

Statement of Cash Flows: EITF's Proposed Classification of Certain Cash Receipts and Cash Payments

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At its November 2015 meeting, the FASB's Emerging Issues Task Force (EITF) reached tentative conclusions on eight of the nine issues relating to the classification of certain cash receipts and payments on the statement of cash flows. The remaining issue – on the classification of cash flows related to restricted cash – will be discussed at a future meeting.

Take a guess! How do you think the EITF answered the following seven questions on the classification of certain cash receipts and payments? The answers – based on the EITF's forthcoming consensus-for-exposure – appear beginning on Page 4.



1. Entity A decides to prepay its debt. Under the debt agreement, Entity A is required to pay the lender a prepayment fee. How should the prepayment fee be classified in the statement of cash flows?
 - a. Operating activities
 - b. Financing activities
 - c. Investing activities
 - d. Partially as operating activities and partially as financing activities

2. Entity B issues a zero-coupon bond. At maturity, Entity B makes a cash payment to settle the zero-coupon bond. How should the cash payment be classified in the statement of cash flows?
 - a. Operating activities
 - b. Financing activities
 - c. Investing activities
 - d. Partially as operating activities and partially as financing activities

3. Entity C acquires a business. As part of the business combination, it makes a cash payment for the settlement of a contingent consideration liability **three months** after the business combination occurred. How should the cash payment be classified in the statement of cash flows?
 - a. Operating activities
 - b. Financing activities
 - c. Investing activities
 - d. Partially as operating activities and partially as financing activities

4. Entity D acquires a business. As part of the business combination, it makes a cash payment for the settlement of a contingent consideration liability **eighteen months** after the business combination occurred. How should the cash payment be classified in the statement of cash flows?
 - a. Operating activities
 - b. Financing activities
 - c. Investing activities
 - d. Partially as operating activities and partially as financing activities

5. Entity E suffered significant damages to its manufacturing facility, equipment and inventory during a fire. As a result, it had to shut down its operations for a few months. The entity received a lump sum settlement from its insurance company to compensate for the loss of facility, equipment, and inventory, as well as for the business interruption. The entity plans to use all the proceeds to re-build the facility. How should the insurance settlement be classified in the statement of cash flows?
 - a. Operating activities
 - b. Financing activities
 - c. Investing activities
 - d. Partially as operating activities and partially as investing activities

6. Entity F holds a corporate-owned life insurance (COLI) policy on its key management. The Chief Financial Officer dies in an accident and Entity F receives the insurance settlement on the COLI policy. How should the insurance settlement be classified in the statement of cash flows?
 - a. Operating activities
 - b. Financing activities
 - c. Investing activities
 - d. Partially as operating activities and partially as investing activities

7. Entity G receives distributions from an equity method investee. How should distributions received be classified in the statement of cash flows?
 - a. Operating activities
 - b. Financing activities
 - c. Investing activities
 - d. It depends. It could be operating activities or investing activities

Answers:

- 1. Entity A decides to prepay its debt. Under the debt agreement, Entity A is required to pay the lender a prepayment fee. How should the prepayment fee be classified in the statement of cash flows?**

Answer: (b) Financing activities.

The EITF tentatively concluded that debt prepayment fees are analogous to debt issuance costs, which under ASC 230 are reflected as a cash flow from financing activities when paid.

- 2. Entity B issues a zero-coupon bond. At maturity, Entity B makes a cash payment to settle the zero-coupon bond. How should the cash payment be classified in the statement of cash flows?**

Answer: (d) Partially as operating activities and partially as financing activities.

At settlement, the EITF believes that the portion of the cash payment attributable to the accreted or implied interest should be classified as a cash outflow from operating activities, while the portion of the cash payment attributable to the principal of the debt should be classified as a cash outflow from financing activities.

- 3. Entity C acquires a business. As part of the business combination, it makes a cash payment for the settlement of a contingent consideration liability three months after the business combination occurred. How should the cash payment be classified in the statement of cash flows?**

Answer: (c) Investing activities.

The EITF believes that a cash payment made for the settlement of a contingent consideration liability that is paid at or near the time of acquisition is classified as a cash outflow from investing activities.

- 4. Entity D acquires a business. As part of the business combination, it makes a cash payment for the settlement of a contingent consideration liability eighteen months after the business combination occurred. How should the cash payment be classified in the statement of cash flows?**

Answer: (d) Partially as operating activities and partially as financing activities.

The portion of the total cash payment that does not exceed the amount of the contingent consideration liability recognized at the acquisition date (including measurement-period adjustments) is classified as a cash outflow from financing activities. The remaining portion of the cash payment – attributable to fair value changes occurring after the initial measurement of the contingent consideration liability (including measurement-period adjustments) – is classified as a cash outflow from operating activities.

- 5. Entity E suffered significant damages to its manufacturing facility, equipment and inventory during a fire. As a result, it had to shut down its operations for a few months. The entity received a lump sum settlement from its insurance company to compensate for the loss of facility, equipment, and inventory, as well as for the business interruption. The entity plans to use all the proceeds to rebuild the facility. How should the insurance settlement be classified in the statement of cash flows?**

Answer: (d) Partially as operating activities and partially as investing activities.

The cash proceeds from the insurance would be classified based on the nature of the insurance coverage (nature of the loss).

Nature of the Loss	Classification
Manufacturing facility	Investing activity
Manufacturing equipment	Investing activity
Inventory	Operating activity
Business interruption	Operating activity

6. Entity F holds a corporate-owned life insurance (COLI) policy on its key management. The Chief Financial Officer dies in an accident and Entity F receives the insurance settlement on the COLI policy. How should the insurance settlement be classified in the statement of cash flows?

Answer: (c) Investing activities.

The COLI policy is viewed as an investment. Therefore, the proceeds received from the insurance settlement are classified as cash inflow from investing activities. Note: The premiums paid on the COLI policy may be classified in the same manner as the proceeds – that is, as investing activities.

7. Entity G receives distributions from an equity method investee. How should distributions received be classified in the statement of cash flows?

Answer: (d) It depends. It could be operating activities or investing activities.

Distributions received from an equity method investee should be classified by applying the cumulative earnings approach. Under this approach, all distributions would be presumed to be returns on the investment and classified as operating inflows.

However, if cumulative distributions received exceed the investor's cumulative equity in the investee's earnings, the excess would be considered a return of the investment and classified as investing inflows.

To demonstrate, assume that as of the beginning of the year, Investor had received \$100 in cumulative distributions from an investee. In addition, Investor's cumulative share of the investee's earnings were \$140. In the current reporting period, Investor's share of the investee's earnings is \$10 (or \$150 cumulatively). Investor also receives a \$90 distribution from the investee. Investor would report \$50 of this distribution as a cash inflow from operating activities. The remaining \$40, representing the cumulative distributions in excess of Investor's cumulative share of investee's earnings (\$190 - \$150), would be presented as a cash inflow from investing activities.