FASB EXPOSURE DRAFT

Proposed Accounting Standards Update

Issued: January 29, 2016
Comments Due: March 29, 2016

Statement of Cash Flows (Topic 230)

Classification of Certain Cash Receipts and Cash Payments

a consensus of the FASB Emerging Issues Task Force

The Board issued this Exposure Draft to solicit public comment on proposed changes to Topic 230 of the *FASB Accounting Standards Codification*®. Individuals can submit comments in one of three ways: using the electronic feedback form on the FASB website, emailing written comments to director@fasb.org, or sending a letter to "Technical Director, File Reference No. EITF-15F, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Financial Accounting Standards Board

The *FASB Accounting Standards Codification*® is the source of authoritative generally accepted accounting principles (GAAP) recognized by the FASB to be applied by nongovernmental entities. An Accounting Standards Update is not authoritative; rather, it is a document that communicates how the Accounting Standards Codification is being amended. It also provides other information to help a user of GAAP understand how and why GAAP is changing and when the changes will be effective.

Notice to Recipients of This Exposure Draft of a Proposed Accounting Standards Update

The Board invites comments on all matters in this Exposure Draft and is requesting comments by March 29, 2016. Interested parties may submit comments in one of three ways:

- Using the electronic feedback form available on the FASB website at Exposure Documents Open for Comment
- Emailing a written letter to director@fasb.org, File Reference No. EITF-15F
- Sending written comments to "Technical Director, File Reference No. EITF-15F, FASB, 401 Merritt 7, PO Box 5116, Norwalk, CT 06856-5116."

Do not send responses by fax.

All comments received are part of the FASB's public file. The FASB will make all comments publicly available by posting them to the online public reference room portion of its website.

An electronic copy of this Exposure Draft is available on the FASB's website.

FASB FINANCIAL ACCOUNTING STANDARDS BOARD

Proposed Accounting Standards Update

Statement of Cash Flows (Topic 230)

Classification of Certain Cash Receipts and Cash Payments

January 29, 2016

Comment Deadline: March 29, 2016

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Why Is the FASB Issuing This Proposed Accounting Standards Update (Update) and What Are the Main Provisions?

Stakeholders indicated that there is diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows under Topic 230, Statement of Cash Flows, and other Topics.

This proposed Update addresses eight specific cash flow issues with the goal of reducing the existing diversity in practice. Those cash flow issues and the proposed solutions include:

Cash Flow Issue	Proposed Solution
***Debt Prepayment or Debt Extinguishment Costs*:** There is no specific guidance on the classification of cash payments for debt prepayment or extinguishment costs.	Cash payments for debt prepayment or extinguishment costs would be classified as cash outflows for financing activities.
***Settlement of Zero-Coupon Bonds*:** There is no specific guidance on the classification of the cash payment made by a bond issuer at the settlement of a zero-coupon bond.	At settlement, the portion of the cash payment attributable to the accreted interest would be classified as cash outflows for operating activities, and the portion of the cash payment attributable to the principal would be classified as cash outflows for financing activities.
***Contingent Consideration Payments Made after a Business Combination*:** There is no specific guidance on the classification of cash payments made by an acquirer after a business combination for the settlement of a contingent consideration liability.	Cash payments made by an acquirer that are not paid soon after a business combination for the settlement of a contingent consideration liability would be separated and classified as cash outflows for financing activities and operating activities. Cash payments up to the amount of the contingent consideration liability recognized at the acquisition date would be

Cash Flow Issue	Proposed Solution
	classified as financing activities; any excess would be classified as operating activities.
Proceeds from the Settlement of Insurance Claims**:** Existing guidance is unclear on the classification of proceeds received from the settlement of insurance claims.	Cash proceeds received from the settlement of insurance claims would be classified on the basis of the related insurance coverage (that is, the nature of the loss). For insurance proceeds that are received in a lump-sum settlement, an entity would be required to determine the classification on the basis of the nature of each loss included in the settlement.
Proceeds from the Settlement of Corporate-Owned Life Insurance Policies, including Bank-Owned Life Insurance Policies**:** There is no specific guidance on the classification of proceeds received from corporate-owned life insurance policies.	Cash proceeds received from the settlement of corporate-owned life insurance policies would be classified as cash inflows from investing activities. The cash payments for premiums on corporate-owned policies may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities.
Distributions Received from Equity Method Investees**:** There is no specific guidance on determining the classification of distributions received by an investor from an equity method investee.	Distributions received from an equity method investee would be presumed to be returns on investment and classified as cash inflows from operating activities, unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment, exceed cumulative equity in earnings recognized by the investor. When such an excess occurs, the current-period distribution up to this excess would be considered a return of investment and would be classified as cash inflows from investing

Cash Flow Issue	Proposed Solution
	activities. This proposed solution does not address equity method investments measured using the fair value option.
***Beneficial Interests in Securitization Transactions*: There is no specific guidance on (1) the presentation of a transferor's beneficial interests obtained in securitized financial assets at the inception of the securitization and (2) the classification of cash receipts from collections on a transferor's beneficial interests in securitized trade receivables.	A transferor's beneficial interest obtained in a securitization of financial assets would be disclosed as a noncash activity, and cash receipts from payments on a transferor's beneficial interests in securitized trade receivables would be classified as cash inflows from investing activities.
***Separately Identifiable Cash Flows and Application of the Predominance Principle*: Current guidance is unclear about whether and when cash receipts and payments should be classified into more than one class of cash flows and when classification should be based on the predominant cash flow.	Additional guidance would clarify when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) and when an entity should classify the aggregate of those cash receipts and payments into one class of cash flows on the basis of predominance.

Who Would Be Affected by the Amendments in This Proposed Update?

The amendments in this proposed Update would apply to all entities, including both business entities and not-for-profit entities that are required to present a statement of cash flows under Topic 230.

How Would the Main Provisions Differ from Current Generally Accepted Accounting Principles (GAAP) and Why Would They Be an Improvement?

Current GAAP is either unclear or does not include specific guidance on the eight cash flow classification issues included in this proposed Update. The amendments in this proposed Update are an improvement to GAAP because the proposed amendments would provide guidance for each of the eight issues, thereby reducing the current and potential future diversity in practice described above.

When Would the Amendments Be Effective?

The amendments in this proposed Update would be applied retrospectively to all prior periods presented. If it is impracticable to apply the proposed amendments retrospectively for some of the issues, the amendments for those issues would be applied prospectively as of the earliest date practicable. The effective date and the ability to early adopt will be determined after the Task Force considers stakeholder feedback on this proposed Update.

Questions for Respondents

The Board invites individuals and organizations to comment on all matters in this proposed Update, particularly on the issues and questions below. Comments are requested from those who agree with the proposed guidance as well as from those who do not agree. Comments are most helpful if they identify and clearly explain the issue or question to which they relate. Those who disagree with the proposed guidance are asked to describe their suggested alternatives, supported by specific reasoning.

Question 1: Should cash payments for debt prepayment or extinguishment costs be classified as cash outflows for financing activities? If not, what classification is more appropriate and why?

Question 2: Should the cash payment made at the settlement of a zero-coupon bond be separated and classified as follows: the portion of the cash payment attributable to the accreted interest as cash outflows for operating activities, and the portion of the cash payment attributable to the principal as cash outflows for financing activities? If not, what classification is more appropriate and why?

Question 3: Should cash payments made by an acquirer that are not paid soon after a business combination for the settlement of a contingent consideration liability be separated and classified as follows: the payments, or portion of the payments, up to the amount of the contingent consideration liability recognized at the acquisition date as cash outflows for financing activities, and the payments, or portion of the payments, that exceed the amount of the contingent consideration liability recognized at the acquisition date as cash outflows for operating activities? If not, what classification is more appropriate and why?

Question 4: Is cash flow classification guidance needed to address situations in which an acquirer makes a cash payment for the settlement of a contingent consideration liability soon after the business combination? If so, what classification is appropriate and why?

Question 5: Should the proceeds received from the settlement of insurance claims be classified on the basis of the insurance coverage (that is, the nature of the loss), including those proceeds received in a lump-sum settlement for which an entity would be required to determine the classification on the basis of the nature of each loss included in the settlement? If not, what classification is more appropriate and why?

Question 6: Should cash proceeds received from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, be classified as cash inflows from investing activities? If not, what classification is more appropriate and why?

Question 7: Should cash payments made for premiums of corporate-owned life insurance policies, including bank-owned life insurance policies, be permitted to be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities? If not, what classification is more appropriate and why?

Question 8: Should distributions received from an equity method investee when an investor applies the equity method be presumed to be returns on investment and classified as cash inflows from operating activities unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor? When such an excess occurs, should the current-period distribution up to this excess be considered a return of investment and classified as cash inflows from investing activities? If not, what approach is more appropriate and why?

Question 9: Should a transferor's beneficial interest obtained in a securitization of financial assets be disclosed as a noncash activity? If not, what treatment is more appropriate and why?

Question 10: Should cash receipts from payments on a transferor's beneficial interests in securitized trade receivables be classified as cash inflows from investing activities? If not, what classification is more appropriate and why?

Question 11: Is the additional guidance that clarifies when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) and when an entity should classify the aggregate of those cash receipts and payments into one class of cash flows on the basis of predominance understandable and operable? If not, please explain why and what additional guidance would be more appropriate.

Question 12: Should the proposed amendments for all eight cash flow issues be applied using a retrospective transition method? If not, what transition approach is more appropriate and for which specific cash flow issues and why?

Question 13: Should the proposed amendments include a provision that if it is impracticable for some of the amendments to be applied using a retrospective transition method, then those amendments would be applied prospectively as of the earliest date practicable? Why or why not?

Question 14: Should an entity be required to provide the transition disclosures specified in the proposed Update? Should any other transition disclosures be required? If yes, please explain what transition disclosures should be required and why.

Question 15: How much time will be necessary to implement the proposed amendments? Do entities other than public business entities that are required to present a statement of cash flows under Topic 230 (that is, private companies and not-for-profit entities, but not employee benefit plans) need additional time to apply the proposed amendments? Why or why not?

Question 16: Should early adoption be allowed?

Amendments to the *FASB Accounting Standards Codification®*

Summary of Proposed Amendments to the Accounting Standards Codification

1. The following table is a summary of the proposed amendments to the Codification. The amendments are organized by each specific cash flow issue. Some of the Codification paragraphs are amended by more than one issue. Each issue only includes the amendments applicable to that issue. The appendix of this proposed Update includes a summary of the paragraphs that were amended by more than one issue.

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Introduction

2. The Accounting Standards Codification is amended as described in paragraphs 3–24. In some cases, to put the change in context, not only are the amended paragraphs shown but also the preceding and following paragraphs. Terms from the Master Glossary are in **bold** type. Added text is <u>underlined</u>, and deleted text is ~~struck out~~.

Issue 1: Debt Prepayment or Debt Extinguishment Costs

3. The following amendments reflect the Task Force's consensus that cash payments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders, should be classified as cash outflows for financing activities.

Amendments to Subtopic 230-10

4. Amend paragraphs 230-10-45-15, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

> > Cash Flows from Financing Activities

230-10-45-15 All of the following are cash outflows for financing activities:

a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments.
b. Repayments of amounts borrowed.
c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.

d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
e. Payments for debt issue costs <u>and for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders</u>.

Issue 2: Settlement of Zero-Coupon Bonds

5. The following amendments reflect the Task Force's consensus that at the settlement of a zero-coupon bond, the portion of the cash payment attributable to the accreted interest should be classified as cash outflows for operating activities, and the portion of the cash payment attributable to the principal should be classified as cash outflows for financing activities.

Amendments to Subtopic 230-10

6. Amend paragraphs 230-10-45-15, 230-10-45-17, and 230-10-45-25, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

> > Cash Flows from Financing Activities

230-10-45-15 All of the following are cash outflows for financing activities:

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

The distributions may be either at inception or over the term of the derivative instrument.

e. Payments for debt issue costs.

> > Cash Flows from Operating Activities

230-10-45-17 All of the following are cash outflows for operating activities:

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

> > Reporting Operating, Investing, and Financing Activities

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

a. Cash collected from customers, including lessees, licensees, and the like
b. Interest and dividends received. Interest and dividends that are donor restricted for long-term purposes as included in the list of **financing**

activities and paragraph 230-10-45-14(c) are not part of operating cash receipts.

c. Other operating cash receipts, if any
d. Cash paid to employees and other suppliers of goods or services, including suppliers of insurance, advertising, and the like
e. Interest paid, including any amounts paid to settle zero-coupon bonds that are attributable to accreted interest
f. Income taxes paid and separately, the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included as a cost of goods or services recognizable for accounting purposes also had not been deductible in determining taxable income (see Section 230-10-45-14(e))
g. Other operating cash payments, if any.

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

7. Amend paragraph 230-10-50-2, with a link to transition paragraph 230-10-65-2, as follows:

Disclosure

> Interest and Income Taxes Paid

230-10-50-2 If the indirect method is used, amounts of interest paid (net of amounts capitalized), including any amounts paid to settle zero-coupon bonds that are attributable to accreted interest, and income taxes paid during the period shall be disclosed.

Issue 3: Contingent Consideration Payments Made after a Business Combination

8. The following amendments reflect the Task Force's consensus that cash payments made by an acquirer that are not paid soon after a business combination for the settlement of a contingent consideration liability should be separated and classified as cash outflows for financing activities and operating activities.

Amendments to Subtopic 230-10

9. Amend paragraphs 230-10-45-15 and 230-10-45-17, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

> > Cash Flows from Financing Activities

230-10-45-15 All of the following are cash outflows for financing activities:

a. Payments of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments.
b. Repayments of amounts borrowed.
c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.
d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.
e. Payments for debt issue costs.
f. Payments, or the portion of the payments, made by the acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, if the payment was not made soon after the business combination occurred. See also paragraph 230-10-45-17(ee).

> > Cash Flows from Operating Activities

230-10-45-17 All of the following are cash outflows for operating activities:

a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.
b. Cash payments to other suppliers and employees for other goods or services.
c. Cash payments to governments for taxes, duties, fines, and other fees or penalties and the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or

services recognizable for financial reporting purposes also had not been deductible in determining taxable income. (This is the same amount reported as a financing cash inflow pursuant to paragraph 230-10-45-14(e).)

d. Cash payments to lenders and other creditors for interest.

e. Cash payment made to settle an asset retirement obligation.

ee. Cash payments, or the portion of the payments, made by the acquirer to settle a contingent consideration liability that exceed the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, if the payment was not made soon after the business combination occurred. See also paragraph 230-10-45-15(f).

f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

Amendments to Subtopic 958-805

10. Amend paragraph 958-805-45-11, with a link to transition paragraph 230-10-65-2, as follows:

Not-for-Profit Entities—Business Combinations

Other Presentation Matters

Acquisition by a Not-for-Profit Entity

> Statement of Cash Flows

958-805-45-11 An NFP acquirer shall report the entire amount of any net cash ~~flow~~flows related to an acquisition (cash paid as consideration, if any, less acquired cash of the acquiree) in the statement of cash flows as an **investing activity**, except for cash payments made to settle a contingent consideration liability arising from the acquisition that are not paid soon after the business combination. Example 7 (see paragraphs 958-805-55-68 through 55-70) illustrates this requirement. Cash payments, or the portion of the payments, made by the NFP acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, if the payment was not made soon after the business combination occurred, shall be classified as cash outflows for financing activities. Cash payments, or the portion of the payments, made by the NFP acquirer to settle a contingent consideration liability that exceed the amount of the contingent consideration liability recognized at the acquisition date, including measurement period adjustments, if the payment was not made soon after the business combination occurred, shall be classified as cash outflows for operating activities.

Issue 4: Proceeds from the Settlement of Insurance Claims

11. The following amendments reflect the Task Force's consensus that the proceeds received from the settlement of insurance claims should be classified on the basis of the insurance coverage (that is, the nature of the loss).

Amendments to Subtopic 230-10

12. Amend paragraph 230-10-45-16, and add paragraph 230-10-45-21B and its related heading, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

> > Cash Flows from Operating Activities

230-10-45-16 All of the following are cash inflows from operating activities:

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

> > Proceeds from the Settlement of Insurance Claims

230-10-45-21B Cash receipts resulting from the settlement of insurance claims, excluding proceeds received from corporate-owned life insurance policies and bank-owned life insurance policies, shall be classified on the basis of the related insurance coverage (that is, the nature of the loss). For insurance proceeds that

<u>are received in a lump-sum settlement, an entity shall determine the classification on the basis of the nature of each loss included in the settlement.</u>

13. Amend paragraphs 230-10-55-10, 230-10-55-13, and 230-10-55-20(m), with a link to transition paragraph 230-10-65-2, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Direct and Indirect Method for a Manufacturing Entity

230-10-55-10 The following is a statement of cash flows for the year ended December 31, 19X1, for Entity A, a U.S. corporation engaged principally in manufacturing activities. This statement of cash flows illustrates the direct method of presenting cash flows from operating activities, as encouraged in paragraph 230-10-45-25.

Entity A
Consolidated Statement of Cash Flows
For the Year Ended December 31, 19X1
Increase (Decrease) in Cash and Cash Equivalents

Cash flows from operating activities:		
Cash received from customers	$ 13,850	
Cash paid to suppliers and employees	(12,000)	
Dividend received from affiliate	20	
Interest received	55	
Interest paid (net of amount capitalized)	(220)	
Income taxes paid	(325)	
Insurance proceeds received for business interruption	5~~15~~	
Cash paid to settle lawsuit for patent infringement	(30)	
Net cash provided by operating activities		~~$1,365~~$1,355
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Insurance proceeds received for damage to equipment	10	
Capital expenditures	(1,000)	
Payment for purchase of Entity B, net of cash acquired	(925)	
Net cash used in investing activities		~~(1,175)~~(1,165)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under capital lease obligation	(125)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	
Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600
Cash and cash equivalents at end of year		$ 1,665
Reconciliation of net income to net cash provided by operating activities:		
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 affiliate	(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	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		~~605~~595
Net cash provided by operating activities		~~$1,365~~$1,355

230-10-55-13 The following is Entity A's statement of cash flows for the year ended December 31, 19X1, prepared using the indirect method, as described in paragraph 230-10-45-28.

Entity A
Consolidated Statement of Cash Flows
For the Year Ended December 31, 19X1
Increase (Decrease) in Cash and Cash Equivalents

Cash flows from operating activities:		
Net income		$ 760
Depreciation and amortization	$ 445	
Provision for losses on accounts receivable	200	
Gain on sale of facility	(80)	
Undistributed earnings of affiliate	(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	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		~~605~~595
Net cash provided by operating activities		~~1,365~~1,355
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Insurance proceeds received for damage to equipment	10	
Capital expenditures	(1,000)	
Payment for purchase of Entity B, net of cash acquired	(925)	
Net cash used in investing activities		~~(1,175)~~(1,165)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under capital lease obligation	(125)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	
Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600
Cash and cash equivalents at end of year		$ 1,665

230-10-55-20 The following transactions were entered into by Entity A during 19X1 and are reflected in the preceding financial statements:

m. Entity A collected insurance proceeds of $15 ($5 from a business interruption claim that resulted when a storm precluded shipment of inventory for one week and $10 from a property claim that resulted when fully depreciated manufacturing equipment was damaged by a fire).

Issue 5: Proceeds from the Settlement of Corporate-Owned Life Insurance Policies, including Bank-Owned Life Insurance Policies

14. The following amendments reflect the Task Force's consensus that cash proceeds received from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, should be classified as cash inflows from investing activities. The following amendments also reflect the Task Force's consensus that cash payments for premiums on corporate-owned life insurance policies, including bank-owned life insurance policies, may be classified as cash outflows for investing activities, operating activities, or a combination of investing and operating activities.

Amendments to Subtopic 230-10

15. Add paragraph 230-10-45-21C, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

<u>**230-10-45-21C** Cash receipts from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, shall be classified as cash inflows from investing activities. Cash payments for premiums on corporate-owned life insurance policies, including bank-owned life insurance policies, may be classified as cash outflows for investing activities, operating activities, or a combination of cash outflows for investing and operating activities.</u>

Issue 6: Distributions Received from Equity Method Investees

16. The following amendments reflect the Task Force's consensus that distributions received by an investor from an equity method investee are presumed to be returns on investment and classified as cash inflows from operating activities unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor. When such an excess occurs, the current-period distribution up to this excess is considered a return of investment and shall be classified as cash inflows from investing activities. The

amendments do not address equity method investments measured using the fair value option.

Amendments to Subtopic 230-10

17. Add paragraph 230-10-45-21D and its related heading, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

<u>> > Distributions Received from Equity Method Investees</u>

<u>**230-10-45-21D** When an investor applies the equity method, all distributions received from an equity method investee are presumed to be returns on investment and shall be classified as cash inflows from operating activities unless the investor's cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor (as adjusted for amortization of basis differences). When such an excess occurs, the current-period distribution up to this excess is considered a return of investment and shall be classified as cash inflows from investing activities.</u>

18. Amend paragraph 230-10-55-20(c), with a link to transition paragraph 230-10-65-2, as follows:

Implementation Guidance and Illustrations

> Illustrations

> > Example 1: Direct and Indirect Method for a Manufacturing Entity

230-10-55-20 The following transactions were entered into by Entity A during 19X1 and are reflected in the preceding financial statements:

c. Entity A received a dividend of $20 from an affiliate accounted for under the equity method of accounting. <u>The dividend was determined to be a return on investment under the guidance in paragraph 230-10-45-21D.</u>

Issue 7: Beneficial Interests in Securitization Transactions

19. The following amendments reflect the Task Force's consensus that a transferor's beneficial interest obtained in a securitization of financial assets should be disclosed as a noncash activity and cash receipts from payments on a transferor's beneficial interests in securitized trade receivables should be classified as cash inflows from investing activities.

Amendments to Subtopic 230-10

20. Amend paragraphs 230-10-45-12, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

> > Cash Flows from Investing Activities

230-10-45-12 All of the following are cash inflows from investing activities:

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

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

21. Amend paragraph 230-10-50-4, with a link to transition paragraph 230-10-65-2, as follows:

Disclosure

> Noncash Investing and Financing Activities

230-10-50-4 Examples of noncash investing and financing transactions are converting debt to equity; acquiring assets by assuming directly related liabilities, such as purchasing a building by incurring a mortgage to the seller; obtaining an asset by entering into a capital lease; <u>obtaining a beneficial interest as consideration for transferring financial assets (excluding cash), including the transferor's trade receivables, in a securitization transaction;</u> obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

Issue 8: Separately Identifiable Cash Flows and Application of the Predominance Principle

22. The following amendments reflect the Task Force's consensus to provide additional guidance to clarify when an entity should separate cash receipts and cash payments into more than one class of cash flows and when an entity should classify those cash receipts and payments into one class of cash flows on the basis of predominance.

Amendments to Subtopic 230-10

23. Amend paragraph 230-10-45-22 and add paragraph 230-10-45-22A, with a link to transition paragraph 230-10-65-2, as follows:

Statement of Cash Flows—Overall

Other Presentation Matters

> Classification

> > More than One Class of Cash Flows

230-10-45-22 Certain cash receipts and payments may have aspects of more than one class of cash flows. ~~For example, a cash payment may pertain to an item that~~

~~could be considered either inventory or a productive asset. If so, the appropriate classification shall depend on the activity that is likely to be the predominant source of cash flows for the item. For example, the acquisition and sale of equipment to be used by the entity or rented to others generally are investing activities. However, equipment sometimes is acquired or produced to be used by the entity or rented to others for a short period and then sold. In those circumstances, the acquisition or production and subsequent sale of those assets shall be considered operating activities.~~ The classification of those cash receipts and payments shall be determined first by applying specific guidance in this Topic and other applicable Topics. In the absence of specific guidance, a reporting entity shall determine each separately identifiable source or each separately identifiable use within the cash receipts and cash payments on the basis of the nature of the underlying cash flows. A reporting entity shall then classify each separately identifiable source or use within the cash receipts and payments on the basis of their nature in financing, investing, or operating activities.

230-10-45-22A In situations in which cash receipts and payments have aspects of more than one class of cash flows and cannot be separated by source or use, the appropriate classification shall depend on the activity that is likely to be the predominant source or use of cash flows for the item.

Transition and Open Effective Date Information

24. Add paragraph 230-10-65-2 and its related heading as follows:

> Transition Related to Accounting Standards Update No. 2016-XX, *Statement of Cash Flows (Topic 230): Classification of Certain Cash Receipts and Cash Payments*

230-10-65-2 The following represents the transition and effective date information related to Accounting Standards Update No. 2016-XX, *Statement of Cash Flows (Topic 230)*: *Classification of Certain Cash Receipts and Cash Payments:*

a. The pending content that links to this paragraph shall be effective for fiscal years beginning after [date or dates to be inserted after exposure], and interim periods within or after those fiscal years [timing of interim period adoption to be inserted after exposure].
b. An entity shall apply the pending content that links to this paragraph retrospectively to all periods presented.
c. If it is impracticable to apply the pending content that links to this paragraph retrospectively to any prior period presented (see paragraphs 250-10-45-9 through 45-10), an entity shall apply the pending content that links to this paragraph as if the change was made prospectively as of the earliest date practicable.
d. An entity shall provide the disclosures in paragraphs 250-10-50-1(a) and (b)(1) and 250-10-50-2, as applicable, in the first interim and annual period the entity adopts the pending content that links to this paragraph.

If retrospective application to any prior period is impracticable, an entity also shall provide the disclosures in paragraph 250-10-50-1(b)(4).

The amendments in this proposed Update were approved for publication by the unanimous vote of the seven members of the Financial Accounting Standards Board:

Russell G. Golden, *Chairman*
James L. Kroeker, *Vice Chairman*
Daryl E. Buck
Thomas J. Linsmeier
R. Harold Schroeder
Marc A. Siegel
Lawrence W. Smith

Appendix: Paragraphs Amended by Multiple Issues

A1. This appendix provides the complete amendments for those paragraphs that are amended by more than one cash flow issue. No new amendments are included in this appendix.

Paragraph 230-10-45-15

230-10-45-15 All of the following are cash outflows for financing activities:

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

Paragraph 230-10-45-17

230-10-45-17 All of the following are cash outflows for operating activities:

a. Cash payments to acquire materials for manufacture or goods for resale, including principal payments on accounts and both short- and long-term notes payable to suppliers for those materials or goods. The term *goods* includes certain loans and other debt and equity instruments of other entities that are acquired specifically for resale, as discussed in paragraph 230-10-45-21.

b. Cash payments to other suppliers and employees for other goods or services.
c. Cash payments to governments for taxes, duties, fines, and other fees or penalties and the cash that would have been paid for income taxes if increases in the value of equity instruments issued under share-based payment arrangements that are not included in the cost of goods or services recognizable for financial reporting purposes also had not been deductible in determining taxable income. (This is the same amount reported as a financing cash inflow pursuant to paragraph 230-10-45-14(e).)
d. Cash payments to lenders and other creditors for interest, including any amounts paid to settle zero-coupon bonds that are attributable to accreted interest.
e. Cash payment made to settle an asset retirement obligation.
ee. Cash payments, or the portion of the payments, made by the acquirer to settle a contingent consideration liability that exceed the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, if the payment was not made soon after the business combination occurred. See also paragraph 230-10-45-15(f).
f. All other cash payments that do not stem from transactions defined as investing or financing activities, such as payments to settle lawsuits, cash contributions to charities, and cash refunds to customers.

Paragraph 230-10-55-20

230-10-55-20 The following transactions were entered into by Entity A during 19X1 and are reflected in the preceding financial statements:

a. Entity A wrote off $350 of accounts receivable when a customer filed for bankruptcy. A provision for losses on accounts receivable of $200 was included in Entity A’s selling, general, and administrative expenses.
b. Entity A collected the third and final annual installment payment of $100 on a note receivable for the sale of inventory and collected the third of four annual installment payments of $150 each on a note receivable for the sale of a plant. Interest on these notes through December 31 totaling $55 was also collected.
c. Entity A received a dividend of $20 from an affiliate accounted for under the equity method of accounting. The dividend was determined to be a return on investment under the guidance in paragraph 230-10-45-21D.
d. Entity A sold a facility with a book value of $520 and an original cost of $750 for $600 cash.
e. Entity A constructed a new facility for its own use and placed it in service. Accumulated expenditures during the year of $1,000 included capitalized interest of $10.

f. Entity A entered into a capital lease for new equipment with a fair value of $850. Principal payments under the lease obligation totaled $125.

g. Entity A purchased all of the capital stock of Entity B for $950 in a business combination. The fair values of Entity B's assets and liabilities at the date of acquisition are presented below.

Cash	$ 25
Accounts receivable	155
Inventory	350
Property, plant, and equipment	900
Patents	80
Goodwill	70
Accounts payable and accrued expenses	(255)
Long-term note payable	(375)
Net assets acquired	$950

h. Entity A borrowed and repaid various amounts under a line-of-credit agreement in which borrowings are payable 30 days after demand. The net increase during the year in the amount borrowed against the line-of-credit totaled $300.

i. Entity A issued $400 of long-term debt securities.

j. Entity A's provision for income taxes included a deferred provision of $150.

k. Entity A's depreciation totaled $430, and amortization of intangible assets totaled $15.

l. Entity A's selling, general, and administrative expenses included an accrual for incentive compensation of $50 that has been deferred by executives until their retirement. The related obligation was included in other liabilities.

m. Entity A collected insurance proceeds of $15 ($5 from a business interruption claim that resulted when a storm precluded shipment of inventory for one week and $10 from a property claim that resulted when fully depreciated manufacturing equipment was damaged by a fire).

n. Entity A paid $30 to settle a lawsuit for patent infringement.

o. Entity A issued $1,000 of additional common stock of which $500 was issued for cash and $500 was issued upon conversion of long-term debt.

p. Entity A paid dividends of $200.

Background Information and Basis for Conclusions

Introduction

BC1. The following summarizes the Task Force's considerations in reaching the conclusions in this proposed Update. It includes the Board's basis for ratifying the Task Force conclusions when needed to supplement the Task Force's considerations. It also includes reasons for accepting certain approaches and rejecting others. Individual Task Force and Board members gave greater weight to some factors than to others.

Background Information

BC2. Stakeholders have indicated that there is diversity in practice in how certain cash receipts and cash payments are presented and classified in the statement of cash flows, which results either from a lack of guidance in Topic 230 and other Topics or from guidance that is unclear in its application. This proposed Update addresses eight specific cash flow issues with the goal of reducing the existing diversity in practice.

Issue 1: Debt Prepayment or Debt Extinguishment Costs

BC3. Debt prepayment or debt extinguishment costs are paid by a borrower in connection with settling a debt financing arrangement before the maturity date. A lender often will include a prepayment penalty provision in the financing agreement that can be based on a number of factors, including an approximation of the interest that will not be paid as a result of the early settlement. The absence of specific guidance has resulted in borrowers classifying cash payments for debt prepayment or extinguishment costs as either financing activities or operating activities.

BC4. Some Task Force members suggested that these cash payments may be consideration for foregone future interest and, thus, do not have the same characteristics as interest (that is, the value paid for amount of time that monies are borrowed). They noted that these payments are associated with the extinguishment of debt principal and should be classified as financing activities. Some Task Force members noted that a user would treat those cash payments as financing activities because they relate to financing transactions. Additionally, some Task Force members believe that these costs are similar to debt issue costs, which are classified as cash outflows for financing activities. However, other Task Force members believe that those cash payments include an element of interest and said that on the basis of the existing guidance in Topic 230, cash payments to lenders and other creditors for interest should be classified as cash outflows for operating activities.

BC5. The Task Force reached a consensus-for-exposure that cash payments for debt prepayment or extinguishment costs should be classified as cash outflows for financing activities. The Task Force also concluded that those costs should include all costs for the prepayment or extinguishment of debt (that is, third-party costs, premiums paid to repurchase debt in an open-market transaction, and other fees paid to lenders).

Issue 2: Settlement of Zero-Coupon Bonds

BC6. Zero-coupon bonds are a type of debt security that generally are issued or traded at significant discounts from their face amounts. Interest on zero-coupon bonds is not paid throughout the term of the bond but, instead, is paid at maturity. Diversity in practice exists in how to classify the cash payment made by the bond issuer upon settlement of a zero-coupon bond. Specifically, there is diversity in how to classify the portion of the cash payment attributable to the accreted interest.

BC7. On the basis of the current guidance in Topic 230, the majority of Task Force members supported separating and classifying the cash payment for the settlement of zero-coupon bonds into operating and financing activities. That is, a portion of the cash payment is attributable to accreted interest, and Topic 230 explicitly states that payments related to interest shall be classified as operating activities within the statement of cash flows. Additionally, a portion of the cash payment is attributable to principal, and Topic 230 explicitly states that repayments of amounts borrowed shall be classified as financing activities within the statement of cash flows.

BC8. A minority of Task Force members believe that the lack of an interest payment each period constitutes a refinancing of interest due; therefore, the issuer of a zero-coupon bond refinances its interest every period into additional principal through a noncash transaction. Those Task Force members believe that, at settlement, the entire cash payment on a zero-coupon bond should be classified as cash outflows for financing activities.

BC9. The Task Force reached a consensus-for-exposure that, at settlement, the portion of the cash payment attributable to the accreted interest should be classified as cash outflows for operating activities and the portion of the cash payment attributable to the principal should be classified as cash outflows for financing activities.

Issue 3: Contingent Consideration Payments Made after a Business Combination

BC10. As defined in the Master Glossary, *contingent consideration* is usually an obligation of the acquirer to transfer additional assets or equity interests to the former owners of an acquiree as part of the exchange for control of the acquiree if specified future events occur or conditions are met. Topic 230 and Topic 805, Business Combinations, do not provide specific guidance on the cash flow statement classification of cash payments made by the acquirer to settle a contingent consideration liability after the business combination. The lack of guidance has resulted in entities classifying cash payments made after a business combination for the settlement of a contingent consideration liability in operating, investing, or financing activities, or in a combination of those activities.

BC11. The majority of the Task Force members favored separating cash payments made to settle a contingent consideration liability and classifying them as cash outflows for both financing activities and operating activities because that approach is the one applied most often in practice today and in their view most closely aligns with the requirements of Topic 230. Other Task Force members supported classifying the entire payment as a financing activity because they believe that the entire payment has a financing aspect and that it is more useful to include all cash flows associated with the settlement of such consideration in one place on the cash flow statement.

BC12. The Task Force reached a consensus-for-exposure that cash payments made by an acquirer after a business combination for the settlement of a contingent consideration liability should be separated and classified as cash outflows for financing activities and operating activities. Specifically, the payments, or the portion of the payments, up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, should be classified as cash outflows for financing activities if the payment was not made soon after the business combination occurred. Amounts paid in excess of the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, should be classified as cash outflows for operating activities if the payment was not made soon after the business combination occurred.

Issue 4: Proceeds from the Settlement of Insurance Claims

BC13. Diversity in practice exists on how to classify proceeds received from the settlement of insurance claims. Existing guidance states, in part, that cash inflows from operating activities include proceeds of insurance settlements except for those that are directly related to investing or financing activities, such as from destruction of a building. Stakeholders have indicated that it is unclear what "directly related to investing or financing activities" means and whether it was meant to relate to the insurance coverage or the planned use of the insurance proceeds.

BC14. The Task Force believes that the proceeds received from the settlement of insurance claims should be classified on the basis of the insurance coverage. The Task Force noted that the intent of guidance for proceeds received from the settlement of insurance claims is for those proceeds to be classified on the basis of the nature of the loss, and they believe that classification based on the nature of the loss provides more relevant information to users of financial statements.

BC15. The Task Force reached a consensus-for-exposure that a reporting entity should classify the proceeds received from the settlement of insurance claims, excluding proceeds received from corporate-owned life insurance policies and bank-owned life insurance policies, on the basis of the insurance coverage (that is, the nature of the loss), including those proceeds that are received in a lump-sum settlement for which reasonable judgment is required to determine the classification on the basis of the nature of each loss.

Issue 5: Proceeds from the Settlement of Corporate-Owned Life Insurance Policies, including Bank-Owned Life Insurance Policies

BC16. Life insurance policies are purchased by entities for a variety of purposes, including funding the cost of providing employee benefits and protecting against the loss of key persons. These types of policies generally have been known as corporate-owned life insurance and bank-owned life insurance. (References to corporate-owned life insurance also include bank-owned life insurance.) One of the primary benefits of using an insurance policy as a funding mechanism is the ability for an entity to receive the death benefits tax-free. Investment income is accumulated tax-free through the internal build-up of the cash surrender value.

BC17. The Task Force indicated that there is diversity in practice on how to classify the proceeds received upon settlement of corporate-owned life insurance policies on the basis of an entity’s intended objectives or purposes for acquiring the corporate-owned life insurance policy. Additionally, many Task Force members expressed interest in also considering how to classify premiums paid on corporate-owned life insurance policies. Because of the current lack of explicit guidance in GAAP, stakeholders have indicated that entities classify premium payments on corporate-owned life insurance policies in investing activities, in operating activities, or in a combination of those activities.

BC18. The Task Force reached a consensus-for-exposure that cash proceeds received from the settlement of corporate-owned life insurance policies should be classified as cash inflows from investing activities. The majority of Task Force members believe that corporate-owned life insurance policies are purchased primarily as investment vehicles and, therefore, the proceeds should be classified as investing activities.

BC19. The Task Force considered, but ultimately rejected, separating cash proceeds from the settlement of corporate-owned life insurance policies and classifying them as cash inflows from operating and investing activities. Some Task Force members supported that approach because they believe that corporate-owned life insurance policies generally have both a term insurance component, which would be an income replacement, and an investment component, which would facilitate the growth of capital. Furthermore, separating the proceeds received from the settlement of corporate-owned life insurance policies and classifying the components into more than one class of cash flows would be more consistent with the consensuses-for-exposure reached on Issues 2, 3, 4, 6, and 8 in this proposed Update. However, the Task Force decided that the benefit of splitting the cash flows between two categories would not justify the effort.

BC20. The Task Force also reached a consensus-for-exposure to permit, but not require, alignment of the classification of premiums paid with the classification of proceeds received. Therefore, cash payments for premiums may be classified as cash outflows for investing activities, operating activities, or a combination of cash outflows for investing and operating activities. Some Task Force members favored not requiring the alignment of premiums paid and proceeds received because they wanted to allow management flexibility in determining the most appropriate classification for premium payments. Additionally, premium payments generally are insignificant to the financial statements as a whole.

Issue 6: Distributions Received from Equity Method Investees

BC21. Cash receipts from an equity method investee that represent returns on investment typically are classified as cash inflows from operating activities, consistent with the classification of cash receipts of interest and dividends. Cash receipts from an equity method investee that represent returns of investment typically are classified as cash inflows from investing activities, consistent with the classification of returns of investment in equity instruments of other entities (other than certain equity instruments carried in a trading account). However, while there is agreement on these concepts, there is diversity in practice on how they are applied.

BC22. The Task Force reached a consensus-for-exposure that all distributions received from an equity method investee are presumed to be returns on investment and classified as cash inflows from operating activities unless the investor’s cumulative distributions received less distributions received in prior periods that were determined to be returns of investment exceed cumulative equity in earnings recognized by the investor (as adjusted for amortization of basis differences). When such an excess occurs, the current-period distribution up to this excess is considered a return of investment and classified as cash inflows from investing activities. Task Force members supported this approach because it is applied most often in practice today, is well understood, and would increase consistency in financial reporting. The consensus-for-exposure did not address equity method investments measured using the fair value option.

BC23. The Task Force considered, but ultimately rejected, an approach under which distributions from an equity method investee would be classified as discussed in paragraph BC22 above, unless specific facts and circumstances of a distribution (or a portion of a distribution) are known. If those facts and circumstances are known, a distribution that represents a return of investment would be classified as cash inflows from investing activities. Task Force members believe that this approach could add a layer of complexity to the analysis and would not be a practical approach to determining the cash flows classification. Additionally, Task Force members believe that some investors may not be able to obtain the information necessary to assess the specific facts and circumstances to apply this approach.

Issue 7: Beneficial Interests in Securitization Transactions

BC24. In a securitization transaction accounted for as a sale under Topic 860, Transfers and Servicing, the transferor typically sells financial assets to an unconsolidated securitization entity in return for cash and a beneficial interest. That is, the transferor does not receive in cash the full fair value of the financial assets at the inception of the securitization transaction. Rather, the transferor receives an amount of cash based on amounts paid by third parties for interests in the assets (that is, the fair value of the assets net of the beneficial interest retained by the transferor). There is no specific cash flow guidance on whether, at inception of a securitization transaction, the receipt of the beneficial interest by the transferor of the financial assets should be considered a noncash activity or whether the transaction should be presented on a gross basis as a cash inflow for the sale of the financial assets and a cash outflow for the purchase of the beneficial interest.

BC25. A securitization transaction may involve the transfer of trade receivables. After the transfer of trade receivables in a securitization transaction, the transferor (due to the retention of a beneficial interest) has a right to receive cash from the securitization entity's collections on the trade receivables. There is no specific guidance in Topic 230 on how to classify cash receipts associated with beneficial interests in securitization transactions. That lack of specific guidance has resulted in entities classifying the subsequent cash receipts from payments on beneficial interests obtained by the transferor in a securitization of the transferor's trade receivables as either operating activities or investing activities in the statement of cash flows. Diversity in practice has not been identified for cash receipts from beneficial interests involving financial assets other than trade receivables (for example, mortgages and commercial loans).

BC26. The Task Force reached a consensus-for-exposure to require disclosure of a transferor's beneficial interest obtained in a securitization of financial assets as a noncash activity. The Task Force supported this disclosure because it reflects the actual form of the securitization transaction. That is, it would be consistent with the form of the securitization transaction because a transferor of assets does not receive or pay cash to obtain the beneficial interest. The Task Force also noted that disclosing a transferor's beneficial interest as a noncash activity is consistent with the requirement in Topic 230, which states that noncash investing activities shall be disclosed.

BC27. Some Task Force members noted that financial statement users typically view cash receipts from a transferor's beneficial interest in securitized trade receivables as an operating activity. As such, when those cash receipts are classified as investing activities, financial statement users may adjust the statement of cash flows to classify them as operating activities. One Task Force member also noted that classifying the cash receipts as an investing activity creates a lack of symmetry between sales and operating cash flows. That is, the sale that created the trade receivable that was securitized will never result in a subsequent operating cash inflow for the seller. Additionally, that Task Force member noted that the absence of symmetry raises a broader question about cash flow symmetry for other fact patterns beyond this issue.

BC28. However, the Task Force reached a consensus-for-exposure that cash receipts from payments on a transferor's beneficial interests in securitized trade receivables should be classified as cash inflows from investing activities. The Task Force supported this classification because GAAP supports treating a transferor's beneficial interests like an investment security. Although cash flows from trading securities that are acquired specifically for resale typically result in an operating activities classification, some Task Force members believe that it is unlikely that a beneficial interest in securitized trade receivables would be acquired specifically for resale. Some of those same Task Force members supported the investing activities classification because the transferor's ability to receive cash from its beneficial interest is sometimes linked to the performance of third-party trade receivables. That is, the additional exposure to credit risk makes the transferor's beneficial interest more akin to an investment in the securitization entity than to an existing trade receivable. The Task Force also noted that an investing activity classification is consistent with existing guidance in Topic 230 when considering its consensus-for-exposure to disclose the transferor's beneficial interest obtained in a securitization of financial assets as a noncash activity. That is, Topic 230 requires disclosure of noncash investing activities but does not require disclosure of noncash operating activities. In addition, an investing activity classification is consistent with the structure of securitization transactions, whereby the trade receivables are transferred to the securitization entity (that is, the transferor does not retain ownership of the trade receivables). Therefore, the Task Force noted that the transferor should not classify cash receipts from its beneficial interest as if they are collections of trade receivables.

BC29. In reaching its consensus-for-exposure, the Task Force considered whether the cash receipts from beneficial interests arising from long-term trade receivables should be bifurcated between interest and notional components consistent with the consensuses-for-exposure reached on Issues 2, 3, 4, 6, and 8 to separate and classify cash flows into more than one class of cash flows and consistent with existing guidance that requires receipts of interest to be classified as operating activities in the statement of cash flows. However, stakeholders have indicated that the interest component on such transactions is generally insignificant. Therefore, the Task Force does not believe that the benefits of bifurcating the interest and notional components justify the cost. As such, the Task Force decided that *all* cash receipts from payments on a transferor's beneficial interest in securitized trade receivables should be classified as investing activities in the statement of cash flows as a practical expedient.

Issue 8: Separately Identifiable Cash Flows and Application of the Predominance Principle

BC30. Topic 230 recognizes that the most appropriate classification of cash flows will not always be clear, particularly in situations in which cash receipts and payments have aspects of more than one class of cash flows. In those situations, the appropriate classification depends on the nature of the activity that is likely to be the predominant source of cash flows for the item. That guidance is referred to as the predominance principle.

BC31. Significant diversity in practice exists about the interpretation and application of the predominance principle. The lack of clear guidance has resulted in some entities applying the predominance principle narrowly (that is, to only a few cash receipts and cash payments). Other entities apply the principle more broadly, particularly when there is a lack of specific cash flow classification guidance in Topic 230 and in other Topics.

BC32. The Task Force reached a consensus-for-exposure to provide additional guidance that clarifies when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows (including when reasonable judgment is required to estimate and allocate cash flows) and when an entity should classify the aggregate of those cash receipts and payments into one class of cash flows based on predominance. In applying the additional guidance, the classification of cash receipts and payments should be determined first by applying specific guidance in Topic 230 and other applicable Topics. In the absence of specific guidance, a reporting entity should determine each separately identifiable source (for inflows) or each separately identifiable use (for outflows) within the cash receipts and cash payments on the basis of the nature of the underlying cash flows. A reporting entity should then classify in financing, investing, or operating activities the cash receipts and payments for each nature that was separately identified. In situations in which cash receipts and payments have aspects of more than one class of cash flows and those aspects cannot be separately identified by their nature, the appropriate classification shall depend on the activity that is likely to be the predominant source or use of cash flows for the item. Some Task Force members noted that an entity should determine each separately identifiable source or use within cash receipts and cash payments on the basis of the nature of the underlying cash flows because it is consistent with the principle in Topic 230 that nature is the basis for determining the classification of all cash flows. Some Task Force members emphasized that the cash flow statement should not be considered on a standalone basis when applying the clarifying guidance. Rather, the classification of the cash flows related to an asset or liability should be consistent with its classification on the statement of financial position. For example, the cash flows from amounts reported as inventory on the statement of financial position should be classified as operating activities in the statement of cash flows.

BC33. The Task Force considered, but ultimately rejected, providing implementation guidance and illustrative examples about how an entity could determine the predominant cash flow. Some Task Force members noted that the additional guidance on how to apply the predominance principle is clear and, therefore, illustrative examples are not necessary. Furthermore, because the Task Force reached a consensus-for-exposure on specific cash flow classification issues for which stakeholders indicated that the predominance principle is being applied, there is less need to provide illustrative examples because fewer cash flow classifications will be determined as a result of applying this additional guidance.

BC34. The Task Force also reached a consensus-for-exposure to not require specific disclosures when classification is based on the predominant cash flow. Many Task Force members stated that classifying cash payments or receipts on the basis of the predominant cash flow is not an accounting policy election and that entities that choose to classify cash flows on the basis of the predominant cash flow should not be required to provide extensive disclosures.

Effective Date and Transition

BC35. The Task Force reached a consensus-for-exposure that the amendments in this proposed Update should be applied retrospectively to all periods presented. The Task Force believes that there will be a significant benefit to retrospective transition because it would enhance the interperiod consistency and comparability of financial information. The Task Force also reached a consensus-for-exposure to provide an impracticability provision similar to that in Topic 250, Accounting Changes and Error Corrections, in order to alleviate cost and complexity for those entities that lack the information necessary to apply the proposed amendments or portions of the proposed amendments retrospectively.

BC36. The Task Force reached a consensus-for-exposure to require the transition disclosures in paragraphs 250-10-50-1(a) and (b)(1) and 250-10-50-2, as applicable, in the interim and annual period in which the amendments in this proposed Update are adopted. If retrospective application to any prior period is impracticable, the Task Force reached a consensus-for-exposure to also require the disclosures in paragraph 250-10-50-1(b)(4).

BC37. The Task Force will determine the effective date and whether early adoption should be allowed after it considers stakeholder feedback on this proposed Update.

How Do the Proposed Provisions Compare with International Financial Reporting Standards (IFRS)?

BC38. IFRS does not provide specific guidance about the cash flow classification of cash payments for debt prepayment or extinguishment costs, proceeds received from the settlement of insurance claims, proceeds received from the settlement of corporate-owned life insurance policies, including bank-owned life insurance policies, beneficial interests in securitization transactions, cash payments for the settlement of a zero-coupon bond, contingent consideration payments made after a business combination, and distributions received from an equity method investee. For those issues, the amendments in this proposed Update will differ from IFRS.

BC39. IFRS provides guidance that states that a single transaction may include cash flows that are classified differently, which is consistent with a portion of the amendments in this proposed Update that clarify when an entity should separate cash receipts and payments and classify them into more than one class of cash flows.

BC40. IFRS also provides guidance that states that cash payments to manufacture or acquire assets held for rental to others and subsequently held for sale are cash flows from operating activities and that the cash receipts from rents and subsequent sales also are cash flows from operating activities. The amendments in the proposed Update address when an entity should separate cash receipts and payments and classify them into more than one class of cash flows and when an entity should apply the predominance principle for all types of transactions for which no specific authoritative guidance exists rather than just situations in which assets are held for rental to others and subsequently sold.

Benefits and Costs

BC41. The objective of financial reporting is to provide information that is useful to present and potential investors, creditors, donors, and other capital market participants in making rational investment, credit, and similar resource allocation decisions. However, the benefits of providing information for that purpose should justify the related costs. Present and potential investors, creditors, donors, and other users of financial information benefit from improvements in financial reporting, while the costs to implement new guidance are borne primarily by present investors. The Task Force's assessment of the costs and benefits of issuing new guidance is unavoidably more qualitative than quantitative because there is no method to objectively measure the costs to implement new guidance or to quantify the value of improved information in financial statements.

BC42. The Task Force does not anticipate that entities will incur significant costs as a result of the amendments in this proposed Update because the amendments would not represent a significant change in practice for most entities. The Task Force agreed that specific guidance on these cash flow classification issues would benefit users by reducing diversity in practice. Thus, on balance, the Task Force concluded that those benefits would justify the limited costs that entities are expected to incur as a result of the application of the proposed amendments.

Amendments to the XBRL Taxonomy

The provisions of this Exposure Draft, if finalized as proposed, would require changes to the U.S. GAAP Financial Reporting Taxonomy (Taxonomy). We welcome comments on these proposed changes to the Taxonomy through ASU Taxonomy Changes provided at www.fasb.org. After the FASB has completed its deliberations and issued a final Accounting Standards Update, proposed amendments to the Taxonomy will be made available for public comment at www.fasb.org and finalized as part of the annual release process.