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June 2025

On the Radar

Statement of Cash Flows

Because ASC 230 is largely principles-based, financial statement preparers must exercise significant judgment when classifying certain cash receipts and payments in their statement of cash flows. Given the lack of prescriptive rules, cash flow presentation continues to challenge financial statement preparers, as noted in recent statements made by regulators. As a result, the FASB has continued to evaluate issues related to the presentation of cash receipts and payments in the statement of cash flows.

Remarks Made by Regulators at the 2024 AICPA & CIMA Conference

Former SEC Chief Accountant Paul Munter discussed the statement of cash flows at the 2024 AICPA & CIMA Conference on Current SEC and PCAOB Developments. In his opening remarks, Mr. Munter reiterated his previous remarks regarding the statement of cash flows and its importance for investors. He reminded both preparers and auditors of their responsibility "to ensure that the statement of cash flows and related cash and non-cash disclosures are provided the same quality focus as other components of the financial statements."

In addition, Deputy Chief Accountant Sarah Lowe noted that the SEC staff has commented on cash flow classification. She observed that when making changes to certain cash flows within the statement of cash flows, registrants may need to exercise significant judgment to determine the appropriate classification of such changes. She advised registrants to consider the predominant source of the cash flows in their unique scenario when making this determination in accordance with ASC 230. Further, Ms. Lowe noted that registrants that use significant judgment should consider providing accounting policy disclosures in their footnotes to explain the basis for such cash flow presentation.

Connecting the Dots

Certain cash receipts and payments may have aspects of more than one class of cash flows. Paragraph BC39 of ASU 2016-15 provides guidance on "when an entity should separate cash receipts and cash payments and classify them into more than one class of cash flows . . . and when an entity should classify the aggregate of those cash receipts and payments into one class of cash flows based on predominance." The classification of cash receipts and payments that have aspects of more than one class of cash flows should be determined by first applying specific guidance in U.S. GAAP. When such guidance is not available, financial statement preparers should separate each identifiable source or use of cash flows within the cash receipts and cash payments on the basis of the nature of the underlying cash flows. Each separately identified source or use of cash receipts or payments should then be classified on the basis of its nature. Classification based on the activity that is most likely to be the predominant source or use of cash flows is only appropriate when the source or use of cash receipts and payments has multiple characteristics and is not separately identifiable.

Examples of SEC Comments

The extracts in this publication are specifically related to the statement of cash flows and have been reproduced from comments published on the SEC's Web site. Dollar amounts and information identifying registrants or their businesses have been redacted from the comments.

For a discussion of SEC comment letters to registrants on additional topics, see Deloitte's Roadmap *SEC Comment Letter Considerations, Including Industry Insights*.

Category Classification

Examples of SEC Comments

- Please tell us your basis for classifying the capitalization of contract costs as an investing cash flow activity as opposed to an operating activity.
- We note that you present increases and decreases in book overdrafts as cash flows from financing activities. In this regard, please provide us with your basis for reporting changes in book overdrafts as cash flows from financing activities instead of cash flows from operating activities. Also, clarify whether the overdraft is with a bank.
- Please explain why you classified your short-term investments as trading and why the corresponding cash flows have been classified as investing instead of as operating in your Statements of Cash Flows. See ASC 320 and ASC 230-10-45-20.

ASC 230 requires entities to classify cash receipts and cash payments as operating, investing, or financing activities on the basis of the nature of the cash flow. Many of the SEC staff's comments are related to understanding the classification or potential misclassification among these three cash flow categories. In some cases, the SEC staff has raised questions about the presentation of cash inflows resulting from a transaction in a manner inconsistent with the underlying balance sheet classification.

Net Versus Gross Presentation

Examples of SEC Comments

- Please revise the other assets and liabilities, net line item to present changes in other assets separately from other liabilities and further breakout any material components. Refer to ASC paragraphs 230-10-45-7 and 45-29.
- We note that you present the caption Investments in property and equipment, net. Please revise future filings to separately present the cash inflows and cash outflows for property and equipment on a gross basis as discussed in ASC 230-10-45-26.

The SEC staff may challenge whether it is appropriate to report the net amount of certain cash receipts and cash payments on the face of the statement of cash flows. Generally, cash payments should not be presented net of cash receipts in the statement of cash flows. However, ASC 230-10-45-7 through 45-9 state that although reporting gross cash receipts and gross cash payments provides more relevant information, financial statement users sometimes may not need gross reporting to understand certain activities. Further, the netting criteria in ASC 230-10-45-8 (turnover is quick, the amounts are large, and the maturities are short) must be met for an entity to present investing and financing activity on a net basis. Accordingly, the SEC staff may ask a registrant to revise the presentation or to explain (in accordance with ASC 230) why it is appropriate to report certain cash flows on a net basis rather than on a gross basis.

Extended Vendor Payable Arrangements

Example of an SEC Comment

We note your "Accounts Payable days" are [X] days as of [the fiscal year-end]. We further note your Accounts Payable days [have] increased substantially over the past ten years . . . . Please tell us if you are engaging in supply chain finance operations and mechanisms, such as reverse factoring or similar methods to increase your Accounts Payable days. Otherwise, please explain how you have been able to achieve such extended accounts payable terms with your suppliers.

The SEC staff has recently issued comments to registrants that use extended vendor-payable arrangements involving the participation of a paying agent or other financial institution. Under such programs, the paying agent or financial institution may settle the payment obligation directly with the registrant's supplier, for a fee, earlier than the extended payment term. Because there is no explicit authoritative guidance on these arrangements, the SEC staff has challenged registrants' determinations of whether the payments under such programs (1) constitute trade payables, which would represent operating activities, or (2) are more akin to debt, which would represent financing activities. In addition, the staff has encouraged registrants to provide enhanced disclosures about their extended vendor payable arrangements, such as the following:

- A description of the program, including relevant terms, related risks, and impacts on the registrant's working capital, liquidity, and capital resources.
- Amounts settled through the program, including relevant terms, related risks, and impacts on the registrant's working capital, liquidity, and capital resources.
- Amounts remaining in trade payables at year-end for which the registrant's supplier has elected early payment (i.e., the balance sheet impact).

Digital Assets

Other than the guidance in ASU 2023-08 (discussed below), there is no explicit guidance in U.S. GAAP on the accounting for digital assets, including how an entity classifies its receipts of and payments for such assets in the statement of cash flows. As a result, an entity must apply judgment when classifying cash flows associated with transactions involving such assets. These transactions commonly include purchases and sales of crypto assets, crypto asset safeguarding, and crypto asset lending.

Changing Lanes

In December 2023, the FASB issued ASU 2023-08, which addresses the accounting and disclosure requirements for certain crypto assets. The ASU provides guidance on, among other topics, cash flow presentation related to the sale of crypto assets received as noncash consideration in the ordinary course of business. For all entities, the ASU's amendments are effective for fiscal years beginning after December 15, 2024, including interim periods within those fiscal years. Early adoption is permitted. If an entity adopts the amendments in an interim period, it must adopt them as of the beginning of the fiscal year that includes that interim period.

For more information about the ASU and the presentation of certain digital asset transactions in the statement of cash flows, see Deloitte's Roadmap *Digital Assets*.

Constructive Receipt and Disbursement

An entity may enter into arrangements in which cash is received by or disbursed to another party on behalf of the entity. Although these arrangements may not result in a direct exchange of cash to or from the entity, the same economic result is achieved if cash is received by or disbursed to the entity directly (i.e., constructive receipt and constructive disbursement, respectively). Because ASC 230 does not address constructive receipt and disbursement, an entity will need to use judgment when determining the substance of the arrangement to present the cash flows of the arrangement.

For example, a company may purchase real estate by taking out a mortgage with a third-party financing entity. In some cases, the third-party lender will not deposit cash into the company's bank account but will electronically wire cash directly to an escrow account at the closing of the transaction, which in turn is wired directly to the seller. Since the third-party lender is acting as the buyer's agent and transfers the proceeds of the mortgage directly to the escrow agent on behalf of the buyer, the substance of the transaction is that the buyer received the proceeds of the mortgage as a financing cash inflow and disbursed the purchase price of the real estate as an investing cash outflow. Accordingly, the transaction should be presented in such a manner in the company's statement of cash flows.

Looking Ahead — Standard Setting

Recent FASB Activity

In November 2023, the FASB added to its technical agenda a project on the statement of cash flows in response to feedback indicating that improvements to financial institutions' statement of cash flows are needed to provide investors with more decision-useful information. For example, users of financial institutions' financial statements indicated that the existing framework that outlines operating, investing, and financing cash flows fails to effectively reflect the complexities of such institutions' operations. Other commenters expressed a desire for improved disclosures related to changes in working capital. Further, the project is aimed at reorganizing and disaggregating the information in the statement of cash flows for financial institutions (e.g., a requirement for such entities to separately disclose the amount of cash interest income received). In addition to this project on the statement of cash flows, the FASB is exploring improvements to the statement of cash flows more broadly in a project on its research agenda.

Moreover, in January 2025, the FASB released an invitation to comment (ITC) that requests feedback from stakeholders on the Board's future standard-setting agenda. The Board hopes that such feedback will enable it to reduce complexity and costs while improving the usefulness of the financial information provided to investors. The ITC includes the following question related to the statement of cash flows:

> **Question 52:** Should the FASB pursue a project on the statement of cash flows? If yes, which improvements, if any, are most important? Should the FASB leverage the current guidance in Topic 230, Statement of Cash Flows? If yes, would it be preferable to retain the direct method, the indirect method, or both? Should this potential project be a broad project applicable to all entities that provide a statement of cash flows or limited to certain entities or industries? Please explain. [Footnote omitted]

Comments on the ITC are due by June 30, 2025.

Connecting the Dots

In discussing the statement of cash flows at the 2024 AICPA & CIMA Conference on Current SEC and PCAOB Developments, Mr. Munter invited stakeholders to provide thoughtful feedback related to the FASB's current research project on this topic. He noted that he supports the FASB's efforts to improve consistency and comparability in this area (e.g., cash flow classification, information about noncash transactions). Mr. Munter also highlighted the need to "dig deeper" into stakeholder feedback to better understand investors' informational needs. For example, he noted that he has heard some investors say that the direct-method cash flow statement is unnecessary and others say that they want more information about certain cash flows, including cash collected from customers, cash paid to employees, and cash paid to suppliers and other creditors.

Deloitte's Roadmap *Statement of Cash Flows* comprehensively discusses the accounting guidance on the statement of cash flows, primarily that in ASC 230.

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