Financial reporting developments

A comprehensive guide

Statement of cash flows

Accounting Standards Codification 230

May 2025

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To our clients and other friends

Accounting Standards Codification (ASC) 230, *Statement of Cash Flows,* addresses the presentation of the statement of cash flows. This publication is designed to assist professionals in understanding the statement of cash flows. This publication reflects our current understanding of this guidance based on our experience with financial statement preparers and related discussions with the staff of the Financial Accounting Standards Board (FASB or Board) and Securities and Exchange Commission (SEC or Commission).

This publication has been updated to provide further clarifications and enhancements to our interpretive guidance. Refer to Appendix E for a summary of important changes to this publication.

We hope this publication will help you understand and apply the accounting for the statement of cash flows. EY professionals are prepared to assist you in your understanding and are ready to discuss your concerns and questions.

Ernst + Young LLP

May 2025

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Notice to readers:

This publication includes excerpts from and references to the Financial Accounting Standards Board (FASB or Board) Accounting Standards Codification (Codification or ASC). The Codification uses a hierarchy that includes Topics, Subtopics, Sections and Paragraphs. Each Topic includes an Overall Subtopic that generally includes pervasive guidance for the Topic and additional Subtopics, as needed, with incremental or unique guidance. Each Subtopic includes Sections that in turn include numbered Paragraphs. Thus, a Codification reference includes the Topic (XXX), Subtopic (YY), Section (ZZ) and Paragraph (PP).

Throughout this publication references to guidance in the Codification are shown using these reference numbers. References are also made to certain pre-Codification standards (and specific sections or paragraphs of pre-Codification standards) in situations in which the content being discussed is excluded from the Codification.

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1 Overview and scope

1.1 Overview

The purpose of a statement of cash flows is to provide details on the changes in cash, cash equivalents, restricted cash and restricted cash equivalents during a period. The total amounts of cash, cash equivalents, restricted cash and restricted cash equivalents at the beginning and end of the period shown in the statement of cash flows should be the same as similarly titled line items or subtotals shown in the balance sheet as of those dates, and any amounts included in other line items. The cash inflows and outflows that comprise the change in cash, cash equivalents, restricted cash and restricted cash equivalents during a period are classified as operating, investing or financing activities.

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Objectives

230-10-10-1

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

230-10-10-2

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

a. Assess the entity's ability to generate positive future net cash flows

b. Assess the entity's ability to meet its obligations, its ability to pay dividends, and its needs for external financing

c. Assess the reasons for differences between net income and associated cash receipts and payments

d. Assess the effects on an entity's financial position of both its cash and noncash investing and financing transactions during the period.

Other Presentation Matters

230-10-45-1

A statement of **cash** flows shall report the cash effects during a period of an entity's operations, its investing transactions, and its financing transactions.

The statement of cash flows guidance in ASC 230 is principles based and often requires judgments about classifying certain cash receipts and cash payments. To that end, we encourage entities to fully and adequately disclose their policies and related judgments with respect to the statement of cash flows and ensure that their policies are consistently applied. Transparent financial reporting combined with complete disclosure will enhance users' ability to understand an entity's statement of cash flows.

1.2 Scope

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Scope and Scope Exceptions

230-10-15-2

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

230-10-15-3

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

230-10-15-4

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

a. A statement of cash flows is not required to be provided by a defined benefit pension plan that presents financial information in accordance with the provisions of Topic 960. Other employee benefit plans that present financial information similar to that required by Topic 960 (including the presentation of plan investments at fair value) also are not required to provide a statement of cash flows. Employee benefit plans are encouraged to include a statement of cash flows with their annual financial statements when that statement would provide relevant information about the ability of the plan to meet future obligations (for example, when the plan invests in assets that are not highly liquid or obtains financing for investments).

b. Provided that the conditions in (c) are met, a statement of cash flows is not required to be provided by the following entities:

   1. An investment company within the scope of Topic 946 on investment companies
   2. Subparagraph superseded by Accounting Standards Update No. 2013-08.
   3. A common trust fund, variable annuity account, or similar fund maintained by a bank, insurance entity, or other entity in its capacity as a trustee, administrator, or guardian for the collective investment and reinvestment of funds.

c. For an investment company specified in (b) to be exempt from the requirement to provide a statement of cash flows, all of the following conditions must be met:

   1. Subparagraph superseded by Accounting Standards Update No. 2013-08.
   2. During the period, substantially all of the entity's investments were carried at **fair value** and classified in accordance with Topic 820 as Level 1 or Level 2 measurements or were measured using the practical expedient in paragraph 820-10-35-59 to determine their fair values and are redeemable in the near term at all times.

3. The entity had little or no debt, based on the average debt outstanding during the period, in relation to average total assets. For the purpose of determining average debt outstanding, obligations resulting from redemptions of shares by the entity from unsettled purchases of securities or similar assets, or from covered options written generally may be excluded. However, any extension of credit by the seller that is not in accordance with standard industry practices for redeeming shares or for settling purchases of investments shall be included in average debt outstanding.

4. The entity provides a statement of changes in net assets.

All entities, including business entities and not-for-profit entities, other than those specific exceptions noted below, are required to present a statement of cash flows for each period in which results of operations are presented in a complete set of financial statements.

A statement of cash flows is not required in the unusual situations in which only a balance sheet or an income statement is presented because such a presentation would not constitute a complete set of financial statements. A SEC registrant usually presents a statement of cash flows for the three most recent years to correspond with the periods for which an income statement is required. Only the two most recent fiscal years (versus three fiscal years otherwise required) are required of a smaller reporting company as defined in Regulation S–K Item 10(f)(1).

A statement of cash flows is not required for defined benefit pension plans that present financial information in accordance with the provisions of ASC 960, *Plan Accounting — Defined Benefit Pension Plans*, and certain other employee benefit plans that present financial information similar to that required by ASC 960. We believe the key to deciding whether the defined benefit plan exemption applies to similar plans is whether the employee benefit plan prepares a statement of changes in net assets that would be substantially similar to a statement of cash flows. For example, the exemption would apply to the typical defined contribution plan or health and welfare plan that does little more than receive cash, invest in highly liquid assets and disburse cash. For such a plan, the statement of changes in net assets would differ so little from a statement of cash flows that presenting both statements would be unnecessary duplication. An example of an employee benefit plan that might not qualify for the exemption would be an employee stock ownership plan (ESOP) that engaged in complicated stock transactions that departed significantly from cash receipts and disbursements. For such a plan, the statement of changes in net assets and the statement of cash flows would portray significantly different information, and both statements should be presented. However, employee benefit plans are encouraged to include a statement of cash flows with their annual financial statements when that statement would provide relevant information about the ability of the plan to meet future obligations.

A statement of cash flows also is not required for certain investment companies, as they are provided a scope exception within ASC 230.

1.3 Effects of recent accounting standards updates (updated July 2024)

The following table highlights recent FASB Accounting Standards Updates (ASUs) that modify the guidance in ASC 230. This publication has been updated to reflect the amendments to ASC 230 resulting from these standards.

Additionally, in November 2023, the Board added a project to its technical agenda to make targeted improvements to the statement of cash flows to provide investors with decision-useful information. The scope of the project is to develop a disclosure about an entity's cash interest received and for financial institutions to reorganize and disaggregate the statement of cash flows. The FASB also retained a project about the statement of cash flows on the research agenda to explore further improvements. Entities should consider monitoring the FASB's activities in this area.

Accounting Standards Update	Effective dates[1]	Early adoption permitted?
2023-06, *Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*	SEC filers, including those required to file or furnish financial statements in connection with the sale or issuance of securities without contractual restrictions on transfer: Effective upon the removal of the related SEC requirement. Non-SEC filers: Effective two years after the removal of the related SEC requirement.	No
2023-08, *Intangibles — Goodwill and Other — Crypto Assets (Topic 350-60): Accounting for and Disclosure of Crypto Assets*	(P) 15 December 2024 (N) 15 December 2024	Yes
2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*	(P) 15 December 2024 (N) 15 December 2025	Yes

[1] The update is effective for fiscal years beginning on or after the date included in the table. (P) refers to public business entities (PBEs) and (N) refers to all other entities.

2 Form and content

2.1 Overview

ASC 230 requires that a statement of cash flows show the change during the period in the total of cash, cash equivalents, restricted cash and restricted cash equivalents. The cash inflows and outflows that comprise that change are classified as operating, investing or financing activities.

A statement of cash flows may present operating cash flows either indirectly, by reconciling between net income and net cash flow from operating activities, or directly, by presenting major classes of operating cash receipts (e.g., from customers) and cash payments (e.g., to suppliers and employees for goods and services). Most investing and financing cash receipts and payments must be presented on a gross basis rather than as net changes. There are limited exceptions to this requirement — the most common relates to the cash flow activities of certain assets and liabilities with original maturities of three months or less.

Refer to Appendix A, *Statement of cash flows for a commercial company*, for an illustrative example of a statement of cash flows.

2.2 Disclosure and presentation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-4

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

230-10-45-5

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

Disclosure

230-10-50-8

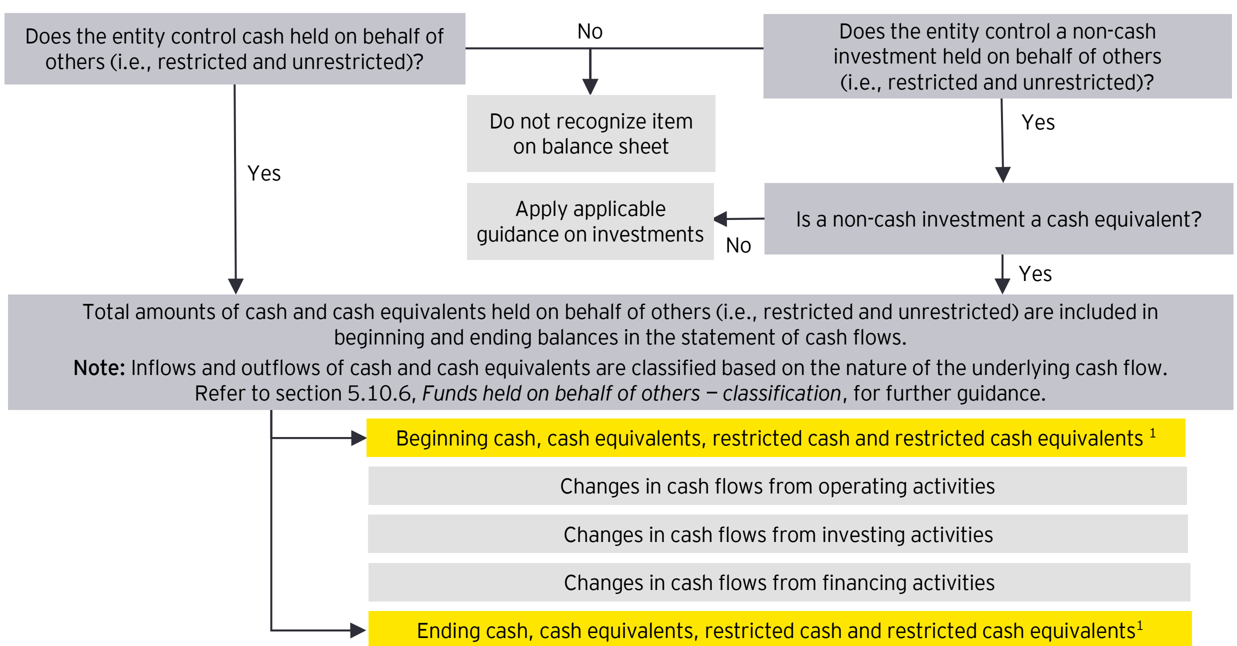
When cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents are presented in more than one line item within the statement of financial position, an entity shall, for each period that a statement of financial position is presented, present on the face of the statement of cash flows or disclose in the notes to the financial statements, the line items and amounts of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents reported within the statement of financial position. The amounts, disaggregated by the line item in which they appear within the statement of financial position, shall sum to the total amount of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents at the end of the corresponding period shown in the statement of cash flows. This disclosure may be provided in either a narrative or a tabular format (see paragraphs 230-10-55-12A and 230-10-55-18A).

ASC 230-10-45-4 requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. While ASC 230 acknowledges that cash, cash equivalents, restricted cash and restricted cash equivalents controlled by the entity may be presented in more than one line item in the balance sheet, it requires entities to explain the changes in those amounts in the statement of cash flows. That is, an entity must identify all cash, cash equivalents, restricted cash and restricted cash equivalents that are included in its balance sheet to use as the starting point for preparing its statement of cash flows. When these amounts are presented in more than one line item on the balance sheet, entities are required to present a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. This reconciliation can be presented either on the face of the statement of cash flows or in the notes to the financial statements.

Cash purchases and sales of cash equivalents generally are part of the reporting entity's cash management activities rather than part of its operating, investing and financing activities, and details of those transactions need not be reported in a statement of cash flows. In addition, transfers between cash, cash equivalents, restricted cash or restricted cash equivalents are not part of the entity's operating, investing or financing activities, and details of those transfers are not reported as cash flow activities in the statement of cash flows (ASC 230-10-45-5).

Cash, cash equivalents, restricted cash and restricted cash equivalents controlled by the entity may also include funds held on behalf of others. Refer to sections 3.1, *Overview*, and 3.6.1, *Funds held on behalf of others*, for discussion on determining when an entity controls funds held on behalf of others and section 5.10.6, *Funds held on behalf of others — classification*, for discussion on the presentation of cash activity related to such amounts in the statement of cash flows.

The following flowchart summarizes considerations for funds held on behalf of others:



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[1] When these amounts are presented in more than one line item in the balance sheet, entities are required to present a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet (either on the face of the statement of cash flows or in the notes to the financial statements). Refer to section 3.4, *Restricted cash and restricted cash equivalents*, for further discussion and Appendix A.1, *Complete statement of cash flows — indirect method*, for an example of such a reconciliation.

2.3 Reconciliation of net income to net cash flow from operating activities

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-2

A reconciliation of net income and net cash flow from **operating activities**, which generally provides information about the net effects of operating transactions and other events that affect net income and operating cash flows in different periods, also shall be provided.

230-10-45-29

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

ASC 230 provides two alternatives for presenting cash flows from operating activities:

- The direct method presents major classes of cash receipts and payments.
- The indirect method presents a reconciliation of net income to net cash flow from operating activities.

Net cash flow from operating activities is the same regardless of the method used. Entities (other than NFPs) using the direct method must also provide the reconciliation of net income and net cash flow from operating activities in a separate schedule. Entities using the indirect method must provide sufficient information, including separate identification of changes in receivables, inventory and payables for operating items (in the reconciliation), and separate disclosure of interest paid and income taxes paid on the face of the statement of cash flows or in the notes, so users can estimate amounts that would have been presented had the direct method been used.

Although the indirect method is the predominant method currently used in practice, ASC 230 encourages use of the direct method. Conceptually, the direct method is more consistent with the presentation of investing and financing activities as it more clearly presents the actual cash receipts and payments during the period; however, it is extremely difficult to implement in all but the simplest operations. The indirect approach provides a useful link to income statements and balance sheets, is more familiar to financial statement users and generally is the less costly approach to prepare.

Changing from one method of presenting operating cash flows to another is not specifically addressed in ASC 230; however, we believe that the guidance in ASC 250, *Accounting Changes and Error Corrections*, regarding a voluntary change in accounting principle should be followed.

2.3.1 Direct method

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

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 the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount

f. Income taxes paid

g. Other operating cash payments, if any.

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

230-10-45-30

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

2.3.1.1 Direct method — determining amounts of major classes of cash flows

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Implementation Guidance and Illustrations

230-10-55-1

Given sufficiently detailed information, major classes of operating **cash** receipts and payments may be determined indirectly by adjusting revenue and expense amounts for the change during the period in related asset and liability accounts. For example, cash collected from customers may be determined indirectly by adjusting sales for the change during the period in receivables from customers for the entity's delivery of goods or services. Likewise, cash paid to suppliers and employees may be determined indirectly by adjusting cost of sales and expenses (exclusive of depreciation, interest, and income taxes) for the change during the period in inventories and payables for operating items. That procedure, of course, requires the availability of information concerning the change during the period in the appropriate classes of receivables and payables. The more detailed the categories of operating cash receipts and payments to be reported, the more complex the procedure for determining them. For the resulting operating cash receipts and payments to be accurate, the effects of all noncash entries to accounts receivable and payable, inventory, and other balance sheets accounts used in the calculation shall be eliminated. For example, the change in accounts receivable would have to be determined exclusive of any bad debt write-offs and other noncash charges and credits to customer accounts during the period.

230-10-55-2

Amounts of operating cash receipts and payments at the minimum level of detail specified in paragraph 230-10-45-25 often may be determined indirectly without incurring unduly burdensome costs over those involved in appropriately applying the indirect method. For example, determining net cash flow from **operating activities** by the indirect method requires the availability of the total amount of operating receivables. That is, any receivables for investing or financing items shall be segregated. Within the total amount of operating receivables, information on receivables from customers for an entity's delivery of goods or services may well be available separately from those for interest and dividends. Thus, it may be possible to determine indirectly cash collected from customers and interest and dividends received using much the same information needed to determine net cash flow from operating activities using the indirect method.

230-10-55-3

The same procedure may be used to determine cash paid to suppliers and employees. Determining net cash flow from operating activities by the direct method requires the availability of the total amount of payables pertaining to operating activities. Within that amount, payables to suppliers and employees may well be available separately from those for interest and taxes. However, determining operating cash payments in more detail than the minimum specified in paragraph 230-10-45-25 might involve significant incremental costs over those already required to apply the indirect method because information on subcategories of payables to suppliers and employees may not be available.

230-10-55-4

Many entities may well be able to determine amounts of operating cash receipts and payments at the minimum level of detail that this Subtopic encourages (see paragraph 230-10-45-25) indirectly at reasonable cost by the procedure discussed in paragraphs 230-10-55-1 through 55-3. But few, if any, entities have experimented with the procedure, and the degree of difficulty encountered in applying it undoubtedly would vary depending on the nature of an entity's operations and the features of its current accounting system.

Presentation of operating cash flows using the direct method does not require a separate cash-based accounting system. Given sufficiently detailed information, major classes of operating cash receipts and payments may be determined indirectly by adjusting revenue and expense amounts for the change during the period in related asset and liability accounts. For example, cash flows for receipts from customers often may be determined by adjusting sales for the change during the period in accounts receivable from customers. Similarly, cash paid to suppliers and employees may be determined indirectly by adjusting cost of sales and other expenses (exclusive of depreciation, interest and income taxes) for the change during the period in inventories and payables pertaining to operating items.

That procedure, of course, requires the availability of information concerning the change during the period in the appropriate classes of receivables and payables. The more detailed the categories of operating cash receipts and payments to be reported, the more complex the procedure for determining them. For the resulting operating cash receipts and payments to be accurate, the effects of all noncash entries to accounts receivable and payable, inventory and other balance sheets accounts used in the calculation must be eliminated.

For example, the change in accounts receivable would have to be determined exclusive of any bad debt write-offs and other noncash charges and credits to customer accounts during the period. Likewise, to present separately cash payments for inventory sold and cash payments for selling, general and administrative costs, an entity would have to segregate the change in accounts payable for each of these categories.

2.3.2 Indirect method (updated July 2024)

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-28

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

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

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

230-10-45-31

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

230-10-45-32

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

Disclosure

230-10-50-2

If the indirect method is used, amounts of interest paid (net of amounts capitalized), including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount, and income taxes paid during the period shall be disclosed.

Pending Content:

Transition Date: *(P) December 16, 2024; (N) December 16, 2025* **| Transition Guidance:** 740-10-65-9

If the indirect method is used, amounts of interest paid (net of amounts capitalized), including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount, shall be disclosed.

230-10-50-2A

Pending Content:

Transition Date: *(P) December 16, 2024; (N) December 16, 2025* **| Transition Guidance:** 740-10-65-9

Income taxes paid (net of refunds received) shall be disclosed in accordance with paragraphs 740-10-50-22 through 50-23.

When reporting cash flows from operating activities by the indirect method, predominant practice is to present the reconciliation from net income, inclusive of income attributable to controlling and noncontrolling interests, to cash flows from operating activities on the face of the statement of cash flows, although it is acceptable to present the reconciliation in the notes to the financial statements. If the reconciliation is presented separately in the notes to the financial statements, net cash flow from operating activities should be presented as a single line item in the statement of cash flows.

At a minimum, the reconciliation should show changes in receivables, inventories and payables pertaining to operating activities. When meaningful, further breakdowns are encouraged (ASC 230-10-45-29).

When using the indirect method, entities need to evaluate whether there are amounts accrued for capital expenditures that should be excluded from investing cash outflows in the current period so that cash flows reflect only payments that have occurred. Refer to section 5.3.3, *Consideration of accrued capital expenditures*, for further details.

Additionally, interest paid and income taxes paid should be separately disclosed on the face of the statement of cash flows or in the notes.

FASB amendment

The FASB issued ASU 2023-09, *Income Tax (Topic 740): Improvements to Income Taxes Disclosures*. With respect to the disclosure of income taxes paid, the guidance requires all entities to disclose, on an annual basis, income taxes paid (net of refunds received) disaggregated by federal (national) taxes in the country of domicile, state taxes and foreign taxes. The guidance also requires all entities to disclose annually the amount of income taxes paid (net of refunds received) to each individual jurisdiction if the amount equals or exceeds a quantitative threshold of 5% of total income taxes paid (net of refunds received). For public business entities, the guidance is effective for annual periods beginning after 15 December 2024. For other entities, it is effective for annual periods beginning after 15 December 2025. All entities should apply the guidance prospectively but have the option to apply it retrospectively. Early adoption is permitted.

2.4 Gross versus net cash flows

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-7

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

230-10-45-8

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

230-10-45-9

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

a. Investments (other than cash equivalents)

b. Loans receivable

c. Debt.

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

230-10-45-26

Except for items described in paragraphs 230-10-45-8 through 45-9, both investing cash inflows and outflows and financing cash inflows and outflows shall be reported separately in a statement of cash flows—for example, outlays for acquisitions of property, plant, and equipment shall be reported separately from proceeds from sales of property, plant, and equipment; proceeds of borrowings shall be reported separately from repayments of debt; and proceeds from issuing stock shall be reported separately from outlays to reacquire the entity's stock.

Gross presentation is generally more useful to the users of financial statements as it provides more meaningful insight into the business and operations of an entity. For instance, it is considered to be more informative to report proceeds from sales of assets of $1,000 and capital expenditures of $500 than to report a net decrease in property, plant and equipment of $500. While gross presentation is a conceptual underpinning of statement of cash flows reporting, ASC 230-10-45-8 provides an exception for which gross reporting is not required (i.e., can be reported net). The following are examples where certain cash receipts and cash payments may be reported net when turnover is quick, the amounts are large, and the maturities are short:

- ***Revolving lines of credit*** — Revolving lines of credit (revolvers) are either repayable on demand or subject to an underlying note that specifies a maturity date. Borrowings and payments related to revolvers that are either repayable on demand or that are subject to a note with an original maturity of less than three months
- ***Trading securities*** — The cash receipts and payments for trading securities that are appropriately classified within operating activities; refer to section 5.4.1, *Acquisitions and sales of certain securities*, for further discussion
- ***Assets or liabilities with an original maturity of three months or less*** — The cash receipts and payments for investments (other than cash equivalents), loans receivable, and debt that have original maturity of three months

Additionally, refer to section 2.4.1, *Gross versus net cash flows — financial institutions*, for further exceptions pertaining to financial institutions.

2.4.1 Gross versus net cash flows — financial institutions

Excerpt from Accounting Standards Codification

Financial Services — Depository and Lending

Statement of Cash Flows

942-230-45-1

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

a. Deposits placed with other financial institutions and withdrawals of deposits

b. Time deposits accepted and repayments of deposits

c. Loans made to customers and principal collections of loans.

942-230-45-2

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

Because of the difficulty in capturing cash flow information separately for short-term and long-term assets, some banks, savings institutions and credit unions present gross cash flows for assets with maturities of three months or less. Net presentation is appropriate when a bank, savings institution or credit union is substantively holding or disbursing cash on behalf of its customers, such as demand deposits of a bank. Importantly, ASC 942-230-45-1 does not apply to other types of financial institutions (e.g., finance companies, insurance companies).

2.4.1.1 Commercial letters of credit

Banks may facilitate trading activities of customers by issuing commercial letters of credit. These transactions involve a cash payment when the letter of credit is drawn upon and a cash receipt from the customer to reimburse the bank to liquidate the letter of credit and for the fee to compensate the bank for having issued the letter of credit.

A bank may recognize liabilities (acceptances outstanding) and corresponding assets (customers' acceptance liability) on its balance sheet in connection with letter of credit issuances (e.g., when a bank receives a draft obligating it to satisfy a customer transaction at some future date). Regardless of whether assets and liabilities are recognized, we believe the bank is substantively disbursing cash on behalf of its customer when performing under a commercial letter of credit. As such, we do not believe presentation of gross cash flow information is required.

2.4.1.2 Fee-based financial services

Many fee-based services provided by financial institutions may have cash flow implications beyond the fee received. For example, collection services for a customer generate a cash receipt when the collection occurs and a cash payment when the customer's demand deposit account is credited. Additionally, a financial institution servicing mortgage loans for others accepts cash from the borrower and tenders that cash (less the servicing fee) to the investor.

We do not believe the gross cash flows (other than the fee received) from transactions such as these should be presented in the statement of cash flows because the financial institution is substantively holding, receiving or disbursing cash on behalf of its customer.

2.5 Other considerations

2.5.1 Cash flow per share and other liquidity measures

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-3

Financial statements shall not report an amount of cash flow per share. Neither cash flow nor any component of it is an alternative to net income as an indicator of an entity's performance, as reporting per-share amounts might imply. Reporting a contractually determined per-unit amount, such as a per-unit amount of cash flow distributable under the terms of a partnership agreement or other agreement between an entity and its owners, is not the same as reporting a cash flow per-share amount intended to provide information useful to all investors and creditors and thus is not precluded by this Subtopic.

ASC 230-10-45-3 prohibits reporting an amount of cash flow per share or any component of cash flow per share. Question 102.05 in the Compliance and Disclosure Interpretations regarding non-GAAP financial measures published by the SEC's Division of Corporation Finance also prohibits liquidity-per-share measures but does not prohibit non-GAAP performance measures (e.g., non-GAAP earnings per share). Question 102.05 notes that per-share data is prohibited if it can be used as a liquidity measure, even if management presents it solely as a performance measure. Refer to section 7.1.2, *Non-GAAP per-share amounts,* of our Financial reporting developments (FRD) publication, ***Earnings per share***, for further discussion.

2.5.2 Cash flows from discontinued operations

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-24

A statement of cash flows for a period shall report net cash provided or used by operating, investing, and financing activities and the net effect of those flows on the total of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents during the period. The statement of cash flows shall report that information in a manner that reconciles beginning and ending totals of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents.

ASC 230 requires an entity to report cash inflows and outflows as operating, investing or financing activities but does not address the presentation of discontinued operations in the statement of cash flows. Historically, the presentation of discontinued operations in the statement of cash flows has varied in practice. At the 2005 AICPA National Conference on Current PCAOB and SEC Developments, the SEC staff expressed its views as to acceptable presentation and identified certain discontinued operations presentation formats considered inconsistent with the authoritative guidance.

Some of the statement of cash flows presentations the SEC staff believes are acceptable include:

- Combining cash flows from discontinued operations with cash flows from continuing operations within each cash flow statement category (i.e., no separate presentation of cash flows from discontinued operations in the statement of cash flows)
- Identifying cash flows from discontinued operations separately within each statement of cash flows category (i.e., present cash flows from discontinued operations as separate line items within operating, investing and financing activities)
- Identifying net cash flows from discontinued operations separately, by category and in total, in the statement of cash flows (i.e., present net cash flows from discontinued operations near the bottom of the cash flow statement, before net increase/decrease in cash and cash equivalents, with amounts of cash flows from discontinued operations by the operating, investing and financing categories, and in the aggregate)

If an entity chooses to segregate cash flows provided by continuing operations from cash flows related to discontinued operations, it is **not** appropriate to present cash flows related to discontinued operations in one net line item of the statement of cash flows.

The following table illustrates some of the presentations of discontinued operations in the statement of cash flows we believe are consistent with the presentation formats discussed above.

	Alternative 1	Alternative 2a	Alternative 2b	Alternative 3a	Alternative 3b
Statement of cash flows categories	**No separate presentation of discontinued operations**	**Separately present cash flows from discontinued operations within the cash flows categories**		**Separately present cash flows from discontinued operations in a separate category at the bottom of the statement of cash flows**	
Operating	All operating	Continuing + Discontinued (w/detail) Total	Continuing + Discontinued (net) Total	Continuing	Continuing
Investing	All investing	Continuing + Discontinued (w/detail) Total	Continuing + Discontinued (net) Total	Continuing	Continuing
Financing	All financing	Continuing + Discontinued (w/detail) Total	Continuing + Discontinued (net) Total	Continuing	Continuing
Below Financing				Discontinued: Operating w/detail Investing w/detail Financing w/detail	Discontinued: Operating (net) Investing (net) Financing (net)

The SEC staff also emphasized the importance of considering disclosures concerning the cash flows from discontinued operations in the liquidity and capital resources section of management's discussion and analysis in Form 10-K, including:

- A description of how cash flows from discontinued operations are reported in the statement of cash flows
- A quantification, where material, of the cash flows from discontinued operations if not separately presented in the statement of cash flows
- A description of how the absence of cash flows from discontinued operations, whether positive or negative is expected to affect future liquidity and capital resources

In deciding whether to segregate the cash flows related to discontinued operations from the cash flows provided by continuing operations, particularly as it relates to the operating section of the statement of cash flows, entities should consider the long-term reporting implications. If an entity presents cash from continuing and discontinued operations separately, the separate cash flows of the discontinued operation must be presented for all periods affected. This might include periods long after sale or liquidation of the operation (e.g., if the seller agrees to pay for future postretirement health care benefits of retirees of the discontinued operation). These cash flows could be material for many future years, resulting in a presentation with no discontinued operations reported in the income statements in periods that cash flows from discontinued operations are reported in the statement of cash flows.

Operating cash flows of a discontinued operation should be reported as an operating activity up to the date of sale. In addition to net cash flows from normal operations, cash flows related to unusual or infrequently occurring transactions of a discontinued operation, such as a reversion of pension plan assets or a payment of severance benefits, also should be reported in the operating activities section of the statement of cash flows. Upon sale of the discontinued operations, the cash received (i.e., proceeds from sale less cash sold if any) should be classified as an investing activity. Note that the gain or loss recorded, both when the net assets are designated as held for sale and at the time of sale, should be presented as a reconciling item in the reconciliation of net income and net cash provided by operating activities.

2.5.2.1 Income tax effects of discontinued operations

When cash flows related to discontinued operations are segregated, there is no requirement (or, in many cases, a practical means) to allocate income taxes between cash flows from continuing and discontinued operations, although the allocation is required on the income statement in accordance with ASC 205-20-45-3.

2.5.2.2 Disclosures — cash flows from discontinued operations

Excerpt from Accounting Standards Codification

Presentation of Financial Statements — Discontinued Operations

Disclosure

205-20-50-5B

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

a. The pretax profit or loss (or change in net assets for a not-for-profit entity) of the discontinued operation for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity). […]

c. […] Either of the following:

   1. The total operating and investing cash flows of the discontinued operation for the periods in which the results of operations of the discontinued operation are presented in the statement where net income is reported (or statement of activities for a not-for-profit entity)

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

In accordance with ASC 205-20-50-5B(c), companies should disclose, to the extent not presented on the face of the financial statements, either the total operating and investing cash flows of the discontinued operation **or** the depreciation, amortization, capital expenditures, and significant operating and investing noncash items of the discontinued operation. This disclosure should be made for the periods in which the results of operations of the disposed component are presented as discontinued operations on the face of the statement where net income is reported.

2.5.3 Separate accounts — insurance companies

Assets held in separate accounts that meet the conditions in ASC 944-80, *Financial Services — Insurance — Separate Accounts*, should be measured at fair value and reported as a summary total, with an equivalent summary total reported for related liabilities. The related investment performance (including interest, dividends, realized gains and losses, and changes in unrealized gains and losses) and the corresponding amounts credited to the separate account holder should be offset within the same statement of operations line-item netting to zero. As a result, an insurance company does not present in its statement of cash flows the cash flows of the separate accounts.

3 Cash and cash equivalents, including those with restrictions

3.1 Overview

Because companies commonly invest their excess cash in short-term, highly liquid investments, the statement of cash flows focuses on the aggregate concepts of cash, cash equivalents, restricted cash and restricted cash equivalents. Collectively, changes in cash on hand, on deposit or invested in short-term financial instruments that are readily convertible to a relatively fixed amount of cash (i.e., without significant volatility) are considered elements of cash, cash equivalents, restricted cash and restricted cash equivalents.

As such, it is important to understand what cash, cash equivalents, restricted cash and restricted cash equivalents are and when they are recognized on an entity's balance sheet.

Cash, cash equivalents, restricted cash and restricted cash equivalents are recognized on an entity's balance sheet when the entity has control over those amounts. While the determination of whether an entity controls cash or cash equivalents, including those with restrictions, may be straightforward in many cases (e.g., cash on hand) it may not be in other cases (e.g., when funds are held on behalf of others). The following characteristics, individually or in the aggregate, indicate an entity has control over cash or cash equivalents, including those with restrictions:

- The entity has the ability to direct how and when the funds would be used.
- The entity has physical possession of the funds (e.g., petty cash, checks on hand).
- The funds are held in the entity's account with a bank or other financial institution and the entity has the ability to transact in such accounts at any time (e.g., make deposits and withdrawals without prior notice or penalty).

3.2 Definition of cash

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Glossary

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.

Cash is the standard medium of exchange and the basis for measuring and accounting for all other financial statement elements. Cash must be readily available for the payment of obligations and free from any contractual restriction that limits its use (i.e., excludes restricted cash). Refer to section 3.4, *Restricted cash and restricted cash equivalents*, for further guidance on restricted cash and restricted cash equivalents.

In addition to currency on hand and demand deposits with financial institutions, cash also consists of negotiable instruments such as money orders, certified checks, cashier's checks, personal checks and bank drafts. Although banks have the legal right to demand notice before withdrawal, savings accounts are usually classified as cash because prior notice is rarely demanded.

3.2.1 Outstanding checks and checks written but not yet released

Outstanding checks, which represent those checks that have been written, issued, and mailed or delivered to the payee by the end of an accounting period and are out of the control of the payor entity, should be deducted from that entity's balance sheet caption "cash." Cash is misrepresented if such outstanding checks are classified as liabilities rather than as reductions to cash as it should only include cash within the entity's control.[1] A payor's balance sheet caption "cash" should include all cash within the payor's control, namely cash in banks plus cash on hand plus deposits in transit, less outstanding checks.

Checks written but not yet released (i.e., not mailed or delivered) by the end of an accounting period remain under the control of the payor and, thus, should not be deducted from the balance sheet caption "cash." These checks would be classified in accounts payable or a relevant liability.[2]

3.2.2 Bank overdrafts and book overdrafts (negative cash balances)

Bank overdrafts represent disbursements (e.g., checks, withdrawals) that are honored by a financial institution when an entity does not have sufficient funds in its bank account to cover the disbursement amount. Unless the right-of-setoff criteria specified in ASC 210-20-45-1[3] are met, bank overdrafts should be classified as current liabilities (i.e., not netted against positive cash account balances[4] in other accounts with the same or different institutions), and, if material, be separately presented.

Book overdrafts represent outstanding checks that are in excess of funds on deposit (including deposits in transit) at such institution. Similar to bank overdrafts, unless the right-of-setoff criteria specified in ASC 210-20-45-1 are met, book overdrafts should be classified as current liabilities (i.e., not netted against positive cash account balances in other accounts with the same or different institutions) and, if material, be separately presented. However, reclassifying all outstanding checks to current liabilities when some level of such checks is covered by funds on deposit (including deposits in transit) is not appropriate. Only the amount of outstanding checks greater than funds on deposit (including deposits in transit) should be classified as a current liability. Note, however, that this determination should be at the individual bank account level. For example, if a company has four separate accounts and only one of the accounts is in an overdraft position, cash on deposit in the three accounts with positive balances is not reduced by the overdraft account, assuming the company does not have the right of setoff (ASC 210-20). Rather, cash is reported for the three accounts with positive balances, and a current liability is reported for the fourth account in the overdraft position.

Note that the netting of assets and liabilities (i.e., offsetting), when the right-of-setoff criteria specified in ASC 210-20-45-1 are met, is an accounting policy that would be applied consistently to similar transactions.

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[1] Interpretative guidance based on AICPA Technical Questions and Answers, Q&A Section 1100.08, *Classification of Outstanding Checks*.

[2] Interpretative guidance based on AICPA Technical Questions and Answers, Q&A Section 2110.02, *Checks Held at Balance Sheet Date*.

[3] A right of setoff is a debtor's legal right, by contract or otherwise, to discharge all or a portion of the debt owed to another party by applying against the debt an amount that the other party owes to the debtor. For purposes of this interpretation, cash on deposit at a financial institution is to be considered by the depositor as cash rather than as an amount owed to the depositor (i.e., a receivable) as noted in ASC 210-20-55-18A. If, however, the cash was restricted (e.g., under the terms of a loan agreement) and the financial institution had the valid and legal right of offset, the entity could set off the restricted cash (which is akin to a receivable) and the loan payable.

[4] Interpretative guidance based in part on AICPA Technical Questions and Answers, Q&A Section 1300.15, *Presentation of Cash Overdraft on Statement of Cash Flows*.

Refer to section 5.2.5, *Bank overdraft and book overdraft*, for statement of cash flows presentation of bank overdrafts and book overdrafts.

3.2.2.1 Financial institution reciprocal account balances

Excerpt from Accounting Standards Codification

Financial Services — Depository and Lending — Balance Sheet

Other Presentation Matters

942-210-45-3A

A financial institution that accepts deposits may have balances due from the same financial institution from which it has accepted a deposit, also called reciprocal balances. Reciprocal account balances shall be offset if they will be offset in the process of collection or payment. Overdrafts of such accounts shall be reclassified as liabilities, unless the financial institution has other accounts at the same financial institution against which such overdrafts can be offset.

3.3 Definition of cash equivalents (updated July 2024)

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Glossary

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).

Master Glossary

Readily Convertible to Cash

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

a. Interchangeable (fungible) units

b. Quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price.

(Based on paragraph 83(a) of FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*.)

Pending Content:

Transition Date: *(P) December 16, 2024; (N) December 16, 2025* **| Transition Guidance:** 105-10-65-9

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

a. Interchangeable (fungible) units

b. Quoted prices available in an active market that can rapidly absorb the quantity held by the entity without significantly affecting the price.

Cash equivalents are defined as short-term and highly liquid investments that meet the following two characteristics:

- They are so near their maturity that they present insignificant risk of changes in value due to changes in interest rates.
- They are readily convertible to known amounts of cash.

In developing the definition of a cash equivalent, the FASB noted in the Statement 95 Basis for Conclusions that "the objective of enterprises' cash management programs generally is to earn interest on temporarily idle funds rather than to put capital at risk in the hope of benefiting from favorable price changes that may result from changes in interest rates or other factors. Although any limit to the maturity of items that can qualify as cash equivalents is somewhat arbitrary, the Board decided to specify a limit of three months or less. The Board believes that that limit will result in treating as cash equivalents only those items that are so near cash that it is appropriate to refer to them as the 'equivalent' of cash" (Statement 95, paragraph 53).

The ASC Master Glossary definition notes that maturity is determined based on the entity holding the instrument as opposed to the terms on issuance. For example, both a three-month U.S. Treasury bill and a three-year U.S. Treasury note purchased three months from maturity would qualify as cash equivalents. However, a US Treasury note purchased three years ago does not become a cash equivalent when its remaining maturity is three months.

The ASC Master Glossary defines "readily convertible to cash" as assets that have both of the following:

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

An investment that is both short-term and highly liquid meets the definition of a cash equivalent. However, we believe an investment with an original maturity of more than three months that can be withdrawn early without a significant economic penalty (e.g., foregone interest) is similar to a demand deposit regardless of its stated maturity and, thus, meets the definition of a cash equivalent.

The evaluation of whether an investment meets the definition of a cash equivalent should be performed when it is initially acquired and on an ongoing basis. In other words, when an investment previously classified as a cash equivalent no longer meets the definition of a cash equivalent (e.g., it is determined to no longer be highly liquid), an entity should reclassify it out of cash equivalents.

Refer to section 2.2, *Disclosure and presentation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents*, for discussion.

3.3.1 Policy for determining the components of cash equivalents

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-6

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

ASC 230-10-45-6 clarifies that not all investments that meet the definition of cash equivalents are required to be treated as cash equivalents. An entity should establish a policy about which short-term, highly liquid investments that meet the definition of cash equivalents are treated as cash equivalents. For example, a bank might decide that all investments that meet the definition of cash equivalents, except for those purchased for trading, will be treated as cash equivalents. On the other hand, an entity whose operations consist largely of investing in short-term, highly liquid investments might decide that all those items will be treated as investments rather than cash equivalents.

Banks and other financial institutions commonly carry three-month U.S. Treasury bills, commercial paper and similar short-term financial instruments in their trading and investments accounts, in which they are commingled with longer-term investments. Those institutions generally contend that purchases and sales of those items are part of their trading or investing activities — not part of their cash management program — and they prefer not to treat those items as cash equivalents in their statement of cash flows, which would require segregating them from other items in their trading and investment accounts.

ASC 230-10-45-6 clarifies that items that meet the definition of cash equivalents that are part of a larger pool of investments properly considered investing activities need not be segregated and treated as cash equivalents. Because entities have the ability to exclude certain qualifying investments from the classification of cash equivalents and that gives rise to differences between entities, ASC 230-10-50-1 requires entities to disclose their accounting policy for determining which items are treated as cash equivalents (refer to section 3.3.5, *Disclosure requirements*, for further discussion). Changes to that accounting policy would be subject to a preferability assessment and require retroactive adjustment of prior-period financial statements. Refer to section 3.4, *Justification for a change in accounting principle*, of our FRD, ***Accounting changes and error corrections***, for further discussion of voluntary changes in accounting principle.

3.3.1.1 Credit and debit card payments in transit

Many entities have cash that is in transit (e.g., from a credit and/or debit card payment processor). While the settlement of such cash in transit may occur in varying intervals, often there will be amounts in transit that exist at the end of a reporting period that will settle shortly after such reporting date (i.e., typically within five business days). We believe the classification of such amounts as either accounts receivables or cash equivalents, if they meet the definition of cash equivalents, as described above, is an accounting policy election that should be consistently applied, and, if material, disclosed.

3.3.2 Investments that generally qualify as cash equivalents

3.3.2.1 Short-term paper

The following examples of short-term paper often meet the requirements to be classified as cash equivalents when they have an original maturity (i.e., maturity at the time of purchase) of three months or less:

- U.S. Treasury bills
- Certificates of deposit
- Commercial paper
- Money market savings certificates

Regardless of whether it is classified as a cash equivalent, most short-term paper would also be subject to the accounting and disclosure requirements for investments in marketable debt and equity securities. Refer to our FRD, ***Certain investments in debt and equity securities***, for further details.

3.3.2.2 Money market funds (updated July 2024)

Money market funds, another common example of short-term paper, are mutual funds that generally pay dividends that reflect prevailing short-term interest rates and are redeemable on demand. Certain money market funds are registered with the SEC while others are not.

SEC rules[5] require institutional prime money market funds, including institutional municipal money market funds, to base their net asset value (NAV) on the market value of the securities in their portfolios (i.e., a floating NAV). Because the floating NAV needs to be rounded to the fourth decimal place (e.g., $1.0000 NAV per share), these funds do not report using stable prices (e.g., $1.00 NAV per share) using an amortized cost valuation method or penny-rounding, in contrast with certain retail or government money market funds.[6] In addition, liquidity fees or restrictions may be imposed on redemptions of investments in certain circumstances. If a fund's NAV changes by more than an insignificant amount or a fund imposes a liquidity fee, an investment in the fund may no longer meet the definition of a cash equivalent.

The following sections provide classification considerations for different types of money market funds.

3.3.2.2.1 Rule 2a-7 money market funds (updated July 2024)

Certain money market funds are registered under the Investment Company Act of 1940 (Act) and regulated pursuant to Rule 2a-7 under the Act. Despite having no maturity date, Rule 2a-7 money market funds, which are redeemable upon demand and usually allow for withdrawal by check or wire transfer, are examples of investments that generally can be classified as cash equivalents. The Rule 2a-7 definition of a money market fund requires the mutual fund to invest in low-risk securities (e.g., US government bonds, US Treasury bills, commercial paper). These money market funds have relatively low risks compared with other mutual funds, pay dividends that generally reflect short-term interest rates and seek to maintain their NAV at $1 per share.

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[5] SEC Release No. 33-9616, *Money Market Fund Reform; Amendments to Form PF*, issued 14 August 2014.

[6] As noted in SEC Release No. 33-11211, *Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A*, if a retail or government fund's stable share price and market-based value per share deviate by more than one half of 1%, the fund's board may adjust the fund's share price below $1.00, colloquially known as "breaking the buck," and the fund must compare its stable share price to the market-based value per share of its portfolios at least daily.

The SEC adopted rules in 2014 intended to minimize Rule 2a-7 funds' exposure to rapid redemptions and make the risks of investing in them more transparent.[7] In 2023, the SEC made the following amendments to Rule 2a-7:

- **Floating NAVs** — Institutional prime money market funds, including institutional municipal money market funds, are required to have floating NAVs that are based on the market value of the securities in their portfolios rounded to the fourth decimal place.[8]
- **Fees** — The board of an institutional prime or institutional tax-exempt money market fund is responsible for imposing a fee on redemptions when the fund has total daily net redemptions that exceed 5% of net assets, or such smaller amount of net redemptions as the board determines. This fee has no upper limit. However, irrespective of liquidity or redemption levels, a board may charge a discretionary fee to redeeming investors of prime or tax-exempt money market funds of not more than 2% of the value of the shares redeemed, when the board determines that the fee is in the best interests of the fund. Government money market funds[9] are permitted to opt into the discretionary liquidity fee framework.

SEC Financial Reporting Releases (FRR) Section 220, *Cash Equivalents*, provides the following guidance for determining whether an investment in a fund subject to the amendments of Rule 2a-7 meets the definition of a cash equivalent:

FRR Section 220

Current U.S. GAAP defines cash equivalents as "short-term, highly liquid investments that are readily convertible to known amounts of cash and that are so near their maturity that they present insignificant risk of changes in value because of changes in interest rates." U.S. GAAP includes an investment in a money market fund as an example of a cash equivalent. The Commission's position continues to be that, under normal circumstances, an investment in a money market fund that has the ability to impose a fee or gate[10] under rule 2a-7(c)(2) qualifies as a "cash equivalent" for purposes of U.S. GAAP. However, as is currently the case, events may occur that give rise to credit and liquidity issues for money market funds. If such events occur, including the imposition of a fee or gate[11] by a money market fund under rule 2a-7(c)(2), shareholders would need to reassess if their investments in that money market fund continue to meet the definition of a cash equivalent. A more formal pronouncement (as requested by some commenters) to confirm this position is not required because the federal securities laws provide the Commission with plenary authority to set accounting standards, and we are doing so here.

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[7] Refer to SEC Release No. 33-9616, *Money Market Fund Reform: Amendments to Form PF*, which was issued on 23 July 2014 and SEC Release No. 33-11211, *Money Market Fund Reforms; Form PF Reporting Requirements for Large Liquidity Fund Advisers; Technical Amendments to Form N-CSR and Form N-1A*, which was issued on 12 July 2023.

[8] SEC guidance in FRR Sections 404.05.c and 404.05.c1 states that a floating NAV fund may continue to use amortized cost to value portfolio securities with remaining maturities of 60 days or less "when it can reasonably conclude, at each time it makes a valuation determination, that the amortized cost value of the portfolio security is approximately the same as the fair value of the security as determined without the use of amortized cost valuation." For the SEC staff's interpretation of what constitutes "approximately the same," refer to Q&A #16 of the **SEC Division of Investment Management's 2014 Money Market Fund Reform Frequently Asked Questions**.

[9] Rule 2a-7 defines a government money market fund as "a money market fund that invests 99.5% or more of its total assets in cash, government securities, and/or repurchase agreements that are collateralized fully."

[10] Amendments to rule 2a-7 remove a money market fund's ability to temporarily suspend redemptions (i.e., impose a gate).

[11] Amendments to rule 2a-7 remove a money market fund's ability to temporarily suspend redemptions (i.e., impose a gate).

> If events occur that cause shareholders to determine that their money market fund shares are not cash equivalents, the shares would need to be classified as investments, and shareholders would have to treat them either as trading securities or available-for-sale securities. For example, during the financial crisis, certain money market funds experienced unexpected declines in the fair value of their investments due to deterioration in the creditworthiness of their assets and, as a result, portfolios of money market funds became less liquid. Investors in these money market funds would have needed to determine whether their investments continued to meet the definition of a cash equivalent.
>
> The adoption of a floating NAV alone for certain Rule 2a-7 funds will not preclude shareholders from classifying their investments in money market funds as cash equivalents, under normal circumstances, because fluctuations in the amount of cash received upon redemption would likely be small and would be consistent with the concept of a 'known' amount of cash. As already exists today with stable share price money market funds, events may occur that give rise to credit and liquidity issues for money market funds so that shareholders would need to reassess if their investments continue to meet the definition of a cash equivalent.

The SEC believes that under normal circumstances an investment in a floating NAV money market fund or a money market fund that has the ability to impose a fee or gate still qualifies as a cash equivalent. However, if the fund is experiencing credit or liquidity issues, including those that cause the imposition of a fee or gate, the investor must reassess whether its investment continues to meet the definition of a cash equivalent.

3.3.2.2.2 Other money market funds (updated May 2025)

A money market fund that does not meet the definition under Rule 2a-7 should be evaluated for classification based on the fund's particular characteristics and requirements. For example, an investment in a fund that allows for immediate withdrawal (i.e., by granting check-writing capability) without restriction and that presents "insignificant risk to changes in value" typically qualifies for classification as a cash equivalent provided that the amount of cash that will be received upon redemption is known at the time of the initial investment.

We believe the money market fund's investment objectives and risk management policies should be considered when determining whether an investment in such a fund is subject to an insignificant risk to changes in value. For example, an unregistered fund that (1) has an investment objective of preserving investor capital (i.e., net asset value of $1 per unit), (2) has an investment policy that is similar to that of a registered money market fund and (3) provides liquidity similar to a Rule 2a-7 fund generally would be consistent with a cash equivalent.

The following are some common risk management policies and characteristics of investment portfolios held by money market funds that are intended to preserve investor capital and provide liquidity that should be evaluated in determining the classification of an investment as a cash equivalent:

- Investment portfolios are managed so that the dollar-weighted average maturity of all investments is very short.[12]
- Investments are sufficiently liquid to meet reasonably foreseeable shareholder redemptions.[13]
- Fund investments are sufficiently diversified to limit the fund's exposure to any given issuer.[14]
- Fund invests exclusively in high-quality securities.[15]

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[12] Refer to paragraph (d)(1) of Rule 2a-7 for additional guidance on the portfolio maturity requirements of Rule 2a-7 money market funds.

[13] Refer to paragraph (d)(4) of Rule 2a-7 for additional guidance on the portfolio liquidity requirements of Rule 2a-7 money market funds.

[14] Refer to paragraph (d)(3) of Rule 2a-7 for additional guidance on the portfolio diversification requirements of Rule 2a-7 money market funds.

[15] Refer to paragraph (d)(2) of Rule 2a-7 for additional guidance on the portfolio quality requirements of Rule 2a-7 money market funds.

While unregistered money market funds that have similar policies and characteristics as Rule 2a-7 money market funds are generally consistent with a cash equivalent, other unregistered money market funds that do not conform to Rule 2a-7 policies may still be considered cash equivalents. Each money market fund should be evaluated individually to determine whether it meets the criteria to be considered a cash equivalent.

3.3.3 Investments that generally do not qualify as cash equivalents

3.3.3.1 Equity investments and investments with maturities greater than three months

The longer the term of the investment, the greater the risk that a change in market conditions (such as interest rates) can have an effect on its value that is other than insignificant. For this reason, ASC 230 excludes equity investments from cash equivalents (because equity securities do not have a stated maturity and the issuers are not obligated to redeem the securities) and restricts the inclusion of other investments to those with a short maturity of, for example, three months or less from the date of their acquisition by the entity.

An investment that is quoted in an active market would be readily convertible to known amounts of cash and, therefore, could be regarded as highly liquid. However, this is not enough to meet the definition of a cash equivalent. Investments that are redeemable at any time can be classified as cash equivalents provided that the amount of cash that will be received upon redemption is known at the time of the initial investment. That is, the investments cannot be considered cash equivalents simply because they can be converted to cash at any time at the then market price in an active market.

However, interests in certain money market funds (e.g., money market funds regulated pursuant to Rule 2a-7 under the Investment Company Act of 1940) can be classified as cash and cash equivalents even though they are considered equity securities. Refer to section 3.3.2.2, *Money market funds*, for further information.

3.3.3.2 Auction rate securities

Auction rate securities (ARS) are securities that have long-term maturities but have their interest rates (or dividend rates in preferred securities) reset on a periodic basis (e.g., weekly, monthly, quarterly). The rates are often reset under a system called a Dutch auction. Historically, some investors have asserted that ARSs should be classified as cash equivalents because the holder of the instrument (i.e., the seller in these auctions) has the opportunity to obtain cash for the instrument on the auction or remarketing date. That is, the market rate is re-established at each auction or remarketing date, and the seller can receive the par amount for its investment. As the auctions were expected to occur in intervals of three months or less, some believed that these instruments were properly classified as cash equivalents.

ARSs are not cash equivalents because these instruments are not puttable to the issuer and, in general, do not have maturity dates of three months or less when purchased. The fact that these instruments may be actively traded in the marketplace is not relevant for this accounting determination.

Refer to section 5.4.1.1, *Auction rate securities and variable rate demand obligations*, for further discussion on the classification of cash flow activity related to ARSs.

3.3.3.3 Variable rate demand obligations

Variable rate demand obligations (VRDO), also referred to as variable rate demand notes, are similar to ARSs, but are generally puttable at a remarketing date. For any VRDO to be classified as a cash equivalent, it must be puttable to the original issuer throughout its entire term. In other words, the issuer ultimately must stand ready to provide current liquidity to the holder.

Some investors have argued that this put feature provides the liquidity necessary to conclude that the instrument is "readily convertible to a known amount of cash" as required by ASC 230-10-20 to be classified as a cash equivalent. The remarketing agent can draw on its letter of credit or other liquidity facility to fund the put if there is an unsuccessful remarketing (in contrast to an ARS, which does not include a put).

We believe that a VRDO would be classified as a cash equivalent only in those rare instances that the instrument is puttable to the original issuer, not the remarketing agent.

An unconditional put at par to the issuer included (i.e., embedded) in the note instrument must exist for a VRDO to meet the definition of a cash equivalent. For example, an unconditional put at par to the issuer that could be exercised on any reset (provided such resets occur every three months or less from date of purchase), regardless of whether the remarketing failed, would provide liquidity to the holder. Such a put feature embedded in a debt instrument generally would not be considered a separate instrument as it would not need to be bifurcated in accordance with the guidance in ASC 815. Rather it would be considered an integral part of the VRDO, satisfying the substance of the criteria in ASC 230 as a cash equivalent. In our experience, such a circumstance (an unconditional put at par to the issuer) is rare.

Refer to section 5.4.1.1, *Auction rate securities and variable rate demand obligations*, for further discussion on the presentation of activity related to VRDOs in the statement of cash flows.

3.3.3.4 Centralized cash management arrangements

Some entities have centralized cash management arrangements in which excess cash is swept into a pool with cash of their affiliates. These type of sweep accounts generally are parent entity bank accounts that are used to fund the cash requirements of the other affiliates in the arrangement. These arrangements aim to reduce lending costs and provide a higher rate of return on invested cash.

We believe that the determination of whether funds deposited or investments in the cash pool are classified as cash or cash equivalents on an affiliate's standalone financial statements is based on the legal structure of the arrangement (i.e., which entity controls the funds).

If an affiliate does not control the funds deposited or investments in the cash pool, it would recognize them as a note due from the parent rather than as cash or cash equivalents. A note due from the parent, even if payable on demand or within three months of notice of repayment, generally would not be considered a cash equivalent, even if the risk of a change in value due to a change in interest rates is insignificant. We believe this is because funds deposited or investments in the cash pool are available only to entities within the consolidated entity and not to a third-party investor or the public. Such notes are instead considered loans, and the affiliate generally would classify them as a receivable from the parent. A note due to the parent generally would be classified by the affiliate as a note payable to the parent.

Changes in an affiliate's receivable relating to a centralized cash management program are presented as investing activities in the statement of cash flows in accordance with the guidance in ASC 230-10-45-12 and 45-13. Changes in an affiliate's note payable relating to a centralized cash management program are presented as financing activities in accordance with the guidance in ASC 230-10-45-14 and 45-15. Payments to, and receipts from, the cash pool would be presented on a gross or net basis as appropriate, in accordance with the guidance in ASC 230-10-45-7 through 45-9. Refer to section 2.4, *Gross versus net cash flows*, for further discussion.

3.3.4 Measurement

US GAAP does not provide specific initial and subsequent measurement requirements for items that qualify as cash equivalents. As such, other accounting Topics should be referenced for such applicable guidance. For example, debt securities that are considered cash equivalents are subject to the accounting and disclosure requirements of ASC 320. However, since cash equivalent items represent short-term, highly liquid investments that are readily convertible to known amounts of cash, their amortized cost generally would be expected to approximate their respective fair value.

3.3.5 Disclosure requirements

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Disclosure

230-10-50-1

An entity shall disclose its policy for determining which items are treated as **cash equivalents**. Any change to that policy is a change in accounting principle that shall be effected by restating financial statements for earlier years presented for comparative purposes.

ASC 230-10-50-1 requires entities to disclose their accounting policy for determining which items are treated as cash equivalents. Refer to section 3.3.1, *Policy for determining the components of cash equivalents*, for further discussion.

Additional disclosure requirements may apply depending on the nature of the items treated as cash equivalents. For example, even if determined to be cash equivalents, investments in debt securities that are in the scope of ASC 320-10 are subject to all of the accounting and disclosure requirements in ASC 320-10.

Cash equivalents that are measured at fair value on a recurring basis after initial recognition are also subject to ASC 820's disclosure requirements. Additionally, ASC 820-10-50-2E requires reporting entities to disclose the hierarchy classification for cash equivalents that are not measured at fair value but for which the fair value is disclosed (e.g., certain investments in held-to-maturity debt securities that are classified as cash equivalents and carried at amortized cost).

3.3.6 Cash and cash equivalents — insurance companies

Insurance companies generally present short-term investments, including those that meet the definition of cash equivalents and based on the company's accounting policy are treated as cash equivalents, in the balance sheet with investments rather than with cash and cash equivalents. Refer to section 3.3.1, *Policy for determining the components of cash equivalents*. While ASC 230 acknowledges that cash and cash equivalents, including those with restrictions, may be presented in more than one line item in the balance sheet, it requires those amounts to be included in the changes in cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows and the related beginning and ending balances, regardless of the balance sheet line item in which those amounts are presented. When cash and cash equivalents, including those with restrictions (e.g., insurance service providers that hold funds on behalf of others), are presented in more than one line item on the balance sheet, entities are required to present a reconciliation of the totals in the statement of cash flows to the related captions in the balance sheet. Refer to section 3.4, *Restricted cash and restricted cash equivalents*, and section 3.6.1, *Funds held on behalf of others*, for further discussion.

3.4 Restricted cash and restricted cash equivalents

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Disclosure

230-10-50-7

An entity shall disclose information about the nature of restrictions on its cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents. An entity within the scope of Topic 958 on not-for-profit entities also shall provide the disclosures required in paragraph 958-210-50-3 (see paragraphs 230-10-55-12A and 230-10-55-18A).

ASC 230-10-45-4 requires entities to include restricted cash and restricted cash equivalents as an element of changes in the total cash and cash equivalents on the statement of cash flows. However, ASC 230 does not define restricted cash and restricted cash equivalents. The Emerging Issues Task Force indicated in the Basis for Conclusions (BC 9) of ASU 2016-18 that it "considered defining restricted cash; however, it ultimately decided that the issue resulting in diversity in practice is the presentation of changes in restricted cash on the statement of cash flows. The Task Force's intent is not to change practice for what an entity reports as restricted cash or restricted cash equivalents." As such, an entity's determination of what is restricted cash and restricted cash equivalents should be based on an accounting policy election and applied consistently.

ASC 230 requires an entity to disclose information about the nature of restrictions on its amounts generally described as restricted cash and restricted cash equivalents. Additionally, SEC Regulation S-X, Rule 5-02, requires SEC registrants to separately disclose cash and cash equivalents that are restricted as to withdrawal or usage, including a description of the provision of any restrictions, and includes the following examples:

- Legally restricted deposits held as compensating balances against short-term borrowing arrangements
  - Time deposits and short-term certificates of deposit generally are not included in legally restricted deposits (refer to section 3.4.1, *Compensating balance arrangements*, for further discussion, including when separate presentation on the balance sheet is required)
- Contracts entered into with others
- Company statements of intention with regard to particular deposits

While not identified as an example in Rule 5-02, cash held in bank accounts in countries operating under exchange controls or other legal restrictions that prevent its general use also may be considered restricted. That determination should be made based on the individual facts and circumstances.

Although US GAAP does not require separate presentation on the balance sheet for restricted cash and cash equivalents, based on the requirement of Regulation S-X, Rule 5-02, it is common for SEC registrants to separately present restricted cash and restricted cash equivalents from cash and cash equivalents on their balance sheet.

In addition to the Regulation S-X, Rule 5-02 requirement for SEC registrants, certain industries follow specific presentation or disclosure guidance relating to restricted cash and restricted cash equivalents, including the following:

- Health care — refer to ASC 954-210-45-5
- Not for profit entities — refer to ASC 958-210-50-1 to 50-3
- Insurance — refer to SEC Regulation S-X, Rule 7-03

Refer to section 3.5, *Balance sheet classification*, for discussion on classifying restricted cash and restricted cash equivalents in a classified balance sheet.

3.4.1 Compensating balance arrangements

The SEC defines a compensating balance as "that portion of any demand deposit (or any time deposit or certificate of deposit) maintained by a corporation (or by any other person on behalf of the corporation) which constitutes support for existing borrowing arrangements of the corporation (or any other person) with a lending institution. Such arrangements would include both outstanding borrowings and the assurance of future credit availability."[16] A compensating balance arrangement may be established as part of a loan or line of credit agreement, as a separate supplement to a loan or credit agreement, or as part of an oral agreement not formally documented.

The requirements for SEC registrants for disclosing compensating balance arrangements are detailed in Regulation S-X, Rule 5-02, *Balance sheets*, and guidelines and interpretations for disclosure of such arrangements are detailed in FRR Section 203, *Disclosure of Compensating Balances and Short-Term Borrowing Arrangements*. Additionally, Staff Accounting Bulletin (SAB) Topic 6.H, *Accounting Series Release (ARS) 148 — Disclosure of Compensating Balances And Short-Term Borrowing Arrangements*, provides additional SEC staff views in the form of frequently asked questions about disclosures for compensating balances.

Rule 5-02.1 of Regulation S-X requires disclosure of compensating balances, to avoid undisclosed commingling of such balances with other funds having different liquidity characteristics and bearing no determinable relationship to borrowing arrangements. Compensating balance arrangements that legally restrict the withdrawal or use of funds should be separately presented on the balance sheet, if material, as described in FRR Section 203.02.b and the provisions of such restrictions should be described in the notes to the financial statements.

Rule 5-02.1 also requires footnote disclosure distinguishing the amounts of such balances maintained under a formal agreement to assure future credit availability and the terms of such agreement.

In evaluating the materiality of a compensating balance arrangement to determine whether it should be disclosed or segregated on the balance sheet, FRR Section 203.02.b says that a number of factors should be considered, including:

- Impact of compensating balance on the effective cost of financing
- Ratio of compensating balance to total cash
- Ratio of compensating balance to total liquid assets
- Ratio of compensating balance to net working capital

In general, the SEC suggests in FRR Section 203.02.b that compensating balances that aggregate to an amount greater than 15% of liquid assets (i.e., current restricted and unrestricted cash balances plus marketable securities) would be material, but balances less than 15% may also be material depending on their nature. For example, lesser amounts may be material if they have a significant impact on the cost of financing. Compensating balances maintained by the company for the benefit of affiliates, officers, directors, principal stockholders or other similar parties also may be of particular significance to investors. Separate disclosure of such balances may be required under other SEC rules and regulations even if they are not of a magnitude such that they would meet the materiality guidelines set forth in FRR Section 203.02.b.

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[16] Section 203.02.a of SEC FRR 203, *Disclosure of Compensating Balances and Short-Term Borrowing Arrangements*.

Requirements for disclosure of compensating balance arrangements, including materiality assessment, are detailed in FRR Section 203.02.b. The following is an excerpt from that section.

Excerpt from FRR Section 203.02.b

The manner of disclosure cannot be specified with precision since it will vary according to the factual situation involved. These rules call for disclosure of compensating balance arrangements. Such disclosure will involve segregation on the face of the balance sheet whenever such balances are maintained under an agreement which legally restricts the use of such funds. Examples of such arrangements would include situations where a certificate of deposit must be held while a loan is outstanding or where a minimum balance must be maintained at all times while credit is extended or available. Footnote disclosure will be appropriate in other circumstances where such balances are determinable amounts although not legally restricted as to withdrawal. Footnote disclosure would be required even though the arrangement is not reduced to writing if determinable amounts (e.g., a percentage of short-term borrowings, a percentage of unused lines of credit, an agreed average balance) have been agreed upon by both parties involved. An arrangement where the balance required is expressed as an average over time would ordinarily lead to additional footnote disclosure of the average amount required to be maintained for arrangements in existence at the reporting date since the amount held at the close of the reporting period might vary significantly from the average balance held during the period and bear little relationship to the amount required to be maintained over time. If arrangements requiring maintenance of compensating balances during the year were materially greater than those at year end, that fact should be disclosed. Disclosure may also include a statement, if appropriate, that the amounts are legally subject to withdrawal with or without sanctions, as applicable. If many banks are involved, the disclosure should summarize the most common arrangements and aggregate the compensating balances involved.

Restrictions on the use of funds may include contracts entered into with others or company statements of intention with regard to particular deposits. Examples of the former might be letters of credit and escrow accounts. Examples of the latter are cash balances set aside for use in a capital expenditure program or to meet a particular debt obligation when it comes due. Cash balances related to statements of intention should only be segregated when particular deposits or balances have been earmarked for such special purposes. Board approval of a capital budget calling for the expenditure of certain amounts would not be the basis for segregation unless the specific amounts of cash to be spent are identified and set aside.

Where a company is not in compliance with a compensating balance requirement, that fact generally should be disclosed along with stated or possible sanctions whenever such possible sanctions may be immediate (not vague or unpredictable) and material.

In determining whether compensating balance arrangements are sufficiently material to require segregation or disclosure, various factors should be considered. Among these may be the relationship of the amount of the balances to total cash, total liquid assets, net working capital, and the impact of the balances on the effective cost of financing. In the usual case, reportable compensating balances which in the aggregate amount to more than 15 percent of liquid assets (current cash balances, restricted and unrestricted, plus marketable securities) would be considered to be material. Lesser amounts may be material if they have a significant impact on the cost of financing. Compensating balances maintained by the company for the benefit of affiliates, officers, directors, principal stockholders or other similar parties may be of particular significance to investors. Separate disclosure of such balances may be required under other Commission rules and regulations even if they are not of a magnitude such that they would meet the materiality guidelines set forth above.

In addition to the disclosure requirements described above, FRR Sections 203.03 and 203.04 provide disclosure requirements for funds maintained for future credit availability and unused lines of credit or commitments, which are summarized below:

- **Funds maintained for future credit availability** — Regulation S-X, Rule 5-02.1 requires disclosure of funds maintained under an agreement for the purpose of assuring future credit availability. FRR Section 203.03 states that these funds would be included as part of compensating balances disclosed separately on the balance sheet or in the footnotes in accordance with Rule 5-02.1. This requirement contemplates separate disclosure of such amounts and the related terms for both long- and short-term future credit availability in the notes to the financial statements.
- **Unused lines of credit or commitments** — Rules 5-02.19(b) and 5-02.22(b) of Regulation S-X also require the disclosure of the amount and terms of unused lines of credit for short-term financing arrangements and commitments for long-term financing arrangements, if significant (e.g., standby commitments, commitments for future disbursements and unused revolving credits maturing after one year). FRR Section 203.04 notes various factors that should be considered in determining significance, such as total debt by term of such debt, total capital, total cash requirements and the like. The rules also provide that disclosure be made of the conditions under which lines of credit or commitments for long-term financing arrangements may be withdrawn.
- FRR Section 203.04 also notes that unused lines of credit disclosed as supporting commercial paper or other debt arrangements should include only usable lines. For this purpose, usable lines are construed to be total lines used to support commercial paper less lines needed to meet "cleanup" provisions of a borrowing arrangement. Such provisions require borrowers to retire credit extended at a bank or banks at some specified interval for a specified period. Total lines outstanding are therefore not necessarily a measure of the total credit available on a continuing basis. Similarly, if a corporation has lines arranged with several banks that in total exceed borrowing levels permitted under existing lending agreements, disclosure should be limited to usable amounts.
- SAB Topic 6.H notes that compensating balance arrangements disclosed in the notes should be for the latest fiscal year but generally not for any later interim period unless a material change has occurred since year-end. However, FRR Section 203.02.c.iv notes that if the terms of the arrangements require balance sheet segregation, that should be reflected in all balance sheets presented. FRR 203.02.c.iv also notes that if the change in the arrangements from one period to the next is so great as to constitute a fact of unusual significance to the investor in appraising the company, the change should be disclosed.

3.4.1.1 Compensating balance — measurement

In many instances, the measurement of a compensating balance arrangement is based on an average outstanding loan balance. While the SEC recognizes in FRR Section 203.02.c that precise measurement of compensating balances may not be practicable in certain circumstances, reasonable estimates should be made. As every situation cannot be anticipated, the need for judgment cannot be avoided. To promote consistency among reporting entities, specific guidance is offered by the SEC in the following areas:

- **Minimum operating balances** — FRR Section 203.02.c.i notes that a company's minimum operating cash balance is not to be subtracted in calculating a total compensating balance despite the argument that minimum operating cash balances have no incremental cost to the company (borrower). However, a company may disclose the dual purpose of such amounts.
- **Float** — The compensating balance arrangements negotiated between a company and its bank are normally expressed in terms of the collected bank ledger balance, but the financial statements are presented on the basis of the company's books. FRR Section 203.02.c.ii describes certain factors that complicate the calculation of the compensating balance to be disclosed, such as the delays in presentment of checks and deposits in transit (i.e., "float"), which may cause the balance shown in the

bank's ledger to differ from the balance in the company's books, and the bank ledger's inclusion of funds subject to collection, which may not be considered as meeting compensating balance requirements. In order to make the disclosure of compensating balance amounts segregated on the balance sheet consistent with the cash amounts reflected in the financial statements, the balance figure agreed upon by the bank and the company should be adjusted, if possible, by the estimated float so that such an adjusted amount shown on the balance sheet will properly relate to company book amounts for total cash. Both the agreed-upon collected balance at the bank and the adjusted balance relating to the corporation's books should be disclosed along with a brief description of the criteria used to make the adjustment. Similar adjustments and disclosure should be made for arrangements disclosed only in the footnotes if practicable and relevant to the arrangements described. A reasonable estimate of float based on the information management uses to manage its bank relationships will be satisfactory. The excerpt of SAB Topic 6.H reproduced below includes an example of how to determine the amount of compensating balance to be disclosed taking into consideration float, including uncollected funds.

- **Compensation for other bank services** — FRR Section 203.02.c.iii notes that balances maintained solely to compensate a bank for its account handling function and other bank services, but not in connection with financing arrangements, are not included in calculating compensating balances. However, if a bank allows such balances to serve both as compensating balances in connection with a financing arrangement and as compensation for other bank services, the balances are considered as compensating balances in connection with a financing arrangement and a company may disclose the dual purpose of such amounts.

3.4.1.2 Compensating balances — SEC staff's views

Excerpts of the SEC staff's views on compensating balances documented in SAB Topic 6.H are included below:

Excerpts from SAB Topic 6.H

H. Accounting Series Release 148 — Disclosure Of Compensating Balances And Short-Term Borrowing Arrangements (Adopted November 13, 1973 As Modified By ASR 172 Adopted On June 13, 1975 And ASR 280 Adopted On September 2, 1980)

Facts: ASR 148 (as modified) amends Regulation S-X to include:

1. Disclosure of compensating balance arrangements.
2. Segregation of cash for compensating balance arrangements that are legal restrictions on the availability of cash.

1. Applicability

a. Arrangements with other lending institutions

Question: In addition to banks, is ASR 148 applicable to arrangements with factors, commercial finance companies or other lending entities?

Interpretive Response: Yes.

b. Bank holding companies and brokerage firms

Question: Do the provisions of ASR 148 apply to bank holding companies and to brokerage firms filing under Rule 17a-5?

Interpretive Response: Yes; however, brokerage firms are not expected to meet these requirements when filing Form X-17a-5.

c. Financial statements of parent company and unconsolidated subsidiaries

Question: Are the provisions of ASR 148 applicable to parent company financial statements in addition to consolidated financial statements? To financial statements of unconsolidated subsidiaries?

Interpretive Response: ASR 148 data for consolidated financial statements only will generally be sufficient when a filing includes consolidated and parent company financial statements. Such data are required for each unconsolidated subsidiary or other entity when a filing is required to include complete financial statements of those entities. When the filing includes summarized financial data in a footnote about such entities, the disclosures under ASR 148 relating to the consolidated financial statements will be sufficient.

d. Foreign lenders

Question: Are ASR 148 disclosure requirements applicable to arrangements with foreign lenders?

Interpretive Response: Yes.

2. Classification of short-term obligations — Debt related to long-term projects

[**EY Note:** Omitted as section does not relate to compensating balances]

3. Compensating balances

a. Compensating balances for future credit availability

Facts: Rule 5-02.1 of Regulation S-X requires disclosure of compensating balances in order to avoid undisclosed commingling of such balances with other funds having different liquidity characteristics and bearing no determinable relationship to borrowing arrangements. It also requires footnote disclosure distinguishing the amounts of such balances maintained under a formal agreement to assure future credit availability.

Question: In disclosing compensating balances maintained to assure future credit availability, is it necessary to segregate compensating balances for an unused portion of a regular line of credit when a total compensating balance amount covering both used and unused amounts of a line of credit is disclosed?

Interpretive Response: No.

b. Changes in compensating balances

Facts: ASR 148 guidelines indicate the need for additional disclosures where compensating balances were materially greater during the period than at the end of the period.

Question: Does this disclosure relate to changes in the arrangement (e.g., the required compensating balance percentage) or changes in borrowing levels?

Interpretive Response: Both.

c. Float

Facts: ASR 148 states that "compensating balance arrangements … are normally expressed in terms of collected bank ledger balances but the financial statements are presented on the basis of the company's books. In order to make the disclosure of compensating balance amounts … consistent with the cash amounts reflected in the financial statements, the balance figure agreed upon by the bank and the company should be adjusted if possible by the estimated float."

Question: In determining the amount of "float" as suggested by ASR 148 guidelines, frequently an adjustment to the bank balance is required for "uncollected funds." On what basis should this adjustment be estimated?

Interpretive Response: The adjustment should be estimated based upon the method used by the bank or a reasonable approximation of that method. The following is a sample computation of the amount of compensating balances to be disclosed where uncollected funds are involved.

Assumptions: The company has agreed to maintain compensating balances equal to 20% of short-term borrowings.

Short-term borrowings	$ 10,000,000
Compensating balances per bank balances	2,000,000
Estimated float (approximates the excess of outstanding checks over deposits in transit)	480,000
Estimated uncollected funds	320,000
Computation:	
Compensating balances per bank balances	2,000,000
Estimated uncollected funds	320,000
Estimated float	(480,000)
Compensating balances stated in terms of a book cash balance and to be disclosed	$ 1,840,000

4. Miscellaneous

a. Periods required

Question: For what periods are ASR 148 disclosures required?

Interpretive Response: Disclosure of compensating balance arrangements and other disclosures called for in ASR 148 are required for the latest fiscal year but are generally not required for any later interim period unless a material change has occurred since year end.

b. 10-Q Disclosures

Question: Are ASR 148 disclosures required in 10-Q's?

Interpretive Response: In general, ASR 148 disclosures are not required in Form 10-Q. However, in some instances material changes in borrowing arrangements or borrowing levels may give rise to the need for disclosure either in Form 10-Q or Form 8-K.

3.5 Balance sheet classification

Excerpt from Accounting Standards Codification

Balance Sheet — Overall

Other Presentation Matters

210-10-45-1

Current assets generally include all of the following:

a. Cash available for current operations and items that are **cash equivalents** […]

210-10-45-3

A one-year time period shall be used as a basis for the segregation of current assets in cases where there are several operating cycles occurring within a year. However, if the period of the operating cycle is more than 12 months, as in, for instance, the tobacco, distillery, and lumber businesses, the longer period shall be used. If a particular entity has no clearly defined operating cycle, the one-year rule shall govern.

210-10-45-4

The concept of the nature of current assets contemplates the exclusion from that classification of such resources as the following:

a. Cash and claims to cash that are restricted as to withdrawal or use for other than current operations, are designated for expenditure in the acquisition or construction of noncurrent assets, or are segregated for the liquidation of long-term debts. Even though not actually set aside in special accounts, funds that are clearly to be used in the near future for the liquidation of long-term debts, payments to sinking funds, or for similar purposes shall also, under this concept, be excluded from current assets. However, if such funds are considered to offset maturing debt that has properly been set up as a current liability, they may be included within the current asset classification. [...]

Master Glossary

Operating Cycle

The average time intervening between the acquisition of materials or services and the final cash realization constitutes an operating cycle.

In a classified balance sheet, cash and cash equivalents are typically presented as current assets in accordance with ASC 210-10-45-1. However, ASC 210-10-45-4(a) indicates that cash and claims to cash are *excluded* from the current asset classification when they are:

- Restricted as to withdrawal or use for other than current operations
- Designated for expenditure in the acquisition or construction of noncurrent assets
- Segregated for the liquidation of long-term debts
- Funds that are clearly to be used in the near future for the liquidation of long-term debts, payments to sinking funds or similar purposes; if such funds are considered to offset maturing debt that has properly been set up as a current liability, they may be included within the current asset classification.

Restricted cash and restricted cash equivalents are presented either as current assets or noncurrent assets on the balance sheet, depending on the date of availability or disbursement. Consistent with ASC 210-10-45-3, classification in the current section is appropriate if the cash is to be used within a year or the operating cycle, whichever is longer, for payment of existing or maturing obligations. On the other hand, consistent with ASC 210-10-45-4(a), if the cash is to be held for a longer period of time, the restricted cash is shown in the noncurrent section of the balance sheet. For example, cash set aside for plant expansion, retirement of long-term debt or the purchase of long-term investments is frequently classified in the noncurrent section.

3.6 Other considerations

3.6.1 Funds held on behalf of others

Entities in certain industries (e.g., payroll, payment processing and insurance service providers) may hold cash and cash equivalents on behalf of their customers or other parties. There may be certain contractual and/or regulatory restrictions related to how the entity may use such cash (refer to section 3.4, *Restricted cash and restricted cash equivalents*, for further discussion). An entity that holds cash and cash equivalents on behalf of others should carefully evaluate whether it controls the cash and cash equivalents, and if so, recognize those amounts on its balance sheet. Refer to section 3.1, *Overview*, for further discussion of evaluating control and section 5.10.6, *Funds held on behalf of others – classification*, for further discussion on the presentation of cash and cash equivalents held on behalf of others in the statement of cash flows.

3.6.2 Crypto assets

The AICPA's Practice Aid, *Accounting for and auditing of digital assets*, which is intended to provide non-authoritative guidance on how to account for digital assets, provides interpretative guidance that crypto assets (e.g., bitcoin, ether, litecoin) generally do not meet the definition of cash or cash equivalents as they are not considered legal tender[17] and are not backed by sovereign governments. In addition, crypto assets typically do not have a maturity date and have traditionally experienced significant price volatility. See section 5.11, *Crypto assets*, for further discussion of the related statement of cash flows classification.

[17] Legal tender is specific to a jurisdiction. For example, the U.S. Code states, "United States coins and currency (including Federal reserve notes and circulating notes of Federal reserve banks and national banks) are legal tender for all debts, public charges, taxes, and dues." This statute means that all forms of money identified within are a valid and legal offer of payment for debts when tendered to a creditor.

4 Classification of cash flows

4.1 Overview

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-10

A statement of cash flows shall classify cash receipts and cash payments as resulting from investing, financing, or operating activities.

Classifying cash flows as operating, investing and financing enables users to identify and evaluate significant relationships among and within the three kinds of activities. These classifications are also intended to present links among cash flows perceived to be related, such as proceeds from borrowing transactions and cash repayments of borrowings and allow users to understand cash flow effects for major activities of the company and to identify trends.

Frequently, cash flow classification requires significant judgment. Reasonable conclusions about classifying cash flows might differ depending on how one assesses the substance of a particular transaction. Judgments are also often complicated by the fact that some transactions generate cash flows with multiple cash flow statement classification requirements. For these reasons, the following sections include excerpts from ASC 230 on the cash flow classification guidance for each category — operating, investing and financing. Refer to section 5 for discussion of many common cash flow classification issues.

4.2 Investing activities

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Glossary

230-10-20

Investing Activities

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

Sections 5.2.1, *Loans and trade receivables*, and 5.4.1, *Acquisitions and sales of certain securities*, describe the cash flow reporting for the acquisition and disposal of certain loans or other debt or equity instruments that are acquired specifically for resale.

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-11

Cash flows from purchases, sales, and maturities of available-for-sale debt securities shall be classified as cash flows from **investing activities** and reported gross in the statement of cash flows.

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) and collections on a transferor's beneficial interests in a securitization of the transferor's trade receivables

b. Receipts from sales of equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-18 and certain donated equity instruments received by NFPs as discussed in paragraph 230-10-45-21A) and from returns of investment in those instruments

c. Receipts from sales of property, plant, and equipment and other productive assets

d. Subparagraph not used.

e. Receipts from sales of loans that were not specifically acquired for resale. That is, if loans were acquired as investments, cash receipts from sales of those loans shall be classified as investing cash inflows regardless of a change in the purpose for holding those loans.

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

230-10-45-13

All of the following are cash outflows for investing activities:

a. Disbursements for loans made by the entity and payments to acquire debt instruments of other entities (other than cash equivalents and certain debt instruments that are acquired specifically for resale as discussed in paragraph 230-10-45-21).

b. Payments to acquire equity instruments of other entities (other than certain equity instruments carried in a trading account as described in paragraph 230-10-45-18).

c. Payments at the time of purchase or soon before or after purchase to acquire property, plant, and equipment and other productive assets, including interest capitalized as part of the cost of those assets. Generally, only advance payments, the down payment, or other amounts paid at the time of purchase or soon before or after purchase of property, plant, and equipment and other productive assets are investing cash outflows. However, incurring directly related debt to the seller is a financing transaction (see paragraphs 230-10-45-14 through 45-15), and subsequent payments of principal on that debt thus are financing cash outflows.

d. Payments made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability.

4.3 Financing activities

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Glossary

230-10-20

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.

Other Presentation Matters

230-10-45-14

All of the following are cash inflows from financing activities:

a. Proceeds from issuing equity instruments

b. Proceeds from issuing bonds, mortgages, notes, and from other short- or long-term borrowing

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

d. Proceeds received from derivative instruments that include financing elements at inception, whether the proceeds were received at inception or over the term of the derivative instrument, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments

e. Subparagraph superseded by Accounting Standards Update No. 2016-09.

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. Cash paid to a tax authority by a grantor when withholding shares from a grantee's award for tax-withholding purposes shall be considered an outlay to reacquire the entity's equity instruments.

b. Repayments of amounts borrowed, including the portion of the repayments made to settle zero-coupon debt instruments that is attributable to the principal or the portion of the repayments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to the principal.

c. Other principal payments to creditors who have extended long-term credit. See paragraph 230-10-45-13(c), which indicates that most principal payments on seller-financed debt directly related to a purchase of property, plant, and equipment or other productive assets are financing cash outflows.

d. Distributions to counterparties of derivative instruments that include financing elements at inception, other than a financing element inherently included in an at-the-market derivative instrument with no prepayments. The distributions may be either at inception or over the term of the derivative instrument.

e. Payments for debt issue costs.

f. Payments, or the portion of the payments, not made soon after the acquisition date of a business combination by an acquirer to settle a contingent consideration liability up to the amount of the contingent consideration liability recognized at the acquisition date, including measurement-period adjustments, less any amounts paid soon after the acquisition date to settle the contingent consideration liability. See also paragraph 230-10-45-17(ee).

g. Payments for debt prepayment or debt extinguishment costs, including third-party costs, premiums paid, and other fees paid to lenders that are directly related to the debt prepayment or debt extinguishment, excluding accrued interest.

4.4 Operating activities (updated July 2024)

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Glossary

230-10-20

Operating Activities

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

Other Presentation Matters

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 and refunds from suppliers.

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.

d. Cash payments to lenders and other creditors for interest, including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount or the portion of the payments made to settle other debt instruments with coupon interest rates that are insignificant in relation to the **effective interest rate** of the borrowing that is attributable to accreted interest related to the debt discount. For all other debt instruments, an issuer shall not bifurcate cash payments to lenders and other creditors at settlement for amounts attributable to accreted interest related to the debt discount, nor classify such amounts as cash outflows for operating activities.

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

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

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

Operating cash flows include all transactions and other events that are not defined as investing or financing activities. That general rule may, in certain circumstances, be overcome. For example, all cash received from the sale of property, plant and equipment is usually classified as an investing activity. However, real estate companies that acquire real estate for resale in the normal course of business might classify the cash flows of the real estate sales as operating cash flows.

ASC 410 and ASC 230 state that cash payments made to settle an asset retirement obligation should be classified as operating activities on the statement of cash flows. However, they do not address how increases in long-lived assets resulting from capitalizing asset retirement costs should be presented in the statement of cash flows. Increases in long-lived assets resulting from capitalizing asset retirement costs do not result in the receipt or payment of cash. Accordingly, the increase in long-lived assets should not be reflected in the statement of cash flows as cash outflows for investing activities (e.g., as capital expenditures). However, we believe the change should be disclosed as noncash activities in accordance with ASC 230.

4.5 More than one class of cash flows

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

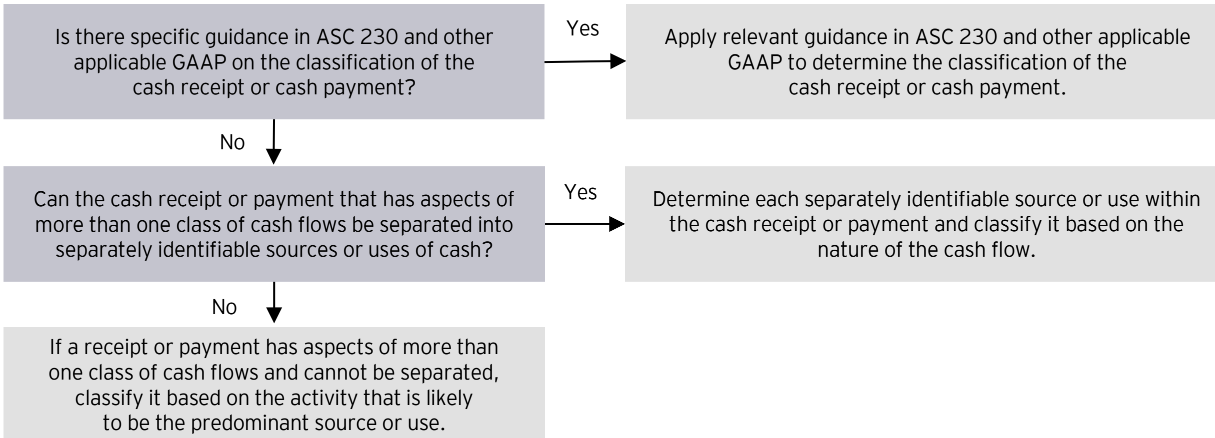
230-10-45-22

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

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 (for example, when a piece of equipment is acquired or produced by an entity to be rented to others for a period of time and then sold), the appropriate classification shall depend on the activity that is likely to be the predominant source or use of cash flows for the item.

ASC 230 describes how to determine the cash flow classification when cash receipts and cash payments have aspects of more than one class of cash flows. The following flowchart depicts that guidance.



If an entity determines that cash receipts and cash payments have aspects of more than one class of cash flows, it will first need to apply specific guidance in ASC 230 and other applicable topics. The following example illustrates how an entity applies the guidance in ASC 230 to a cash payment that has aspects of more than one class of cash flows.

Illustration 4-1: Cash payment with aspects of more than one class of cash flows — applying relevant guidance in ASC 230

Facts:

Entity A pays $100,000 to a vendor and allocates the consideration between the purchase of (1) property, plant and equipment that it uses to manufacture goods that it sells to its customer ($75,000) and (2) materials used in the production of those goods ($25,000).

Analysis:

Entity A applies ASC 230-10-45-22 and concludes that there is applicable guidance in ASC 230 that addresses the proper classification of cash outflows.

Entity A determines that the $75,000 purchase of property, plant and equipment should be classified as an investing cash outflow. That is because ASC 230-10-45-13(c) requires an entity to classify payments at the time of purchase (or soon before or after purchase) to acquire property, plant and equipment as cash outflows for investing activities.

Entity A determines that the $25,000 purchase of production materials should be classified as an operating cash outflow. That is because ASC 230-10-45-17(a) requires an entity to classify cash payments to acquire materials used to manufacture goods as cash outflows for operating activities.

If there is no guidance that addresses those cash receipts and cash payments, the entity will determine each separately identifiable source or use and classify the receipt or payment based on the nature of the cash flow. If a receipt or payment has aspects of more than one class of cash flows and cannot be separated, classification will depend on the predominant source or use. The following example illustrates how an entity determines the predominant source or use when a cash payment has aspects of more than one class of cash flows and cannot be separated.

Illustration 4-2:	Determining the predominant source or use when a receipt or payment has aspects of more than one class of cash flows and cannot be separated

Facts:

Entity A pays $100,000 to a vendor for the purchase of equipment that it uses to provide a service to its customers. The arrangements with the customers do not include a lease of the purchased equipment. Occasionally, Entity A also sells the property, plant and equipment directly to its customers (i.e., the entity sells the same equipment that it uses in its operations).

Analysis:

Entity A applies ASC 230-10-45-22A and concludes that the payment has aspects of more than one class of cash flows and cannot be separated. ASC 230 requires an entity to classify cash payments to acquire the equipment as cash outflows for investing activities and classify cash payments to acquire goods for resale as cash outflows for operating activities.

Entity A classifies the $100,000 purchase of equipment as an investing cash outflow based on the predominant source of cash flows, which is the use of the equipment to provide a service to its customers.

Because the purchase of the equipment is classified as an investing cash outflow, proceeds from the sale of the equipment will also be classified as investing cash inflows.

Judgment may be required to determine the predominant source or use of cash receipts or payments. Entities should consider the following SEC staff remarks when the most appropriate cash flow classification is not clear. Although these remarks were given before the most recent amendments to ASC 230-10-45-22 through 45-22A, we believe they continue to be informative.

In remarks at the 2006 AICPA National Conference on Current SEC and PCAOB Developments, the SEC staff cautioned that if the most appropriate classification is not clear, this does not mean that any classification is appropriate. Rather, registrants must analyze the nature of the activity and the predominant source of the related cash flows. The SEC staff also noted that registrants should provide quantified disclosure sufficient to inform investors of the statement of cash flows classification selected and the alternative classifications considered and rejected. The SEC staff often comments when classification of cash flow activities is not clear, correct or consistent. For example, an entity recorded the purchase of an asset as an investing cash flow, the rental proceeds of the asset as an operating cash flow and the sale of the asset as an operating cash flow. Such presentation of the purchase and sale cash flows is inconsistent. If the asset is an operating asset, all cash flows should have been recorded in the operating section of the statement of cash flows. On the other hand, if the asset is a capital investment, both the sale and purchase of the asset should have been recorded in the investing section of the statement of cash flows.

4.6 Noncash investing and financing activity

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Disclosure

230-10-50-3

Information about all **investing** and **financing activities** of an entity during a period that affect recognized assets or liabilities but that do not result in **cash** receipts or cash payments in the period shall be disclosed. Those disclosures may be either narrative or summarized in a schedule, and they shall clearly relate the cash and noncash aspects of transactions involving similar items.

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 a **right-of-use asset** in exchange for a **lease liability**; obtaining a beneficial interest as consideration for transferring financial assets (excluding cash), including the transferor's trade receivables, in a securitization transaction; obtaining a building or investment asset by receiving a gift; and exchanging noncash assets or liabilities for other noncash assets or liabilities.

230-10-50-5

Some transactions are part cash and part noncash; only the cash portion shall be reported in the statement of cash flows.

230-10-50-6

If there are only a few such noncash transactions, it may be convenient to include them on the same page as the statement of cash flows. Otherwise, the transactions may be reported elsewhere in the financial statements, clearly referenced to the statement of cash flows.

Noncash investing and financing transactions (e.g., converting debt to equity) are not included in the statement of cash flows but must be presented in separate disclosures. The FASB requires disclosure of these transactions because even though noncash transactions result in no cash inflows or outflows in the period in which they occur, they generally have a significant effect on prospective cash flows. Some transactions are part cash and part noncash. In those cases, only the cash portion is reported in the statement of cash flows (refer to section 5.3.3, *Consideration of accrued capital expenditures*, for further discussion of accrued capital expenditures).

Seller financing and lease transactions, which are discussed in section 5.3.2, *Leases*, are examples of activities that are disclosed as noncash transactions.

4.6.1 Renewals of loans and deposits

Banks may roll over commercial loans and certificates of deposit at maturity. We do not believe such rollovers should be reported in the statement of cash flows because there is no cash receipt or payment by the bank (other than the cash receipt or payment, if any, related to interest). Further, these rollovers do not generally affect recognized assets or liabilities, and therefore there is no change in financial position to be disclosed as a noncash investing or financing activity.

4.6.2 Constructive receipts and disbursements

An entity may enter into arrangements where cash is received or disbursed by another party on behalf of the entity. Even though an entity may not directly exchange cash, the same economic results may be achieved and therefore in substance represent constructive receipts and disbursements. We believe judgment will be needed to determine the appropriate presentation and/or disclosure of such arrangements.

Refer to sections 5.2.4, *Inventory purchases from a supplier financed by a subsidiary of the supplier (*i.e., *'floor plan' financing transactions)*, and 5.3.1, *Seller-financed purchases*, for examples of where constructive cash receipts or disbursements may occur.

4.7 Change in classification

The statement of cash flows guidance in ASC 230 is principles based. As such, there may be more than one acceptable presentation for certain cash flow classifications on the statement of cash flows. However, we believe cash flow presentation should be consistently applied to similar transactions. Nonetheless, if GAAP does not provide specific alternatives, we believe a change in classification from one acceptable classification to another is a reclassification and not a voluntary change in accounting principle.

When an entity changes the classification of a cash flow item on the statement of cash flows, prior periods presented (if applicable) should be adjusted to reflect the new classification in accordance with ASC 205-10-45-3, and the change in presentation should be clearly disclosed in accordance with ASC 205-10-50-1.

5 Common issues related to classification

5.1 Overview

This section discusses several common issues with respect to classification of cash flows as operating, investing or financing cash flows.

5.2 Working capital accounts

5.2.1 Loans and trade receivables

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-21

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

The appropriate classification in the statement of cash flows of a commercial entity for cash flows related to loans and trade receivables requires a determination of the source of the loans or receivables. If the loans or receivables result from the sale of an entity's goods or services to its customers, the resulting cash receipts are always operating cash inflows, whether by collection from the customer or sale of the notes or receivables (ASC 230-10-45-16). This also applies to long-term customer receivables consistent with the SEC staff's view as discussed at the 2004 AICPA National Conference on Current SEC and PCAOB Developments.

However, when the entity originates or purchases loans or trade receivables that do not result directly from the sale of goods or services to its customers, classification is based on management's intent to either hold the loans or trade receivables for sale or for investment. Cash receipts and cash payments resulting from acquisitions and sales of loans should be classified as operating cash flows if those loans are acquired specifically for resale and are carried at fair value or at the lower of amortized cost basis or fair value (ASC 230-10-45-21). Cash receipts and cash payments from sales of loans acquired as investments (as compared with being acquired for resale) should be classified as investing cash inflows regardless of a change in the purpose for holding these loans (ASC 230-10-45-12). Thus, if at origination (assuming that origination did not result from the sale of goods or services to customers) or purchase management initially classifies loans or trade receivables as held for investment, the related cash receipts and payments should be classified as investing cash flows, even if management subsequently decides to sell the loans or trade receivables or subsequently classifies the receivables as held for sale.[18]

5.2.1.1 Loan fees and costs

ASC 310-20, *Receivables — Nonrefundable Fees and Other Costs*, requires certain fees and costs associated

[18] Remarks by Todd E. Hardiman, ***Statement of Cash Flow Classification of Long-Term Customer Receivables*** (December 2004).

with lending activities to be deferred and amortized to income over future periods. These fees and costs are integral to lending activities and should be accounted for as components of a loan's origination cost.

For statement of cash flows presentation, we believe the net deferred fees and costs should be presented in the same category as the cash flows of the related loan. That is, fees and costs associated with a loan held for investment[19] are reflected in investing activities and fees and costs associated with loans held for sale are reflected in operating activities. The subsequent amortization of the net deferred fees and costs should be presented as a noncash income or expense item in the reconciliation of net income and net cash flow from operating activities.

5.2.2 Securitized loan or trade receivables

The following sections address cash flow presentation questions that arise in transactions involving the securitization of loans or trade receivables (e.g., factoring of loans or trade receivables).

5.2.2.1 Securitized loans or trade receivables — presentation

ASC 230-10-50-4 requires that beneficial interests obtained in financial assets transferred to an unconsolidated securitization entity be disclosed as a noncash investing activity. A company should not gross up the cash flow statement by recognizing both a cash inflow for the portion of loans or trade receivables transferred for which it received a beneficial interest, rather than cash, and a cash outflow for the purchase of the beneficial interest. For example, if an entity sells receivables with a carrying amount of $100 and receives cash of $80 and a beneficial interest of $20, it should reflect a cash inflow of $80 and disclose a noncash investing activity of $20, as opposed to a cash inflow of $100 and a cash outflow of $20 to purchase the beneficial interest.

5.2.2.2 Initial cash receipts in securitizations accounted for as sales

As noted in section 5.2.1, *Loans and trade receivables*, cash receipts from the sale of accounts receivable, including securitization transactions accounted for as sales in accordance with ASC 860, *Transfers and Servicing*, are classified as cash flows from operating activities.

5.2.2.3 Accounting and cash flow presentation considerations for beneficial interests

ASC 230-10-45-12(a) requires that cash collections on a transferor's beneficial interests in a securitization of the transferor's trade receivables be classified as cash inflows from investing activities.

5.2.3 Inventory financing by a captive finance subsidiary of the seller

At the 2004 AICPA National Conference on Current SEC and PCAOB Developments, the SEC staff discussed its view related to cash flow reporting by sellers that provide customers with product purchase financing. When financing the sale of product inventory through a captive finance subsidiary, the SEC staff believes that the seller's cash flow statement should not reflect the payment of the sales consideration by the customer through financing obtained from the captive finance subsidiary as both an operating cash inflow and an investing cash outflow, respectively, when there has not been a cash inflow to the entity on a consolidated basis. On a consolidated basis, the payment from the finance subsidiary to the parent supplier is eliminated. As a result, no activity should be presented in the consolidated statement of cash flows. Entities may have considered the gross presentation because they viewed the manufacturing and finance operations as separate and distinct businesses and believed that the gross presentation was a better depiction of the cash flows of those operations. However, the SEC staff believes that, on a consolidated basis, there has been no cash received or expended by the entity and, as such, gross activity should not be presented in the statement of cash flows.

Note that this view relates only to the financing of sales with an entity's direct customer and not for sales

[19] Loans and trade receivables that management has intent and ability to hold for the foreseeable future or until maturity or payoff.

by an entity's customers to end consumers, where such end consumers elect to finance their purchases with the entity's captive finance subsidiary. In those cases, the origination and subsequent collection of financing provided to such end consumers would be properly reflected by the entity as investing activities.

Refer to section 5.2.1, *Loans and trade receivables*, for discussion of classification of loans and trade receivables from customers.

5.2.4 Inventory purchases from a supplier financed by a subsidiary of the supplier (i.e., 'floor plan' financing transactions)

Classification in the statement of cash flows by a dealer for its inventory purchases from a supplier that are financed by a subsidiary of the supplier (often referred to as "floor plan" financing transactions) differs from purchases from a supplier financed by non-supplier-affiliated financing sources.

In a financing transaction between a dealer and a subsidiary of the supplier for the purchase of inventory from the supplier, the finance subsidiary typically pays the supplier (its parent) directly, with no actual cash outflow to the dealer (the purchaser of the inventory and borrower). The finance subsidiary then holds a lien on the inventory and will be repaid at a future date by the dealer, typically when the underlying inventory is sold. In this fact pattern, the dealer should present the purchase from the supplier as an increase to inventory and an increase to trade loans within operating activities in the statement of cash flows when presenting operating activities using the indirect method (under the direct method, there is no cash flow to report). The dealer would report the repayment as a reduction of trade loans within operating activities. The net result of these transactions to the dealer is a net operating cash inflow within operating activities equivalent to the gross profit on the sale of the inventory to the end customer. This approach is consistent with the SEC staff's view as discussed at the 2005 AICPA National Conference on Current SEC and PCAOB Developments.

In contrast, a different presentation would be appropriate when the source of financing is unaffiliated with the supplier. In a third-party financing arrangement, the inventory purchase from the supplier by the dealer should be reported as an operating cash outflow, while the loan from the unaffiliated financing source should be reported as a financing inflow by the dealer. The repayment of the loan to the unaffiliated financing source should later be reported as a financing outflow by the dealer. Again, the result of these transactions by the dealer is a net operating cash inflow within operating activities equivalent to the gross profit on the sale of the inventory to the end customer. This approach is consistent with the SEC staff's view as discussed at the 2005 AICPA National Conference on Current SEC and PCAOB Developments.

These financing arrangements may involve constructive receipts and disbursements. Refer to section 4.6.2, *Constructive receipts and disbursements*, for further details.

5.2.5 Bank overdraft and book overdraft

Bank overdrafts, which represent disbursements (e.g., checks, withdrawals) without sufficient funds in the entity's bank account that are cleared by the bank and create an obligation for the entity, should be considered financing activities. ASC 230-10-45-14 describes that proceeds from issuing bonds, mortgages, notes, and other short- or long-term borrowings are financing activities.

Book overdrafts, which relate to a temporary excess of outstanding checks in excess of funds on deposit in a particular account, are analogous to accounts payable and may be considered an element of cash flows from operating activities.

Refer to section 3.2.2, *Bank overdrafts and book overdrafts (negative cash balances),* for determination whether bank overdrafts and book overdrafts meet the definition of cash and cash equivalents.

5.2.6 Capitalized contract costs

ASC 340-40, *Other Assets and Deferred Costs — Contracts with Customers*, provides guidance for certain costs related to a contract with a customer in the scope of ASC 606, *Revenue from Contracts with Customers*.

ASC 340-40-25-1 requires an entity to recognize as an asset the incremental costs of obtaining a contract with a customer (e.g., sales commissions) if the entity expects to recover those costs. ASC 340-40-25-5 requires an entity to recognize an asset from the costs incurred to fulfill a contract if they meet certain criteria.

While ASC 340-40 does not address the presentation of capitalized contract costs in the statement of cash flows, we believe these costs should generally be classified as operating cash flows because they are similar in nature to certain operating cash outflows described in ASC 230-10-45-17.

ASC 340-40 refers to sales commissions as a type of an incremental cost to obtain a contract with a customer that are often paid to employees. Payroll expenses are generally considered operating expenses incurred in the ordinary course of business; therefore, these types of costs should be presented as operating cash flows in the statement of cash flows. The fact that ASC 340-40 requires the capitalization of certain selling costs that meet certain criteria does not change the nature of the cash flow. Similarly, costs incurred to fulfill a contract with a customer are generally incurred in the ordinary course of business and should also be presented as operating cash flows.

5.3 Productive asset transactions

5.3.1 Seller-financed purchases

Seller-financed purchases are considered to be noncash investing (or operating, depending on the asset acquired) and financing transactions for the buyer to the extent of the initial seller financing. These transactions are excluded from the statement of cash flows but are disclosed in accordance with ASC 230-10-50-3 through 50-6. In the Basis for Conclusions for Statement 95, the Board described its view that excluding noncash investing and financing transactions from the statement of cash flows and disclosing them separately achieves cash flow reporting objectives without increasing implementation difficulties. For example, the purchase of equipment that is wholly financed by a seller is recognized as a noncash investing and financing transaction. However, if only a portion of the purchase is financed through the seller, the amount paid before, at the time of or soon after the purchase is reported as an investing cash outflow. In both of these cases, the amount of seller financing is disclosed by the purchaser as a noncash investing and financing transaction.

In contrast, if a purchase of equipment is financed through a third party (i.e., not the seller), the entire amount of cash paid for purchase of the equipment is an investing activity, while the cash received from borrowing is a financing cash inflow. Whether financing is obtained from the seller or from a third party, subsequent principal payments against the financing are reported as cash outflows from financing activities.

These financing arrangements may involve constructive receipts and disbursements. Refer to section 4.6.2, *Constructive receipts and disbursements*, for further details.

5.3.2 Leases

A lessee's recognition of a right-of-use (ROU) asset and lease liability at commencement of an operating or finance lease has no statement of cash flow implications (unless there is a lease prepayment) and is disclosed as a noncash investing and financing transaction (ASC 842-20-50-4(g)(2)). In addition to the noncash disclosures for the initial recognition of a new lease, a lessee should also make disclosures for other noncash changes to lease balances (e.g., an increase in the right-of-use asset resulting from a reassessment event).

As lease payments related to finance leases are made after lease commencement, a lessee presents repayment of the principal portion of the lease liability as a financing cash outflow and the interest on the lease liability as an operating cash outflow, similar to a payment for interest. A lessee generally classifies payments arising from operating leases as operating activities unless the lease cost is capitalized as part of the cost of construction of another asset, in which case the payment is presented as an investing outflow. Variable lease payments and short-term lease payments not included in the lease liability are presented as operating cash outflows (ASC 842-20-45-5). Refer to section 4.9, *Presentation*, of our FRD, ***Lease accounting: Accounting Standards Codification 842, Leases***, for an illustrative example of the statement of cash flows presentation for an operating lease and a finance lease.

Lessors are required to present cash receipts from leases as cash inflows from operating activities (ASC 842-30-45-5 and ASC 842-30-45-7). However, lessors in the scope of ASC 942, *Financial Services — Depository and Lending*, must classify principal payments received under sales-type and direct financing leases in investing activities in the statement of cash flows.

5.3.2.1 Payments to purchase an underlying asset subject to a lease (added July 2024)

A lessee may decide to purchase an underlying asset subject to a lease from the lessor, thereby terminating the lease either through exercising an existing purchase option or separately negotiating the purchase prior to lease expiration. In accordance with ASC 842-20-40-2, any difference between the purchase price and the carrying amount of the lease liability immediately prior to the purchase is recorded as an adjustment to the carrying amount of the purchased asset. The statement of cash flows presentation for the purchase of the underlying asset may depend on the classification of the lease. For an operating lease, we believe either of the following approaches would be acceptable and would be applied consistently to similar transactions:

- **Approach 1**: Payment to extinguish the lease liability — The transaction represents a noncash exchange of the ROU asset for the underlying asset and is disclosed as noncash investing activity. The cash outflow extinguishes the lease liability and is classified consistently with other lease payments under the lease (i.e., operating activities in accordance with ASC 842-20-45-5(c)). Any amount paid in excess of the carrying amount of the lease liability is classified as investing activities.

- **Approach 2**: Payment to purchase the underlying asset — The cash outflow is for purchase of the underlying asset. The lease termination is accounted for as a noncash transaction that removes the lease liability and ROU asset. If the carrying amount of the lease liability exceeds the carrying amount of the ROU asset, the portion of the payment representing the excess of the lease liability above the carrying amount of the ROU asset is classified consistently with other lease payments under the lease (i.e., operating activities in accordance with ASC 842-20-45-5(c)). The remaining cash outflow is classified as investing activities.

For a finance lease, we believe Approach 1 is more appropriate. This lease is similar to a financed purchase of an underlying asset. As such, if a lessee purchases an underlying asset in a finance lease before the expiration of the lease term, the cash outflow represents extinguishment of the financial liability related to the financed purchase. However, given the lack of specific guidance, we are aware that diversity exists in this area and that Approach 2 may be acceptable.

5.3.2.2 Payments made at or before lease commencement (added May 2025)

A lessee may make lease payments on or before the lease commencement date. We believe the classification of these cash payments in the statement of cash flows is based on whether the lease has commenced. We have also observed diversity in practice in classification when a lease payment is made prior to lease commencement.

Lease classification	Payments made at lease commencement	Payments made before lease commencement
Operating	Operating (consistent with lease payments made after lease commencement)	Operating (if lease classification is expected) or investing
Finance	Financing (consistent with lease payments made after lease commencement)	Financing (if lease classification is expected) or investing

5.3.3 Consideration of accrued capital expenditures

Entities need to evaluate whether there are amounts accrued for capital expenditures that should be excluded from investing cash outflows in the current period so that cash flows reflect only payments that have occurred. That is, liabilities incurred for capital expenditures during the current reporting period that remain unpaid as of the end of the current reporting period are disclosed as noncash investing activity. Refer to section 4.6, *Noncash investing and financing activity*, for further discussion of the disclosure requirement. Entities should not disclose as noncash investing activity the period-to-period change in the liability account used to track accrued capital expenditures because the change may include cash payments for previously received equipment.

Illustration 5-1: Accrued capital expenditures

Facts:

Entity A is a calendar-year public business entity that maintains an accrued capital expenditures account to track capital expenditures that it has received, but for which it has not yet paid. The balance in Entity A's accrued capital expenditures account was $300 on 31 December 20X0. Entity A remits payment for the accrued capital expenditures on 15 January 20X1.

On 15 March 20X1, Entity A receives capital equipment of $100 that it recognizes as an asset on its balance sheet. Entity A also recognizes an accrued capital expenditures liability of the same amount. There were no other purchases of capital equipment during the three-month period ended 31 March 20X1. Entity A remits payment for the equipment on 15 April 20X1.

Analysis:

Entity A discloses receipt of $100 of equipment as noncash investing activity in its financial statements for the three-month period ended 31 March 20X1 because it received the equipment during the reporting period but has not yet paid for it. Entity A also includes $300 of investing cash outflows in its statement of cash flows for the three-month period ended 31 March 20X1 because it paid for the previously accrued capital expenditures during the reporting period.

Assuming no other capital expenditures are made during the six-month period ended 30 June 20X1, Entity A would include $400 of investing cash outflows in its statement of cash flows for the six-month period ended 30 June 20X1 for payments made during the reporting period related to the acquisition of capital equipment.

ASC 230-10-45-13(c) indicates that cash outflows for investing activities include payments made at the time of purchase of property, plant and equipment, and other productive assets or "soon before or after purchase." This means that companies need to evaluate whether purchases of these assets include a seller financing element (i.e., payments extend beyond normal trade payment terms) that should be classified as cash outflows for financing activities rather than investing activities. Payments made "soon before or after purchase" should be reflected as cash outflows for investing activities only in the period in which the payment is made.

5.3.4 Customers in a cloud computing arrangement (updated July 2024)

Customers in a cloud computing arrangement that either includes a software license or a service contract may capitalize certain implementation costs in accordance with ASC 350-40, *Intangibles — Goodwill and Other — Internal-Use Software*.

For a cloud computing arrangement that includes a software license, a customer would account for the software license as internal-use software (i.e., intangible asset) if it meets all of the criteria in accordance with ASC 350-40-15-4A. A customer would need to evaluate whether any implementation costs incurred should be included in the qualified costs that can be capitalized for the related internal-use software. While there is no guidance on how internal-use software costs should be classified in the statement of cash flows, those costs are generally classified as investing cash flows in the statement of cash flows.

For a cloud computing arrangement that is a service contract (i.e., does not meet the criteria in ASC 350-40-15-4A to be capitalized as an intangible asset), ASC 350-40-45-3 requires a customer to classify payments for capitalized implementation costs in the statement of cash flows in the same manner as payments of the fees for the service component of the hosting arrangement. While there is no guidance on how hosting service fees should be classified in the customer's statement of cash flows, we believe that payments for hosting fees and capitalized implementation costs generally will be classified as operating cash flows.

5.4 Investments in debt and equity securities

5.4.1 Acquisitions and sales of certain securities

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-19

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

230-10-45-20

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

Investments — Debt Securities — Overall

Recognition

Classification of Debt Securities

320-10-25-1

At acquisition, an entity shall classify **debt securities** into one of the following three categories:

a. **Trading securities**. If a **security** is acquired with the intent of selling it within hours or days, the security shall be classified as **trading.** However, at acquisition an entity is not precluded from classifying as trading a security it plans to hold for a longer period. Classification of a security as trading shall not be precluded simply because the entity does not intend to sell it in the near term.

b. **Available-for-sale securities**. Investments in debt securities not classified as trading securities or as held-to-maturity securities shall be classified as available-for-sale securities.

c. Held-to-maturity securities. Investments in debt securities shall be classified as held-to-maturity only if the reporting entity has the positive intent and ability to hold those securities to maturity.

Other Presentation Matters

Cash Flow Presentation

320-10-45-11

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

Investments—Equity Securities

Other Presentation Matters

321-10-45-1

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

The following table summarizes how cash flows from purchases, sales and maturities of securities are presented in the statement of cash flows.

<table>
<tr><th>Type of security</th><th>Classification of security</th><th>Classification of cash flows from purchases, sales and maturities</th></tr>
<tr><td rowspan="3">Debt securities (ASC 320)[1]</td><td>Trading</td><td>Cash receipts and cash payments resulting from purchases, sales and maturities of trading securities as defined in ASC 320-10-25-1(a) measured at fair value should be classified in the statement of cash flows in accordance with ASC 230-10-45-19 based on the nature and purpose for which the security was acquired.

As such, we believe the cash flows related to trading securities that are acquired with the intent to actively buy and sell in the near term should be classified as operating activities.

ASC 320 allows an entity to designate a security as trading even if their intent is to hold such security for a longer period and thus the nature and purpose for which the securities acquired may not be generating profit based on short-term price fluctuations. As such, we believe the cash flows related to securities that are designated as trading but are not acquired with the intent to actively buy and sell in the near term should be classified as investing activities.

Cash flows related to trading securities classified as operating can be reported net. Cash flows related to trading securities classified as investing are reported gross. Refer to section 2.4, Gross versus net cash flows, for further discussion.</td></tr>
<tr><td>Available-for-sale</td><td rowspan="2">Cash receipts and cash payments resulting from purchases, sales and maturities of available-for-sale securities (AFS) and held-to-maturity (HTM) securities should be classified as investing and reported gross for each class of security in the statement of cash flows.</td></tr>
<tr><td>Held-to-maturity</td></tr>
<tr><td>Equity securities (ASC 321)[1]</td><td colspan="2">Entities generally measure equity investments in the scope of ASC 321, Investments — Equity Securities, at fair value and recognize any changes in fair value in net income at the end of each reporting period. ASC 321-10-45-1 and ASC 230-10-45-19 require entities to classify cash flows from purchases and sales of equity investments based on the nature and purpose for which they acquired the ownership interests. Because ASC 321 generally requires changes in the fair value of equity investments to be reflected in net income, entities that use the indirect method of preparing the statement of cash flows need to adjust</td></tr>
</table>

Type of security	Classification of security	Classification of cash flows from purchases, sales and maturities
	net income for these amounts to determine cash flows from operating activities.	
[1] Cash flows related to interest and dividend income are presented in operating activities regardless of how the cash flows from purchases, sales and maturities are presented.		

Certain sales of debt securities near maturity (e.g., sales within three months of maturity) are deemed to have occurred at maturity. We believe that the proceeds received on such sales may be classified as cash received on maturity in the cash flow statement.

Transfers between held-to-maturity or available-for-sale and trading result in a noncash transfer between investing and operating activities. Those activities affect recognized assets, even though they do not result in cash receipts or cash payments in the current period. Therefore, such activity, if significant, should be included in the disclosures of noncash activity.

For a discussion of the classification of debt and equity securities, refer to our FRD, ***Certain investments in debt and equity securities***.

5.4.1.1 Auction rate securities and variable rate demand obligations

Auction rate securities (ARS) and variable rate demand obligations (VRDO) (collectively variable rate notes, or VRNs) typically are investments in debt securities that are accounted for under ASC 320 (refer to sections 3.3.3.2, *Auction rate securities*, and 3.3.3.3, *Variable rate demand obligations*, for further discussion). As such, presentation of the activity related to VRNs in the statement of cash flows should be consistent with their balance sheet classification. For example, cash flows from purchases, sales and redemptions of VRNs accounted for pursuant to ASC 320 and classified in the balance sheet as available-for-sale should be classified as cash flows from investing activities and reported on a gross basis (that is by not netting their purchases and sales) in the statement of cash flows. Cash flows from purchases, sales and redemptions of VRNs accounted for pursuant to ASC 320 and classified in the balance sheet as trading securities should be classified in the statement of cash flows in accordance with ASC 230-10-45-19, which requires classification based on the nature and purpose for which the securities were acquired. Refer to section 5.4.1, *Acquisitions and sales of certain securities*, for further discussion on the statement of cash flow presentation of debt securities, including those classified as trading. Refer to our FRD, ***Certain investments in debt and equity securities***, for further discussion on the balance sheet classification of debt securities.

5.4.2 Distributions received from investments (other than those from consolidated entities)

Distributions received from investments (other than those from consolidated entities) that represent returns *on* the investor's investment are reported as cash flows from operating activities in the investor's statement of cash flows, consistent with ASC 230-10-45-16(b). Cash distributions from such entities that represent returns *of* the investor's investment are reported as cash flows from investing activities, consistent with ASC 230-10-45-12(b). Similarly, proceeds received from the sale by an investor of its interest in such an entity are reported as cash flows from investing activities. The assessment of whether a distribution received from investments (other than those from consolidated entities) are returns *on* or returns *of* the investment may be challenging for certain investments. One common example is an equity method investment. The FASB provides two approaches for classifying distributions from equity method investments as discussed in the following sections.

5.4.2.1 Determining whether distributions are returns on or returns of the investment for equity method investments

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-21D

When a reporting entity applies the equity method, it shall make an accounting policy election to classify distributions received from equity method investees using either of the following approaches:

a. Cumulative earnings approach: Distributions received are considered 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.

b. Nature of the distribution approach: Distributions received shall be classified on the basis of the nature of the activity or activities of the investee that generated the distribution as either a return on investment (classified as a cash inflow from operating activities) or a return of investment (classified as a cash inflow from investing activities) when such information is available.

If an entity elects to apply the nature of the distribution approach and the information to apply that approach to distributions received from an individual equity method investee is not available to the investor, the entity shall report a change in accounting principle on a retrospective basis by applying the cumulative earnings approach described in (a) above for that investee. In such situations, an entity shall disclose that a change in accounting principle has occurred with respect to the affected investee(s) due to the lack of available information and shall provide the disclosures required in paragraphs 250-10-50-1(b) and 250-10-50-2, as applicable. With either approach described in (a) or (b) above, an entity also shall comply with the applicable accounting policy disclosure requirements in paragraphs 235-10-50-1 through 50-6.

An entity elects, as an accounting policy election, to apply either the cumulative earnings approach or the nature of the distribution approach to determine whether distributions received from equity method investees are returns on investment (operating cash inflows) or returns of investment (investing cash inflows). This accounting policy election will apply to all distributions received from all equity method investees, and entities have to disclose the approach they elect.

If an entity elects the nature of the distribution approach but does not have enough information to apply that approach for an individual equity method investee, the entity should apply the cumulative-earnings approach for that investee on a retrospective basis and continue to apply the nature of the distribution approach for all other equity method investees. When such a change occurs, the entity is required to provide the disclosures required in ASC 250-10-50-1(b) and ASC 250-10-50-2 in both the interim and annual period of the change.

5.4.2.1.1 Cumulative earnings approach

Under the cumulative earnings approach, all distributions received by the investor are deemed to be returns on the investment (and thus classified as operating cash flows), unless the cumulative distributions exceed the cumulative equity in earnings recognized by the investor. The excess distributions are deemed to be returns of the investment and are classified as investing cash flows.

Careful consideration should be given to distributions received when the carrying value of the investment is near or below zero to determine whether the return from the investee is a return on, or a return of, the investor's investment.

Additionally, the manner in which the cash is generated by the investee to fund the distribution is not considered in assessing the distribution from the investee. In other words, it does not matter whether the cash was generated through a refinancing, sale of assets or operating results. Rather, the investor need only consider the relationship between the cash received from the investee and its cumulative equity in the undistributed earnings of the investee in assessing whether the distribution from the investee is a return on or return of its investment. Cash received from the equity method investee is presumed to be a return on the investment to the extent that, on a cumulative basis, distributions received by the investor are less than its share of the equity in the undistributed earnings of the entity.

5.4.2.1.2 Nature of distribution approach

Under the nature of distribution approach, distributions received are classified on the basis of the nature of the activity or activities of the investee that generated the distribution (return on investment or a return of investment). In other words, the investor considers whether the cash for the distribution was generated through a refinancing, sale of assets or operating results.

At times, an equity method investee has operating losses during the year but a positive cash flow allows it to distribute funds to its investors. We believe distributions that are funded by the normal or financing operations of the equity method investee would be a return on investment and presented as an operating cash inflow under the nature of distribution approach. If, however, the distribution was funded from assets sold by the equity method investee outside of its normal course of business, this distribution would generally be considered a return of the investment, classified by the investor as a cash inflow from investing activities. Likewise, we believe that a liquidating dividend received from an equity method investee should be recognized as a cash inflow from investing activities.

5.5 Business combinations and asset acquisitions

5.5.1 Business combinations

5.5.1.1 Sale and purchases (updated July 2024)

Cash flows for purchases and from sales of productive assets, including the acquisition or sale of a business, are presented as investing activities. Changes in assets and liabilities that are typically presented in the operating or financing activities sections of the statement of cash flows, but that result from the purchase or sale of a business, are presented as an investing activity. When preparing the statement of cash flows, care should be taken to exclude the effects of the business combination on specific asset and liability accounts from the calculation of other amounts in the statement of cash flows. For example, companies that use the indirect method of presenting cash flows will reconcile net income to operating income. That reconciliation includes changes in the balances of operating assets and liabilities. Those changes must be calculated by excluding the effect of adding the assets acquired or liabilities assumed in the business combination to specific asset or liability accounts. The statement of cash flows should reflect, as a single line item, cash paid to purchase a business (net of cash acquired) or cash received from the sale of a business (net of cash sold). The noncash effects of a business combination, including any noncash consideration included in the purchase consideration and the total effects on the assets and liabilities of the acquirer also are required to be disclosed. However, such disclosures also are required by the guidance in ASC 805, *Business Combinations*, and generally need not be repeated.

Note that subsequent to the acquisition of a business, cash flows of the newly acquired entity are combined with those of the consolidated entity and presented within operating, investing and financing activities as appropriate.

5.5.1.2 Transaction costs

We believe that the cash paid for transaction costs incurred in a business combination is most appropriately classified in the operating section of the statement of cash flows. ASC 805 requires transaction costs to be expensed as incurred (ASC 805-10-25-23). Classifying the cash flows as an operating activity would be consistent with the requirement to recognize the costs as an expense. In addition, classification of these costs as an operating activity would be consistent with the guidance that "cash flows from operating activities are generally the cash effects of transactions and other events that enter into the determination of net income" (ASC 230-10-20).

5.5.1.3 Contingent consideration (updated July 2024)

Contingent consideration arrangements will often be settled at an amount different than the amount initially included in measurement of the consideration transferred under ASC 805. Contingent consideration classified as an asset or a liability is remeasured to fair value at each reporting date until the contingency is resolved with the changes in fair value (that are not measurement period adjustments) recognized in earnings (ASC 805-30-35-1).[20] These subsequent changes in the fair value of the contingent consideration arrangement should be classified as an adjustment to cash flows from operating activities because the change in fair value was an input in determining net income.

Cash payments made soon after (i.e., within a relatively short period of time, such as three months or less) the consummation of a business combination generally will be classified as cash outflows for investing activities (ASC 230-10-45-13(d)). Cash payments not made soon after the consummation of a business combination to settle a contingent consideration liability will be classified as cash outflows from financing and operating activities. The portion of the cash payment up to the acquisition date fair value of the contingent consideration liability (including any measurement-period adjustments) will be classified as a financing outflow, and amounts paid in excess of the acquisition date fair value of that liability will be classified as operating outflows.

The following table summarizes how cash payments for contingent consideration are presented in the statement of cash flows depending on the timing and amount of the payments:

Timing of cash payments made after the acquisition date	Amount	Statement of cash flows presentation
Within a relatively short period of time (i.e., three months or less)	All amounts paid to settle the contingent consideration liability	Investing activities
Not within a relatively short period of time (i.e., greater than three months)	Amounts paid up to the acquisition date fair value of the contingent consideration liability (including measurement-period adjustments)	Financing activities
	Amounts paid in excess of the acquisition date fair value of the contingent liability (including measurement period adjustments)	Operating activities

[20] Unless the arrangement is a hedging instrument for which ASC 815, *Derivatives and Hedging*, requires the changes to be initially recognized in other comprehensive income.

Illustration 5-2: Contingent consideration
On 1 January 20X1, Acquirer acquires Target from Seller. The purchase agreement includes contingent consideration in the form of a royalty based on a percentage of Target's sales for a two-year period in excess of a specified baseline. Any amounts due are payable at the end of the two-year period (i.e., 31 December 20X2). As part of the purchase accounting, the fair value of this contingent consideration arrangement was determined to be $100. At the end of 20X1, Acquirer determines that the fair value of the contingent consideration arrangement increased to $125, which was not attributable to a measurement period adjustment (i.e., the increase in fair value resulted from events that occurred after the acquisition date), and recorded an accrual and an income statement charge for the $25 increase. Acquirer uses the indirect method for reporting cash flows from operating activities and presented the $25 fair value increase as an adjustment to reconcile net income to cash flows from operating activities. If Acquirer used the direct method for reporting cash flows from operating activities, the change in fair value of the contingent consideration would not be reported in the 20X1 statement of cash flows as no cash was paid in connection with the contingent consideration arrangement in 20X1. At the end of 20X2, Acquirer determines the actual amount of contingent royalty owed to Seller is $150 and makes the payment on 31 December 20X2. Acquirer prepares its statement of cash flows for year 20X2 and presents the initial amount of contingent consideration recognized in purchase accounting for the Target acquisition of $100 as a cash outflow from financing activities. The $50 balance of the payment, which resulted from changes in the fair value of the contingent consideration arrangement between the date of acquisition and the settlement of the contingent consideration arrangement, is reported as a cash outflow from operating activities. Because Acquirer uses the indirect method to report cash flows from operating activities, $25 of the $50 balance would reduce operating activity cash flows by reducing 20X2 net income, and the remaining $25 would be reported as a change in the accrual balance (i.e., the $25 accrual in 20X1 would be relieved upon settlement).

5.5.2 Asset acquisitions

The asset acquisition guidance (ASC 805-50, *Business Combinations – Related Issues*) does not provide guidance on how acquiring entities should classify cash payments made to acquire an asset or group of assets. Accordingly, entities apply the guidance in ASC 230 to classify cash flows pertaining to the assets acquired as either operating, investing or financing activities, based on the nature of the cash flows (i.e., the assets being acquired).

5.5.2.1 Acquired IPR&D assets in an asset acquisition with no alternative future use

An entity that acquires in-process research and development (IPR&D) assets in an asset acquisition follows the guidance in ASC 730, *Research and Development*, which requires that both tangible and intangible identifiable IPR&D assets with no alternative future use be allocated a portion of the consideration transferred and charged to expense at the acquisition date.

ASC 230 does not address how acquiring entities should classify cash payments made to acquire IPR&D assets that have no alternative future use in an asset acquisition, which has resulted in diversity in practice.

Some entities classify cash payments for acquired IPR&D assets with no alternative future use as an investing activity in accordance with paragraph 5.12 of the AICPA *Accounting and Valuation Guide for Assets Acquired to Be Used in Research and Development Activities*, which states the following:

> "Best practices suggest that an acquiring entity should report its cash acquisition of assets to be used in R&D activities as an investing outflow in its statement of cash flows. In this regard, an acquiring entity should treat assets acquired to be used in R&D activities similar to how it reports other acquired assets in the statement of cash flows. Although acquired IPR&D may lack an alternative future use and, therefore, would be expensed immediately, it is still an asset for cash flow statement purposes.
>
> When arriving at cash flows from operating activities under the indirect method of reporting cash flows, best practices suggest that an acquiring entity should add back to net income the costs of assets acquired to be used in R&D activities that are charged to expense. That adjustment is necessary to eliminate from operating cash flows those cash outflows of assets acquired to be used in R&D activities that are reflected in investing activities."

Other entities classify cash payments for acquired IPR&D with no alternative future use as operating activities, since ASC 230 generally provides that cash flows from operating activities reflect the cash effects of transactions and other events that determine net income. Because ASC 730 requires entities to expense acquired IPR&D assets with no alternative future use at the acquisition date, these entities believe that classifying the corresponding cash outflow as an operating activity is reasonable. In addition, ASC 230 states that cash flows from operating activities include all transactions and other events that are not defined as investing or financing activities.

Because of the lack of guidance in ASC 230 on acquired IPR&D with no alternative future use, we believe that it may be reasonable to classify these cash payments as either operating cash outflows or investing cash outflows. An entity should provide appropriate disclosures about its policy and judgments and consistently apply that policy.

5.6 Debt and equity financing transactions

5.6.1 Stock issuance costs (updated May 2025)

Stock issuance costs for stock that is classified as equity (i.e., direct and incremental costs related to stock issuance, such as legal fees, printing costs and bankers' or underwriters' fees) are accounted for as a reduction in the proceeds of the stock included in equity. Stock issuance costs incurred before the stock issuance may be deferred until the issuance is complete, at which point the costs will reduce the proceeds. We believe cash payments for stock issuance costs should be classified in the statement of cash flows as a financing activity separate from cash proceeds received from the issuance of the stock by analogy to debt issuance costs, which are specifically addressed in ASC 230-10-45-15(e).

For more details on accounting for stock issuance costs, refer to our FRD, ***Issuer's accounting for debt and equity financings*.**

5.6.2 Debt prepayment or extinguishment costs

ASC 230-10-45-15(g) requires that cash payments for debt prepayment or extinguishment costs be classified as financing cash outflows.

5.6.3 Settlement of zero-coupon debt instruments

ASC 230-10-45-17(d) requires entities to classify the portion of the cash payment made to settle a zero-coupon debt instrument or a debt instrument with an insignificant cash coupon attributable to accreted interest related to the debt discount as a cash outflow for operating activities. The portion of the cash payment attributable to the principal is classified as a cash outflow for financing activities (ASC 230-10-45-15(b)).

To determine if a debt instrument has an insignificant interest rate and is, therefore, within the scope of this guidance, an entity should compare the coupon interest rate to the effective interest rate of the borrowing. Debt instruments without a stated coupon interest rate (e.g., commercial paper) would be included in the scope of this guidance.

5.6.4 Payment-in-kind interest (i.e., settlement of interest by issuing additional underlying debt instruments)

Questions have arisen regarding the classification of paid-in-kind interest (PIK) and similar arrangements (e.g., deeply discounted instruments) whereby interest owed on an original principal amount of debt is accrued and added to the original principal amount of debt but is not paid until maturity either through the payment of cash or through the issuance of PIK notes with identical terms as the original debt. For the purpose of this discussion, consider a borrowing at a deep discount (receive $75) with maturity at the face amount of the note (assume $100). In the income statement, the $25 difference is accreted through interest expense over the life of the debt.

Under the indirect method, cash flows from operating activities would include a reconciling item to the extent of noncash expense consistent with the guidance in ASC 230-10-45-28, which notes:

> Adjustments to net income of a business entity … to determine net cash flow from operating activities shall reflect accruals for interest earned but not received and interest incurred but not paid.

When the interest is ultimately settled (e.g., at maturity of the in-kind security), we believe the payment is the payment of the interest initially due and should be reported as an operating activity, because cash outflows for operating activities include "cash payments to lenders and other creditors for interest, including the portion of the payments made to settle zero-coupon debt instruments that is attributable to accreted interest related to the debt discount…" (ASC 230-10-45-17(d)). Using the example at the beginning of this section, application of this view would suggest the $25 be classified as an operating cash flow. While the legal form of a zero-coupon borrowing and a borrowing with paid-in-kind interest is different, the underlying concept is the same. Refer to section 5.6.3, *Settlement of zero-coupon debt instruments,* for further discussion.

5.6.5 Proceeds from settlement of debt securities purchased at a discount (added May 2025)

While ASC 230 provides guidance on how a debt issuer classifies the settlement of debt issued at a discount (refer to section 5.6.3, *Settlement of zero-coupon debt instruments*), it does not provide guidance on how an investor classifies settlement of debt issued at a discount. We believe the guidance on more than one class of cash flows is appropriate to consider (refer to section 4.5, *More than one class of cash flows*). Considering this guidance, proceeds up to the amount invested would represent a return of the investment and classified as investing cash flows. Proceeds in excess of the amount invested would be considered a return on the investment (i.e., interest income) and classified as operating cash flows. However, classifying cash flows as entirely investing activities may be appropriate if the debt security is not significantly discounted.

5.6.6 Transaction costs (added May 2025)

We believe that transaction costs, other than debt or stock issuance costs, paid to third parties as part of a debt or equity issuance are most appropriately classified as operating cash flows.

5.7 Employee compensation related transactions

5.7.1 Contributions and premiums related to postretirement plans

Contributions to postretirement plans (e.g., a defined benefit pension plan) are reported as operating cash outflows because they relate to employee compensation. Likewise, with respect to qualified defined benefit pension plans, an entity's annual premium paid to the Pension Benefit Guaranty Corporation (PBGC) also represents an operating cash outflow.

Entities that reorganize in bankruptcy often enter into agreements with the PBGC regarding their liability under employee benefit plans that provide for a settlement for the plan liability through an assumption by the PBGC. The agreements with the PBGC typically require that payments be made by the entity at and/or after the entity's emergence from bankruptcy for the defined benefit plans that were assumed by the PBGC. Despite the fact that payments made to the PBGC pursuant to these agreements may extend for several years, the cash outflows should not be classified as financing activities in the statement of cash flows. The form of settlement of the pension liability does not change the substance of the activity for which cash is being paid, and, therefore, it retains its classification as an operating activity. In addition, the classification of these payments as an operating activity does not change in the event the registrant is required to apply fresh-start reporting pursuant to ASC 852, *Reorganizations*, on emergence from bankruptcy. Refer to section 4.4.4, *PBGC agreements*, of our FRD, ***Bankruptcies, liquidations and quasi-reorganizations***, for further details.

5.7.2 Repurchase of shares from a grantee to satisfy tax withholding (updated July 2024)

Some stock option plans allow grantees to use shares received from the exercise of an option to satisfy their tax withholding requirement. Similarly, a plan may permit the grantee to use vested shares to satisfy a tax withholding obligation. In effect, the granting entity repurchases a portion of the shares at fair value and uses the cash on behalf of the grantee to satisfy the tax withholding requirements. While the actual mechanics likely are the issuance of a reduced number of shares and a direct payment of cash by the grantor to the taxing authorities, from an accounting standpoint the transaction is recorded as a treasury stock purchase from the grantee and, instead of giving the grantee the cash for the shares, the cash is remitted to the taxing authorities on the grantee's behalf.

ASC 230-10-45-15(a) requires a grantor to classify as a financing activity in its statement of cash flows the cash paid to a tax authority when shares are withheld to satisfy the grantor's statutory income tax withholding obligation. This classification is consistent with how other repurchases of an entity's equity instruments are classified and applies to both equity- and liability-classified share-based payments.

5.7.3 Excess tax benefits and tax deficiencies from share-based payment awards

Generally, the amount of income tax benefit recognized in any period is equal to the amount of compensation cost recognized multiplied by the employer's statutory tax rate. A tax deduction for an award (generally at option exercise or share vesting) that exceeds the cumulative amount of compensation cost recognized in the financial statements for that award results in an excess tax benefit, whereas a tax deduction for an award that is less than the cumulative amount of compensation cost for that award results in a tax deficiency. Excess tax benefits and tax deficiencies (including tax benefits of dividends on share-based payment awards) are recognized as income tax expense or benefit in the income statement and, therefore, should be classified as operating activities in the statement of cash flows (ASC 230-10-45-17(c)).

5.8 Derivatives and hedging (updated July 2024)

While the guidance in ASC 230 and ASC 815 on the presentation of cash flows from derivative instruments is limited, ASC 230-10-45-27 does provide some guidance on the presentation of cash receipts and payments from derivatives, including those designated in a hedging relationship.

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-27

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

Disclosure

230-10-50-9

Pending Content:

Transition Date: *(P) June 30, 2027; (N) June 30, 2027* **I Transition Guidance:** 105-10-65-7

An entity shall disclose its accounting policy for where cash flows associated with derivative instruments and their related gains and losses are presented.

FASB amendment

In October 2023, the FASB issued ASU 2023-06, *Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*, which incorporates several SEC disclosure requirements into US GAAP. The guidance requires entities to disclose their accounting policy for where cash flows associated with derivative instruments and their related gains and losses are presented in the statement of cash flows. For entities subject to the SEC requirements and those required to file or furnish financial statements in connection with the sale or issuance of securities without contractual restrictions on transfer, the guidance will be effective upon the removal of the related SEC requirement and early adoption is not permitted. For all other entities, the effective date will be two years later, and early adoption is permitted. If the SEC has not removed the related disclosure from its regulations by 30 June 2027, the amendments will be removed from the Codification and not become effective for any entity.

The following table summarizes the statement of cash flows classification considerations associated with various derivative instruments. Further discussion is provided in the subsequent sections.

<table>
<tr><th colspan="2">Derivative instrument</th><th>Cash flow classification</th></tr>
<tr><td colspan="2">Derivative containing an other-than-insignificant financing element at inception</td><td>Financing activities for the borrower and we believe generally investing activities for the lender
Refer to Section 5.8.1, Derivative with a financing element.</td></tr>
<tr><td colspan="2">Derivative acquired or originated for trading purposes</td><td>Operating activities
Refer to Section 5.8.2, Derivative acquired or originated for trading purposes.</td></tr>
<tr><td rowspan="2">Derivative that does not contain an other-than-insignificant financing element or a derivative that is not acquired or originated for trading purposes</td><td>Designated as an accounting hedge (ASC 230-10-45-27)</td><td>1. Classified according to the nature of the cash flows associated with the derivative. While often viewed as investing activities, we believe could be operating activities depending on the outcome of an analysis of the nature of the derivative’s cash flows, or
2. Classified in the same category as the item being hedged
Refer to Section 5.8.3, Derivative designated as an accounting hedge.</td></tr>
<tr><td>Not designated as an accounting hedge</td><td>1. Classified according to the nature of the cash flows associated with the derivative. While often viewed as investing activities, we believe could be operating activities depending on the outcome of an analysis of the nature of the derivative’s cash flows, or
2. We note that some entities will classify consistently with the presentation of the hedged item by analogy to the guidance in ASC 230-10-45-27
Refer to Section 5.8.4, Derivative not designated as an accounting hedge.</td></tr>
</table>

5.8.1 Derivative with a financing element

Both ASC 230-10-45-14 and 45-15 and ASC 815-10-45-12 require that all cash flows related to a derivative instrument containing an other-than-insignificant financing element at inception be reflected in the borrower’s statement of cash flows as cash flows from financing activities. Our understanding is that this guidance is intended to avoid the possibility that a derivative could be used to hide a borrowing and, thus, not reflect the true nature of a liability in the financial statements. The FASB has not explicitly addressed the presentation of cash flows from a derivative containing a financing element for the lender. However, we believe classifying those cash flows in investing activities is generally appropriate for the lender.

The FASB acknowledges in ASC 815-10-45-11 that identifying a contract with a financing element is a matter of judgment but notes that derivative contracts that, at inception, contain off-market terms or require an up-front payment, or both, often contain a financing element. ASC 815-10-45 does not provide specific guidance on how to determine whether a financing element is other-than-insignificant. Refer to section 2.4.3.2, *Derivatives containing other-than-insignificant financing elements*, of our FRD, ***Derivatives and hedging***, for further details on determining whether a financing element in a derivative is other-than-insignificant.

We note that when an existing derivative instrument is amended, the modified instrument will typically contain off-market terms at the time of the amendment. As such, we believe the amendment of the derivative instrument should be evaluated to determine whether it contains an other-than-insignificant financing element.

For example, consider a "blend and extend" transaction in which an entity renegotiates the terms of its existing pay-fixed, receive variable interest rate swap (liability) with the bank counterparty to (i) extend the maturity date so that the expected cash outflows on the swap are spread over a longer period of time and (ii) amend the fixed rate so that the fair value of the swap remains essentially the same before and after the amendments. In this transaction, the entity is essentially "rolling" one derivative contract into a new derivative contract with the same (negative) fair value but different terms, thereby avoiding the cash outflow that would be required to terminate the original derivative. The amended derivative would be considered to contain a financing element, since the transaction is akin to the entity having received a loan to pay off the first derivative, and the "payback" of that loan is embedded into the terms of the new derivative contract.

Furthermore, contracts that are designed to provide cash inflows for one party in early periods followed by cash outflows to the counterparty in later periods often contain a financing element. These differ from other instruments, such as at-the-money or out-of-the-money option contracts that require an up-front premium payment solely for the option's time value or swaps that are expected (but not certain) to result in cash inflows in early periods followed by cash outflows in later periods.

5.8.2 Derivative acquired or originated for trading purposes

We believe it is reasonable to classify all cash flows from a derivative held for trading (i.e., a derivative not designated as a hedging instrument in a formal accounting hedge relationship or functioning as an economic hedge) as operating cash flows in accordance with ASC 230-10-45-20 if they were acquired for resale in the near term and measured at fair value, and do not contain an other-than-insignificant financing element, as discussed in section 5.8.1, *Derivative with a financing element*. For example, all cash flows from a derivative held for trading could include a premium paid on options acquired or originated for trading purposes.

5.8.3 Derivative designated as an accounting hedge

As described in ASC 230-10-45-27, generally each cash receipt or payment is classified according to its nature without regard to whether it stems from an item intended as a hedge of another item. For example, ASC 230-10-45-27 notes that the purchase or sale of a futures contract is an investing activity even though the contract is intended as a hedge of a firm commitment to purchase inventory. As such, cash flows of a derivative designated as an accounting hedge are often viewed as investing activities. However, we believe they could be operating activities, depending on the outcome of an analysis of the nature of the derivative's cash flows. Alternatively, as further described in ASC 230-10-45-27, cash flows of a derivative that does not contain an other-than-insignificant financing element and is designated in a cash flow or fair value hedge may be classified in the statement of cash flows consistent with the presentation of the hedged item. This includes options that require an up-front premium payment solely as compensation for time value or swaps that are expected (but not certain) to result in cash inflows in early periods followed by cash outflows in later periods. The decision to classify cash flows from hedging derivatives consistent with the presentation of the hedged item is an accounting policy that must be disclosed.

Additionally, if cash flows of a derivative designated as an accounting hedge are categorized as an investing activity, gains and losses on derivatives (whether realized or unrealized) should be presented as a reconciling item in the reconciliation of net income and net cash flow from operating activities to offset the operating cash flow impact of the gain or loss (when the indirect method is presented).

5.8.3.1 Termination payment/receipt of forward-starting swap hedging forecasted issuance of fixed-rate debt

When entities hedge the forecasted issuance of fixed-rate debt with forward-starting swaps, they will typically terminate the swaps on the debt issuance date (i.e., when risk of variability in the cash flows ceases to exist). If market interest rates have increased, the hedger will be entitled to a cash receipt on settlement of the swap. If market interest rates have decreased, the hedger must make a cash payment to the swap counterparty on settlement. Questions have been raised about the appropriate classification in the statement of cash flows of the termination payments made/received to settle the forward-starting swap.

ASC 230-10-45-27 indicates that cash receipts or payments are generally classified according to their nature, but states that cash flows from a derivative instrument designated in a hedging relationship may be classified in the same category as the cash flows from the items being hedged, provided that the derivative does not include an other-than-insignificant financing element at inception and that the accounting policy is disclosed.

Example 21 in ASC 815-30-55-128 through 55-133 discusses the following two strategies that companies can use when hedging the forecasted issuance of fixed-rate debt:

1. Entity A plans to issue fixed-rate debt in 6 months at or near par at the then current market interest rate. As a result, there will be no variability in debt proceeds, but each of the probable interest payments that will result from the debt are exposed to variability up until the date of issuance. In this case, Entity A would document that it is hedging the variability in future interest payments due to changes in the benchmark interest rate.

2. Entity B plans to issue fixed-rate debt in 6 months at a fixed interest rate of 9%, regardless of what the then market interest rate will be. As a result, the proceeds will vary, with the debt being issued at a discount or premium depending on the market rate on the issuance date. However, the interest payments are not exposed to variability (because the company has already indicated the coupon rate it intends to pay). In this case, Entity B would document that is hedging the variability in the cash proceeds attributable to changes in the benchmark interest rate.

While Entity A and Entity B would designate different cash flows as being hedged in these examples, they would use the *identical* forward-starting interest rate swap as a hedging instrument in both situations.

Based on the guidance in ASC 230-10-45-27 that cash flows from a derivative instrument designated in a hedging relationship may be classified in the same category as the cash flows from the items being hedged, we believe it would be appropriate for Entity A to classify the cash settlement of the swap (either inflow or outflow) as operating because it is hedging interest payments which are an operating cash flow item, and for Entity B to classify the cash settlement of the swap as financing because it is hedging the debt proceeds which are a financing cash flow item.

However, we are aware that some in practice have taken the view that the classification of the debt issuance proceeds should be viewed collectively with the cash inflow or outflow from the termination of the hedging swap when determining classification in the statement of cash flows. They argue that Entity A has effectively created synthetic discount debt or synthetic premium debt, while Entity B has created synthetic at-par debt. Therefore, they believe it is acceptable in both situations to consider the debt issuance proceeds together with the cash inflow or outflow from hedge termination as financing cash flows.

In addition, they note that, since entities A and B are using the identical derivative to hedge their financing programs, the cash flow statement presentation of the swap termination payments in the above example should not differ. They believe the guidance in Example 21 only addresses the issue of when amounts in accumulated other comprehensive income (AOCI) would be reclassified to earnings if the debt is issued at a date later than originally forecasted and does not specifically address cash flow statement presentation.

Finally, proponents of this view believe that presenting Entity A's hedge termination cash flow, a potentially large number, as operating before any interest cash flows on the hedged debt have begun would not be meaningful to investors.

We believe it is acceptable to classify the cash flows from the settlement of the forward-starting swap under the hedge strategy executed by Entity A in the example above as either operating or financing. The determination should be based upon an accounting policy election that is well disclosed and consistently applied.

5.8.4 Derivative not designated as an accounting hedge

A derivative may be used for various reasons other than as a hedge designated under ASC 815, including as an economic hedge or for other purposes. As described in ASC 230-10-45-27, each cash receipt or payment is classified according to its nature without regard to whether it stems from an item intended as a hedge of another item. For example, the purchase or sale of a futures contract is an investing activity, even though the contract is intended as a hedge of a firm commitment to purchase inventory.

As such, cash flows of a derivative not designated as an accounting hedge (i.e., an economic hedge) are often viewed as investing activities. However, we believe they could be operating activities, depending on the outcome of an analysis of the nature of the derivative's cash flows. Alternatively, we note that some entities will classify the cash flows of a derivative that does not contain an other-than-insignificant financing element and is used in an economic hedge consistent with the presentation of the "hedged" item by analogy to the guidance in ASC 230-10-45-27. The decision to classify the cash flows from a derivative in an economic hedge consistent with the presentation of the "hedged" item would be considered an accounting policy that must be disclosed.

5.8.5 Other considerations related to derivatives

5.8.5.1 Forward placement commitment contract and when-issued security

A forward placement commitment contract provides that a seller delivers a specified security to a buyer at a specified future date and price. Forward contracts are not traded on organized exchanges, and the contract generally can be terminated only by agreement of both parties to the contract.

An entity may also commit to purchase securities on a when-issued basis. These securities (e.g., Government National Mortgage Association securities) normally begin trading before the closing date of the offering.

From the buyer's perspective, a forward placement commitment contract and when-issued security are similar in that cash payment is not required until after the securities are delivered. Gains and losses included in income (whether realized or unrealized) should be treated like gains or losses on other investments; that is, they should be presented as a reconciling item in the reconciliation of net income and net cash flow from operating activities to offset the operating cash flow effect of the gain or loss (when the indirect method is presented). These gains and losses may include the mark to market on any such forward placement contract or when-issued security that are accounted for as derivatives under ASC 815 (e.g., those that may not receive an exception from derivative accounting).

Upon the settlement of the commitment contract, the buyer makes a cash payment at the commitment contract price to purchase the underlying securities. On the balance sheet, it recognizes the securities at the then-market price and de-recognizes any asset or liability associated with the forward placement contract or when-issued security that is accounted for as derivatives. From the buyer's perspective, the actual cash payment represents the:

- Purchase of the securities
- Settlement of the associated derivative asset or liability

In the statement of cash flows, they are presented as two separate transactions, although only one net cash flow has actually occurred.

Illustration 5-3: Forward placement commitment contract

A forward placement commitment contract provides that the buyer purchases a security at $100 in 30 days. The contract is accounted for as a derivative, with an initial fair value of zero. On the 30th day, the market price for the underlying security is $105. The buyer has recognized a derivative asset of $5 for the forward commitment contract. In the statement of cash flows, the buyer would show the settlement of the transaction (including the purchase of the security and the settlement of the forward commitment contract) as the following:

Cash inflows from investing activities:	
Receipts from settlements of derivative contracts	$ 5
Cash outflows for investing activities:	
Payments to acquire securities	($ 105)

The net cash outflows for investing activities of the statement of cash flows is the actual cash payment of $100 made by the buyer.

The cash flows related to the purchase of the securities and settlement of the commitment contract should be presented as investing activities in the statement of cash flows unless the nature of the derivative supports alternative classification. For example, many financial institutions may classify these cash flows as operating because the underlying securities are acquired specifically for resale and carried at fair value in a trading account.

5.8.5.2 Centrally cleared derivatives (added July 2024)

After the financial crisis of 2008, lawmakers and regulators around the world took steps to increase liquidity and reduce counterparty credit risk in the over-the-counter (OTC) derivatives market. In the US, the Dodd-Frank Wall Street Reform and Consumer Protection Act requires many OTC derivatives to be centrally cleared unless the end user qualifies for an exception to this rule. The European Market Infrastructure Regulation also requires central clearing for certain OTC derivatives.

Parties to a centrally cleared OTC derivative exchange daily payments that reflect the daily change in value of the derivative. These payments are commonly referred to as "variation margin" and serve to protect the parties from a loss if one of them were to default. Historically, variation margin payments were typically treated as collateral against the derivative position, and the receiving party pays interest to the party that posted the collateral.

Certain clearinghouses such as the Chicago Mercantile Exchange and LCH. Clearnet Limited amended their rulebooks in 2016 and in 2017 to legally characterize variation margin payments for certain OTC derivatives they clear as settlements of the derivatives' exposures rather than collateral against the exposures. These contracts are commonly referred to as settled-to-market (STM) contracts, in contrast to collateralized-to-market (CTM) contracts where variation margin payments are treated as collateral rather than legal settlements of the derivatives exposure. Refer to section 8.13.3, *Centrally cleared derivative instruments*, of our FRD, ***Derivatives and hedging***, for further details.

As a result of the change to the legal characterization of variation margin payments, questions were raised as to whether variation margin payments and receipts in STM contracts would be required to be presented consistently with other settlement payments of derivatives in the statement of cash flows.

In response to this question, the SEC's Office of the Chief Accountant indicated that the staff would not object to entities presenting variation margin cash flows differently from other cash flows from the related derivative instrument, with one exception. Consistent with the guidance in ASC 230, the SEC staff noted that all cash inflows and outflows (including variation margin payments and receipts) of a derivative instrument that includes an other-than-insignificant financing element at inception should be considered cash flows from financing activities by the borrower.

5.9 Insurance companies (updated May 2025)

ASC 230 does not provide guidance on the cash flow classification of insurance premiums received or benefits paid by an insurance company. We believe that cash flows from these amounts are generally classified as operating activities because they represent the operations of an insurance company. The sections below provide authoritative and interpretive guidance on specific situations relevant for insurance companies.

5.9.1 Insurance companies — investing activities

Insurance companies hold a variety of investments, including stocks, bonds, mortgage loans and real estate. ASC 230 requires separate presentation of cash receipts and cash payments related to investing activities, but it does not provide guidance on the level of detail to be presented for the various types of investments.

Although insurance companies typically capture information about the cost of investments acquired and the proceeds from sales, maturities and repayments of investments by type of investment (e.g., stocks, bonds, mortgage loans) to prepare a statement of cash flows for the Annual Statement they file with state regulatory authorities, we do not believe that this level of detail is required by ASC 230. As such, companies should use their judgment and consideration of other guidance (e.g., ASC 320, *Investments — Debt Securities*, which provides specific guidance) in determining the level of detail they provide. Refer to section 5.4.1, *Acquisitions and sales of certain securities*, for further discussion on the classification of investments in certain securities.

5.9.2 Insurance companies — universal life-type policies

Universal life-type policies are long-duration insurance contracts that do not have fixed and guaranteed terms. ASC 944-20, *Financial Services — Insurance — Insurance Activities*, defines universal life-type policies as life insurance and annuity products that involve significant mortality or morbidity risk to the insurer and that have one or more of the following features (ASC 944-20-15-26):

- One or more policy charges are not fixed by the policy and can include mortality charges that may be changed by the insurance company subject to guaranteed maximums or minimums.
- The policy's account balance (or cash value) or the rate at which interest is credited to the account balance is not fixed and guaranteed by the policy.
- The policyholder can vary the amount of premiums to be paid within policy limits and without consent of the insurance company.

Insurance companies account for universal life-type policies by establishing a liability for the policyholder account balance. Refer to section 4, *Accounting for universal life-type contracts,* of our FRD, ***Accounting for certain life insurance and annuity products***, for further discussion.

The following shows the various transactions that affect the liability for the policyholder account balance on all universal life-type policies during a period.

	Liability — beginning of period	$ XXX
+	Cash receipts from policyholders	XXX
-	Charges for mortality/administration	(XXX)
+	Interest credited	XXX
-	Cash payments for redemption of interest credited	(XXX)
-	Cash payments for return of account balance (e.g., upon surrender of policy or for mortality events)	(XXX)
	Liability — end of period	$ XXX

Universal life-type policies are similar to certain deposits of a financial institution in that they represent a borrowing. Consistent with other borrowings under ASC 230, the cash receipts from policyholders and payments representing a return of policyholder balances should be presented within financing activities in the statement of cash flows. This is similar to the presentation by a financial institution of sales and maturities of certificates of deposit.

Consistent with how other payments of interest are presented in accordance with ASC 230 (ASC 230-10-45-17(d)), cash flows related to interest credited to policyholder accounts would be presented within operating activities in the statement of cash flows. This presentation is also consistent with the way financial institutions present interest credited on certificates of deposit. We believe the redemption of interest credited to policyholders would be presented within operating activities in the statement of cash flows consistent with other interest payments. However, there may be diversity in practice in presenting such cash flows as financing.

Universal life-type policies may also include market risk benefits. Market risk benefits are contracts or contract features that provide protection to the policyholder from capital market risk and expose the insurer to other-than-nominal capital market risk. Similar to the treatment of interest credited to policyholders, cash flows related to changes in the market risk benefit liability and redemption of the liability (i.e., the amount in excess of the account balance) would generally be presented within operating activities. However, some insurance companies present redemptions as financing activities, as these redemptions are generally paid with the account balance in connection with a surrender or mortality event.

Universal life contracts may also include other contract features that provide for benefits in addition to the account balance that don't meet the criteria of market risk benefits or embedded derivatives, such as those protecting the death benefit of a life contract (e.g., secondary guarantees under universal life insurance policies), annuitization or other insurance benefits. We believe that cash flows from these amounts are generally classified as operating activities as they represent the operations of an insurance company.

Charges for mortality, administration and similar items that are recognized as revenue in the insurance company's income statement should be treated as operating cash inflows in the statement of cash flow presentation.

5.9.3 Insurance companies — policy acquisition costs

An insurance entity should capitalize, except in limited situations, acquisition costs that are related directly to the successful acquisition of new or renewal insurance contracts, such as commission payments to agents, and amortize these costs to expense over the policy term in accordance with ASC 944-30. These deferred policy acquisition costs should be presented as an operating cash flow when paid. Refer to section 3.1, *Deferrable acquisition costs,* of our FRD, ***Accounting for certain life insurance and annuity products***, and the *Deferred acquisition costs* section of our Technical Line, ***A closer look at how insurers will have to change their accounting and disclosures for long-duration* contracts**, for further discussion.

5.9.4 Insurance companies — funds withheld reinsurance arrangements

Funds withheld reinsurance arrangements are structured similarly to other reinsurance contracts (i.e., coinsurance contracts). When risk is transferred, the ceding entity records a reinsurance recoverable for the reserves of the underlying policies ceded to the reinsurer and the assuming entity records a liability for its share of reserves. The "funds withheld" provision permits the ceding entity to retain the assets relating to the underlying policies. Essentially, at the inception of the contract, there is a "hypothetical loan" from the assuming entity to the ceding entity equal to the portfolio of assets (and reserves) that were not transferred from the ceding entity to the assuming entity as part of the reinsurance arrangement. The amounts withheld are recorded as a liability by the ceding entity and a receivable by the assuming entity, and the change, including cash flows related to net settlement, would be presented within operating activities.

If the funds withheld reinsurance arrangement does not transfer risk, the ceding entity and assuming entity should account for the funds withheld as a deposit (i.e., financing) by applying deposit accounting in accordance with ASC 340-30, *Other Assets and Deferred Costs — Insurance Contracts That Do Not Transfer Insurance Risk*. In this situation, the ceding entity should present changes in the funds withheld liability and adjustments due to policyholder activities (e.g., premium payments and claim receipts) as financing cash flows similar to how other borrowings are presented in the statement of cash flows.

The assuming entity should also present changes in the funds withheld receivable and policyholder activities as investing cash flows, because they would be considered receipts from collections of loans made by the assuming entity in accordance with ASC 230-10-45-12(a).

The ceding entity should consider the guidance above on universal life-type policies (refer to section 5.9.2, *Insurance companies — Universal life-type policies* for the interest credited on the funds withheld liability). The assuming entity should present the interest income on the funds withheld receivable in investing activities in the statement of cash flows because they would be considered receipts from collections of loans made by the assuming entity in accordance with ASC 230-10-45-12(a).

5.10 Other transactions

5.10.1 Insurance claim proceeds

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

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 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.

230-10-45-21C

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

ASC 230 requires entities to classify insurance settlement proceeds (except those related to corporate- or bank-owned life insurance policies) based on the related insurance coverage (i.e., the nature of the loss). Entities are required to allocate a lump-sum settlement that relates to more than one type of loss (e.g., loss of a building in a fire and business interruption costs) to each type of loss to determine how the proceeds should be classified.

ASC 230 also requires entities to classify corporate, including bank-owned life insurance (COLI) settlement proceeds as cash inflows from investing activities. Cash payments for premiums on COLI are classified as cash outflows for investing activities, operating activities or a combination of them both.

5.10.2 Securities lending

Securities lending transactions typically are initiated by securities dealers, broker-dealers and other financial institutions that need specific securities to make deliveries, either to cover a short sale or a customer's failure to deliver securities sold. Securities lending arrangements are an alternative to purchasing securities in the open market and may be preferred to better manage a dealer's inventory in any number of ways. As viewed by the marketplace, in a typical securities lending transaction, a borrower provides cash or a security (or pool of securities) as collateral for borrowing a specific security or securities.

Securities lending transactions involve transfers of financial assets that must be evaluated for accounting as either sales or secured borrowings. In some securities lending transactions, the criteria for a sale of financial assets are met. During the term of such an agreement, the securities lender or transferor surrenders control over the securities transferred, and the borrower of securities or transferee obtains control over those transferred securities with the ability to sell or transfer them. However, most securities lending transactions are accompanied by an agreement that entitles and obligates the transferor to repurchase or redeem the transferred securities before their maturity. Such transfers are generally accounted for as secured borrowings under ASC 860 because of the transferor's obligation to repurchase or redeem the transferred securities before their maturities.

With respect to the treatment of securities lending arrangements by the securities lender in the statement of cash flows, practice varies in presenting the receipt of cash collateral in exchange for transferred securities accounted for as a secured borrowing and the subsequent reinvestment of that cash. We believe that it is most appropriate to reflect the receipt of cash in exchange for the transferred security as a financing inflow similar to a borrowing arrangement. The subsequent repurchase of the transferred securities would be accounted for as a financing cash outflow (i.e., a repayment of the borrowing). Many entities that engage in securities lending arrangements are broker-dealers or other financial institutions, and they frequently report such activity as an operating activity.

5.10.3 Fair value option for financial assets and liabilities

The guidance in ASC 825-10-45-3 indicates that cash receipts and payments related to items for which the fair value option (FVO) is elected should be classified within the statement of cash flows based on the nature and purpose for which the items were acquired or incurred, consistent with the cash flow statement classification guidance above (refer to section 5.4.1, *Acquisitions and sales of certain securities,* for further guidance). Similar to securities classified as trading, cash receipts and cash payments related to items measured under the FVO guidance could be classified within operating activities (for those instruments acquired with the intent to sell in the near term), within investing activities (for those instruments acquired with no intent to sell in the near term), or a portion in operating activities and a portion in investing activities (for instruments acquired with different intent).

5.10.4 Carve-out financial statements

When preparing financial statements for a carve-out entity, the statement of cash flows should reflect the relevant information about the cash receipts and cash payments of the carve-out entity during the periods presented in accordance with ASC 230. For example, intercompany transactions that were eliminated in the parent entity's financial statements often comprise a substantial amount of activity in the carve-out statement of cash flows. Refer to section 4.2, *Statement of cash flows*, of our publication, ***Guide to preparing carve-out financial statements***, for further discussion.

5.10.5 Transactions with noncontrolling interest holders while control is maintained

While ASC 230 does not provide specific guidance on the statement of cash flow presentation for transactions with noncontrolling interest holders, it does state that "proceeds from issuing equity instruments" and "payment of dividends or other distributions to owners, including outlays to reacquire the entity's equity instruments" are financing activities (ASC 230-10-45-14 and 45-15). As such, we believe that equity transactions with noncontrolling interest holders while control is maintained that are in the scope of ASC 810, *Consolidation*, should be presented within financing activities in the statement of cash flows. This view is consistent with guidance in ASC 810 that all residual economic interest holders have an equity interest in the consolidated entity, even if the residual interest is related to a subsidiary, and the requirement to present noncontrolling interests in the consolidated statement of financial position as a separate component of equity. Further, this view is consistent with its requirement for changes in a parent's ownership interest in a subsidiary, while the parent retains a controlling financial interest, to be accounted for as equity transactions.

5.10.6 Funds held on behalf of others — classification

As discussed in section 2.2, *Disclosure and presentation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents,* ASC 230-10-45-4 requires entities to show the changes in the total of cash, cash equivalents, restricted cash and restricted cash equivalents in the statement of cash flows. While ASC 230 acknowledges that cash, cash equivalents, restricted cash and restricted cash equivalents controlled by the entity may be presented in more than one line item on the balance sheet, it requires entities to explain the changes in those amounts in the statement of cash flows. That is, an entity must identify all cash, cash equivalents, restricted cash and restricted cash equivalents that are included on its balance sheet to use as the starting point for preparing its statement of cash flows.

As discussed in section 3.6.1, *Funds held on behalf of others,* entities in certain industries (e.g., payroll, payment processing and insurance service providers) may hold cash and cash equivalents on behalf of their customers or other parties. There may be certain contractual and/or regulatory restrictions related to how the entity may use such cash (refer to section 3.4, *Restricted cash and restricted cash equivalents*, for further discussion). An entity that holds cash and cash equivalents on behalf of others should carefully evaluate whether it controls the cash and cash equivalents and, if so, recognize those amounts on its balance sheet and include them in the beginning and ending cash and cash equivalents balance on the statement of cash flows.

The cash inflows and cash outflows from cash and cash equivalents held on behalf of others should be classified based on the nature of the underlying cash flows. We understand that the SEC staff believes these cash flows are most appropriately classified as financing activities. This approach considers the funds held on behalf of others a borrowing that is settled when the funds are disbursed. However, classification as operating activities may also be acceptable.

Separately, we believe cash inflows and outflows from temporarily investing cash and cash equivalents held on behalf of others in noncash or noncash-equivalent investments are generally classified as investing activities.

5.10.7 Assets donated to not-for-profits, including those with restrictions

Excerpt from Accounting Standards Codification

Not-for-Profit Entities — Statement of Cash Flows

Implementation Guidance and Illustrations

958-230-55-3

When an NFP reports cash received (or cash receipts from the sale of donated **financial assets** that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash as discussed in paragraph 230-10-45-21A) with a **donor-imposed restriction** that limits its use to long-term purposes in conformity with paragraph 958-210-45-6, an adjustment to the change in net assets to reconcile to net cash flows from operating activities is necessary when using the indirect method of reporting cash flows in order to present those cash receipts as cash inflows from financing activities as required by paragraph 230-10-45-14(c).

Pending Content:

Transition Date: *(P) December 16, 2024; (N) December 16, 2024* | **Transition Guidance:** 350-60-65-1

When an NFP reports cash received (or cash receipts from the sale of donated **financial assets** or crypto assets accounted for in accordance with Subtopic 350-60 that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash as discussed in paragraph 230-10-45-21A) with a **donor-imposed restriction** that limits its use to long-term purposes in conformity with paragraph 958-210-45-6, an adjustment to the change in net assets to reconcile to net cash flows from operating activities is necessary when using the indirect method of reporting cash flows in order to present those cash receipts as cash inflows from financing activities as required by paragraph 230-10-45-14(c).

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-21A

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

Pending Content:

Transition Date: *(P) December 16, 2024; (N) December 16, 2024* | **Transition Guidance:** 350-60-65-1

Cash receipts resulting from the sale of donated **financial assets** (for example, donated debt or equity instruments) or crypto assets accounted for in accordance with Subtopic 350-60 by NFPs that upon receipt were directed without any NFP-imposed limitations for sale and were converted nearly immediately into cash shall be classified as operating cash flows. If, however, the donor restricted the use of the contributed resource to a long-term purpose of the nature of those described in paragraph 230-10-45-14(c), then those cash receipts meeting all the conditions in this paragraph shall be classified as a financing activity.

5.10.7.1 Collections — not-for-profit entities

A not-for-profit that holds works of art, historical treasures and similar items that meet the definition of a collection may choose not to capitalize the collection in accordance with ASC 958-360-25-3. Cash flows from the purchase, sale or insurance recoveries of both capitalized and noncapitalized collection items are reported as investing activities in the statement of cash flows (refer to ASC 958-230-55-5A for statement of cash flow guidance on noncapitalized collection items).

5.11 Crypto assets

5.11.1 Purchase and sale of crypto assets

Cash receipts and payments related to a sale or purchase of crypto assets should be classified as operating, investing or financing transactions according to their nature and purpose as prescribed by ASC 230. If the cash receipts and payment are classified as an investing or financing activity, they should be presented gross in the statement of cash flows unless they are eligible for net presentation. Refer to section 2.4, *Gross versus net cash flows*, for examples of when net presentation may be appropriate.

5.11.2 Crypto assets received as noncash consideration in the ordinary course of business (added July 2024)

Excerpt from Accounting Standards Codification

Statement of Cash Flows — Overall

Other Presentation Matters

230-10-45-27A

Pending Content:

Transition Date: *(P) December 16, 2024; (N) December 16, 2024* | **Transition Guidance:** 350-60-65-1

If crypto assets accounted for in accordance with Subtopic 350-60 are received as noncash consideration in the ordinary course of business (for example, in exchange for goods and services transferred to a customer) and converted nearly immediately into cash, the cash received shall be classified as operating activities. In this context, the term nearly immediately refers to a short period of time that is expected to be within hours or a few days, rather than weeks.

FASB amendment

The FASB issued ASU 2023-08, *Intangibles — Goodwill and Other — Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets*, in December 2023. The guidance requires an entity to classify cash receipts from the sale of crypto assets that it receives as noncash consideration in the ordinary course of business and converts nearly immediately into cash as cash flows from operating activities. The ASU does not otherwise provide any guidance in classifying cash flows associated with crypto assets, but rather management should continue to apply judgment based on an entity's facts and circumstances, focusing on the nature of the cash flows and the purpose of the activities that give rise to them. The guidance is effective for all entities for fiscal years beginning after 15 December 2024, including interim periods within those fiscal years. Early adoption is permitted.

5.11.3 Lending of crypto assets (added May 2025)

When an entity lends crypto assets to a borrower, the exchange of those loaned crypto assets is analogous to making and collecting loans. Therefore, we believe that it is appropriate for the lender to present the transaction as a noncash investing activity. Refer to section 4.6, *Noncash investing and financing activity*, for more information. Any gains or loss on the exchange, income statement effects of the credit loss allowance or lender fees received in the form of crypto assets would be presented as a reconciling item in the reconciliation of net income to net cash flow from operating activities.

6 Foreign currency cash flows

6.1 Overview

Entities with foreign currency transactions or foreign operations are required to include the reporting currency equivalent of foreign currency cash flows in the cash flow statement using exchange rates in effect at the time the cash flows occur (ASC 830-230-45-1). The effect of exchange rate changes on foreign currency cash, cash equivalents, restricted cash and restricted cash equivalents balances, which are relevant to understanding changes in cash but do not result from actual cash flows, should be presented as a separate part of the reconciliation of the change in cash, cash equivalents, restricted cash and restricted cash equivalents. Usually, this requirement is met by:

1. Preparing separate statements of cash flows for the foreign operations in the functional currency of those foreign operations
2. Translating these cash flow statements to the reporting currency
3. Consolidating them along with the cash flow statements of the domestic entities

This process is known as the consolidating approach. Although the consolidating approach is more precise in the preparation of the statement of cash flows, companies may use alternative approaches to approximate the effects of exchange rates on the statement of cash flows. An alternative is discussed further in section 6.3, *Alternatives to the consolidating approach*.

6.2 Presenting the effects of exchange rate changes (translation)

Excerpt from Accounting Standards Codification

Foreign Currency Matters

Statement of Cash Flows

830-230-45-1

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

Foreign currency translation

Because translation effects do not represent cash receipts or payments, they are not included as cash flows from operating, investing or financing activities. The effects of translation are recognized in other comprehensive income and may affect the ultimate amount of a cash receipt or payment from the perspective of a consolidating parent. However, exchange rate changes on cash balances in and of themselves do not give rise to cash flows.

Foreign currency transactions

The cash flow effects of foreign currency transactions should be remeasured to the functional currency of the entity that entered the transaction by using the exchange rates in effect at the time of the cash flows. It is acceptable to use an appropriately determined weighted average exchange rate for the period for remeasuring foreign currency transactions if the result is substantially similar to using actual rates in effect at the dates of each cash flow.

At the balance sheet date, monetary assets and liabilities that are denominated in currencies other than functional currency are remeasured into the functional currency. Periodic changes in these remeasurements before settlement (or other liquidation) are accounted for as foreign currency gains and losses and, therefore, affect reported earnings. For example, a US functional currency company may have a Japanese yen-denominated loan. At each reporting period before these accounts are settled, the US functional currency company would remeasure the yen-denominated loan to dollars.

Remeasurement effects do not result in actual cash flows, so adjustments within the cash flow statement are necessary to eliminate the extent to which net income has been affected by remeasurement. Remeasurement effects should be classified according to the nature of the transaction. Depending on the timing of when the underlying transaction is recorded and settled, entities will have to determine whether foreign currency transaction gains and losses should be presented as reconciling items in the reconciliation of net income and net cash flow from operating activities. Consider the following example:

Illustration 6-1: Foreign currency transaction gain or loss

Assume Company A (US company with US dollar functional currency) makes a sale denominated in yen in the amount of 10,000 yen on 5 January 20X0. The exchange rate at the time is $1 to 100 yen.

Receivable	$	100		
Revenue			$	100

To record the sale in US dollars based on the exchange rate in effect at the time of the transaction.

On 31 March 20X0, the exchange rate is $1 to 80 yen.

Receivable	$	25		
FX Gain			$	25

To record the change in exchange rate as of the end of the period. Calculated as the difference between (10,000 yen/80) and (10,000 yen/100).

On 31 March 20X0, the transaction is settled.

Cash	$	125		
Receivables			$	125

To record the settlement of the transaction.

If the sale and collection of the receivable occur in the same period, there would be no reconciling item between net income and net cash flow from operating activities. In the example above, the total net income recorded and the net cash flow from operating activities are both $125. However, if the receivable is collected after the balance sheet date (e.g., 15 April 20X0), the unrealized foreign exchange gain accrued as of 31 March 20X0 by increasing accounts receivable at the balance sheet date ($25) would be included with changes in the accounts receivable balance. Therefore, the unrealized foreign exchange gain would be a noncash reconciling item to offset this change in accounts receivable under the indirect method. Under the direct method, a company that determines cash received from customers by adjusting sales by the change in receivables during the period (i.e., the indirect-direct method) also will have to consider the change in receivables resulting from an unrealized exchange gain or loss.

Unrealized exchange gains or losses (i.e., from remeasurement of amounts denominated or stated in another currency) are presented as a reconciling item in the reconciliation of net income and net cash flow from operating activities, similar to the presentation of depreciation and other noncash income and expense items.

Under the indirect method, if a foreign currency exchange gain or loss relates to an investing or financing transaction (e.g., repayment of foreign currency-denominated debt), that exchange gain or loss would be presented in the reconciliation from net income to net cash flows from operating activities. In the period when the transaction that generates the exchange gain or loss is settled, the associated cash receipt or payment is classified as an operating, investing or financing cash flow depending on the nature of the transaction (i.e., the classification of the actual foreign currency cash flows upon settlement is not affected by the fact that actual cash flows are denominated in a currency other than the functional currency).

Illustration 6-2: Exchange gain or loss on financing activity

Assume Company A (US company with US dollar functional currency) enters into a foreign currency-denominated borrowing agreement with a bank in the amount of €10,000 on 9 January 20X0. The exchange rate at the time is $1 to €0.80.

Cash	$ 12,500	
Loan payable		$ 12,500

To record the borrowing based on the exchange rate in effect at the time of the transaction.

On 31 March 20X0, the exchange rate is $1 to €0.75.

FX Loss	$ 833	
Loan payable		$ 833

To record the change in exchange rate as of the end of the period. Calculated as the difference between (€10,000/0.80) and (€10,000/0.75).

On 31 March 20X0, Company A repays the borrowing.

Loan payable	$ 13,333	
Cash		$ 13,333

To record the repayment of the borrowing.

In this scenario, an exchange loss of $833 would be a reconciling item in the reconciliation of net income and net cash flow from operating activities, and the cash payment of $13,333 would be presented as a financing activity. Even if the transaction was not settled on 31 March 20X0, an unrealized exchange loss of $833 would still be a reconciling item in the reconciliation of net income and net cash flow from operating activities because the exchange gain or loss included in the determination of net income is a noncash item.

Cash payments and cash receipts related to foreign currency hedging transactions follow the guidance in ASC 230-10-45-27. Refer to section 5.8, *Derivatives and hedging*.

6.3 Alternatives to the consolidating approach

Although many companies use the consolidating approach (as generally described in section 6.1, *Overview*), others look for other ways of preparing the consolidated statement of cash flows. Alternatives to the consolidating approach may be particularly appealing to companies with many foreign operations, most of which are individually insignificant to the consolidated financial statements.

Many companies consider the effects of exchange rate fluctuations on changes in the balance sheet amounts in which gross cash receipts and payments must be presented in the statement of cash flows (e.g., fixed assets, long-term borrowings). However, few companies analyze the effects of exchange rate changes for items presented net in the statement of cash flows (e.g., accounts receivable, inventories, accounts payable).

Companies can approximate the effects of exchange rate changes by making detailed calculations only for selected subsidiaries or even selected cash receipts or payments of those subsidiaries that will significantly affect the consolidated statement of cash flows. For any such expedient technique to be acceptable, it must approximate the results that would be expected to be obtained if more precise data were used.

6.4 Preparing and translating a foreign currency statement of cash flows

The following illustration depicts how to prepare a local functional currency statement of cash flows and translate it into a reporting currency cash flow statement.

Illustration 6-3: Preparing and translating a foreign currency statement of cash flows

Assume the following financial information for Overseas Company (OC), a wholly owned foreign subsidiary of a US company that has determined FC to be its functional currency.

OC's balance sheets

		31 December				Increase
		20X9		**20X8**		**(decrease)**
Assets						
Current assets:						
Cash, cash equivalents and restricted cash	FC	752,222	FC	535,784	FC	216,438
Accounts receivable		1,400,000		1,685,000		(285,000)
Inventories		1,500,000		1,600,000		(100,000)
Prepaid expenses		75,000		-		75,000
		3,727,222		3,820,784		(93,562)
Property and equipment		2,400,000		2,250,000		150,000
Accumulated depreciation		(410,000)		(260,000)		(150,000)
		1,990,000		1,990,000		-
	FC	5,717,222	FC	5,810,784	FC	(93,562)

Liabilities and shareholder's equity

		31 December				
		20X9		**20X8**		**Increase (decrease)**
Current liabilities:						
Accounts payable and accrued expenses	FC	2,036,281	FC	1,740,429	FC	295,852
Intercompany debt		738,915		946,372		(207,457)
		2,775,196		2,686,801		88,395
Long-term debt		1,600,000		2,000,000		(400,000)
Deferred income taxes		60,000		45,000		15,000
Shareholder's equity						
Capital stock		600,000		600,000		-
Paid-in capital		200,000		200,000		-
Retained earnings		482,026		278,983		203,043
		1,282,026		1,078,983		203,043
	FC	5,717,222	FC	5,810,784	FC	(93,562)

OC's 20X9 statement of income and retained earnings

Sales	FC	7,800,000
Other income		31,211
		7,831,211
Cost and expenses		
Cost of goods sold		6,410,000
General and administrative		650,000
Depreciation		150,000
Interest		220,000
		7,430,000
		401,211
Foreign currency remeasurement gain		207,457
Income before income taxes		608,668
Income taxes:		
Current		290,625
Deferred		15,000
		305,625
Net income		303,043
Retained earnings at 1 January 20X9		278,983
		582,026
Less dividends paid		(100,000)
Retained earnings at 31 December 20X9	FC	482,026

Assume the following additional information.

The exchange rate between the US dollar and the FC was .317 at 31 December 20X8, .406 at 31 December 20X9 and the weighted average exchange rate for 20X9 was .346.

Additional information:

- The only change in property and equipment other than the annual depreciation charge was a cash purchase of property on 1 January 20X9 for FC 150,000.
- The FC 400,000 decrease in long-term debt relates to principal payments.
- The FC 207,457 remeasurement gain relates to intercompany debt denominated in US dollars.
- The FC 100,000 dividend was paid on 31 December 20X9.
- Interest payable decreased by FC 10,000, and income taxes payable increased by FC 15,625 during 20X9.
- Changes in all other balances occurred ratably during the year.

OC's cash flow statement, prepared in FC and then translated to US dollars, is illustrated below:

OC's statement of cash flows
Year ended 31 December 20X9

		Local currency	Exchange rate	Reporting currency
Operating activities				
Net income	FC	303,043	.346(1)	$ 104,852
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation		150,000	.346(1)	51,900
Deferred taxes		15,000	.346(1)	5,190
Decrease in accounts receivable		285,000	.346(1)	98,610
Decrease in inventories		100,000	.346(1)	34,600
Increase in prepaid expenses		(75,000)	.346(1)	(25,950)
Increase in accounts payable and accrued expenses		295,852	.346(1)	102,365
Foreign currency remeasurement gain		(207,457)	.346(1)	(71,780)
Net cash provided by operating activities		866,438	.346(1)	299,787
Investing activities				
Purchases of property and equipment		(150,000)	.317(2)	(47,550)
Net cash used by investing activities		(150,000)		(47,550)
Financing activities				
Repayment of long-term debt		(400,000)	.346(1)	(138,400)
Cash dividend		(100,000)	.406(3)	(40,600)
Net cash used by financing activities		(500,000)		(179,000)
Effect of exchange rate changes on cash, cash equivalents and restricted cash		N/A		62,321(5)
Increase in cash, cash equivalents and restricted cash		216,438		135,558
Cash, cash equivalents and restricted cash at beginning of year		535,784	.317(4)	169,844
Cash, cash equivalents and restricted cash at end of year	FC	752,222	.406(4)	$ 305,402

(1) Weighted average rate.

(2) This illustration assumes that the purchase of property and equipment was made on 1 January 20X9 to demonstrate the statement of cash flow implications. More commonly, companies purchase property and equipment throughout the year and, if so, it is generally acceptable to translate these purchases using the weighted average rate.

(3) Dividend was paid 31 December 20X9.

(4) Rate at respective period end.

(5) This amount is calculated as:

Beginning cash, cash equivalents and restricted cash balance in local currency	FC	$ 535,784		
Net change in exchange rate during year (.406 — .317)		.089	$	47,684
Net cash provided by operating activities in local currency		866,438		
Year-end exchange rate		.406		351,774
Less: net cash flows provided by operating activities in US dollars				299,787
				51,987
Net cash used by investing activities in local currency		(150,000)		
Year-end exchange rate		.406		(60,900)
Less: net cash flows provided by investing activities in US dollars				(47,550)
				(13,350)
Net cash used by financing activities in local currency		(500,000)		
Year-end exchange rate		.406		(203,000)
Less: net cash flows provided by financing activities in US dollars				(179,000)
				(24,000)
Effect of exchange rate changes on cash, cash equivalents and restricted cash				$ 62,321

Cash provided by operating activities using the direct method would be calculated below:

Illustration 6-4: Translated operating cash flows — direct method

	Local currency	Exchange rate	US dollar
Cash received from customers	FC 8,085,000(1)	.346(2)	$ 2,797,410
Other cash received	31,211	.346(2)	10,799
Cash paid to suppliers and employees	(6,744,773)(1)	.346(2)	(2,333,692)
Interest paid	(230,000)(3)	.346(2)	(79,580)
Income taxes paid	(275,000)(3)	.346(2)	(95,150)
	FC 866,438		$ 299,787

(1) This amount could be derived — refer to section 2.3.1, *Direct method*.

(2) Weighted average exchange rate during the year.

(3) Differences between these amounts and corresponding amounts reported in the statement of income are due to changes in beginning and end of year interest and income tax accruals recorded within accounts payable and accrued expenses.

6.5 Foreign subsidiaries that have their parent's functional currency

In certain cases, the functional currency of a foreign subsidiary is not the local currency, but is instead the same as the reporting currency. Notwithstanding this determination, the accounting records of the foreign entity are often maintained in the local currency. After the remeasurement process into the parent's functional currency has been completed (which in this case is the same as the reporting currency), compilation of the entity's cash flow statement and consolidation of cash flow activities of the foreign subsidiary into its parent's cash flow statement would proceed as if the foreign subsidiary maintained its accounting records in the parent's functional currency.

6.5.1 Highly inflationary economies

ASC 830-10-45-11 states that a highly inflationary economy is one that has cumulative inflation of approximately 100% or more over a three-year period. The financial statements of a foreign entity in a highly inflationary economy are remeasured as if the functional currency were the reporting currency. Accordingly, a US parent's subsidiary in a highly inflationary economy would use the US dollar as its functional currency. When a US parent's subsidiary that operates in a highly inflationary economy has local currency borrowings that include provisions for interest rate adjustments based on inflation rates, sometimes referred to as the monetary correction element, interest payments on these borrowings, which would include both the nominal and monetary correction elements, should be reported as cash flows from operating activities similar to all other interest paid.

A Illustrative statement of cash flows example for a commercial company

This appendix illustrates the application of the guidance in ASC 230 by a US manufacturing entity, USCO, Inc., that has no foreign operations or foreign currency transactions. Section 6, *Foreign currency cash flows*, illustrates statement of cash flow reporting by entities with foreign operations. ASC 230 also contains comprehensive examples of cash flow reporting by a manufacturing entity (ASC 230-10-55), a multinational entity (ASC 830-230-55) and a financial institution (ASC 942-230-55).

A.1 Complete statement of cash flows — indirect method

The following illustration depicts the process of analyzing changes in the consolidated balance sheet amounts and demonstrates how certain transactions should be presented in a statement of cash flows.

Illustration A-1: Consolidated balance sheets, statement of income and assumptions

Consolidated balance sheets

	31 December	
	20X5	20X4
Assets		
Cash and cash equivalents	$ 6,500	$ 5,500
Restricted cash	700	250
Accounts receivable, less allowance of $900 in 20X5 and $500 in 20X4	29,000	20,000
Notes receivable	5,000	12,000
Inventories	50,000	44,000
Prepaid expenses	1,500	500
Other long-term assets (includes long-term restricted cash of $300 in 20X5 and $250 in 20X4)	3,300	3,250
Property, plant and equipment	100,050	83,050
Accumulated depreciation and amortization	(35,550)	(30,550)
Equity method investment	6,200	4,100
Intangible assets	2,800	1,400
	$ 169,500	$ 143,500
Liabilities and shareholders' equity		
Short-term notes payable	3,000	7,000
Accounts payable and accrued expenses	33,000	27,650
Long-term debt	35,000	21,000
Finance lease liabilities	16,500	14,900
Deferred income taxes	3,000	2,000
Common stock	19,000	16,000
Retained earnings	60,000	54,950
	$ 169,500	$ 143,500

Consolidated statement of income

Year ended 31 December 20X5

Sales	$ 150,000
Other income	10,000
Cost of sales	(122,000)
Selling and administrative	(15,400)
Depreciation and amortization	(8,600)
Equity method income	3,000
Gain on sale of equipment	2,500
Interest expense	(5,500)
Income tax expense	(6,000)
Net income	$ 8,000

Assume the following additional information:

A. During 20X5, USCO purchased the common stock of Target for $8,000 cash. The Target's assets and liabilities were recognized and measured in accordance with ASC 805 as follows at the date of acquisition:

Cash	$ 300
Accounts receivable	2,000
Inventory	3,000
Property, plant and equipment	10,000
Finite-lived intangible assets	2,000
Accounts payable and accrued expenses	(1,500)
Long-term debt	(7,800)
	$ 8,000

B. USCO wrote off $350 of bad debts and recognized a provision for losses on receivables (in selling and administrative expense) of $750.

C. Included in accounts payable and accrued expenses are accruals for income taxes payable of $3,500 and $3,000 and for interest payable of $2,300 and $2,000, as of 31 December 20X5 and 20X4, respectively.

D. USCO collected principal of $2,500 on an installment note receivable related to a sale of product and $4,500 on a note receivable from the sale of a plant in 20X4.

E. USCO entered into a finance lease for equipment with a present value of lease payments of $2,000. Principal payments on this and other finance lease liabilities amounted to $400.

F. USCO borrowed $9,000 on a long-term basis during the year and made payments of $1,800 on long-term debt.

G. USCO borrowed $5,500 and repaid $9,500 under a revolving credit agreement with an original maturity of one year. USCO signed a single note with a one-year term when the agreement occurred for the maximum amount available under the line of credit.

H. USCO received a dividend (i.e., a return on investment) of $900 from an equity method investee.

I. USCO received $6,500 from the sale of equipment with a net book value of $4,000 and an original cost of $7,000.

J. USCO constructed a new warehouse for its use for $12,000, including capitalized interest of $300.

K. USCO's depreciation expense (including amortization of finance lease right-of-use assets), amortization of intangibles and provision for deferred taxes were $8,000, $600 and $1,000, respectively.

L. USCO issued $3,000 of additional common stock, $2,000 for cash and $1,000 upon the conversion of long-term debt.

M. USCO paid dividends of $2,950 to shareholders.

The following illustrates a worksheet technique that identifies information to be reported in a statement of cash flows.

Numerical references in parentheses map to information presented in the statement of cash flows and related disclosures that are illustrated after the worksheet.

Illustration A-2: Statement of cash flows worksheet

	Consolidated increase (decrease)	Purchase of Target	Increase (decrease) excluding effects of the Target purchase		
Assets					
Cash and cash equivalents	$ 1,000	$ (300) (1)	$ 700 (4)		
Restricted cash	450		450 (5)	Provision for bad debts	$ (750) (7)
Accounts receivable, less allowance of $900 in 20X5 and $500 in 20X4	9,000	(2,000)	7,000 (6)	Increase before provision for bad debts	7,750 (8)
					$ 7,000
				Payment received on installment sale of product	$ (2,500) (9)
Notes receivable	(7,000)		(7,000)	Payment received on note for sale of plant	(4,500) (10)
					$ (7,000)
Inventories	6,000	(3,000)	3,000 (11)		
Prepaid expenses	1,000		1,000 (12)		
Other long-term assets	50		50 (5a)*	Purchase of property, plant and equipment	$ 12,000 (13)
Property, plant and equipment	17,000	(10,000)	7,000	Acquisition of equipment under finance lease	$ 2,000 (14)
				Original cost of equipment sold	(7,000) (15)
					$ 7,000
				Depreciation expense	$ (8,000) (16)
Accumulated depreciation and amortization	(5,000)		(5,000)	Accumulated depreciation of equipment sold	3,000 (17)
					$ (5,000)
				Equity method income	$ 3,000 (18)
Equity method investment	2,100		2,100	Dividend received from equity method investee	(900) (19)
					$ 2,100
	$ 26,000	($ 17,300) (2)	$ 8,700		

* The $50 increase in Other long-term assets is related to a change in the long-term restricted cash balance.

	Consolidated increase (decrease)	Purchase of Target		Increase (decrease) excluding effects of the Target purchase				
Liabilities and shareholders' equity								
Short-term notes payable	$ (4,000)			$ (4,000)		Proceeds from borrowing under revolving line of credit	$ 5,500	(21)
						Repayments of borrowings under revolving line of credit	(9,500)	(22)
							$ (4,000)	
Accounts payable and accrued expenses	5,350	($1,500)		3,850		Increase in accrued income tax	$ 500	(23)
						Increase in accrued interest	300	(24)
						Increase in accounts payable and other accrued expenses	3,050	(25)
							$ 3,850	
Long-term debt	14,000	(7,800)		6,200		New long-term borrowings	$ 9,000	(26)
						Repayment of long-term borrowings	(1,800)	(27)
						Conversion of long-term debt to common stock	(1,000)	(28)
							$ 6,200	
Finance lease liabilities	1,600			1,600		New finance lease	$ 2,000	(29)
						Principal payments on finance lease liabilities	(400)	(30)
							$ 1,600	
Deferred income taxes	1,000			1,000	(31)			
Common stock	3,000			3,000		Sale of common stock for cash	$ 2,000	(32)
						Issuance of common stock upon conversion of long-term debt	1,000	(33)
							$ 3,000	
Retained earnings	5,050			5,050		Net income	$ 8,000	
						Dividends paid to shareholders	(2,950)	(34)
	$ 26,000	($ 9,300)	(3)	$ 16,700			$ 5,050	

Illustration A-3: Statement of cash flows — indirect method

Year ended 31 December 20X5		
Operating activities		
Net income	$ 8,000	
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	8,600	(16) + (20)
Provision for losses on accounts receivable	750	(7)
Provision for deferred income taxes	1,000	(31)
Undistributed earnings of equity method investee	(2,100)	(18) + (19)
Gain on sale of equipment	(2,500)	
Payment received on installment sale	2,500	(9)
Changes in assets and liabilities, net of effects from purchase of Target:		
Increase in accounts receivable	(7,750)	(8)
Increase in inventories	(3,000)	(11)
Increase in prepaid expenses	(1,000)	(12)
Increase in accounts payable and accrued expenses	3,850	(23) + (24) + (25)
Net cash provided by operating activities	8,350	
Investing activities		
Purchases of property, plant and equipment	(12,000)	(13)
Purchase of Target, net of cash acquired	(7,700)	(2) − (3) − (1)
Proceeds from sale of equipment	6,500	(15) − (17) + ($2,500)*
Payment received on note for sale of plant	4,500	(10)
Net cash used in investing activities	(8,700)	
Financing activities		
Proceeds from revolving line of credit and long-term borrowings	14,500	(21) + (26)
Principal payments on revolving line of credit, long-term debt and finance lease liabilities	(11,700)	(22) + (27) + (30)
Proceeds from sale of common stock	2,000	(32)
Dividends paid	(2,950)	(34)
Net cash provided by financing activities	1,850	
Net increase in cash, cash equivalents and restricted cash	1,500	(1) + (4) + (5) + (5a)
Cash, cash equivalents and restricted cash at beginning of year	6,000	
Cash, cash equivalents and restricted cash at end of year	$ 7,500	

* Proceeds from sale of equipment includes the $2,500 gain on sale of equipment to arrive at the total amount of $6,500

Supplemental Disclosures:

Reconciliation of cash, cash equivalents and restricted cash: The following table provides a reconciliation of cash, cash equivalents and restricted cash reported on the balance sheet that sum to the total of the same such amounts shown in the statement of cash flows.

	12/31/20X5
Cash and cash equivalents	$ 6,500
Restricted cash	700
Long-term restricted cash (within other long-term assets)	300
Total cash, cash equivalents and restricted cash shown in the statement of cash flow	$ 7,500

Significant accounting policies note: USCO considers all highly liquid investments with a maturity of three months or less when purchased to be cash equivalents. USCO uses the cumulative earnings approach for classifying distributions received from equity method investees.

Restricted cash note: Amounts included in restricted cash represent those required to be set aside by a contractual agreement with an insurer for the payment of specific workers' compensation claims. Restricted cash included in other long-term assets represent amounts pledged as collateral for long-term financing arrangements as contractually required by a lender. The restriction will lapse when the related long-term debt is paid off.

Debt or property, plant and equipment note: During 20X5, USCO incurred interest cost of $5,800 ($5,500 interest expense + $300 capitalized). Interest paid (net of amounts capitalized) was $5,200 ($5,800 − (24) − $300 capitalized) during 20X5.

Income taxes note: USCO made income tax payments of $4,500 (Income tax expense − (31) − (23)) during 20X5.

Acquisitions note: In 20X5, USCO acquired the common stock of Target for $8,000 ((2) − (3)) and recognized acquired assets of $17,300 (2) and assumed liabilities of $9,300 (3).

Leases note: In 20X5, USCO incurred a finance lease liability of $2,000 (29).

Shareholders' equity note: In 20X5, USCO called and redeemed all 5.75% convertible debentures outstanding. Debenture holders of securities with a carrying amount of $1,000 ((28), (33)) elected to convert the debentures into 20,000 shares of common stock.

The locations of the disclosures above are merely suggestions. They also may be presented in a separate note specific to the statement of cash flows or another appropriate location. As discussed in section 2.3.2, *Indirect method*, the reconciliation of net income and cash provided by operating activities may be presented in a separate schedule (e.g., immediately following the statement of cash flows) or in the notes, rather than in the statement of cash flows. Using this approach, the statement of cash flows illustrated on the previous page would report only a single line item for cash provided by operating activities.

A.2 Operating cash flows using the direct method

Presentation of cash provided by 20X5 operating activities of USCO using the direct method is illustrated below. When net cash flows from operating activities is presented using the direct method, the reconciliation of net income and net cash flow from operating activities must be presented elsewhere in the financial statements.

Illustration A-4: Operating cash flows — direct method		
Operating activities		
Cash received from customers	$ 144,750	(See Illustration A-5)
Dividend received from equity method investee	900	(19)
Other income operating cash receipts	10,000	
Cash paid to suppliers and employees	(137,600)	(See Illustration A-5)
Interest paid	(5,200)	A
Income taxes paid	(4,500)	B
	$ 8,350	

A ($5,200) = ($5,500) of interest expense — $300 of accrued interest (24)

B ($4,500) = ($6,000) of income tax expense — $1,000 of deferred income taxes (31) — $500 of accrued income tax (23)

The following calculations illustrate indirectly determining cash received from customers and cash paid to suppliers and employees when operating cash flows are presented using the direct method (refer to section 2.3.1.1, *Direct method - determining amounts of major classes of cash flows*, for a discussion of this method).

Illustration A-5: Indirectly determining cash received from customers and cash paid to suppliers and employees		
Cash received from customers during the year		
Sales		$ 150,000
Payment received on installment sale		2,500 (9)
Gross accounts receivable at 1 January 20X5	$ 20,500	
Accounts receivable acquired in purchase of Target	2,000	
Accounts receivable written off	(350)	
Gross accounts receivable at 31 December 20X5	(29,900)	
Excess of new accounts receivable over collections from customers		(7,750) (8)
		$ 144,750
Cash paid to suppliers and employees during the year		
Cost of sales		$ 122,000
Selling and administrative expenses	$ 15,400	
Expenses not requiring cash outlay (provision for uncollectible accounts receivable)	(750) (7)	
Net expenses requiring cash payments		14,650
Inventory at 1 January 20X5	(44,000)	
Inventory acquired in purchase of Target	(3,000)	
Inventory at 31 December 20X5	50,000	
Net increase in inventory from USCO's operations		3,000 (11)
Increase in prepaid expenses		1,000 (12)
Accounts payable and accrued expenses at 1 January 20X5	27,650	
Amounts related to income taxes and interest at 1 January 20X5	(5,000)	
Accounts payable and accrued expenses assumed in purchase of Target Company	1,500	
Accounts payable and accrued expenses at 31 December 20X5	(33,000)	
Amounts related to income taxes and interest at 31 December 20X5	5,800	
Amounts charged to expense but not paid during year		(3,050) (25)
		$ 137,600

B Abbreviations used in this publication

Abbreviation	FASB Accounting Standards Codification
ASC 205-10	FASB ASC Subtopic 205-10, *Presentation of Financial Statements — Overall*
ASC 205-20	FASB ASC Subtopic 205-20, *Presentation of Financial Statements — Discontinued Operations*
ASC 210	FASB ASC Topic 210, *Balance Sheet*
ASC 230	FASB ASC Topic 230, *Statement of Cash Flows*
ASC 250	FASB ASC Topic 250, *Accounting Changes and Error Corrections*
ASC 310-20	FASB ASC Subtopic 310-20, *Receivables — Nonrefundable Fees and Other Costs*
ASC 320	FASB ASC Topic 320, *Investments — Debt Securities*
ASC 321	FASB ASC Topic 321, *Investments — Equity Securities*
ASC 340-30	FASB ASC Subtopic 340-30, *Other Assets and Deferred Costs — Insurance Contracts That Do Not Transfer Insurance Risk*
ASC 340-40	FASB ASC Subtopic 340-40, *Other Assets and Deferred Costs — Contracts with Customers*
ASC 350-40	FASB ASC Subtopic 350-40, *Intangibles — Goodwill and Other — Internal-Use Software*
ASC 410	FASB ASC Topic 410, *Asset Retirement and Environmental Obligations*
ASC 606	FASB ASC Topic 606, *Revenue from Contracts with Customers*
ASC 730	FASB ASC Topic 730, *Research and Development*
ASC 805	FASB ASC Topic 805, *Business Combinations*
ASC 810	FASB ASC Topic 810, *Consolidation*
ASC 815	FASB ASC Topic 815, *Derivatives and Hedging*
ASC 820	FASB ASC Topic 820, *Fair Value Measurement*
ASC 825	FASB ASC Topic 825, *Financial Instruments*
ASC 830	FASB ASC Topic 830, *Foreign Currency Matters*
ASC 842	FASB ASC Topic 842, *Leases*
ASC 852	FASB ASC Topic 852, *Reorganizations*
ASC 860	FASB ASC Topic 860, *Transfers and Servicing*
ASC 942	FASB ASC Topic 942, *Financial Services — Depository and Lending*
ASC 944	FASB ASC Topic 944, *Financial Services — Insurance*
ASC 954	FASB ASC Topic 954, *Health Care Entities*
ASC 958	FASB ASC Topic 958, *Not-for-Profit Entities*
ASC 960	FASB ASC Topic 960, *Plan Accounting — Defined Benefit Pension Plans*
ASU 2016-18	FASB Accounting Standards Update No. 2016-18, *Statement of Cash Flows (Topic 230): Restricted Cash*

Abbreviation	FASB Accounting Standards Codification
ASU 2023-06	FASB Accounting Standards Update 2023-06, *Disclosure Improvements: Codification Amendments in Response to the SEC's Disclosure Update and Simplification Initiative*
ASU 2023-08	FASB Accounting Standards Update 2023-08, *Intangibles — Goodwill and Other — Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets*
ASU 2023-09	FASB Accounting Standards Update 2023-09, *Income Taxes (Topic 740): Improvements to Income Tax Disclosures*

Abbreviation	Other authoritative standards
Item 10	SEC Regulation S-K Item 10, *General*
Rule 2a-7	Securities and Exchange Commission Rule 2a-7, Money Market Funds
Rule 5-02	Regulation S-X: Form and content of and requirements for financial statements, Balance sheets
Rule 7-03	Regulation S-X: Form and content of and requirements for financial statements, Balance sheets
SAB Topic 6.H	SEC Staff Accounting Bulletin Topic 6.H, *Interpretations of Accounting Series Releases and Financial Reporting Releases — Accounting Series Release 148 — Disclosure of Compensating Balances And Short-Term Borrowing Arrangements*

Abbreviation	Non-authoritative standards
Statement 95	FASB Statement No. 95, *Statement of Cash Flows*

C Index of ASC references in this publication

ASC paragraph	Section	Title
205-10-45-3	4.7	Change in classification
205-10-50-1	4.7	Change in classification
205-20-45-3	2.5.2.1	Income tax effects of discontinued operations
205-20-50-5B	2.5.2.2	Disclosures — cash flows from discontinued operations
205-20-50-5B(c)	2.5.2.2	Disclosures — cash flows from discontinued operations
210-10-45-1	3.5	Balance sheet classification
210-10-45-3	3.5	Balance sheet classification
210-10-45-4(a)	3.5	Balance sheet classification
210-20-45-1	3.2.2	Bank overdrafts and book overdrafts (negative cash balances)
210-20-55-18A	3.2.2	Bank overdrafts and book overdrafts (negative cash balances)
230-10-10-1	1.1	Overview
230-10-10-2	1.1	Overview
230-10-15-2	1.2	Scope
230-10-15-3	1.2	Scope
230-10-15-4	1.2	Scope
230-10-20	3.2	Definition of Cash
230-10-20	3.3	Definition of Cash equivalents
230-10-20	4.2	Investing activities
230-10-20	4.3	Financing activities
230-10-20	4.4	Operating activities
230-10-20	3.3.3.3	Variable rate demand obligations
230-10-20	5.5.1.2	Transaction costs
230-10-45-1	1.1	Overview
230-10-45-2	2.3	Reconciliation of net income to net cash flow from operating activities
230-10-45-3	2.5.1	Cash flow per share and other liquidity measures
230-10-45-4	2.2	Disclosure and presentation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents
230-10-45-4	3.4	Restricted cash and restricted cash equivalents
230-10-45-4	5.10.6	Funds held on behalf of others — classification

ASC paragraph	Section	Title
230-10-45-5	2.2	Disclosure and presentation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents
230-10-45-6	3.3.1	Policy for determining the components of cash equivalents
230-10-45-7	2.4	Gross versus net cash flows
230-10-45-7 through 45-9	3.3.3.4	Centralized cash management arrangements
230-10-45-8	2.4	Gross versus net cash flows
230-10-45-9	2.4	Gross versus net cash flows
230-10-45-10	4.1	Overview
230-10-45-11	4.2	Investing activities
230-10-45-12	4.2	Investing activities
230-10-45-12	5.2.1	Loans and trade receivables
230-10-45-12(b)	5.4.2	Distributions received from investments (other than those from consolidated entities)
230-10-45-12(a)	5.2.2.3	Accounting and cash flow presentation considerations for beneficial interests
230-10-45-12(a)	5.9.4	Insurance companies — funds withheld reinsurance arrangements
230-10-45-12 and 45-13	3.3.3.4	Centralized cash management arrangements
230-10-45-13	4.2	Investing activities
230-10-45-13(c)	4.5	More than one class of cash flows
230-10-45-13(c)	5.3.3	Consideration of accrued capital expenditures
230-10-45-13(d)	5.5.1.3	Contingent consideration
230-10-45-14	4.3	Financing activities
230-10-45-14	5.2.5	Bank overdraft and book overdraft
230-10-45-14 and 45-15	3.3.3.4	Centralized cash management arrangements
230-10-45-14 and 45-15	5.10.5	Transactions with noncontrolling interest holders while control is maintained
230-10-45-14 and 45-15	5.8.1	Derivative with a financing element
230-10-45-15	4.3	Financing activities
230-10-45-15(a)	5.7.2	Repurchase of shares from a grantee to satisfy tax withholding
230-10-45-15(b)	5.6.3	Settlement of zero-coupon debt instruments
230-10-45-15(e)	5.6.1	Stock issuance costs
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230-10-45-16	4.4	Operating activities
230-10-45-16	5.2.1	Loans and trade receivables
230-10-45-16(b)	5.4.2	Distributions received from investments (other than those from consolidated entities)
230-10-45-17	4.4	Operating activities
230-10-45-17	5.2.6	Capitalized contract costs

ASC paragraph	Section	Title
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230-10-45-17(c)	5.7.3	Excess tax benefits and tax deficiencies from share-based payment awards
230-10-45-17(d)	5.6.3	Settlement of zero-coupon debt instruments
230-10-45-17(d)	5.6.4	Payment-in-kind interest (i.e., settlement of interest by issuing additional underlying debt instruments)
230-10-45-17(d)	5.9.2	Insurance companies — universal life-type policies
230-10-45-19	5.4.1	Acquisitions and sales of certain securities
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230-10-45-21B	5.10.1	Insurance claim proceeds
230-10-45-21C	5.10.1	Insurance claim proceeds
230-10-45-21D	5.4.2.1	Determining whether distributions are returns on or returns of the investment for equity method investments
230-10-45-22	4.5	More than one class of cash flows
230-10-45-22 through 45-22A	4.5	More than one class of cash flows
230-10-45-22A	4.5	More than one class of cash flows
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230-10-45-26	2.4	Gross versus net cash flows
230-10-45-27	5.8	Derivatives and hedging
230-10-45-27	5.8.3	Derivative designated as an accounting hedge
230-10-45-27	5.8.3.1	Termination payment/receipt of forward-starting swap hedging forecasted issuance of fixed-rate debt
230-10-45-27	5.8.4	Derivative not designated as an accounting hedge
230-10-45-27	6.2	Presenting the effects of exchange rate changes (translation)
230-10-45-27A	5.11.2	Crypto assets received as noncash consideration in the ordinary course of business
230-10-45-28	2.3.2	Indirect method
230-10-45-28	5.6.4	Payment-in-kind interest (i.e., settlement of interest by issuing additional underlying debt instruments)
230-10-45-29	2.3	Reconciliation of net income to net cash flow from operating activities
230-10-45-29	2.3.2	Indirect method
230-10-45-30	2.3.1	Direct method

ASC paragraph	Section	Title
230-10-45-31	2.3.2	Indirect method
230-10-45-32	2.3.2	Indirect method
230-10-50-1	3.3.1	Policy for determining the components of cash equivalents
230-10-50-1	3.3.5	Disclosure requirements
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230-10-50-2	2.3.2	Indirect method
230-10-50-2 through 2A	Appendix F	Disclosure requirements
230-10-50-2A	2.3.2	Indirect method
230-10-50-3	4.6	Noncash investing and financing activity
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230-10-50-3 through 50-6	5.3.1	Seller-financed purchases
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230-10-50-4	4.6	Noncash investing and financing activity
230-10-50-5	4.6	Noncash investing and financing activity
230-10-50-6	4.6	Noncash investing and financing activity
230-10-50-7	3.4	Restricted cash and restricted cash equivalents
230-10-50-7	Appendix F	Disclosure requirements
230-10-50-8	2.2	Disclosure and presentation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents
230-10-50-8	Appendix F	Disclosure requirements
230-10-50-9	5.8	Derivatives and hedging
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230-10-55	Appendix A	Illustrative statement of cash flows example for a commercial company
230-10-55-1	2.3.1.1	Direct method – Determining amounts of major classes of cash flows
230-10-55-2	2.3.1.1	Direct method – Determining amounts of major classes of cash flows
230-10-55-3	2.3.1.1	Direct method – Determining amounts of major classes of cash flows
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250-10-50-1(b)	5.4.2.1	Determining whether distributions are returns on or returns of the investment for equity method investments
250-10-50-2	5.4.2.1	Determining whether distributions are returns on or returns of the investment for equity method investments
320-10-25-1	5.4.1	Acquisitions and sales of certain securities
320-10-45-11	5.4.1	Acquisitions and sales of certain securities
321-10-45-1	5.4.1	Acquisitions and sales of certain securities
340-40-25-1	5.2.6	Capitalized contract costs

ASC paragraph	Section	Title
340-40-25-5	5.2.6	Capitalized contract costs
350-40-15-4A	5.3.4	Customers in a cloud computing arrangement
350-40-45-3	5.3.4	Customers in a cloud computing arrangement
805-10-25-23	5.5.1.2	Transaction costs
805-30-35-1	5.5.1.3	Contingent consideration
815-10-45-11	5.8.1	Derivative with a financing element
815-10-45-12	5.8.1	Derivative with a financing element
815-30-55-128 through 55-133	5.8.3.1	Termination payment/receipt of forward-starting swap hedging forecasted issuance of fixed-rate debt
820-10-50-2E	3.3.5	Disclosure requirements
825-10-45-3	5.10.3	Fair value option for financial assets and liabilities
830-10-45-11	6.5.1	Highly inflationary economies
830-230-45-1	6.1	Overview
830-230-45-1	6.2	Presenting the effects of exchange rate changes (translation)
830-230-55	Appendix A	Illustrative statement of cash flows example for a commercial company
842-20-40-2	5.3.2.1	Payments to purchase an underlying asset subject to a lease
842-20-45-5	5.3.2	Leases
842-20-45-5(c)	5.3.2.1	Payments to purchase an underlying asset subject to a lease
842-20-50-4(g)(2)	5.3.2	Leases
842-30-45-5	5.3.2	Leases
842-30-45-7	5.3.2	Leases
942-210-45-3A	3.2.2.1	Financial institution reciprocal account balances
942-230-45-1	2.4.1	Gross versus net cash flows – financial institutions
942-230-45-2	2.4.1	Gross versus net cash flows – financial institutions
942-230-55	Appendix A	Illustrative statement of cash flows example for a commercial company
944-20-15-26	5.9.2	Insurance companies — universal life-type policies
954-210-45-5	3.4	Restricted cash and restricted cash equivalents
958-210-50-1 to 50-3	3.4	Restricted cash and restricted cash equivalents
958-230-55-3	5.10.7	Assets donated to not-for-profits, including those with restrictions
958-230-55-5A	5.10.7.1	Collections — not-for-profit entities
958-360-25-3	5.10.7.1	Collections — not-for-profit entities

D Glossary

Excerpt from Accounting Standards Codification

Master Glossary

Cash

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

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).

Contribution

An unconditional transfer of cash or other assets, as well as **unconditional promises to give**, to an entity or a reduction, settlement, or cancellation of its liabilities in a voluntary nonreciprocal transfer by another entity acting other than as an owner. Those characteristics distinguish contributions from:

a. Exchange transactions, which are reciprocal transfers in which each party receives and sacrifices approximately commensurate value

b. Investments by owners and distributions to owners, which are nonreciprocal transfers between an entity and its owners

c. Other nonreciprocal transfers, such as impositions of taxes or legal judgments, fines, and thefts, which are not voluntary transfers.

In a contribution transaction, the resource provider often receives value indirectly by providing a societal benefit although that benefit is not considered to be of commensurate value. In an exchange transaction, the potential public benefits are secondary to the potential direct benefits to the resource provider. The term contribution revenue is used to apply to transactions that are part of the entity's ongoing major or central activities (revenues), or are peripheral or incidental to the entity (gains). See also **Inherent Contribution** and **Conditional Contribution**.

Current Assets

Current assets is used to designate cash and other assets or resources commonly identified as those that are reasonably expected to be realized in cash or sold or consumed during the normal operating cycle of the business. See paragraphs 210-10-45-1 through 45-4.

Donor-Imposed Restriction

A donor stipulation (donors include other types of contributors, including makers of certain grants) that specifies a use for a contributed asset that is more specific than broad limits resulting from the following:

a. The nature of the not-for-profit entity (NFP)

b. The environment in which it operates

c. The purposes specified in its articles of incorporation or bylaws or comparable documents for an unincorporated association.

Some donors impose restrictions that are temporary in nature, for example, stipulating that resources be used after a specified date, for particular programs or services, or to acquire buildings or equipment. Other donors impose restrictions that are perpetual in nature, for example, stipulating that resources be maintained in perpetuity. Laws may extend those limits to investment returns from those resources and to other enhancements (diminishments) of those resources. Thus, those laws extend donor-imposed restrictions.

Donor-Restricted Endowment Fund

An endowment fund that is created by a donor stipulation (donors include other types of contributors, including makers of certain grants) requiring investment of the gift in perpetuity or for a specified term. Some donors or laws may require that a portion of income, gains, or both be added to the gift and invested subject to similar restrictions. The term does not include a **Board-Designated Endowment** Fund. See **Endowment Fund**.

Effective Interest Rate

The rate of return implicit in the **financial asset**, that is, the contractual interest rate adjusted for any net deferred fees or costs, premium, or discount existing at the origination or acquisition of the financial asset. For **purchased financial assets with credit deterioration**, however, to decouple interest income from credit loss recognition, the premium or discount at acquisition excludes the discount embedded in the purchase price that is attributable to the acquirer's assessment of credit losses at the date of acquisition.

Exchange Rate

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

Fair Value

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

Financial Asset

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

a. Receive cash or another financial instrument from a second entity

b. Exchange other financial instruments on potentially favorable terms with the second entity.

Financing Activities

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

Foreign Currency

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

Foreign Currency Transactions

Transactions whose terms are denominated in a currency other than the entity's functional currency. Foreign currency transactions arise when a reporting entity does any of the following:

a. Buys or sells on credit goods or services whose prices are denominated in foreign currency

b. Borrows or lends funds and the amounts payable or receivable are denominated in foreign currency

c. Is a party to an unperformed forward exchange contract

d. For other reasons, acquires or disposes of assets, or incurs or settles liabilities denominated in foreign currency.

Investing Activities

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

Lease Liability

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

Market Participants

Buyers and sellers in the principal (or most advantageous) market for the asset or liability that have all of the following characteristics:

a. They are independent of each other, that is, they are not **related parties**, although the price in a related-party transaction may be used as an input to a fair value measurement if the reporting entity has evidence that the transaction was entered into at market terms

b. They are knowledgeable, having a reasonable understanding about the asset or liability and the transaction using all available information, including information that might be obtained through due diligence efforts that are usual and customary

c. They are able to enter into a transaction for the asset or liability

d. They are willing to enter into a transaction for the asset or liability, that is, they are motivated but not forced or otherwise compelled to do so.

Operating Activities

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

Orderly Transaction

A transaction that assumes exposure to the market for a period before the measurement date to allow for marketing activities that are usual and customary for transactions involving such assets or liabilities; it is not a forced transaction (for example, a forced liquidation or distress sale).

Purchased Financial Assets with Credit Deterioration

Acquired individual **financial assets** (or acquired groups of financial assets with similar risk characteristics) that as of the date of acquisition have experienced a more-than-insignificant deterioration in credit quality since origination, as determined by an acquirer's assessment. See paragraph 326-20-55-5 for more information on the meaning of similar risk characteristics for assets measured on an amortized cost basis.

Reporting Currency

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

Right-of-Use Asset

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

E Summary of important changes

Section 1: Overview and scope

- Section 1.3 was updated to remove the discussion of Accounting Standards Updates that are effective for all entities and highlight recent standard setting. (July 2024)

Section 2: Form and content

- Section 2.3.2 was updated to provide a standard setting update on ASU 2023-09, *Income Tax (Topic 740): Improvements to Income Taxes Disclosures*. (July 2024)

Section 3: Cash and cash equivalents, including those with restrictions

- Section 3.3 was updated to provide guidance on determining investments that meet the definition of cash equivalents. (July 2024)
- Section 3.3.2.2.1 was updated to reflect amendments made by the SEC to Rule 2a-7 on money market fund. (July 2024)
- Section 3.3.2.2.2 was updated to address unregistered money market funds that do not conform to the policies and characteristics of Rule 2a-7 money market funds. (May 2025)

Section 4: Classification of cash flows

- Section 4.4 was updated to provide guidance on the statement of cash flows presentation for long-lived assets resulting from capitalizing asset retirement costs. (July 2024)

Section 5: Common issues related to classification

- Section 5.3.2.1 was added to provide guidance on the statement of cash flows presentation for the payment to purchase an underlying asset subject to a lease. (July 2024)
- Section 5.3.2.2 was added to address payments made at or before lease commencement. (May 2025)
- Section 5.3.4 was updated to provide cash flow classification guidance for a cloud computing arrangement that includes a license to internal-use software. (July 2024)
- Section 5.5.1.1 was updated with a consideration for assets and liabilities acquired from the business combination when preparing the statement of cash flows. (July 2024)
- Section 5.5.1.3 was updated with a table summarizing how cash payments for contingent consideration are presented in the statement of cash flows depending on the timing and amount of the payments. (July 2024)
- Section 5.6.1 was updated to provide statement of cash flow guidance for payments related to stock issuance costs. (May 2025)
- Section 5.6.5 was added to provide statement of cash flow guidance for proceeds received from the settlement of debt securities purchased at a discount. (May 2025)
- Section 5.6.6 was added to provide guidance on statement of cash flow classification for transaction costs related to debt and equity transactions. (May 2025)

- Section 5.7.2 was updated to clarify that the statement of cash flows classification guidance related to repurchase of shares from a grantee to satisfy tax withholding applies to both equity- and liability-classified share-based payments. (July 2024)
- Section 5.8 was updated with a table summarizing the classification of cash flows associated with various derivative instruments. This section and the related subsections were also reorganized. The table below provides a mapping for reorganized sections, as well as two added sections. (July 2024)

Pre-2024 Section	Title	Post-2024 Section	Title
5.8	Derivatives and hedging	5.8	Derivatives and hedging
5.8.1	Classification of settlement cash flows for non-option derivatives	5.8.3	Derivative designated as an accounting hedge
		5.8.4	Derivative not designated as an accounting hedge
5.8.2	Derivatives with financing elements	5.8.1	Derivative with a financing element
5.8.3	Cash flows of derivatives designated in a hedging relationship	5.8.3	Derivative designated as an accounting hedge
5.8.3.1	Termination payment/receipt of forward-starting swap hedging forecasted issuance of fixed-rate debt	5.8.3.1	Termination payment/receipt of forward-starting swap hedging forecasted issuance of fixed-rate debt
5.8.4	Trading derivatives	5.8.2	Derivative acquired or originated for trading purposes
N/A	Added	5.8.5	Other considerations related to derivatives
5.8.5	Forward placement commitment contracts and when-issued securities	5.8.5.1	Forward placement commitment contract and when-issued security
5.8.6	Put and call options and standby commitments	5.8.3	Derivative designated as an accounting hedge
		5.8.4	Derivative not designated as an accounting hedge
N/A	Added	5.8.5.2	Centrally cleared derivatives

- Section 5.9 was updated to provide statement of cash flow guidance for premiums received and benefits paid by an insurance company. (May 2025)
- Section 5.9.2 was updated to provide guidance on statement of cash flow classification for market risk and other benefits included in universal life-type policies. (May 2025)
- Section 5.11.2 was added to reflect the amendments to the Codification from ASU 2023-08, *Intangibles — Goodwill and Other — Crypto Assets (Subtopic 350-60): Accounting for and Disclosure of Crypto Assets.* (July 2024)
- Section 5.11.3 was added to provide statement of cash flow guidance related to crypto lending with a borrower. (May 2025)

F Disclosure requirements

The following table summarizes disclosure requirements under ASC 230 with a mapping of related sections in this publication.

Codification	Disclosure Requirement	Related Section	Title
230-10-50-1	Cash equivalents policy	3.3.5	Disclosure requirements
230-10-50-2 through 2A	Interest and income taxes paid	2.3.2	Indirect method
230-10-50-3 through 50-6	Noncash investing and financing activities	4.6	Noncash investing and financing activity
230-10-50-7	Nature of restrictions on its cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents.	3.4	Restricted cash and restricted cash equivalents
230-10-50-8	Reconciliation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents to balance sheet	2.2	Disclosure and presentation of cash, cash equivalents, and amounts generally described as restricted cash or restricted cash equivalents
230-10-50-9	Accounting policy for derivative instruments	5.8.3	Derivative designated as an accounting hedge

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