Statement of cash flows classifications are clarified by FASB

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Various stakeholders have notified the Financial Accounting Standards Board (FASB) that there is diversity in practice in how certain cash receipts and payments are presented and classified in the statement of cash flows. The FASB has issued Accounting Standard Update (ASU) 2016-15 to address eight specific cash flow issues to reduce the existing diversity in practice.

<u>Debt Extinguishments or Prepayment Costs</u>

These cash payments should be classified as cash outflows for financing activities.

<u>Settlement of Zero-Coupon or Other Debt Instruments with Insignificant Rates</u>

When an entity settles these debt instruments, the issuer should classify the portion of the cash payment attributable to accreted interest for the debt discount as cash outflows for operating activities. The portion of the cash payment attributable to the principal should be classified as cash outflows for financing activities.

<u>Insurance Proceeds</u>

Cash proceeds received from the settlement of insurance claims, including lump-sum amounts, should be classified on the basis of the related insurance coverage. For example, proceeds relating to the loss of equipment would be cash flows from investing activities.

Cash proceeds for the settlement of corporate-owned life insurance policies should be classified as cash inflows from investing activities. Cash payments on these policies, however, may be classified as cash outflows for investing activities, operating activities, or a combination of both. For example, the portion of the premium that builds up cash surrender value might be classified as investing activity, with the remaining portion classified as operating activity.

<u>Contingent Consideration Payments after a Business Combination</u>

When settling a contingent consideration liability *soon after* the business acquisition date (i.e., approximately three months or less), the payment should be classified as cash outflows for investing activities. Payments made thereafter should be classified as cash outflows for financing activities up to the amount of the contingent liability recognized at acquisition. Any excess should be classified as operating activities.

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

When an entity has equity method investees, an accounting policy election must be made to classify distributions received using either of the following approaches:

1. *Cumulative earnings approach* – Under this approach, an investor would compare distributions received in the current year to its cumulative equity method earnings since inception. Distributions received up to the amount of cumulative equity earnings would be considered a return on investment (operating activity). Any excess would be considered a return of investment (investing activity).

2. *Nature of distribution approach* – Under this approach, an investor would classify distributions received based on the nature of the activities of the investee that generated the distribution as either a return of investment (investing activity) or a return on investment (operating activity), if such information is available.

Beneficial Interests in Securitization Transactions

In a securitization transaction, the transferor typically sells or otherwise transfers financial assets to a securitization entity in return for cash and a beneficial interest. The FASB provides guidance for the transferor on the disclosures and cash flow classification of such transactions.

Other Cash Flows

Entities should use reasonable judgement to separate cash flows. In the absence of specific guidance, an entity should classify each cash source and use based on the nature of the underlying cash flows. For cash flows with aspects of more than one class that cannot be separated, the classification should be based on the activity that is likely to be the predominant source or use of cash flow.

Effective Date

ASU 2016-15 is effective for non-public entities for fiscal years beginning after December 15, 2018 (i.e., calendar year 2019 financial statements). Early adoption is permitted. The ASU should be applied retrospectively to each period presented.
