

Statement of Financial Accounting Standards No. 102

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Statement of Cash Flows—Exemption of Certain
Enterprises and Classification of Cash Flows
from Certain Securities Acquired for Resale

(an amendment of FASB Statement No. 95)

February 1989



Financial Accounting Standards Board
of the Financial Accounting Foundation
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Statement of Financial Accounting Standards No. 102

Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale

an amendment of FASB Statement No. 95

February 1989

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FAS 102: Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale

an amendment of FASB Statement No. 95

FAS 102 Summary

This Statement amends FASB Statement No. 95, *Statement of Cash Flows*, to exempt from the requirement to provide a statement of cash flows (a) defined benefit pension plans covered by FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, and certain other employee benefit plans and (b) highly liquid investment companies that meet specified conditions.

This Statement also requires that cash receipts and cash payments resulting from acquisitions and sales of (a) securities and other assets that are acquired specifically for resale and carried at market value in a trading account and (b) loans that are acquired specifically for resale and carried at market value or the lower of cost or market value be classified as operating cash flows in a statement of cash flows.

This Statement is effective for financial statements issued after February 28, 1989, with earlier application encouraged.

INTRODUCTION

1. FASB Statement No. 95, *Statement of Cash Flows*, establishes standards for cash flow reporting and requires a statement of cash flows as part of a full set of financial statements for all business enterprises. Statement 95 supersedes APB Opinion No. 19, *Reporting Changes in Financial Position*.

2. FASB Statement No. 35, *Accounting and Reporting by Defined Benefit Pension Plans*, establishes specific financial reporting requirements for those plans and states that existing generally accepted accounting principles other than those discussed in that Statement may apply. The applicability of Statement 95 to defined benefit pension plans and other employee benefit

plans is not specifically addressed by Statement 95.

3. Statement 95 acknowledges that information about the cash flows of certain investment companies may be less important than similar information for other enterprises, but the Board decided when that Statement was issued that investment companies should not be exempted from the requirement to provide a statement of cash flows because information about cash flows is relevant. Several representatives of investment companies requested that the Board reconsider the applicability of Statement 95 to those companies. Discussions with those representatives and others focused primarily on the usefulness of a statement of cash flows for highly liquid investment companies with little or no debt.

4. Statement 95 requires business enterprises to present a statement of cash flows that classifies cash receipts and cash payments according to whether they result from operating, investing, or financing activities and provides a definition of each category. Statement 95 recognizes that certain cash receipts and cash payments may have aspects of more than one category of cash flows. For example, a cash payment may pertain to an item that, depending on the circumstances, could be either inventory or a productive asset. The Board was asked to address the appropriate classification of cash flows resulting from the active trading of securities in a trading account of a bank, broker and dealer in securities, or other enterprise.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Exemptions from the Requirement to Provide a Statement of Cash Flows

5. 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 Statement 35. Other employee benefit plans that present financial information similar to that required by Statement 35 (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).

6. Provided that the conditions in paragraph 7 are met, a statement of cash flows is not required to be provided by (a) an investment company that is subject to the registration and regulatory requirements of the Investment Company Act of 1940 (1940 Act), (b) an investment enterprise that has essentially the same characteristics as those subject to the 1940 Act, or (c) a common trust fund, variable annuity account, or similar fund maintained by a bank, insurance company, or other enterprise in its capacity as a trustee, administrator, or guardian for the collective investment and reinvestment of moneys.

7. For an investment enterprise specified in paragraph 6 to be exempt from the requirement to provide a statement of cash flows, all of the following conditions must be met:

- a. During the period, substantially all of the enterprise's investments were highly liquid (for example, marketable securities, and other assets for which a market is readily available).
- b. Substantially all of the enterprise's investments are carried at market value.¹
- c. The enterprise had little or no debt, based on the average debt outstanding ² during the period, in relation to average total assets.
- d. The enterprise provides a statement of changes in net assets.

Classification of Cash Flows from Acquisitions and Sales of Certain Securities and Other Assets

8. Banks, brokers and dealers in securities, and other enterprises may carry securities and other assets in a trading account.³ Cash receipts and cash payments resulting from purchases and sales of securities and other assets shall be classified as operating cash flows if those assets are acquired specifically for resale and are carried at market value in a trading account.

9. Some loans are similar to 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 market value or at the lower of cost or market value.⁴ Cash receipts resulting from sales of loans that were not specifically acquired for resale shall be classified as investing cash inflows. 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.

Amendments to Statement 95

10. Statement 95 is amended as follows:

- a. The following footnote is added at the end of the first sentence of paragraph 3:

*A statement of cash flows is not required for defined benefit pension plans and certain other employee benefit plans or for certain investment companies as provided by FASB Statement No. 102, *Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Acquired for Resale*.

- b. The following sentence is added to the end of paragraph 15:

Investing activities exclude acquiring and disposing of certain loans or other debt or

equity instruments that are acquired specifically for resale, as discussed in Statement 102.

- c. The parenthetical comment in paragraphs 16(a) and 17(a) is superseded by the following:

(other than cash equivalents and certain debt instruments that are acquired specifically for resale)

- d. The following parenthetical comment is added after the word *enterprises* in paragraphs 16(b) and 17(b):

(other than certain equity instruments carried in a trading account)

- e. The following footnote is added after the word *goods* in paragraphs 22(a) and 23(a):

*The term *goods* includes certain loans and other debt and equity instruments of other enterprises that are acquired specifically for resale, as discussed in Statement 102.

- f. The statement of cash flows and the reconciliation of net income to net cash provided by operating activities included in paragraph 147 of Example 3 of Appendix C is superseded by the statement of cash flows and the reconciliation of net income to net cash provided by operating activities included in paragraph 30 of Appendix B of this Statement. The statement of financial position and the statement of operations included in paragraph 148 and the transactions described in paragraph 149(a) of that example are superseded by the statement of financial position and the statement of operations included in paragraph 31 and the transactions described in paragraph 32 of Appendix B of this Statement.

Effective Date and Transition

11. This Statement is effective for financial statements issued after February 28, 1989. Earlier application is encouraged. Comparative amounts in financial statements for earlier periods shall be reclassified to comply with the requirements of this Statement.

This Statement was adopted by the affirmative votes of six members of the Financial Accounting Standards Board. Mr. Lauver dissented.

Mr. Lauver dissents from the issuance of this Statement because of the manner in which it exempts certain employee benefit plans and investment companies from the requirement to issue a statement of cash flows. Although it may be defensible to exempt certain enterprises from a requirement to issue a statement of cash flows, he believes that any exemption should be made by establishing criteria believed to indicate that a statement of cash flows provides little useful information to users and exempting all enterprises satisfying those criteria. He would not establish exemptions by selectively designating industries or types of businesses because that

approach inevitably produces inequities and inconsistencies. For example, in the instances covered by this Statement, employee benefit plans that own illiquid assets and finance their investment in part with debt are exempted from issuing a statement of cash flows but investment companies in a similar position are not exempted.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*

Victor H. Brown

Raymond C. Lauver

James J. Leisenring

C. Arthur Northrop

A. Clarence Sampson

Robert J. Swieringa

Appendix A

BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

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Appendix A: BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

Introduction

12. This appendix discusses factors deemed significant by members of the Board in reaching the conclusions in this Statement. It discusses reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others. The Board concluded that it could reach an informed decision on the basis of existing information without a public hearing.

13. An FASB Exposure Draft, *Statement of Cash Flows—Exemption of Certain Enterprises and Classification of Cash Flows from Certain Securities Held for Resale*, was issued for public comment on November 30, 1988. The Board received 69 letters of comment in response to the Exposure Draft. Nearly all respondents supported the Board's conclusions, although some respondents addressed only specific issues. Some respondents suggested certain modifications that generally would clarify the Board's intent.

Employee Benefit Plans

14. The financial reporting requirements of defined benefit pension plans are addressed in Statement 35. Paragraph 6 of that Statement specifies that the annual financial statements of a plan shall include:

- a. A statement that includes information regarding the net assets available for benefits as of the end of the plan year
- b. A statement that includes information regarding the changes during the year in the net assets available for benefits
- c. Information regarding the actuarial present value of accumulated plan benefits as of either the beginning or end of the plan year
- d. Information regarding the effects, if significant, of certain factors affecting the year-to-year change in the actuarial present value of accumulated plan benefits.
[Footnote reference omitted.]

Statement 35 also states that existing generally accepted accounting principles other than those discussed in that Statement may apply to the financial statements of defined benefit pension plans.

15. The Board concluded that paragraph 6 of Statement 35 presents a comprehensive list of

the basic financial statements that defined benefit pension plans are required to provide, although additional financial information may be provided. Furthermore, the Board concluded that Statement 95 was not intended to modify the reporting requirements for those plans.

16. Other employee benefit plans that are not covered by Statement 35, such as health and welfare plans, may have characteristics similar to those of defined benefit pension plans and may present financial information similar to that required by Statement 35 (including the presentation of plan investments at fair value). The Board believes that those plans likewise should not be required to provide a statement of cash flows.

17. The Board does not prohibit the inclusion of a statement of cash flows with the annual financial statements of an employee benefit plan. In fact, the Board encourages plans to provide a statement of cash flows when that statement would provide relevant information about the ability of the plan to meet future obligations. For example, the Board believes that a statement of cash flows would provide relevant information about a plan's ability to meet future obligations when the plan invests in assets that are not highly liquid, such as real estate, or obtains financing for its investments.

Investment Companies

18. Before the issuance of Statement 95, the Board considered whether investment companies should be required to provide a statement of cash flows as part of a full set of financial statements. The Board recognized that information about the cash flows of certain investment companies may be less important than similar information for other enterprises, but the Board decided that information about cash flows is relevant and that investment companies should not be exempted from a requirement to provide a statement of cash flows.

19. While the Board continues to believe that information about cash flows is relevant for investment companies, the Board readdressed the need for highly liquid investment companies to provide a statement of cash flows under certain conditions. Highly liquid investment companies are those whose assets consist predominantly of cash, securities, and other assets for which a market is readily available. For example, open-end investment companies hold themselves out as being able to redeem their outstanding shares within seven days; therefore, they are required to maintain a portfolio of investments that enables them to fulfill that obligation.

20. For highly liquid investment companies that do not finance investments with debt, the Board concluded that the financial statements other than a statement of cash flows generally would provide sufficient information for a user to assess the enterprises' liquidity, financial flexibility, profitability, and risk. However, for investment companies that invest in assets for which a market is not readily available or that finance investments with debt, the Board believes that a statement of cash flows would provide relevant information about the enterprises' investing and financing activities to assist users in those assessments.

21. Investment companies were not required to provide a statement of changes in financial position. Investment companies that are subject to the reporting requirements of the 1940 Act are required to provide a statement of changes in net assets. Net assets and changes in those net assets are relevant because net asset value per share is used by many investment companies to determine the price of shares redeemed and sold. Although the purpose and format of a statement of changes in net assets are different from those of a statement of cash flows, much of the information contained in those statements is similar. The Board concluded that for investment companies that meet the conditions specified in paragraph 7, the cost of providing a statement of cash flows would exceed the benefits.

22. Certain investment enterprises may not be subject to the registration requirements of the 1940 Act either because the number of stockholders is limited or because they are otherwise exempted from the 1940 Act (for example, offshore funds, commodity pools, certain common trust funds of banks, or variable annuity accounts of life insurance companies). Because those investment enterprises have essentially the same characteristics as investment companies that are subject to the requirements of the 1940 Act, the Board concluded that the exemption also should apply to them provided they meet the conditions specified in paragraph 7.

Classification of Cash Flows from Acquisitions and Sales of Certain Securities and Other Assets

23. Statement 95 requires that cash flows be classified as investing, financing, or operating and provides a definition of each category. Paragraph 15 of Statement 95 defines investing activities to 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 enterprise (other than materials that are part of the enterprise's inventory).

Operating activities include all transactions and other events that are not defined as investing or financing activities. Paragraph 21 of that Statement states that 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.

24. Paragraph 24 of Statement 95 recognizes that certain cash receipts and payments may have aspects of more than one category of cash flows. For example, a cash payment may pertain to an item that, depending on the circumstances, could be either inventory or a productive asset. Furthermore, paragraph 86 states that the three categories of operating, investing, and financing are not clearly mutually exclusive. For items at the margin, a reasonable case may be made for alternative classifications. Paragraph 87 notes that the Board recognizes that the most appropriate classification of items will not always be clear.

25. The definitions of operating and investing activities in Statement 95 provide flexibility for the appropriate classification of cash receipts and payments for assets that generally are productive assets but in certain cases may be inventory. For example, real estate generally is considered a productive asset, and a cash payment to purchase real estate generally is an investing cash outflow. However, if real estate is acquired by a real estate developer to be subdivided, improved, and sold in individual lots, then the cash payment to purchase that real estate would be classified as an operating cash flow because the real estate is acquired specifically for resale and is similar to inventory in other businesses.

26. For certain enterprises, purchases and sales of trading account assets have characteristics of both investing activities and operating activities. However, the purchases and sales of debt and equity instruments of other enterprises, are defined by Statement 95 as investing activities. The Board was asked to address the appropriate classification of cash flows from purchases and sales of securities in a trading account of a bank or a broker and dealer in securities. Because, trading account assets are also similar to inventory in other businesses in that they generally are acquired specifically for resale and are turned over very rapidly, the Board concluded that cash receipts and cash payments resulting from purchases and sales of securities and other assets that are acquired specifically for resale and are carried at market value in a trading account should be reported as operating cash flows.

27. Loans that are originated or purchased specifically for resale, are turned over rapidly, and are carried at market value or at the lower of cost or market value also are similar to inventory in other businesses. Therefore, the Board concluded that cash receipts and cash payments resulting from originations or purchases and sales of those loans also should be reported as operating cash flows.

28. The Board decided to require rather than permit cash flows from the activities described in paragraphs 26 and 27 to be classified as operating cash flows in order to achieve greater comparability among enterprises in classifying similar items.

29. When the Board addressed the issue of classification of cash flows resulting from the active trading of assets in a trading account, the Board also discussed whether additional net reporting of cash receipts and cash payments might be appropriate. The Board received several requests primarily from banks to reconsider the requirements of Statement 95 to report gross cash flows for various items for which they believe that the costs of accumulating the data exceed the benefits of the additional disclosures. Gross cash flows from trading activities were identified as particularly costly to accumulate. The Board concluded that the possibility of additional net reporting should be considered but that further research was required before a decision could be reached about the circumstances, if any, in which additional net reporting might be appropriate. That issue will be considered by the Board at a later date.

Appendix B: AMENDMENTS TO APPENDIX C OF STATEMENT 95

30. The statement of cash flows and the reconciliation of net income to net cash provided by operating activities for Financial Institution, Inc., provided in paragraph 147 of Statement 95 are superseded by the following:

Financial Institution, Inc.
Statement of Cash Flows
For the Year Ended December 31, 19X1

Cash flows from operating activities:

Interest received	\$ 5,320	
Fees and commissions received	1,320	
Proceeds from sales of trading securities	20,550	
Purchase of trading securities	(21,075)	
Financing revenue received under leases	60	
Interest paid	(3,925)	
Cash paid to suppliers and employees	(795)	
Income taxes paid	<u>(471)</u>	
Net cash provided by operating activities		\$ 1,014

Cash flows from investing activities:

Proceeds from sales of investment securities	2,225	
Purchase of investment securities	(4,000)	
Net increase in credit card receivables	(1,300)	
Net decrease in customer loans with maturities of 3 months or less	2,250	
Principal collected on longer term loans	26,550	
Longer term loans made to customers	(36,300)	
Purchase of assets to be leased	(1,500)	
Principal payments received under leases	107	
Capital expenditures	(450)	
Proceeds from sale of property, plant, and equipment	<u>260</u>	
Net cash used in investing activities		(12,158)

Cash flows from financing activities:

Net increase in demand deposits, NOW accounts, and savings accounts	3,000	
Proceeds from sales of certificates of deposit	63,000	
Payments for maturing certificates of deposit	(61,000)	
Net increase in federal funds purchased	4,500	

Net increase in 90-day borrowings	50	
Proceeds from issuance of nonrecourse debt	600	
Principal payment on nonrecourse debt	(20)	
Proceeds from issuance of 6-month note	100	
Proceeds from issuance of long-term debt	1,000	
Repayment of long-term debt	(200)	
Proceeds from issuance of common stock	350	
Payments to acquire treasury stock	(175)	
Dividends paid	<u>(240)</u>	
Net cash provided by financing activities		<u>10,965</u>
Net decrease in cash and cash equivalents		(179)
Cash and cash equivalents at beginning of year		<u>6,700</u>
Cash and cash equivalents at end of year		<u>\$ 6,521</u>

Reconciliation of net income to net cash provided by operating activities:

Net income		\$ 1,056
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation	\$ 100	
Provision for probable credit losses	300	
Provision for deferred taxes	58	
Loss on sales of investment securities	75	
Gain on sale of equipment	(50)	
Increase in trading securities (including unrealized appreciation of \$25)	(700)	
Increase in taxes payable	175	
Increase in interest receivable	(150)	
Increase in interest payable	75	
Decrease in fees and commissions receivable	20	
Increase in accrued expenses	<u>55</u>	
Total adjustments		<u>(42)</u>
Net cash provided by operating activities		<u>\$ 1,014</u>

31. The statement of financial position and the statement of operations for Financial Institution, Inc., provided in paragraph 148 of Statement 95 are superseded by the following:

Financial Institution, Inc.
Statement Of Financial Position

	<u>1/1/X1</u>	<u>12/31/X1</u>	<u>Change</u>
Assets:			
Cash and due from banks	\$ 4,400	\$ 3,121	\$ (1,279)
Federal funds sold	<u>2,300</u>	<u>3,400</u>	<u>1,100</u>
Total cash and cash equivalents	6,700	6,521	(179)
Trading securities	4,000	4,700	700
Investment securities	5,000	6,700	1,700
Credit card receivables	8,500	9,800	1,300
Loans	28,000	35,250	7,250
Allowance for credit losses	(800)	(850)	(50)
Interest receivable	600	750	150
Fees and commissions receivable	60	40	(20)
Investment in direct financing lease	—	421	421
Investment in leveraged lease	—	392	392
Property, plant, and equipment, net	<u>525</u>	<u>665</u>	<u>140</u>
Total assets	<u>\$52,585</u>	<u>\$64,389</u>	<u>\$11,804</u>
Liabilities:			
Deposits	\$38,000	\$43,000	\$ 5,000
Federal funds purchased	7,500	12,000	4,500
Short-term borrowings	1,200	1,350	150
Interest payable	350	425	75
Accrued expenses	275	330	55
Taxes payable	75	250	175
Dividends payable	—	80	80
Long-term debt	2,000	2,300	300
Deferred taxes	<u>—</u>	<u>58</u>	<u>58</u>
Total liabilities	49,400	59,793	10,393
Stockholders' equity:			
Common stock	1,250	2,100	850
Treasury stock	—	(175)	(175)
Retained earnings	<u>1,935</u>	<u>2,671</u>	<u>736</u>
Total stockholders' equity	<u>3,185</u>	<u>4,596</u>	<u>1,411</u>
Total liabilities and stockholders' equity	<u>\$52,585</u>	<u>\$64,389</u>	<u>\$11,804</u>

Financial Institution, Inc.
Statement of Operations
For the Year Ended December 31, 19X1

Revenues:

Interest income	\$5,500	
Fees and commissions	1,300	
Net gain on sales of trading and investment securities	75	
Unrealized appreciation of trading securities	25	
Lease income	60	
Gain on sale of equipment	50	
Total revenues		\$7,010

Expenses:

Interest expense	4,000	
Provision for probable credit losses	300	
Operating expenses	850	
Depreciation	100	
Total expenses		5,250

Income before income taxes	1,760
Provision for income taxes	704
Net income	\$1,056

32. The transactions of Financial Institution, Inc., described in paragraph 149(a) of Statement 95 are superseded by the following:

Financial Institution sold trading securities with a carrying value of \$20,400 for \$20,550 and purchased trading securities for \$21,075. Financial Institution recorded unrealized appreciation on trading securities of \$25. Financial Institution also sold investment securities with a book value of \$2,300 for \$2,225 and purchased new investment securities for \$4,000.

Footnotes

FAS102, Footnote 1--Securities for which market value is determined using matrix pricing techniques, which are described in the AICPA Audit and Accounting Guide, *Audits of Investment Companies*, would meet this condition. Other securities for which market value is not readily determinable and for which fair value must be determined in good faith by the board of directors would not.

FAS102, Footnote 2--For the purpose of determining average debt outstanding, obligations resulting from redemptions of shares by the enterprise 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.

FAS102, Footnote 3--Characteristics of trading account activities are described in FASB Statement No. 89, *Financial Reporting and Changing Prices*, and in the AICPA Industry Audit Guide, *Audits of Banks*, and Audit and Accounting Guide, *Audits of Brokers and Dealers in Securities*.

FAS102, Footnote 4--Mortgage loans and mortgage-backed securities held for sale are required to be reported at the lower of cost or market value in accordance with FASB Statement No. 65, *Accounting for Certain Mortgage Banking Activities*.