in ASC 230-10-45-15, ASC 230-10-45-17, and ASC 230-10-45-25 also applies to other debt instruments “with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to the principal.” The objective of including these other debt instruments (rather than all debt instruments) is to improve comparability related to entities’ presentation of economically similar transactions.

**Connecting the Dots**

ASC 230 does not define the term “insignificant” or otherwise provide guidance on what would constitute insignificant coupon rates. Consequently, entities that issue other debt instruments with coupon rates that are insignificant in relation to the effective interest rate attributable to the principal will most likely need to exercise greater judgment in evaluating the portion of the rates that is insignificant. We generally believe that an entity should determine whether an interest rate is insignificant by looking to the market. For example, a 1 percent coupon rate may not be insignificant if the market rate is 2 percent. However, an entity may conclude that a 1 percent coupon rate is insignificant compared with a market rate of 10 percent and that the 1 percent rate is therefore within the scope of ASC 230-10-45-15, ASC 230-10-45-17, and ASC 230-10-25.

6.4.3 Debt Instruments That Contain Interest Payable in Kind

Entities may issue debt instruments that require or permit the payment of the periodic interest coupons in kind. The ASC master glossary defines payment-in-kind bonds as follows:

Bonds in which the issuer has the option at each interest payment date of making interest payments in cash or in additional debt securities. Those additional debt securities are referred to as baby or bunny bonds. Baby bonds generally have the same terms, including maturity dates and interest rates, as the original bonds (parent payment-in-kind bonds). Interest on baby bonds may also be paid in cash or in additional like-kind debt securities at the option of the issuer.

On the basis of the EITF's deliberations leading up to the issuance of ASU 2016-15 (codified in ASC 230), we understand that the requirements discussed in [Section 6.4.2](#) apply to all debt instruments that are economically similar to zero-coupon bonds (including debt instruments that contain periodic interest coupons that are payable in kind).⁵ Therefore, we believe that the guidance in ASC 230-10-45-15, ASC 230-10-45-17, and ASC 230-10-45-25 should be considered for debt instruments that:

- Require periodic interest coupons to be paid in kind through an addition to the contractual principal amount of the original debt instrument.
- Permit the debtor to pay each periodic interest coupon in cash or in kind, with any payments made in kind added to the contractual principal amount of the original debt instrument.
- Require periodic interest coupons to be paid in kind through the issuance of a new debt instrument that has the same terms as the original debt instrument.
- Permit the debtor to pay each periodic interest coupon in cash or in kind, with any payments in kind paid through the issuance of a new debt instrument that has the same terms as the original debt instrument.

While the guidance in ASC 230-10-45-15, ASC 230-10-45-17, and ASC 230-10-45-25 specifically addresses only the debtor's cash flow statement classification, we believe that it is also relevant to the investor's cash flow statement classification. Therefore, we think that the following payments should be classified as operating activities: (1) the portion of payments received upon settlement of zero-coupon debt instruments that is attributable to accreted interest and (2) the portion of payments received upon settlement of other debt instruments with coupon interest rates that are insignificant in relation to the effective interest rate of the borrowing that is attributable to accreted interest (including debt instruments that contain periodic interest coupons that are payable in kind). The principal portion received on these debt instruments would continue to be classified as investing activities.

The guidance discussed above (and in [Section 6.4.2](#)) should not affect the classification of cash flows for the following types of financial instruments that contain periodic coupons that are payable in kind:

- *Convertible debt instruments or convertible preferred stock instruments that are settled through the issuance of common stock* — The settlement of convertible securities for common stock is treated as a noncash investing or financing activity.
- *Preferred stock instruments that are classified in equity* — The issuer of preferred stock classifies payments of dividends on, and redemptions of, equity-classified preferred stock instruments as financing activities. Therefore, the ASU's guidance does not apply to the issuer; however, it does apply to the investor. Under this guidance, the investor would be required to classify (1) dividends received on equity-classified preferred stock instruments as operating activities and (2) redemptions of equity-classified preferred stock instruments as investing activities.

⁵ We generally believe that when ASU 2016-15 is applied, debt instruments that contain periodic interest coupons that are payable in kind are economically similar to zero-coupon bonds.

6.5 Changes to Historical Classification

In certain instances, an entity may elect to change its historical classification of certain items in the statement of cash flows. We do not believe that such a change in classification would represent a change in accounting principle as defined in ASC 250 if the entity is able to conclude that both the previous classification and the new classification are acceptable under GAAP. Instead, the change should be viewed as a change from one acceptable presentation to another acceptable presentation in accordance with ASC 230. Further, an entity should retrospectively apply the revised classification for each year presented in the financial statements and include appropriate disclosure of the change.

Conversely, a change to an entity's policy for determining which items are treated as cash equivalents represents a change in accounting principle for which the entity must demonstrate preferability in accordance with ASC 250 (see [Section 4.1](#) regarding the definition of cash and cash equivalents).

Example 6-10

Entity A has decided to change the approach it uses for presentation in its statement of cash flows in the current year from the direct method to the indirect method, since management considers presentation under the indirect method to be more informative and readily understandable by financial statement users.

Both the direct method and the indirect method are acceptable under U.S. GAAP, and the change is considered to be a change in presentation, which is analogous to a reclassification. Entity A will retroactively reclassify the statement of cash flows presented and disclose the reclassification in the notes to the financial statements.

Chapter 7 — Common Issues Related to Cash Flows

The previous chapters of this Roadmap describe general principles and provide certain examples related to the classification of cash flows between operating, financing, and investing activities. This chapter addresses common issues associated with the classification of cash flows as operating, investing, or financing.

7.1 Foreign Currency Cash Flows

ASC 830-230

45-1 A statement of **cash** flows of an entity with **foreign currency** transactions or foreign operations shall report the **reporting currency** equivalent of foreign currency cash flows using the **exchange rates** in effect at the time of the cash flows. An appropriately weighted average exchange rate for the period may be used for translation if the result is substantially the same as if the rates at the dates of the cash flows were used. (That is, paragraph 830-30-45-3 applies to cash receipts and cash payments.) The statement of cash flows shall report the effect of exchange rate changes on cash balances held in foreign currencies as a separate part of the reconciliation of the change in cash and **cash equivalents** during the period. See Example 1 (paragraph 830-230-55-1) for an illustration of this guidance.

Pending Content (Transition Guidance: ASC 230-10-65-3)

45-1 A statement of cash flows of an entity with foreign currency transactions or foreign operations shall report the reporting currency equivalent of foreign currency cash flows using the exchange rates in effect at the time of the cash flows. An appropriately weighted average exchange rate for the period may be used for translation if the result is substantially the same as if the rates at the dates of the cash flows were used. (That is, paragraph 830-30-45-3 applies to cash receipts and cash payments.) The statement of cash flows shall report the effect of exchange rate changes on cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents held in foreign currencies as a separate part of the reconciliation of the change in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents during the period. See Example 1 (paragraph 830-230-55-1) for an illustration of this guidance.

Entities may have transactions that are denominated in a foreign currency or businesses that operate in foreign currency environments. An entity should report the cash flow effect of transactions denominated in a foreign currency by using the exchange rates in effect on the date of such cash flows. As noted in ASC 830-230-45-1, instead of using the actual exchange rate on the date of a foreign currency transaction, an entity may use “an appropriately weighted average exchange rate” for translation “if the result is substantially the same as if the rates at the dates of the cash flows were used.”

A consolidated entity with operations whose functional currencies are foreign currencies may use the following approach when preparing its consolidated statement of cash flows:

- Prepare a separate statement of cash flows for each foreign operation by using the operation's functional currency.
- Translate the stand-alone cash flow statement prepared in the functional currency of each foreign entity into the reporting currency of the parent entity.
- Consolidate the individual translated statements of cash flows.

The effects of exchange rate changes, or translation gains and losses, are not the same as the effects of transaction gains and losses and should not be presented or calculated in the same manner.

Effects of exchange rate changes may have a direct impact on cash receipts and payments but do not directly result in cash flows themselves.

Because unrealized transaction gains and losses arising from the remeasurement of foreign-currency-denominated monetary assets and liabilities on the balance sheet date are included in the determination of net income, such amounts should be presented as a reconciling item between net income and net cash from operating activities (either on the face of the statement under the indirect method or in a separate schedule under the direct method).

Subsequently, any cash flows arising from the settlement of the foreign-currency-denominated asset and liability should be presented in the statement of cash flows as an operating, investing, or financing activity on the basis of the nature of such cash flows.

Translation gains and losses, however, are recognized in other comprehensive income and are not included in the cash flows from operating, investing, or financing activities.

The effects of exchange rate changes on cash should be shown as a separate line item in the statement of cash flows as part of the reconciliation of beginning and ending cash balances. This issue was discussed in paragraph 101 of the Basis for Conclusions of FASB Statement 95, which stated, in part:

The effects of exchange rate changes on assets and liabilities denominated in foreign currencies, like those of other price changes, may affect the amount of a cash receipt or payment. **But exchange rate changes do not themselves give rise to cash flows, and their effects on items other than cash thus have no place in a statement of cash flows.** To achieve its objective, a statement of cash flows should reflect the reporting currency equivalent of cash receipts and payments that occur in a foreign currency. Because the effect of exchange rate changes on the reporting currency equivalent of cash held in foreign currencies affects the change in an enterprise's cash balance during a period but is not a cash receipt or payment, the Board decided that **the effect of exchange rate changes on cash should be reported as a separate item in the reconciliation of beginning and ending balances of cash.** [Emphasis added]

In a manner consistent with the implementation guidance in ASC 830-230-55-15, the effect of exchange rate changes on cash and cash equivalents is the sum of the following two components:

1. For each foreign operation, the difference between the exchange rates used in translating functional currency cash flows and the exchange rate at year-end multiplied by the net cash flow activity for the period measured in the functional currency.
2. The fluctuation in the exchange rates from the beginning of the year to the end of the year multiplied by the beginning cash balance denominated in currencies other than the reporting currency.

Example 1 of ASC 830-230-55-1 through 55-15 (see [Appendix A](#)) illustrates the computation of the effect of exchange rate changes on cash.

For more information about foreign currency accounting and reporting matters, see Deloitte's [A Roadmap to Foreign Currency Transactions and Translations](#).

7.2 Constructive Receipt and Disbursement

An entity may enter into arrangements in which cash is received by or disbursed to another party on behalf of the entity. Although these arrangements may not result in a direct exchange of cash to or from the entity, the same economic result is achieved if cash is received by or disbursed to the entity directly (i.e., constructive receipt and constructive disbursement, respectively). Consequently, it is often difficult to determine whether the entity should report these cash flows in its statement of cash flows.

In some industries, the entity (e.g., an automobile dealer) may finance its purchases of inventory through the supplier and, in many cases, the finance entity is a subsidiary of the supplier. The finance subsidiary pays the supplier directly on behalf of the automobile dealer and no cash is disbursed by the dealer until the inventory is sold. As discussed in AICPA Technical Q&As Section 1300.16, the dealer reports purchases as increases in inventory and trade loans (a noncash transaction), with repayments of the trade loans presented within operating activities in the statement of cash flows.

However, when the finance entity is not a subsidiary of a supplier (i.e., a third party), the amounts financed are not trade loans; rather, they are third-party loans.¹ As a result, they should be reflected as cash transactions in the dealer's statement of cash flows as follows:

- *Unrelated finance entity remits proceeds to the supplier (on behalf of the dealer)* — The dealer should present this transaction as a financing cash inflow (to reflect the amount "received" from the third-party loan) and an operating cash outflow (to reflect the amount "paid" to purchase inventory).
- *Dealer repays loan to finance company* — The dealer should present this transaction as a financing cash outflow.

This principle is applicable in other industries that may not have inventory financing arrangements. For example, a company may purchase real estate by taking out a mortgage with a third-party financing entity. At the closing of the purchase transaction, the third-party lender electronically wires cash directly to an escrow account, which in turn is wired directly to the seller. The cash from the mortgage does not get deposited into the company's bank account (or get paid out of the company's bank accounts) since it is paid directly from the lender to the seller as part of closing escrow. Since the third-party lender is acting as the buyer's agent and transfers the proceeds of the mortgage directly to the escrow agent on behalf of the buyer, the substance of the transaction is that the buyer received the proceeds of the mortgage as a financing cash inflow and disbursed the purchase price of the real estate as an investing cash outflow. Accordingly, the transaction should be presented in such a manner in the company's statement of cash flows.

¹ This issue was discussed by an SEC staff member at the 2005 AICPA Conference on Current SEC and PCAOB Developments.

7.3 Stock Compensation

Because the receipt of employee services in exchange for a share-based payment award is a noncash item, the granting of such awards is not presented in the statement of cash flows.

However, in presenting cash flows under the indirect method, an entity would present the compensation cost recognized in net income in each reporting period as a reconciling item in arriving at cash flows from operations. In addition, an entity must present any cash paid by employees (e.g., the exercise price) to the entity for such awards as cash inflows from financing activities.

However, the complexity of stock compensation arrangements often leads to additional presentation issues related to an entity's statement of cash flows. This section discusses the following presentation issues:

- Cash received upon early exercise of a share-based payment award.
- Income tax effects of share-based payment awards.
- Settlement of equity-classified share-based payment awards.
- Settlement of liability-classified share-based payment awards.
- Remittances of minimum statutory withholding on share-based payment awards.

For more information about the accounting for share-based payment awards, see Deloitte's [A Roadmap to Accounting for Share-Based Payment Awards](#).

7.3.1 Cash Received Upon Early Exercise of a Share-Based Payment Award

An early exercise refers to an employee's ability to change his or her tax position by exercising a share-based payment award and receiving shares before the completion of the requisite service period (i.e., before the award is vested). The early exercise of an award results in the employee's deemed ownership of the shares for U.S. federal income tax purposes, which in turn results in the commencement of the holding period (under the tax law), allowing any subsequent appreciation in the value of the shares received (and realized upon the sale of those shares) to be taxed at a capital gains rate rather than an ordinary income tax rate.

Under ASC 718, an early exercise of a share-based payment award is not considered substantive for accounting purposes (see ASC 718-10-55-31(a)). That is, the share is not considered "issued" because the employee is still required to perform the requisite service to earn the share. Although the share is not considered issued, the cash received from the early exercise represents proceeds from the issuance of an equity instrument and would still be classified as a financing activity. As a result, such cash would be recognized as a cash inflow from financing activities under ASC 230-10-45-14(a).

In addition, as defined in ASC 230-10-20, cash flows from operating activities are "generally the cash effects of transactions and other events that enter into the determination of net income." A transaction in which cash is received from an employee who elects to early exercise an option is not the type of transaction that enters into the determination of net income.

7.3.2 Income Tax Effects of Share-Based Payment Awards

Before the issuance of [ASU 2016-09](#), entities were required to present any realized excess or deficient tax deductions (“excess tax benefit” or “tax deficiency”) on a gross basis as separate components of financing activities.² However, ASU 2016-09 clarified that the income tax effect of any excess tax benefit or tax deficiency is recognized in the income statement; therefore, excess tax benefits or tax deficiencies represent operating activities in a manner consistent with other cash flows related to income taxes.

7.3.3 Tax Benefit Deficiencies of Share-Based Payment Awards

[Section 7.3.3 has been deleted and incorporated into Section 7.3.2. Examples 7-1, 7-1A, and 7-2 have been deleted.]

7.3.4 Settlement of Equity-Classified Share-Based Payment Awards

When settling an equity-classified share-based payment award, an entity presents the settlement in its statement of cash flows on the basis of whether the amount paid to settle the award is greater than or less than the fair-value-based measure of the award on the settlement date:

- *Amount paid to settle the award does not exceed the fair-value-based measure of the award on the settlement date* — In accordance with ASC 718-20-35-7, if the cash paid to repurchase the equity-classified award does not exceed the fair-value-based measure of the award on the repurchase date, the cash paid to repurchase the award is charged to equity. That is, repurchase of the equity-classified award is viewed as reacquisition of the entity's equity instruments. Accordingly, the cash paid to reacquire the entity's equity instruments is presented as a cash outflow for financing activities under ASC 230-10-45-15(a), which indicates that payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments, are cash outflows for financing activities.
- *Amount paid to settle the award exceeds the fair-value-based measure of the award on the settlement date* — If the cash paid to repurchase the equity-classified award exceeds the fair-value-based measure of the award on the repurchase date, the cash paid in excess of the fair-value-based measure of the award is viewed as compensation for additional employee services and is recognized as additional compensation cost. Accordingly, if the equity-classified award is repurchased for an amount in excess of the fair-value-based measure, the portion of the cash paid to reacquire the entity's equity instruments that equals the fair-value-based measure of the award is presented as a cash outflow for financing activities under ASC 230-10-45-15(a). The portion of the cash paid in excess of the fair-value-based measure, for additional employee services, is presented as a cash outflow for operating activities under ASC 230-10-45-17(b), which notes that cash payments to employees for services are cash outflows for operating activities.

² ASU 2016-09 removed ASC 230-10-45-14(e), which stated that the following was a cash inflow from financing activities: “Cash retained as a result of the tax deductibility of increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services that is recognizable for financial reporting purposes. For this purpose, excess tax benefits shall be determined on an individual award (or portion thereof) basis.” Such excess tax benefits were the same amounts that an entity was required to show as an operating cash outflow in accordance with ASC 230-10-45-17(c), which the ASU also removed.

Example 7-2A

Company A is making a tender offer to repurchase \$20 million of common stock in the aggregate (the stock was originally distributed as share-based compensation awards) from its current employees. On the basis of an independent third-party valuation, A concludes that the purchase price paid to the employees for the common stock exceeds the fair value of the common stock by a total of \$4.5 million. In accordance with ASC 718-20-35-7, the amount paid to employees up to the fair value of common stock acquired should be recognized in equity as a treasury stock transaction and should therefore be presented as a cash outflow for financing activities. The \$4.5 million that was paid in excess of the fair value of the common stock constitutes compensation expense and is therefore presented as a cash outflow for operating activities.

7.3.5 Settlement of Liability-Classified Share-Based Payment Awards

In accordance with ASC 718-30, the grant-date fair-value-based measure and any subsequent changes in the fair-value-based measure of a liability-classified award through the date of settlement are recognized as compensation cost. Accordingly, the cash paid to settle the liability-classified award is effectively payment for employee services and is presented as a cash outflow for operating activities under ASC 230-10-45-17(b).

Note that an entity may enter into an agreement to repurchase (or offer to repurchase) an equity-classified award for cash. Depending on the facts and circumstances, the agreement to repurchase (or offer to repurchase) may be accounted for as either (1) a settlement of the equity-classified award or (2) a modification of the equity-classified award that changes the award's classification from equity to liability, followed by a settlement of the now liability-classified award.

If the agreement to repurchase (or offer to repurchase) is considered a settlement of an equity-classified award, the cash paid to reacquire the entity's equity instruments is presented in a manner consistent with the discussion in [Section 7.3.4](#). If the agreement to repurchase (or offer to repurchase) is considered a modification of the equity-classified award that changes the award's classification from equity to liability, the cash paid to settle the liability-classified award should be presented in the statement of cash flows in a manner similar to the conclusion above. That is, under ASC 230-10-45-17(b), the cash paid to settle the liability-classified award is effectively payment for employee services and is presented as a cash outflow for operating activities.

7.3.6 Remittances of Minimum Statutory Withholding on Share-Based Payment Awards

Regardless of whether the employer meets the employee's minimum statutory tax withholding requirement for liability-classified or equity-classified share-based payment awards through either a net settlement feature or a repurchase of shares upon exercise of an employee share option (or vesting of a nonvested share), an entity must account for the withholding as two transactions in the statement of cash flows. That is, in substance, this transaction is (1) a gross issuance of shares and (2) a repurchase of the amount of shares needed to satisfy the employee's minimum statutory tax withholding requirement. Therefore, the presentation in the statement of cash flows must also reflect the two transactions.

First, the gross issuance of shares is presented as a financing activity. For example, the cash received for an employee share option as payment for the exercise price of the award is classified as a financing cash inflow. In contrast, for a nonvested share award, because no cash is received from the employee, the gross issuance of shares is presented as a noncash financing activity.

In the second step, when an employee elects to have shares withheld to satisfy its minimum statutory withholding tax obligation, the employer is deemed to have repurchased a portion of the shares that were received by the employee in the first step. While the employee does not receive cash directly, the employer has, in substance, repurchased shares from the employee and remitted the cash consideration to the tax authority on the employee's behalf. Because the cash payment is related to a repurchase of stock, it is presented as a financing cash outflow.

In some circumstances, an exercise of the award may occur in one reporting period while the amount withheld for tax purposes may not be remitted to the tax authority by an employer, on behalf of the employee, until a subsequent reporting period. In these circumstances, for the second step of the transaction, the financing cash outflow is reported in the period in which the cash is paid to the tax authority. In the initial reporting period, the employer has issued the gross amount of shares and is deemed to have repurchased the requisite number of shares needed to satisfy the employee's minimum statutory tax withholding requirement by issuing a note payable to the employee. The note payable issued for the repurchase amount is viewed as a noncash event that has no impact on the statement of cash flows. In the subsequent reporting period, the employer remits the payment for the note payable; however, the employee requests that the amount be remitted to the tax authority on the employee's behalf instead of directly to the employee. This results in the financing cash outflow.

Example 7-3

An entity grants 1,000 nonvested shares to an employee. The plan allows the employer to net-settle the award to cover the minimum statutory tax withholding requirement. Upon vesting, the entity withholds 250 shares to cover the minimum statutory withholding requirement and issues the employee the remaining 750 shares. For cash flow purposes, the entity must account for this transaction as (1) the gross issuance of 1,000 shares and (2) the repurchase of 250 shares to satisfy the minimum statutory withholding requirement. Because no cash is received from the employee for the nonvested share award, the gross issuance of the 1,000 shares is classified as a noncash financing activity. The "repurchase," through the net settlement feature, of the 250 shares to satisfy the minimum statutory withholding requirement is classified as a financing cash outflow. The contemporaneous "receipt of cash," through the net settlement feature, from the employee and the remittance of cash by the entity to the tax authority have no net impact on the statement of cash flows.



Connecting the Dots

In June 2018, the FASB issued [ASU 2018-07](#),³ which simplifies the accounting for share-based payments granted to nonemployees for goods and services. Under the ASU, most of the guidance on share-based payments to nonemployees is aligned with the requirements for share-based payments granted to employees. As a result, much of the guidance in ASC 718, including most of its requirements related to classification and measurement of share-based payment awards to employees, will apply to nonemployee share-based payment arrangements. The ASU also revises ASC 230-10-45-15(a) to extend the requirement to classify, as a financing activity, a repurchase of shares to satisfy an employee's minimum statutory tax withholding obligation related to share-based payments granted to nonemployees.

³ The amendments in ASU 2018-07 are effective for public business entities for fiscal years beginning after December 15, 2018, including interim periods within those fiscal years. For all other entities, the amendments are effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020. Early adoption is permitted, provided that the adoption date is no earlier than the date on which an entity adopts ASC 606.

7.4 Derivatives

ASC 230-10

45-27 Generally, each cash receipt or payment is to be classified according to its nature without regard to whether it stems from an item intended as a hedge of another item. For example, the proceeds of a borrowing are a financing cash inflow even though the debt is intended as a hedge of an investment, and the purchase or sale of a futures contract is an investing activity even though the contract is intended as a hedge of a firm commitment to purchase inventory. However, cash flows from a derivative instrument that is accounted for as a fair value hedge or cash flow hedge may be classified in the same category as the cash flows from the items being hedged provided that the derivative instrument does not include an other-than-insignificant financing element at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments (that is, the forward points in an at-the-money forward contract) and that the accounting policy is disclosed. If the derivative instrument includes an other-than-insignificant financing element at inception, all cash inflows and outflows of the derivative instrument shall be considered cash flows from financing activities by the borrower. If for any reason hedge accounting for an instrument that hedges an identifiable transaction or event is discontinued, then any cash flows after the date of discontinuance shall be classified consistent with the nature of the instrument.

7.4.1 Hedging Derivatives

Under ASC 230-10-45-27, a cash receipt or payment related to a hedging derivative should “be classified according to its nature without regard to whether it stems from an item intended as a hedge of another item. For example, the proceeds of a borrowing are a financing cash inflow even though the debt is intended as a hedge of an investment, and the purchase or sale of a futures contract is an investing activity even though the contract is intended as a hedge of a firm commitment to purchase inventory.”

However, an entity may classify the cash flows from a derivative instrument that is accounted for as a fair value hedge or a cash flow hedge (and that does not contain an other-than-insignificant financing element at inception) in the same category as the cash flows from the items being hedged as long as the entity has elected and disclosed such classification as its accounting policy. Otherwise, the entity should classify the cash flows from the derivative either (1) as an investing activity under ASC 230-10-45-27 or (2) in accordance with the nature of the derivative instrument and how the derivative is used in the context of the entity's business. If periodic settlement payments are required for the hedging derivative, the cash flow classification of any termination payment should be consistent with the classification of the periodic settlements.

The examples below illustrate an entity's classification approaches when its accounting policy is to classify cash flows in the same category as the cash flows from the items being hedged.

Example 7-4

Entity A designates a forward-starting swap as a hedge of the forecasted issuance of fixed-rate debt. The entity plans to issue debt at par at the then-current market interest rate (i.e., the market interest rate as of the date the debt is issued) and will therefore have no variability in debt proceeds; however, each of the probable interest payments resulting from the debt is exposed to variability up until the date of issuance. Accordingly, the forward-starting swap is a hedge of the interest payments and the related cash flows should be classified as operating activities in the statement of cash flows.

Example 7-5

Entity B designates a forward-starting swap as a hedge of the forecasted issuance of fixed-rate debt. The entity plans to issue debt at a stipulated, fixed interest rate (4 percent, regardless of current market rates as of the date the debt is issued). As a result, the debt proceeds will be variable (i.e., the debt will be issued at a discount or a premium) because market rates will change during the period leading up to the actual debt issuance date. The interest payments are not exposed to variability (since the entity has already determined the coupon it intends to pay). Therefore, the forward-starting swap is a hedge of the forecasted debt proceeds and the cash flows on the derivative should be classified as financing activities in the statement of cash flows.

If a hedging derivative includes “an other-than-insignificant financing element at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments (that is, the forward points in an at-the-money forward contract),” the borrower classifies all cash flows associated with that derivative instrument as financing activities and the lender generally classifies all cash flows associated with that derivative instrument as investing activities.

7.4.2 Nonhedging Derivatives

While no explicit cash flow category is required for the classification of cash flows arising from nonhedging derivatives, ASC 230 does provide presentation guidance on cash flows pertaining to the following nonhedging derivative instruments:

- *Derivatives with a significant financing element* — If a nonhedging derivative includes “an other-than-insignificant financing element at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments (that is, the forward points in an at-the-money forward contract),” the borrower must classify all cash flows from the derivative instrument as financing activities in accordance with ASC 230-10-45-27. ASC 230 addresses the borrower’s classification of cash flows on a derivative with an other-than-insignificant financing element at inception but does not explicitly address the lender’s classification of cash flows on a derivative with an other-than-insignificant financing element at inception. In a manner consistent with the guidance in ASC 230-10-45-27, it is appropriate for a lender to classify cash flows related to a derivative with an other-than-insignificant financing element at inception as investing activities; however, such classification may not be required in all circumstances.
- *Derivatives acquired or originated for trading purposes* — ASC 230-10-45-19 through 45-21, which address the classification of cash receipts and payments resulting from purchases and sales of securities, loans, and other assets that are acquired specifically for resale, require that those cash flows be classified as operating activities. In accordance with this guidance, a trading entity that enters into derivatives as part of its trading business should classify the cash flows from those derivatives as operating activities (provided that those derivatives do not contain a significant financing element at inception).

An entity should apply the other guidance below on nonhedging derivatives if a nonhedging derivative (1) does not contain a significant financing element at inception and (2) was not acquired or originated for trading purposes.

7.4.3 Other Nonhedging Derivatives

Cash flows pertaining to physically settled derivatives related to the entity's ongoing revenue-producing and cost-generating activities should generally be classified as operating activities in accordance with ASC 230-10-45-16(a) and ASC 230-10-45-17(a). For all other nonhedging derivatives, ASC 230 does not specifically require an entity to classify cash flows as investing activities; thus, an entity can make an accounting policy election to apply either of the following approaches to nonhedging derivatives:

- Classify the cash flows related to all other nonhedging derivatives as investing activities.
- Classify the cash flows related to all other nonhedging derivatives in accordance with the nature of the derivative instrument and how it is used in the context of the entity's business.

When the cash flows associated with nonhedging derivatives are material, an entity should disclose its policy for classifying the cash flows associated with such instruments.

The table below outlines acceptable classifications for nonhedging derivatives in the statement of cash flows. Note that in the examples, none of the derivatives contain a significant financing element at inception. Furthermore, when alternative classifications are acceptable, the entity's accounting policy election regarding the classification of cash flows related to other nonhedging derivatives will dictate the proper classification.

Derivative Example	Classification of the Derivative's Cash Flows
A manufacturing entity enters into a receive-variable, pay-fixed interest rate swap in conjunction with the issuance of a floating-rate debt instrument. The term of the interest-rate swap coincides with the term of the debt, and the variable leg on the swap is the same as the floating-rate index on the debt. The interest-rate swap was entered into to alter the economic interest cost related to the entity's floating-rate debt.	<p>Investing activities or operating activities.</p> <p>Classification as an investing activity is consistent with ASC 230-10-45-27.</p> <p>Classification as an operating activity is consistent with the nature of the derivative instrument and how the derivative instrument is used in the context of the entity's business. The derivative instrument derives its periodic cash flows on the basis of an interest rate underlying and was entered into to alter the entity's interest costs. Cash payments for interest are classified as operating activities in accordance with ASC 230-10-45-17(d).</p>
A financial institution enters into a foreign currency forward contract that requires it to pay U.S. dollars (USD) and receive euros (EUR). The forward contract matures on the same date as the maturity of the principal amount of the institution's EUR-denominated long-term debt. The forward contract was entered into to alter the USD-equivalent amount that must be paid at maturity of the debt.	<p>Investing activities or financing activities.</p> <p>Classification as an investing activity is consistent with ASC 230-10-45-27.</p> <p>Classification as a financing activity is consistent with the nature of the derivative instrument and how the derivative instrument is used in the context of the entity's business. The derivative instrument derives its cash flows on the basis of a currency underlying and was entered into to alter the amount payable upon maturity of the institution's debt. Cash payments made to repay amounts borrowed are classified as financing activities in accordance with ASC 230-10-45-15.</p>
A power generator that uses a gas-fired plant to generate electricity enters into physically settleable forward gas purchase contracts that are within the scope of ASC 815. The gas purchased is used to run the power plant.	<p>Operating activities.</p> <p>Since the derivative is physically settled and the gas purchased is used to operate the power plant, cash flows related to the derivative should be classified as an operating activity. Otherwise, the power generator could potentially reflect a significant amount of its cost-generating activities as investing activities.</p>

(Table continued)

Derivative Example	Classification of the Derivative's Cash Flows
<p>A power generator that uses a gas-fired plant to generate electricity enters into futures contracts on gas to economically hedge its exposure to gas prices. The power generator does not plan to take delivery of the gas.</p>	<p>Investing activities or operating activities.</p> <p>Classification as an investing activity is consistent with ASC 230-10-45-27.</p> <p>Classification as an operating activity is consistent with the nature of the derivative instrument and how the derivative instrument is used in the context of the entity's business. The derivative may be considered part of the ongoing revenue-producing and cost-generating activities of the power generator. Cash receipts and payments related to sales and costs of goods sold are classified as operating activities in accordance with ASC 230-10-45-16 and 45-17.</p> <p>Note that since the derivative will be net settled, the power generator is not required to classify the cash flows as an operating activity.</p>
<p>An Internet advertising agency enters into a one-year futures contract on crude oil. The agency expects that crude oil prices will increase between the trade date and maturity date of the futures contract, resulting in a gain upon settlement. The agency does not plan to take delivery of the crude oil. The futures contract is not held for trading purposes.</p>	<p>Investing activities.</p> <p>Classification as an investing activity is consistent with ASC 230-10-45-27. Such classification is also consistent with the nature of the derivative instrument and how the derivative instrument is used in the context of the entity's business. The crude oil futures contract was entered into for speculative or investment purposes.</p>

7.5 Business Combinations

Cash flows related to the purchases and sales of businesses; property, plant, and equipment; and other productive assets are presented as investing activities in the statement of cash flows. In a business combination, all cash paid to purchase the business is presented as a single line item in the statement of cash flows, net of any cash acquired. That is, changes in the individual assets acquired and liabilities assumed that occur on the acquisition date are no longer reflected as separate line items in the statement of cash flows. After an acquisition, the cash flows of the acquirer and acquiree are combined and presented in a consolidated statement of cash flows.

An entity may also need to consider other financial reporting implications of a business combination depending on the nature and terms of the transaction. For example, any noncash effects of a business combination, such as an acquisition involving noncash consideration (as described in [Example 5-1](#)), must be disclosed in a narrative format or summarized in a schedule.

For additional considerations related to an entity's accounting for a business combination, see Deloitte's [A Roadmap to Accounting for Business Combinations](#).

7.5.1 Presentation of Acquisition-Related Costs

When consummating a business combination, an acquirer frequently incurs acquisition-related costs such as advisory, legal, accounting, valuation, and professional and consulting fees. Except for certain debt and equity issuance costs, ASC 805 requires that an entity expense all such acquisition-related costs as incurred. The costs of issuing debt or equity securities as part of a business combination are recognized in accordance with other applicable accounting literature.

In the deliberations before the issuance of Statement 141(R) (codified in ASC 805), the FASB determined that acquisition-related costs are not considered part of the fair value exchange between the buyer and seller of the business; rather, they are separate transactions in which the buyer pays for services that it receives. Further, the definition of “operating activities” in the ASC master glossary states, in part, that “[c]ash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income.” Because acquisition-related costs accounted for under ASC 805 are expensed and affect net income, these costs should be reflected as operating cash outflows in the statement of cash flows.

7.5.2 Settlement of Acquired Liabilities After a Business Combination

After an acquisition, the acquirer may make payments to settle a liability legally assumed in a business combination. The cash outflow related to the settlement of the liability could be classified as an operating, investing, or financing activity depending on the nature of the payment. The payment should be classified as it would have been in the absence of the business combination. For example:

- If the payment was for inventory purchased on account, it would represent an operating cash outflow.
- If the payment was for property, plant, and equipment that was purchased on account and was paid within three months of its original purchase date, it would represent an investing cash outflow.
- If the payment was in connection with a debt obligation legally assumed in an acquisition that remained outstanding after the acquisition, it would represent a financing cash outflow. However, as described below, if the payment is related to debt extinguished in conjunction with a business combination, the entity must consider certain facts and circumstances of the business combination to determine the appropriate presentation in its statement of cash flows.

7.5.3 Debt in a Business Combination

An acquirer may sometimes use cash to settle debt of the acquiree at or close to the acquisition date. In such cases, it is necessary to determine whether the cash distributed should be reported as consideration transferred to effect the acquisition or as cash paid to settle the debt assumed in the acquisition. While cash paid on the acquisition date to settle debt of the acquiree is generally reported as consideration transferred, cash paid close to the acquisition date to settle debt of the acquiree might also be reported as consideration transferred if the acquirer is deemed not to have assumed the risks inherent in the debt (e.g., when the separation of the payment from the acquisition date is more administrative).

The classification in the statement of cash flows of cash paid to settle the acquiree’s debt in a business combination should be consistent with the acquirer’s treatment of the debt in acquisition accounting (i.e., whether the debt was treated as a liability assumed in acquisition accounting). If the acquirer concludes that it assumes the acquiree’s debt as part of the business combination, the acquirer will generally present the extinguishment as a financing activity (in a manner consistent with how it would present the repayment of a debt obligation outside of a business combination). Conversely, if the acquirer concludes that it does not assume the acquiree’s debt as part of the business combination that was subsequently extinguished, the acquirer will generally present the extinguishment as an investing activity (in a manner consistent with how it would present cash consideration paid in a business combination).

[Example 7-6 has been deleted.]

Example 7-6A**Acquirer Does Not Assume Acquiree's Debt**

Company A acquires Company B in a business combination. Before the acquisition, B had \$1 million in outstanding debt owed to a third-party bank. Company A pays the seller \$5 million in cash and repays the \$1 million debt upon the closing of the business combination. Company A concludes that it did not assume B's debt (i.e., that it repaid the debt on B's behalf). As of the acquisition date, B's net assets recognized in accordance with ASC 805 are \$4 million. Company A calculates the goodwill resulting from the acquisition of B as follows:

Cash consideration paid to the seller	\$ 5,000,000
Repayment of B's debt	<u>1,000,000</u>
Total consideration transferred to acquire B	6,000,000
Less: B's net assets under ASC 805	<u>(4,000,000)</u>
Goodwill	<u>\$ 2,000,000</u>

Because A did not assume B's debt, the total consideration transferred is \$6 million in cash. Therefore, A should present the \$6 million as an investing outflow in its statement of cash flows.

Example 7-6B**Acquirer Assumes Acquiree's Debt**

Assume the same facts as in Example 7-6A, except that Company A concludes that it assumed Company B's debt. As a result, B's net assets recognized in accordance with ASC 805 are \$3 million (i.e., \$4 million less \$1 million in debt). Company A calculates the goodwill resulting from the acquisition of B as follows:

Consideration transferred to acquire B	\$ 5,000,000
B's net assets under ASC 805, excluding debt assumed	<u>4,000,000</u>
Add: Liability assumed for B's debt	<u>(1,000,000)</u>
Less: B's total net assets under ASC 805	<u>(3,000,000)</u>
Goodwill	<u>\$ 2,000,000</u>

Because A assumed B's debt, the consideration transferred is \$5 million in cash paid to the seller, and the \$1 million to repay B's debt is a liability assumed in the acquisition accounting. Therefore, A should present \$5 million as an investing outflow and \$1 million as a financing outflow in its statement of cash flows.

[Example 7-7 has been deleted.]

7.5.4 Contingent Consideration in a Business Combination

ASC 805 requires the acquirer to recognize the acquisition-date fair value of the contingent consideration arrangement as part of the consideration transferred in exchange for the acquiree. The contingent consideration arrangement is classified either as a liability or as equity in accordance with applicable U.S. GAAP.

7.5.4.1 *Contingent Consideration Classified as a Liability*

If the acquiring entity determines that the contingent consideration arrangement should be classified as a liability, the initial fair value of the contingent consideration as of the acquisition date should be reflected as a **noncash** investing activity. In accordance with ASC 230-10-50-3, this arrangement should be either disclosed narratively or summarized in a schedule because no cash consideration is transferred on the acquisition date. It should not be reflected in investing activities. In subsequent periods, the contingent consideration liability must be remeasured at fair value as of each reporting date until the contingency is resolved, with the changes recognized as an expense in the determination of earnings (unless the change is the result of a measurement-period adjustment or the arrangement is a hedging instrument for which ASC 815 requires changes to be recognized in other comprehensive income). Because the subsequent fair value adjustment enters into the determination of the acquiring entity's net income and is a noncash item, it should be reflected as a reconciling item between net income and cash flows from operating activities in the statement of cash flows.

If the contingent consideration is satisfied in either cash or cash equivalents upon resolution of the contingency, the classification of payments made to settle the contingent consideration liability should be determined on the basis of when such payments are made in relation to the date of the business combination. Essentially, classification of the payments depends on whether they are made soon after the acquisition in a business combination transaction. While ASC 230 does not define the term "soon after," we generally believe that this term would apply to payments made within three months or less of the acquisition date. This view is also consistent with paragraph BC16 of ASU 2016-15, which states that "some Task Force members believe that a payment for contingent consideration that was made soon after a business combination is an extension of the cash paid for the business acquisition (an investing activity), if that payment for contingent consideration was made within a relatively short period of time after the acquisition date (for example, three months or less)." Therefore, because a payment made on or soon after the business combination date (to settle the liability related to contingent consideration) is viewed as an extension of the business combination, such payments made soon after the date of the business combination are presented as investing activities in the acquirer's statement of cash flows in accordance with ASC 230-10-45-13(d).

Conversely, contingent consideration payments that are not made on the acquisition date or soon after the business combination are not viewed as an extension of the business combination. Therefore, such payments should be separated and presented as:

- *Financing cash flows* — The cash paid to settle the contingent consideration liability recognized at fair value as of the acquisition date (including measurement-period adjustments), less payments made soon after the business combination date, should be reflected as a cash outflow for financing activities in accordance with ASC 230-10-45-15(f).
- *Operating cash flows* — The cash payments not made soon after the business combination date that exceed those classified as financing activities should be reflected as a cash outflow for operating activities in accordance with ASC 230-10-45-17(ee).

As indicated in paragraph BC14 of ASU 2016-15, the separation of contingent consideration payments not made soon after the business combination date is consistent with the approach most entities used before the ASU was issued. Paragraph BC14 further notes that this approach is the one that is most closely aligned with certain principles in ASC 230.

These principles include:

- The cash paid to settle the contingent consideration liability recognized at fair value as of the acquisition date (including measurement-period adjustments) should be reflected as a cash outflow for financing activities in the statement of cash flows. Effectively, the acquiring entity financed the acquisition and the cash outflow therefore represents a subsequent payment of principal on the borrowing and should be reflected in accordance with ASC 230-10-45-15(f).
- The remaining portion of the amount received/paid (i.e., the changes in fair value of the contingent consideration liability after the acquisition date) should be reflected as a cash inflow/outflow from operating activities because the fair value adjustments were recognized in earnings. If the amount paid to settle the contingent consideration liability is less than the amount recorded on the acquisition date (i.e., the fair value of the contingent consideration decreased), the entity would only reflect the portion of the liability that was paid as a cash outflow for financing activities. The difference between the liability and the amount paid is a fair value adjustment. This adjustment enters into the determination of the acquiring entity's net income and is a noncash item, so it should be reflected as a reconciling item between net income and cash flows from operating activities in the consolidated statement of cash flows.

Example 7-8

On December 1, 20X2, Company A (a calendar-year-end private company) acquires 100 percent of Company B for \$1 million. The purchase agreement includes a contingent consideration arrangement under which A agrees to pay additional cash consideration if the earnings of B (which will be operated as a separate subsidiary of A) exceed a specified target for the year ended December 31, 20X3. Company A classifies the contingent consideration arrangement as a liability and records the contingent consideration liability at its acquisition-date fair value amount, provisionally determined to be \$500,000.

On April 15, 20X3, A finalizes its valuation of the contingent consideration liability. Therefore, A estimates the acquisition-date fair value of the contingent consideration liability to be \$600,000 and records a measurement-period adjustment for \$100,000 (the measurement-period adjustment related to facts and circumstances that existed as of the acquisition date), with an offsetting adjustment to goodwill.

Company B achieves the performance target for the year ended December 31, 20X3; accordingly, A determines that it must pay \$750,000 to B's former owners to settle the contingent consideration arrangement. For the year ended December 31, 20X3, A recognizes \$150,000 (\$750,000 – \$600,000) in earnings to reflect the subsequent remeasurement of the contingent consideration liability to fair value. On January 31, 20X4, A settles the obligation.

No payments to settle the liability for contingent consideration were made soon after the business acquisition date.

Company A would present the following amounts in its statement of cash flows for the years ended:

- *December 31, 20X2* — The provisional accrual of \$500,000 would be reflected as a **noncash** investing activity and would be either disclosed narratively or summarized in a schedule.
- *December 31, 20X3* — The adjustment to the provisional accrual of \$100,000 would be reflected as a **noncash** investing activity and would be either disclosed narratively or summarized in a schedule. The subsequent remeasurement adjustment to the contingent consideration liability of \$150,000 would be reflected as a reconciling item between net income and cash flows from operating activities.
- *December 31, 20X4* — Of the \$750,000 paid, \$600,000 represents the amount to settle the contingent consideration liability recognized at fair value as of the acquisition date (including measurement-period adjustments) and should be reflected as a cash outflow for financing activities. The remaining portion of the \$750,000 paid (i.e., the \$150,000 change in fair value of the contingent consideration liability after the acquisition date) should be reflected as a cash outflow for operating activities because the fair value adjustments were recognized in earnings.

Example 7-9

Assume the same facts as in Example 7-8 except that when B achieves the performance target for the year ended December 31, 20X3, A determines that it only needs to pay \$550,000 to B's former owners to settle the contingent consideration arrangement. For the year ended December 31, 20X3, A recognizes a credit of \$50,000 (\$550,000 – \$600,000) in earnings to reflect the subsequent remeasurement of the contingent consideration liability to fair value.

Company A would present the same amounts as those in Example 7-8 in its statement of cash flows for the year ended December 31, 20X2. Company A would then present the following amounts for the years ended:

- *December 31, 20X3* — The adjustment to the provisional accrual of \$100,000 would be reflected as a **noncash** investing activity and would be either disclosed narratively or summarized in a schedule. The subsequent remeasurement adjustment to the contingent consideration liability of \$50,000 would be reflected as a reconciling item between net income and cash flows from operating activities.
- *December 31, 20X4* — The entire amount of the \$550,000 paid represents the amount to settle the contingent consideration liability recognized at fair value as of the acquisition date (including measurement-period adjustments) and should be reflected as a cash outflow for financing activities.

7.5.4.2 Contingent Consideration Classified as Equity

If the acquiring entity determines that the contingent consideration arrangement should be classified as equity, it is not required to remeasure the amount recorded as of the acquisition date at fair value as of each reporting period after the acquisition date. The initial recognition of the contingent consideration arrangement as of the acquisition date (including measurement-period adjustments), as well as the issuance of shares to settle the contingent consideration arrangement on the date the contingency is resolved, should be reflected as noncash investing and financing activities and, in accordance with ASC 230-10-50-3, should be either disclosed narratively or summarized in a schedule.

7.5.5 Acquired IPR&D Assets With No Alternative Future Use

In accordance with ASC 730, IPR&D assets acquired in an asset acquisition rather than in a business combination should be expensed as of the acquisition date unless such assets have an alternative future use, in which case they should be capitalized. All IPR&D assets acquired in a business combination should initially be capitalized regardless of whether they have an alternative future use. For more information, see Chapter 4 of Deloitte's *Life Sciences: Accounting and Financial Reporting Update — Including Interpretive Guidance*.

We have observed diversity in practice related to how cash payments for IPR&D assets acquired in an asset acquisition are reported in the statement of cash flows when such assets have no alternative future use. While some entities classify the cash payments in operating activities, other entities classify them in investing activities. Given the lack of authoritative guidance on this matter and the diversity in practice, we believe that it is acceptable for an entity to present cash payments related to the IPR&D assets acquired in an asset acquisition that have no alternative use as either operating or investing activities. This election is an accounting policy matter that an entity should consistently apply to similar arrangements and disclose if material.

Considerations related to the classification as operating or investing activities include:

- *Operating activities* — Classification in operating activities of cash outflows for IPR&D assets acquired in an asset acquisition that do not have an alternative future use is supported by the following:
 - ASC 230 does not specifically define such cash outflows as investing or financing activities.
 - Since such cash outflows are immediately expensed, they represent “the cash effects of transactions and other events that enter into the determination of net income” in a manner consistent with the definition of operating activities in the ASC master glossary.
- *Investing activities* — Classification in investing activities of cash outflows for IPR&D assets acquired in an asset acquisition that do not have an alternative future use is supported by the following Q&A in paragraph 5.12 of the AICPA Accounting and Valuation Guide *Assets Acquired to Be Used in Research and Development Activities*:

Question 1: How should an acquiring entity classify in its statement of cash flows an R&D charge associated with the costs of IPR&D projects acquired as part of an asset acquisition that have no alternative future use?

Answer: Best practices suggest that an acquiring entity should report its cash acquisition of assets to be used in R&D activities as an investing outflow in its statement of cash flows. In this regard, an acquiring entity should treat assets acquired to be used in R&D activities similar to how it reports other acquired assets in the statement of cash flows. Although acquired IPR&D may lack an alternative future use and, therefore, would be expensed immediately, it is still an asset for cash flow statement purposes.

When arriving at cash flows from operating activities under the indirect method of reporting cash flows, best practices suggest that an acquiring entity should add back to net income the costs of assets acquired to be used in R&D activities that are charged to expense. That adjustment is necessary to eliminate from operating cash flows those cash outflows of assets acquired to be used in R&D activities that are reflected in investing activities.

In addition, if the cash outflows are treated as investing activities, the cash flow reporting of IPR&D assets acquired in a business combination would be aligned with that of IPR&D assets acquired in an asset acquisition.

7.6 Leases

[ASU 2016-02](#) (codified in ASC 842), which revised the leasing guidance in U.S. GAAP, became effective for public business entities, as well as certain NFPs and employee benefit plans, for fiscal years, and interim periods within those fiscal years, beginning after December 15, 2018. For all other entities, ASU 2016-02 will become effective for fiscal years beginning after December 15, 2019, and interim periods within fiscal years beginning after December 15, 2020.

An entity adopts ASC 842 by using a modified retrospective approach. Under this approach, the standard is effectively implemented either (1) as of the earliest period presented and through the comparative periods in the entity's financial statements or (2) as of the effective date of ASC 842, with a cumulative-effect adjustment to equity. Upon transition to ASC 842, lessees will bring most leases onto the balance sheet and will disclose them as noncash investing and financing activities. For a more detailed understanding of the requirements of ASC 842, see Deloitte's [A Roadmap to Applying the New Leasing Standard](#).

7.6.1 Initial and Subsequent Recognition of Leases

Before the Adoption of ASC 842

7.6.1.1 Capital Leases

In accordance with ASC 840, for a capital lease, a lessee recognizes a lease asset and lease liability at lease commencement. Accordingly, the lessee would account for the capital lease transaction in its statement of cash flows at lease commencement as a noncash investing and financing transaction, as discussed in ASC 230-10-50-4, which states:

Examples of noncash investing and financing transactions are converting debt to equity; acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; **obtaining an asset by entering into a capital lease**; obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities. [Emphasis added]

In other words, the statement of cash flows would not be affected by the noncash nature of a situation in which an entity enters into a capital lease. Instead, the entity would only provide noncash investing and financing disclosures (see [Chapter 5](#) for more information). Subsequently, when the lessee makes principal payments under a capital lease, the lessee should reflect the principal payment as a cash outflow from a financing activity in the statement of cash flows. The portion of capital lease payment that reflects the interest payment should be classified as a cash outflow from an operating activity in the statement of cash flows.

7.6.1.2 Operating Leases

Under ASC 840, there is no balance sheet recognition at lease commencement for operating leases. Consequently, there is no accounting for the lessee's operating lease transaction at lease commencement in the lessee's statement of cash flows. Subsequently, lease payments are presented as cash outflows from operating activities in the lessee's statement of cash flows in a manner consistent with how the lease expense is recognized in the lessee's income statement.

After the Adoption of ASC 842

7.6.1.3 Lessee Presentation

In accordance with ASC 842, upon entering into operating **and** finance leases, a lessee records on its balance sheet a right-of-use (ROU) asset and lease liability as of lease commencement. Accordingly, upon initial recognition of an ROU asset and lease liability at lease commencement, the lessee would disclose the recognition of the ROU asset and lease liability as a noncash activity. Such presentation is consistent with ASC 230-10-50-4, which was amended in ASC 842 to remove the reference to capital leases and therefore make the guidance applicable to all leases. ASC 230-10-50-4, as amended, states:

Examples of noncash investing and financing transactions are converting debt to equity; acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; **obtaining a right-of-use asset in exchange for a lease liability**; obtaining a beneficial interest as consideration for transferring financial assets (excluding cash), including the transferor's trade receivables, in a securitization transaction; obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities. [Emphasis added]

ASC 842-20

45-5 In the statement of cash flows, a lessee shall classify all of the following:

- a. Repayments of the principal portion of the lease liability arising from finance leases within financing activities
- b. Interest on the lease liability arising from finance leases in accordance with the requirements relating to interest paid in Topic 230 on cash flows
- c. Payments arising from operating leases within operating activities, except to the extent that those payments represent costs to bring another asset to the condition and location necessary for its intended use, which should be classified within investing activities
- d. Variable lease payments and short-term lease payments not included in the lease liability within operating activities.

In accordance with ASC 842-20-45-5(a) and (b), for lease payments made to repay a finance lease liability, the lessee should present, in its statement of cash flows, (1) the principal portion of the payments as cash outflows from financing activities and (2) the interest portion of the payments as cash outflows from operating activities. Presentation of cash outflows in the statement of cash flows for finance leases in accordance with ASC 842 is (1) comparable to how principal and interest payments are presented for other financial liabilities⁴ and (2) consistent with how cash outflows for capital leases under ASC 840 are presented.

For operating leases under ASC 842, subsequent repayments of lease liabilities should be classified in operating activities in accordance with ASC 842-20-45-5(c) and (d). Further, a lessee should present, as cash outflows for operating activities, lease payments made that were not included in the lease liability on the lessee's balance sheet. For example, lease payments not included in the lessee's lease liability include (1) variable lease payments and (2) lease payments for leases in which the related lease terms are one year or less (i.e., short-term leases) and for which the lessee elects as a policy to treat such leases as executory contracts in a manner similar to operating leases under ASC 840. However, ASC 842-20-45-5(c) notes that there is an exception to presentation as operating activities when payments are made for costs of bringing another asset to the condition and location necessary for its intended use, in which case those payments should be classified as investing outflows.

Paragraph BC271 of ASU 2016-02 explains the Board's rationale behind its decision that cash flows from operating leases and variable lease payments that are not included in the lease liability should be classified as operating activities:

In addition, the Board decided that cash flows from operating leases and variable lease payments that are not included in the lease liability should be classified as operating activities because the corresponding lease costs, if recognized in the statement of comprehensive income, will be presented in income from continuing operations. The previous sentence notwithstanding, Topic 842 states that lease payments capitalized as part of the cost of another asset (for example, inventory or a piece of property, plant, or equipment) should be classified in the same manner as other payments for that asset.

⁴ See paragraph BC270 of ASU 2016-02.

The example below illustrates the financial statement presentation for a finance lease and operating lease.

Example 7-9A

A lessee enters into a three-year lease and agrees to make the following annual payments at the end of each year: \$10,000 in year 1, \$15,000 in year 2, and \$20,000 in year 3. The initial measurement of the ROU asset and liability to make lease payments is \$38,000 at a discount rate of 8 percent.

This table highlights the differences in accounting for the lease as a finance lease and an operating lease:

Year	Both Models	Finance Lease				Operating Lease		
	Lease Liability	Interest Expense <X>	Amortization Expense <Y>	Total Lease Expense <X + Y>	ROU Asset	Lease Expense <Z>	Reduction in ROU Asset <Z - X>	ROU Asset
0	\$ 38,000				\$ 38,000			\$ 38,000
1	31,038	\$ 3,038	\$ 12,666	\$ 15,704	25,334	\$ 15,000	\$ 11,962	26,038
2	18,520	2,481	12,667	15,148	12,667	15,000	12,519	13,519
3	—	<u>1,481</u>	<u>12,667</u>	<u>14,148</u>	—	<u>15,000</u>	<u>13,519</u>	—
Total		<u>\$ 7,000</u>	<u>\$ 38,000</u>	<u>\$ 45,000</u>		<u>\$ 45,000</u>	<u>\$ 38,000</u>	

For the finance lease model, the interest expense calculated is a function of the lease liability balance and the discount rate (i.e., \$38,000 multiplied by 8 percent in year 1). For the finance lease, the lessee includes amortization expense as a noncash add-back to the operating activities section of the statement of cash flows, which is calculated on a straight-line basis (\$38,000 divided by 3). The principal portion of the cash payment is reflected in the financing section as principal paid. There is no need to separately add interest expense since it is already included in net income in the operating section. The supplemental section includes interest paid.

Income Statement	Year Ended 12/31/2011	Balance Sheet	12/31/2010	12/31/2011
	Revenues		\$ 203,283	Assets
Expenses		Cash	\$ 13,463	\$ 146,520
Operating expense	63,522	ROU asset	<u>38,000</u>	<u>25,334</u>
Amortization expense	12,666	Total assets	51,463	171,854
Total expenses	<u>76,188</u>	Liabilities		
Total operating income	127,095	Current liabilities	2,336	5,632
Interest expense	<u>3,038</u>	Finance lease liability*	<u>38,000</u>	<u>31,038</u>
Net income	\$ 124,057	Total liabilities	40,336	36,670
		Equity	\$ 11,127	\$ 135,184

* For illustrative purposes, this amount has not been separated into current and noncurrent portions.

Example 7-9A (continued)

Equity	As of and Year Ended 12/31/2011	Cash Flow Statement	Year Ended 12/31/2011
Beginning	\$ 11,127	Net income	\$ 124,057
Income	<u>124,057</u>	Amortization expense	12,666
Ending	\$ 135,184	Change in operating liabilities	<u>3,296</u>
		Operating	140,019
		Investing	—
		Principal paid	<u>(6,962)</u>
		Financing	(6,962)
		Change in cash flows	133,057
		Beginning cash	<u>13,463</u>
		Ending cash	146,520
		Interest paid	\$ 3,038

For the operating lease model, the lessee may include noncash lease expense as a noncash add-back to the operating section of the statement of cash flows (\$15,000 – \$3,038 = \$11,962); this reflects the portion of the lease expense that amortized the ROU asset. While this presentation reflects a best practice, there may be other acceptable methods of presentation for the change in ROU assets; however, it would be inappropriate to present the change in ROU assets in amortization expense. Entities contemplating a different method of presentation are encouraged to discuss the method with their accounting advisers. The cash payment is reflected in the operating section as a change in operating liabilities. Because interest expense is not included in operating leases, there are no separate disclosures for this activity.

Income Statement	Year Ended 12/31/2011	Balance Sheet	12/31/2010	12/31/2011
Revenues	\$ 203,283	Assets		
Expenses		Cash	\$ 13,463	\$ 146,520
Operating expense	63,522	ROU asset	<u>38,000</u>	<u>26,038</u>
Lease expense	<u>15,000</u>	Total assets	51,463	171,558
Total expenses	78,522	Liabilities		
Total operating income	124,761	Current liabilities	2,336	5,632
Interest expense	<u>—</u>	Operating lease liability*	<u>38,000</u>	<u>31,038</u>
Net income	\$ 124,761	Total liabilities	40,336	36,670
		Equity	\$ 11,127	\$ 135,888

* For illustrative purposes, this amount has not been separated into current and noncurrent portions.

Example 7-9A (continued)

Equity	As of and Year Ended 12/31/2011	Cash Flow Statement	Year Ended 12/31/2011
Beginning	\$ 11,127	Net income	\$ 124,761
Income	<u>124,761</u>	Noncash lease expense	11,962
Ending	\$ 135,888	Change in operating liabilities*	<u>(3,666)</u>
		Operating	133,057
		Investing	—
		Principal paid	<u>—</u>
		Financing	—
		Change in cash flows	133,057
		Beginning cash	<u>13,463</u>
		Ending cash	\$ 146,520
		Interest paid	—

* The change in operating liabilities in this case is derived from the change in total liabilities. In this example, when the lease is an operating lease, all liabilities are operating liabilities. By contrast, when the lease is a finance lease, the lease liability is not treated as an operating liability.

In addition, ASC 842-20-50-1 states that the “objective of the disclosure requirements is to enable users of financial statements to assess the amount, timing, and uncertainty of cash flows arising from leases.” As a result, entities are required to provide various other cash and noncash disclosures for lease transactions under ASC 842 to supplement the amounts recorded in the financial statements (in addition to the disclosures they are required to provide under ASC 230). Such disclosures include the following:

ASC 842-20

50-4 For each period presented in the financial statements, a lessee shall disclose the following amounts relating to a lessee’s total lease cost, which includes both amounts recognized in profit or loss during the period and any amounts capitalized as part of the cost of another asset in accordance with other Topics, and the cash flows arising from lease transactions: . . .

- g. Amounts segregated between those for finance and operating leases for the following items:
 1. Cash paid for amounts included in the measurement of lease liabilities, segregated between operating and financing cash flows
 2. Supplemental noncash information on lease liabilities arising from obtaining right-of-use assets . . .

While ASC 230 does not explicitly require entities to provide these disclosures in the statement of cash flows, entities should ensure that they comply with the requirements in ASC 842-20-50 related to any incremental cash and noncash disclosures that must be included in the footnotes to the financial statements.

7.6.1.4 Lessor Presentation

ASC 842-30

Sales-Type and Direct Financing Leases

45-5 In the statement of cash flows, a lessor shall classify cash receipts from leases within operating activities. However, if the lessor is within the scope of Topic 942 on financial services — depository and lending, it shall follow the guidance in paragraph 942-230-45-4 for the presentation of principal payments received from leases.

Operating Leases

45-7 In the statement of cash flows, a lessor shall classify cash receipts from leases within operating activities.

With the exception of depository and lending lessors within the scope of ASC 942,⁵ a lessor's classification of cash receipts from leases should be classified as cash inflows from operating activities (regardless of whether the lease is classified as a sales-type, direct financing, or operating lease) because, as noted in paragraph BC335 of ASU 2016-02, "[t]he Board decided that in the statement of cash flows, a lessor should classify lease payments received on all leases within operating activities because leasing is generally part of a lessor's revenue-generating activities."

7.6.2 Lease Incentives

A lessor may make payments to incentivize a lessee to enter into a lease agreement. For example, a lessor may provide a lessee with a tenant improvement allowance to fund the lessee's expenditures related to improving the leased space primarily for the lessee's benefit. The sections below discuss how a lessee would classify payments received for such cash incentives paid by a lessor.

Before the Adoption of ASC 842

When a lessee makes payments for leasehold improvements in an operating lease, the cash outflow should be presented as an investing activity in the statement of cash flows. When leasehold improvements made by a lessee are reimbursed by a landlord (i.e., the lessor pays the lessee an incentive, which in this case is related to the lessee's leasehold improvements), the lessee should separately present the cash inflow from the lessor as an operating activity in the lessee's statement of cash flows. The SEC staff supports this view, as discussed in its February 7, 2005, [letter](#) to the Center for Public Company Audit Firms, which states, in part:

Landlord/Tenant Incentives — The staff believes that: (a) leasehold improvements made by a lessee that are funded by landlord incentives or allowances under an operating lease should be recorded by the lessee as leasehold improvement assets and amortized over a term consistent with the guidance in item 1 above; (b) the incentives should be recorded as deferred rent and amortized as reductions to lease expense over the lease term in accordance with paragraph 15 of SFAS 13 and the response to Question 2 of FASB Technical Bulletin 88-1 ("FTB 88-1"), Issues Relating to Accounting for Leases, and therefore, the staff believes it is inappropriate to net the deferred rent against the leasehold improvements; and (c) **a registrant's statement of cash flows should reflect cash received from the lessor that is accounted for as a lease incentive within operating activities and the acquisition of leasehold improvements for cash within investing activities.** The staff recognizes that evaluating when improvements should be recorded as assets of the lessor or assets of the lessee may require significant judgment and factors in making that evaluation are not the subject of this letter. [Emphasis added]

⁵ To resolve a stakeholder-identified conflict between the example in ASC 942-230-55-2 and the guidance in ASC 842-30-45-5, the FASB issued ASU 2019-01, which clarifies that depository and lending lessors within the scope of ASC 942 would be required to classify principal payments received from sales-type and direct financing leases within investing activities.

After the Adoption of ASC 842

ASC 842 indicates that lease incentives paid or payable to the lessee at commencement should be accounted for as a reduction to the fixed payments in the initial measurement of the ROU asset. As a result, the receipt of a landlord incentive affects the initial recognition of the ROU asset and lease liability, which is disclosed as a noncash activity, as noted in [Section 7.6.1.3](#). However, we believe that, because the receipt of the landlord incentive effectively reduces the lease payments made in future periods, the receipt of the cash incentive should be classified in a manner consistent with the related lease payment. In other words, a cash incentive received from a landlord in connection with an operating lease should be classified in the lessee's statement of cash flows as an inflow from operating activities in a manner consistent with the cash flow presentation of an operating lease payment; on the other hand, an incentive received in connection with a finance lease should be classified as an inflow from financing activities.

7.6.3 Sale-Leaseback Transactions

Under both ASC 840 and ASC 842, the presentation of cash inflows resulting from a sale-leaseback transaction depends on whether the seller-lessee achieves sale accounting. If the transaction satisfies the conditions for sale accounting, the cash inflows resulting from the transaction are presented as an investing activity in the statement of cash flows in a manner consistent with the underlying balance sheet classification. If the transaction does not satisfy the conditions for sale accounting, the cash inflows resulting from the transaction should be classified as a financing activity in the statement of cash flows.

7.6.4 Termination Costs Received From the Lessor

In certain instances, a lessor might want to exit an operating lease before the end of the lease term. Motivating factors for an early lease termination may include an alternative use for the asset that is more economically beneficial, a more profitable lease agreement with a different lessee, or an intent to sell the leased asset. To facilitate an early lease termination, a lessor often will need to compensate a lessee to exit a lease early.

Under both ASC 840 and ASC 842, we view cash received from a lessor to early terminate a lease as similar to a cash incentive, which lessees generally receive from lessors at the onset of lease arrangements. Therefore, we believe that the timing of when a lessee receives cash from the lessor should not affect how the cash receipt is presented in the lessee's statement of cash flows. As a result, as with the presentation of lease incentives (as discussed further in [Section 7.6.2](#)), the receipt of a termination payment should be presented in a manner consistent with the related lease payment. In other words, an early termination payment received from a landlord in connection with either an operating or a finance lease should be classified in the lessee's statement of cash flows as an inflow from operating or financing activities, respectively.

7.6.5 Payments for Land-Use Rights

In some countries, such as China, most, if not all, land is government-owned, and government-imposed restrictions are placed on the transfer of legal title to real property. Rather than permitting titles of real property to be transferred, governments in such countries may grant land-use rights under which entities can use the property for a specified period (i.e., 50 years), with renewal options for similar terms. Such entities typically would be required to make an up-front payment in full for the right to use the land for the stated term and generally would not have the right to purchase the land at the end of the term.

There is no specific guidance addressing the classification of land-use rights, including up-front payments for such rights, in the statement of cash flows.

Before the Adoption of ASC 842

Under ASC 840, there are currently two acceptable alternatives that entities have applied in practice when classifying payments for land-use rights. The first of these alternatives is to classify the payments as cash outflows in operating activities because the arrangement either is or is akin to an operating lease in accordance with ASC 840-10. This view is based on the facts that real property is the sole item being leased, title to the land is not transferred to the entity, and the entity does not have an option to purchase the property. Entities that classify payments for land-use rights within operating activities believe that the payments, in substance, represent prepaid rent related to an operating lease.

The second of these alternatives is to classify the payments as cash outflows for investing activities on the basis of the notion that the purpose of purchasing land-use rights is to obtain the right to construct buildings or other real property on that land, and payments to construct real property are classified as investing activities in accordance with ASC 230-10-45-13. Entities that classify payments for land-use rights within investing activities view both the land-use rights payment and payments to construct the real property on the land as part of their overall capital expenditure initiatives. Entities that enter into agreements with more extensive terms also believe that, although title to the underlying land is never transferred, the terms are economically similar to those in which the title to the land is acquired, in part because of the significant period of time afforded by the land-use right.

After the Adoption of ASC 842

The classification of payments for land-use rights depends on whether the agreement is or contains a lease in accordance with ASC 842. We believe that if the agreement meets the definition of a lease, the associated payments should be classified in a manner consistent with the guidance on classification of other lease payments (see [Section 7.6.1](#)).

If the agreement does not meet the definition of a lease, entities should consider other applicable GAAP in determining the appropriate cash flow presentation. In such cases, classification should be determined on the basis of the nature of the underlying cash flow in accordance with the principles in ASC 230. For example, if an entity were to conclude that the payment is capitalizable and meets the definition of an intangible asset under ASC 350, classification as an investing outflow may be appropriate.



Connecting the Dots

Because (1) ownership of the land is not generally transferred in these arrangements (rather, a right of use is granted for a period) and (2) land is an asset that is within the scope of ASC 840 and ASC 842, some believe that entities should evaluate land-use rights to determine whether they are leases. While views differed on whether, under ASC 840, a land-use right is akin to an operating lease or a right to construct buildings or other real property on that land, we believe that, under ASC 842, the parties to a land-use arrangement should assess whether the contract is or contains a lease before considering other applicable GAAP.

7.7 Deferred Costs

ASC 230 does not explicitly address the presentation of deferred costs (i.e., incurred costs that are deferred on the balance sheet). However, when determining the appropriate presentation in the statement of cash flows, an entity should consider the underlying principle described in ASC 230-10-10-1, which states that the “primary objective of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an entity during a period.” Accordingly, the cash flow presentation should generally be in line with the balance sheet treatment. That is, cash outflows related to current assets or inventory that are recognized as a period expense in an entity’s income statement should generally be classified as an operating activity in the statement of cash flows. Cash outflows related to noncurrent productive assets that are capitalized in an entity’s balance sheet should generally be classified as an investing activity in the statement of cash flows.

Example 7-10

Company E is a provider of software services to the health care industry. Recently, E has developed new software to market to new and existing customers. In accordance with ASC 985-20, E capitalizes the costs of developing the new software and therefore classifies the software development costs as an investing activity in its statement of cash flows. The software development costs are costs of developing a productive asset for E.

In this example, the software development costs paid by E are similar to construction costs paid by a manufacturing company to construct a manufacturing facility. That is, E’s payments of costs incurred to develop new software create an asset that is used to generate future revenue in a manner similar to how a manufacturing facility generates future revenue for a manufacturer. In both cases, the cash outflows for costs of generating future revenue are presented as investing activities in the statement of cash flows.

See [Section 7.12](#) for discussion of deferred costs associated with cloud computing arrangements (CCAs).

7.8 Government Grants

Government grants are a form of government assistance that may be granted to public business entities or private companies to encourage those entities to fulfill certain objectives (e.g., providing a financial grant to an entity to fund cancer research). Generally, a recipient of a government grant is not expected to repay the grant provided that the recipient complies with the grant’s conditions.

Not all government assistance is provided to a recipient in the form of a cash payment. For example, a government grant could be in the form of tax credits. In these situations, an entity must determine whether the tax credits are refundable.

Refundable tax credits (e.g., qualifying research and development (R&D) credits in certain countries and state jurisdictions and alternative fuel tax credits for U.S. federal income tax) do not depend on an entity’s ongoing tax status or tax position, allowing an entity to receive a refund despite being in a taxable loss position. Consequently, the refundable tax credits are similar to government grants and are generally accounted for similarly. This section discusses such tax credits as well as other government grants. For more information on the accounting for refundable tax credits, see [Section 2.04 of Deloitte’s *A Roadmap to Accounting for Income Taxes*](#).

Tax credits whose realization ultimately depends on taxable income (e.g., investment tax credits and R&D) are not refundable. Such tax credits are recognized as a reduction of income tax, should be accounted for in accordance with ASC 740, and are not discussed in this section. Entities are encouraged to consult with their accounting advisers when it is not clear whether tax credits are refundable.

7.8.1 Expenditures Incurred Before Receipt of a Grant

When an entity pays for capital expenditures or operating expenses before the reimbursement of government grant monies, it should present the receipt of the government grant in the statement of cash flows in a manner consistent with the presentation of the related cash outflow (as determined under ASC 230-10-45). For example, a government grant that is intended to reimburse an entity for qualifying operating expenses would be presented in the statement of cash flows as an operating activity if the grant was received after the operating expenses were incurred.

Example 7-11

Entity C is entitled to receive \$100 million in tax credits upon completing a new manufacturing facility and obtaining a certificate of occupancy from the local authority. Because C does not need to incur a tax liability to collect the tax credits, the tax credits are refundable and are not within the scope of ASC 740.

On December 31, 20X1, C starts the construction of the facility and presents the capital expenditures as an investing activity in its statement of cash flows. On December 31, 20X2, C completes the manufacturing facility and pays the remaining total construction costs. On January 1, 20X3, C obtains the certificate of occupancy and receives the \$100 million in tax credits.

In this example, because the construction costs are classified as an investing activity in C's statement of cash flows and the payments are made before the receipt of the grant, C would present the grant monies as an investing activity in its statement of cash flows for 20X3.

Example 7-12

Entity P is awarded a government grant to receive up to \$50 million of aggregate funding for certain R&D activities. The intent of the government grant is for P to perform R&D activities to achieve the grant's stated objectives.

Entity P records R&D expenses as period expenses and classifies the cash outflows for the R&D expenses as an operating activity in its statement of cash flows. Therefore, P should classify the cash inflows from receipt of grant monies as an operating activity in its statement of cash flows.

7.8.2 Expenditures Incurred After Receipt of a Grant

Receiving a grant before incurring the related expenditures is similar to an entity's receipt of a refundable loan advance or to an NFP's receipt of a contribution of refundable advance that by donor stipulation is restricted for capital investment. ASC 230-10-45-14(c) requires that the following be classified as cash inflows from financing activities:

Receipts from contributions and investment income that by donor stipulation are restricted for the purposes of acquiring, constructing, or improving property, plant, equipment, or other long-lived assets or establishing or increasing a donor-restricted endowment fund.

Therefore, when an entity receives the government grant before incurring the related capital expenditures or operating expenses, it should present the receipt of the government grant as a financing cash inflow in the statement of cash flows. In addition, when the entity incurs the expenditures in accordance with the conditions of the government grant, it should disclose the existence of a noncash financing activity resulting from the fulfillment of the grant requirements.

Example 7-13

Assume the same facts as in Example 7-12 except that the grant monies are received before any capital expenditures are incurred. Entity C would record the grant monies as an asset with a corresponding liability on the balance sheet. The receipt of the grant would be reflected as a financing cash inflow in the statement of cash flows in accordance with ASC 230-10-45-14(c).

7.9 Classification of Cash Flows Related to Beneficial Interests in Trade Receivables

An entity may transfer/sell trade receivables to fund working capital and liquidity needs. In such transactions, the seller/transferor of the trade receivable, instead of receiving the entire consideration in cash, may agree to receive part of the consideration in cash and the balance as a noncash beneficial interest in the transferred/sold trade receivable. Such a beneficial interest may or may not be in a certificated form and is generally subordinated to the performance of the receivables transferred/sold.

[Example 7-14 has been deleted.]

In accordance with ASC 230-10-50-4, a transferor's beneficial interest obtained in a securitization of financial assets (excluding cash), including a securitization of the transferor's trade receivables, should be disclosed as a noncash activity. Further, cash receipts from payments on a transferor's beneficial interests in the securitized trade receivables should be classified as cash inflows from investing activities in accordance with ASC 230-10-45-12.

[Example 7-14A has been deleted.]

7.9.1 Application of ASU 2016-15 to the Sale of Trade Receivables to Multiseller Commercial Paper Conduit Structures

Questions have arisen regarding how to apply ASU 2016-15's guidance on beneficial interests in securitization transactions, particularly for entities that have sold trade receivables to a multiseller commercial paper conduit structure. Such questions stem from the fact that an entity that has sold trade receivables to a multiseller commercial paper conduit structure must apply the amended guidance in ASC 230-10-45-12(a) and ASC 230-10-50-4 as well as the requirements in ASC 230-10-45-16(a).⁶

While commercial paper conduit structures may differ, common features of such programs include the following:

- An entity (the "seller") transfers trade receivables to a nonconsolidated securitization entity. Such transfers qualify as sales under ASC 860.
- The seller transfers trade receivables at the inception of its involvement with the securitization entity and continues to transfer trade receivables to the securitization entity as frequently as daily. The securitization entity also receives collections from the seller's trade receivables previously sold as frequently as daily.
- The seller continues to service the trade receivables sold to the securitization entity.

⁶ ASC 230-10-45-16(a) states that cash inflows from operating activities include "[c]ash receipts from sales of goods or services, including receipts from collection or sale of accounts and both short- and long-term notes receivable from customers arising from those sales. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21." In accordance with this guidance, an entity presents the proceeds received upon a sale of trade receivables as an operating activity. As discussed below, the proceeds received on the sale of trade receivables to a securitization entity is represented by the cash purchase price.

- For each trade receivable transferred to the securitization entity, the seller has the right to receive cash at a maximum advance rate. The maximum advance rate, which is determined by a formula in the agreements related to the securitization, represents the maximum amount of cash the seller can receive upon the transfer of trade receivables to the securitization entity. If the amount of cash available from the securitization entity to purchase trade receivables from the seller on a particular day is less than the maximum advance rate, the seller is entitled to only the available cash upon transfers of trade receivables to the securitization entity.
- The amount of cash received by the seller upon each sale of trade receivables to the securitization entity is referred to as the cash purchase price (CPP), and the remaining consideration received for the transfer of trade receivables is represented by a deferred purchase price (DPP). The DPP represents a beneficial interest in the securitization entity.
- After the initial transfer of trade receivables at the inception of the seller's involvement with the securitization entity, the cash available to pay the CPP related to transfers of trade receivables is generally limited to the amount of cash received from collections of trade receivables previously sold to the securitization entity. To the extent that there are insufficient "same day" collections to fund the maximum advance rate, the entity will legally receive an additional DPP interest.
- Any cash collections on previously transferred trade receivables that exceed the maximum advance rate for that same day's trade receivables sold to the securitization entity are held in an escrow account until each periodic settlement date.
- The settlement period is monthly. At the end of each monthly settlement period, the amounts in the escrow account are disbursed to (or retained by) the seller, the administrative agent of the conduit and other service providers, and the conduit in accordance with the terms of the securitization entity. The amount of cash in the escrow account to which the seller is entitled represents repayments of DPP amounts and, to some extent, a deferred payment of CPP amounts related to days on which the cash available as CPP for transfers of trade receivables was less than the maximum advance rate because the collections on trade receivables previously sold on that particular day were insufficient to pay the maximum advance rate.

The guidance in ASU 2016-15 is not clear regarding the unit of account for determining the portions of each transfer of trade receivables to a securitization entity that represent CPP (i.e., operating activities) and DPP (i.e., investing activities). However, on the basis of discussions with the SEC staff, we believe that the unit of account is each day's transactional activity.

Accordingly, an entity should evaluate each day's transactional activity to determine the CPP and DPP portions of trade receivables transferred to the securitization entity. Thus, if the cash available from a particular day's collections of previously sold trade receivables is not sufficient to fund the maximum advance rate on that day's trade receivables sold to the securitization entity, that deficit will reflect a noncash investing activity, which, when collected, will represent an investing activity.

7.10 Classification of Cash Flows for Repurchase Agreements and Reverse Repurchase Agreements

The ASC master glossary defines a “repurchase agreement” and “reverse repurchase agreement,” in part, as follows:

- *Repurchase agreement* — An “agreement under which the transferor (repo party) transfers a financial asset to a transferee (repo counterparty or reverse party) in exchange for cash and concurrently agrees to reacquire that financial asset at a future date for an amount equal to the cash exchanged plus or minus a stipulated interest factor.”
- *Reverse repurchase agreement accounted for as a collateralized borrowing* — A “transaction that is accounted for as a collateralized lending in which a buyer-lender buys securities with an agreement to resell them to the seller-borrower at a stated price plus interest at a specified date or in specified circumstances.”

Most repurchase and reverse repurchase agreements are accounted for as secured borrowing and lending arrangements under ASC 860 because the transferor usually has retained effective control over the transferred securities. Because a repurchase agreement represents a collateralized borrowing (for the cash recipient) and a reverse repurchase agreement represents a collateralized lending (for the transferee of the security), the related cash flows should be classified as financing and investing activities, respectively.

On the basis of discussions with the FASB staff, another acceptable method for determining the appropriate classification of the cash flows related to repurchase and reverse repurchase agreements is to evaluate the specific facts and circumstances and the reasons for entering into each agreement to determine its nature and the entity's intent. As a result, both repurchase agreements and reverse repurchase agreements could be classified in the same section of the statement of cash flows (i.e., operating, investing, or financing). For example:

- It is acceptable to classify the cash flows related to repurchase agreements and reverse repurchase agreements as operating activities if the transactions are entered into in connection with the entity's principal activities (e.g., broker-dealers or other entities with similar operations). Such classification is further supported by a note in Exhibit 6-7 of the AICPA Audit and Accounting Guide *Brokers and Dealers in Securities*, which states:

Depending on the nature of the activity, securities purchased under agreements to resell can be classified as operating or investing; likewise, securities sold under agreements to repurchase can be classified as operating or financing.

- It is acceptable to classify cash flows related to both repurchase agreements and reverse repurchase agreements as investing cash flows when the primary intent of entering into the transactions is to increase the return on an entity's investment portfolio. For example, an entity may enter into a repurchase agreement to reinvest the cash proceeds in another investment because the entity believes it can earn a higher return than the spread on the repurchase side of the repurchase agreement. Therefore, even though funds were essentially a secured borrowing in the first leg of the repurchase agreement, the business purpose and substance of the transaction were to generate a higher yield on the investment portfolio and, accordingly, “both legs” could be classified as an investing activity.
- It is acceptable to classify the cash flows related to both repurchase agreements and reverse repurchase agreements as financing activities if the primary purpose of the arrangement is to provide funds to finance operations or raise working capital.

7.11 Assets Held for Sale

Cash and cash equivalents may be included in a disposal group or component that is classified as an asset held for sale, regardless of whether such an asset meets the definition of a discontinued operation (see [Section 3.3](#) for additional considerations related to the presentation of discontinued operations in the statement of cash flows). Accordingly, the “cash and cash equivalents” line item on the balance sheet may exclude some of the entity’s cash and cash equivalents (i.e., the portion that is included in the “assets held for sale” line item). As a result, an entity will need to modify its normal presentation of such amounts in the statement of cash flows. The following two methods are acceptable ways to adjust the statement of cash flows for cash and cash equivalents included in assets held for sale:

- *Method 1* — First, (1) cash and cash equivalents included in the “assets held for sale” line item on the balance sheet at the beginning of the period are added to beginning cash presented in the statement of cash flows and (2) the corresponding amount at the end of the period is added to ending cash and cash equivalents in the statement of cash flows. Next, the adjusted amounts in the statement of cash flows are reconciled to the amounts presented on the balance sheet in a footnote.
- *Method 2* — A reconciling line item is presented that shows the change in cash balances included in the assets held for sale caption after financing activities and before beginning cash balances. An entity may present the following under Method 2:

Net cash provided by operating activities	XXX
Net cash used in investing activities	(XXX)
Net cash provided by financing activities	XXX
Net increase/decrease in cash and cash equivalents, including cash classified within current assets held for sale	XXX
Less: Net increase/decrease in cash classified within current assets held for sale	(XXX)
Net increase/decrease in cash and cash equivalents	XXX
Cash, beginning of period	XXX
Cash, end of period	XXX

7.12 Cloud Computing Arrangements

In August 2018, the FASB issued [ASU 2018-15](#), which amends ASC 350-40 to address a customer’s accounting for implementation costs incurred in a CCA that is a service contract. ASU 2018-15 aligns the accounting for costs incurred to implement a CCA that is a service arrangement with the guidance on capitalizing costs associated with developing or obtaining internal-use software. Specifically, the ASU amends ASC 350 to include in its scope implementation costs of a CCA that is a service contract and clarifies that a customer should apply ASC 350-40 to determine which implementation costs should be capitalized in a CCA that is considered a service contract.

In accordance with ASC 350-40-45-3, cash flows to implement a CCA that is a service contract and that meet the capitalization criteria in ASC 350-40 must be presented in an entity’s statement of cash flows “in the same manner as the cash flows for the fees for the associated hosting arrangement.” The FASB gives a rationale for this requirement in paragraph BC12 of ASU 2018-15:

This is because the asset recognized for the implementation costs is recognized only as a result of enhancing the value of the hosting service, which itself is not recognized as an asset. Thus, although the implementation costs are recognized as a standalone asset, the future benefit derived from that asset is linked to the benefit derived from the hosting service, which is expensed as incurred.

For additional considerations related to ASU 2018-15, see Deloitte's September 11, 2018, [Heads Up](#).



Connecting the Dots

Capitalized implementation costs related to a CCA that is a service contract differ from capitalized costs associated with developing or obtaining internal-use software. Internal-use software is, by its nature, a recognizable intangible asset. Accordingly, any incurred and capitalized costs associated with developing or obtaining internal-use software form part of the acquired asset and would generally also be considered an intangible asset. Furthermore, and as discussed in [Section 7.7](#), the cash flow presentation should generally be in line with the balance sheet treatment. That is, cash outflows related to noncurrent productive assets that are capitalized in an entity's balance sheet should generally be classified as an investing activity in the statement of cash flows.

However, a CCA that is a service contract does not give rise to a recognizable intangible asset because it is an executory service contract. Consequently, any costs incurred to implement a CCA that is a service contract would not be capitalized as an intangible asset (since they do not form part of an intangible asset); rather, such costs would be characterized in a company's financial statements in the same manner as other service costs and assets related to service contracts (e.g., prepaid expense). That is, these costs would be capitalized as part of the service contract, and financial statement presentation of the cash flows, the resulting asset, and related amortization would be consistent with the ongoing periodic costs of the underlying CCA.

Appendix A — Implementation Guidance and Illustrations

ASC 830-230

Illustrations

Example 1: Statement of Cash Flows for Manufacturing Entity With Foreign Operations

55-1 This Example illustrates a statement of **cash** flows under the direct method for a manufacturing entity with foreign operations. The illustrations of the reconciliation of net income to net cash provided by **operating activities** may provide detailed information in excess of that required for a meaningful presentation. Other formats or levels of detail may be appropriate for particular circumstances.

ASC 830-230 (continued)

55-2 The following is a consolidating statement of cash flows for the year ended December 31, 19X1, for Entity F, a multinational U.S. corporation engaged principally in manufacturing activities, which has two wholly owned foreign subsidiaries — Subsidiary A and Subsidiary B. For Subsidiary A, the local currency is the **functional currency**. For Subsidiary B, which operates in a highly inflationary economy, the U.S. dollar is the functional currency.

Entity F					
Consolidating Statement of Cash Flows					
For the Year Ended December 31, 19X1					
Increase (Decrease) in Cash and Cash Equivalents					
	Parent Entity	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Cash flows from operating activities:					
Cash received from customers	\$ 4,610 ^(a)	\$ 888 ^(a)	\$ 561 ^(a)	\$ (430)	\$ 5,629
Cash paid to suppliers and employees	(3,756) ^(a)	(806) ^(a)	(370) ^(a)	430	(4,502)
Interest paid	(170)	(86)	(135)	–	(391)
Income taxes paid	(158)	(25)	(21)	–	(204)
Interest and dividends received	57	–	–	(22)	35
Miscellaneous cash received (paid)	–	45	(5)	–	40
Net cash provided by operating activities	583	16	30	(22)	607
Cash flows from investing activities :					
Proceeds from sale of equipment	150	116	14	–	280
Payments for purchase of equipment	(450)	(258)	(15)	–	(723)
Net cash used in investing activities	(300)	(142)	(1)	–	(443)
Cash flows from financing activities :					
Proceeds from issuance of short-term debt	20	75	–	–	95
Intra-entity loan	(15)	–	15	–	–
Proceeds from issuance of long-term debt	–	165	–	–	165
Repayment of long-term debt	(200)	(105)	(35)	–	(340)
Payment of dividends	(120)	(22)	–	22	(120)
Net cash provided by (used in) financing activities	(315)	113	(20)	22	(200)
Effect of exchange rate changes on cash	–	9 ^(b)	(5) ^(b)	–	4
Net change in cash and cash equivalents	(32)	(4)	4	–	(32)
Cash and cash equivalents at beginning of year	255	15	5	–	275
Cash and cash equivalents at end of year	<u>\$ 223</u>	<u>\$ 11</u>	<u>\$ 9</u>	<u>\$ –</u>	<u>\$ 243</u>

^(a) The computation of this amount is provided in paragraph 830-230-55-14.

^(b) The computation of this amount is provided in paragraph 830-230-55-15.

ASC 830-230 (continued)**Reconciliation of net income to net cash provided by operating activities:**

	Parent Entity	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Net income	\$ 417	\$ 50	\$ (66)	\$ (37)	\$ 364
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	350	85	90	–	525
(Gain) loss on sale of equipment	(115)	–	25	–	(90)
Writedown of facility to net realizable value	50	–	–	–	50
Exchange gain	–	–	(115)	–	(115)
Provision for deferred taxes	90	–	–	–	90
Increase in accounts receivable	(85)	(37)	(9)	–	(131)
(Increase) decrease in inventory	(80)	(97)	107	15	(55)
Increase (decrease) in accounts payable and accrued expenses	(41)	16	(6)	–	(31)
Increase (decrease) in interest and taxes payable	<u>(3)</u>	<u>(1)</u>	<u>4</u>	<u>–</u>	<u>–</u>
Net cash provided by operating activities	<u>\$ 583</u>	<u>\$ 16</u>	<u>\$ 30</u>	<u>\$ (22)</u>	<u>\$ 607</u>

55-3 The entity would make the following disclosure.

Cash in excess of daily requirements is invested in marketable securities consisting of U.S. Treasury bills with maturities of three months or less. Such investments are deemed to be cash equivalents for purposes of the statement of cash flows.

ASC 830-230 (continued)

55-4 Summarized in the following tables is financial information for the current year for Entity F, which provides the basis for the statement of cash flows presented in paragraph 830-230-55-2.

Entity F					
Consolidating Statement of Financial Position					
December 31, 19X1					
	Parent Entity	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Assets:					
Cash and cash equivalents	\$ 233	\$ 11	\$ 9	\$ -	\$ 243
Accounts receivable	725	95	20	-	840
Intra-entity loan receivable	15	-	-	(15)	-
Inventory	630	281	96	(15)	992
Investments	730	-	-	(730)	-
Property, plant, and equipment, net	3,305	1,441	816	-	5,562
Other assets	160	11	-	-	171
Total assets	<u>\$ 5,788</u>	<u>\$ 1,839</u>	<u>\$ 941</u>	<u>\$ (760)</u>	<u>\$ 7,808</u>
Liabilities:					
Accounts payable and accrued expenses	\$ 529	\$ 135	\$ 38	\$ -	\$ 702
Interest payable	35	11	4	-	50
Taxes payable	45	5	2	-	52
Short-term debt	160	135	-	-	295
Intra-entity debt	-	-	15	(15)	-
Long-term debt	1,100	315	40	-	1,455
Deferred taxes	342	-	-	-	342
Total liabilities	2,211	601	99	(15)	2,896
Stockholders' equity:					
Capital stock	550	455	275	(730)	550
Retained earnings	3,027	554	567	(15)	4,133
Cumulative translation adjustment	-	229	-	-	229
Total stockholders' equity	<u>3,577</u>	<u>1,238</u>	<u>842</u>	<u>(745)</u>	<u>4,912</u>
Total liabilities and stockholders' equity	<u>\$ 5,788</u>	<u>\$ 1,839</u>	<u>\$ 941</u>	<u>\$ (760)</u>	<u>\$ 7,808</u>

ASC 830-230 (continued)

Entity F					
Consolidating Statement of Income					
For the Year Ended December 31, 19X1					
	Parent Entity	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Revenues	\$ 4,695	\$ 925	\$ 570	\$ (430)	\$ 5,760
Cost of sales	(3,210)	(615)	(406)	415	(3,816)
Depreciation and amortization	(350)	(85)	(90)	-	(525)
General and administrative expenses	(425)	(110)	(65)	-	(600)
Interest expense	(165)	(90)	(135)	-	(390)
Interest and dividend income	57	-	-	(22)	35
Gain (loss) on sale of equipment	115	-	(25)	-	90
Miscellaneous income (expense)	(50)	45	(5)	-	(10)
Exchange gain	<u>-</u>	<u>-</u>	<u>115</u>	<u>-</u>	<u>115</u>
Increase before income taxes	667	70	(41)	(37)	659
Provision for income taxes	<u>(250)</u>	<u>(20)</u>	<u>(25)</u>	<u>-</u>	<u>(295)</u>
Net income	<u>\$ 417</u>	<u>\$ 50</u>	<u>\$ (66)</u>	<u>\$ (37)</u>	<u>\$ 364</u>

55-5 The U.S. dollar equivalents of one unit of local currency applicable to Subsidiary A and to Subsidiary B are as follows.

	Subsidiary A	Subsidiary B
1/1/X1	.40	.05
Weighted average	.43	.03
12/31/X1	.45	.02

55-6 The computation of the weighted-average exchange rate for Subsidiary A excludes the effect of Subsidiary A's sale of inventory to the parent entity at the beginning of the year discussed in paragraph 830-230-55-10(a).

ASC 830-230 (continued)

55-7 Comparative statements of financial position for the parent entity and for each of the foreign subsidiaries are as follows.

Comparative Statements of Financial Position

	Parent Entity			Subsidiary A			Subsidiary B			Subsidiary B					
	U.S. Dollars (USD)			Local Currency (LC)			U.S. Dollars (USD)			Local Currency (LC)			U.S. Dollars (USD)		
	1/1/X1	12/31/X1	Change	1/1/X1	12/31/X1	Change	1/1/X1	12/31/X1	Change	1/1/X1	12/31/X1	Change	1/1/X1	12/31/X1	Change
Assets:															
Cash and cash equivalents	255	223	(32)	38	25	(13)	15	11	(4)	100	449	349	5	9	4
Accounts receivable	640	725	85	125	210	85	50	95	45	700	1,000	300	35	20	(15)
Intra-entity loan receivable	-	15	15	-	-	-	-	-	-	-	-	-	-	-	-
Inventory	550	630	80	400	625	225	160	281	121	2,900	3,200	300	203	96	(107)
Investments	730	730	-	-	-	-	-	-	-	-	-	-	-	-	-
Property, plant, and equipment, net	3,280	3,305	25	3,075	3,202	127	1,230	1,441	211	6,200	5,900	(300)	930	816	(114)
Other assets	170	160	(10)	25	25	-	10	11	1	-	-	-	-	-	-
Total assets	<u>5,625</u>	<u>5,788</u>	<u>163</u>	<u>3,663</u>	<u>4,087</u>	<u>424</u>	<u>1,465</u>	<u>1,839</u>	<u>374</u>	<u>9,900</u>	<u>10,549</u>	<u>649</u>	<u>1,173</u>	<u>941</u>	<u>(232)</u>
Liabilities:															
Accounts payable and accrued expenses	570	529	(41)	263	300	37	105	135	30	2,100	1,900	(200)	105	38	(67)
Interest payable	40	35	(5)	15	24	9	6	11	5	200	200	-	10	4	(6)
Taxes payable	43	45	2	25	12	(13)	10	5	(5)	-	120	120	-	2	2
Short-term debt	140	160	20	125	300	175	50	135	85	-	-	-	-	-	-
Intra-entity debt	-	-	-	-	-	-	-	-	-	-	500	500	-	15	15
Long-term debt	1,300	1,100	(200)	550	700	150	220	315	95	3,000	2,000	(1,000)	150	40	(110)
Deferred taxes	252	342	90	-	-	-	-	-	-	-	-	-	-	-	-
Total liabilities	2,345	2,211	(134)	978	1,336	358	391	601	210	5,300	4,720	(580)	265	99	(166)
Stockholders' equity:															
Capital stock	550	550	-	1,300	1,300	-	455	455	-	1,375	1,375	-	275	275	-
Retained earnings	2,730	3,027	297	1,385	1,451	66	526	554	28	3,225	4,454	1,229	633	567	(66)
Cumulative translation adjustment	-	-	-	-	-	-	93	229	136	-	-	-	-	-	-
Total stockholders' equity	3,280	3,577	297	2,685	2,751	66	1,074	1,238	164	4,600	5,829	1,229	908	842	(66)
Total liabilities and stockholders' equity	<u>5,625</u>	<u>5,788</u>	<u>163</u>	<u>3,663</u>	<u>4,087</u>	<u>424</u>	<u>1,465</u>	<u>1,839</u>	<u>374</u>	<u>9,900</u>	<u>10,549</u>	<u>649</u>	<u>1,173</u>	<u>941</u>	<u>(232)</u>

ASC 830-230 (continued)

55-8 Statements of income in local currency and U.S. dollars for each of the foreign subsidiaries are as follows.

Statements of Income								
For the Year Ended December 31, 19X1								
	Subsidiary A				Subsidiary B			
	Local Currency		U.S. Dollars		Local Currency		U.S. Dollars	
Revenues	LC	2,179	USD	925 ^(a)	LC	19,000	USD	570
Cost of sales		(1,458)		(615) ^(b)		(9,667)		(406)
Depreciation and amortization		(198)		(85)		(600)		(90)
General and administrative expenses		(256)		(110)		(2,167)		(65)
Interest expense		(209)		(90)		(4,500)		(135)
Gain (loss) on sale of equipment		–		–		150		(25)
Miscellaneous income (expense)		105		45		(167)		(5)
Exchange gain		–		–		–		115
Income before income taxes		163		70		2,049		(41)
Provision for income taxes		(47)		(20)		(820)		(25)
Net income	<u>LC</u>	<u>116</u>	<u>USD</u>	<u>50</u>	<u>LC</u>	<u>1,229</u>	<u>USD</u>	<u>(66)</u>
^(a) This amount was computed as follows:								
			LC 400 @ .40 =	USD	160			
			Sales to customers	LC 1,779 @ .43 =	<u>765</u>			
			Total sales in U.S. dollars		<u>USD 925</u>			
^(b) This amount was computed as follows:								
			Cost of sale to parent entity at beginning of year	LC 400 @ .40 =	USD	160		
			Cost of sales to customers	LC 1,058 @ .43 =	<u>455</u>			
			Total cost of sales in U.S. dollars		<u>USD 615</u>			

ASC 830-230 (continued)

55-9 All of the following transactions were entered into during the year by the parent entity and are reflected in the preceding financial statements:

- a. The parent entity invested cash in excess of daily requirements in U.S. Treasury bills. Interest earned on such investments totaled USD 35.
- b. The parent entity sold excess property with a net book value of USD 35 for USD 150.
- c. The parent entity's capital expenditures totaled USD 450.
- d. The parent entity wrote down to its estimated net realizable value of USD 25 a facility with a net book value of USD 75.
- e. The parent entity's short-term debt consisted of commercial paper with maturities not exceeding 60 days.
- f. The parent entity repaid long-term notes of USD 200.
- g. The parent entity's depreciation totaled USD 340, and amortization of intangible assets totaled USD 10.
- h. The parent entity's provision for income taxes included deferred taxes of USD 90.
- i. Because of a change in product design, the parent entity purchased all of Subsidiary A's beginning inventory for its book value of USD 160. All of the inventory was subsequently sold by the parent entity.
- j. The parent entity received a dividend of USD 22 from Subsidiary A. The dividend was credited to the parent entity's income.
- k. The parent entity purchased from Subsidiary B USD 270 of merchandise of which USD 45 remained in the parent entity's inventory at year-end. Intra-entity profit on the remaining inventory totaled USD 15.
- l. The parent entity loaned USD 15, payable in U.S. dollars, to Subsidiary B.
- m. Entity F paid dividends totaling USD 120 to shareholders.

55-10 All of the following transactions were entered into during the year by Subsidiary A and are reflected in the above financial statements. The U.S. dollar equivalent of the local currency amount based on the exchange rate at the date of each transaction is included. Except for the sale of inventory to the parent entity (the transaction in [a]), Subsidiary A's sales and purchases and operating cash receipts and payments occurred evenly throughout the year.

- a. Because of a change in product design, Subsidiary A sold all of its beginning inventory to the parent entity for its book value of LC 400 (USD 160).
- b. Subsidiary A sold equipment for its book value of LC 275 (USD 116) and purchased new equipment at a cost of LC 600 (USD 258).
- c. Subsidiary A issued an additional LC 175 (USD 75) of 30-day notes and renewed the notes at each maturity date.
- d. Subsidiary A issued long-term debt of LC 400 (USD 165) and repaid long-term debt of LC 250 (USD 105).
- e. Subsidiary A paid a dividend to the parent entity of LC 50 (USD 22).

ASC 830-230 (continued)

55-11 The following transactions were entered into during the year by Subsidiary B and are reflected in the preceding financial statements. The U.S. dollar equivalent of the local currency amount based on the exchange rate at the date of each transaction is included. Subsidiary B's sales and operating cash receipts and payments occurred evenly throughout the year. For convenience, all purchases of inventory were based on the weighted-average exchange rate for the year. Subsidiary B uses the first-in, first-out (FIFO) method of inventory valuation.

- a. Subsidiary B had sales to the parent entity as follows.

	Local Currency		U.S. Dollars	
Intra-entity sales	LC	9,000	USD	270
Cost of sales		<u>(4,500)</u>		<u>(180)</u>
Gross profit	<u>LC</u>	<u>4,500</u>	<u>USD</u>	<u>90</u>

- b. Subsidiary B sold equipment with a net book value of LC 200 (USD 39) for LC 350 (USD 14). New equipment was purchased at a cost of LC 500 (USD 15).
- c. Subsidiary B borrowed USD 15 (LC 500), payable in U.S. dollars, from the parent entity.
- d. Subsidiary B repaid LC 1,000 (USD 35) of long-term debt.

ASC 830-230 (continued)

55-12 Statements of cash flows in the local currency and in U.S. dollars for Subsidiary A and Subsidiary B are as follows.

Statements of Cash Flows								
For the Year Ended December 31, 19X1								
Increase (Decrease) in Cash								
	Subsidiary A				Subsidiary B			
		Local Currency	U.S. Dollars		Local Currency	U.S. Dollars		
Cash flows from operating activities:								
Cash received from customers	LC	2,094 ^(a)	USD	888 ^(a)	LC	18,700 ^(a)	USD	561 ^(a)
Cash paid to suppliers and employees		(1,092) ^(a)		(806) ^(a)		(12,334) ^(a)		(370) ^(a)
Interest paid		(200)		(86) ^(b)		(4,500)		(135) ^(b)
Income taxes paid		(60)		(25) ^(b)		(700)		(21) ^(b)
Miscellaneous receipts (payments)		<u>105</u>		<u>(45)^(b)</u>		<u>(167)</u>		<u>(5)^(b)</u>
Net cash provided by operating activities		37		16		999		30
Cash flows from investing activities:								
Proceeds from sale of equipment		275		116 ^(c)		350		14 ^(c)
Payments for purchase of equipment		<u>(600)</u>		<u>(258)^(c)</u>		<u>(500)</u>		<u>(15)^(c)</u>
Net cash used in investing activities		(325)		(142)		(150)		(1)
Cash flows from financing activities:								
Net increase in short-term debt		175		75 ^(c)		-		-
Proceeds from intra-entity loan		-		-		500		15 ^(c)
Proceeds from issuance of long-term debt		400		165 ^(c)		-		-
Repayment of long-term debt		(250)		(105) ^(c)		(1,000)		(35) ^(c)
Payment of dividends		<u>(50)</u>		<u>(22)^(c)</u>		<u>-</u>		<u>-</u>
Net cash provided by (used in) financing activities		275		113		(500)		(20)
Effect of exchange rate changes on cash		<u>-</u>		<u>9^(d)</u>		<u>-</u>		<u>(5)^(d)</u>
Net increase (decrease) in cash		(13)		(4)		349		4
Cash at beginning of year		<u>38</u>		<u>15</u>		<u>100</u>		<u>5</u>
Cash at end of year		<u>LC 25</u>		<u>USD 11</u>		<u>LC 449</u>		<u>USD 9</u>

^(a) The computation of this amount is provided in paragraph 830-230-55-14.

^(b) This amount represents the U.S. dollar equivalent of the **foreign currency** cash flow based on the weighted-average exchange rate for the year.

^(c) This amount represents the U.S. dollar equivalent of the foreign currency cash flow based on the exchange rate in effect at the time of the cash flow.

^(d) The computation of this amount is provided in paragraph 830-230-55-15.

ASC 830-230 (continued)**55-13** A reconciliation of net income to net cash provided by operating activities follows.

	Subsidiary A		Subsidiary B	
	Local Currency	U.S. Dollars	Local Currency	U.S. Dollars
Net income	LC 116	USD 50	LC 1,229	USD (66)
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	198	85 ^(a)	600	90 ^(b)
(Gain) loss on sale of equipment	-	-	(150)	25 ^(b)
Exchange gain	-	-	-	(115) ^(c)
Increase in accounts receivable	(85)	(37) ^(a)	(300)	(9) ^(a)
Increase (decrease) in inventory	(225)	(97) ^(a)	(300)	107 ^(d)
Increase (decrease) in accounts payable and accrued expenses	37	16 ^(a)	(200)	(6) ^(a)
Increase (decrease) in interest and taxes payable	<u>(4)</u>	<u>(1)^(a)</u>	<u>120</u>	<u>4^(a)</u>
Net cash provided by operating activities	<u>LC 37</u>	<u>USD 16</u>	<u>LC 999</u>	<u>USD 30</u>

^(a) This amount represents the U.S. dollar equivalent of the foreign currency amount based on the weighted-average exchange rate for the year.

^(b) This amount represents the U.S. dollar equivalent of the foreign currency amount based on historical exchange rates.

^(c) This amount represents the exchange gain included in net income as a result of remeasuring Subsidiary B's financial statements from the local currency to U.S. dollars.

^(d) This amount represents the difference between beginning and ending inventory after remeasurement into U.S. dollars based on historical exchange rates.

ASC 830-230 (continued)

55-14 The following is the computation of cash received from customers and cash paid to suppliers and employees as reported in the consolidating statement of cash flows for Entity F appearing in paragraph 830-230-55-2.

	Parent Entity	Subsidiary A		Subsidiary B	
		Local Currency	U.S. Dollars	Local Currency	U.S. Dollars
Cash received from customers during the year					
Revenues	USD 4,695	LC 2,179	USD 925	LC 19,000	USD 570
Increase in accounts receivable	<u>(85)</u>	<u>(85)</u>	<u>(37)</u>	<u>(300)</u>	<u>(9)</u>
Cash received from customers	<u>USD 4,610</u>	<u>LC 2,094</u>	<u>USD 888</u>	<u>LC 18,700</u>	<u>USD 561</u>
Cash paid to suppliers and employees during the year					
Cost of sales	USD 3,210	LC 1,458	USD 615	LC 9,667	USD 406
Effect of exchange rate changes on cost of sales	-	-	-	-	(116) ^(a)
General and administrative expenses	<u>425</u>	<u>256</u>	<u>110</u>	<u>2,167</u>	<u>65</u>
Total operating expenses requiring cash payments	3,635	1,714	725	11,834	355
Increase in inventory	80	225	97	300	9
(Increase) decrease in accounts payable and accrued expenses	<u>41</u>	<u>(37)</u>	<u>(16)</u>	<u>200</u>	<u>6</u>
Cash paid to suppliers and employees	<u>USD 3,756</u>	<u>LC 1,902</u>	<u>USD 806</u>	<u>LC 12,334</u>	<u>USD 370</u>

^(a) This adjustment represents the difference between cost of sales remeasured at historical exchange rates (USD 406) and cost of sales translated based on the weighted-average exchange rate for the year (USD 290). The adjustment is necessary because cash payments for inventory, which were made evenly throughout the year, were based on the weighted-average exchange rate for the year.

ASC 830-230 (continued)

55-15 The following is the computation of the effect of exchange rate changes on cash for Subsidiary A and Subsidiary B.

Computation of Effect of Exchange Rate Changes on Cash				
	Subsidiary A		Subsidiary B	
Effect on beginning cash balance:				
Beginning cash balance in local currency	LC	38	LC	100
Net change in exchange rate during the year		<u>× .05</u>		<u>× (.03)</u>
Effect on beginning cash balance		USD 2		USD (3)
Effect from operating activities during the year:				
Cash provided by operating activities in local currency	LC	37	LC	999
Year-end exchange rate		<u>× .45</u>		<u>× .02</u>
Operating cash flows based on year-end exchange rate	USD	16 ^(a)	USD	20
Operating cash flows reported in the statement of cash flows		<u>16</u>		<u>30</u>
Effect from operating activities during the year		-		(10)
Effect from investing activities during the year:				
Cash used in investing activities in local currency	LC	(325)	LC	(150)
Year-end exchange rate		<u>× .45</u>		<u>× .02</u>
Investing cash flows based on year-end exchange rate	USD	(146)	USD	(3)
Investing cash flows reported in the statement of cash flows		<u>(142)</u>		<u>(1)</u>
Effect from investing activities during the year		(4)		(2)
Effect from financing activities during the year:				
Cash provided by (used in) financing activities in local currency	LC	275	LC	(500)
Year-end exchange rate		<u>× .45</u>		<u>× .02</u>
Financing cash flows based on year-end	USD	124	USD	(10)
Financing cash flows reported in the statement of cash flows		<u>113</u>		<u>(20)</u>
Effect from financing activities during the year		<u>11</u>		<u>10</u>
Effect of exchange rate changes on cash		<u>USD 9</u>		<u>USD (5)</u>

^(a) This amount includes the effect of rounding.

Appendix B — Selected ASC Glossary Terms

This appendix includes certain terms from the ASC master glossary.

ASC Master Glossary

Acquiree

The business or businesses that the acquirer obtains control of in a business combination. This term also includes a nonprofit activity or business that a not-for-profit acquirer obtains control of in an acquisition by a not-for-profit entity.

Acquirer

The entity that obtains control of the acquiree. However, in a business combination in which a variable interest entity (VIE) is acquired, the primary beneficiary of that entity always is the acquirer.

Acquisition Date

The date on which the acquirer obtains control of the acquiree.

Amortization

The process of reducing a recognized liability systematically by recognizing gains or by reducing a recognized asset systematically by recognizing losses. In accounting for pension benefits or other postretirement benefits, amortization also means the systematic recognition in net periodic pension cost or other postretirement benefit cost over several periods of amounts previously recognized in other comprehensive income, that is, gains or losses, prior service cost or credits, and any transition obligation or asset.

Available-for-Sale Securities

Investments not classified as either trading securities or as held-to-maturity securities.

Award

The collective noun for multiple instruments with the same terms and conditions granted at the same time either to a single employee or to a group of employees. An award may specify multiple vesting dates, referred to as graded vesting, and different parts of an award may have different expected terms. References to an award also apply to a portion of an award.

Note: The following definition is Pending Content; see Transition Guidance in 718-10-65-11.

The collective noun for multiple instruments with the same terms and conditions granted at the same time either to a single grantee or to a group of grantees. An award may specify multiple vesting dates, referred to as graded vesting, and different parts of an award may have different expected terms. References to an award also apply to a portion of an award.

ASC Master Glossary (continued)**Beneficial Interests**

Rights to receive all or portions of specified cash inflows received by a trust or other entity, including, but not limited to, all of the following:

- a. Senior and subordinated shares of interest, principal, or other cash inflows to be passed-through or paid-through
- b. Premiums due to guarantors
- c. Commercial paper obligations
- d. Residual interests, whether in the form of debt or equity.

Business Combination

A transaction or other event in which an acquirer obtains control of one or more businesses. Transactions sometimes referred to as true mergers or mergers of equals also are business combinations. . . .

Capital Lease

From the perspective of a lessee, a lease that meets any of the four lease classification criteria in paragraph 840-10-25-1.

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

Glossary term superseded by Accounting Standards Update No. 2016-02.

Cash

Consistent with common usage, cash includes not only currency on hand but demand deposits with banks or other financial institutions. Cash also includes other kinds of accounts that have the general characteristics of demand deposits in that the customer may deposit additional funds at any time and also effectively may withdraw funds at any time without prior notice or penalty. All charges and credits to those accounts are cash receipts or payments to both the entity owning the account and the bank holding it. For example, a bank's granting of a loan by crediting the proceeds to a customer's demand deposit account is a cash payment by the bank and a cash receipt of the customer when the entry is made.

Cash Equivalents

Cash equivalents are short-term, highly liquid investments that have both of the following characteristics:

- a. Readily convertible to known amounts of cash
- b. So near their maturity that they present insignificant risk of changes in value because of changes in interest rates.

Generally, only investments with original maturities of three months or less qualify under that definition. Original maturity means original maturity to the entity holding the investment. For example, both a three-month U.S. Treasury bill and a three-year U.S. Treasury note purchased three months from maturity qualify as cash equivalents. However, a Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an entity with banking operations).

Cash Flow Hedge

A hedge of the exposure to variability in the cash flows of a recognized asset or liability, or of a forecasted transaction, that is attributable to a particular risk.

Contingent Consideration

Usually an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. However, contingent consideration also may give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

ASC Master Glossary (continued)**Dividends**

Dividends paid or payable in cash, other assets, or another class of stock and does not include stock dividends or stock splits.

Excess Tax Benefits

The realized tax benefit related to the amount (caused by changes in the fair value of the entity's shares after the measurement date for financial reporting) of deductible compensation cost reported on an employer's tax return for equity instruments in excess of the compensation cost for those instruments recognized for financial reporting purposes.

Note: The following definition is Pending Content; see Transition Guidance in 718-10-65-4.

Glossary term superseded by Accounting Standards Update No. 2016-09.

Exchange Rate

The ratio between a unit of one currency and the amount of another currency for which that unit can be exchanged at a particular time.

Fair Value [Definition 2]

The price that would be received to sell an asset or paid to transfer a liability in an orderly transaction between market participants at the measurement date.

Fair Value Hedge

A hedge of the exposure to changes in the fair value of a recognized asset or liability, or of an unrecognized firm commitment, that are attributable to a particular risk.

Financial Asset

Cash, evidence of an ownership interest in an entity, or a contract that conveys to one entity a right to do either of the following:

- a. Receive cash or another financial instrument from a second entity
- b. Exchange other financial instruments on potentially favorable terms with the second entity.

Finance Lease

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

From the perspective of a lessee, a lease that meets one or more of the criteria in paragraph 842-10-25-2.

Financing Activities

Financing activities include obtaining resources from owners and providing them with a return on, and a return of, their investment; receiving restricted resources that by donor stipulation must be used for long-term purposes; borrowing money and repaying amounts borrowed, or otherwise settling the obligation; and obtaining and paying for other resources obtained from creditors on long-term credit.

Foreign Currency

A currency other than the functional currency of the entity being referred to (for example, the dollar could be a foreign currency for a foreign entity). Composites of currencies, such as the Special Drawing Rights, used to set prices or denominate amounts of loans, and so forth, have the characteristics of foreign currency.

Foreign Currency Translation

The process of expressing in the reporting currency of the reporting entity those amounts that are denominated or measured in a different currency.

Foreign Entity

An operation (for example, subsidiary, division, branch, joint venture, and so forth) whose financial statements are both:

- a. Prepared in a currency other than the reporting currency of the reporting entity
- b. Combined or consolidated with or accounted for on the equity basis in the financial statements of the reporting entity.

ASC Master Glossary (continued)**Functional Currency**

An entity's functional currency is the currency of the primary economic environment in which the entity operates; normally, that is the currency of the environment in which an entity primarily generates and expends cash. (See paragraphs 830-10-45-2 through 830-10-45-6 and 830-10-55-3 through 830-10-55-7.)

Grant Date

The date at which an employer and an employee reach a mutual understanding of the key terms and conditions of a share-based payment award. The employer becomes contingently obligated on the grant date to issue equity instruments or transfer assets to an employee who renders the requisite service. Awards made under an arrangement that is subject to shareholder approval are not deemed to be granted until that approval is obtained unless approval is essentially a formality (or perfunctory), for example, if management and the members of the board of directors control enough votes to approve the arrangement. Similarly, individual awards that are subject to approval by the board of directors, management, or both are not deemed to be granted until all such approvals are obtained. The grant date for an award of equity instruments is the date that an employee begins to benefit from, or be adversely affected by, subsequent changes in the price of the employer's equity shares. Paragraph 718-10-25-5 provides guidance on determining the grant date. . . .

Inventory

The aggregate of those items of tangible personal property that have any of the following characteristics:

- a. Held for sale in the ordinary course of business
- b. In process of production for such sale
- c. To be currently consumed in the production of goods or services to be available for sale.

The term inventory embraces goods awaiting sale (the merchandise of a trading concern and the finished goods of a manufacturer), goods in the course of production (work in process), and goods to be consumed directly or indirectly in production (raw materials and supplies). This definition of inventories excludes long-term assets subject to depreciation accounting, or goods which, when put into use, will be so classified. The fact that a depreciable asset is retired from regular use and held for sale does not indicate that the item should be classified as part of the inventory. Raw materials and supplies purchased for production may be used or consumed for the construction of long-term assets or other purposes not related to production, but the fact that inventory items representing a small portion of the total may not be absorbed ultimately in the production process does not require separate classification. By trade practice, operating materials and supplies of certain types of entities such as oil producers are usually treated as inventory.

Investing Activities

Investing activities include making and collecting loans and acquiring and disposing of debt or equity instruments and property, plant, and equipment and other productive assets, that is, assets held for or used in the production of goods or services by the entity (other than materials that are part of the entity's inventory). Investing activities exclude acquiring and disposing of certain loans or other debt or equity instruments that are acquired specifically for resale, as discussed in paragraphs 230-10-45-12 and 230-10-45-21.

Lease

An agreement conveying the right to use property, plant, or equipment (land and/or depreciable assets) usually for a stated period of time.

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

A contract, or part of a contract, that conveys the right to control the use of identified property, plant, or equipment (an identified asset) for a period of time in exchange for consideration.

ASC Master Glossary (continued)**Lease Liability**

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

A lessee's obligation to make the lease payments arising from a lease, measured on a discounted basis.

Net Asset Value per Share

Net asset value per share is the amount of net assets attributable to each share of capital stock (other than senior equity securities, that is, preferred stock) outstanding at the close of the period. It excludes the effects of assuming conversion of outstanding convertible securities, whether or not their conversion would have a diluting effect.

Net Share Settlement [Definition 1]

A form of settling a financial instrument under which the entity with a loss delivers to the entity with a gain shares of stock with a current fair value equal to the gain.

Nonvested Shares

Shares that an entity has not yet issued because the agreed-upon consideration, such as employee services, has not yet been received. Nonvested shares cannot be sold. The restriction on sale of nonvested shares is due to the forfeitability of the shares if specified events occur (or do not occur).

Note: The following definition is Pending Content; see Transition Guidance in 718-10-65-11.

Shares that an entity has not yet issued because the agreed-upon consideration, such as the delivery of specified goods or services and any other conditions necessary to earn the right to benefit from the instruments, has not yet been satisfied. Nonvested shares cannot be sold. The restriction on sale of nonvested shares is due to the forfeitability of the shares if specified events occur (or do not occur).

Not-for-Profit Entity

An entity that possesses the following characteristics, in varying degrees, that distinguish it from a business entity:

- a. Contributions of significant amounts of resources from resource providers who do not expect commensurate or proportionate pecuniary return
- b. Operating purposes other than to provide goods or services at a profit
- c. Absence of ownership interests like those of business entities.

Entities that clearly fall outside this definition include the following:

- a. All investor-owned entities
- b. Entities that provide dividends, lower costs, or other economic benefits directly and proportionately to their owners, members, or participants, such as mutual insurance entities, credit unions, farm and rural electric cooperatives, and employee benefit plans.

Operating Activities

Operating activities include all transactions and other events that are not defined as investing or financing activities (see paragraphs 230-10-45-12 through 45-15). Operating activities generally involve producing and delivering goods and providing services. Cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income.

Operating Lease

From the perspective of a lessee, any lease other than a capital lease.

From the perspective of a lessor, a lease that meets the conditions in paragraph 840-10-25-43(d).

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

From the perspective of a lessee, any lease other than a finance lease.

From the perspective of a lessor, any lease other than a sales-type lease or a direct financing lease.

ASC Master Glossary (continued)**Other Comprehensive Income**

Revenues, expenses, gains, and losses that under generally accepted accounting principles (GAAP) are included in comprehensive income but excluded from net income.

Physical Settlement [Definition 2]

The party designated in the contract as the buyer delivers the full stated amount of cash to the seller, and the seller delivers the full stated number of shares to the buyer.

Readily Convertible to Cash

Assets that are readily convertible to cash have both of the following:

- a. Interchangeable (fungible) units
- b. Quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price. . . .

Reporting Currency

The currency in which a reporting entity prepares its financial statements.

Repurchase Agreement

An agreement under which the transferor (repo party) transfers a financial asset to a transferee (repo counterparty or reverse party) in exchange for cash and concurrently agrees to reacquire that financial asset at a future date for an amount equal to the cash exchanged plus or minus a stipulated interest factor. Instead of cash, other securities or letters of credit sometimes are exchanged. Some repurchase agreements call for repurchase of financial assets that need not be identical to the financial assets transferred.

Requisite Service Period

The period or periods during which an employee is required to provide service in exchange for an award under a share-based payment arrangement. The service that an employee is required to render during that period is referred to as the requisite service. The requisite service period for an award that has only a service condition is presumed to be the vesting period, unless there is clear evidence to the contrary. If an award requires future service for vesting, the entity cannot define a prior period as the requisite service period. Requisite service periods may be explicit, implicit, or derived, depending on the terms of the share-based payment award.

Research and Development

Research is planned search or critical investigation aimed at discovery of new knowledge with the hope that such knowledge will be useful in developing a new product or service (referred to as product) or a new process or technique (referred to as process) or in bringing about a significant improvement to an existing product or process.

Development is the translation of research findings or other knowledge into a plan or design for a new product or process or for a significant improvement to an existing product or process whether intended for sale or use. It includes the conceptual formulation, design, and testing of product alternatives, construction of prototypes, and operation of pilot plants.

Reverse Repurchase Agreement Accounted for as a Collateralized Borrowing

A reverse repurchase agreement accounted for as a collateralized borrowing (also known as a reverse repo) refers to a transaction that is accounted for as a collateralized lending in which a buyer-lender buys securities with an agreement to resell them to the seller-borrower at a stated price plus interest at a specified date or in specified circumstances. The receivable under a reverse repurchase agreement accounted for as a collateralized borrowing refers to the amount due from the seller-borrower for the repurchase of the securities from the buyer-lender. In certain industries, the terminology is reversed; that is, entities in those industries refer to this type of agreement as a repo.

Right of Setoff

A right of setoff is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor.

ASC Master Glossary (continued)**Right-of-Use Asset**

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

An asset that represents a lessee's right to use an underlying asset for the lease term.

Sale-Leaseback Accounting

A method of accounting for a sale-leaseback transaction in which the seller-lessee records the sale, removes all property and related liabilities from its balance sheet, recognizes gain or loss from the sale, and classifies the leaseback in accordance with the Lessees Subsections of Subtopic 840-40.

Note: The following definition is Pending Content; see Transition Guidance in 842-10-65-1.

Glossary term superseded by Accounting Standards Update No. 2016-02.

Service Inception Date

The date at which the requisite service period begins. The service inception date usually is the grant date, but the service inception date may differ from the grant date (see Example 6 [see paragraph 718-10-55-107]).

Note: The following definition is Pending Content; see Transition Guidance in 718-10-65-11.

The date at which the employee's requisite service period or the nonemployee's vesting period begins. The service inception date usually is the grant date, but the service inception date may differ from the grant date (see Example 6 [see paragraph 718-10-55-107] for an illustration of the application of this term to an employee award).

Settlement of an Award

An action or event that irrevocably extinguishes the issuing entity's obligation under a share-based payment award. Transactions and events that constitute settlements include the following:

- a. Exercise of a share option or lapse of an option at the end of its contractual term
- b. Vesting of shares
- c. Forfeiture of shares or share options due to failure to satisfy a vesting condition
- d. An entity's repurchase of instruments in exchange for assets or for fully vested and transferable equity instruments.

The vesting of a share option is not a settlement because the entity remains obligated to issue shares upon exercise of the option.

Share Option

A contract that gives the holder the right, but not the obligation, either to purchase (to call) or to sell (to put) a certain number of shares at a predetermined price for a specified period of time. Most share options granted to employees under share-based compensation arrangements are call options, but some may be put options.

Note: The following definition is Pending Content; see Transition Guidance in 718-10-65-11.

A contract that gives the holder the right, but not the obligation, either to purchase (to call) or to sell (to put) a certain number of shares at a predetermined price for a specified period of time.

Subsequent Events

Events or transactions that occur after the balance sheet date but before financial statements are issued or are available to be issued. There are two types of subsequent events:

- a. The first type consists of events or transactions that provide additional evidence about conditions that existed at the date of the balance sheet, including the estimates inherent in the process of preparing financial statements (that is, recognized subsequent events).
- b. The second type consists of events that provide evidence about conditions that did not exist at the date of the balance sheet but arose subsequent to that date (that is, nonrecognized subsequent events).

ASC Master Glossary (continued)**Subsidiary**

An entity, including an unincorporated entity such as a partnership or trust, in which another entity, known as its parent, holds a controlling financial interest. (Also, a variable interest entity that is consolidated by a primary beneficiary.)

Trading Securities

Securities that are bought and held principally for the purpose of selling them in the near term and therefore held for only a short period of time. Trading generally reflects active and frequent buying and selling, and trading securities are generally used with the objective of generating profits on short-term differences in price.

Transaction Gain or Loss

Transaction gains or losses result from a change in exchange rates between the functional currency and the currency in which a foreign currency transaction is denominated. They represent an increase or decrease in both of the following:

- a. The actual functional currency cash flows realized upon settlement of foreign currency transactions
- b. The expected functional currency cash flows on unsettled foreign currency transactions.

Transferee

An entity that receives a financial asset, an interest in a financial asset, or a group of financial assets from a transferor.

Transferor

An entity that transfers a financial asset, an interest in a financial asset, or a group of financial assets that it controls to another entity.

Vested Shares

Vested shares are allocated shares for which a participant's right to receive the shares or redeem the shares for cash is no longer contingent on remaining in the service of the employer. Allocated shares that have not been vested may be forfeited if a participant terminates his or her employment and reallocated to other participants. Whether the shares in a participant's employee stock ownership plan account are vested depends on the length of that employee's service and the vesting provisions of the employee stock ownership plan. The Internal Revenue Code specifies minimum vesting requirements for benefits attributable to employer contributions. Accordingly, the shares allocated to participants at any date will include shares that are fully vested, shares that are not vested, and (if graded vesting is used) shares that are partially vested.

Appendix C — SEC Staff Review Process and Sample SEC Comments: Statement of Cash Flows

SEC Staff Review Process

The SEC's Division of Corporation Finance (the "Division") selectively reviews filings made under the Securities Act of 1933 and the Securities Exchange Act of 1934. In January 2009, the SEC staff issued an [overview](#) that explains its filing review and comment letter process.¹ The overview aims to increase transparency in the review process and expresses the staff's willingness to discuss issues with registrants. For example, the overview indicates that the "[staff] views the comment process as a dialogue with a company about its disclosure" and that a "company should not hesitate to request that the staff reconsider a comment it has issued or reconsider a staff member's view of the company's response to a comment at any point in the filing review process."

The overview is divided into two main sections:

- *The filing review process* — This section explains that the Division comprises 11 offices staffed by experts in specialized industries, accounting, and disclosures. The section includes background on the different types of review (required and selective) and covers the comment process, indicating that "[m]uch of the [staff's] review [process] involves evaluating the disclosure from a potential investor's perspective and asking questions that an investor might ask when reading the document." The section also addresses how to respond to staff comments and close a filing review.
- *The reconsideration process* — This section emphasizes that "staff members, at all levels, are available to discuss disclosure and financial statement presentation matters with a company and its legal, accounting, and other advisors." In addressing a registrant's potential request for the SEC staff to reconsider a staff member's comment or view on a registrant's response, the staff emphasizes that registrants do not have to "follow a formal protocol." However, the staff explains where registrants should start and the steps involved in the normal course of the reconsideration process. The staff also specifies contact information for each office for both accounting and financial disclosure matters and legal and textual disclosure matters.

Registrants may involve the SEC's Office of the Chief Accountant (OCA) during any stage of the review process. Unlike the Division's role, which is to address matters related to the age, form, and content of registrants' financial statements that are required to be filed, the OCA's role is to address questions concerning a registrant's application of GAAP. [Guidance](#) on consulting with the OCA is available on the SEC's Web site.

¹ An [overview of the legal, regulatory, and capital markets](#) offices is also available on the SEC's Web site.

A registrant that receives an SEC comment letter should generally respond within the time frame indicated in the letter. The registrant should continue to respond to any requests for more information until it receives a letter from the Division stating that the Division has no further comments. A registrant that does not receive a completion letter within a reasonable amount of time after submitting a response letter should call its SEC staff reviewer (named in the letter) to ask about the status of the review. If the review is complete, the registrant should request a completion letter.

To increase the transparency of the Division's review process, comment letters and company responses to those letters are made public, via the SEC's Web site, at least 20 business days after the Division has completed its review of a periodic or current report or declared a registration statement effective.

The extracts in this publication have been reproduced from comments published on the SEC's Web site that were issued between July 1, 2014, and June 30, 2015. Dollar amounts and information identifying registrants or their businesses have been redacted from the comments.

For a discussion of SEC comment letters on additional topics, see Deloitte's [A Roadmap to SEC Comment Letter Considerations, Including Industry Insights](#).

Examples of SEC Comments

Category Classification

We note you classified dividends received from your banking subsidiary of \$[X] in 2014, \$[X] in 2013, and \$[X] in 2012 as cash flows from investing activities. Please tell us why you classified these cash inflows to the parent company as investing cash flows as opposed to operating cash flows. Please refer to ASC 230-10-45-16(b) for specific guidance on how to classify dividends received on a statement of cash flows.

Many of the SEC staff's comments are related to misclassification among the three cash flow categories: operating, investing, and financing. ASC 230 distinguishes between returns **of** investment, which should be classified as inflows from investing activities (see ASC 230-10-45-12(b)), and returns **on** investment, which should be classified as inflows from operating activities (see ASC 230-10-45-16(b)). Under ASC 230-10-45-16(b), cash inflows from operating activities include "[c]ash receipts from returns on loans, other debt instruments of other entities, and equity securities — interest and dividends." See [Section 6.1.4](#) for further discussion.

At the 2014 AICPA Conference on Current SEC and PCAOB Developments, the SEC staff noted that it has observed an increased number of classification errors in registrants' statements of cash flows. Further, such errors are generally not attributable to complex fact patterns. The SEC staff identified various actions that registrants could take when preparing the statement of cash flows to potentially reduce the likelihood of errors, including:

- Evaluating the completeness and accuracy of the information collected for preparation of the statement.
- Standardizing and automating required reports and other information.
- Separately considering the effect of nonrecurring transactions in the statement.
- Preparing the statement earlier to allow for adequate review.

- Selecting employees that have the appropriate expertise to prepare the statement of cash flows and providing them with sufficient training on the accounting requirements related to the statement.
- Incorporating risk assessment and monitoring controls in addition to control activities.

Net Versus Gross Presentation

Please note that borrowings and payments on your revolving credit facility should be recorded on a gross basis in the statement of cash flows unless the original maturity of the borrowings is three months or less. Refer to ASC 230-10-45-9 and advise us why the borrowings and payments were not reflected on a gross basis.

The SEC staff may challenge whether it is appropriate to report the net amount of certain cash receipts and cash payments on the face of the statement of cash flows. ASC 230-10-45-7 through 45-9 state that although reporting gross cash receipts and cash payments provides more relevant information, financial statement users sometimes may not need gross reporting to understand certain activities. The SEC staff may ask a registrant to revise the presentation or to explain (in accordance with ASC 230) why it is appropriate to report certain cash flows on a net basis rather than on a gross basis. See [Section 3.2](#) for further discussion of reporting cash flows on a gross or net basis.

Appendix D — Differences Between U.S. GAAP and IFRS Standards

While much of the presentation guidance in U.S. GAAP is similar to that in IFRS® Standards, there are key differences. The table below summarizes these differences.

Subject	U.S. GAAP	IFRS Standards
Scope	<p>Although all entities are required to present a statement of cash flows, there are certain exceptions. Entities that are not required to present a statement of cash flows include defined benefit pension plans that prepare financial information in accordance with ASC 960, certain investment companies within the scope of ASC 946 that meet all of the conditions in ASC 230-10-15-4(c), and certain funds described in ASC 230-10-15-4(b)(3).</p>	<p>Under paragraph 7 of IAS 7, all entities are required to present a statement of cash flows (i.e., there are no scope exceptions).</p>
Comparative periods	<p>Under ASC 230, presentation of comparative periods is not required.</p> <p>However, SEC Regulation S-X, Rule 3-02, requires that an audited cash flow statement be presented for the previous three fiscal years.</p>	<p>Under paragraph 36 of IAS 7, the most recent two years must be presented.</p> <p>Under the general requirements of paragraphs 38 and 38A of IAS 1, comparative information related to the preceding period should be presented for all amounts reported in the current-period statement of cash flows and the supporting notes. Consequently, an entity should present, at a minimum, two statements of cash flows.</p>
Definitions of cash and cash equivalents	<p>The definitions of cash and cash equivalents in ASC 230-10-20 include cash and short-term, highly liquid investments. However, bank overdrafts are excluded from these definitions.</p> <p>An entity's statement of cash flows must "explain the change during the period in the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents" (emphasis added).</p>	<p>The definitions of cash and cash equivalents in paragraph 6 of IAS 7 include cash and short-term, highly liquid investments. Bank overdrafts may be included in these definitions in certain situations (i.e., if they are an "integral part of an entity's cash management"). An entity that classifies bank overdrafts as cash and cash equivalents will need to disclose this policy.</p>

(Table continued)

Subject	U.S. GAAP	IFRS Standards
Classification in the statement of cash flows	ASC 230-10-45-10 requires that cash flows be classified and presented in one of three categories: operating, investing, or financing. ASC 230 provides more specific guidance than IFRS Standards on items to be included in each category.	Paragraph 10 of IAS 7, requires that cash flows be classified and presented in one of three categories: operating, investing, or financing. IAS 7 is more flexible than U.S. GAAP regarding which items are to be included in each category.
Method of reporting cash flows from operating activities	Under ASC 230-10-45-25, use of the direct or indirect method is allowed. Under both methods, net income must be reconciled to net cash flows from operating activities.	Under paragraph 18 of IAS 7, use of the direct or indirect method is allowed. Net income must be reconciled to net cash flows from operating activities only under the indirect method.
Presentation of components of transactions with characteristics of more than one category of cash flows	Under ASC 230-10-45-22, ASC 230-10-45-22A, and ASC 230-10-45-23, an entity will first need to determine whether there are separately identifiable cash flows. If so, such cash flows are presented on the basis of their nature. In the absence of separately identifiable cash flows, an entity would present such cash flows collectively on the basis of the predominant source or use of the cash flows.	Paragraph 12 of IAS 7 requires that individual components of a single transaction be classified separately as operating, investing, or financing activities.
Disclosure of cash flows pertaining to discontinued operations	An entity must disclose either of the following if it is not already presented on the face of the cash flows statement: <ul style="list-style-type: none"> <li data-bbox="548 1129 938 1213">• The total operating and investing cash flows of the discontinued operation. <li data-bbox="548 1224 919 1371">• The depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation. 	In accordance with paragraph 33(c) of IFRS 5, disclosure of cash flows from discontinued operations under each category is required either on the face of the cash flow statement or in the notes.
Presentation of cash flow per share on the face of the financial statements	ASC 230-10-45-3 prohibits an entity from reporting cash flow per share.	Under IFRS Standards (including IAS 7, which does not mention this metric), disclosure of cash flow per share is not explicitly prohibited.
Cash flows from hedging instruments	A company may classify cash flows from hedging activities in the same category as the cash flows from the hedged item provided that the requirements in ASC 230-10-45-27 are met (i.e., regarding the financing element at inception and disclosure of the accounting policy).	Paragraph 16 of IAS 7 requires entities to classify cash flows from hedging activities in the same category as the cash flows from the item being hedged.

(Table continued)

Subject	U.S. GAAP	IFRS Standards
Taxes paid	Under ASC 230-10-45-25, taxes paid are classified as operating activities.	Under paragraph 14(f) of IAS 7, taxes paid are classified as operating activities unless they can be specifically identified within financing and investing activities.
Interest and dividends paid and received	<p data-bbox="513 436 870 520">Under ASC 230, interest paid and received is classified as operating activities.</p> <p data-bbox="513 541 943 947">Dividends received are classified as operating activities because these are generally considered to be returns on an entity's investment. However, a dividend from an equity method investment may be investing if the distribution is a return of investment. That is, for distributions from equity method investments, an entity is required to determine whether the distribution is a return on or a return of the entity's investment. See Section 6.1.4 for specific guidance on distributions from equity method investments.</p> <p data-bbox="513 968 943 1024">Dividends paid are classified as financing activities.</p>	<p data-bbox="979 436 1349 520">Under IAS 7, entities may present interest paid as either operating or financing activities.</p> <p data-bbox="979 541 1409 632">In addition, entities may present interest and dividends received as either operating or investing activities.</p> <p data-bbox="979 653 1409 793">Note that IAS 7 does not include a requirement to determine whether a distribution from an equity method investment is a return on, or a return of, the entity's investment.</p>
Settlement of zero-coupon debt instruments or other debt instruments that are insignificant in relation to the effective interest rate of the borrowing	As bonds are accreted from issuance to maturity, the interest expense is presented as a reconciling item between net income and cash flows from operating activities. At redemption, the cash paid to settle the interest component is classified as an operating activity and the cash paid to settle the principal is classified as a financing activity. See Sections 6.4.2 and 6.4.3 .	Rather than including specific guidance as is done in U.S. GAAP, IFRS Standards include principles related to assessing the classification of the cash flows as operating, investing, or financing activities.
Contingent consideration payments made after the date of a business combination	Contingent consideration payments that are not made soon after the acquisition date must be classified as financing activities; any excess cash payments will be classified as operating activities. Cash payments made soon after the acquisition date in a business combination transaction must be classified as investing activities (see Section 7.5.4.1).	IFRS Standards do not provide guidance similar to that in U.S. GAAP (under U.S. GAAP, such guidance is based on when contingent consideration payments are made in relation to the date of a business combination). Instead, an entity should assess the nature of the transaction on the basis of the general principle of classification of the cash flows as operating or financing activities.
Proceeds from the settlement of insurance claims	Proceeds from the settlement of insurance claims should generally be classified on the basis of the nature of the loss (see Section 6.3.2).	Rather than including specific guidance as is done in U.S. GAAP, IFRS Standards include principles related to assessing the classification of the cash flows as operating, investing, or financing activities.

(Table continued)

Subject	U.S. GAAP	IFRS Standards
Proceeds from the settlement of company-owned or bank-owned life insurance policies	ASC 230-10-45-21C indicates that proceeds from the settlement of company-owned or bank-owned life insurance policies should be classified as investing activities (see Section 6.1.7).	Rather than including specific guidance as is done in U.S. GAAP, IFRS Standards include principles related to assessing the classification of the cash flows as operating, investing, or financing activities.
Beneficial interests in a securitization transaction	For U.S. GAAP guidance, see Sections 7.9 and 7.9.1 .	Rather than including specific guidance as is done in U.S. GAAP, IFRS Standards include principles related to assessing the classification of the cash flows as operating, investing, or financing activities.
Income tax effects of share-based payment awards	Excess tax benefits or tax deficiencies represent operating activities (see Section 7.3.2).	IFRS Standards do not include explicit guidance on classifying excess tax benefits related to share-based payment awards.
Remittances of minimum statutory withholding on share-based payment awards	For U.S. GAAP guidance, see Section 7.3.6 .	IAS 7 does not specify how an entity should classify cash that an employer pays to tax authorities when the entity repurchases shares from the employee to satisfy the entity's tax withholding obligation. An entity should assess the nature of the cash flows as operating or financing, as well as the applicable noncash activity disclosures.
Leases	After the adoption of ASC 842, a lessee should present payments associated with operating leases as an operating activity in the statement of cash flows. A lessee should present payments associated with finance leases in the statement of cash flows as (1) a financing activity, for the principal portion of the payment, and (2) an operating activity, for the interest portion of the payment. See Section 7.6.1 .	Under IFRS 16, a lessee is required to use a single approach (similar to the FASB's finance lease approach) to subsequently account for the ROU asset. For this reason, the lessee should present payments associated with its leases in the statement of cash flows as (1) a financing activity, for the principal portion of the payment in accordance with IAS 7.17(e), and (2) interest as either a financing or an operating activity in the statement of cash flows, depending on the lessee's accounting policy election under IAS 7. ¹

¹ Paragraph 33 of IAS 7 acknowledges that there is no consensus on the classification of interest paid and that an entity may therefore choose to classify interest paid as either an operating activity or a financing activity.

Appendix E — Changes Made in the 2019 Edition of This Publication

The tables below summarize the substantive changes made in the 2019 edition of this Roadmap as a result of FASB and SEC activity as well as practice developments.

New Content

Section Added	Title	Description
7.5.5	Acquired IPR&D Assets With No Alternative Future Use	Discusses interpretive views that have resulted from diversity in practice related to how cash payments for IPR&D assets acquired in an asset acquisition (when such assets have no alternative future use) are presented in the statement of cash flows.
7.12	Cloud Computing Arrangements	Discusses the presentation in the statement of cash flows of implementation costs incurred in a cloud computing arrangement that is a service contract.

Amended Content

Section Amended	Title	Description of Change
4.1.1	Restricted Cash	Removed pre- and post-effective-date discussions related to ASU 2016-18 because the ASU is or will be effective for all entities in 2019. Accordingly, Example 4-1B was also deleted since it is no longer relevant.
4.1.2	Classification of Interest Earned on Restricted Funds	Removed pre- and post-effective-date discussions related to ASU 2016-18 because the ASU is or will be effective for all entities in 2019. Accordingly, Examples 4-1C and 4-1D were also deleted since they are no longer relevant.
6.1.4	Distributions From Equity Method Investments	Removed pre- and post-effective-date discussions related to ASU 2016-15 because the ASU is or will be effective for all entities in 2019.
6.1.6	Securities	Reorganized into separate sections for debt securities and equity securities and updated references to ASU 2016-01, which is codified in ASC 321.

(Table continued)

Section Amended	Title	Description of Change
6.1.7	Company- and Bank-Owned Life Insurance Policies	Removed pre- and post-effective-date discussions related to ASU 2016-15 because the ASU is or will be effective for all entities in 2019.
6.2.1	Debt Extinguishments and Modifications	Removed pre- and post-effective-date discussions related to ASU 2016-15's guidance on debt extinguishments because the ASU is or will be effective for all entities in 2019. Added interpretive views on debt modifications.
6.3.2	Cash Proceeds From Insurance Claims	Removed pre- and post-effective-date discussions related to ASU 2016-15 because the ASU is or will be effective for all entities in 2019.
6.4	More Than One Class of Cash Flows	Removed pre- and post-effective-date discussions related to ASU 2016-15 because the ASU is or will be effective for all entities in 2019. In addition, reorganized existing examples in the context of the revised section, including by adding Example 6-7D.
6.4.2	Classification of Cash Flows of Repayments of Zero-Coupon Bonds and Other Debt Instruments With Coupon Interest Rates That Are Insignificant in Relation to the Effective Interest Rate of the Borrowing	Removed pre- and post-effective-date discussions related to ASU 2016-15 because the ASU is or will be effective for all entities in 2019. Also deleted Example 6-9 because it is no longer relevant.
6.5	Changes to Historical Classification	Added Example 6-10.
7.3.2	Income Tax Effects of Share-Based Payment Awards	Removed interpretive views on periods before ASU 2016-09 is effective, including Example 7-1.
7.3.6	Remittances of Minimum Statutory Withholding on Share-Based Payment Awards	Removed interpretive views on periods before ASU 2016-09 is effective and included considerations related to ASU 2018-07, which was issued in June 2018 and addresses the accounting for share-based payments to nonemployees.
7.5.3	Debt in a Business Combination	Included additional considerations. Replaced Example 7-6 with Examples 7-6A and 7-6B.
7.5.4.1	Contingent Consideration Classified as a Liability	Removed pre- and post-effective-date discussions related to ASU 2016-15 because the ASU is or will be effective for all entities in 2019.
7.6	Leases	Added discussion of the presentation of certain lease-related balances in the statement of cash flows before and after an entity adopts ASC 842.
7.9	Classification of Cash Flows Related to Beneficial Interests in Trade Receivables	Removed pre- and post-effective-date discussions related to ASU 2016-15 because the ASU is or will be effective for all entities in 2019. Deleted Examples 7-14 and 7-14A because they are no longer relevant.

Deleted Content

Section Deleted	Title	Description
3.4	Presentation as a Result of a Reporting Entity's Adoption of ASU 2015-02	ASU 2015-02 and ASU 2016-18 are or will become effective for all entities in 2019. As a result, this section is no longer applicable.
7.3.3	Tax Benefit Deficiencies of Share-Based Payment Awards	Section deleted and incorporated into Section 7.3.2. Deleted Examples 7-1, 7-1A, and 7-2 because they are no longer relevant.

Appendix F — Titles of Standards and Other Literature

The following are the titles of standards and other literature mentioned in this publication:

AICPA Literature

Accounting and Valuation Guide

Assets Acquired to Be Used in Research and Development Activities

Audit and Accounting Guide

Brokers and Dealers in Securities

Technical Questions and Answers

Section 1300.13, "Classification of Increase in Cash Value of Officers' Life Insurance in Statement of Cash Flows"

Section 1300.15, "Presentation of Cash Overdraft on Statement of Cash Flows"

Section 1300.16, "Purchase of Inventory Through Direct Financing"

Section 1300.18, "Presentation on the Statement of Cash Flows of Distributions From Investees With Operating Losses"

Section 4110.09, "Costs Incurred to Acquire Treasury Stock"

FASB Literature

ASC Topics

ASC 205, *Presentation of Financial Statements*

ASC 210, *Balance Sheet*

ASC 230, *Statement of Cash Flows*

ASC 235, *Notes to Financial Statements*

ASC 250, *Accounting Changes and Error Corrections*

ASC 255, *Changing Prices*

ASC 305, *Cash and Cash Equivalents*

ASC 320, *Investments — Debt and Equity Securities*

ASC 321, *Investments — Equity Securities*

ASC 325, *Investments — Other*
ASC 326, *Financial Instruments — Credit Losses*
ASC 350, *Intangibles — Goodwill and Other*
ASC 360, *Property, Plant, and Equipment*
ASC 405, *Liabilities*
ASC 470, *Debt*
ASC 718, *Compensation — Stock Compensation*
ASC 730, *Research and Development*
ASC 740, *Income Taxes*
ASC 805, *Business Combinations*
ASC 810, *Consolidation*
ASC 815, *Derivatives and Hedging*
ASC 820, *Fair Value Measurement*
ASC 825, *Financial Instruments*
ASC 830, *Foreign Currency Matters*
ASC 835, *Interest*
ASC 840, *Leases*
ASC 842, *Leases*
ASC 852, *Reorganizations*
ASC 860, *Transfers and Servicing*
ASC 908, *Airlines*
ASC 940, *Financial Services — Brokers and Dealers*
ASC 942, *Financial Services — Depository and Lending*
ASC 946, *Financial Services — Investment Companies*
ASC 948, *Financial Services — Mortgage Banking*
ASC 958, *Not-for-Profit Entities*
ASC 960, *Plan Accounting — Defined Benefit Pension Plans*
ASC 985, *Software*

ASUs

2013-08, *Financial Services — Investment Companies (Topic 946): Amendments to the Scope, Measurement, and Disclosure Requirements*

2014-08, *Presentation of Financial Statements (Topic 205) and Property, Plant, and Equipment (Topic 360): Reporting Discontinued Operations and Disclosures of Disposals of Components of an Entity*

2015-02, *Consolidation (Topic 810): Amendments to the Consolidation Analysis*

2015-15, *Interest — Imputation of Interest (Subtopic 835-30): Presentation and Subsequent Measurement of Debt Issuance Costs Associated With Line-of-Credit Arrangements: Amendments to SEC Paragraphs Pursuant to Staff Announcement at June 18, 2015 EITF Meeting*

2015-16, *Business Combinations (Topic 805): Simplifying the Accounting for Measurement-Period Adjustments*

2016-01, *Financial Instruments — Overall (Subtopic 825-10): Recognition and Measurement of Financial Assets and Financial Liabilities*

2016-02, *Leases (Topic 842)*

2016-09, *Compensation — Stock Compensation (Topic 718): Improvements to Employee Share-Based Payment Accounting*

2016-14, *Not-for-Profit Entities (Topic 958): Presentation of Financial Statements of Not-for-Profit Entities*

2016-15, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments — a consensus of the FASB Emerging Issues Task Force*

2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash — a consensus of the FASB Emerging Issues Task Force*

2018-07, *Compensation — Stock Compensation (Topic 718): Improvements to Nonemployee Share-Based Payment Accounting*

2018-15, *Intangibles — Goodwill and Other — Internal-Use Software (Subtopic 350-40): Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*

2019-01, *Leases (Topic 842) — Codification Improvements*

International Standards

IFRS 5, *Non-Current Assets Held for Sale and Discontinued Operations*

IFRS 8, *Operating Segments*

IFRS 9, *Financial Instruments*

IFRS 10, *Consolidated Financial Statements*

IFRS 11, *Joint Arrangements*

IFRS 15, *Revenue From Contracts With Customers*

IFRS 16, *Leases*

IAS 1, *Presentation of Financial Statements*

IAS 7, *Statement of Cash Flows*

IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*

IAS 12, *Income Taxes*

IAS 16, *Property, Plant and Equipment*

IAS 17, *Leases*

IAS 21, *The Effects of Changes in Foreign Exchange Rates*

IAS 23, *Borrowing Costs*

IAS 32, *Financial Instruments: Presentation*

IAS 39, *Financial Instruments: Recognition and Measurement*

SEC Literature

Final Rule

No. 33-9616, *Money Market Reform; Amendments to Form PF*

Regulation S-X

Rule 3-10, "Financial Statements of Guarantors and Issuers of Guaranteed Securities Registered or Being Registered"

SAB Topic

SAB Topic 5.A, "Expenses of Offering"

Superseded Literature

EITF Issues

15-F, "Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments"

16-A, "Restricted Cash"

FASB Statements

No. 13, *Accounting for Leases*

No. 95, *Statement of Cash Flows*

No. 102, *Statement of Cash Flows — Exemption of Certain Enterprises and Classification of Cash Flows From Certain Securities Acquired for Resale*

No. 115, *Accounting for Certain Investments in Debt and Equity Securities*

No. 123(R), *Share-Based Payment*

No. 141(R), *Business Combinations*

No. 159, *The Fair Value Option for Financial Assets and Financial Liabilities*

FASB Technical Bulletin

No. 88-1, *Issues Relating to Accounting for Leases*

Appendix G — Abbreviations

Abbreviation	Description
AICPA	American Institute of Certified Public Accountants
APIC	additional paid-in capital
ARS	auction rate security
ASC	FASB Accounting Standards Codification
ASU	FASB Accounting Standards Update
BOLI	bank-owned life insurance
CCA	cloud computing arrangement
COLI	company-owned life insurance
CPP	cash purchase price
DPP	deferred purchase price
EA	emission allowance
EITF	Emerging Issues Task Force
ERISA	Employee Retirement Income Security Act of 1974
EUR	euro
FASB	Financial Accounting Standards Board
GAAP	generally accepted accounting principles
IAS	International Accounting Standard
IFRIC	IFRS Interpretations Committee

Abbreviation	Description
IFRS	International Financial Reporting Standard
IPR&D	in-process research and development
LC	local currency
MD&A	Management's Discussion and Analysis
MMF	money market fund
NAV	net asset value
NFP	not-for-profit (entity)
OCA	SEC's Office of the Chief Accountant
PCAOB	Public Company Accounting Oversight Board
R&D	research and development
ROU	right of use
SAB	SEC Staff Accounting Bulletin
SEC	Securities and Exchange Commission
SFAS	Statement of Financial Accounting Standards
VRDN	variable-rate demand note
USD	U.S. dollar