



BLUEPRINT: A BDO SERIES

# Statement of Cash Flows Under ASC 230

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# Overview

This Blueprint summarizes the guidance on reporting and classifying cash receipts and payments in a cash flow statement, which is primarily codified in Financial Accounting Standards Board (FASB) Accounting Standards Codification (ASC) 230, *Statement of Cash Flows*. It also includes interpretive guidance, examples, and insights on applying ASC 230.

ASC 230 requires a cash flow statement to be included as part of a full set of financial statements for most entities. It also provides standards for reporting cash flows in general-purpose financial statements whose objective is to provide useful financial information about an entity to existing and potential investors, lenders, and other resource providers (collectively, users) in making decisions about providing resources to the entity.

The primary objective of a cash flow statement is to provide users with relevant information about an entity's cash receipts and payments during the reporting period, which they use along with other information in the financial statements and disclosures to assess the entity's cash flow generation capabilities, liquidity, and financial flexibility (for example, the entity's ability to finance growth organically). The cash flow statement may, for example, help lenders or equity investors assess the entity's ability to generate positive future net cash flows through operations to repay debt, distribute dividends, and reinvest cash to maintain or expand operating capacity. The cash flow statement and related disclosures also help users understand and bridge the differences between net income and the associated cash receipts and payments and assess the effects on an entity's financial position of both its cash and noncash investing and financing transactions during the period.

## SCOPE OF ASC 230

ASC 230 applies to all entities, including business entities and not-for-profit entities (NFPs), with some exceptions. If the entity provides a set of financial statements that includes **both** a balance sheet and an income statement, it must provide a cash flow statement for each period for which an income statement (or statement of activities for NFPs) is provided.

See Chapter 1 for scope and scope exceptions.

## CASH, CASH EQUIVALENTS, AND RESTRICTED CASH

A cash flow statement explains the changes during a reporting period in an entity's total cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents (and referred to as such in this Blueprint). Transfers among cash, cash equivalents, restricted cash, and restricted cash equivalents are not cash inflows or outflows of the entity because there is no cash receipt or payment with a source outside the entity. In contrast, cash receipts into or payments from cash, cash equivalents, restricted cash and restricted cash equivalents with third parties represent cash flows an entity classifies as operating, investing, or financing. Accordingly, an entity must appropriately identify items reported as cash, cash equivalents, restricted cash, and restricted cash equivalents.

See Chapter 2 for what is considered cash, cash equivalents, restricted cash, and restricted cash equivalents.

## REPORTING CASH FLOWS

### Gross vs. Net

In reporting its cash flows, an entity typically must report cash receipts and payments separately so that users receive relevant information about its cash flow activities. That is the case for investing and financing activities, which typically must be reported separately. However, gross reporting might not always be necessary to understand the entity's cash flows, and net reporting is sufficient when conditions are met.

### Reporting Cash Flows From Operating Activities

ASC 230 encourages entities to report cash flows from operating activities directly by showing major classes of operating cash receipts and payments (the direct method) but stops short of requiring it. Most entities report operating cash flows indirectly (the indirect method). Under the indirect method, the entity adjusts net income for revenue and expense items that were not the result of operating cash transactions during the reporting period.

## Other Reporting Matters

Other reporting matters an entity considers include:

- ▶ Whether to report constructive cash receipts and payments for transactions when cash did not pass through the entity's cash accounts.
- ▶ How to report cash flows when an entity has components (or groups of components) presented as discontinued operations.
- ▶ What cash flow information is required in interim financial statements.

See Chapter 3 for reporting requirements.

## CLASSIFYING CASH FLOWS

Under ASC 230, an entity classifies cash receipts and payments as one of three categories:



Classification is based on the nature of the cash flow and is intended to provide financial statement users with relevant information about how an entity generates and uses cash.

- ▶ Investing activities generally involve the acquisition and disposal of productive assets, such as cash paid to purchase property, plant, and equipment (PP&E), and investments not classified as cash equivalents.
- ▶ Financing activities relate to changes in the size and composition of the entity's equity and borrowings and includes cash inflows from issuing shares or debt and cash outflows such as dividend payments or debt repayments.
- ▶ Operating activities represent the residual category – that is, any cash flow that is not investing or financing activities; it typically includes the cash effects of transactions that affect net income, such as cash receipts from customers and cash payments to employees and suppliers of goods and services.



### CATEGORIES NOT MUTUALLY EXCLUSIVE

Some cash receipts and payments have aspects of more than one class of cash flows. Therefore, the three categories (investing, financing, and operating) are not mutually exclusive, and judgment may be required to classify a transaction. Classification depends on:

- ▶ Whether there is specific guidance in ASC 230 or other U.S. generally accepted accounting principles (GAAP).
- ▶ If not, whether the cash receipts and payments can be separated by identifiable source or use.
- ▶ If not, the activity that is the predominant source or use of cash flows for the item.

To help entities classify cash flows, ASC 230 provides examples of the types of activities included in each category, as shown below.

<p>Investing activities</p> 	<ul style="list-style-type: none"> <li>▶ Making and collecting loans and acquiring and disposing of debt or equity instruments (except for specific loans or other debt or equity instruments acquired specifically for resale)</li> <li>▶ Acquiring and disposing of PP&amp;E and other productive assets (that is, assets held for or used by the entity in the production of goods or services other than materials that are part of the entity's inventory)</li> </ul>
<p>Financing activities</p> 	<ul style="list-style-type: none"> <li>▶ Obtaining resources from owners and providing them with a return on, and of, their investment</li> <li>▶ Receiving restricted resources that by donor stipulation must be used for long-term purposes</li> <li>▶ Borrowing money and repaying amounts borrowed or settling the obligation</li> <li>▶ Obtaining and paying for other resources obtained from creditors on long-term credit</li> </ul>
<p>Operating activities</p> 	<ul style="list-style-type: none"> <li>▶ Producing and delivering goods and providing services</li> <li>▶ Generally, the cash effects of transactions and other events that affect net income</li> <li>▶ All other transactions and events that are not defined as investing or financing activities</li> </ul>

ASC 230 also provides additional guidance for each category (see Chapter 4).

See Chapter 5 for in-depth cash flow guidance on specific transactions and Chapter 7 for a comprehensive example on classifying cash flows and disclosing cash flow information under ASC 230.

## DISCLOSURES

ASC 230 (or sometimes other U.S. GAAP) requires entities to provide disclosures to inform users about an entity's accounting policies in preparing its cash flow statement and to provide additional information not otherwise provided in the statement itself. For example, entities must disclose information about noncash investing and financing activities which, while not having a current-period cash effect, generally have a significant effect on the entity's future cash flows.

See Chapter 6 for disclosure requirements.

## INDUSTRY GUIDANCE

While ASC 230 is the primary source of cash flow guidance, some industry specific topics in U.S. GAAP include incremental cash flow guidance.

See Chapter 8 for industry guidance.

## HISTORY OF CASH FLOW GUIDANCE AND FUTURE STANDARD-SETTING

Users have consistently focused on the cash flow statement to understand an entity's cash flow activities – that is, the sources and uses of its cash. However, the primary cash flow guidance was issued in the late 1980s and has not been holistically revisited. The primary cash flow guidance was first issued in 1987 under Statement of Financial Accounting Standards (SFAS) No. 95, *Statement of Cash Flows*, now codified in ASC 230, which required all business enterprises to include a cash flow statement in their financial statements. It was further amended by SFAS No. 102, *Statement of Cash Flows – Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale* and SFAS No. 104, *Statement of Cash Flows – Net Reporting of Certain Cash Receipts and Cash Payments and Classification of Cash Flows from Hedging Transactions*.

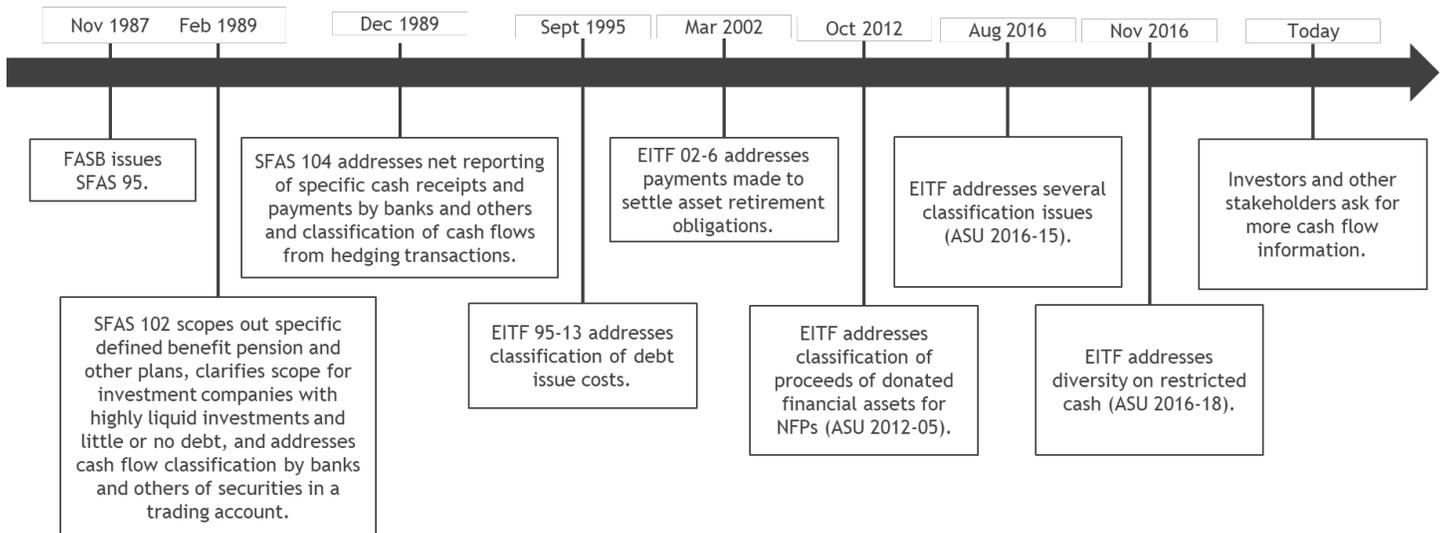
Targeted amendments were made over the years to address scope exceptions, gross vs. net reporting of cash flows, and issues for which there was diversity in practice. That included situations in which cash items have aspects of more

than one class of cash flows, in part because of the definition of operating activities, which includes transactions and other events that affect net income. The Emerging Issues Task Force (EITF) addressed many of those issues:

- ▶ EITF No. 95-13, *Classification of Debt Issue Costs in the Statement of Cash Flows*
- ▶ EITF No. 02-6, *Classification in the Statement of Cash Flows of Payments Made to Settle an Asset Retirement Obligation within the Scope of FASB Statement No. 143*
- ▶ ASU 2012-05, *Not-for-Profit Entities: Classification of the Sale Proceeds of Donated Financial Assets in the Statement of Cash Flows*
- ▶ ASU 2016-15, *Classification of Certain Cash Receipts and Cash Payments*
- ▶ ASU 2016-18, *Restricted Cash*

More recently, investors and other users have identified improvements to the cash flow statement as a top priority, including in the [2021](#) and [2025](#) FASB Invitation to Comment – Agenda Consultation, in which they asked for more disaggregated and transparent information. The Securities and Exchange Commission (SEC) staff also has [remarked](#) on the importance of high-quality and reliable information in the cash flow statement as a critical component for investors.

The graphic summarizes the evolution of the cash flow guidance under ASC 230 since the issuance of SFAS 95.



## FASB PROJECTS: CASH FLOW STATEMENT

The FASB has two projects on its agenda related to cash flow issues.

- ▶ [Making targeted improvements for financial institutions](#) to:
  - Reorganize and disaggregate the cash flow statement to improve its decision usefulness.
  - Develop a disclosure about an entity's cash interest received.
- ▶ [Clarifying whether some digital assets \(such as stablecoins\) can be classified as cash equivalents](#)

The FASB also has placed a [research project](#) on its agenda to explore further potential improvements and may address additional cash flow issues raised by stakeholders.

## ABOUT THE BLUEPRINT

This Blueprint summarizes ASC 230 after adopting the following Accounting Standards Updates (ASU):

- ▶ ASU 2023-08, *Intangibles – Goodwill and Other – Crypto Assets (Subtopic 350-60)* (see BDO’s Bulletin: [FASB Issues Accounting Standard for Certain Crypto Assets](#), for guidance on effective dates)
- ▶ ASU 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures* (see BDO’s Bulletin: [BDO Knows ASC 740: New Income Tax Disclosures \(ASU 2023-09\)](#), for guidance on effective dates)

This Blueprint refers to those collectively as “ASC 230.” It also includes reference to nonauthoritative guidance in AICPA Technical Questions and Answers (TQA) and speeches by SEC staff.

This Blueprint summarizes key aspects of ASC 230 that commonly arise when applying ASC 230 and includes practical examples and interpretive guidance to help entities and practitioners apply ASC 230. It is organized into chapters in an order that facilitates the understanding of the requirements and concepts related to preparing and presenting a cash flow statement. All references to income statement and net income include the statement of activities and change in net assets, respectively, for an NFP.

While ASC 230 is the primary source of guidance on cash flow classification and reporting, some other topics provide incremental cash flow guidance, such as ASC 320, *Investments – Debt Securities*, which includes guidance on classifying and reporting cash flows from available-for-sale, held-to-maturity, and trading debt securities. This Blueprint includes the guidance in those topics (for example, see Section 5.3 for investments). Chapter 8 discusses industry-specific cash flow guidance.

The graphics and illustrations in this Blueprint are provided to help readers understand the accounting guidance. Classifying cash flows for an entity’s transactions may vary based on the facts and circumstances and therefore may differ from the illustrations provided in this Blueprint.

The arrow shows the organization of this Blueprint.



This Blueprint focuses on U.S. GAAP. More information on cash flow classification under International Financial Reporting Standards (IFRS) is available [here](#).

## ACKNOWLEDGEMENTS

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# Chapter 1: Scope of ASC 230



## 1.1 OVERVIEW: SCOPE OF ASC 230



### FASB REFERENCES

ASC 230-10-15-1 through 15-3

ASC 230 applies to all entities including business entities and NFPs, with some exceptions (see Section 1.2). If the entity provides a set of financial statements that includes a balance sheet **and** an income statement, it must provide a cash flow statement for each period for which an income statement is provided.

### **BDO INSIGHTS: WHEN AND HOW MANY CASH FLOW STATEMENTS TO PROVIDE**

An entity with financial statements that include a balance sheet and income statement must provide a cash flow statement for each period it provides an income statement. For example, if a business entity provides a balance sheet for the fiscal year ended 20X5 and comparative income statements for the fiscal years ended 20X4 and 20X5, it must provide a cash flow statement for the fiscal years ended 20X4 and 20X5 (each period an income statement is provided).<sup>1</sup> If the same business entity were to provide a balance sheet only for the fiscal year ended 20X5, or only an income statement for the fiscal year ended 20X5, no cash flow statement would be required.<sup>2</sup> See Section 3.6 for interim reporting considerations.

<sup>1</sup> AICPA TQA 1300.03, *Comparative Statements of Cash Flows*.

<sup>2</sup> Id. at 1300.05, *Statement of Cash Flows for Annual Report With Balance Sheet Only*.

**BDO INSIGHTS: FINANCIAL INSTITUTIONS NOT SCOPED OUT OF ASC 230**

ASC 230 applies to most entities, including financial institutions such as commercial banks. While the nature of their business and cash flow activities differ from those of nonfinancial entities, the FASB did not scope them out of ASC 230 in part because banks, like nonfinancial entities, need cash to invest in their operations, pay their obligations, and provide a return to their investors. However, the FASB accommodated their reporting of specific cash activities (see Sections 3.2 and 8.5). Also, as discussed in the Overview Chapter, the FASB has added a project on making targeted improvements for financial institutions, including to reorganize and disaggregate their cash flow statements.

**1.2 SCOPE EXCEPTIONS FROM ASC 230****FASB REFERENCES**

ASC 230-10-15-4 and ASC 820-10-35-59

ASC 230 does not apply to the following entities:

- ▶ Defined benefit pension plans (or other employee benefit plans, such as health and welfare plans) that present financial information in accordance (or consistent) with the guidance in ASC 960, *Plan Accounting – Defined Benefit Pension Plans*.
  - While not required, an employee benefit plan is encouraged to include a cash flow statement in its annual financial statements if that would provide users with relevant information about the plan's ability to meet future obligations, such as when the plan invests in assets that are not highly liquid, such as real estate, or obtains financing for its investments.
- ▶ Investment companies in the scope of ASC 946, *Financial Services – Investment Companies*; common trust funds; variable annuity accounts; or similar funds 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. However, to be scoped out of ASC 230, the entity must meet **all** the conditions below.

 <p><b>Measurement and Terms of Investments</b></p>	Substantially all its investments during the period were carried at fair value and classified as Level 1 or 2 under ASC 820, <i>Fair Value Measurement</i> (or were measured using the net asset value per share practical expedient in ASC 820-10-35-59), and are at all times redeemable in the near term.
 <p><b>Little or No Debt</b></p>	It had little or no debt, based on the average debt outstanding during the period in relation to average total assets. <sup>3</sup>
 <p><b>Statement of Changes in Net Assets</b></p>	It provides a statement of changes in net assets.

<sup>3</sup> When 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 not in accordance with standard industry practices for redeeming shares or for settling purchases of investments are included in average debt outstanding.

See BDO's Blueprint, [Control and Consolidation Under ASC 810](#), for considerations on the definition of an investment company, including the fundamental and other characteristics of an investment company.

## 1.3 FOREIGN CURRENCY MATTERS: STATEMENT OF CASH FLOWS



### FASB REFERENCES

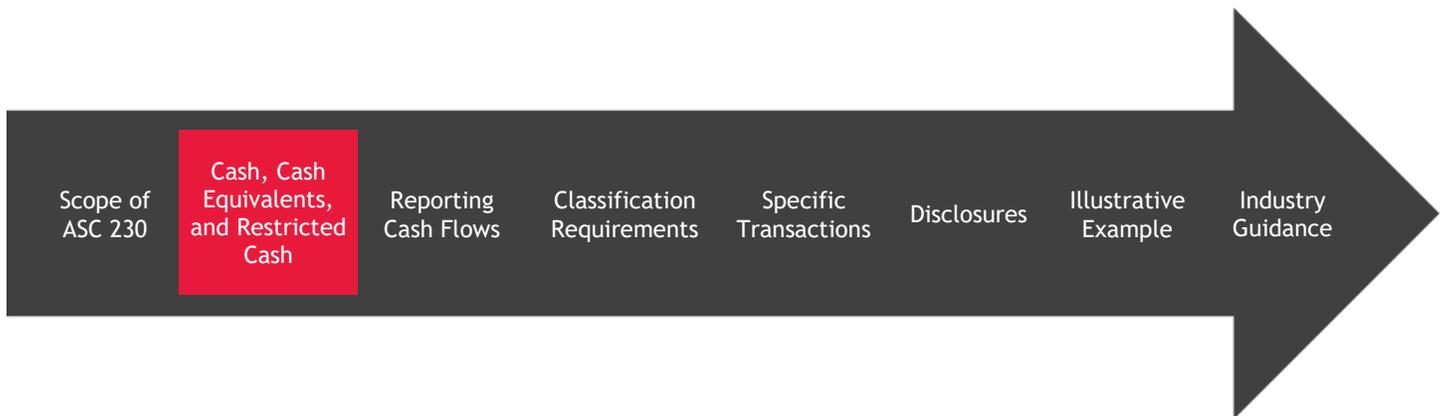
ASC 830-230-45-1 and ASC 830-230-55-1

ASC 830-230, *Foreign Currency Matters – Statement of Cash Flows*, provides guidance on reporting cash flows for entities with foreign currency transactions or foreign currency operations. While exchange rate changes for assets and liabilities denominated in a foreign currency can affect the amount of cash receipts or payments, exchange rate changes do not, by themselves, give rise to cash flows. Accordingly, and because a cash flow statement's purpose is to report cash receipts and payments during a reporting period, the effect of exchange rate changes on items other than cash are not reported in the cash flow statement. Therefore:

- ▶ The reporting currency equivalent of foreign currency cash receipts and payments is reported using the exchange rates in effect at the time of the cash receipts or payments (which can be a weighted average exchange rate if the outcome is substantially the same).
- ▶ The effect of exchange rate changes on cash, cash equivalents, restricted cash, and restricted cash equivalents that are held in foreign currencies is reported as a separate item in the reconciliation of beginning and ending total cash balances.

Example 1 in ASC 830-230-55-1 provides an illustration.

# Chapter 2: Cash, Cash Equivalents, and Restricted Cash



## 2.1 OVERVIEW: CASH, CASH EQUIVALENTS, AND RESTRICTED CASH



### FASB REFERENCES

ASC 230-10-45-4 through 45-6

A cash flow statement explains the changes during the reporting period in the total of cash, cash equivalents, restricted cash, and restricted cash equivalents. Transfers among cash, cash equivalents, and restricted cash or restricted cash equivalents are not cash inflows or outflows of the entity because there is no cash receipt or payment with a source outside the entity. In contrast, cash receipts into or payments from cash, cash equivalents, restricted cash, or restricted cash equivalents with third parties are cash flows the entity classifies as operating, investing, or financing (see Chapter 4). Accordingly, the entity must appropriately identify items reported as cash, cash equivalents, restricted cash, and restricted cash equivalents.

Whether cash is on hand, on deposit, or invested in highly liquid short-term financial instruments is irrelevant to users' assessments of an entity's liquidity and future cash flows because the movements from one form of cash to another is not meaningful to them.<sup>4</sup> Accordingly, the cash flow statement focuses in part on the aggregate of cash and cash equivalents, which ASC 230 defines (see Section 2.2 for cash and Section 2.3 for cash equivalents). However, not all investments that qualify as cash equivalents are reported as such in the cash flow statement based on an entity's accounting policy (see Section 2.3.2).

In contrast, ASC 230 does not define the term "restricted cash," but it does provide some examples. Entities also may look to S-X Rule 5-02(1), which provides guidance on cash and cash items subject to restrictions on withdrawal or use (see Section 2.4). Because there is no definition of restricted cash and restricted cash equivalents, an entity must disclose information about its restricted cash balances (see Section 6.3).

<sup>4</sup> SFAS 95, para. 51.

Digital assets such as cryptocurrency are not considered cash because they are not backed by a sovereign government or considered legal tender, and they are generally not considered cash equivalents because they do not have a maturity date (as discussed in Section 2.3) and experience significant price volatility.<sup>5</sup> See Section 5.9.3.1 for the cash flow presentation of sales of crypto assets.

An entity cannot use ambiguous terms such as “funds” in its cash flow statement. Rather, an entity must use descriptive terms such as “cash” or “cash and cash equivalents.” If cash and related cash accounts, such as restricted cash, are presented in more than one line item on the balance sheet, specific disclosures are required (see Section 6.3).



## FASB PROJECTS: CASH FLOW STATEMENT

After considering feedback received during its outreach activities, including the 2025 agenda consultation and [report](#) from the President’s Working Group on Digital Asset Markets, the FASB added to its agenda a [project](#) on clarifying whether some digital assets (such as stablecoins) can be classified as cash equivalents.

## 2.2 CASH

### 2.2.1 Overview: Cash



## FASB REFERENCES

### ASC 230-10-20: 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.*

Based on the definition, cash includes currency on hand (petty cash and checks on hand), demand deposits, and similar accounts in which the entity (customer) can deposit and withdraw funds at any time without prior notice or penalty. Savings accounts also typically are considered cash.

<sup>5</sup> AICPA Audit and Accounting Guide, “Accounting for and Auditing of Digital Assets,” Ch. 1, Question 1.

## 2.2.2 Cash Overdrafts



### FASB REFERENCES

ASC 210-20-45-1 and ASC 210-20-55-18A

Entities and banks regularly enter arrangements whereby banks will accept and honor disbursements even if they exceed the funds on deposit in the entities' bank accounts. That could result in an entity having a bank account with a negative balance, which the entity must present as debt, not cash, in its balance sheet. Accordingly, the change in bank overdrafts in a reporting period is presented within financing activities, not as part of cash.

### BDO INSIGHTS: PRESENTATION CONSIDERATIONS FOR ENTITIES WITH MULTIPLE BANK ACCOUNTS

An entity may have multiple bank accounts, either with the same or different banks, with some bank accounts in a positive balance and some in a negative (overdraft) position. Typically, the entity **cannot** net those amounts on the balance sheet and cash flow statement.<sup>6</sup>

For example, an entity has five bank accounts, with four accounts in a positive balance and one in an overdraft position.

- ▶ If the five accounts are with different banks, the entity presents the activity from the four positive bank accounts as cash and the change in bank overdrafts within financing activities because the accounts are with different banks (counterparties) and therefore cannot be offset.
- ▶ If the five accounts are with the same bank, ASC 210-20-55-18A states that the depositor considers cash on deposit at a financial institution as cash rather than as an amount owed to the depositor (receivable). Therefore, the deposited cash typically cannot be used to offset an overdraft position (debt) in another bank account with the same bank.

Determining whether the right-of-setoff requirements are met requires the use of professional judgment based on the facts and circumstances.

## 2.2.3 Checks Issued Near Reporting Period-End and Book Overdrafts

Many entities have processes to write checks before month-end to settle amounts becoming due on accounts payables. As part of their cash management strategy and to prevent cash overdrafts (see Section 2.2.2), entities might retain some or all the checks and mail them after the reporting period. Consistent with AICPA TQA 2110.02, *Checks Held at Balance Sheet Date*, the entity must add back all held checks to cash and accounts payable because the entity has custody of and therefore controls those checks.

In contrast, an entity reduces cash for checks that are no longer in its custody and control (that is, checks that were mailed or delivered to the payee) but that have not cleared its account by the balance sheet date. That is consistent with AICPA TQA 1100.08, *Classification of Outstanding Checks*, which notes that the balance sheet caption "cash" represents an amount that is within the entity's control and includes:



If the reduction in cash for checks no longer in the entity's control results in a book overdraft (that is, the sum of those outstanding checks exceeds the amount of cash in banks and deposits in transit), the entity excludes that excess from cash and presents it as a liability.

<sup>6</sup> Consistent with AICPA TQA 1300.15, *Presentation of Cash Overdraft on Statement of Cash Flows*.

**BDO INSIGHTS: CLASSIFYING BOOK OVERDRAFTS IN THE CASH FLOW STATEMENT**

U.S. GAAP does not provide explicit guidance on how to present the change in book overdrafts in the cash flow statement. Unlike cash overdrafts (see Section 2.2.2), a book overdraft does not result in a cash activity, and the bank has not extended credit to the entity. Accordingly, we believe it is most appropriate to present changes in book overdrafts in operating activities or, if the entity reports cash flows from operating activities under the indirect method, in the reconciliation of net income to net cash flows from operating activities (see Section 3.3).

If the entity has multiple bank accounts, either with the same bank or different banks, and some accounts are in a book overdraft position, the entity also must determine the appropriate reporting for those bank accounts. Typically, the entity **cannot** net them on the balance sheet and cash flow statement unless allowed by ASC 210-20, *Balance Sheet – Offsetting* (see Section 2.2.2).

**2.3 CASH EQUIVALENTS****2.3.1 Overview: Cash Equivalents****FASB REFERENCES**

## ASC 230-10-20: 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 equivalents are short-term, highly liquid investments that meet **both** key characteristics below (meeting one characteristic alone, such as maturity, is not sufficient).

- ▶ Readily convertible to known amounts of cash
- ▶ So near their maturity they present insignificant risks of value changes.

Common examples of cash equivalents include U.S. treasury bills, commercial paper, and federal funds sold. Money market funds also are typically considered cash equivalents if they comply with Rule 2a-7 of the Investment Company Act of 1940 because registered money market funds must invest in securities with minimal credit risk and a short duration and are subject to constraints related to credit risk and diversification. Other money market funds must be assessed based on their individual circumstances, including investment policies, liquidity, and restrictions regarding withdrawal. Equity securities (other than money market funds) are not cash equivalents, in part because they do not have a maturity.

Also, as discussed in Section 2.3.2, not all investments meeting the definition of cash equivalents are classified as such.

**BDO INSIGHTS: EMBEDDED FEATURES MIGHT AFFECT WHETHER INVESTMENTS ARE CASH EQUIVALENTS**

Typically, only investments with original maturities of no more than three months from purchase can be considered cash equivalents, assuming they are also readily convertible to known amounts of cash. When assessing the maturity characteristic, we believe an entity must consider the investment's substantive maturity, which might differ from its contractual maturity because of embedded features. For example, an investment with a maturity of greater than three months might include an embedded put right allowing the holder to redeem the investment at any time without penalties. If so, the instrument might meet the definition of cash equivalents if it also is readily convertible to known amounts of cash.

Determining whether an investment meets the definition of cash equivalents requires the use of professional judgment based on the facts and circumstances.

**ONGOING CASH EQUIVALENTS ASSESSMENT**

Determining whether an investment qualifies as cash equivalents is not a one-time assessment made only at the time of acquisition. The entity must reassess classification whenever there is a change in facts or circumstances. For example, an entity holds a money market fund initially considered cash equivalents. If a month after purchase the fund experiences credit and liquidity issues and now imposes fees or redemption gates (restrictions), the entity must reassess whether the money market fund continues to meet the definition of cash equivalents.<sup>7</sup> If the fund no longer represents cash equivalents, the entity must reclassify the investment on its balance sheet and treat the change as a cash outflow, even though the investment remained within the same fund (see Section 5.3 for classification).

An entity should have processes to track changes in facts and circumstances that can change whether a short-term and highly liquid investment continues to meet the definition of cash equivalents.

**2.3.2 Cash Equivalents Policy****FASB REFERENCES**

ASC 230-10-45-6 and ASC 230-10-50-1

Section 2.3.1 defines and provides examples of cash equivalents. However, not all investments that qualify as cash equivalents must be treated as such when preparing the cash flow statement. Accordingly, an entity must establish and consistently apply an accounting policy defining which items are part of cash equivalents (see Section 6.2 for disclosure requirements).

<sup>7</sup> Section III.A.7 in the adopting release for the SEC's [final rules](#) amending the rules that govern money market funds under the Investment Company Act of 1940.

Such a policy should consider an entity's business and cash management practices (that is, its treasury function and activities). For example:

- ▶ An entity with banking operations may have three-month treasury bills and similar highly liquid short-term investments that qualify as cash equivalents but that it purchases for trading purposes and therefore reports as investments rather than cash equivalents.
- ▶ An entity with operations consisting largely of investing in short-term and highly liquid investments that qualify as cash equivalents can report those as investments rather than cash equivalents.

See Section 5.3 for cash flow classification if an entity does not report the investments as cash equivalents.

#### **BDO INSIGHTS: CHANGING AN ENTITY'S CASH EQUIVALENTS ACCOUNTING POLICY**

Any change in the entity's accounting policy regarding what constitutes cash equivalents is a change in accounting principle requiring an assessment of preferability (including a preferability letter for SEC registrants) under ASC 250, *Accounting Changes and Error Corrections*, and retrospective adjustment to the comparative periods presented.

### **2.3.3 Credit and Debit Card Receivable**

Entities might have credit and debit card receivables from payment processors at a reporting date, which typically settle within a few business days.

#### **BDO INSIGHTS: CLASSIFICATION OF CREDIT AND DEBIT CARD RECEIVABLES**

There is diversity in how entities report credit and debit card receivables under ASC 230.

- ▶ Some entities include such amounts in accounts receivable. If the entity reports cash flows from operating activities under the indirect method (see Section 3.3), it reports the change in accounts receivable, including the change in credit and debit card receivables, as a reconciling item from net income to net cash flows from operating activities (see Section 3.3.2).
- ▶ Other entities include such amounts in cash equivalents, assuming the receivables are readily convertible to known amounts of cash and are so near their maturity that there is an insignificant risk of changes in value because of changes in interest rates. If so, the change in such account are part of the reconciliation of beginning-of-period and end-of-period total cash shown in the cash flow statement.

An entity should elect one approach as an accounting policy and apply it consistently.

## **2.4 RESTRICTED CASH AND RESTRICTED CASH EQUIVALENTS**



### **FASB REFERENCES**

ASC 230-10-45-4, ASC 230-10-55-12A, ASC 230-10-55-18A, and ASC 958-205-55-21

Cash and cash equivalents might be restricted for various reasons. As discussed in Section 2.1, an entity includes restricted cash and restricted cash equivalents in the reconciliation of beginning-of-period and end-of-period total cash shown in the cash flow statement. Transfers between cash, cash equivalents, restricted cash, and restricted cash equivalents are not cash inflows or outflows of the entity and are therefore not reported as cash flows from operating, investing, or financing activities because there is no cash receipt or payment with a source outside the entity.

**NO DEFINITION OF RESTRICTED CASH OR RESTRICTED CASH EQUIVALENTS**

ASC 230 does not define restricted cash or restricted cash equivalents. In deliberating ASU 2016-18, the EITF decided not to change practice for what is, or how an entity reports, restricted cash. However, BC9 of ASU 2016-18 highlights some EITF members' belief that only financial instruments that first meet the definition of cash or cash equivalents (before considering restrictions) can be considered restricted cash or restricted cash equivalents.

While ASC 230 does not define restricted cash or restricted cash equivalents, it includes the following examples:

- ▶ Amounts required to be set aside by a contractual agreement with an insurer for the payment of specific workers' compensation claims.
- ▶ Amounts pledged as collateral for long-term financing arrangements as contractually required by a lender.
- ▶ Amounts received with a donor-imposed restriction that limits use of that cash to long-term purposes (for example, investing in land, buildings, and equipment).

S-X Rule 5-02(1) also requires SEC registrants to separately disclose cash and cash items that are restricted for withdrawal or use. It gives the following examples of restrictions:

- ▶ Legally restricted deposits held as compensating balances against short-term borrowing arrangements.
- ▶ Contracts entered with others, such as letters of credit and escrow accounts.
- ▶ An entity's statements of intention for specific deposits, such as cash set aside for use in a capital expenditure program or to meet a specific debt obligation when it comes due.

While such guidance applies to SEC registrants, non-SEC registrants should consider providing similar disclosures.

Because ASC 230 does not define restricted cash and restricted cash equivalents, an entity must develop an accounting policy on what constitutes restricted cash and apply it consistently. See Section 6.3 for disclosures.

**BDO INSIGHTS: CHANGING RESTRICTED CASH AND RESTRICTED CASH EQUIVALENT ACCOUNTING POLICY**

Because there is no definition of restricted cash or restricted cash equivalents in U.S. GAAP, an entity must disclose its accounting policy on what constitutes restricted cash (see Section 6.3). Any change in the entity's accounting policy is a change in accounting principle requiring an assessment of preferability (including a preferability letter for SEC registrants) under ASC 250 and retrospective adjustment to the comparative periods presented.

# Chapter 3: Reporting Cash Flows



## 3.1 OVERVIEW: REPORTING CASH FLOWS



### FASB REFERENCES

ASC 230-10-45-1, ASC 230-10-45-3, and ASC 230-10-45-24

A cash flow statement must report the net cash provided by or used in operating, investing, and financing activities and the net effect of those cash flows during the period on the total of cash, cash equivalents, restricted cash, and restricted cash equivalents. The entity must provide that information such that it reconciles the beginning and ending totals of cash, cash equivalents, restricted cash, and restricted cash equivalents. An entity **cannot** report cash flow per share; cash flow is not meant to replace net income as a measure of an entity's performance.

An entity typically must separately report cash receipts and payments (that is, present such amounts on a gross basis) so that users receive relevant information about the entity's cash activities, particularly for its investing and financing activities. However, gross reporting might not always be necessary to understand the entity's cash flows; net reporting is sufficient when conditions are met (see Section 3.2).

In reporting net cash flows from operating activities, an entity can report those either directly by showing major classes of operating cash receipts and payments (the direct method) or indirectly by reconciling net income to net cash flows from operating activities (the indirect method). ASC 230 encourages entities to report cash flows from operating activities using the direct method but stops short of requiring it. Regardless of the selected method, a business entity must provide a reconciliation of net income to net cash flows from operating activities (see Section 3.3). As a result, most entities apply the indirect method.

In some cases, cash receipts and payments do not directly pass through an entity's bank accounts, such as when a third party acts on the entity's behalf in receiving or disbursing cash. Although the entity does not itself receive or disburse cash, it must consider whether the economic substance indicates that it must report such constructive cash flows in its cash flow statement, which depends on facts and circumstances and may require judgment (see Section 3.4).

If an entity disposes of a component (or group thereof) that it presents as discontinued operations under ASC 205-20, *Presentation of Financial Statements – Discontinued Operations*, it must consider how to report cash flows from the discontinued operations in the cash flow statement (see Section 3.5).

Lastly, SEC registrants filing Form 10-Q must include at a minimum year-to-date interim cash flow statements for the period between the previous fiscal year-end and end of the most recent fiscal quarter, as well as for the corresponding previous period (see Section 3.6).

## 3.2 GROSS AND NET CASH FLOWS



### FASB REFERENCES

ASC 230-10-45-7 through 45-9, ASC 230-10-45-26, ASC 230-10-55-10, and ASC 230-10-55-13

Gross presentation of cash receipts and payments generally provides users with more relevant information than if such amounts are presented net. If an entity were to report only net changes in PP&E in investing activities, users would not have sufficient information about the entity's cash activities related to, for example, purchases, capital expenditures or improvements, and proceeds from the sale of PP&E. Accordingly, cash receipts and payments typically must be presented gross in the cash flow statement.

However, gross presentation is not always necessary to understand the entity's cash flows; net presentation is sufficient when **all** the following conditions are met:



Net Basis  
Presentation  
Criteria Met

- ▶ Turnover is quick
- ▶ Amounts are large
- ▶ Original maturity of the asset or liability is short (three months or less)

Net presentation of cash receipts and payments is not limited to financial institutions; other entities also might have items that meet the net presentation requirements. See Section 8.5 for more guidance related to banks, savings institutions, and credit unions.

When the above conditions are met, the cash flows related to the following items qualify for net presentation:

- ▶ Investments such as trading securities classified in operating activities (see Section 5.3.1).
- ▶ Loans receivable, including financial institution credit card receivables (the cardholder can pay in full when first billed, usually within one month, without incurring interest charges and charges do not stem from the entity's sale of goods or services).
- ▶ Debt with an **original** maturity of three months or less, including debt due on demand.
- ▶ Revolving line of credit arrangements with **original** maturities of three months or less.
- ▶ Demand deposits of a bank, or customer accounts payable of a broker dealer, for which the entity substantively holds or disburses cash on behalf of its customers.

Net presentation is also allowed for operating activities when an entity applies the indirect method (see Section 3.3.2).

In contrast, gross presentation is required for cash receipts and payments related to the activities below (net presentation is **not** permitted).

ACTIVITIES	EXAMPLES
Investing (see Section 4.2)	<ul style="list-style-type: none"> <li>▶ Payments to purchase PP&amp;E</li> <li>▶ Capital expenditure disbursements</li> <li>▶ Proceeds from the sale of PP&amp;E</li> </ul>
Financing (see Section 4.3)	<ul style="list-style-type: none"> <li>▶ Proceeds from long-term debt issuance</li> <li>▶ Repayments of long-term debt</li> <li>▶ Proceeds from stock issuances</li> <li>▶ Treasury stock purchases</li> </ul>

### 3.3 REPORTING CASH FLOWS FROM OPERATING ACTIVITIES



#### FASB REFERENCES

ASC 230-10-45-25 and ASC 230-10-45-28

As discussed in Section 3.1, entities can elect the direct or indirect method for reporting cash flows from operating activities, both of which result in reporting the same net amount.

Direct method  
(see Section 3.3.1)

Present major classes of the items below whose sum represents net cash flows from operating activities:

- ▶ Gross operating cash receipts, such as cash received from customers
- ▶ Gross operating cash payments, such as cash payments to suppliers for goods and services purchased

Indirect method  
(see Section 3.3.2)

Reconcile net income to net cash flows from operating activities, by removing the effects of:

- ▶ Deferrals of past operating cash flows
- ▶ Accruals of expected future operating cash flows
- ▶ All other items included in the income statement that do not have a cash effect in the period, including those that relate to investing or financing activities

While ASC 230 encourages entities to apply the direct method, most entities report cash flows from operating activities under the indirect method.

#### **BDO INSIGHTS: CHANGING METHOD FOR REPORTING CASH FLOWS FROM OPERATING ACTIVITIES**

Under ASC 230, an entity can apply either the direct or indirect method to report cash flows from operating activities. An entity is not precluded from changing methods, and if it does, we believe that represents a change in **classification** (not a change in accounting principle) under ASC 250 and therefore does not require an assessment of preferability. However, the entity should retrospectively adjust any comparative cash flow statements with appropriate disclosure about the change in method.<sup>8</sup>

<sup>8</sup> Consistent with AICPA TQA 1300.20, *Direct vs. Indirect Method for Statement of Cash Flows*.

### 3.3.1 Applying the Direct Method



#### FASB REFERENCES

ASC 230-10-45-25, ASC 230-10-45-29 through 45-30, ASC 230-10-55-1 through 55-4, ASC 230-10-55-7 through 55-10, ASC 230-10-55-21, and ASC 958-205-55-19

If an entity uses the direct method to report net cash flows from operating activities, it must separately report at least the major classes of gross operating cash receipts and payments shown below.



#### Operating Cash Receipts

- ▶ Cash collected from customers, including lessees and licensees
- ▶ Interest and dividends received, except those that are donor-restricted for long-term purposes and included in financing activities (see Section 4.3)
- ▶ Any other operating cash receipts



#### Operating Cash Payments

- ▶ Cash paid to employees and suppliers of goods or services, such as insurance and marketing
- ▶ Interest paid, including the portion of payments to settle zero-coupon and similar debt instruments attributable to accreted interest and debt discount (see Section 5.4.2)
- ▶ Income taxes paid
- ▶ Any other operating cash payments

ASC 230 encourages entities to provide further breakdowns they consider meaningful and feasible. For example, a retailer or manufacturer could separate cash paid to employees and suppliers into payments for costs of inventory and payments for selling, general, and administrative expenses.

If the entity has sufficiently detailed information, ASC 230 also allows an approach that indirectly determines major classes of gross operating cash receipts and payments by adjusting revenues and expenses for the change in related assets and liabilities. For example, in determining cash collected from customers, the entity can adjust sales for the change in receivables from customers and eliminate the effects of noncash entries reflected in accounts receivable, such as bad debt write-offs and other noncash charges and credits, as illustrated in ASC 230-10-55-21 and Example 3-1.

While that approach uses much of the same information needed under the indirect method (see Section 3.3.2), it becomes more complex as the categories of operating gross cash flows reported increase and could, depending on an entity's accounting system and nature of operations, result in significant incremental costs as compared to those incurred when applying the indirect method.



#### REQUIREMENT TO PROVIDE A RECONCILIATION OF NET INCOME TO NET OPERATING CASH FLOWS

Except for an NFP (see Section 8.7), if an entity uses the direct method, it must also provide a reconciliation of net income to net cash flow from operating activities in a separate schedule, as discussed in Section 3.3.2.

Example 3-1 illustrates reporting under the direct method by a manufacturing entity, with cash from customers determined indirectly by adjusting revenue for the change in accounts receivable and for noncash entries. See ASC 958-205-55-19 for an illustration of the direct method by an NFP.

**EXAMPLE 3-1 (ADAPTED FROM ASC 230-10-55-10 AND ASC 230-10-55-21): CASH FLOWS FROM OPERATING ACTIVITIES UNDER THE DIRECT METHOD****FACTS**

- ▶ Entity A is a manufacturing entity that uses the direct method to report cash flows from operating activities.
- ▶ During its fiscal year 20X1, Entity A:
  - Had customer sales of \$13,965
  - Wrote off \$350 of accounts receivable stemming from a customer bankruptcy
  - Collected \$100 on an installment note for the sale of inventory
  - Purchased all the capital stock of Entity B, whose accounts receivable at the acquisition date was \$155
  - Had gross accounts receivable from customers at the beginning and end of the year of \$2,370 and \$2,390, respectively
- ▶ For simplicity, assume Entity A identified the other major classes of operating cash receipts and payments below.

**OPERATING CASH RECEIPTS**

- ▶ Dividends: \$20
- ▶ Interest on notes receivable: \$55
- ▶ Insurance proceeds for business interruption: \$5

**OPERATING CASH PAYMENTS**

- ▶ Suppliers and employees: \$12,000
- ▶ Interest: \$220
- ▶ Income taxes: \$325

**CONCLUSION AND ANALYSIS**

- ▶ Entity A uses the above information to report major classes of gross operating cash receipts and payments.
- ▶ Entity A determines cash collected from customers indirectly by adjusting sales for the change during the year in receivables from customers and eliminating the effect of noncash entries, as shown below.

**CASH RECEIVED FROM CUSTOMERS DURING THE YEAR****DECEMBER 31, 20X1**

Customer sales	\$	13,965
Installment collection on sale of inventory		100
Gross accounts receivable at beginning of year	\$	2,370
Accounts receivable acquired in purchase of Entity B		155
Accounts receivable written off		(350)
Gross accounts receivable at end of year		(2,390)
Excess of new accounts receivable over collections from customers		(215)
Cash received from customers during the year	\$	13,850

- ▶ Entity A reports the major classes of cash flows from operating activities shown below.

**CASH RECEIVED FROM CUSTOMERS DURING THE YEAR****DECEMBER 31, 20X1**

Cash received from customers	\$	13,850
Cash paid to suppliers and employees		(12,000)
Dividend received from affiliate		20
Interest received		55
Interest paid		(220)
Income taxes paid		(325)
Insurance proceeds received for business interruption		5
Net cash provided by operating activities	\$	1,385

### 3.3.2 Applying the Indirect Method



#### FASB REFERENCES

ASC 230-10-45-2, ASC 230-10-45-28 through 45-32, ASC 230-10-55-13, and ASC 958-205-55-20

Entities that do not apply the direct method (see Section 3.3.1) must determine and report net cash flows from operating activities indirectly by reconciling net income to net cash flow from operating activities. For an entity with consolidated financial statements, the reconciliation starts with consolidated net income, which includes amounts attributable to the controlling and noncontrolling interests (NCIs; see Section 5.5.3).

The indirect method requires adjusting net income to remove the effects of the items in the table.

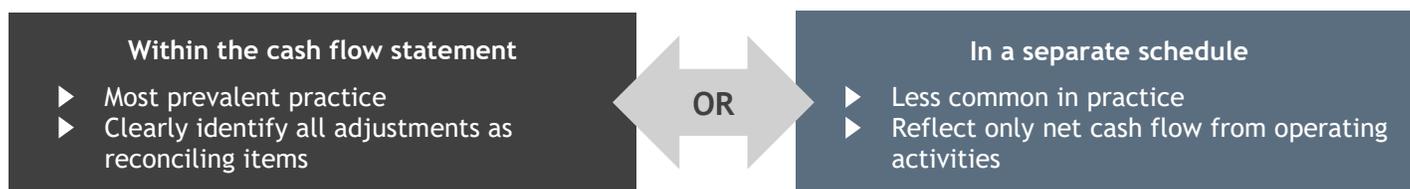
ADJUSTMENTS	EXAMPLES
All items included in net income that do not affect cash flows or that relate to investing or financing activities	<ul style="list-style-type: none"> <li>▶ Depreciation of PP&amp;E</li> <li>▶ Amortization of finance lease right-of-use (ROU) assets (see Section 5.8.2)</li> <li>▶ Amortization of finite-lived intangible assets</li> <li>▶ Impairments of long-lived assets</li> <li>▶ Gains or losses on sales of PP&amp;E, intangibles, and discontinued operations</li> <li>▶ Provision for credit losses</li> <li>▶ Changes in fair value of contingent consideration classified as a liability (or asset) (see Section 5.6)</li> <li>▶ Share-based compensation expense (see Section 5.5.2)</li> <li>▶ Unrealized gains or losses on investments measured at fair value through earnings (see Section 5.3)</li> <li>▶ Gains or losses on sales of investments</li> <li>▶ Gains or losses on debt extinguishments (see Section 5.4.3)</li> </ul>
All deferrals of past operating cash receipts and payments, as well as all accruals of expected future operating cash receipts and payments	<ul style="list-style-type: none"> <li>▶ Change in inventory<sup>(a)</sup></li> <li>▶ Change in deferred income or revenue (contract liabilities)<sup>(a)</sup></li> <li>▶ Change in operating receivables and contract assets<sup>(a)</sup></li> <li>▶ Change in operating payables<sup>(a)</sup></li> <li>▶ Interest earned but not received<sup>(a)(b)</sup></li> <li>▶ Interest incurred but not paid<sup>(a)(b)</sup></li> </ul>

(a) The entity might have to adjust the change in these accounts for noncash items or items that relate to investing or financing activities. Examples include changes in accounts payable (accrued expenses) that relate to capitalization of PP&E, as well as all acquired operating assets (such as inventory or accounts receivable) and liabilities (like accounts payable or accrued expenses) recognized in a business combination (see Section 5.6 and Example 7-1).

(b) Although this interest might be accrued in assets or liabilities whose changes typically relate to investing or financing activities (such as loans or deposits), the accrued interest must be presented as an adjustment to net income within operating activities (see Section 4.4). However, interest credited directly to a deposit account that has the general characteristics of cash (see Section 2.2) is a cash outflow of the payor and a cash inflow of the payee when recognized.

When an entity uses the indirect method, it must separately report all major classes of reconciling items. For example, major classes of deferrals and accrual (including changes in inventory, operating receivables, and operating payables) must be separately reported. ASC 230 encourages entities to further disaggregate any categories deemed meaningful. For example, an entity could disaggregate changes in operating receivables among changes in receivables from customers for sales of goods or services, as well as changes in other operating receivables.

An entity that applies the indirect method may report the reconciliation either:



The entity also must disclose interest and income taxes paid (see Section 6.4).

Example 3-2 illustrates the application of the indirect method by a manufacturing entity. See ASC 958-205-55-20 for an illustration of the indirect method by an NFP.

#### EXAMPLE 3-2 (ADAPTED FROM ASC 230-10-55-13): CASH FLOWS FROM OPERATING ACTIVITIES UNDER THE INDIRECT METHOD

##### FACTS

- ▶ Assume the same facts as in Example 3-1, except that Entity A reports cash flows from operating activities using the indirect method.
- ▶ Entity A has net income of \$760 for the year.
- ▶ Entity A has the following changes in assets and liabilities during the year related to operating activities:
  - Increase in accounts receivable (net of the accounts receivable written off and effects of purchase of Entity B (see Example 3-1)): \$215
  - Decrease in inventory: \$205
  - Increase in prepaid expenses: \$25
  - Decrease in accounts payable and accrued expenses: \$220
  - Increase in interest and income taxes payable: \$50
  - Increase in deferred taxes: \$150
  - Increase in other liabilities: \$50
- ▶ Entity A identifies the following items included in net income that do not affect cash flows or that relate to investing or financing activities:
  - Depreciation and amortization expense: \$445
  - Provision for losses on accounts receivable: \$200
  - Gain on the sale of its facility: \$80
  - Undistributed earnings of an equity method investee (determined to be a return on investment (see Section 5.3.3)): \$25
  - Gain on insurance proceeds received for damage to equipment: \$10
- ▶ Entity A collected the final annual installment payment of \$100 on a note receivable for sale of inventory.

##### CONCLUSION AND ANALYSIS

- ▶ Entity A uses the above information to reconcile net income to net cash provided by operating activities.

CASH FLOWS FROM OPERATING ACTIVITIES	DECEMBER 31, 20X5	
Net income	\$	760
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	\$	445
Provision for losses on accounts receivable		200
Gain on sale of facility		(80)
Undistributed earnings of equity method investee		(25)
Payment received on installment note receivable for sale of inventory		100
Gain on insurance proceeds received for damage to equipment		(10)
Change in assets and liabilities net of effects from purchase of Entity B:		
Increase in accounts receivable		(215)
Decrease in inventory		205
Increase in prepaid expenses		(25)
Decrease in accounts payable and accrued expenses		(220)
Increase in interest and income taxes payable		50
Increase in deferred taxes		150
Increase in other liabilities		50
Total adjustments		625
Net cash provided by operating activities	\$	1,385
▶ The net cash provided by operating activities amount is the same as in Example 3-1 determined under the direct method.		
▶ Because Entity A applies the indirect method to report cash flow from operating activities, it must disclose interest paid and income taxes paid during the year (see Section 6.4).		

### 3.4 CONSTRUCTIVE DISBURSEMENTS AND RECEIPTS

In some transactions, such as when a bank or escrow agent acts as an intermediary on behalf of the entity, an entity's cash payments and receipts do not directly pass through its cash accounts. For example:

- ▶ In a real estate transaction, a purchaser might instruct its lender to pay the seller directly or the cash might flow through an escrow account, bypassing the purchaser's cash accounts.
- ▶ In a debt restructuring, an intermediary might use the proceeds from a new borrowing to repay an existing loan with another lender or a new lender might pay off an existing loan directly with the existing lender without the cash flowing through the borrower's cash accounts or with only the net proceeds received.
- ▶ In a business combination, an acquirer might obtain financing to pay selling shareholders or repay existing debt with the funds disbursed directly by a financial institution or escrow agent.
- ▶ A parent might pay on behalf of a subsidiary expenses that are recognized in the subsidiary's separate financial statements, even though the cash did not flow through the subsidiary's bank accounts.

Although cash does not enter or exit the entity's cash accounts, the economic result might be the same as if cash did pass through them. That leads to a question about whether the entity should report the transactions in its cash flow statement as constructive cash flows.

**BDO INSIGHTS: CONSTRUCTIVE DISBURSEMENTS AND RECEIPTS**

Although an entity might not itself directly disburse or receive cash in a transaction, it should consider whether the economic substance of the transaction indicates that constructive cash inflows and outflows should be reported. While ASC 230 is silent, the concept of constructive cash inflows and outflows was addressed in an SEC staff speech at the [2005 AICPA National Conference on Current SEC and PCAOB Developments](#) (adapted in Examples 3-3 and 3-4) and through AICPA TQA (adapted in Examples 3-4 and 3-5).<sup>9</sup>

In determining whether to report constructive cash inflows and outflows, we believe an entity must consider the transaction's facts and circumstances. For example, we believe an entity generally should report constructive cash flows when it contracts with a third party to act on its behalf (for example, a transfer agent, investment bank, or lender) or when cash does not flow through the entity's cash accounts for administrative convenience (rather than because of legal or regulatory restrictions). If a transaction does not result in reporting constructive cash flows, an entity should consider the disclosure requirements for noncash investing and financing activities (see Section 6.5).

Reaching a conclusion about constructive disbursements and receipts requires the application of professional judgment based on the facts and circumstances.

**EXAMPLE 3-3: DEALER FLOOR PLAN FINANCING WITH THIRD-PARTY FINANCE COMPANY – CONSTRUCTIVE CASH FLOWS****FACTS**

- ▶ Entity A is an automobile dealer that purchases inventory from a manufacturer.
- ▶ Entity A finances its purchase through a finance company that is **not** affiliated with the manufacturer.
- ▶ The finance company pays the manufacturer directly and is repaid later when Entity A sells the automobiles.
- ▶ Entity A applies the indirect method to report cash flows from operating activities (see Section 3.3).

**CONCLUSION AND ANALYSIS**

- ▶ The financing arrangement represents third-party financing because the finance company acted on Entity A's behalf.
- ▶ Although Entity A did not pay cash for the inventory purchase, it must report an increase in inventory (a constructive cash outflow) within operating activities and an increase in third-party loans (constructive cash inflow) within financing activities.
- ▶ Entity A reports subsequent loan repayments within financing activities (see Section 4.3).

**EXAMPLE 3-4: DEALER FLOOR PLAN FINANCING THROUGH MANUFACTURER'S FINANCE SUBSIDIARY – NO CONSTRUCTIVE CASH FLOWS****FACTS**

- ▶ Assume the same facts as in Example 3-3, except that Entity A finances the purchase of automobiles through the manufacturer's finance subsidiary.
- ▶ The finance subsidiary pays its parent (the manufacturer) on Entity A's behalf and holds a lien on the automobiles.
- ▶ Entity A repays the finance subsidiary when the automobiles are sold.

<sup>9</sup> AICPA TQA 1300.16 *Purchase of Inventory Through Direct Financing*, and 1300.19, *Classification of Payments on Equipment Finance Note*, respectively.

**CONCLUSION AND ANALYSIS**

- ▶ Entity A concludes that the substance of the loan is a trade loan because the finance company is the manufacturer's subsidiary.
- ▶ On the purchase date, Entity A reports the purchase of automobiles as an increase in inventory and an increase in trade loans within operating activities with **no** cash flow effect.
- ▶ Entity A classifies the trade loan repayments to the finance subsidiary as **operating** cash outflows (rather than as a financing activity), consistent with the guidance in Section 4.4 related to principal payments on accounts and notes payable to suppliers for goods acquired for resale.
- ▶ Because the transaction is included in operating cash flows, no incremental cash flow disclosures are required (see Section 6.5).

**EXAMPLE 3-5: EQUIPMENT FINANCE NOTE WITH THIRD-PARTY BANK – CONSTRUCTIVE CASH FLOWS****FACTS**

- ▶ Entity A purchases equipment from a supplier by borrowing money from a third-party bank.
- ▶ The bank remits the payment directly to the supplier on Entity A's behalf.

**CONCLUSION AND ANALYSIS**

- ▶ Because the bank acted on Entity A's behalf, on the purchase date, Entity A reports the purchase of equipment as a constructive cash outflow within investing activities (see Section 4.2) and a constructive cash inflow within financing activities (see Section 4.3). In other words, Entity A reports cash flows as if it received cash from the bank for the loan and paid the supplier.
- ▶ Entity A classifies subsequent principal payments to the bank as financing cash outflows (see Section 4.3).

**EXAMPLE 3-6: DEBT RESTRUCTURING THROUGH ADMINISTRATIVE AGENT – CONSTRUCTIVE CASH FLOWS****FACTS**

- ▶ Borrower A has a term loan with an outstanding principal balance of \$30 million that matures December 31, 20X6, and has a stated interest rate of 7%.
- ▶ Borrower A hires an administrative agent to refinance the term loan, resulting in the issuance of a new term loan with a different lender. The new term loan has a principal balance of \$30 million; matures December 31, 20X8; and has a stated interest rate of 5%.
- ▶ The administrative agent receives the proceeds from the new term loan and transfers them directly to the existing lender to extinguish the original loan. There is no accrued interest outstanding on the original loan at the repayment date.

**CONCLUSION AND ANALYSIS**

- ▶ Although the proceeds from the new term loan and repayment of the original loan did not flow through Borrower A's cash accounts, the administrative agent received and transferred cash on its behalf. Therefore, Borrower A should report within financing activities (see Section 4.3) a constructive cash inflow for the new loan and a constructive cash outflow for the repayment of the original loan.
- ▶ Because there was no accrued interest on the original loan at the repayment date, no amounts are presented within operating activities.

### 3.5 DISCONTINUED OPERATIONS



#### FASB REFERENCES

ASC 205-20-45-1B, ASC 205-20-45-1E, ASC 230-10-45-28, and ASC 360-10-45-15

An entity reports the disposal of a component (or group of components) in discontinued operations if the disposal represents a strategic shift that has, or will have, a major effect on the entity's operations and financial results and the entity's component (or group of components) is **any** of the following:

- ▶ Meets the criteria in ASC 205-20 to be classified as held for sale.
- ▶ Is disposed of by sale.
- ▶ Is disposed of other than by sale in accordance with ASC 360, *Property, Plant, and Equipment* (for example, by abandonment or in a distribution to owners in a spinoff).

ASC 230 does not address how an entity must present cash flows from discontinued operations within the cash flow statement. During a speech (see Section 3.4), the SEC staff discussed three acceptable methods, shown below.

METHOD	DESCRIPTION	EXAMPLE
<b>METHOD 1: COMBINE WITHIN THE CATEGORIES</b>	Combine the cash flows from discontinued operations with the cash flows from continuing operations in each of the three categories	<div style="border: 1px dashed gray; padding: 10px;"> <p><b>Cash flows from operating activities:</b> Continuing operations + <b>Discontinued operations</b></p> <p><b>Cash flows from investing activities:</b> Continuing operations + <b>Discontinued operations</b></p> <p><b>Cash flows from financing activities:</b> Continuing operations + <b>Discontinued operations</b></p> </div>
<b>METHOD 2: SEPARATED WITHIN THE CATEGORIES</b>	Separately identify the cash flows that relate to discontinued operations in each of the three categories (net or in detail)	<div style="border: 1px dashed gray; padding: 10px;"> <p><b>Cash flows from operating activities:</b> Continuing operations <b>Discontinued operations (net or in detail)</b> Total</p> <p><b>Cash flows from investing activities:</b> Continuing operations <b>Discontinued operations (net or in detail)</b> Total</p> <p><b>Cash flows from financing activities:</b> Continuing operations <b>Discontinued operations (net or in detail)</b> Total</p> </div>

METHOD	DESCRIPTION	EXAMPLE
<b>METHOD 3: SEPARATED AT THE BOTTOM OF THE STATEMENT</b>	Present cash flows from discontinued operations separately for operating, investing, and financing activities near the bottom of the statement immediately before the net increase or decrease in cash, cash equivalents, restricted cash, and restricted cash equivalents	<div style="border: 1px dashed gray; padding: 10px;"> <p><b>Cash flows from operating activities:</b> Continuing operations</p> <p><b>Cash flows from investing activities:</b> Continuing operations</p> <p><b>Cash flows from financing activities:</b> Continuing operations</p> <p><b>Discontinued operations cash flows:</b></p> <p style="color: red;">Operating activities (net or in detail)</p> <p style="color: red;">Investing activities (net or in detail)</p> <p style="color: red;">Financing activities (net or in detail)</p> </div>

The net cash proceeds from sale of a discontinued operation (proceeds from the sale less any cash sold) is an investing cash flow (see Section 4.2), and any gain (loss) on disposition is a reconciling item within operating activities if the entity applies the indirect method to report cash flows from operating activities (see Section 3.3.2). See Section 6.6 for incremental disclosure requirements, which depend on how the entity reports cash flows from discontinued operations.



#### PRESENTATION METHODS NOT ACCEPTABLE FOR DISCONTINUED OPERATIONS

Although ASC 230 does not address the presentation of cash flows from discontinued operations, some presentations are not acceptable. For example, the SEC staff has noted that the presentations below are **not** allowed because they do not conform with the basic requirement in ASC 230 that cash flows be reported as operating, investing, or financing activities:

- ▶ Aggregating operating, investing, and financing cash flows from discontinued operations into a single line item.
- ▶ Presenting the operating, investing, and financing cash flows from discontinued operations all within operating cash flows.



#### REPORTING OPERATING CASH FLOWS UNDER THE INDIRECT METHOD

As discussed in Section 3.3, an entity can apply the indirect method to report cash flows from operating activities. If so, and if the entity has cash flows from discontinued operations, it cannot start the reconciliation with income from continuing operations because ASC 230-10-45-28 is clear that the starting point in that reconciliation is net income.

### 3.6 INTERIM REPORTING REQUIREMENTS FOR CASH FLOW STATEMENTS

Under Regulation S-X Rule 10-1, *Interim Financial Statements*, SEC registrants filing Form 10-Q must include year-to-date interim cash flow statements<sup>10</sup> and can provide interim cash flow statements for cumulative 12-month periods, as shown below.

<p>Required: Year-to-date</p> 	<p><b>Presentation:</b></p> <ul style="list-style-type: none"> <li>▶ Year-to-date from the end of the previous fiscal year</li> <li>▶ Corresponding period of the previous fiscal year</li> </ul>
	<p><b>Example:</b> A calendar-year-end entity with an interim period ended June 30, 20X5, must provide interim cash flow statements:</p> <ul style="list-style-type: none"> <li>▶ From January 1, 20X5 through June 30, 20X5</li> <li>▶ For the comparative period January 1, 20X4, through June 30, 20X4</li> </ul>

<p>Optional: Cumulative 12-months</p> 	<p><b>Presentation:</b></p> <ul style="list-style-type: none"> <li>▶ Trailing 12-month period ended during the most recent fiscal quarter</li> <li>▶ Corresponding period of the previous year</li> </ul>
	<p><b>Example:</b> A calendar-year-end entity with an interim period ended June 30, 20X5, may also provide interim cash flow statements:</p> <ul style="list-style-type: none"> <li>▶ From July 1, 20X4 through June 30, 20X5</li> <li>▶ For the comparative period July 1, 20X3, through June 30, 20X4</li> </ul>

An SEC registrant may abbreviate the interim cash flow statement by starting with a single amount for net cash flows from operating activities and showing individual investing and financing cash changes only if they exceed 10% of the average of net cash flows from operating activities for the most recent three years. De minimis amounts do not need to be shown separately.



#### FASB PROJECTS: ASU 2025-11

The FASB issued ASU 2025-11, *Narrow-Scope Improvements*, to clarify the scope, form and content, and disclosures required under ASC 270, *Interim Reporting*. The amendments affect all entities that provide interim financial statements and notes in accordance with U.S. GAAP, as discussed in BDO's Bulletin, [FASB Clarifies Interim Reporting Guidance](#).

<sup>10</sup> SEC registrants that engage in seasonal production and sale of a single-crop agricultural commodity may instead provide interim cash flow statements for the 12-month period ended during the most recent fiscal quarter and for the corresponding preceding period.

## 3.7 REORGANIZATIONS



### FASB REFERENCES

ASC 852-10-45-13 and ASC 852-10-50-6A

ASC 852, *Reorganizations*, provides guidance on reporting cash flows by entities between the dates of filing for reorganization under Chapter 11 of the Bankruptcy Code and emergence.

An entity presents reorganization items separately within the operating, investing, and financing categories of the cash flow statement. As discussed in Section 3.3.1, further disaggregation of operating items that must be reported separately is encouraged if the entity considers such disaggregation meaningful and feasible. Accordingly, further identification of cash flows from reorganization items should be provided to the extent feasible. For example, interest received might be segregated between estimated normal recurring interest received and interest received on cash accumulated because of the reorganization. If the entity uses the indirect method (see Section 3.3.2), it must disclose (or include a supplementary schedule of) the details of operating cash receipts and payments resulting from the reorganization. Therefore, the direct method might better accomplish those objectives.

# Chapter 4: Classification Requirements



## 4.1 OVERVIEW: CLASSIFICATION REQUIREMENTS

Under ASC 230, an entity classifies cash receipts and payments among three categories:



Separate classification provides financial statement users with relevant information about how an entity generates and uses cash and is based on the nature of the cash flow.

- ▶ Investing activities generally involve the acquisition and disposal of productive assets, such as cash paid to purchase PP&E, and investments not classified as cash equivalents (see Sections 2.3 and 4.2).
- ▶ Financing activities relate to changes in the size and composition of the entity's equity and borrowings and includes cash inflows from issuing shares or debt and cash outflows, such as dividend payments or debt repayments (see Section 4.3).
- ▶ Operating activities represent the residual category (that is, any cash flow that is not investing or financing activities); it typically includes the cash effects of transactions that affect net income, such as cash receipts from customers and cash payments to employees and suppliers of goods and services (see Section 4.4).

However, not all transactions directly affect cash. Noncash investing and financing activities, such as obtaining a lease or converting debt to equity, must be separately disclosed (see Section 6.5).

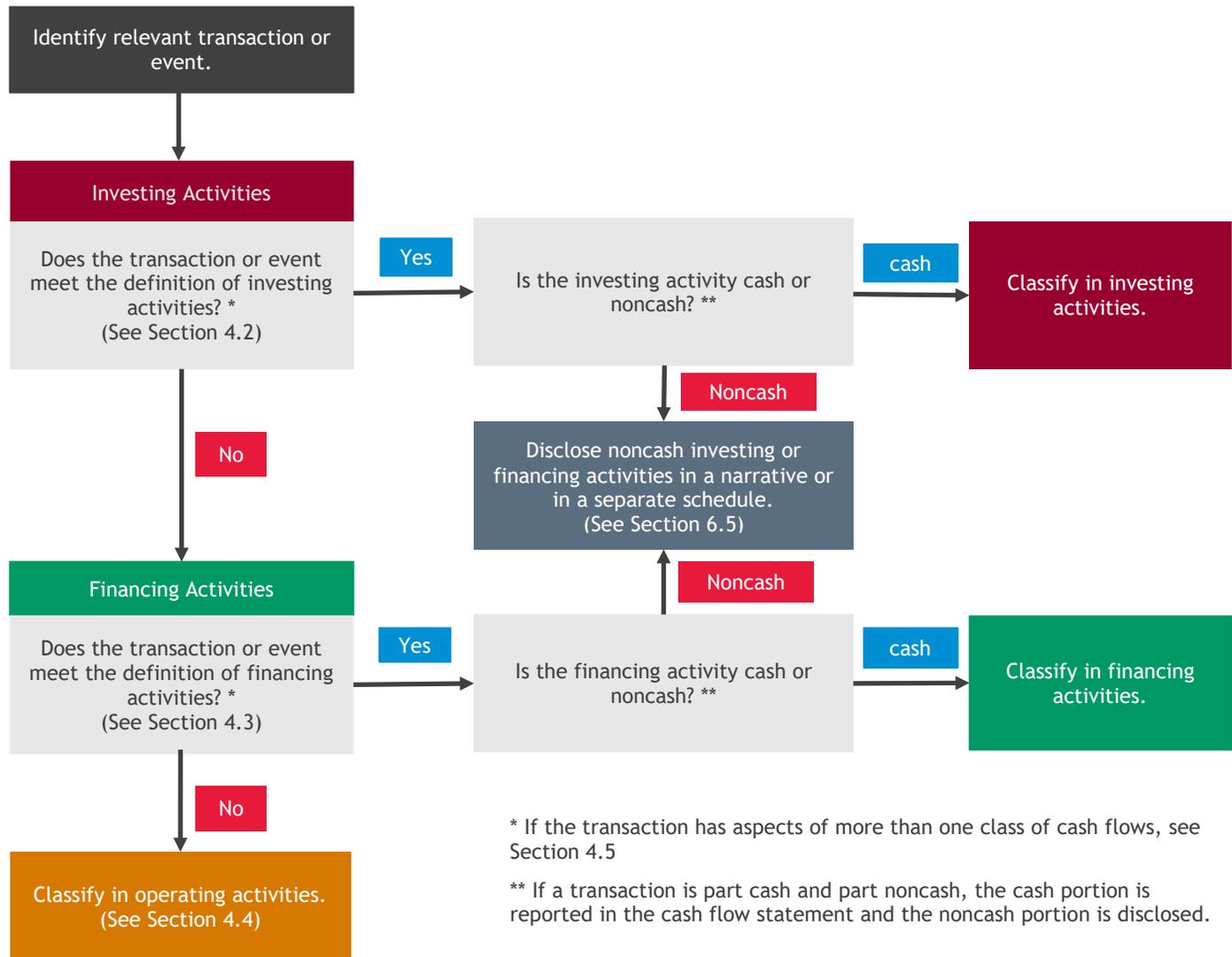


### SOME CASH RECEIPTS AND PAYMENTS HAVE ASPECTS OF MORE THAN ONE CLASS OF CASH FLOWS

Some cash receipts and payments have aspects of more than one class of cash flows (see Section 4.5). Classifying a transaction in these cases requires judgment and consideration of:

- ▶ Whether there is specific guidance in ASC 230 or other U.S. GAAP
- ▶ If not, whether the cash receipts and payments can be separated by identifiable source or use
- ▶ If not, the activity that is likely the predominant source or use of cash flows for the item

The flowchart below illustrates the steps to classify a transaction in the cash flow statement.



## 4.2 INVESTING ACTIVITIES



### FASB REFERENCES

ASC 230-10-20: Investing Activities, ASC 230-10-45-11 through 45-13, ASC 230-10-50-4, ASC 230-10-55-10, ASC 230-10-55-13, and ASC 970-230-45-1

ASC 230 defines 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.*

ASC 230 also states that the cash receipts and payments shown in the table are investing activities.

ASSET TYPE <sup>(a)</sup>	INVESTING CASH INFLOWS	INVESTING CASH OUTFLOWS
LOANS	Receipts from collections or sales of loans made by the entity and of other entities' debt instruments <sup>(b)(c)(d)</sup>	Disbursements for loans made by the entity and payments to acquire debt instruments of other entities <sup>(b)(c)</sup>
EQUITY INVESTMENTS	Receipts from sales of equity instruments of other entities and from returns <b>of</b> investment in those instruments (see Section 5.3.3) <sup>(c)(d)</sup>	Payments to acquire equity instruments of other entities <sup>(c)</sup>
PP&E AND OTHER PRODUCTIVE ASSETS	Receipts from sales of PP&E and other productive assets	Advance or down payments or other payments at the time of purchase (or <b>soon before or after</b> purchase) to acquire PP&E and other productive assets, including interest capitalized as part of the cost of those productive assets <sup>(e)(f)</sup>
OTHERS	Receipts from collections on a transferor's beneficial interests in a securitization of the transferor's trade receivables	Payments made <b>soon after</b> the acquisition date of a business combination by an acquirer to settle a contingent consideration liability (see Section 5.6.3)

(a) Receipts from disposing of loans, equity instruments, or PP&E include proceeds from insurance settlements that are directly related to their disposal, such as insurance proceeds from the disposal of a building that is damaged or destroyed (see Section 5.9.2).

(b) Excludes cash equivalents (see Section 2.3).

(c) Excludes some debt and equity instruments acquired specifically for resale (see Sections 5.2 and 5.3).

(d) Excludes some donated debt and equity instruments received by NFPs (see Section 5.9.3.2).

(e) Excludes incurring seller-financed debt directly related to the acquisition of PP&E (and other productive assets), which is presented as both a noncash financing and investing activity (see Section 6.5). Subsequent principal payments to the seller on such debt are financing cash outflows (see Section 4.3) unless made soon after purchase. Accordingly, most principal payments on seller-financed debt directly related to acquisition of PP&E are financing cash outflows.

(f) Excludes cash payments to purchase real estate that a developer intends to subdivide, improve, and sell in individual lots, which are operating activities (see Section 8.8).



#### MEANING OF 'SOON BEFORE OR AFTER'

An entity classifies cash payments to acquire PP&E or other productive assets within investing activities if payments are made at the time of purchase or **soon before or after** purchase. While ASC 230 does not define that phrase, practice generally has interpreted it to mean three months or less, which is consistent with other aspects of ASC 230, including the guidance on contingent consideration payments (see Section 5.6.3). Accordingly, if payments to purchase PP&E or other productive assets extend beyond three months, they generally should be classified within financing activities.

**EXAMPLE 4-1 (ADAPTED FROM ASC 230-10-55-10 AND ASC 230-10-55-13): CASH FLOWS FROM INVESTING ACTIVITIES****FACTS**

- ▶ Entity A is a manufacturing entity reporting its cash flows for its fiscal year 20X1, during which it had the following cash transactions related to its PP&E:
  - March 15, 20X1: Sold equipment for \$600, which it collected on that date, resulting in a \$50 gain on sale.
  - November 15, 20X1: Purchased a manufacturing facility for \$925, which it paid for on December 15, 20X1.
- ▶ Entity A reports cash flows from operating activities using the indirect method (see Section 3.3).

**CONCLUSION AND ANALYSIS**

- ▶ Entity A classifies the cash receipts and payments within investing activities because they relate to PP&E and the payment for the manufacturing facility occurred soon after purchase.
- ▶ Entity A must separately present its cash flows from investing activities (that is, it cannot present them net (see Section 3.2)).
- ▶ Entity A includes the \$50 gain on sale on PP&E as an adjustment in its reconciliation of net income to net cash flow from operating activities, which is not presented below (see Section 3.3.2).
- ▶ The following is an excerpt of Entity A's cash flow statement for the year ended 20X1:

<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	<b>DECEMBER 31, 20X1</b>
Proceeds from sale of equipment	\$ 600
Capital expenditures	(925)
Net cash used in investing activities	<u>\$ (325)</u>

**EXAMPLE 4-2: NONCASH INVESTING ACTIVITIES****FACTS**

- ▶ Assume the same facts as in Example 4-1, except that Entity A pays for the facility in January 20X2.

**CONCLUSION AND ANALYSIS**

- ▶ Entity A discloses the purchase of the facility as a noncash investing activity in 20X1 (see Section 6.5) because no cash was paid during 20X1.
- ▶ Entity A's payment for the facility in 20X2 is an investing activity because payment is made soon after purchase.

**4.3 FINANCING ACTIVITIES****FASB REFERENCES**

ASC 230-10-20: Financing Activities and ASC 230-10-45-14 through 45-15

ASC 230 defines 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.*

ASC 230 also states that the cash receipts and payments below are financing activities.

CATEGORY	FINANCING CASH INFLOWS	FINANCING CASH OUTFLOWS
DEBT	<ul style="list-style-type: none"> <li>▶ Proceeds from issuing bonds, mortgages, notes, and other short- or long-term borrowings</li> </ul>	<ul style="list-style-type: none"> <li>▶ Repayments of amounts borrowed and other principal payments to creditors that have extended long-term credit, including:               <ul style="list-style-type: none"> <li>• Principal on zero-coupon and similar debt instruments (see Section 5.4.2)</li> <li>• Most principal payments on seller-financed debt directly related to a purchase of PP&amp;E or other productive assets (except as discussed in Section 4.2)</li> </ul> </li> <li>▶ Payments for debt issue costs</li> <li>▶ Payments for debt prepayment or debt extinguishment costs, including directly related third-party costs, premiums and other fees paid to lenders, but excluding accrued interest</li> </ul>
EQUITY	<ul style="list-style-type: none"> <li>▶ Proceeds from issuing equity instruments, such as common and preferred stock</li> </ul>	<ul style="list-style-type: none"> <li>▶ Dividend payments or other distributions to owners</li> <li>▶ Outlays to reacquire the entity's equity, including shares withheld from a grantee's award for tax-withholding (see Section 5.5.2)</li> </ul>
DERIVATIVE INSTRUMENTS	<ul style="list-style-type: none"> <li>▶ Proceeds, whether at inception or over the instrument's term, from derivatives that include financing elements at inception other than a financing element inherently included in an at-the-market derivative instrument with no prepayments (see Section 5.7.1)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Distributions, either at inception or over the instrument's term, to counterparties that include financing elements at inception other than a financing element inherently included in an at-the-market derivative instrument with no prepayments (see Section 5.7.1)</li> </ul>
OTHERS	<ul style="list-style-type: none"> <li>▶ Receipts from contributions and investment income with donor restrictions to acquire, construct, or improve PP&amp;E or other long-lived assets or to establish or increase a donor-restricted endowment fund</li> </ul>	<ul style="list-style-type: none"> <li>▶ Some cash payments related to business combinations to settle a contingent consideration liability (see Section 5.6.3)</li> </ul>



### NOT ALL LOAN REPAYMENTS ARE FINANCING ACTIVITIES

The table above notes that repayments of amounts borrowed and other principal payments to creditors that have extended long-term credit are classified within financing activities. However, not all loan repayments are financing activities. As discussed in Section 4.4, an entity must classify payments to acquire manufacturing materials or goods for resale within operating activities, which includes principal payments on accounts payable, and **also** short- and long-term notes payable to suppliers for those materials or goods (see Example 3-4 for an illustration of a trade loan in a dealer floor plan financing). Further, when an entity finances the purchase of PP&E with the seller, it classifies payments made soon after that purchase within investing activities (see Section 4.2).

## 4.4 OPERATING ACTIVITIES



### FASB REFERENCES

ASC 230-10-20: Operating Activities and ASC 230-10-45-16 through 45-17

ASC 230 defines operating activities.

### Operating Activities



*Include all transactions and other events that are not defined as investing or financing activities. 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.*

Under ASC 230, an entity must first consider if a transaction or other event is an investing or financing activity, with operating activities representing the residual category. ASC 230 states that the cash receipts and payments below are operating activities.

CATEGORY	OPERATING CASH INFLOWS	OPERATING CASH OUTFLOWS
OPERATIONS	<ul style="list-style-type: none"> <li>▶ Receipts from sales of goods or services, including receipts from collection or sale of accounts receivable and both short- and long-term notes receivable from customers arising from those sales<sup>(a)</sup></li> </ul>	<ul style="list-style-type: none"> <li>▶ Payments to acquire materials for manufacture or goods for resale, including principal payments on accounts payables and both short- and long-term notes payable to suppliers for those materials or goods<sup>(a)</sup></li> <li>▶ Payments to other suppliers and employees for other goods or services</li> <li>▶ Payments to governments for taxes, duties, fines, and other fees or penalties</li> </ul>
INTEREST AND DIVIDENDS	<ul style="list-style-type: none"> <li>▶ Interest and dividend receipts from returns on loans, other debt instruments of other entities, and equity securities</li> </ul>	<ul style="list-style-type: none"> <li>▶ Interest payments to lenders and other creditors, including accreted interest on settlement of zero-coupon and similar debt instruments (see Section 5.4.2)</li> </ul>
OTHERS	<ul style="list-style-type: none"> <li>▶ All other cash receipts that do not stem from transactions defined as investing activities (see Section 4.2) or financing activities (see Section 4.3), such as amounts received to settle lawsuits and refunds from suppliers</li> </ul>	<ul style="list-style-type: none"> <li>▶ Payments to settle asset retirement obligations</li> <li>▶ Some cash payments related to business combinations to settle a contingent consideration liability (see Section 5.6.3)</li> <li>▶ All other cash payments that do not stem from transactions defined as investing activities (see Section 4.2) or financing activities (see Section 4.3), such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers</li> </ul>

(a) The term “goods” includes loans and other debt and equity instruments of other entities acquired specifically for resale (see Sections 5.2 and 5.3)

Examples 3-1 and 3-2 illustrate the reporting of cash flows from operating activities using the direct and indirect methods. Section 3.3.2 includes a list of items that are most commonly included in the reconciliation from net income to net cash flows from operating activities.

### **BDO INSIGHTS: INSTALLMENT SALES AND PURCHASES OF INVENTORY**

An entity classifies in operating activities all cash:

- ▶ Collected from customers for sales of inventory
- ▶ Paid to suppliers for purchases of inventory and materials for manufacture

Therefore, operating activities include installment sales and purchases (that is, those that result in short- and long-term notes), even though they might have aspects of both operating and investing (for the seller) or financing (for the buyer). Said differently, for sales and purchases of inventory, ASC 230 does not differentiate cash flows occurring at or near the sale or purchase date from subsequent receipts or repayments of notes for those items. That is consistent with the view that cash flows from operating activities reflect the cash effect of transactions and other events that affect net income.

That differs from the requirements for purchases of PP&E and other productive assets (see Section 4.2) and settlements of contingent consideration in a business combination (see Section 5.6.3) for which the timing of payment affects classification.

### **BDO INSIGHTS: CASH FLOW CLASSIFICATION FOR INTEREST PAYMENTS**

An entity generally classifies interest payments to lenders and other creditors within operating activities, consistent with the view that cash flows from operating activities reflect the cash effect of transactions and other events that affect net income. However, not all interest payments are classified within operating activities. An entity that capitalizes interest as part of qualifying assets, such as PP&E, in accordance with ASC 835-20, *Interest – Capitalization of Interest*, classifies such interest payments within investing activities (see Section 4.2).

## 4.5 MORE THAN ONE CLASS OF CASH FLOWS



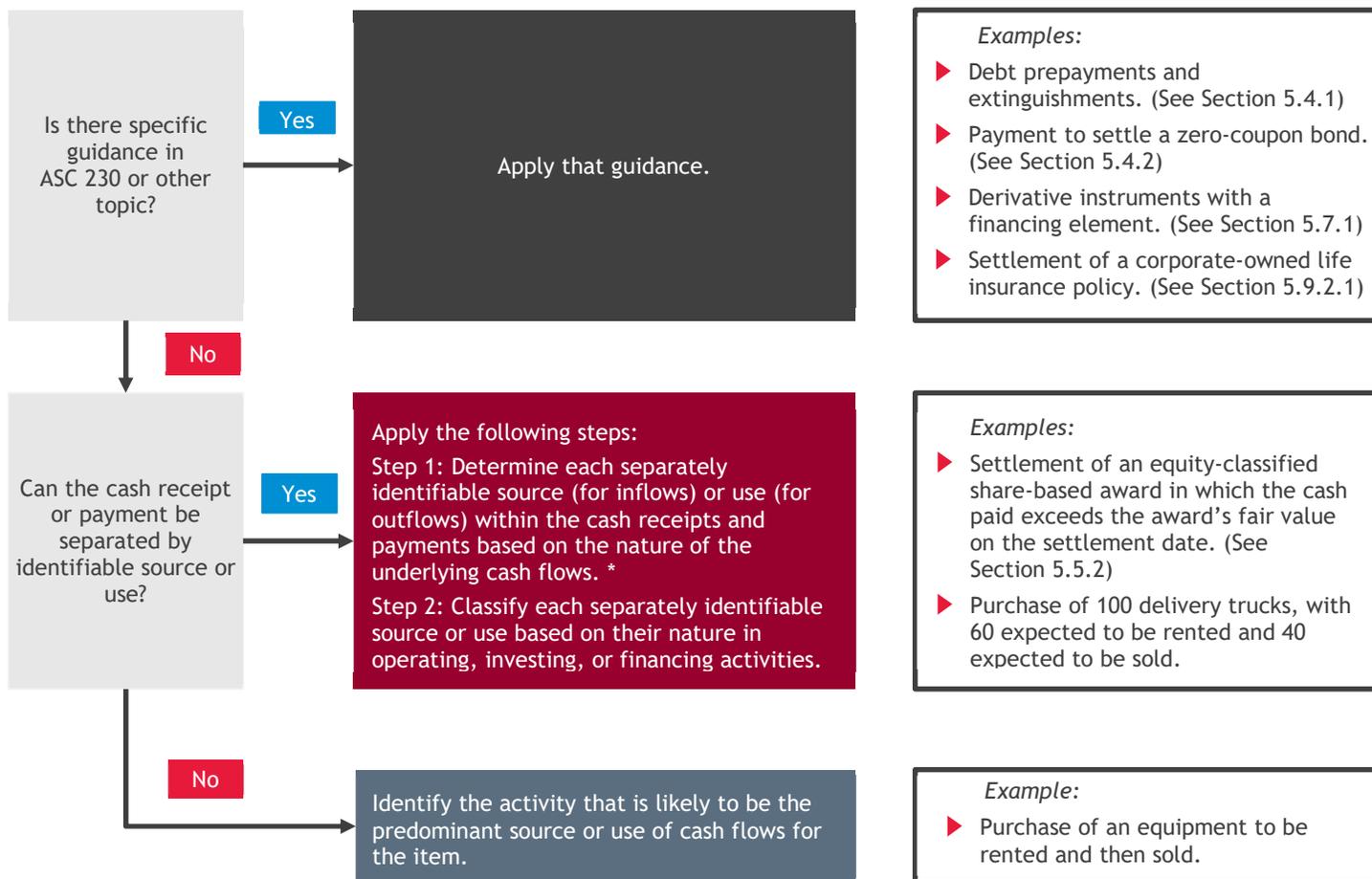
### FASB REFERENCES

ASC 230-10-45-22 through 45-22A

As discussed in Section 4.1, an entity classifies cash receipts and payments within operating, investing, or financing activities. ASC 230 defines, and provides additional guidance for, each category.

However, the appropriate classification might not always be clear because the three categories are not mutually exclusive. Some cash receipts and payments could have aspects of more than one class of cash flows, especially considering that the definition of operating activities includes “*the cash effects of transactions and other events that enter into the determination of net income*” (see Section 4.4).

For example, if an entity prepays debt before its maturity, and that prepayment includes a make-whole interest payment (an approximation of the interest that will not be paid as a result of the early settlement), the cash payment might be viewed as having aspects of more than one class of cash flows because repayment of debt is a financing activity (see Section 4.3) while payment of interest to lenders is an operating activity (see Section 4.4). Similarly, a cash payment to settle a zero-coupon bond includes an interest and principal component and therefore has aspects of operating and financing activities, respectively. While ASC 230 addresses those examples (see Section 5.4), other circumstances could result in cash flows that have aspects of more than one class of cash flows. When that occurs, an entity applies the steps in the flowchart below.



\* Including when judgment is necessary to estimate the amount of each separately identifiable source or use.

### BDO INSIGHTS: WHEN TO APPLY THE PREDOMINANCE GUIDANCE

An entity applies the predominance guidance when there is no specific U.S. GAAP addressing cash flow classification and the entity cannot separately identify sources or uses within the cash receipt or payment. We believe determining the predominant source or use of cash flows for a cash receipt or payment typically applies when each dollar of the cash receipt or payment exhibits aspects of more than one class of cash flows.<sup>11</sup>

For example, if an entity purchases an asset to be rented for a period and then sold, each dollar of the cash payment has aspects of both investing activities and operating activities:

- ▶ The asset will be used to generate rental income; its acquisition is therefore like the acquisition of a productive asset, which is an investing activity.
- ▶ The asset also will eventually be sold; its acquisition is therefore like the acquisition of inventory, which is an operating activity.

The entity must determine the activity that is likely to be the predominant source or use for the cash payment and classify the **entire** cash payment accordingly. For example, if the entity determines the predominant use is as a productive asset (as a rental), it would classify the entire cash payment within investing activities. In this example,

<sup>11</sup> This is consistent with FASB staff discussions in [Issue Summary No. 1, Supplement No. 1](#) in EITF Issue No. 15-F, *Statement of Cash Flows: Classification of Certain Cash Receipts and Cash Payments* (preceding the issuance of ASU 2016-15).

we believe the entity must also classify the cash receipt from selling the asset within investing activities to be consistent with the initial classification.

In contrast, if an entity purchases a fleet of 100 delivery trucks with the intent of renting some and selling others, and there is uncertainty about which trucks will be rented and which will be sold, the entity might have available information (such as historical internal data) to reasonably estimate the proportion of each. If so, there are two separately identifiable sources (investing activities for the automobiles to be rented and operating activities for those that will be sold, using the same logic discussed above), and the entity would not apply the predominance guidance. For example, if the entity reasonably expects 60 trucks will be rented and 40 will be sold, it would classify 60% and 40% of the cash payment within investing and operating activities, respectively.

Determining cash flow classification of cash payments or receipts with aspects of more than one class of cash flows requires the use of professional judgment based on the facts and circumstances.

#### EXAMPLE 4-3: PURCHASE OF EQUIPMENT TO BE RENTED AND THEN SOLD

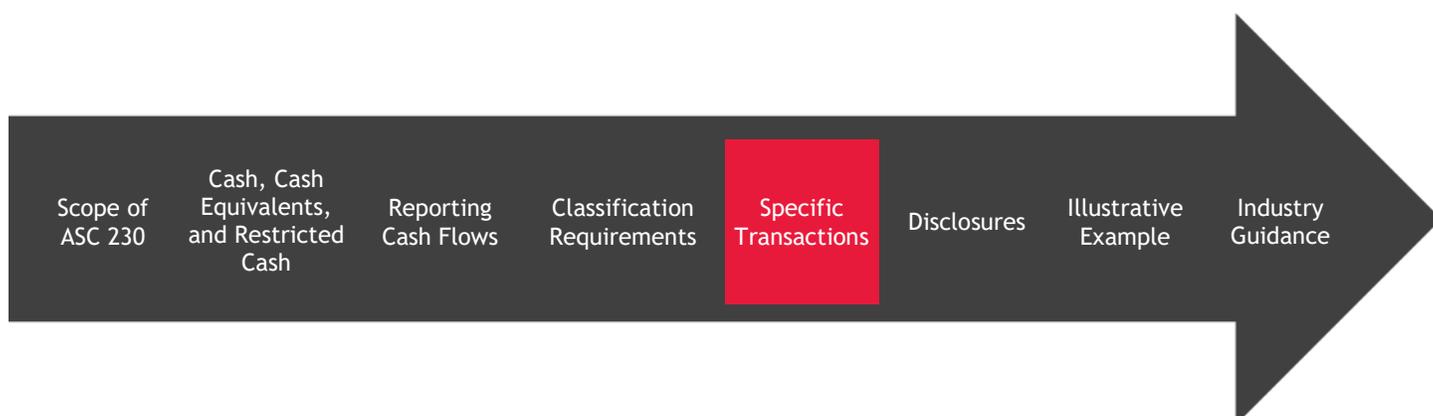
##### FACTS

- ▶ Entity A purchases equipment with an economic life of 15 years for \$500,000 cash.
- ▶ Entity A intends to lease the equipment under operating leases for most of its economic life and then sell it.

##### CONCLUSION AND ANALYSIS

- ▶ Entity A determines there is no specific guidance either in ASC 230 or other U.S. GAAP addressing cash flow classification for the cash payment.
- ▶ Entity A also determines there are no separately identifiable sources or uses within the cash payment because the equipment will be used for two purposes (rental and sale).
- ▶ Accordingly, Entity A must identify the activity that is likely to be the predominant source or use of cash flows. Because Entity A expects most of the cash inflows to be rent-related, it classifies the **entire** cash payment of \$500,000 as a cash outflow from investing activities, consistent with the acquisition of PP&E and other productive assets (see Section 4.2).
- ▶ Because Entity A classifies the initial purchase within investing activities, it should also classify the proceeds from selling the equipment therein.

# Chapter 5: Specific Transactions



## 5.1 OVERVIEW: SPECIFIC TRANSACTIONS

Chapter 4 discussed the general classification requirements under ASC 230. This Chapter addresses how to apply the general classification requirements to specific transactions.

## 5.2 LOAN RECEIVABLES



### FASB REFERENCES

ASC 230-10-45-12(e) and ASC 230-10-45-21

An entity may originate or purchase loans that it accounts for under ASC 310, *Receivables*. If loans are acquired specifically for resale and carried at fair value or at the lower of amortized cost basis or fair value (such as mortgage loans held for sale under ASC 948-310, *Financial Services – Mortgage Banking, Receivables*), the entity classifies cash flows from those acquisitions and sales within operating activities. If instead the entity intends to hold the loans for investment, it classifies cash flows from those loans within investing activities, regardless of whether the purpose for holding those loans changes.

However, as discussed in Section 4.4, receipts from sales of goods or services, which include receipts from collection or sale of accounts and notes receivable (whether short- or long-term) from customers arising from those sales are operating cash inflows.

Interest received on loans is reported within operating activities, regardless of whether they are originated, acquired for resale, or held for investment (see Section 4.4).

### **BDO INSIGHTS: LOAN ORIGATION FEES AND COSTS**

An entity originating or purchasing loans may receive or incur loan origination fees, which it defers and recognizes over the life of the loan as an adjustment to interest income. We believe an entity must classify loan origination costs and fees paid or received the same way as the cash flows on the loan to which they relate. For example, an entity must classify cash payments for loan origination costs and fees within operating activities if the loan was acquired specifically for resale or within investing activities if the loan is held for investment.

Also, when an entity reports cash flows from operating activities using the indirect method (see Section 3.3), it includes the amortization of loan origination fees and costs in interest income as a reconciling item from net income to net cash flows from operating activities (see Section 3.3.2).

## 5.3 INVESTMENTS

How an entity classifies cash flows from debt and equity securities and other investments in the cash flow statement depends on how it accounts for and classifies such investments under U.S. GAAP. Section 2.3 discusses securities that are considered cash equivalents.

### 5.3.1 Debt Securities



#### FASB REFERENCES

ASC 230-10-45-11, ASC 230-10-45-19 through 45-20, ASC 320-10-25-1, ASC 320-10-35-1, and ASC 320-10-45-11

An entity may acquire debt securities, such as corporate bonds, convertible debt and U.S. treasury securities, that it accounts for under ASC 320. How an entity classifies cash flows from debt securities in the cash flow statement depends on how it accounts and classifies such securities under ASC 320. The table summarizes that guidance and how an entity classifies cash flows related to purchases, sales, and maturities of debt securities under ASC 230.

ASC 320 GUIDANCE			CASH FLOW CLASSIFICATION UNDER ASC 230
CLASSIFICATION	DESCRIPTION	ASSET MEASUREMENT	
TRADING SECURITIES	Securities the entity intends to sell within hours or days. However, at acquisition an entity may classify as trading a security it plans to hold for a longer period (that is, the entity does not intend to sell in the near term).	Fair value, with unrealized holding gains and losses included in earnings.	Based on the nature and purpose for which the securities were acquired. If the entity actively trades the debt securities to generate a profit, classify as operating. Otherwise, classify as investing. <sup>(a)</sup>
HELD-TO-MATURITY	Securities the entity has the positive intent and ability to hold to maturity.	Amortized cost.	Investing. <sup>(b)</sup>
AVAILABLE-FOR-SALE	Securities not classified as trading securities or as held-to-maturity securities.	Fair value, with unrealized holding gains and losses generally reported in other comprehensive income until realized.	Investing. <sup>(b)</sup>

(a) Purchases and sales of trading securities classified in operating activities that have large amounts, quick turnover, and short maturities can be presented net (see Section 3.2).

(b) Must be reported gross for each security classification.

As discussed in Section 4.4, an entity reports interest and dividend receipts within operating activities.

### 5.3.2 Equity Securities



#### FASB REFERENCES

ASC 230-10-45-19 and ASC 321-10-45-1

An entity classifies cash flows from purchases and sales of equity securities accounted for under ASC 321, *Investments – Equity Securities*, based on the nature and purpose for which the securities were acquired. Like debt securities (see Section 5.3.1), if the entity actively trades equity securities to generate a profit, it classifies the related cash flows within operating activities. However, unlike debt securities, purchases and sales of equity securities cannot be presented net (see Section 3.2) because equity investments do not have a maturity.

As discussed in Section 4.4, an entity reports interest and dividend receipts within operating activities.

### 5.3.3 Equity Method Investments



#### FASB REFERENCES

ASC 230-10-45-21D, ASC 235-10-50-1 through 50-6, ASC 250-10-50-1(b), and ASC 250-10-50-2

An entity (investor) may have various transactions and activities related to its equity method investees accounted for under ASC 323, *Investments – Equity Method and Joint Ventures*. The table summarizes classification in the cash flow statement.

PURCHASES AND SALES	EQUITY METHOD EARNINGS	DISTRIBUTIONS
Classify within investing activities (see Section 4.2)	If the investor uses the indirect method to prepare its cash flow statement (see Section 3.3), its equity in earnings (losses) is a reconciling item from net income to net cash flows from operating activities (see Section 3.3.2)	Classify distributions that represent: <ul style="list-style-type: none"> <li>▶ <b>Returns on</b> investment as cash inflows from <b>operating</b> activities</li> <li>▶ <b>Returns of</b> investment as cash inflows from <b>investing</b> activities</li> </ul> (See table below for determination)

To determine whether distributions from equity method investments are returns on, or returns of, investment, the investor must use one of the below approaches as an accounting policy for **all** equity method investments.

CUMULATIVE EARNINGS APPROACH	NATURE OF THE DISTRIBUTION APPROACH
Distributions received are <b>returns on</b> investment and therefore operating cash inflows unless (a) the investor's cumulative distributions received less distributions received in prior periods that were returns of investment exceed (b) cumulative equity method earnings (as adjusted for basis differences amortization). Any excess is considered a <b>return of</b> investment and therefore investing cash inflows.	Distributions received are classified as either a return on investment (operating cash inflows) or a return of investment (investing cash inflows) based on the nature of the activity or activities of the investee that generated the distribution when such information is available.

Regardless of the approach elected, the entity must comply with the relevant accounting policy disclosure requirements in ASC 235-10-50-1 through 50-6.



### SELECTING AN ACCOUNTING POLICY WHEN INVESTOR HAS MULTIPLE EQUITY METHOD INVESTMENTS

An investor that has multiple equity method investments must apply the same accounting policy to all its equity method investments. However, if an investor elects the nature of the distribution approach, but the relevant information for an individual equity method investee is not available, the investor must apply the cumulative earnings approach for that investee and retrospectively report a change in accounting principle by applying the cumulative earnings approach for that investee. The investor also must disclose that the lack of available information has triggered a change in accounting principle for any affected investees and provide the disclosures required by ASC 250-10-50-1(b) and ASC 250-10-50-2, as applicable. The nature of the distribution approach would continue to apply to all of the investor's other equity method investees, assuming the information for that approach is available.

#### BDO INSIGHTS: CHANGES IN ACCOUNTING POLICY MUST BE PREFERRED

As discussed above, an investor must elect an accounting policy for all its equity method investments to apply either the cumulative earnings approach or the nature of the distribution approach. Other than as discussed above (when the information necessary to apply the nature of the distribution approach is not available for an individual equity investee), any change to the entity's accounting policy is a change in accounting principle that requires an assessment of preferability (including a preferability letter for SEC registrants) under ASC 250 and requires retrospective adjustment to the comparative periods presented. Determining whether the change is preferable requires the use of professional judgment based on the facts and circumstances.

#### BDO INSIGHTS: APPLYING THE NATURE OF DISTRIBUTION APPROACH

Before ASU 2016-15, which provides the guidance summarized above, diversity existed on differentiating between **return on** and **return of** investments for distributions from equity method investees. Some investors applied a cumulative earnings approach. Others applied a look-through approach, in which distributions received from equity method investees were presumed to be returns on investment and thus operating cash inflows unless information indicated the nature of the distribution was a return of investment and therefore investing cash inflows. Because of mixed feedback, ASU 2016-15 does not mandate one approach.

However, the nature of the distribution approach in ASC 230 differs from the prior look-through approach because there is no presumption under the nature of the distribution approach that all distributions are returns on investment. Rather, if an investor elects that approach, it must classify all distributions based on the nature of any activity of the investee that generated the distributions. For example, an investor would classify distributions resulting from an investee's proceeds from sale of PP&E within investing activities and distributions received from the investee's normal operations within operating activities.

See BDO's Blueprint, [Equity Method Investments Under ASC 323](#), for more guidance on the accounting for such investments. See Example 7-1 of this Blueprint for an illustration regarding equity method investments in the cash flow statement.

### 5.3.4 Investments: Life Settlement Contracts



#### FASB REFERENCES

ASC 325-30-45-5

An investor classifies cash receipts and payments related to life settlement contracts under ASC 325-30, *Investments – Other, Investments in Insurance Contracts*, based on the nature and purpose for which the life settlements were acquired.

## 5.4 DEBT FINANCING TRANSACTIONS

### 5.4.1 Overview: Debt Financing Transactions



#### FASB REFERENCES

ASC 230-10-45-14(b), ASC 230-10-45-15, and ASC 230-10-45-17(d)

An entity (issuer) of a debt instrument classifies **separately** within financing activities (see Section 4.3):

- ▶ Proceeds from issuing debt net of any payments to or received from creditors (such as lender fees) accounted for as a debt discount or premium
- ▶ Payments for debt issuance costs representing costs such as legal fees incurred with parties other than the lender and that are directly attributable to the debt financing

The above cash flow amounts are reported separately because they are received from, or paid to, different parties.

Subsequently, the issuer classifies interest payments on amounts borrowed generally within operating activities (see Section 4.4) and repayments of principal amounts borrowed within financing activities.

If the issuer reports cash flows from operating activities under the indirect method (see Section 3.3), it:

- ▶ Includes the amortization of debt discounts, premium, and debt issue costs in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2) to remove the effects of noncash interest expense
- ▶ Discloses interest paid (see Section 6.4)

#### **BDO INSIGHTS: NEGATIVE AMORTIZATION OF DEBT**

Sometimes, cash repayments on debt may be less than the periodic interest due, which results in the amount of interest not paid becoming part of the debt balance, creating negative amortization. If so, an entity that reports cash flows from operating activities under the indirect method (see Section 3.3) should include the negative amortization in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2) to remove the effect of the noncash expense. The entity should also consider disclosing the negative amortization.<sup>12</sup>

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 extinguishment (excluding accrued interest), are classified within financing activities. Payments for accrued interest generally are classified within operating activities (see Section 4.4). See Section 5.4.2 for payments to settle zero-coupon and similar debt instruments.

<sup>12</sup> AICPA TQA 1300.22, *Negative Amortization of Long-Term Debt in Cash Flows Statement*.

Under U.S. GAAP, proceeds received in debt financing transactions (and fees and other issuance costs) might have to be allocated to other freestanding financial instruments (such as warrants) or bifurcated embedded derivatives (such as redemption or conversion features). If so, the entity classifies the proceeds from the financing and payments for fees and other issuance costs that are allocated to the debt instrument, as discussed above. The remaining proceeds and payments allocated to other freestanding instruments or bifurcated embedded derivatives are classified according to their nature.

See BDO's Blueprint, [Accounting for Complex Financial Instruments](#), for accounting guidance. See Example 7-1 of this Blueprint for an illustration of debt financing transactions in the cash flow statement.

### 5.4.2 Zero-Coupon and Similar Debt Instruments



#### FASB REFERENCES

ASC 230-10-45-15(b), ASC 230-10-45-17(d), and ASC 230-10-45-25(e)

Zero-coupon bonds are debt instruments that generally do not pay interest during the instrument's life but instead are issued or traded at deep discounts from their face amounts to compensate for the lack of a coupon interest. The debt's face or principal amount differs from the net cash proceeds, resulting in a debt discount the issuer amortizes over the debt's term as interest cost in accordance with ASC 835-30, *Interest – Imputation of Interest*. The debt's total interest cost during its term is measured by the difference between its initial carrying amount and the total amount the entity agrees to repay the lender at maturity.

ASC 230 provides guidance for zero-coupon debt instruments and similar debt instruments with coupon interest rates that are **insignificant** compared to the borrowing's effective interest rate, as shown in the table.

ITEM	CASH FLOW GUIDANCE
Proceeds the issuer receives at issuance	Classify within financing activities
Interest accreted during the life of the debt instrument related to the debt discount	If the entity uses the indirect method to report cash flows from operating activities (see Section 3.3), add back in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2)
Payment the issuer makes to settle the debt instrument	Separate the cash payment and classify the cash payment attributable to: <ul style="list-style-type: none"> <li>▶ Accreted interest (debt discount) within operating activities, consistent with payments for interest (see Section 4.4)</li> <li>▶ Principal (amounts borrowed) within financing activities, consistent with repayments of other debt (see Section 4.3)</li> </ul>

#### BDO INSIGHTS: SCOPE OF ZERO-COUPON DEBT GUIDANCE

To increase comparability between economically similar debt instruments, the guidance in the table above applies to zero-coupon debt and debt instruments with coupon interest rates that are **insignificant** compared to the borrowing's effective interest rate (that is, deeply discounted debt instruments with near zero-coupon interest rates, such as commercial paper). While ASC 230 does not address when coupon interest rates are considered insignificant compared to the borrowing's effective interest rate, other areas of U.S. GAAP use that threshold and generally interpret it to mean less than 10%.

Also, because an issuer determines the effective interest rate of the debt by determining the discount rate that equates the present value of cash flows to the debt's **carrying amount**, we believe an issuer should consider discounts created from allocating proceeds among the debt and other freestanding financial instruments (such as warrants) or between the debt and bifurcated embedded derivatives when determining whether the coupon interest rate is insignificant compared to the borrowing's effective interest rate.

For all other debt instruments, an issuer **cannot** analogize to the guidance on zero-coupon and similar debt instruments and therefore should not, at settlement of the debt, bifurcate the cash payments to lenders for amounts attributable to accreted interest related to the debt discount. Specifically, the issuer classifies the **entire** cash payment within financing activities.<sup>13</sup>

Example 5-1 illustrates presentation in the cash flow statement for a zero-coupon debt instrument.

#### EXAMPLE 5-1: ZERO-COUPON DEBT

##### FACTS

- ▶ Entity A issues a five-year non-interest-bearing bond with a \$1 million face value for \$850,000 in cash.
- ▶ At the maturity date, Entity A repays the bond for \$1 million.
- ▶ Entity A applies the indirect method to report cash flows from operating activities (see Section 3.3).

##### CONCLUSION AND ANALYSIS

- ▶ Entity A classifies the initial proceeds of \$850,000 within financing activities (see Section 4.3).
- ▶ Over the five-year life of the bond, Entity A accretes interest expense, which it adds back in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).
- ▶ At the maturity date, Entity A separates the cash payment and classifies \$850,000 within financing activities (see Section 4.3) and \$150,000 (accrued interest related to the debt discount) within operating activities (see Section 4.4)

### 5.4.3 Debt Restructurings

An entity can renegotiate and amend its debt arrangements with lenders for various reasons, such as to increase borrowings to finance an expansion of its operations, refinance debt that is nearing maturity, or manage cash flow difficulties. The debtor and creditor can agree to modify an existing loan agreement or exchange one debt instrument for another. Anytime a debtor and creditor change the terms of their relationship by amending a loan agreement or exchanging one instrument for another, the debtor must determine the appropriate accounting model to apply to the changes made to the debt arrangement.

If the debtor pays off the original loan's creditor with proceeds from a new lender, it accounts for the original loan as an extinguishment and the new loan as a separate borrowing. In that case, it classifies separately within financing activities (consistent with Section 5.4.1):

- ▶ Proceeds from issuing debt to the new lender (net of any new lender fees)
- ▶ Payments for extinguishing the original loan, including third-party costs, premiums, and other fees paid to the original lender that are directly related to the debt extinguishment (excluding accrued interest which is typically within operating activities (see Section 4.4))
- ▶ Payments for debt issue costs associated with the new debt

In contrast, if the debtor restructures a loan arrangement with the same creditor, it must first consider the troubled debt restructuring (TDR) guidance in ASC 470-60, *Troubled Debt Restructurings by Debtors*. If the debt restructuring is not a TDR, the debtor applies ASC 470-50, *Modifications and Extinguishments*, to determine the appropriate accounting. See Chapter 7 of BDO's Blueprint, [Accounting for Complex Financial Instruments](#), for further guidance.

<sup>13</sup> BC9 of ASU 2016-15.

In a debt restructuring transaction, a bank or transfer agent often serves as an intermediary on behalf of the borrower, and the cash transfers often do not directly pass through the borrower's cash accounts. For example, proceeds from a new borrowing may be used to repay an existing loan with another lender or a new lender may pay off an existing loan directly with the existing lender without the cash flowing through the borrower's cash accounts or with only the net proceeds received. See Section 3.4 for guidance on constructive cash flows.

#### 5.4.3.1 Modification or Exchange Is a TDR

A TDR can include one or a combination of:

- ▶ A transfer of assets (such as receivables from third parties or real estate) or equity interests from the debtor to the creditor to fully or partially satisfy a debt obligation
- ▶ A modification of debt terms or an exchange of an existing debt instrument for another debt instrument with the same creditor

An entity (the debtor) accounts for a TDR according to the restructuring type (full settlement, partial settlement, or restructuring of terms). A TDR can result in the entity recognizing a gain or loss in the income statement, as shown below.

GAIN OR LOSS TYPE	DEBT IS FULLY SETTLED	DEBT IS PARTIALLY SETTLED AND/OR TERMS ARE RESTRUCTURED
Gain or loss from asset disposal	▶ An entity recognizes a gain or loss on asset disposal for the difference between the fair value and carrying amount of any assets transferred.	
Gain on debt restructuring (A TDR generally does not result in a loss on debt restructuring by the debtor because a restructuring must include a creditor concession to be a TDR.)	▶ An entity recognizes a gain on debt restructuring for the excess of the debt's carrying amount over the fair value of any assets or equity interests transferred (or the debt's fair value if it is more clearly evident).	▶ An entity recognizes a gain on debt restructuring <b>only if</b> the total cash payments based on the new terms are less than the debt's carrying amount as adjusted for any assets or equity interests transferred.  ▶ If so, all future payments are accounted for as reductions to the debt's carrying amount and no interest expense is recognized.

For debt with restructured terms (or for the remaining debt carrying amount, if the TDR involves partial settlement), the debt's carrying amount is not adjusted and no gain is recognized when the total future cash payments are greater than or equal to the debt's carrying amount. Instead, the debtor accounts for the change in terms prospectively by determining the effective interest rate that equates the debt's carrying amount to the present value of the restructured cash flows.

Legal fees and other direct costs incurred to effect a TDR must be deducted in measuring a gain on restructuring of payables or included in expense for the period when there is no gain on restructuring unless they are incurred in granting an equity interest to a creditor and recognized as a reduction of equity.

**BDO INSIGHTS: CASH FLOW CLASSIFICATION IN A TDR (PRESENTATION BY THE DEBTOR)**

The cash flow presentation for a TDR depends on the accounting (the table assumes the entity reports cash flows from operating activities under the indirect method (see Section 3.3)).

ACCOUNTING FOR A TDR	CASH FLOW REPORTING
Transfer of assets (other than cash) or equity interests from the debtor to the creditor to fully or partially satisfy a debt obligation	<ul style="list-style-type: none"> <li>▶ Disclose as noncash investing and financing activities (see Section 6.5)</li> <li>▶ Include any gain or loss on asset disposal in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2)</li> </ul>
Debt is fully settled with a gain	<ul style="list-style-type: none"> <li>▶ Include the gain on debt restructuring in the reconciliation of net income to net cash flows from operating activities</li> </ul>
Debt is partially settled with a gain (total future payments are <b>less than</b> the debt's carrying amount)	<ul style="list-style-type: none"> <li>▶ Include the gain on debt restructuring in the reconciliation of net income to net cash flows from operating activities</li> <li>▶ Classify <b>all</b> future payments within financing activities (see Section 4.3) because no interest is recognized for accounting, even though the restructured debt might have a stated interest rate</li> </ul>
Debt is restructured with no gain (total future payments are <b>greater than</b> the debt's carrying amount)	<ul style="list-style-type: none"> <li>▶ Classify the portion of payments representing interest (calculated using the effective interest rate after the restructuring) within operating activities (see Section 4.4)</li> <li>▶ Classify the portion of payments representing principal repayments within financing activities</li> <li>▶ Disclose the portion of payments representing interest as interest paid (see Section 6.4)</li> </ul>
Legal fees and other direct costs incurred to effect a TDR	<ul style="list-style-type: none"> <li>▶ Classify payments for costs to grant equity interests within financing activities (see Section 5.5.1)</li> <li>▶ Classify payments for other costs within operating activities because they affect net income (see Section 4.4)</li> </ul>

**5.4.3.2 Modification or Exchange Is Not a TDR**

The accounting for modifications or exchanges that are not TDRs differs based on whether the modified (new) debt is substantially different from the original (old) debt.

- ▶ If the debt instruments are substantially different, the transaction is accounted for as an extinguishment of the old debt and issuance of new debt.
- ▶ Otherwise, the change in terms is accounted for prospectively as a modification of terms.

The table summarizes the accounting under each model.

	EXTINGUISHMENT ACCOUNTING	MODIFICATION ACCOUNTING
Accounting model	<ul style="list-style-type: none"> <li>▶ Recognize the new debt at fair value as part of the reacquisition price.</li> <li>▶ Write off the old debt.</li> <li>▶ Recognize the difference between the reacquisition price and the net carrying amount of the old debt as a gain or loss on extinguishment.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Account for the change in terms prospectively by determining the effective interest rate that equates the debt's carrying amount to the present value of the new cash flows.</li> <li>▶ Subsequently measure the debt at amortized cost using the new effective interest rate.</li> </ul>
Unamortized debt discounts, premiums, and issuance costs	<ul style="list-style-type: none"> <li>▶ Write off any unamortized debt discounts, premiums, and issuance costs related to the old debt as part of the gain or loss on extinguishment.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Continue to amortize any unamortized debt discounts, premiums, and issuance costs related to the old debt prospectively, along with any new lender fees, using the effective interest method.</li> </ul>
New lender (creditor) fees	<ul style="list-style-type: none"> <li>▶ Include fees paid to (or received from) the creditor in the gain or loss on debt extinguishment.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Capitalize fees paid to (or received from) the creditor as part of the debt and amortize them prospectively.</li> </ul>
New debt issuance (third-party) costs	<ul style="list-style-type: none"> <li>▶ Capitalize debt issuance costs related to the new debt and amortize them prospectively.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Expense debt issuance costs related to the new debt.</li> </ul>

### BDO INSIGHTS: PRESENTATION OF CASH FLOWS IN A RESTRUCTURING THAT IS NOT A TDR

The cash flow presentation for a debt restructuring that is **not** a TDR depends on the accounting (the table assumes the entity reports cash flows from operating activities under the indirect method (see Section 3.3)).

ACCOUNTING FOR OTHER THAN TDRS	CASH FLOW REPORTING FOR A MODIFICATION OR EXTINGUISHMENT
Debt is extinguished with a gain or loss (which includes the write-off of any unamortized debt discounts, premiums, and issuance costs related to the old debt)	<ul style="list-style-type: none"> <li>▶ Include the gain or loss in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2)</li> <li>▶ Disclose the extinguishment of the old debt and issuance of new debt as noncash financing activities (see Section 6.5), except for changes in principal amounts (see below)</li> </ul>
New lender fees and debt issuance costs paid under extinguishment accounting	<ul style="list-style-type: none"> <li>▶ Classify <b>all</b> fees and costs within financing activities, consistent with payments for debt prepayment or debt extinguishment costs (see Section 5.4.1)</li> </ul>

**ACCOUNTING FOR OTHER THAN TDRS****CASH FLOW REPORTING FOR A MODIFICATION OR EXTINGUISHMENT**

New lender fees and debt issuance costs paid under modification accounting

- ▶ Classify new lender fees paid within financing activities because those are accounted for as a debt discount
- ▶ Classify new debt issuance costs paid within operating activities because they affect net income (see Section 4.4)

Payments to existing lenders for principal and accrued interest

- ▶ Classify debt principal repayments within financing activities (see Section 5.4.1), except for zero-coupon and similar debt instruments (see Section 5.4.2)
- ▶ Classify accrued interest payments generally within operating activities (see Section 4.4)

Additional proceeds received from existing lenders

- ▶ Classify within financing activities

If instead the debtor pays off the original loan's creditor with proceeds from a new lender, see Section 5.4.3.

## 5.5 EQUITY TRANSACTIONS

### 5.5.1 Overview: Equity Transactions

**FASB REFERENCES**

ASC 230-10-45-14(a) and ASC 230-10-45-15(a)

An entity (issuer) classifies the following within financing activities (see Section 4.3):

- ▶ Proceeds from issuing equity instruments, such as common and preferred stock
- ▶ Dividend payments and other distributions to owners, including outlays to reacquire the entity's equity instruments (treasury stock transactions)
- ▶ Cash payments to tax authorities by a grantor when withholding shares from a grantee's award

**BDO INSIGHTS: CLASSIFICATION OF EQUITY ISSUANCE COSTS**

While ASC 230 provides guidance on classifying debt issuance costs (see Section 5.4.1), it does not address cash flow classification for equity issuance costs paid to third parties. When an entity incurs costs (such as legal and underwriter fees) that are incremental and directly attributable to an issuance of equity securities classified in equity, it recognizes such costs as an offset against the total equity proceeds. Therefore, we believe it is appropriate for the entity to classify equity issuance cost payments within financing activities. Consistent with the guidance for debt issue costs (see Section 5.4.1), equity issuance costs paid to third parties should be presented **separately** from the proceeds on equity issuance received from investors.

See BDO's Blueprint, [Accounting for Complex Financial Instruments](#), for accounting guidance. See Example 7-1 for an illustration of equity transactions in the cash flow statement.

## 5.5.2 Share-Based Payment Awards



### FASB REFERENCES

ASC 230-10-45-15(a) and ASC 718-740-35-2

The issuance of a share-based payment award generally is a noncash transaction. When an entity presents its cash flow statement using the indirect method (see Section 3.3), the compensation cost for a share-based payment award is presented as a reconciling item from net income to net cash flows from operations (see Section 3.3.2).

Often, the tax deduction for compensation expense for share-based payment awards differs in amount and timing from the compensation cost recorded in the financial statements. An entity recognizes in the income statement as income tax expense or benefit (usually when the award is exercised, expires, or vests), the tax effect of the difference between the cumulative compensation cost recognized for accounting purposes and the deduction for tax purposes. Consistent with government taxes, including income taxes (see Section 4.4), such income tax expense or benefit is presented within operating activities.

Some share-based payment awards (for example, stock options) require the grantee to pay cash on exercise. All proceeds received from such exercise are presented within financing activities. Also, as discussed in Section 4.3, cash paid to a tax authority by an entity when withholding shares from a grantee's award for tax withholding is presented within financing activities. That is because the FASB believes<sup>14</sup> the cash flows related to tax withholding are like a repurchase. In substance, the employer issues a gross number of shares to the employee then repurchases a portion of the shares, subsequently remitting the cash related to the in-substance repurchase to the taxing authorities on behalf of the employee. That approach applies regardless of whether the award is equity- or liability-classified. Said differently, the entity reports **separately** within financing activities:

- ▶ The proceeds it received on exercise of the award
- ▶ The payment to tax authorities it made for the shares withheld

An entity can also settle a share-based payment award in cash instead of shares. For **equity-classified** awards, cash flow classification depends on the amount the entity paid compared to the award's fair value on the settlement date, as shown in the table.

CASH PAYMENT <b>EQUAL TO OR LESS THAN</b> AWARD'S FAIR VALUE	CASH PAYMENT <b>GREATER THAN</b> AWARD'S FAIR VALUE
<ul style="list-style-type: none"> <li>▶ Recognize entire cash payment in equity</li> <li>▶ Classify payment amount within financing activities, consistent with outlays to reacquire the entity's equity instruments (see Section 4.3)</li> </ul>	<ul style="list-style-type: none"> <li>▶ Recognize excess amount as additional compensation cost</li> <li>▶ Separate the cash payment:               <ul style="list-style-type: none"> <li>• Classify cash payment equal to the award's fair value within financing activities</li> <li>• Classify excess payment over the award's fair value within operating activities, which is consistent with cash flows from operating activities, which are generally the cash effects of transactions and other events that affect net income, including compensation cost</li> </ul> </li> </ul>

<sup>14</sup> BC19 of ASU 2016-09, *Improvements to Employee Share-Based Payment Accounting*.

For **liability-classified** awards, the entity classifies the cash payment to settle the award within operating activities. That is because the entity recognizes the grant-date fair value and subsequent changes in the liability-classified award as compensation cost.

### 5.5.3 Noncontrolling Interest Transactions



#### FASB REFERENCES

ASC 230-10-45-14(a), ASC 230-10-45-15(a), ASC 810-10-45-15, and ASC 810-10-45-21A through 45-23

An entity (parent) may consolidate a legal entity (subsidiary) under ASC 810, *Consolidation*. In consolidating the subsidiary, any ownership interests in the subsidiary held by owners other than the parent represent NCIs, which the parent reports within equity of the consolidated group.

Even if a parent retains its controlling financial interest in a subsidiary, its ownership interest can change. That could occur if, for example:

- ▶ The parent buys or sells ownership interests in its subsidiary
- ▶ The subsidiary reacquires some of its ownership interests
- ▶ The subsidiary issues additional ownership interests

The parent might also lose control of a subsidiary; for example, by selling an interest in the subsidiary.

Accordingly, the parent could have cash flow transactions, such as dividend payments and the transactions discussed above, with its NCI holders.

#### **BDO INSIGHTS: CASH FLOW CLASSIFICATION OF TRANSACTIONS WITH NCI**

As discussed above, a parent reports NCI within equity of the consolidated group. ASC 810 also states that changes in a parent's ownership interest while retaining a controlling financial interest do not result in a gain or loss in the income statement. Rather, such changes are accounted for as equity transactions as investments by **owners** and distributions to **owners** acting in their capacity as owners. Accordingly, and because financing activities include proceeds from issuing equity instruments and payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments (see Section 4.3), we believe cash flows from equity transactions with NCI holders while retaining control should be classified within financing activities.

In contrast, if the parent loses control of and deconsolidates the subsidiary, we believe any cash received, net of any cash deconsolidated, should generally be classified as a single line item within investing activities (consistent with the guidance in Sections 4.2 and 5.6.1).

#### **BDO INSIGHTS: CASH FLOW CLASSIFICATION OF TRANSACTION COSTS WHILE RETAINING CONTROL**

As discussed above, a parent might sell or buy its subsidiary's shares while retaining control of the subsidiary. ASC 810 does not discuss how to account for transaction costs (such as legal fees) incurred by a parent for changes in interests while retaining control.

We believe an entity can elect an accounting policy to either expense such costs or account for them in equity. Accordingly, classification of those transaction costs in the cash flow statement depends on the entity's accounting policy.

- ▶ If the entity expenses transaction costs, it classifies the related payments within operating activities, consistent with the definition of operating activities, which includes the cash effects of transactions and other events that affect net income.

- ▶ If the entity accounts for transaction costs in equity, it classifies the related payments within financing activities, consistent with the discussion on equity issuance costs in Section 5.5.1.

## 5.6 BUSINESS COMBINATIONS AND RELATED TOPICS

### 5.6.1 Overview: Business Combinations and Related Topics



#### FASB REFERENCES

ASC 230-10-45-12(c) and ASC 230-10-45-13(c)

An entity (acquirer) classifies cash paid to acquire a business, net of any cash acquired, as a single line within investing activities, consistent with the classification of payments to acquire PP&E and other productive assets (see Section 4.2). Similarly, cash receipts from the sale of a business (net of any cash sold) are investing cash flows.

The unit of account is the business combination; therefore, the acquisition of individual assets and liabilities is not reflected in the individual line items in the cash flow statement. Accordingly, when the acquirer applies the indirect method to report cash flows from operating activities (see Section 3.3), it removes the effects of the business combination on those accounts (see Section 3.3.2) from the change in assets and liabilities in the reconciliation of net income to net cash flows from operating activities (see Example 7-1).

The noncash effects of a business combination, including any noncash consideration for the business combination and the total effects on the acquirer's assets and liabilities, must be disclosed. For example, noncash investing and financing activities that must be disclosed include when an acquirer issues noncash consideration (such as common or preferred stock) to acquire a business (see Section 6.5).

After the business combination, the acquirer classifies within operating, investing, and financing activities the cash flows of the newly acquired business with the cash flows of any existing businesses.

In a business combination, a bank or escrow agent often serves as an intermediary on behalf of the acquirer. In such a situation, cash payments and receipts might not directly pass through an entity's cash accounts. For example, an acquirer might obtain financing to pay selling shareholders or repay existing debt with the funds disbursed directly by a bank or escrow agent. See Section 3.4 for guidance on constructive cash flows.

See BDO's Blueprint, [Business Combinations Under ASC 805](#), for accounting guidance.

### 5.6.2 Acquisition-Related Costs



#### FASB REFERENCES

ASC 230-10-45-17(f), ASC Master Glossary: Operating Activities

In a business combination, acquisition-related costs (such as finder fees and legal fees) are accounted for separately from the business combination and must be expensed as incurred unless they relate to issuing debt or equity instruments for which other U.S. GAAP applies (see Sections 5.4.1 and 5.5.1).

**BDO INSIGHTS: CLASSIFICATION OF TRANSACTION COSTS**

Because acquisition-related costs are considered a transaction separate from the business combination and must be expensed as incurred (assuming they do not relate to issuing debt or equity instruments), we believe they should be presented within operating activities. That classification is consistent with the definition of operating activities, which includes the cash effects of transactions and other events that affect net income, and those that do not stem from transactions defined as investing or financing activities (see Section 4.4).

**5.6.2.1 Break-up Fees****FASB REFERENCES**

ASC 230-10-45-17(f)

In some cases, a party that terminates a business combination may be required to pay the other party a termination payment or “break-up fee.” Because those fees do not result in raising funds from a financing transaction, they do not qualify for capitalization as debt or equity financing costs. Further, under ASC 230, cash outflows for operating activities include all other cash payments that do not stem from transactions defined as investing or financing activities. Therefore, such termination payments are classified within operating activities.

**5.6.3 Contingent Consideration Payments Made After a Business Combination****FASB REFERENCES**

ASC 230-10-45-13(d), ASC 230-10-45-15(f), and ASC 230-10-45-17(ee)

In a business combination, an acquirer might agree to transfer additional cash, other assets, or equity interests to the prior owners of an acquiree as part of the transaction if a future event occurs or specified condition is met. For example, an acquirer might agree to make contingent cash payments to the seller based on achieving revenue targets for the acquiree in the years following the acquisition. Contingent consideration also might give the acquirer the right to the return of previously transferred consideration if specified conditions are met.

For contingent consideration classified as a liability (or asset), the acquirer must initially recognize the contingent consideration payable (or receivable) at its acquisition-date fair value and subsequently remeasure it to fair value each reporting period until the contingency is resolved, with changes in fair value recognized in earnings. However, not all contingent amounts payable to (or receivable from) the former owners are accounted for as contingent consideration. Each contingent payment arrangement must be evaluated to determine whether it must be accounted for as contingent consideration or as a transaction separate from the business combination. Contingent payment arrangements that are determined to be separate from the business combination must be accounted for in accordance with other U.S. GAAP and would be classified according to their nature. See BDO’s Blueprint, [Business Combinations Under ASC 805](#), for guidance on identifying and classifying contingent consideration.

Contingent consideration in a business combination represents a noncash investing activity (see Section 6.5) at the acquisition date. If the acquirer reports cash flows from operating activities under the indirect method (see Section 3.3), subsequent changes in fair value are included in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).

Classification of subsequent cash payments for contingent consideration depends on whether the payments are made **soon after** the acquisition date and, if not, whether the payment exceeds the contingent consideration liability recognized at the acquisition date.

PAYMENTS MADE <b>SOON AFTER</b> ACQUISITION DATE	PAYMENTS NOT MADE <b>SOON AFTER</b> ACQUISITION DATE	
Classify as <b>investing</b> cash outflows, which is consistent with the classification of payments at the time of purchase or soon before or after purchase to acquire PP&E and other productive assets (see Section 4.2).	Classify as <b>financing</b> cash outflows the payments (or portion thereof) <b>up to</b> the contingent consideration liability recognized at the acquisition date (including measurement-period adjustments) less any amounts paid appropriately classified as investing cash outflows.	Classify as <b>operating</b> cash outflows the payments (or portion thereof) <b>in excess of</b> the contingent consideration liability recognized at the acquisition date (including measurement-period adjustments) less any amounts paid appropriately classified as investing cash outflows.

### BDO INSIGHTS: MEANING OF 'SOON AFTER'

ASC 230 does not define or provide guidance on what “soon after” means. However, BC16 of ASU 2016-15 states:

*“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).”*

Accordingly, we believe an entity may use a period of three months or less when applying this guidance.

Example 5-2 illustrates cash flow classification of contingent consideration in a business combination.

### EXAMPLE 5-2: CONTINGENT CONSIDERATION CLASSIFICATION

#### FACTS

- ▶ Entity A is a calendar-year-end entity and acquires Entity B (including its assets and assembled workforce) in a business combination (as defined under ASC 805, *Business Combinations*) on July 1, 20X1.
- ▶ At the acquisition date, Entity B was in the process of obtaining FDA approval for one of its key drugs.
- ▶ As part of the acquisition, the seller is entitled to the following contingent consideration payments in cash:
  - \$1 million if Entity B receives FDA approval of its key drug by September 1, 20X1.
  - 10% of Entity B’s revenue if Entity B has at least \$10 million in revenue between the acquisition date and December 31, 20X1 (the revenue target).
- ▶ Entity A recognized a liability for the contingent consideration of \$2.1 million in the acquisition-date accounting for the acquisition-date fair value of the contingent consideration liability of \$1 million for the FDA approval and \$1.1 million for the revenue-based target (\$11 million \* 10%). (For simplicity, assume that obtaining FDA approval was virtually certain so that the fair value of the payment would equal the amount due, which would typically not be the case.)
- ▶ On August 1, 20X1, Entity B receives FDA approval, and Entity A pays the seller \$1 million in cash.
- ▶ During December 20X1, Entity B reaches its revenue target with \$12 million in revenues from acquisition date to year-end.
  - Entity A increases the revenue-based contingent consideration liability by \$0.1 million (through earnings) to a total liability of \$1.2 million (\$12 million \* 10%) as of December 31, 20X1, which was subsequently relieved after year-end when Entity A pays the seller \$1.2 million in cash on January 5, 20X2.
- ▶ There were no measurement period adjustments.
- ▶ Entity A reports cash flows from operating activities using the indirect method (see Section 3.3).

## CONCLUSION AND ANALYSIS

- ▶ In its December 31, 20X1, cash flow statement, Entity A:
  - Classifies the \$1 million cash payment related to FDA approval within investing activities because the payment is **soon after** (less than three months from) the acquisition date.
  - Adds back the \$0.1 million change in fair value for the revenue-based contingent consideration liability in its reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).
  - Discloses noncash investing activities (see Section 6.5) related to the contingent consideration liabilities recognized in the business combination.
- ▶ In its December 31, 20X2, cash flow statement, Entity A classifies its \$1.2 million cash payment to settle the revenue-based contingent consideration liability, considering it was **not** paid **soon after** the acquisition date:
  - \$1.1 million (acquisition-date contingent consideration liability of \$2.1 million less \$1.0 million paid that was appropriately classified as investing cash outflows) within financing activities.
  - \$0.1 million (excess of \$1.2 million over \$1.1 million acquisition-date liability) within operating activities.

### 5.6.3.1 Working Capital Adjustments



#### FASB REFERENCES

ASC 230-10-45-13(c), ASC Master Glossary: Operating Activities

Acquisition agreements commonly include provisions that require an adjustment to the consideration for the business combination if the working capital balances of the acquiree are above or below a targeted amount. Because working capital is determined at the acquisition date and is not dependent on the outcome of an uncertain future event, working capital adjustments do not represent contingent consideration.

Instead, such adjustments affect the consideration transferred if an adjustment is made after the acquisition date but before the end of the measurement period. Therefore, they are reflected within investing activities. Working capital adjustments that occur after the measurement period are recognized in the income statement; therefore, they are reflected within operating activities.

### 5.6.4 Extinguishment of Debt in Connection With a Business Combination

An acquirer may settle the acquiree's debt in connection with a business combination. If so, a question arises regarding whether the cash outflow to settle the debt is a financing or investing activity. Classification depends on whether the acquirer legally assumes the debt, which depends on facts and circumstances, as discussed in BDO's Blueprint, [Business Combinations Under ASC 805](#).

- ▶ If the acquirer does **not** legally assume the debt, the repayment on behalf of the sellers is part of the consideration transferred for the business combination, and the cash outflow is therefore an investing activity (see Section 5.6.1).
- ▶ If the acquirer legally assumes the debt, it is recognized as a liability assumed as part of the business combination, and the subsequent debt repayment is therefore a financing activity, consistent with the classification of debt repayments unrelated to a business combination (see Section 4.3).

#### **BDO INSIGHTS: CASH FLOW PRESENTATION OF DEBT ASSUMED FOR ADMINISTRATIVE CONVENIENCE**

If debt is legally assumed for administrative convenience but repaid immediately (within one day of the business combination), we believe it is acceptable to classify the cash payment within investing activities. However, under that approach, the entity should **consistently** characterize the cash payment as part of the consideration transferred for the business combination **throughout** the financial statements. Specifically, it would be inconsistent to reflect such debt as an assumed liability in the business combination.

### 5.6.5 Pushdown Accounting

When an acquirer accounts for a business combination, it recognizes the acquiree's assets and liabilities at fair value (with limited exceptions) rather than at their previous carrying amounts. That change in the amounts of the assets and liabilities is commonly referred to as a "stepped-up" or "new" basis. For an acquirer's financial statements, the recognition of a new basis for the acquired assets and liabilities assumed is not optional. In contrast, under pushdown accounting as described in ASC 805-50, *Business Combinations – Related Issues*, the acquiree in a business combination can elect to continue to recognize its assets and liabilities at carryover basis or recognize its assets and liabilities at the acquirer's basis. The use of the acquirer's basis in the preparation of an acquiree's separate financial statements is called "pushdown accounting."

Because the application of pushdown accounting is akin to the creation of a new reporting entity, the successor period is presented separately from the predecessor period using a black line.

When an acquiree elects pushdown accounting, it is indirectly reflecting the new basis of accounting in its financial statements rather than directly applying the acquisition method under ASC 805. As such, the cash flows (in the successor period) might be reflected differently for an entity that applies pushdown accounting than for an acquirer in a business combination.

When applying pushdown accounting, the initial recognition of the net assets by the acquiree in the successor period is generally a noncash activity that represents a contribution of noncash assets and liabilities by the parent (acquirer) to the subsidiary (acquiree) in exchange for receiving the subsidiary's equity. The acquiree then uses those asset and liability balances to determine cash flow activity in the successor period.

#### **BDO INSIGHTS: PRESENTATION OF PREDECESSOR CASH BALANCES IN SUCCESSOR ENTITY**

Predecessor cash balances that carry over to the successor entity affect the cash flow statement.

- ▶ Some successor entities present beginning cash equal to the predecessor's ending cash balance.
- ▶ Others present beginning cash of zero and a cash receipt equal to the predecessor's ending cash balance as a financing activity (that is, a contribution from the acquirer).

We believe either approach is acceptable but that the presentation of opening balances in the cash flow statement should generally be consistent with the presentation of opening balances in the statement of equity as discussed in Section A.9.3 of BDO's Blueprint, [Business Combinations Under ASC 805](#).

#### **BDO INSIGHTS: PRESENTATION OF CASH FLOWS IN PUSHDOWN ACCOUNTING**

In some business combinations, the acquiree can participate directly in the cash flows used to finance the business combination. For example, an acquiree can issue debt in connection with a business combination. If so, the debt cash inflow is presented within financing activities, consistent with how the acquirer accounts for debt proceeds.

However, we generally believe that the cash outflow associated with distributing debt proceeds to the selling shareholders is in substance a dividend to the acquirer (which the acquirer uses to purchase the business) and would be presented as a financing cash outflow rather than as an investing cash outflow because an acquiree cannot acquire itself. Similarly, any other cash consideration paid by the acquiree to effect the acquirer's business combination should generally be presented as a financing cash outflow (a distribution to the acquirer) rather than as an investing cash flow. However, there may be other acceptable alternatives.

The table below illustrates the differences between the cash flow presentation for an acquirer and an acquiree that applies pushdown accounting.

	ACQUIRER'S CLASSIFICATION	ACQUIREE'S CLASSIFICATION
Cash inflow from raising debt when acquiree is not the legal obligor	Financing activity	Not applicable. The acquiree does not recognize a liability unless the acquiree is the legal obligor.
Cash inflow from raising debt when acquiree is the legal obligor	Financing activity	Financing activity
Cash outflow by acquiree for acquisition of business	Investing activity	Financing activity. The acquiree cannot acquire itself, so cash paid by the acquiree to effect the acquirer's business combination is reflected as a distribution to the parent (acquirer).
Initial recognition of the acquiree's assets and liabilities when no cash is paid by acquiree	Investing activity	Noncash activity. The acquiree cannot acquire itself, so initial recognition is not an investing activity but is disclosed as a noncash transaction.

## 5.7 DERIVATIVES AND HEDGING ACTIVITIES

Cash flow classification of derivative instruments depends on:

- ▶ Whether the derivative instrument includes an other-than-insignificant financing element at inception (see Section 5.7.1).
- ▶ If it does not include an other-than-insignificant financing element at inception, whether the derivative instrument is designated as a hedging instrument and the entity makes an accounting policy to link the cash flows of the hedging instrument to those of the hedged item (see Section 5.7.2).

### 5.7.1 Derivative Instruments With an Other-Than-Insignificant Financing Element at Inception



#### FASB REFERENCES

ASC 230-10-45-23, ASC 230-10-45-27, and ASC 815-10-45-11 through 45-15

An instrument accounted for as a derivative under ASC 815-10, *Derivatives and Hedging – Overall*, that includes either (or both) of the below terms often contains a financing element:

- ▶ Off-market terms
- ▶ An upfront cash payment

If a derivative instrument includes an **other-than-insignificant** financing element at inception, the **borrower** (that is, the entity receiving the financing) must present **all** cash inflows and outflows of the derivative instrument within financing activities. Determining whether a derivative instrument includes a financing element and, if so, whether that financing element is other than insignificant at inception, requires the application of professional judgment based on the facts and circumstances.

However, for cash flow classification purposes, the derivative instruments below are not considered to include a financing element:

- ▶ An at-the-market derivative instrument with no prepayments
- ▶ An at-the-money plain-vanilla interest rate swap with no prepayments
- ▶ An at-the-money or out-of-the-money option contract if the payment made at inception to the option writer is for only the option's time value

In contrast, a derivative instrument's contractual terms might be structured so that net payments will be made by one party in the earlier periods and subsequently returned by the counterparty in the later periods of the derivative instrument's term. If so, that derivative instrument must be viewed as containing a financing element and therefore assessed to determine whether the financing element is other than insignificant, even if the derivative instrument has a fair value of zero at inception.

#### **BDO INSIGHTS: DERIVATIVE INSTRUMENTS WITH AN OTHER-THAN-INSIGNIFICANT FINANCING ELEMENT**

Although a derivative instrument with an other-than-insignificant financing element at inception includes aspects of more than one class of cash flows (that is, a borrowing related to the financing element and the derivative instrument according to its nature (see Section 5.7.2)), the entity cannot separate the cash flows and instead must classify **all** cash flows from the derivative instrument within financing activities because of the specific guidance in ASC 230 (therefore, the Section 4.5 guidance on separating cash flows by source or use does not apply).

### **5.7.2 Derivative Instruments Without an Other-Than-Insignificant Financing Element at Inception**



#### **FASB REFERENCES**

ASC 230-10-45-27

For derivative instruments that do **not** include an other-than-insignificant financing element at inception, an entity must generally classify cash receipts and payments according to their nature. For example, the purchase or sale of a futures contract generally is an investing activity.

However, an entity can elect an accounting policy to classify cash flows from a derivative instrument accounted for as a fair value hedge or cash flow hedge in the same category as the cash flows from the items being hedged. For example, if an entity elects that policy, the purchase or sale of a futures contract would be classified as an operating activity if it is designated as a cash flow hedge of a firm commitment to purchase inventory. The accounting policy must be disclosed and applied consistently. If hedge accounting is discontinued for any reason, the entity must classify subsequent cash flows consistent with the nature of the instrument.

For guidance on determining whether a derivative instrument includes an other-than-insignificant financing element at inception, see Section 5.7.1.

#### **BDO INSIGHTS: ACCOUNTING POLICY FOR DERIVATIVES ACCOUNTED FOR AS FAIR VALUE OR CASH FLOW HEDGES**

The FASB believed that linking the cash flows from the hedging transaction to those of the hedged item results in a better depiction of the cash flows than presenting them according to their nature.

In the example described above of a purchase or sale of a futures contract, if the contract is hedging an inventory purchase commitment, the hedging could be viewed as integral to the inventory purchase (which is an operating activity (see Section 4.4)) to reduce exposure to inventory price increases. Entering the futures contract is an operating decision by the entity that is substantially different from an investing activity (see Section 4.2). Accordingly, an entity can, as an accounting policy, classify the cash flows from the derivative instrument in the same category as the item being hedged if the derivative instrument is accounted for as a fair value or cash flow hedge and does not include an other-than-insignificant financing element (see Section 5.7.1).

## 5.8 LEASES

### 5.8.1 Overview: Leases



#### FASB REFERENCES

ASC 842-20-45-5, ASC 842-30-45-5, ASC 842-30-45-7, and ASC 942-230-45-4

Under ASC 842, *Leases*, lessees classify leases as either operating or financing. Lease classification affects how a lessee reports cash flows from its leases in the cash flow statement (see Section 5.8.2). A lessee applies ASC 360 to determine whether its leases are impaired. If the lessee reports cash flows from operating activities under the indirect method (see Section 3.3), it includes any impairment charges in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2). A lessee's leasing activities also can give rise to noncash activities that must be disclosed (see Section 6.5), such as when the lessee recognizes the lease on balance sheet at the commencement date or remeasures a lease already on the balance sheet.

Lessors classify leases as sales-type, direct financing, or operating leases. Unlike lessees, lessors must classify all cash receipts from leases within operating activities, regardless of lease classification, with one exception. Lessors within the scope of ASC 942, *Financial Services – Depository and Lending*, classify principal payments received under sales-type and direct financing leases within investing activities (see Sections 5.8.3 and 8.4). Also, when a lessor classifies a lease as either sales-type or direct financing, it discloses a noncash investing activity (see Section 6.5) for the recognition of a net investment in the lease and derecognition of the underlying asset. If the lessor reports cash flows from operating activities under the indirect method (see Section 3.3), it includes any selling profit or loss for sales-type leases and any selling loss for direct financing leases in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).

An entity that owns PP&E might decide to sell its asset and lease it back. If so, the seller-lessee **and** the buyer-lessor must determine whether to account for the transaction as a sale (purchase) and separate leaseback or as a financing, which affects how the entity reports cash flows from the transaction in its cash flow statement (see Section 5.8.4).

See BDO's Blueprint, [Accounting for Leases Under ASC 842](#), for accounting and disclosure guidance. See Example 7-1 in this Blueprint for an illustration regarding leases in the cash flow statement.



#### LEASE PAYMENTS ARE AN ALLOCATED AMOUNT OF THE CONSIDERATION IN THE CONTRACT

A contract may include one or more lease components (such as the lease of one or more delivery trucks) and one or more nonlease components (for example, maintenance or security services). The amount of lease payments results from an allocation of the consideration in the contract to the lease and nonlease components. Amounts allocated to the nonlease components are not considered lease payments and are not accounted for under ASC 842 unless:

- ▶ A lessee elects the practical expedient not to separate for the asset class.
- ▶ A lessor elects the practical expedient not to separate for the asset class and meets the scope conditions and the nonlease components are not the predominant components.

The discussion in the following sections addresses only the payments allocated to lease components. An entity would apply other relevant guidance to determine the appropriate classification of payments allocated to other components of the transaction.

## 5.8.2 Lessee Cash Flow Classification



### FASB REFERENCES

ASC 842-20-45-5

The requirements for reporting cash flows are consistent with the presentation of expenses arising from leases in the income statement, which depends on lease classification, as shown below.

#### OPERATING LEASES

- ▶ Classify lease payments within operating activities.<sup>(a)</sup>

- ▶ Classify variable lease payments and short-term lease payments not included in the lease liability within operating activities.<sup>(a)</sup>

#### FINANCE LEASES

- ▶ Classify repayments of the principal portion of the lease liability within financing activities.
- ▶ Classify interest on the lease liability like other interest paid (typically within operating activities (see Section 4.4)).<sup>(a)(b)</sup>

<sup>(a)</sup> If those payments represent costs to bring another asset to the condition and location necessary for its intended use (for example, payments capitalized as part of PP&E under ASC 360), classify within investing activities.

<sup>(b)</sup> Interest cost, as defined in ASC 835-20, includes interest related to finance leases.

If the lessee reports cash flows from operating activities under the indirect method (see Section 3.3), it adds back noncash expenses such as amortization expense on finance leases in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).

See Section 6.4 for the interest paid disclosure.

### BDO INSIGHTS: OPERATING LEASE CASH FLOW PRESENTATION UNDER THE INDIRECT METHOD

When a lessee reports cash flows from operating activities under the indirect method and is reconciling net income to net cash flows from operating activities (see Section 3.3.2), neither ASC 230 nor ASC 842 discusses how a lessee should present noncash adjustments to the ROU asset and lease liability for operating leases. We believe one acceptable presentation is for a lessee to (1) add back the amortization of operating lease ROU assets as a “noncash rent expense” or similar caption (but **not** as amortization expense because a lessee recognizes a single lease expense in the income statement); and (2) separately present the change in operating lease liabilities. However, other presentations might be acceptable. For example, presentation as a single net line item is consistent with the presentation of a single operating lease expense in the income statement.

Example 5-3 illustrates cash flow classification for an operating lease by a lessee.

**EXAMPLE 5-3: LESSEE CASH FLOW STATEMENT PRESENTATION – OPERATING LEASE****FACTS**

- ▶ Lessee enters a 10-year lease for heavy machinery for its operations. Payments start at \$100,000 and increase by 5% annually. There are no initial direct costs, lease incentives, or prepaid lease payments.
- ▶ Lessee classifies the lease as operating and recognizes straight-line lease expense of \$125,779 annually (for simplicity, assume the lease expense is the same as Lessee's net loss [A]).
- ▶ The rate implicit in the lease is not readily determinable, so Lessee uses its incremental borrowing rate of 6%.
- ▶ Lessee reports cash flows from operating activities under the indirect method (see Section 3.3).
- ▶ The tables in this example are consistent with how they would be displayed in a spreadsheet, with amounts shown with no decimals and no rounding function used.

**CONCLUSION AND ANALYSIS**

- ▶ Lessee accounts for the lease throughout the lease term, assuming no modifications, reassessments, or impairments as shown below.

YEAR	LEASE LIABILITY					RIGHT-OF-USE ASSET		
	BEGINNING BALANCE	INTEREST [B]	PAYMENT [C]	ENDING BALANCE	AMORTIZATION OF LIABILITY [D] = [B] + [C]	BEGINNING BALANCE	REDUCTION [E] = [A] - [B]	ENDING BALANCE
Year 1	904,337	54,260	(100,000)	858,598	(45,740)	904,337	(71,519)	832,819
Year 2	858,598	51,516	(105,000)	805,114	(53,484)	832,819	(74,263)	758,556
Year 3	805,114	48,307	(110,250)	743,170	(61,943)	758,556	(77,472)	681,084
Year 4	743,170	44,590	(115,763)	671,998	(71,172)	681,084	(81,189)	599,895
Year 5	671,998	40,320	(121,551)	590,767	(81,231)	599,895	(85,459)	514,436
Year 6	590,767	35,446	(127,628)	498,585	(92,182)	514,436	(90,333)	424,103
Year 7	498,585	29,915	(134,010)	394,491	(104,094)	424,103	(95,864)	328,239
Year 8	394,491	23,669	(140,710)	277,450	(117,041)	328,239	(102,109)	226,130
Year 9	277,450	16,647	(147,746)	146,352	(131,099)	226,130	(109,132)	116,998
Year 10	146,352	8,781	(155,133)	—	(146,352)	116,998	(116,998)	—

- ▶ Lessee uses the above information to prepare its cash flow statement. In doing so, it (1) adds back the reduction in ROU asset as a noncash rent expense; and (2) separately presents the change in lease liability as shown below.

	YEAR 1	YEAR 2	YEAR 3	YEAR 4	YEAR 5	YEAR 6	YEAR 7	YEAR 8	YEAR 9	YEAR 10
Net loss [A]	(125,779)	(125,779)	(125,779)	(125,779)	(125,779)	(125,779)	(125,779)	(125,779)	(125,779)	(125,779)
Noncash rent expense [E]	71,519	74,263	77,472	81,189	85,459	90,333	95,864	102,109	109,132	116,998
Change in lease liability [D]	(45,740)	(53,484)	(61,943)	(71,172)	(81,231)	(92,182)	(104,094)	(117,041)	(131,099)	(146,352)
Net cash flows from operating activities [C]	(100,000)	(105,000)	(110,250)	(115,763)	(121,551)	(127,628)	(134,010)	(140,710)	(147,746)	(155,133)

### 5.8.2.1 Lease Incentives Received



#### FASB REFERENCES

ASC 842-10-55-30

A lessee often receives incentives from a lessor to enter a lease or during the lease term, such as:

- ▶ Payments to the lessee (for example, to fund tenant improvements).
- ▶ Payments to third parties on behalf of the lessee (for example, for assuming a lessee's preexisting lease).

Under ASC 842, lease incentives reduce the lease payments and the consideration in the contract if the payment is not in exchange for a distinct good or service. For example, the cash the lessee receives from a lessor to early terminate a preexisting lease is a lease incentive and therefore a reduction in lease payments.

#### **BDO INSIGHTS: LEASE INCENTIVES CASH FLOW PRESENTATION**

Because lease incentives reduce the lease payments and the consideration in the contract, we believe a lessee should classify lease incentive receipts like lease payments (see Section 5.8.2). For example, a lessee classifies lease incentives received on or after the commencement date as cash inflows from:

- ▶ Operating activities for operating leases
- ▶ Financing activities for finance leases

#### **BDO INSIGHTS: CASH FLOW PRESENTATION OF TENANT IMPROVEMENT ALLOWANCES**

It is common for a real estate lessor to provide the lessee with a tenant improvement allowance. If so, the entity must determine whether the lessee or the lessor owns the improvements for accounting purposes.

- ▶ If the improvements are **lessee** assets:
  - Payments the lessee makes for the improvements are investing activities, consistent with payments for other PP&E and productive assets (see Section 4.2).
  - Payments the lessee receives from the lessor are lease incentives (see BDO Insights just above).
- ▶ If the improvements are **lessor** assets, payments the lessee makes for the improvements net of any lessor reimbursements are lease payments, which the lessee classifies as discussed in Section 5.8.2.

### 5.8.2.2 Lessee Exercise of Purchase Option



#### FASB REFERENCES

ASC 842-20-40-2

A lessee might exercise an option to purchase (or negotiate with the lessor to purchase) the leased asset during the lease term, which terminates the lease. If the transaction is not part of a business combination under ASC 805, the lessee adjusts the carrying amount of the asset for any difference between the purchase price and the carrying amount of the lease liability at the purchase date. The lessee then accounts for the asset under ASC 360.

**BDO INSIGHTS: CASH FLOW PRESENTATION FOR LESSEE EXERCISE OF AN ASSET PURCHASE OPTION**

Neither ASC 230 nor ASC 842 addresses cash flow classification when a lessee exercises a purchase option on a leased asset. We believe the two approaches below generally are acceptable.

- ▶ **Extinguishment of lease liability approach.** The payment extinguishes the lease liability, and the lessee:
  - Classifies the payment (up to the lease liability balance) like any other lease payments based on lease classification (see Section 5.8.2); for example, within operating activities for an operating lease.
  - Classifies any excess of the payment over the lease liability balance within investing activities, like other purchases of PP&E (see Section 4.2).
  - Discloses the exchange of the ROU asset for PP&E as a noncash investing activity (see Section 6.5).
- ▶ **Purchase of PP&E approach.** The payment is for the purchase of PP&E, and the lessee:
  - Classifies any payment for the excess of the lease liability balance over the ROU asset carrying amount like other lease payments based on lease classification (see Section 5.8.2), which represents a payment to extinguish the lease liability.
  - Classifies the remaining payment within investing activities, like other purchases of PP&E (see Section 4.2).
  - Discloses the termination of the lease (derecognition of the ROU asset and lease liability) as a noncash investing and financing activity (see Section 6.5).

While we believe a lessee must apply the same approach to leases in similar circumstances, we believe an entity can elect different approaches to leases in different circumstances as an accounting policy. For example, a lessee could apply the extinguishment of lease liability approach for finance leases and the purchase of PP&E approach for operating leases.

Example 5-4 illustrates cash flow reporting by a lessee that exercises a purchase option under the lease.

**EXAMPLE 5-4: LESSEE CASH FLOW REPORTING — LESSEE PURCHASE OF LEASED ASSET****FACTS**

- ▶ Lessee entered a five-year lease of equipment, which is a finance lease.
- ▶ At the end of Year 4 of the lease, Lessee purchases the equipment for \$55,000 when the ROU asset and lease liability carrying amounts are \$50,000 and \$53,000, respectively.
- ▶ Lessee records the following journal entry at the acquisition date:

Debit	PP&E	\$	52,000	
Debit	Lease liability		53,000	
Credit	ROU asset			\$ 50,000
Credit	Cash			55,000

**CONCLUSION AND ANALYSIS**

- ▶ The table summarizes Lessee's cash flow reporting depending on which approach it selected.

**EXTINGUISHMENT OF LEASE LIABILITY APPROACH**

- ▶ Because the lease is a finance lease, Lessee classifies the payment up to the lease liability of \$53,000 within financing activities (see Section 5.8.2).
- ▶ Lessee classifies the excess payment of \$2,000 (\$55,000 - \$53,000) within investing activities.
- ▶ Lessee discloses noncash investing activities of \$50,000 for the derecognition of ROU asset and purchase of PP&E.

**PURCHASE OF PP&E APPROACH**

- ▶ Because the lease is a finance lease, Lessee classifies the payment related to the excess lease liability over the ROU asset of \$3,000 (\$53,000 - \$50,000) within financing activities.
- ▶ Lessee classifies the remaining payment of \$52,000 (\$55,000 - \$3,000) within investing activities.
- ▶ Lessee discloses noncash investing and financing activities of \$50,000 for the derecognition of the ROU asset and lease liability.

### 5.8.3 Lessor Cash Flow Classification



#### FASB REFERENCES

ASC 842-30-45-5, ASC 842-30-45-7, and ASC 942-230-45-4

As discussed in Section 5.8.1, a lessor must classify all cash receipts from leases within operating activities, regardless of lease classification, because leasing is generally part of a lessor's revenue-generating activities.

However, lessors within the scope of ASC 942 classify principal payments received on sales-type and direct financing leases within investing activities (see Section 8.5).

### 5.8.4 Sale and Leaseback Transactions



#### FASB REFERENCES

ASC 842-40-25-1 through 25-3

In a sale and leaseback transaction, one entity (the seller-lessee) transfers an asset it owns to another entity (the buyer-lessor) and leases that asset back from the buyer-lessor in exchange for consideration.

To be considered a sale (by the seller-lessee) and purchase (by the buyer-lessor) under ASC 842, the transaction must meet **all** the following requirements (otherwise, it is a financing):

- ▶ A contract exists and the buyer-lessor obtains control of the asset under ASC 606, *Revenue from Contracts with Customers*
- ▶ The leaseback is classified as an operating lease by the seller-lessee or an operating lease or direct financing lease by the buyer-lessor
- ▶ There are no repurchase options or, if there are, they meet specified conditions

The accounting for a sale and leaseback transaction as either a sale (purchase) or financing affects cash flow classification of the initial cash received (paid) in the transaction and subsequent cash receipts (payments).

#### 5.8.4.1 Accounting When Transfer of Asset Is a Sale



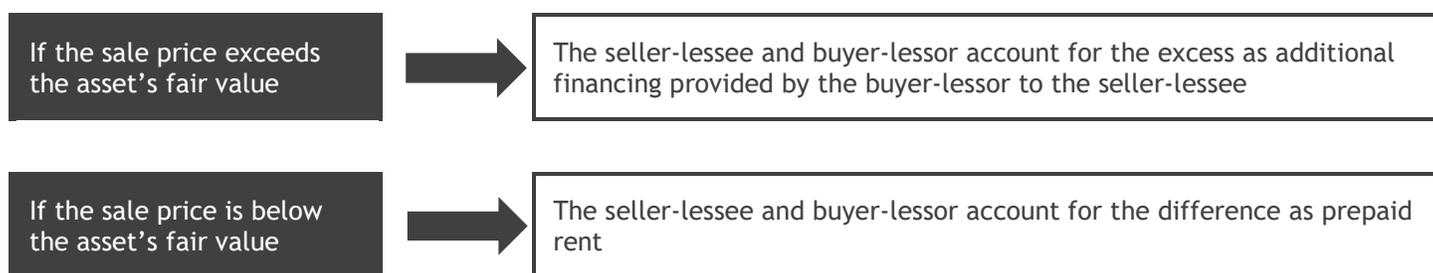
#### FASB REFERENCES

ASC 842-40-25-4 and ASC 842-40-30-2

If the transfer of the asset meets the requirements discussed in Section 5.8.4 and is therefore accounted for as a sale (by the seller-lessee) or purchase (by the buyer-lessor), the sale (purchase) of the asset and subsequent leaseback are accounted for separately. Accordingly, the seller-lessee and buyer-lessor classify separately in the cash flow statement:

- ▶ Cash receipts (payments) for the sale (purchase)
- ▶ Lease payments under the leaseback

Further, except for related-party leases, sale and leaseback accounting is affected by whether the sales price of the asset is at fair value (that is, whether there are off-market terms). Under ASC 842:



The table summarizes cash flow classification for a sale and leaseback transaction accounted for as a sale and separate leaseback.

ITEM	SELLER-LESSEE	BUYER-LESSOR
Proceeds from sale (payment for purchase) of the asset when transaction is at fair value	Investing activities, like the sale of other PP&E (see Section 4.2)	Investing activities, like the acquisition of other PP&E (see Section 4.2)
Proceeds from sale (payment for purchase) of the asset when the sale price is below the asset's fair value	Investing activities up to the proceeds received, like the sale of other PP&E (see Section 4.2) Prepaid rent is a noncash activity	Investing activities up to the proceeds paid, like the acquisition of other PP&E (see Section 4.2) Prepaid rent is a noncash activity
Proceeds from sale (payment for purchase) of the asset in excess of the asset's fair value	Financing activities, like proceeds from debt issuance (see Section 4.3)	Investing activities, like loan disbursements (see Section 4.2)
Leaseback payments (receipts) allocated to repayment of the financing when the initial proceeds (payment) exceed the asset's fair value	Financing activities, like repayments of amounts borrowed (see Section 4.3)	Investing activities, like receipts from collection of loans (see Section 4.2)
Leaseback payments (receipts) allocated to interest on the financing when the initial proceeds (payment) exceed the asset's fair value	Typically, operating activities (see Section 4.4)	Operating activities (see Section 4.4)
Leaseback payments (or payments allocated to the lease if there also is a financing)	Same as any other lease payments for operating leases (see Section 5.8.2). Not applicable for finance leasebacks as that precludes sale accounting (see Section 5.8.4)	Typically, operating activities (see Section 5.8.3)
Gain (loss) on sale of the asset	Reconciling item within operating activities if the seller-lessee uses the indirect method (see Section 3.3)	Not applicable
Leaseback recognition on balance sheet (ROU asset and lease liability)	Noncash investing and financing activity (see Section 6.5)	Not applicable

### 5.8.4.2 Accounting When Transfer of Asset Is Not a Sale



#### FASB REFERENCES

ASC 842-40-25-5

If the transfer of the asset does not meet all requirements discussed in Section 5.8.4, the seller-lessee **and** buyer-lessor account for the transaction as a financing.

<b>Seller-lessee</b>	<ul style="list-style-type: none"> <li>▶ Continues to recognize the transferred asset and apply ASC 360 (for example, continues to depreciate the asset and test it for impairment)</li> <li>▶ Accounts for the proceeds received as a financial liability accounted for under other U.S. GAAP (for example, ASC 470, <i>Debt</i>)</li> <li>▶ Allocates rent payments between interest expense and principal amortization</li> </ul>
<b>Buyer-lessor</b>	<ul style="list-style-type: none"> <li>▶ Does not recognize the transferred asset under ASC 360</li> <li>▶ Accounts for amounts paid initially as a receivable in accordance with other U.S. GAAP</li> <li>▶ Allocates rent payments received between interest income and principal amortization</li> </ul>

Unlike sale and leaseback transactions accounted for as a sale (purchase) and separate leaseback (see Section 5.8.4.1), in a failed sale (purchase), whether the sale price differs from fair value is irrelevant because the entire transaction is accounted for as a financing.

The table summarizes cash flow classification for a sale and leaseback transaction accounted for as a financing.

ITEM	SELLER-LESSEE	BUYER-LESSOR
Proceeds from sale (payment for purchase) of the asset	Financing activities, like proceeds from debt issuance (see Section 4.3)	Investing activities, like loan disbursements (see Section 4.2)
Rent payments (receipts) allocated to repayment of financing	Financing activities, like repayments of amounts borrowed (see Section 4.3)	Investing activities, like receipts from collection of loans (see Section 4.2)
Rent payments (receipts) allocated to interest	Typically, operating activities (see Section 4.4)	Operating activities (see Section 4.4)

## 5.9 OTHER TRANSACTIONS

### 5.9.1 Hosting Arrangements



#### FASB REFERENCES

ASC 350-40-15-4A, ASC 350-40-25-17, ASC 350-40-35-4 through 35-6, and ASC 350-40-45-3

Entities frequently enter cloud computing arrangements, such as software as a service, platform as a service, and infrastructure as a service (hosting arrangements).

When an entity (customer) enters a hosting arrangement, it applies ASC 350-40, *Intangibles – Goodwill and Other – Internal-Use Software*, to determine whether the arrangement includes an internal-use software license. If not, the entity accounts for the hosting arrangement as a service.

	HOSTING INCLUDES A SOFTWARE LICENSE	HOSTING IS A SERVICE
ACCOUNTING FOR HOSTING ARRANGEMENT	<ul style="list-style-type: none"> <li>▶ Recognize software license as an intangible asset.</li> <li>▶ Recognize a liability for any payments for the software license made over time.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Account for the hosting arrangement as a service and generally expense the fees associated with the hosting service as incurred.<sup>15</sup></li> </ul>
ACCOUNTING FOR IMPLEMENTATION COSTS	<ul style="list-style-type: none"> <li>▶ Apply ASC 350-40 to determine which implementation costs to capitalize as part of the asset.</li> <li>▶ Amortize on a straight-line basis unless another systematic and rational basis is more representative of the software's use.</li> </ul>	<ul style="list-style-type: none"> <li>▶ Apply same guidance as hosting arrangements that include a software license to determine which implementation costs to capitalize as an asset related to the service.</li> <li>▶ Expense capitalized implementation costs over the term of the hosting arrangement on a straight-line basis unless another systematic and rational basis is more representative of the pattern in which the entity expects to benefit from access to the hosted software.</li> </ul>
CASH FLOW PRESENTATION	<ul style="list-style-type: none"> <li>▶ Classify cash flows for costs incurred to develop or obtain the internal-use software, including capitalized implementation costs, generally within investing activities consistent with payments for other productive assets (see Section 4.2).</li> <li>▶ If the entity reports cash flows from operating activities using the indirect method (see Section 3.3), include amortization of software costs in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).</li> </ul>	<ul style="list-style-type: none"> <li>▶ Classify cash flows from capitalized implementation costs consistent with classification of cash flows for the fees associated with the arrangement, which is generally within operating activities.</li> <li>▶ If the entity reports cash flows from operating activities using the indirect method (see Section 3.3), include amortization of deferred implementation costs in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).</li> </ul>

## 5.9.2 Proceeds From Settlement of Insurance Claims

### 5.9.2.1 Settlement of Corporate-Owned Life Insurance Policies



#### FASB REFERENCES

ASC 230-10-45-21C

An entity might purchase a life insurance policy, such as for key executives or to provide employee benefits. Such a policy might confer tax benefits, such as the ability for the entity to receive death benefits tax-free and for investment income to accumulate tax-free through internal build-up of the cash surrender value.

<sup>15</sup> BC12 of ASU 2018-15, *Customer's Accounting for Implementation Costs Incurred in a Cloud Computing Arrangement That Is a Service Contract*.

ASC 230 provides cash flow guidance for corporate-owned life insurance (COLI) policies, including bank-owned life insurance policies.

#### PREMIUMS PAID

- ▶ Classify within investing activities, operating activities, or a combination of investing and operating activities

#### CASH RECEIPTS FROM SETTLEMENT

- ▶ Classify within investing activities

#### BDO INSIGHTS: CASH FLOW CLASSIFICATION OF CORPORATE-OWNED LIFE INSURANCE POLICIES

The FASB noted that premium payments generally are insignificant to the financial statements, and that providing a choice on classification for premiums gives management flexibility in determining the most appropriate classification.<sup>16</sup> That flexibility does **not** apply to settlement proceeds, which an entity must classify within investing activities because corporate-owned life insurance policies are purchased primarily as investment vehicles.<sup>17</sup>

#### 5.9.2.2 Settlement of Other Insurance Claims



#### FASB REFERENCES

ASC 230-10-45-21B

An entity classifies cash receipts from the settlement of insurance claims, other than COLI policies and bank-owned life insurance policies (see Section 5.9.2.1), based on the related insurance coverage (that is, the nature of the loss). For example, an entity classifies insurance proceeds related to:

- ▶ Business interruption within operating activities
- ▶ Damage to productive assets (such as equipment) within investing activities

For insurance proceeds received in a lump-sum settlement, an entity must allocate the settlement and determine classification based on the nature of each loss included in the settlement.

#### 5.9.3 Sales of Crypto Assets and Donated Financial Assets

##### 5.9.3.1 Crypto Assets Received as Noncash Consideration



#### FASB REFERENCES

ASC 230-10-45-27A and ASC 350-60-45-3

ASC 350-60 addresses accounting and reporting requirements for specific digital assets. A digital asset is in scope of ASC 350-60 if it meets the criteria below.

<sup>16</sup> BC25 of ASU 2016-15.

<sup>17</sup> *Id.* at BC23.

CRITERION	DESCRIPTION
 Intangible asset	Meets the U.S. GAAP definition of an intangible asset
 No enforceable rights	Does not give the asset holder enforceable rights to, or claims on, underlying goods, services, or other assets
 Located on blockchain	Is generated or resides on a distributed ledger based on blockchain or similar technology
 Protected	Is secured through cryptography
 Fungible	Is readily exchangeable into an identical asset
 Not created by entity	Is not generated or issued by the reporting entity or any of its related parties

See BDO's publication, [Accounting for Cryptocurrencies](#), for accounting guidance.

An entity classifies cash receipts from crypto assets accounted for under ASC 350-60 that it received as noncash consideration in the ordinary course of business, such as in exchange for goods and services to a customer, within operating activities if the entity converts the crypto asset **nearly immediately** into cash. Nearly immediately refers to a brief period expected to be within hours or a few days, not weeks.

#### BDO INSIGHTS: JUDGMENT REQUIRED FOR OTHER CRYPTO ASSET TRANSACTIONS

The FASB provided specific cash flow guidance in a narrow fact pattern in which an entity receives as noncash consideration in the ordinary course of business crypto assets that it nearly immediately converts into cash. The FASB did that because classifying such cash receipts within investing activities did not reflect the transaction's economics. It acknowledged that for other crypto asset transactions, entities determine the appropriate classification by applying ASC 230, considering the transaction's facts and circumstances, and therefore did not provide further cash flow guidance.

#### 5.9.3.2 Classification by an NFP of Sales of Donated Financial Assets and Crypto Assets

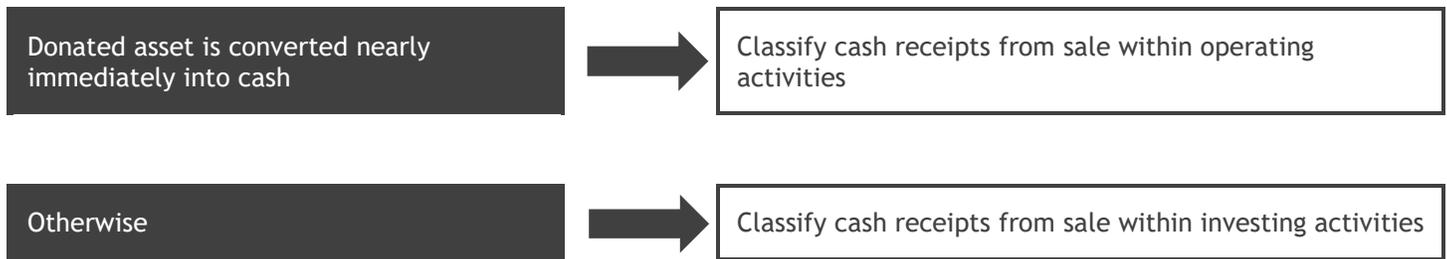


#### FASB REFERENCES

ASC 230-10-45-12 and ASC 230-10-45-21A

NFPs routinely receive cash donations as part of their missions and programs. But they also often receive noncash donations, such as financial assets (for example, donated debt or equity instruments) or crypto assets accounted for under ASC 350-60 (see Section 5.9.3.1). Many NFPs have policies to immediately sell those donated assets for cash.

If an NFP receives donated financial assets or crypto assets under ASC 350-60 directed **without** any NFP-imposed limitations for sale and converts the donated assets into cash, classification depends on whether the donated asset is converted **nearly immediately**, as shown below.



BC7 of ASU 2012-05 notes that an NFP-imposed limitation on the sale of donated financial assets such as a limit order indicates that the NFP is making an investing decision. Such limitation should result in classifying the sale as an investing activity.



#### MEANING OF 'NEARLY IMMEDIATELY'

BC8 of ASU 2012-05 notes that “*nearly immediately is synonymous with promptly and should generally be considered to be within days rather than months, and should be interpreted to be the same regardless of the type of financial asset being sold.*” ASU 2023-08 added cash flow guidance for crypto assets received as noncash consideration, which uses the same wording and specifies that the term “nearly immediately” refers to a brief period expected to be within hours or a few days, not weeks (see Section 5.9.3.1).

In contrast, if the donor restricted the use of the contributed resource for a long-term purpose of acquiring, constructing, or improving PP&E or other long-lived assets or establishing or increasing a donor-restricted endowment fund, the entity must classify the cash receipts within financing activities.



#### SALE OF OTHER DONATED ASSETS NOT ADDRESSED

ASC 230 addresses cash flow classification for the immediate sale of donated financial assets and crypto assets accounted for under ASC 350-60 but does not address sales of other donated assets, such as cars and works of art.

### 5.9.4 Special Purpose Acquisition Corporations

Special purpose acquisition corporations (SPACs) are entities with no commercial operations formed to raise capital through an initial public offering (IPO) for the sole purpose of acquiring one or more target businesses (referred to as “de-SPAC transactions”). SPACs are a mechanism for private companies to go public.

In its IPO, a SPAC typically issues to investors units consisting of a redeemable common stock (public common shares) and a public warrant (or fraction thereof) for common stock. The SPAC’s governance requires the SPAC to place the IPO proceeds in a trust account. The common stock is typically redeemable at a fixed price (typically, \$10 a share), adjusted for the trust account’s interest income and specific expenses. The SPAC also typically issues to its sponsor private placement warrants for common shares in a concurrent private placement.

Typically, the redemption provisions provide that:

- ▶ If the SPAC is unable to consummate a transaction by a specified date (typically within 18-24 months from the IPO), it dissolves and must redeem the public common shares. However, a shareholder vote can extend that date.
- ▶ If the SPAC consummates a business combination (the de-SPAC transaction), the holder has the right to require the SPAC to redeem the public common shares. However, the SPAC’s governing documents often restrict the SPAC from redeeming the public common shares if that causes the SPAC’s minimum net tangible assets to be less than \$5 million.

During its IPO, the SPAC typically incurs underwriter fees, some of which may be paid in cash at the IPO's closing and some of which may be deferred and paid if the SPAC consummates a de-SPAC transaction. Before a de-SPAC transaction, the SPAC may also receive additional financing for liquidity purposes, such as related-party notes from the sponsor or entities affiliated with the sponsor.

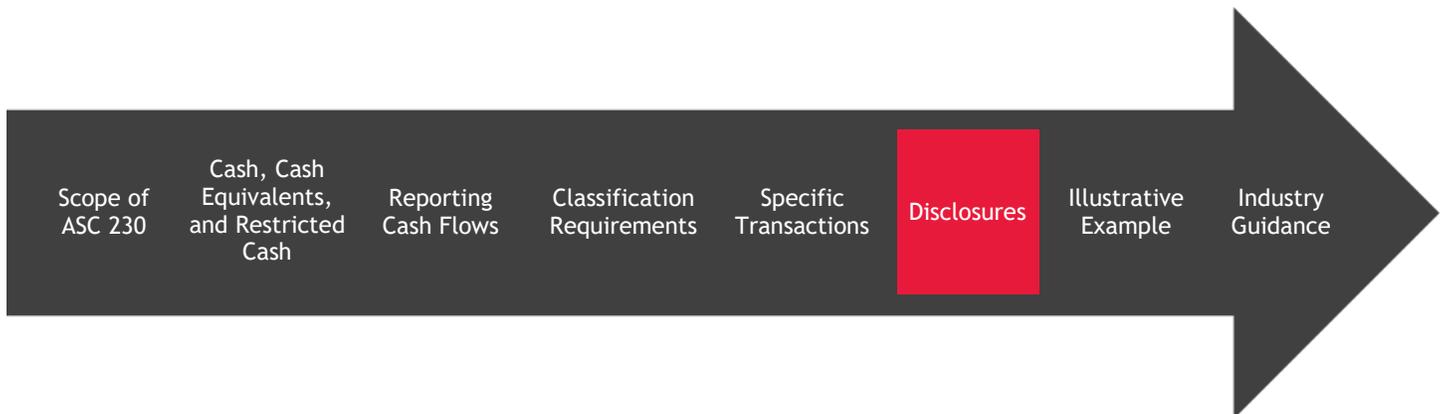
### BDO INSIGHTS: SPAC CASH FLOW CLASSIFICATION ISSUES BEFORE DE-SPAC TRANSACTION

The table summarizes common cash flow classification issues encountered by a SPAC before the de-SPAC transaction.

ITEM	CLASSIFICATION
Proceeds from issuance of IPO units and private placement units	Financing activities, like other issuances of equity (see Section 5.5.1)
Payment of offering costs	Financing activities, like other equity issuance costs (see Section 5.5.1)
Deferred (accrued) underwriting fees payable on de-SPAC	Noncash financing activities (see Section 6.5)
Proceeds from related-party notes	Financing activities, like other debt financing transactions (see Section 5.4.1)
Repayments of related-party notes	Financing activities, like other debt repayments (see Section 5.4.1)
Investment of cash into trust account	Investing activities (see Section 4.2)
Interest and dividends received on trust account	Operating activities (see Section 4.4)
Reinvestments of interest and dividends into trust account	Investing activities (see Section 4.2)
Proceeds from trust account	Investing activities (see Section 4.2)
Redemptions of shareholder units/shares	Financing activities, like treasury stock transactions (see Section 5.5.1)

For de-SPAC transactions that represent a business combination and for which the SPAC is the accounting acquirer, see Section 5.6 of this Blueprint. See Section 7.4.8 of BDO's Blueprint, [Business Combinations Under ASC 805](#), for more guidance on determining which entity is the accounting acquirer.

# Chapter 6: Disclosures



## 6.1 OVERVIEW: DISCLOSURES

ASC 230 (or sometimes other U.S. GAAP) requires entities to disclose accounting policies used in preparing its cash flow statement and additional information not otherwise in the statement. Those disclosures include those shown in the table.



Cash equivalents policy (see Section 6.2)



Noncash investing and financing activities (see Section 6.5)



Restrictions on cash and cash equivalents (see Section 6.3)



Discontinued operations (see Section 6.6)



Interest and income taxes paid (see Section 6.4)



Derivative instruments (see Section 6.7)

For entities under reorganization, see Section 3.7.

## 6.2 DISCLOSURE OF CASH EQUIVALENTS POLICY



### FASB REFERENCES

ASC 230-10-50-1, ASC 230-10-55-12, and ASC 230-10-55-18

As discussed in Section 2.3.2, depending on an entity's cash management practices, short-term and highly liquid investments that meet the definition of **cash equivalents** are not always reported as such in the cash flow statement. Accordingly, an entity must disclose its policy for determining which items are treated as cash equivalents.

If the entity changes its policy, that represents a change in accounting principle that would be effected by restating financial statements for earlier years presented for comparative purposes.

See ASC 230-10-55-12 and 230-10-55-18 for example disclosures.

## 6.3 DISCLOSURE OF RESTRICTIONS ON CASH AND CASH EQUIVALENTS



### FASB REFERENCES

ASC 230-10-50-7 through 50-8, ASC 230-10-55-12A, ASC 230-10-55-18A, and ASC 958-210-50-3

As discussed in Section 2.4, an entity includes restricted cash and restricted cash equivalents in the reconciliation of beginning-of-period and end-of-period total amounts shown on the cash flow statement. An entity must also disclose:

- ▶ Information about the nature of restrictions on its cash, cash equivalents, restricted cash, and restricted cash equivalents.
- ▶ Information required in ASC 958-210-50-3 if the entity is an NFP within the scope of ASC 958, *Not-for-Profit Entities*.
- ▶ When cash, cash equivalents, restricted cash, and restricted cash equivalents are presented in more than one line item on the balance sheet, a reconciliation to the total amount of cash, cash equivalents, restricted cash, and restricted cash equivalents in the cash flow statement. The entity must include a reconciliation for each period a balance sheet is presented, either on the face of the cash flow statement or in the notes, and either in tabular or narrative format.

See ASC 230-10-55-12A and 230-10-55-18A for example disclosures and reconciliation.



### DISCLOSURES RELATED TO NATURE OF RESTRICTIONS

As discussed in BC11 of ASU 2016-18, the EITF rejected prescribing specific disclosures about the nature of restrictions, such as the purpose and terms, source, and length. Accordingly, entities have flexibility to disclose relevant information about the nature of restrictions based on individual circumstances.

## 6.4 DISCLOSURE OF INTEREST AND INCOME TAXES PAID



### FASB REFERENCES

ASC 230-10-50-2 through 50-2A, ASC 230-10-55-14, and ASC 740-10-50-22 through 50-23

As discussed in Section 3.3, most entities report cash flows from operating activities using the indirect method. If so, entities must disclose:

- ▶ Interest paid (net of amounts capitalized), including the portion of payments attributable to accreted interest related to the debt discount when settling zero-coupon and similar debt instruments (see Section 5.4.2)
- ▶ Income taxes paid during the period (before adoption of ASU 2023-09)<sup>18</sup>

<sup>18</sup> ASU 2023-09 is effective for public business entities (PBEs) for fiscal years beginning after December 15, 2024, and for interim periods for fiscal years beginning after December 15, 2025. For entities other than PBEs, the guidance is effective for fiscal years beginning after December 15, 2025, and for interim periods beginning with fiscal years beginning after December 15, 2026. Early adoption is allowed. See BDO's [Publication](#) for guidance.

After adoption of ASU 2023-09, an entity must disclose for each annual reporting period, **regardless** of whether it applies the indirect method, income taxes paid (net of refunds received) disaggregated by federal (national), state, and foreign, and to each individual jurisdiction in which income taxes paid (net of refunds received) is equal to or greater than 5% of total income taxes paid (net of refunds received).

See BDO's publication, [BDO Knows ASC 740: New Income Tax Disclosures \(ASU 2023-09\)](#), for more guidance.

## 6.5 DISCLOSURE OF NONCASH INVESTING AND FINANCING ACTIVITIES



### FASB REFERENCES

ASC 230-10-50-3 through 50-6, ASC 230-10-55-11, and ASC 230-10-55-15

Some investing and financing activities affect an entity's recognized assets or liabilities but do not result in cash receipts or payments, such as the example outlined below.

Converting debt to equity

Acquiring assets by assuming directly related liabilities (such as a building and the mortgage)

Obtaining an ROU asset in exchange for a lease liability

Obtaining a beneficial interest in exchange for financial assets in a securitization transaction

Obtaining a building or investment asset by receiving a gift or donation

Exchanging noncash assets or liabilities for other noncash assets or liabilities

Noncash transactions often significantly affect the entity's **future** cash flows. For example:

- ▶ An operating or finance lease liability requires future lease payments in cash
- ▶ A conversion of debt to equity eliminates future required principal and interest payments that otherwise would be due and paid in cash

Accordingly, entities must disclose all noncash investing and financing activities that affect recognized assets or liabilities. Those disclosures can be either narrative or summarized in a schedule, and they must clearly relate the cash and noncash aspects of transactions involving similar items. If the entity does not disclose the noncash investing and financing activities on the same page as the cash flow statement, it reports that information elsewhere in the financial statements, clearly referenced to the cash flow statement.

When transactions are both cash and noncash, the cash portion is reported in the cash flow statement and the noncash portion is disclosed. That could occur, for example, when an entity acquires real estate in exchange for cash and a mortgage to the seller.

Cash payments and receipts might not directly pass through an entity's cash accounts. As discussed in Section 3.4, the entity might have to report constructive cash flows that it classifies within operating, investing, or financing activities. Otherwise, the entity must disclose the relevant noncash investing and financing activities.

## 6.6 DISCONTINUED OPERATIONS



### FASB REFERENCES

ASC 205-20-50-4A, ASC 205-20-50-5B(c), and ASC 230-10-45-24A

ASC 205-20 requires an entity to present on the face of the financial statements or in the notes **either**:

- ▶ The total operating and investing cash flows of the discontinued operation
- ▶ The depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation

The entity must provide the information for each period for which discontinued operations are included in its net income, including for any significant continuing involvement after the disposal date.

While the disclosure requirements relate specifically to operating and investing activities, an entity is not precluded from disclosing financing cash flow activities.

Depending on which method it uses to report cash flows from discontinued operations (see Section 3.5), an entity might already have provided the required information on the face of its financial statements, in which case no further disclosure is required.

## 6.7 DISCLOSURE OF DERIVATIVE INSTRUMENTS POLICY



### FASB REFERENCES

ASC 230-10-45-27 and ASC 230-10-50-9

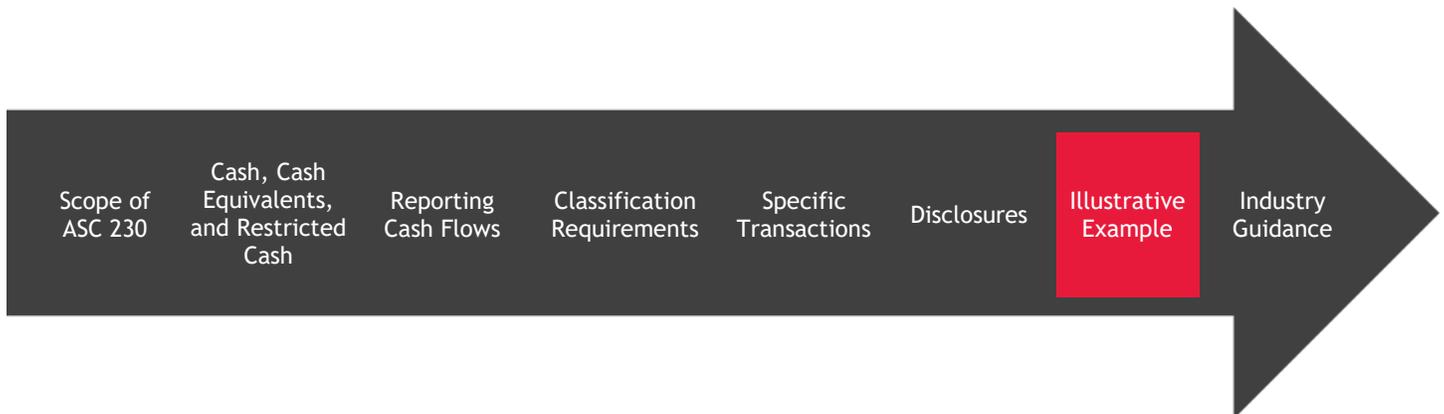
As discussed in Section 5.7.2, an entity can elect an accounting policy to classify cash flows from a derivative instrument accounted for as a fair value or cash flow hedge in the same line item as the cash flows of the item being hedged. That accounting policy is available if the derivative instrument does **not** include an other-than-insignificant financing element at inception (see Section 5.7.1)

Separately, an entity must disclose its accounting policy regarding where cash flows associated with derivative instruments and their related gains and losses are presented. However, that requirement applies only **after** the effective date of ASU 2023-06, *Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, which is:

- ▶ For entities subject to specific existing SEC disclosure requirements and specified other entities, on the date the SEC removes the related disclosures from Regulations S-X and S-K (which has not occurred as of December 2025), with early adoption prohibited.
- ▶ For all other entities, two years later.

For all entities, if the SEC has not removed the applicable requirement from Regulation S-X or S-K by June 30, 2027, the pending amendments will be removed from U.S. GAAP and will not become effective for any entity.

# Chapter 7: Illustrative Example



The example in this Chapter (adapted from Example 1 in ASC 230-10-55) illustrates the application of some of the cash flow requirements discussed in this Blueprint, including how an entity:

- ▶ Determines how many cash flow statements it must provide in its financial statements (see Section 1.1)
- ▶ Reports cash flows from operating activities when it applies the indirect method (see Section 3.3)
- ▶ Reports cash flows from its investing and financing activities (see Sections 4.2 and 4.3, respectively)
- ▶ Discloses information about:
  - Its cash and cash equivalents policy (see Section 6.2)
  - The nature of restrictions on its cash and cash equivalents, including reconciliation between amounts shown on the balance sheet and cash flow statement when cash, cash equivalents, restricted cash, and restricted cash equivalents are presented in more than one line item on the balance sheet (see Section 6.3)
  - Interest and income taxes paid during the reporting period (see Section 6.4)
  - Noncash investing and financing activities for the reporting period (see Section 6.5)

## EXAMPLE 7-1: CASH FLOW STATEMENT FOR MANUFACTURING ENTITY USING INDIRECT METHOD

### FACTS

- ▶ Entity A manufactures and sells windows through a network of dealers serving both corporate and individual customers.
- ▶ Entity A provides a set of financial statements that includes a balance sheet and an income statement for the fiscal year ended 20X2.
- ▶ Entity A reports cash flows from operating activities under the indirect method (see Section 3.3).

### CONCLUSION AND ANALYSIS

- ▶ Entity A must provide a cash flow statement for the fiscal year ended 20X2. That is because an entity must provide a cash flow statement for each period an income statement is provided if the set of financial statements includes a balance sheet **and** an income statement (see Section 1.1), which is the case for Entity A.
- ▶ Entity A prepares the below worksheet summarizing the changes in account balances in its balance sheet for the fiscal years ended 20X1 and 20X2, which it will use to identify, classify, and report cash flows for 20X2, including reconciling net income to net cash flows from operating activities under the indirect method (see Section 3.3.2).

	12/31/20X1	12/31/20X2	CHANGE
Cash and cash equivalents	\$ 701	\$ 2,268	\$ 1,567
Restricted cash	260	130	(130)
Gross account receivables	2,020	2,195	175
Accounts receivable allowance	(300)	(350)	(50)
Accounts receivable net of allowance	1,720	1,845	125
Inventory	705	740	35
Prepaid expenses	45	70	25
Investment in equity method investee	755	785	30
Property, plant and equipment	6,962	7,787	825
Accumulated depreciation	(2,185)	(2,640)	(455)
Property, plant and equipment, net	4,777	5,147	370
Operating lease right-of-use assets, net	833	758	(75)
Intangible assets, net	165	293	128
Total assets	\$ 9,961	\$ 12,036	\$ 2,075
Accounts payable and accrued expenses	848	913	65
Interest payable	55	37	(18)
Income taxes payable	175	134	(41)
Revolving line-of-credit	600	300	(300)
Term loan	2,385	3,035	650
Operating lease obligation	859	805	(54)
Finance lease obligation	—	625	625
Deferred taxes	408	458	50
Other liabilities	225	275	50
Total liabilities	\$ 5,555	\$ 6,582	\$ 1,027
Common stock	1,750	1,750	—
Preferred stock	—	700	700
Retained earnings	2,656	3,004	348
Total shareholders' equity	4,406	5,454	1,048
Total liabilities and shareholders' equity	\$ 9,961	\$ 12,036	\$ 2,075

- Entity A's net income for 20X2 is the starting point in determining cash flows from operating activities under the indirect method and for identifying noncash items to adjust in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).

	20X2
Sales	\$ 15,030
Cost of sales	(11,515)
Depreciation and amortization	(657)
Selling, general, and administrative expenses	(2,226)
Interest expense	(252)
Equity method income	80
Gain on sale of equipment	380
Insurance proceeds	7
Loss from lawsuit	(12)
Income before income taxes	<u>835</u>
Provision for income taxes	(397)
Net income	<u>\$ 438</u>

Entity A considers the below transactions and events during 20X2 when preparing its cash flow statement:

- [1] It acquired for cash all the equity, and obtained control, of one of its suppliers (Entity B) in a business combination. Cash paid net of cash acquired is \$720 (\$735 - \$15). Entity B's assets and liabilities were recognized at the below amounts in accordance with ASC 805 at the acquisition date.

	AMOUNTS
Cash	\$ 15
Accounts receivable	110
Inventory	240
PP&E	450
Intangible assets other than goodwill	80
Goodwill	70
Accounts payable and accrued expenses	(105)
Long-term note	(125)
Net assets acquired	<u>\$ 735</u>

## [2] Related to its operations, Entity A:

- (a) Wrote off \$150 of accounts receivable and accrued a provision for losses of \$200, which is included in selling, general, and administrative expenses.
- (b) Accrued bonuses of \$50 in selling, general, and administrative expenses, which is not due until a specified target is met, which is included in other liabilities.
- (c) Paid \$12 to settle a lawsuit related to a slip-and-fall claim.
- (d) Determined changes in operating assets and liabilities net of accounts receivable written off and effects of purchase of Entity B as shown below.

	CHANGE IN BALANCE SHEET	ACQUISITION OF ENTITY B	RECEIVABLE WRITE-OFFS	CHANGE IN OPERATING ASSETS AND LIABILITIES
		Note [1]	Note [2](a)	
Change in gross accounts receivable*	\$ (175)	\$ 110	\$ (150)	\$(215)
Change in inventory	(35)	240	-	205
Change in accounts payable and accrued expenses	65	(105)	-	(40)

\* Change in gross accounts receivable represents the change in net accounts receivable of \$125 plus the change in allowance of \$50 (\$350 - \$300).

## [3] For its equity method investment, Entity A accrued \$80 of equity method earnings and received a distribution of \$50. Entity A elected to apply the cumulative earnings approach (see Section 5.3.3), under which it determined that the distribution is a return on investment (that is, an operating activity). Therefore, the undistributed earnings of the equity method investee presented in the reconciliation of net income to net cash from operations is \$30.

## [4] Related to its PP&amp;E, Entity A:

- (a) Received insurance proceeds of \$7 from a property claim related to damage to its equipment.
- (b) Sold equipment with a book value of \$520 and original cost of \$700 for \$900 in cash, resulting in a gain of \$380.
- (c) Acquired new equipment for \$350 in cash.
- (d) Entered a finance lease of equipment with an initial measurement of \$725 and annual payments of \$100, with one \$100 payment made before the end of 20X2.

## [5] For its operating leases, see Example 5-3 on how Entity A determined its adjustments to net income (assuming Year 2 is 20X2).

## [6] As debt financing transactions, Entity A:

- (a) Had a net decrease of \$300 in borrowings under its revolving line-of-credit, under which borrowings are payable 30 days after demand. Entity A determined the cash flows from its revolving line-of-credit meet the requirements for net presentation (see Section 3.2).
- (b) Repaid principal amounts of \$125 under its term loan.
- (c) Issued new debt of \$650 to a new third-party lender.

## [7] Related to transactions with its shareholders, Entity A:

- (a) Issued \$700 preferred stock to new investors for cash.
- (b) Paid dividends of \$90 to its common stockholders.

The table summarizes Entity A's cash flow statement for the year ended 12/31/20X2.

STATEMENT OF CASH FLOWS	12/31/20X2
Cash flows from operating activities	
Net income [Income statement]	\$ 438
Adjustments to reconcile net income to net cash from operations	
Depreciation and amortization [Income statement]	\$ 657
Provision for losses on accounts receivable [See Note 2(a)]	200
Undistributed earnings of equity method investees [See Note 3(a)]	(30)
Insurance proceeds received for damage to equipment [Income statement, Note 4(a)]	(7)
Gain on sale of equipment [Income statement, Note 4(b)]	(380)
Noncash rent expense [See Note 5]	74
Deferred income taxes [Balance sheet]	50
Changes in operating assets and liabilities net of effects for acquisition of Entity B	
Accounts receivable [See Note 2(d)]	(215)
Inventory [See Note 2(d)]	205
Prepaid expenses [Balance sheet]	(25)
Accounts payable and accrued expenses [See Note 2(d)]	(40)
Operating lease liability [See Note 5]	(53)
Interest and income taxes payable [Balance sheet (18 + 41)]	(59)
Other liabilities [Balance sheet, Note 2(b)]	50
Total adjustments	<u>427</u>
Net cash provided by operating activities	<u>865</u>
Cash flows from investing activities	
Acquisition of Entity B net of cash acquired [Note 1]	(720)
Insurance proceeds received for damage to equipment [Note 4(a)]	7
Proceeds from sale of equipment [Note 4(b)]	900
Additions to property, plant and equipment [Note 4(c)]	(350)
Net cash used in investing activities	<u>(163)</u>
Cash flows from financing activities	
Principal payments under finance lease obligation [Note 4(d)]	(100)
Net borrowings under line of credit [Note 6(a)]	(300)
Repayments on term loan [Note 6(b)]	(125)
Proceeds from long-term debt issuance [Note 6(c)]	650
Proceeds from issuance of preferred stock [Note 7(a)]	700
Common stock cash dividend paid [Note 7(a)]	(90)
Net cash provided by financing activities	<u>735</u>
Net change in cash, cash equivalents, and restricted cash	<u>1,437</u>
Cash, cash equivalents, and restricted cash, beginning of year	<u>961</u>
Cash, cash equivalents, and restricted cash, end of year	<u>\$ 2,398</u>

The information below summarizes Entity A's disclosures related to its cash flow statement for the year ended December 31, 20X2.

- ▶ Cash and cash equivalents policy: Entity A considers all highly liquid interest-earning investments with a maturity of three months or less at the date of purchase to be cash equivalents.
- ▶ Interest and income taxes paid: The table summarizes the cash paid during 20X2 for interest and income taxes.

	20X2
Interest <sup>(1)</sup>	\$ 270
Income taxes <sup>(2)(3)</sup>	388

<sup>(1)</sup> Interest expense of \$252 plus decrease in interest payable of \$18

<sup>(2)</sup> Provision for income taxes of \$397 plus decrease in income taxes payable of \$41 less increase in deferred taxes of \$50.

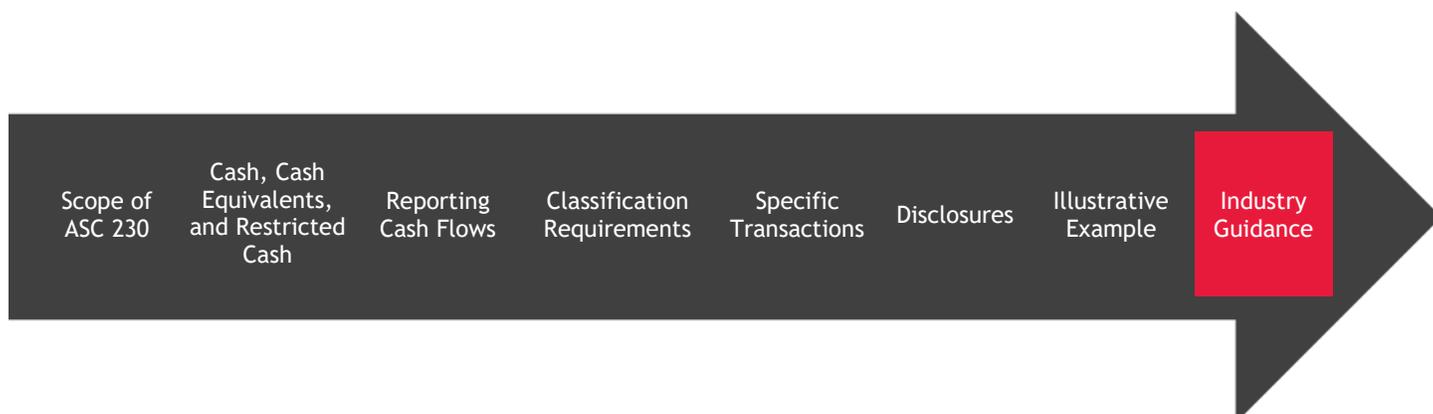
<sup>(3)</sup> After adopting ASU 2023-09, Entity A must disaggregate its income taxes paid (see Section 6.4).

- ▶ Noncash investing and financing activities:
  - Entity A acquired for cash all the capital stock of one of its suppliers (Entity B) in a business combination. See Footnote [X] to the financial statements for related noncash investing and financing activities.
  - Entity A obtained a finance lease ROU asset in exchange for a finance lease obligation of \$725, of which it paid \$100 before year-end.
- ▶ Restricted cash:
  - The table reconciles cash, cash equivalents, and restricted cash reported on the balance sheet to their sum in the cash flow statement.

	20X2
Cash and cash equivalents	\$ 2,268
Restricted cash	130
Total cash, cash equivalent, and restricted cash in the statement of cash flows	\$ 2,398

- Amounts in restricted cash are those that must be set aside for payment of specific workers' compensation claims based on an agreement with an insurer.

# Chapter 8: Industry Guidance



## 8.1 OVERVIEW: INDUSTRY GUIDANCE

While ASC 230 is the primary source of cash flow guidance, some industry-specific topics in U.S. GAAP include incremental cash flow requirements. This chapter summarizes industry-based guidance.

## 8.2 BROADCASTERS



### FASB REFERENCES

ASC 920-230-20: Broadcaster and ASC 920-230-45-1

ASC 920-230, *Entertainment – Broadcasters, Statement of Cash Flows*, addresses classification of cash payments for specific costs incurred by entities (or an affiliated group thereof) that transmit radio or television program material.

A broadcaster might license program material, which grants it the right to broadcast a specified or unlimited number of showings of a package of programs over the license period in exchange for a fee. A broadcaster (licensee) must classify cash payments for costs incurred to obtain the license for program material within operating activities.

Also, if the broadcaster applies the indirect method to report cash flows from operating activities (see Section 3.3), it must include the amortization of capitalized costs of license agreements for program material in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).

## 8.3 ENTERTAINMENT: FILMS



### FASB REFERENCES

ASC 926-230-20: Film Costs, Participation Costs, and Exploitation Costs and ASC 926-230-45-1

ASC 926-230, *Entertainment – Films – Statement of Cash Flows*, addresses classification of cash payments for specific costs incurred by producers or distributors that own or hold rights to distribute or exploit films in one or more markets and territories. It also applies to films marketed by the entity directly or licensed or sold to others.

Entities within the scope of ASC 926-230 often incur costs to produce and market films, including:

- ▶ Film costs, such as costs of story and scenario; compensation of cast, directors, and producers; set construction and operations; wardrobe; sound synchronization; location costs; and post-production costs, such as music and special effects
- ▶ Participation costs, such as compensation paid to parties involved in the film production and for which payments are contingent and based on the film's financial results
- ▶ Exploitation costs, such as marketing and advertising costs incurred with the film distribution

An entity must classify its cash payments for film costs, participation costs, exploitation costs, and manufacturing costs within operating activities.

Also, if the entity applies the indirect method to report cash flows from operating activities (see Section 3.3), it must include the amortization of film costs in the reconciliation of net income to net cash flows from operating activities (see Section 3.3.2).

## 8.4 BROKER-DEALERS



### FASB REFERENCES

ASC 940-320-45-7

ASC 940-320, *Financial Services – Brokers and Dealers, Investments – Debt and Equity Securities*, states that entities within the scope of this guidance must report cash flows from trading securities within operating activities (see Section 4.4).

See also Section 3.2 for guidance on net presentation.

## 8.5 FINANCIAL SERVICES: DEPOSITORY AND LENDING



### FASB REFERENCES

ASC 942-230-45-1 through 45-4 and ASC 942-230-55-1 through 55-5

ASC 942-230, *Financial Services – Depository and Lending – Statement of Cash Flows*, addresses cash flow reporting for entities within the scope of ASC 942, which applies to finance companies; depository institutions insured by the Federal Deposit Insurance Corporation's Deposit Insurance Fund or National Credit Union Administration's National Credit Union Share Insurance Fund; and other finance entities, such as bank holding companies and savings and loan association holding companies.

ASC 942-230 allows only **banks, savings institutions, and credit unions** to report net cash receipts and payments from:

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

When those entities are part of a consolidated entity, the net amounts of cash receipts and payments listed above must be reported separately from the consolidated entity's gross cash receipts and payments for other investing and financing activities, including those investing and financing activities of a subsidiary of the bank, savings institution, or credit union that is not itself a bank, savings institution, or credit union.

See Section 3.2 for additional guidance on net presentation.

**FINANCE COMPANIES AND OTHERS IN THE SCOPE OF ASC 942 MUST REPORT ON A GROSS BASIS**

Only specific entities (that is, banks, savings institutions, and credit unions) within the scope of ASC 942-230 can present cash receipts and payments of the above items on a net basis. Other entities within the scope of ASC 942-230, such as finance companies, must report cash flows for those items on a gross basis.

Lessors within the scope of ASC 942-230 must present principal payments received under sales-type and direct financing leases within investing activities.

ASC 942-230 provides an illustration of the cash flow statement under the direct method for a financial institution.

**FASB PROJECTS: CASH FLOW STATEMENT**

The FASB has added to its agenda a project to make [targeted improvements](#) for financial institutions to:

- ▶ Reorganize and disaggregate the cash flow statement to improve the decision usefulness of their statement
- ▶ Develop a disclosure about an entity's cash interest received

## 8.6 INVESTMENT COMPANIES

**FASB REFERENCES**

ASC 946-230-45-1 and ASC 946-230-55-1

As discussed in Section 1.2, an investment company within the scope of ASC 946 is exempt from providing a cash flow statement if it meets specific conditions. If the investment company does not meet all conditions, it must provide a cash flow statement and disclose noncash investing and financing activities (see Section 6.5). Examples of noncash investing and financing activities that must be disclosed include the reinvestment of dividends and distributions.

## 8.7 NOT-FOR-PROFIT ENTITIES

**FASB REFERENCES**

ASC 958-210-45-6, ASC 958-205-55-18 through 55-20, ASC 958-230-55-1 through 55-6, ASC 958-805-50-15, and ASC 958-805-55-68 through 55-70

ASC 958-230, *Not-for-Profit Entities – Statement of Cash Flows*, and ASC 958-805, *Not-for-Profit Entities – Business Combinations*, provide the below guidance.

ITEM	NFP GUIDANCE
<b>Cash and Cash Equivalents</b>	Assets that otherwise meet the cash equivalents definition (see Section 2.3) might not be considered cash equivalents because of restrictions, such as short-term highly liquid investments, if they are purchased with resources that have donor-imposed restrictions that limit their use to long-term investment.
<b>Cash Received With a Donor-Imposed Restriction That Limits Its Use to Long-Term Purposes</b>	<p>An NFP might have either of the following cash donations with a donor-imposed restriction that limits its use to long-term purposes (in conformity with ASC 958-210-45-6):</p> <ul style="list-style-type: none"> <li>▶ Cash</li> <li>▶ Cash receipts from the sale of donated financial assets (or crypto assets accounted for under ASC 350-60) that on receipt were directed without any NFP-imposed restrictions for sale and converted nearly immediately into cash as discussed in Section 5.9.3.2</li> </ul> <p>If the NFP reports cash flows from operating activities using the indirect method (see Section 3.3), it must adjust the change in net assets for such donated cash to reconcile with net cash flows from operating activities because those cash receipts are cash inflows from financing activities (see Sections 4.3 and 5.9.3.2).</p>
<b>Agency Transactions</b>	<p>An NFP must report within operating activities cash received and paid in agency transactions (that is, exchange transactions in which the NFP acts as an agent, trustee, or intermediary for another party that may be a donor or donee).</p> <p>If the NFP reports cash flows from operating activities using the indirect method (see Section 3.3), it can report those cash receipts and payments on a gross or net basis.</p>
<b>Noncash Investing and Financing Activities</b>	An NFP must separately disclose noncash investing and financing activities (see Section 6.5), such as receiving contributions of buildings, securities, or recognized collection items.
<b>Collections</b>	An NFP must report within investing activities cash flows from purchases, sales, and insurance recoveries of unrecognized, noncapitalized collection items.
<b>Acquisitions</b>	An NFP acquirer must disclose any noncash contributions received and any other noncash amounts received or transferred related to an acquisition as noncash activities in accordance with Section 6.5. Example 7 in ASC 958-805-55-68 through 55-70 illustrates the disclosure of noncash activities.

ASC 958-205-55-18 through 55-20 also illustrate the direct and indirect methods in reporting cash flows from operating activities.

## 8.8 REAL ESTATE

### 8.8.1 Real Estate: General



#### FASB REFERENCES

ASC 970-230-45-1

ASC 970-230, *Real Estate – General – Statement of Cash Flows*, notes that the definitions of investing and operating activities (see Sections 4.2 and 4.4, respectively) provide flexibility for appropriately classifying cash receipts and payments for assets that generally are productive assets but might be inventory in some cases. For example, real estate typically is considered a productive asset, so cash paid to acquire real estate generally is an investing activity. However, if a developer acquires real estate with the intent to subdivide, improve, and sell it in individual lots, the cash paid to purchase that real estate is an operating activity, consistent with inventory in other businesses.

### 8.8.2 Time-Sharing Activities



#### FASB REFERENCES

ASC 978-230-45-1

ASC 978-230, *Real Estate – Time-Sharing Activities – Statement of Cash Flows*, provides guidance for entities within its scope. Time-sharing transactions other than for real estate, such as for cruise ships and corporate jets, are scoped out of this guidance and must apply the general provisions of ASC 230.

An entity in the scope of ASC 978, *Real Estate – Time-Sharing Activities*, must report changes in time-sharing notes receivable, including sales of the notes, within operating activities.

# Appendix A: Other BDO Publications



BDO's Professional Practice – Accounting Group has issued the following Blueprints, which provide detailed accounting guidance, interpretive insights, and practical examples on complex areas of U.S. GAAP:

- ▶ [Issuer's Accounting for Complex Financial Instruments](#)
- ▶ [Segment Reporting Under ASC 280](#)
- ▶ [Equity Method Investments Under ASC 323](#)
- ▶ [Revenue Recognition Under ASC 606](#)
- ▶ [Share-based Payments Under ASC 718](#)
- ▶ [Business Combinations Under ASC 805](#)
- ▶ [Control and Consolidation Under ASC 810](#)
- ▶ [Accounting for Leases Under ASC 842](#)

BDO's Professional Practice – SEC Services Group has issued the following Blueprints to help SEC registrants apply the SEC's rules and regulations related to financial reporting:

- ▶ [Guide to Going Public](#)

## Series Overview: Building Knowledge

In addition to Blueprints, BDO's Professional Practice has issued a suite of publications related to U.S. GAAP and SEC rules and regulations:

- ▶ [Bulletins](#): short, timely communications delivering essential news, alerts, and developments in accounting and SEC reporting
- ▶ [Snapshots](#): summaries of SEC rules and regulations
- ▶ [SEC Reporting Insights](#), updated annually
- ▶ [Conference Highlights: Current SEC & PCAOB Developments](#), updated annually
- ▶ [Effective Date Reminders](#), updated annually
- ▶ [Industry Supplements](#)
- ▶ [Other Publications](#) on new accounting standards and SEC rules and regulations.

For more on IFRS, visit BDO's [IFRS and Corporate Reporting](#) for more information.



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