
Private Company Council Meeting

July 21, 2015
EITF Issue No. 15-F Background and Objective

- **Background**
  - Diversity in practice in application of Topic 230, Statement of Cash Flows
  - April 1, 2015, the Board added nine cash flow classification issues to the EITF’s agenda

- **Objective**
  - Reduce the diversity and improve financial reporting
EITF Issue No. 15-F Cash Flow Classification Issues

Tentative Conclusions Reached (June 2015)

- Debt prepayment or extinguishment costs
- Settlement of zero-coupon bonds
- Contingent consideration payments made after a business combination
- Proceeds from the settlement of insurance claims

Issues to be Discussed by Task Force (September 2015)

- Restricted cash
- Proceeds from the settlement of corporate-owned life insurance policies
- Distributions received from equity method investees
- Beneficial interests in securitization transactions
- Application of the predominance principle
Debt Prepayment or Extinguishment Costs

Issue Description

- Often, a borrower is contractually required to pay the lender a fee to prepay or extinguish debt
- The fee represents:
  - Approximation of a portion of the interest that will not be paid
  - Penalties and other lender costs
- No specific cash flow classification guidance currently exists

Tentative Conclusion Reached

- Cash payments made for debt prepayment or extinguishment costs should be classified as cash outflows for financing activities
Settlement of Zero–Coupon Bonds

Issue Description

- Issuer of a zero-coupon bond classifies the cash proceeds as a financing inflow
- The bond is accreted up to its redemption value through recognition of interest expense
- At settlement, original proceeds plus accreted interest is paid
- Diversity in how the portion of the cash payment attributable to the accreted interest is classified

Tentative Conclusion Reached

- Cash payment for the settlement of a zero-coupon bond should be classified as both an operating activity (that is, the cumulative interest expense) and a financing activity (that is, the repayment of principal)
Contingent Consideration Payments Made After a Business Combination

Issue Description

- No specific cash flow classification guidance currently exists
- Accounting for contingent consideration liability
  - Recognized at acquisition-date fair value
  - Remeasured to fair value through earnings at each reporting date until the contingency is resolved

Tentative Conclusion Reached

- Cash payments made for a contingent consideration liability should be separated and classified as cash outflows for financing and operating activities
  - **Financing activity**, for portion not to exceed the amount of the liability recognized at acquisition-date fair value
  - **Operating activity**, for portion in excess of the amount of the liability recognized at acquisition-date fair value
Proceeds from the Settlement of Insurance Claims

Issue Description

- Topic 230 states that cash inflows from operating activities include proceeds of insurance settlements except those directly related to investing or financing activities, such as from destruction of a building.

- Stakeholders are unclear about:
  - What “directly related to investing or financing activities” means
  - Whether classification should be based on the nature of the covered loss or the intended use of the proceeds

Tentative Conclusion Reached

- Cash proceeds from the settlement of insurance claims should be classified based on the insurance coverage (that is, the nature of each loss)
**Restricted Cash**

**Subissue 1 Description**

- Changes in restricted cash occur when deposits and withdrawals are made.
- Changes often are transfers between restricted cash and unrestricted cash (cash and cash equivalents).
- Transfers occur when:
  - Restricted cash account is established (cash transfers from unrestricted cash to restricted cash).
  - Restrictions are released (cash transfers from restricted cash to unrestricted cash).

**Question**: How should the changes of the principal balances in restricted cash be classified in the statement of cash flows when unrestricted cash is affected?
Restricted Cash

Subissue 1

- **Alternative A**: Changes of the principal balances in restricted cash should be based on the nature of the cash flows, and therefore, classified as investing activities.
  - Investment in a restricted cash vehicle is similar to an investment in marketable securities
  - Deposits and withdrawals of principal balances in restricted cash accounts represent the creation or return of investment

- **Alternative B**: Changes of the principal balances in restricted cash should be classified based on the purpose of the restricted cash.

- See examples (Slide 10)
## Restricted Cash – Subissue 1 Examples

### Example 1:
An entity is required by its insurer to establish a restricted cash account for future payment of workers’ compensation claims. The restricted cash is to be invested in an interest-bearing account until the restriction is released and cash payments are made for workers' compensation claims.

<table>
<thead>
<tr>
<th>View A</th>
<th>View B</th>
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<tbody>
<tr>
<td>Cash Flow #1: Set up the restricted cash account (move money from the unrestricted account to the restricted cash account)</td>
<td>Investing outflow</td>
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<tr>
<td>Cash Flow #2: Release from restriction occurs (move money from the restricted cash account to the unrestricted cash account)</td>
<td>Investing inflow</td>
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### Example 2:
An entity is required by its lender to establish a restricted cash account for the future payment of debt. The restricted cash is required to be invested in an interest-bearing account until the restriction is released and a cash payment is made to pay down debt.

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Restricted Cash

Subissue 2 Description

- There are changes in restricted cash when:
  - Cash payments are made directly from restricted cash
  - Cash receipts are deposited directly into restricted cash
- Cash and cash equivalents are not affected by the changes

**Question**: How should the changes in restricted cash be presented in a statement of cash flows when cash payments are made directly from restricted cash and cash receipts are deposited directly into restricted cash?
Restricted Cash

Subissue 2

- **Alternative A**: Require noncash disclosures
  - Direct changes in restricted cash do not affect cash and cash equivalents

- **Alternative B**: Present cash payments made directly from restricted cash and cash receipts directly deposited into restricted cash in the body of the statement of cash flows
  - Direct changes in restricted cash are actual cash payments and receipts, which is different from typical noncash transactions
  - No guidance on disclosure of noncash operating activities currently exists
Task Force Discussion

- No tentative conclusions reached
- Lack of an explicit definition of restricted cash contributes to the diversity in cash flow classification
- Task Force requested the FASB staff to develop a definition of restricted cash
- Additional outreach to be performed about cash payments made directly from and cash receipts deposited directly into restricted cash

Questions

- How would you define restricted cash (contractually or legally restricted by a third-party, self-imposed, etc.)?
- How do entities track restricted cash? Is the cash commingled or is there a separate physical bank account?
Proceeds from the Settlement of Corporate-Owned Life Insurance (COLI) Policies

Issue Description

- Policies are purchased for a variety of purposes, including:
  - Funding the cost of employee benefits
  - Protecting the loss of key persons
  - As a funding mechanism – investment income accumulated tax-free through the buildup of a cash surrender value (an investment) and death benefits received tax-free

- Nature and purpose can result in competing or multiple cash flow classifications

**Question:** How should the proceeds received from the settlement of COLI policies be classified in the statement of cash flows?
Proceeds from the Settlement of COLI

- **Alternative A**: As an operating activity
  - Funds the cost of employee benefits, nature of operations

- **Alternative B**: As an investing activity
  - Investment income accumulated tax-free through the buildup of the cash surrender value (CSV)

- **Alternative C**: As both an investing activity and an operating activity
  - **Investing activity**, for portion of proceeds equal to amount of premiums attributable to the buildup of the cash surrender value
  - **Operating activity**, for portion of proceeds in excess of premiums attributable to buildup of the cash surrender value
Proceeds from the Settlement of COLI

Task Force Discussion

- Mixed views on the nature of a COLI policy (operating, investing, or a combination thereof)
- Conduct outreach on the classification of premiums paid on a COLI policy
- Conduct outreach to determine if financial statement users find the proceeds on the statement of cash flows to be meaningful

Questions

- Where do entities classify premium payments in the statement of cash flows?
- **Users:** Do you view the proceeds received from the settlement of COLI policies in the statement of cash flows as meaningful information?
- **Preparers:** Does your organization track the cumulative premium payments made for a COLI policy? If so, is the portion of the cumulative premiums paid that is attributable to the build-up of the cash surrender value tracked?
Distributions Received from Equity Method Investees

Issue Description

How to determine whether the cash receipts from an equity method investee represent a return on investment (operating activity) or a return of investment (investing activity)

**Question**: How should the classification of distributions received from an equity method investee in the statement of cash flows be determined?
**Distributions Received from Equity Method Investees**

- **Alternative A**: All distributions received from an equity method investee are presumed to be returns *on* the investment and are classified as cash inflows from operating activities *unless* cumulative distributions exceed the cumulative equity in earnings recognized by the investor. Cumulative distributions in excess of cumulative equity in earnings represent returns *of* the investment and should be classified as cash inflows from investing activities.

- **Alternative B**: Distributions from an equity method investee are presumed to be returns on investment and classified as cash inflows from operating activities. However, in the presence of specific facts and circumstances, that presumption can be overcome.

- **Alternative C**: All distributions received are cash inflows from investing activities.
Beneficial Interests in Securitization Transactions

Subissue 1 Description

An entity that sells assets in a securitization transaction typically retains a beneficial interest in those assets.

**Question**: How should the retained interest obtained by the seller at the inception of a securitization transaction be presented in the statement of cash flows?
Beneficial Interests in Securitization Transactions

Subissue 1

- **Alternative A**: Present the retained interest on a gross basis in the body of the statement of cash flows
  - Cash inflow from the sale of the assets, including the beneficial interest retained by the seller
  - Cash outflow for the “purchase” of the beneficial interest retained by the seller

- **Alternative B**: Require noncash disclosure
  - Disclose the retained interest portion of the transaction as a noncash activity
  - Actual cash received from the assets sold would be presented as a cash inflow, net of the retained interest portion
Beneficial Interests in Securitization Transactions

Subissue 2 Description

Subsequent to the initial sale of assets in a securitization transaction, the holder of the retained interest receives a share of the principal payments collected from the securitized assets.

**Question**: How should the cash received by the holder of the retained interest be classified in the statement of cash flows?
Beneficial Interests in Securitization Transactions

Subissue 2

- **Alternative A**: Principal payments received are similar to cash proceeds from the sale of a security
  - Classify principal payments received as cash inflows from investing activities

- **Alternative B**: Retained interests are considered a re-characterization of the underlying assets
  - Classify principal payments received based on the nature of the underlying assets
Application of the Predominance Principle

Issue Description

- Topic 230 recognizes that the most appropriate classification will not always be clear

- Some cash receipts and payments have aspects of more than one class of cash flows
  - In those situations, the appropriate classification depends on the activity that is likely to be the predominant source of cash flows.

- Some stakeholders have said it is unclear:
  - When a cash receipt or payment should be bifurcated and when to use the predominant cash flow to determine classification
  - Whether it is appropriate to use estimation to quantify the amounts to be classified into more than one class of cash flows
  - Which factors can or should be used to assist in determining predominant cash flow
  - When classification is based on predominance
Application of the Predominance Principle

- **Alternative A**: Clarify when to bifurcate a cash flow, including whether it is appropriate to use estimation and allocation, and when to use the predominant cash flow

- **Alternative B**: Include guidance on additional factors to be used in determining predominant cash flow
  - Ex: Historical cash flows, projected cash flows, short period

- **Alternative C**: When classification is determined using the predominant cash flow, require disclosure of:
  - Ex: Description of the transaction giving rise to the cash flows, classification and amount of cash receipts and payments in the statement of cash flows
Questions or Comments?