IN THE SUPREME COURT OF OHIO

Appeal From the Ohio Board of Tax Appeals

UBS Financial Services, Inc. f/k/a/ Paine Webber, Inc. Appellant, v. Thomas M. Zaino, [Richard A. Levin] Tax Commissioner of Ohio, Appellee.	:	Supreme Court Case No. 2007-1129 Appeal from the Ohio Board of Tax Appeals BTA Case No. 2003-T-1139

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Appellant,	:	Supreme Court Case No. 2007-1129
v.	:	
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Appellee.	:	

INTRODUCTION / SUMMARY

A. The Ohio Dealer in Intangibles Tax is the exclusive Ohio business tax imposed on financial securities brokerage firms, which enjoy broad exemption from the major Ohio business taxes.

As a "dealer in intangibles," the appellant securities brokerage firm, UBS Financial Services, Inc., fka Paine Webber, Inc. ("UBS"), is broadly exempted from Ohio's major business taxes, including the corporate franchise tax, the personal property tax, and the recently enacted commercial activities tax. See R.C. 5733.01(A) (granting blanket exemption from corporate franchise taxation); R.C. 5725.26 (granting a nearly all-encompassing exemption from personal property taxation imposed under R.C. Chapter 5711, except for dealer-owned tangible personal property leased to businesses subject to the personal property tax); and R.C. 5751.01(E)(4) (granting blanket exemption from the commercial activities tax).

In this appeal for the 1999 through 2001 tax years, the financial securities giant contests its liability for the sole business tax[1] that Ohio imposes on it: the dealer-in-intangibles tax ("DIT"), annually levied under R.C. 5725.13. For interstate securities brokers like UBS, which are engaged in business both in and outside of Ohio, determination of the Ohio DIT liability entails a two-step calculation.

B. For interstate securities brokers like UBS, the computation of the tax requires a determination of the broker's over-all net worth as multiplied by a unique-to-the-tax statutory apportionment fraction to derive an Ohio "fair value" of the shares of the dealer.

The calculation of DIT liability requires the interstate dealer to annually report the "fair value" of its shares, as measured by the capital employed by the dealer in Ohio, as of December 31st of the calendar year that immediately precedes the tax year. See R.C. 5725.13, 5725.14, and 5725.15; and the *BTA Decision and Order* at 4, f.n. 4, citing *Household Finance Corp. v. Porterfield* (1970), 24 Ohio St.2d 39, UBS Appx. 10-23. To determine the Ohio fair value of the shares is a two-step process. The first step is to determine the total value of the dealer's shares, commonly referred to as the dealer's "net worth." In the vernacular, the net worth amount answers the starting-point question: "How big is the pie?"

The second step requires the interstate dealer to multiply its total net worth (i.e., the "pie") by a statutory apportionment fraction in order to derive the fair value of the capital employed by the dealer in Ohio (the Ohio "slice"). See former R.C. 5725.14 as in effect for the

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[1] Enjoying broad exemption from the major business taxes, UBS does not, however, entirely escape non-DIT Ohio tax liability. Like most natural persons and corporate entities with a taxable presence in Ohio, dealers in intangibles are subject to the generally applicable sales and use taxes and real property taxes, which are imposed on businesses and non-businesses alike.

tax years at issue. In other words, application of the apportionment formula set forth in R.C. 5725.14 determines Ohio's fair-share slice of the net-worth pie.

Under that statutory apportionment formula as in effect for the tax years at issue, UBS and other dealers in intangibles primarily engaged in buying and selling securities were required to determine their Ohio fair-share slice using a unique-to-the-tax statutory apportionment fraction. Specifically, for the tax years at issue, the numerator of the fraction was "**the aggregate of all commissions charged plus one percent of all other receipts**" attributable to the brokerage firm's Ohio business activity, and the denominator was that same measure but as attributable to the broker's business activity "everywhere." (Emphasis added.) Former R.C. 5725.14[2].

In other words, for dealers in intangibles whose primary business was engaging in buying and selling securities, the Ohio apportionment factor had four components: (1) the Ohio-sitused annual aggregate amount of "commissions charged"; (2) the Ohio-sitused annual aggregate amount of "all other receipts" multiplied by 1%; (3) the total annual aggregate amount "everywhere" of "commissions charged"; and (4) the total annual aggregate amount "everywhere" of "all other receipts" multiplied by 1%.

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[2] As noted by the BTA in its decision below, effective for the 2003 tax year, former R.C 5725.14 was amended to eliminate the "one percent of all other receipts" components of the apportionment fraction. That is, for all post-2002 tax years, the apportionment factor is based solely upon "commissions." See Am. Sub. H.B. No. 405, effective March 14, 2002, 149 Ohio Laws, Part IV, at 6624; *BTA Decision and Order* at 5, f.n. 5.

amount assessed by the Commissioner, of which UBS itself had self-reported and paid $1,153,824 with its timely-filed DIT returns for the tax years at issue.[3]

D. The Commissioner's apportionment-factor interpretation under former R.C. 5725.14 was a long-standing administrative practice uniformly complied with by the brokerage industry for at least the last 50 years of the statute's existence, and, as such, is entitled to great deference.

Under the Commissioner's long-eatablished, long-accepted administrative interpretation, the "receipts" of a brokerage dealer's sales of securities on "its own account," as principal, are its revenues from the sales, i.e., its gains or losses from the sales. In stark contrast, under UBS' interpretation, the costs incurred to purchase the securities would also be included as "receipts," in addition to UBS' profits on the sales of the securities. That is, the full "cash proceeds" of the security sales would be deemed the "receipts."

In its decision below the BTA expressly found that the testimony presented by former Ohio dealer-in-intangibles administrator Michael Sachs established that the "commissioner has for several decades interpreted the term 'receipts' to mean the gain or losses on the transactions." *BTA Decision and Order* at 12. In its opening brief, UBS attempts to impugn the credibility of former Administrator Sachs, but this attack is wholly without substance. Having had over thirty years of experience with the dealer-in-intangibles tax, Mr. Sachs' testimony was clear and

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[3] UBS submitted calculations of the total tax reductions it was claiming pursuant to its petition for reassessment, as presented to the Tax Commissioner, and as resubmitted to the BTA as an exhibit. See the Commissioner's statutory transcript at 11, Supp. 8, and BTA Ex. 1, tab 11, Supp. 1088. Those calculations show a total claimed-reduction in tax for the three years from $1,937,905.88 to $168,247. The reduction to $168,247, however, included a slight amount attributable to the Commissioner's inclusion of "leasehold improvement" assets in the net worth calculation. In its opening brief, UBS has abandoned the leasehold improvements issue. See UBS Br. 2, f.n. 1. Under UBS' apportionment-factor position, the amount of DIT tax arising from the inclusion of the "leasehold improvement" assets would be only an additional $1,952. Thus, under its current position as set forth in its opening brief filed with this Court, UBS would be entitled to eliminate the entire amount of the increases in its DIT liability of $784,082.24 assessed by the Commissioner upon audit, as well as to receive a refund of all but $170,209 of the $1,153,824 in taxes it voluntarily self-reported and paid per its DIT returns for the tax years at issue.

C. Under UBS' apportionment-factor interpretation, its sole Ohio business tax obligations (its dealer-in-intangibles tax liabilities) for its substantial Ohio business presence would suddenly be reduced to only $32,203 for the 1999 tax year; $47,426 for the 2000 tax year; and $90,580 for the 2001 tax year.

UBS' opening brief is masterful in its level of abstraction. Notably absent from UBS' opening brief is a full disclosure of the tax consequences that would arise from this Court's adoption of the UBS position. If UBS' apportionment-fraction interpretation were correct, it should have reported only $170,209 in dealer-in-intangibles tax, rather than the $1,937,905.88 amount assessed by the Commissioner, of which UBS itself had self-reported and paid $1,153,824 with its timely-filed DIT returns for the tax years at issue.[3]

D. The Commissioner's apportionment-factor interpretation under former R.C. 5711.14 was a long-standing administrative practice uniformly complied with by the brokerage industry for at least the last 50 years of the statute's existence, and, as such, is entitled to great deference.

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In urging a radical departure from the long-standing administrative interpretation of the Commissioner, with which the brokerage industry has uniformly complied for at least the last 50 years, UBS would have this Court believe that everyone in the brokerage industry, including UBS itself, for all those decades "got it wrong." If UBS' position were to be accepted -- which it asserted for the first time during the Commissioner's field audit in 2001 -- it would certainly come as a surprise to the industry. It would mean that the Ohio brokerage industry voluntarily, but erroneously, had paid countless millions of dealer-in-intangibles taxes over all of those previous decades.

E. In stark ontrast with the Commissioner's long-standing administrative interpretation of the apportionment statute, UBS's interpretation is in derogation of the General Assembly's objective that the apportionment fraction fairly measure the capital used by UBS in its Ohio activities.

Under UBS' interpretation, suddenly, for each of the tax years at issue, over two trillion dollars' worth of additional "other receipts" would be included in the denominator of UBS' apportionment factor as non-Ohio "other receipts," with only a few million dollars' worth of additional "receipts" added to the numerator. St. 11, Supp. 8; Ex. 1 tab 11, Supp. 1088. Including these vast sums of sales proceeds in the denominator would thus have the effect of rendering virtually meaningless the other component measures set forth by the General Assembly in the apportionment fraction. UBS's "commissions" income amounts, as well as the amounts of all other kinds of income that UBS received for services rendered, would have almost no effect in determining Ohio's fair share of UBS' total net worth.

UBS' interpretation would thwart the General Assembly's objective in enacting the apportionment statute -- to fairly measure the capital employed by UBS in this state. As with all apportionment statutes, former R.C. 5725.14 is to be construed, if possible, to effectuate the legislative intent that the taxpayers' Ohio business activity be fairly measured. *Rio Indal v. Lindley* (1980), 62 Ohio St.2d 283, 286; *Champion Spark Plug Co. v. Lindley* (1982), 70 Ohio St. 2d 82, 84-85; *Wesnovtek Corp v. Wilkins* (2005), 105 Ohio St.3d 312, 313. This consideration should be of paramount importance here. Under the BTA's and Commissioner's holdings, former R.C. 5725.14, as applied to UBS' facts, does just that, whereas UBS' interpretation of the statute would not.

The grossly distortive effect on the Ohio apportionment fraction that would arise from considering as "receipts" the cash proceeds, rather than the revenues from the sales, is particularly evident when one realizes the nature of UBS' "principal" sales of securities. UBS' sales of securities "on its own account" or "principal sales" consist largely of wholly-computerized, virtually simultaneous-occurring buy/sell transactions that UBS engages in as a "market maker." As the Commissioner's expert SEC financial disclosure/accounting witness, Dr. Ray Stephens, testified and his "Securities Turnover" study detailed, on average, UBS' entire inventory of securities held on its own account turned over completely each trading day. See BTA Exhibit A[4], Supp. 1093. Moreover, as measured as a percentage of the sales proceeds amount, UBS derives very little income from these "principal sales" transactions. In fact, for the three taxable years at issue, UBS' average return on its "principal sales" was only 0.05% of the cash sales price -- a rate of return typically generated from minor processing services, not from capital assets truly held for sale.

In sum of this point, the Commissioner's interpretation achieves the General Assembly's objective under former R.C. 5725.14 to fairly measure the capital used by the dealer in this state, whereas UBS' interpretation would fail miserably. As evidenced by the $100-plus million of commission income generated by UBS' Ohio branch offices over the three taxable years at issue, UBS devotes considerable capital in Ohio to generate commission sales in Ohio, as well as considerable capital in generating management fees and interest income. Yet, under UBS' approach, these commissions, management fees and interest amounts would be relegated to insignificance in determining UBS' Ohio apportionment factor. They would be dwarfed by the gross cash proceeds from UBS' "market maker" transactions, which generate a miniscule return

[4] In its "Table of Contents" to its Supplement Volumes, UBS erroneously identified the Commissioner's sixteen BTA Exhibits by using the numbers 1-16, rather than the letters A-P. In this brief, we will refer to the Commissioner's BTA exhibits by letter, consistent with the way they were identified, marked and admitted into evidence at the BTA hearing.

on the sales price and entail the employment of very little of UBS' capital in relation to the gross sales prices of these securities.

F. The reasonableness and lawfulness of the Commissioner's and BTA's interpretation of the statutory phrase "commissions charged plus 1% of all other receipts" in former R.C. 5725.14 is strongly supported by a textual reading and analysis of the statute itself.

As we detail factually and legally in the following sections of this brief, the Commissioner's interpretation reflects both the common and technical usage of the phrase "receipts." Indeed, regarding the term's technical usage, the BTA expressly found the testimony of the Commissioner's expert SEC-financial disclosure and accounting witness, Dr. Ray Stephens, to be "credible and probative of the issue," to the effect that "receipts" as used for financial security industry purposes means the "revenues" or "gains and losses" from the sales of the securities. *BTA Decision and Order* at 12.

Moreover, the Commissioner's interpretation for the term "receipts" as used in former R.C. 5725.14 gains even greater textual support when it is read in *pari materia* with the remainder of the statutory phrase. Commission revenues are a form of "receipts," so it naturally follows that "other receipts" means other kinds of "revenues." In other words, when the term "receipts" is read in conjunction with the other terms of the statutory apportionment fraction, it confirms the common and technical usage of that term.

For these substantive reasons, the BTA's decision affirming the Commissioner should be affirmed. Additionally, we note a separate and independent basis that partially would bar UBS from obtaining the reduction in taxes that it seeks.

G. **UBS' filing of the petition for reassessment conferred UBS only with a right to the Commissioner's review and redetermination of the additional tax liability assessed by the Commissioner upon audit, not with a right to contest the tax that it had reported and paid per its returns.**

In filing a "petition for reassessment" to contest the Commissioner's amended assessment certificates, which increased the liability that UBS had self-reported on its returns, UBS did not thereby obtain the right to a review and redetermination by the Commissioner of the originally assessed tax liability as reported by UBS. The plain meaning of the relevant statutes and this Court's precedent require that result. This is the position that the Commissioner expressed in his BTA brief. See *BTA Decision and Order* at 6. Accordingly, in its decision below, the BTA agreed with the Commissioner that UBS is jurisdictionally barred in the current proceedings from obtaining a refund of the taxes that it self-reported and paid with its returns.

The BTA, however, appears to have further held that its consideration of the apportionment factor issue was jurisdictionally barred altogether. If so, the Commissioner disagrees with the BTA's jurisdictional ruling to the extent that it may be interpreted as holding that UBS was jurisdictionally barred from raising its apportionment-factor challenge as a defense to the increases in tax liability resulting from the Commissioner's issuance of amended assessment certificates. In other words, in our view, UBS was not jurisdictionally barred from asserting its apportionment-factor challenge as a "shield" to contest the liability imposed by the Commissioner upon audit pursuant to the amended assessment certificates. But, UBS was barred from asserting that challenge as a "sword" to obtain a refund of the taxes that it voluntarily reported and paid with its returns.

We now proceed with the Statement of Case and Facts, the Procedural Posture section of which provides substantial detail of the assessment and audit proceedings in order to provide the Court with the context for the jurisdictional issue involved here.

STATEMENT OF CASE AND FACTS

A. Procedural Posture

1. **Upon audit, the Commissioner increased UBS' self-reported DIT liability for each of the tax years, making adjustments both to UBS' reporting of the total net worth and the Ohio apportionment factor.**

Through an audit of UBS' 1999-2001 DIT returns, the Commissioner's field auditors discovered that, for each of the three tax years, UBS had taken an unlawful over- 40% "haircut" off the Ohio-sitused "aggregate commissions" part of the numerator of the apportionment factor[5]. Additionally, the auditors increased UBS' self-reported total net-worth amounts to include UBS' booked "leasehold improvements" assets, which UBS had omitted from the net-worth calculations it had reported on its DIT returns[6].

By reason of the over-40% increase to the "aggregate commissions" component of the numerator of the apportionment fraction, the total numerator amount for each of the tax years increased by almost the same amount (the lack of a complete one-to-one correspondence is attributable to the second component of the numerator, i.e., the relatively miniscule amounts of

[5] See, e.g., (1) the Tax Commissioner's agents' field audit report under the caption "Verification of 'Exhibit A'", Supp. 88; (2) the BTA testimony of UBS witness Louis DeVico, Supp. 795; and (3) UBS Br. 3, first full paragraph. UBS' income statements and supporting documentation, as reviewed by the Commissioner's agents upon audit (and included as exhibits to the field audit report), plainly showed attribution by UBS of those commissions to UBS' Ohio offices. Id.

[6] See the Commissioner's field audit report under the caption "Fair Value Adjustments," Supp. 89.

UBS' Ohio-sitused "all other receipts," which were not increased upon audit). Specifically, for the 1999-2001 tax years, the Commissioner increased the Ohio apportionment factor from the percentages reported by UBS in its returns for those tax years, as follows: for the 1999 tax year from 2.04% to 3.37%, St. 94, 531, Supp. 71, 499; for the 2000 tax year from 2.0072% to 3.332%, St. 98, 553, Supp. 75, 521; and for the 2001 tax year from 2.0017% to 3.26%, St. 56, 581, Supp. 39, 549.

Coupled with the field auditors' net-worth audit adjustments regarding the omitted "leasehold improvement" assets, the field audit resulted in a $784,082 increase of UBS' DIT liability from the $1,153,823 of taxes that UBS had voluntarily reported and paid with its returns for those tax years. The lion's share of the increases was attributable to the "aggregate commissions" adjustment. The Commissioner issued his amended assessment certificates for each of the tax years on July 20, 2001 reflecting his field auditors' findings. These amended assessment certificates increased the "preliminary" assessment certificates that the Commissioner had previously issued for the 1999, 2000, and 2001 tax years on May 3, 1999; May 1, 2000; and May 7, 2001, respectively. Following shortly after UBS' timely filing of its DIT returns for those tax years, the Commissioner had issued his preliminary assessment certificates reflecting UBS' own self-reporting of its DIT liability[7].

[7] For the amended assessment certificates for the 1999-2001 tax years issued on July 20, 2001, see Supp. 485 (1999 tax year); Supp. 507 (2000 tax year); and Supp. 530 (2001 tax year). For the preliminary assessment certificates, each issued by the Commissioner following closely after UBS' filing of its DIT return for the particular tax year, see Supp. 492 (1999 tax year); Supp. 514 (2000 tax year); and Supp. 543 (2001 tax year). Finally, to see that the amount of tax self-reported by UBS for each of the tax years exactly matches the amount set forth on the preliminary assessment certificates, see the first page of each of the returns, Supp. 494 (1999 return); Supp. 517 (2000 return); and Supp. 545 (2001 return).

2. **Pursuant to UBS' petition for reassessment, UBS sought not only to challenge the Commissioner's over-40% increase in UBS' assessment liability arising upon audit, but also sought to drastically reduce its own self-reported liability voluntarily paid per its returns.**

As we will detail in the Law and Argument section, infra, pursuant to R.C. 5725.15 and R.C. 5711.31, whenever the Commissioner issues a DIT assessment in an amount greater than the Ohio fair share amount self-reported by the dealer in its annual DIT return, the dealer may file a "petition for reassessment" contesting the increase. UBS did so in the present case. Following the Commissioner's issuance of his amended assessment certificates on July 20, 2001, UBS filed a petition for reassessment dated September 27, 2001 covering the 1999-2001 tax years. Supp. 19-22.

In its petition, UBS challenged the Commissioner's increases in the assessment liability regarding both the computation of UBS' total net worth and the Ohio apportionment factor applied to that net worth. Regarding the net-worth calculation, UBS contested the Commissioner's inclusion of the book value of "leasehold improvements." UBS asserted that it had properly excluded the book value of those assets from its DIT returns, so that its net worth amount for each tax year should be reduced back to the amount it had self-reported on its return.

The Commissioner rejected this contention in his final determination, and upon appeal the BTA affirmed. *BTA Decision and Order* at 13-14. UBS preserved that challenge in its appeals to this Court but, by way of its opening brief, has unceremoniously abandoned that challenge by footnote. See UBS Br. 2, f.n.1 ("[t]his issue is no longer being pursued").

Regarding the Ohio apportionment factor, UBS contested the Commissioner's determination in two ways. First, UBS asserted that, in its DIT returns for each tax year, it had acted reasonably and lawfully in omitting 40% of the "commissions" income reported on its own books and records as "Ohio" commission income. In support, UBS argued that its reporting of only 60% of these commissions was reasonable because 40% of the activities generating these Ohio-designated commissions assertedly were performed outside of Ohio. Thus, UBS requested that the Commissioner reduce the Ohio-sitused "aggregate commissions" back to the amounts it had self-reported. In the Tax Commissioner's administrative proceedings on the petition, UBS, however, abandoned that argument, and, consequently, it was not addressed in the Commissioner's final determination, nor appealed to the BTA.

Instead, UBS relied upon a second, independent argument. Namely, UBS argued that, even if the Commissioner lawfully had included in the numerator of the apportionment fraction all of the commissions that UBS' own books and records had designated as "Ohio"-sitused commissions, nonetheless, no increase in the apportionment factor would be warranted. Indeed, UBS asserted that, not only was no increase in the Ohio apportionment factor warranted, but that UBS itself erroneously had overstated the Ohio apportionment factor for each of the tax years.

According to UBS, in self-reporting its Ohio apportionment percentage it had erroneously understated the denominator of the fraction by a factor of approximately fifteen-fold, or 1,500%, for each of the tax years. See "Attachment B" to UBS' November 6, 2002 letter from UBS' in-house tax representative, Lou DeVico, to the Commissioner's Appeals Division counsel, William F. Gross, in support of the petition. St. 11, Supp. 8.

Namely, UBS claimed that its own determinations of the "all other receipts" amounts in the numerator and denominator of the apportionment factor attributable to its sales of securities as "principal" were drastically understated. (UBS explained that such "principal" sales are those for which it sells as owner, rather than as broker.) In filing its DIT returns, UBS had followed its own long-standing practice, as well as the Commissioner's, of reporting as the "receipts" for these transactions the revenues that it derived from the sales, i.e., the gains and losses from the sales. After being caught taking its 40%-plus "haircut," UBS asserted that it, instead, should have reported the entire cash sales proceeds as the "receipts" from those transactions, rather than just the revenue amounts.

Having advanced this argument only in a general and informal way during the audit stage, Mr. DeVico quantified it in his attachments to his November 6, 2002 letter by setting forth revised apportionment factors that reflected this position, St. 11, Supp. 8, and supporting documentation, St. 12-14, Supp. 9-12. Under this position, the Ohio apportionment factors would be reduced for the 1999, 2000 and 2001 tax years to only 0.2273%; 0.2902%; and 0.3217%, respectively. St. 11, Supp. 8.

B. Statement of Facts

1. In its opening brief, UBS has materially distorted and ignored the evidence presented in direct conflict with the BTA's own factual findings.

Even at first blush, UBS' blithe assurance to this Court in its opening brief that "no facts are in dispute," UBS Br. 8, is puzzling. After all, the Commissioner, as appellee in the current appeal, only now, through the filing of the present merit brief, sets forth his own factual statement and analysis for this Court, so that UBS had no basis to have made that statement .

But more fundamentally, UBS' characterizations and analyses of the facts, throughout its opening brief, materially distort, ignore, and conflict with the evidentiary record generally, as well as with the BTA's specific factual findings. Indeed in sub-sections 2-5, infra, we focus on four major areas in which UBS' opening brief materially distorts or ignores the actual facts concerning the apportionment factor issue, including characterizations in direct conflict with the BTA's findings.

2. **The Commissioner's statutory interpretation of former R.C. 5725.14 was a long-standing, uniform construction in effect for at least the last 50 years of the statute's existence and was met with universal acceptance from the securities brokerage industry over that time, except for UBS's novel interpretation in the present case.**

For at least the last 50 years for which former R.C. 5725.14 was in existence, and as far back in history as could be shown through probative evidence, the Tax Commissioner has interpreted that statutory apportionment provision ("commissions charged plus 1% of all other receipts") to mean commission income plus 1% of all other income or revenues. Thus, under this statutory interpretation, the aggregate gains and losses arising from a broker's sale of securities on its own account. i.e., the broker's income or revenues from such sales transactions, constitute its "receipts" for such transactions.

In the evidentiary proceedings below, the Board was provided with the strongest probative source of evidence on this point: (1) the testimony of Michael Sachs, whose direct, 30-year Department of Taxation-experience with the dealers in intangibles tax spanned four decades, including his supervision of the tax on behalf of the Tax Commissioner from 1981 through his retirement in 2004, see Tr.II 186-196, Supp. 984-994; and (2) the Tax Commissioner's instructions to the filing of the returns, Form 980-A for the 1995 tax year and thereafter, setting forth that administrative interpretation, Tr.II 210-212, Supp. 1008-1010; see, e.g., the Form 980-A enclosed and mailed to dealers in intangibles with the 1995 tax year return, under the caption of the instruction "Exhibit C," in reference to the return schedule in which the apportionment fraction is determined. Supp. 1214-1215 (included as part of BTA Ex. B)[8].

Throughout Mr. Sachs' tenure and that of his mentor, John Knox, the previous long-time dealer-in-intangibles-tax supervisor (whose own 22-year experience with the tax dated to the late 1950s or early 1960s, Tr.II 192-193, Supp. 990-991), the Commissioner uniformly gave the apportionment statute, former R.C. 5725.14, the same administrative interpretation as is challenged by UBS here. Tr.II 210-211, Supp. 1008-1009.

Mr. Saks further testified that the dealer in intangibles tax instructions, labeled "Tax Form 980-A," were attached with each tax return and that such returns with instructions were sent out annually to all dealers that had filed returns in the previous year, as well as to any other entities desiring a blank return. Tr.II 199, Supp. 997. The BTA evidentiary record included blank tax returns, with the Tax Forms 980-A attached, setting forth the Commissioner's administrative interpretation, for all tax years dating back to 1995 -- the earliest tax year for which the Commissioner, at the time of the BTA hearing in this case, still maintained blank returns and Form 1980-A instructions. Tr.II 200-201, Supp. 998-999, Exs. B-I, Supp. 1204-1382.

The BTA evidentiary record shows that, until the present case, no securities brokerage firm had ever, to the Tax Commissioner's staff's knowledge, challenged the Commissioner's administrative interpretation. In the words of Mr. Sachs, "everyone in the industry was told to file that way, and all audits were performed that way [in accordance with the Tax

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[8]The instruction booklet, Form 980-A, that was mailed with the 1995 tax year return, and for every tax year thereafter through the last tax year that former R.C. 5725.14 applied (the 2002 tax year), contained the following language: "To calculate the Ohio percentage of business for brokers, [use] 100 percent of commissions charged plus 1% of all other income earned in Ohio, divided by 100% of commissions charged everywhere plus 1% of all other income everywhere." Ex. B, Supp. 1215."

Commissioner's administrative interpretation]." Tr.II 213, Supp. 1011. To his own personal knowledge, throughout his entire 30-year career, and that of his predecessor, John Knox, "no one until now [in the present case] has ever questioned it." Id. [9]

Furthermore, upon even a cursory review of a completed broker's dealer in intangibles tax return any such challenge to the Commissioner's administrative interpretation would have been revealed, so that it is unlikely that it would have eluded a Tax Commissioner audit. The tremendous dollar amount increase in the denominator of the apportionment fraction resulting

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[9] By the time the present case was being prepared for the BTA hearing in this case, in 2004, the Department of Taxation's own internally-maintained research archives did not contain any information or documentation concerning the Commissioner's administrative practices regarding the apportionment issue prior to John Knox's tenure with the Ohio dealer-in-intangibles tax beginning in the late 1950s. In its opening brief filed with this Court, however, UBS attaches a copy of an excerpt from a 1941 edition of Pages Annotated concerning the General Code predecessor to former R.C. 5725.14, G.C. 5414-4, which includes a "Comment" from the then-Tax Commissioner, William Evatt. The language that UBS relies upon is Commissioner Evatt's statement that "[s]ince some brokers both deal and sell on commission, it was considered that one per cent of the gross receipt of outright sales should have approximately the same weight as the gross commissions charged.***." UBS Br. 12-13.

UBS then claims that the commentary language supports UBS' interpretation of the apportionment statute, but that claim is highly debatable, at best. First, given the reasoning of Commissioner Evatt, his comment strongly supports the Commissioner's interpretation. Specifically, Commissioner Evatt appears to be stating that 1% of the "gross receipt" from the outright sale of a security is a proxy for the average rate of return of income earned on the sale. Yet, as we detail in Sub-Section 5 of this Statement of Facts section, infra, for the three taxable years at issue, the income from UBS' sales of security on its own account, on average, represented only 0.05% of the sales price of the securities sold. So, in Commissioner Evatt's view, UBS' interpretation would overweight UBS' sales in the apportionment fraction by a factor of twenty-fold.

Moreover, whatever Commissioner Evatt meant by his comment, his commentary in 1941 does not change the Commissioner's long-standing administrative practices thereafter. As found by the BTA, and as established by the testimony of Administrator Sachs, for at least the last 50 years that former R.C. 5725.14 was in existence, the Commissioner's uniform administrative practice was to define "receipts" as revenues or income, not as the entire cash proceeds.

from adoption of UBS's statutory interpretation (in UBS's case 1% of approximately 2 trillion dollars, i.e., $20 billion, for each of the three tax years) would have been an obvious "flag" that the taxpayer broker was taking such a position. Tr.II 215-216, Supp. 1013-1014.

In fact, if securities brokerage firms truly thought that the statutory interpretation that has been advanced by UBS here was a supportable one, they would have had every incentive to challenge the Tax Commissioner's interpretation. Under adoption of UBS's statutory interpretation, its Ohio apportionment factor would be reduced by over 90%, resulting in a corresponding tax liability reduction. Such large savings in dealer in intangibles tax would be a serious inducement for any securities brokerage company engaged in like "market making" activity to that engaged in by UBS in the OTC (over-the-counter) market (i.e., the kinds of "principal transactions" engaged in by UBS here).

Moreover, the total absence of decisional law adds confirmation to Mr. Sachs' unequivocal, first-hand testimony. Prior to the present appeal, no cases existed in which any dealer in intangibles had questioned the Commissioner's interpretation of the apportionment statute. In sum, the evidence establishes that the Commissioner's administrative interpretation of the statute was long-standing, uniform, and universally accepted, except for UBS's challenge in this case.

Additionally, in its opening brief, UBS attempts to attack Mr. Sachs' credibility by suggesting that he was incorrect in his testimony in a few respects, and that his allegedly incorrect testimony misled the BTA, but UBS' attacks do not stand up when Mr. Sachs' BTA testimony is reviewed. Contrary to UBS' suggestion, Mr. Sachs was completely accurate in his testimony and the BTA was not, and could not have been, misled.

UBS' misguided attempt to impugn Mr. Sachs' testimony entails a few steps. First, UBS erroneously suggests that Mr. Sachs testified that the Form 980-A instructions prior to the 1995 tax year expressly set forth the same language appearing in the instructions for the 1995 tax year Form 980-A and thereafter. But in this regard, UBS erroneously confuses Mr. Sachs' testimony concerning the contents of the returns themselves (Form 980) with his testimony concerning the instructions to those returns (Form 980-A). See UBS Br. 14, citing Mr. Sachs' testimony at Tr.II, 202, Supp. 1000.

In this regard, the testimony that UBS cites in its brief in support of its contention concerns the contents of the 1995 tax year return, i.e., **Form 980**, as distinguished from the instructions to the return, **Form 980-A**. In testifying that the Form 980 for the 1995 tax year would be "substantially similar to the returns for the prior years," Mr. Sachs was not referring to the contents of the Form 980-A. Rather, on that subject, Mr. Sachs testified later in the BTA hearing transcript. Regarding the contents of the Form 980-A, Mr. Sachs' testimony forthrightly testified that he did not know whether, prior to the 1995 tax year, the Form 980-A instruction booklet contained the same specific instruction concerning the apportionment factor as did the Form 980-A instructions enclosed with the 1995 returns and thereafter. Specifically, he testified "I couldn't tell you, but I could attest to '95 forward." Tr.II 211, Supp. 1009.

Moreover, UBS's apparent procurement, outside the evidentiary record, of purported reproductions of Forms 980-A in use by the Commissioner prior to the 1994 tax year, even if constituting accurate reproductions of those Forms, does not impugn Mr. Sachs' testimony in any way. Nor in any way do they suggest that the Commissioner's long-standing administrative practice differed from Mr. Sachs' testimony.

The contents of those Forms 980-A simply parrot the statutory language, i.e., the instruction requires securities brokers to set forth their commissions at 100% and their other "receipts" at 1%. Thus, the contents of those Forms 980-A do not conflict in any way with Mr. Sachs' testimony. Namely, that, throughout his 30-year tenure, and throughout the tenure of his predecessor, John Knox, dating back to the late 1950s or early 1960s, the Commissioner's uniform administrative practice, universally complied with by the securities brokerage industry, was for brokers to report the gains and losses, or revenues, from their sales of securities as their "receipts."

3. **The uniform practice and usage within the securities brokerage industry, as mandated for GAAP and SEC financial statement disclosure purposes, is that the aggregate gains and losses from the sales of securities on its own account constitute the broker's revenues or income from such transactions.**

As the BTA expressly found and as UBS's own witness, Thomas Stampfli, openly acknowledged and Dr. Ray Stephens, the Commissioner's expert witness, further confirmed, in the securities brokerage industry, the "trading profits" on a brokerage firm's sales of securities on its own account, i.e., the aggregate gains and losses on those sales, constitute the broker's "revenues" from those transactions. See, *BTA Decision and Order* at 11; Mr. Stampfli's testimony at Tr.I 87, Supp. 642, and Dr. Stephens' testimony at, e.g., Tr.II 117-118, Supp. 915-916[10].

[10] Similarly, the fees and aggregate underwriting gains or losses arising from IPOs (initial public offerings) and other like investment banking activities constitute the "revenues" from those securities sales/ underwriting transactions. See Dr. Stephen's testimony at, e.g., Tr.II 130-131, Supp. 928-929 (referencing numbered paragraph 4.57 captioned "Underwriting Income or Loss," of page 106 of the AICPA "Audit and Accounting Guide" for "Brokers and Dealers in Securities," Ex. P (hereafter often referred to as "AICPA guidelines"), Supp. 1094-1110; Mr. Stampfli's testimony at Tr.I 63-64, Supp. 618-619.

Accordingly, the aggregate gains and losses are reported as "revenues"[11] on the securities brokers' audited financial statements (which are reported to the SEC and widely distributed to shareholders and other users of financial statements), as well as on the brokers' profit and loss statements and supporting documentation detail. Indeed, a review of UBS's own financial statements and supporting documentation establishes its adherence to this usage of the term "revenues." Tr.I 87, Supp. 642; Tr.II 118-119, Supp. 916-917; St. 450, 457, Supp. 425, 432 (pertinent pages of UBS's parent corporation's 1999 annual report relating to "Management's Discussion and Analysis," and "Consolidated Statements of Income," respectively); St. 339-341, Supp. 314-316 (pertinent pages of UBS's glossary of terms used in its chart of accounts relating to "trading profits); and St. 133-294, Supp. 110-271 (UBS's profit and loss report detail for the tax years at issue).

As Dr. Stephens further testified, Generally Accepted Accounted Principles (GAAP) and Generally Accepted Auditing Standards (GAAS) require that, regarding security broker's sales of securities on its own account, "revenues" means the aggregate gains and losses from the sales. The GAAP and GAAS standards are the controlling authority for purposes of financial statement disclosure purposes. As Dr. Stephens explained, as part of the CPA-auditor's certification of the financial statements as being in compliance with GAAS, the auditor must follow GAAP, TR.II 147, 148, Supp. Supp. 945-946.

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[11] As Dr. Stephens explained, the term "revenues" is generally used for purposes of financial statement presentation, rather than "income." More specifically, the term "income" is generally modified in some way to indicate a particular type of income. But, regardless of the modifier, "revenues" may be a broader term than "income" because, in its general use, the term "income" means "revenues minus expenses," Tr.II 145, Supp. 943. However, as Dr. Stephens testified, as applied to the categories of income set forth in AICPA guidelines for securities brokers, the terms "income" and "revenues" equate. Tr.II 145-147, Supp. 943-945.

In support of his testimony as to the meaning of revenues within the securities brokerage industry and as required under GAAP and GAAS, Dr. Stephens identified the relevant excerpts of the AICPA [American Institute of Certified Public Accountants] Audit and Accounting Guide for Brokers and Dealers in Securities, Ex.P, Supp. 1094-1110. He testified that, for GAAP, the AICPA guidelines were the highest existing source of authoritative guidelines for the industry, and that AICPA guidelines specify how the securities brokers account for various items on their audited financial books and records. Tr.II 108, Supp. 906. The AICPA guidelines define the "revenues" or income from the broker's sales of securities on its own account as constituting the aggregate gains and losses from the sales. See paragraph 4.56 of page 106 of the guidelines, Ex.P, Supp. 1098, and UBS's own description of these revenues in its 1999 annual report of "principal transactions," St. 450, 457, Supp. 425, 432. They likewise do so for the various other kinds of business activities engaged in by securities brokers, e.g., commission sales, asset management, investment banking, lending, etc., see generally Ex. P and the Commissioner's cross-examination of Mr. Stampfli.

4. **The BTA expressly found as "credible and probative" Dr. Stephen's expert testimony concerning the meaning of "receipts" as used in the securities brokerage industry for financial purposes to be the "revenues" received in cash (or cash-equivalents) of the brokers, and, thus, as applied to "receipts" from the sales of securities on the brokers' own account, means the aggregate gains and losses from those sales received by the brokers in cash (or cash equivalents).**

The BTA expressly found Dr. Stephens' expert testimony concerning the meaning that the term "receipts" has acquired in the securities brokerage industry to be "credible and probative." BTA Decision and Order at 12. Dr. Stephens testified that the meaning of "receipts" within the brokerage industry, for financial purposes under GAAP, is a special meaning, among the general definitions of that term in common parlance. Specifically, the term "receipts" means "revenues received in cash." E.g., Tr.II 140, Supp. 938. Thus, as applied to the brokers' sales of securities on their own accounts, such receipts (or "revenues received in cash") constitute the amounts received by the brokers from the gain or loss on the sales of the securities, and do not also include the amounts received by the brokers for the recovery of the costs of the securities sold. See Dr. Stephens' testimony at, e.g., Tr.II 141, Supp. 939.

Dr. Stephens testified that the term "receipts" as used for financial purposes under GAAP is a "term of art" as the presiding attorney-examiner explained "term of art" to mean (i.e., "[a term that] takes a meaning different from the vernacular used elsewhere in society, Tr.II 137, 935."). That is, "receipts" in Dr. Stephen's understanding may have multiple meanings in common parlance, but as it is used for financial/accounting purposes, it has acquired that special meaning.

Dr. Stephens further testified that the securities brokerage industry uses the term "receipts" for purposes of cash flow analyses and the presentation of the "statement of cash flow," a standard financial document in any audited, certified financial statements. Tr.II 129-130, Supp. 129-130; St. 461 (UBS' parent corporation's 1999 annual report's "Consolidated Statements of Cash Flow"). In determining a broker's (or any other business concern's) cash flows, the "revenues" from its various business activities are added together with the existing cash and cash equivalents, and the various cash disbursements and expenses are deducted in order to compute the total cash flow "receipts" from operations. Id.

The definition of the term "receipts" in the operational cash flow analyses and financial statement disclosures, as required under GAAP, emanates from the accounting profession's highest authoritative source on this subject: The Financial Accounting Standards Board's

(FASB's) Statement of Financial Accounting Standards No. 95, captioned "Statement of Cash Flows," T.C. Appx. 1-66 (obtained from the FASB official website, http: //www.fasb.org.)[12]. Thus, Dr. Stephens' testimony as to the meaning of "receipts" derives from his expert understanding of the meaning of "receipts" for purposes of GAAP, as defined in the securities brokerage industry. Moreover, for this expert understanding, he has utilized the very highest authority under GAAP.

5. The inclusion within the apportionment fraction of the costs of the securities sold, as part of the "receipts" from a broker's sales of securities on its own account, would disproportionately skew the apportionment fraction so that it could not fairly reflect the broker's business activity within or without Ohio

The gross sales proceeds from its security sales that UBS urges constitute its "receipts" from those sales (approximately 2 trillion dollars, on average, for the three tax years at issue) are figures that are not directly stated in any document in the evidentiary record. These figures are nowhere to be found on UBS's own internal accounting records, including its profit and loss statement detail and balance sheet detail for the subject tax years, St. 128-294, Supp. 105-272. Nor are they found otherwise in the evidentiary record[13], or in its audited financial statements filed with the SEC and issued to its shareholders. Indeed, in its annual report for 1999, UBS's

[12] As FASB's official website "home" declares, FASB's mission is to "establish and improve standards of financial accounting and reporting for the guidance and education of the public, including issuers, auditors, and users of financial information." Accordingly, its official publications, including the attached Statement No. 95, are readily accessible and printable to the general public, in furtherance of FASB's "educational" mission.

[13] The closest that UBS comes to documenting any hard figures setting forth such gross sales proceeds is its "costs of securities sold" summaries for each year, captioned as such, St. 13-15, Supp. 10-12, reproduced (but without these captions) as Ex. 1, tabs 13-15, Supp. 1090-1092. But, "cost of securities sold" is only a component of the total sales proceeds from the sales; the total sales proceeds also include the aggregate gains and losses from those sales.

parent corporation provided a powerful explanation for the absence of such gross sales figures. In the section titled "Management's Discussion and Analysis" at page 7, St. 450, Supp. 425, the following revealing explanation concerning its "principal transactions" was provided:

> For financial reporting purposes, principal transactions revenues include realized and unrealized gains and losses on trading positions and principal investing activities, including hedges. **In assessing the profitability of its trading activities**, the Company [UBS's parent and its various subsidiaries, including UBS, the taxpayer here] views net interest and **principal transactions revenues** in the aggregate. (Emphasis added.)

In other words, for purposes of analyzing profitability, UBS does **not** find pertinent the total gross proceeds from the sales of its securities on its own account. Rather, it looks to the "revenues" from the securities sales, i.e., the aggregate gains and losses from those sales.

The reason for this is most apparent when one realizes the remarkably rapid inventory turnover of its entire securities portfolio and the infinitesimal return these transactions yield, as a percentage of the sales prices. This is shown from Dr. Stephens' inventory turnover analysis, Ex. A, Supp. 1093, for which he used UBS's own figures as set forth in the summary schedule submitted below. See the summary schedules with hand-written additions and deletions, St. 12, Supp. 9, and without such hand-written additions and deletions, St. 303, Supp. 280.

Specifically, based upon 210 trading days per year, the turnover of the portfolio over the three years at issue ranged from 0.8 to 1.2 days. Id. Moreover, the costs of securities sold ranged from 1.9 trillion to 2.2 trillion dollars annually, meaning that, for each trading day, an average of between $10-15 billion of securities were sold. Id. Yet, revenues stated for this activity on UBS's parent's 1999 annual report showed total revenues, i.e., the aggregate gains and losses from these transactions, ranging from $0.86 billion to $1.1 billion annually over the 1997-1999 period. See St. 457, Supp. 432 (the "Consolidated Statements of Income"). This equates to an average return on such sales of a whopping 0.05% -- a rate of return typically generated from minor processing services, not from capital assets truly held for sale.

Suddenly, under UBS's novel statutory interpretation, for the tax years at issue, on average about two trillion dollars would be added to the "all other receipts" category – representing the costs of the securities sold attributable to UBS's sales of securities on its own account. The two trillion dollar figure would then be multiplied by 1%, equaling $20 billion, and this figure would be added to the denominator (which measures the broker's business activity everywhere). Consequently, the Ohio's business activity percentage would be drastically reduced by reason of the grossly disproportionate weighting of UBS's principal transactions business relative to the revenues generated from that activity as compared to the revenues generated from its other activities.

This gross overweighting of the principal transactions, and consequent gross underweighting of commissions and revenues from all other of the broker's business activities, is shown from a consideration of UBS's over-all revenues, as reflected by the financial statements in the evidentiary record. Specifically, the "Consolidated Statements of Income" in UBS's parent corporation for the 1999 annual report, St. 457, Supp. 432 provides a good representation of the over-all revenue picture for the three-year period from 1997-1999. As shown from review of that audited financial statement, revenues from "commissions" ranged from about 50% to 90% higher than revenues from "principal transactions," yet, under UBS's interpretation, over 90% of the denominator of the apportionment factor, for all three tax years, would be attributable to UBS's principal transactions. The commissions would be relegated to the role of a very poor step-sister.

But this is not all; under UBS's statutory interpretation the inverse correlation between the revenue-generating significance of the business activity to its weighting in the apportionment factor is even more pronounced when one compares "principal transactions" to the broker's business activities other than its "commissions" business. For example, revenues from "principal transactions" range from approximately 25% to 90% greater than revenues from "asset management" for the three year period, but, under UBS's statutory interpretation, the weighting of the principal transactions business activity in the denominator of the apportionment fraction would be of a magnitude of over **20,000%** greater than the revenues from asset management[14].

[14] Here is the computation of the "over 20,000%" figure, in rough numbers:

First, determine the influence of the "principal transactions" activity in the denominator of the apportionment fraction. Under UBS's statutory interpretation, the denominator of the apportionment fraction would be increased by an average of about $20 billion, i.e., the $2 trillion for the costs of the securities sold in UBS's principal transactions multiplied by 1% = $20 billion. This figure would be added together with 1% of the aggregate gains and losses from those transactions already included in the denominator under the Commissioner's statutory interpretation. These aggregate gains and losses from the principal transactions average about $1 billion annually. So, 1% of $1 billion = $10 million plus $20 billion = $20.01 billion, representing the portion of the denominator of the fraction attributable to UBS's principal transactions activities.

Second, determine the influence of the "asset management" activity in the denominator of the fraction. Over the three year period, the revenues from that activity generated, on average, approximately $700 million. Under both the Commissioner's and UBS's statutory interpretations, this amount would then be multiplied by 1% = $7 million, or .007 billion. The $.007 billion would be the amount of the denominator attributable to UBS's asset management activity.

Finally, compare the respective influences of the "principal transactions" activity and the "asset management" activity on the denominator, i.e., the $20.01 billion figure relative to the .007 billion figure. The former is 28,580% greater than the latter.

In sum, UBS's approach would unreasonably reduce the Ohio apportionment percentage to an incredibly small fraction of any such Ohio fair-share amount[15] by disproportionately weighting a relatively minor revenue-generating aspect of UBS's securities business.

6. **The Commissioner's and BTA's jurisdiction arises from UBS's filing of a petition for reassessment from the Tax Commissioner's issuance of deficiency assessments for the tax years at issue. As expressly found by the BTA, UBS did not file an amended DIT return, nor did it file an application for final assessment.**

UBS's notice of appeal to the Board from the Tax Commissioner's final determination was an appeal from the Tax Commissioner's resolution of UBS's "petition for reassessment" concerning deficiency assessments issued to UBS for the 1999-2001 tax years. The Commissioner's final determination expressly so provides. St.1, Supp.2. These deficiency assessments increased UBS's dealer in intangibles assessment liability from the amounts that UBS itself had reported on its dealer in intangibles tax returns filed for those tax years. See Ex. 1, tabs 1-3, Supp. 1034-1075. After UBS filed its tax returns for the tax years at issue, the Commissioner's agents conducted a field audit resulting in the Commissioner's issuance of amended assessment certificates reflecting additional tax liability arising from increases in total assessed value. Ex. 1, tabs 5-7, Supp. 1079-1081.

In the written communications between UBS and the Commissioner thereafter, UBS and the Commissioner both clearly communicated that UBS was seeking a petition for reassessment of the assessment liability arising from the field audit. In response to the Commissioner's issuance of the deficiency assessments, UBS filed a letter dated September 27, 2001, St. 35-37,

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[15]For the 1999-2001 tax years at issue, the Ohio percentages of the business activity would be reduced from 3.26%, 3.32%, and 3.37%, respectively, see St. 56, 63, 70, Supp. 39, 46, 53, to about 1/5 of 1%, see Ex.1, tab 11, Supp. 1088.

protesting the increase in the assessment liability occasioned by the Commissioner's issuance of the amended assessment certificates, and by letter dated October 18, 2001 UBS expressly stated that such September 27, 2001 letter was intended by UBS to constitute a written petition for reassessment. St. 33-34. In so filing, UBS expressly did not pay the additional tax, penalties or interest concerning the deficiency assessments, as that was not a jurisdictional requirement under the petition for reassessment requirements. The Commissioner's personnel agreed, in a follow-up letter to UBS dated November 6, 2001, that no such payment of the deficiency assessments was required to confer jurisdiction upon the Commissioner to review the petition for reassessment, but noted a separate duty upon a taxpayer to pay the additional tax pursuant to R.C. 5725.22. St. 32.

The Commissioner also formally advised a third party, the state treasurer, of UBS's filing of its petition for reassessment. As required under R.C. 5711.31, the Commissioner, by notice dated November 8, 2001, informed the treasurer that UBS had filed a petition for reassessment (referred in the notice to the treasurer as an "application for review and redetermination" -- the statutory terminology previously codified in R.C. 5711.31 to describe petitions for reassessment) concerning the deficiency assessments. St. 31, Supp. 26.

Finally, UBS expressed this same understanding in proceedings at the BTA evidentiary hearing. UBS' manager of state and local tax, Lou DeVico, testified to his understanding that the proceedings below entailed review of UBS's petition for reassessment. Tr. II 87, Supp. 885.

Any further facts will be referenced directly to the evidentiary record in the Law and Argument section, which follows.

LAW AND ARGUMENT

Proposition of Law No. 1:

The BTA and Tax Commissioner acted reasonably and lawfully in holding that, under the dealer-in-intangibles tax apportionment statute of former R.C. 5725.14, the "receipts" from a security broker's sales of securities on its own account as principle are the revenues from the sales, i.e., the gains and losses from the sales, and do not also include the costs previously incurred by the broker to purchase the securities.

A. The Commissioner's interpretation of a broker's gains and losses from its sales of securities on its own account as constituting "receipts" within the meaning of the statutory phrase "commissions charged plus one percent of all other receipts" accords with the common usage of the term "receipts" and with the technical usage the term "receipts" has acquired in the securities brokerage industry.

The common and technical usage of the term "receipts" as used within the phrase "commissions charged plus one percent of all other receipts" in former R.C. 5725.14 establish that the Commissioner's interpretation of that unique statutory apportionment language follows from a plain reading of the statute. Even without reading the words "all other receipts" in fuller context, the word "receipts" is commonly used, by itself, to mean "[s]omething received; INCOME." This exact definition is found in the pre-eminent legal dictionary of our times. See Black's Law Dictionary, (7th Ed. 1999) 1274, T.C. Appx. 67-68.

Moreover, and even more fundamentally, the Commissioner's interpretation of the statute accords with the technical meaning that term has acquired within the securities brokerage industry, and, thus, shall be construed accordingly. See R.C. 1.42: "[w]ords and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly."

As expressly found by the BTA below, in UBS' securities brokerage industry, the term "receipts," as applied to the sales of securities by the broker on its own account ("principal transactions"), means the broker's gains or losses from the sales of the securities. *BTA Decision* *and Order* at 12. In so finding, the BTA expressly relied upon the testimony of Dr. Ray Stephens as "probative and credible." Id.

In this regard, Dr. Stephens testified that, as applied to the sales of securities, the term "receipts" within the brokerage industry means "revenues received in cash," and, further, that the broker's "receipts" from principal transactions are the "revenues" from those transactions, i.e., the broker's aggregate gains and losses from those sales. To support his testimony, Dr. Stephens used the best possible documentary sources. See the detailed discussion in Section B.3 and B.4 fully supporting his testimony, including UBS' own financial records and the most authoritative publications under Generally Accepted Accounting Principles (GAAP) and Generally Accepted Auditing Standards (GAAS).

B. Reading the entire statutory phrase "commissions charged plus one percent of all other receipts" in *pari materia* further cements the Commissioner's plain reading of the statute.

As the evidentiary record reflects in detail (see, e.g., the AICPA guidelines, Ex. P, and UBS' own glossary for its P/L chart of accounts, St. 324-391, Supp. 299-366, "commissions" are indisputably a form of revenues or income, as are interest, management fees and investment banking service earnings. The Commissioner and UBS are in accord as to the meaning of the term "receipts" relative to these business activities: the "receipts" for purposes of the statutory apportionment fraction mean the "revenues" from those activities. Thus, when the phrase "commissions charged plus *** all **other** receipts" is read together, the natural reading of the phrase is that "receipts" refer to kinds of revenues, because commissions are a kind of revenues. Moreover, when we realize that the receipts for all other of the kinds of business activities that generate a broker's earnings are "revenues" too, this natural association is even further strengthened.

The Latin phrase *noscitur a sociis* ("it is known by its associates") is appropriately applied here. Specifically, "the meaning of words may be indicated or controlled by those with which they are associated." *Renfroe v. Ashley* (1958), 167 Ohio St. 472, 474. Similarly, "in accordance with the maxim *noscitur a sociis*, the meaning of a word may be ascertained by reference to the meaning of words associated with it; and again, according to a similar rule, the coupling of words together shows that they are to be understood in the same sense." *Myers v. Seaberger* (1887), 45 Ohio St. 232, 236.

C. As a long-standing, universally-accepted administrative interpretation, the Commissioner's application of the plain meaning of the statute is entitled to great weight and shall not be set aside unless judicial construction makes it imperative to do so.

As the BTA expressly found in its decision below, *BTA Decision and Order at 12-13*, and as we detail in Section B. 2 of the Statement of Case and Facts, the Commissioner's administrative interpretation is a long-standing one, at least as far back as the late 1950s or early 1960s. Moreover, it has been universally met with acceptance by the securities brokerage industry, except for this case. Under these facts, the Commissioner's interpretation is entitled to "great deference." *Griggs v. Duke Power Co.* (1971), 401 U.S. 424.

Indeed, Ohio jurisprudence has long recognized this principle and stated it most strongly. As far back as *Indus. Comm'n v. Brown* (1915), 92 Ohio St. 309, 311 the Court applied this principle: "Administrative interpretation of a given law, while not conclusive, is, if long continued, to be reckoned with most seriously and is not to be disregarded and set aside unless judicial construction makes it imperative so to do."

The Court has explicitly applied this same principle, using virtually the same language, in regard to the Tax Commissioner's 23-year-old administrative interpretation of an estate tax statute, as follows: "[s]uch long standing administration practices are not only persuasive, but should not be set aside unless judicial construction makes it imperative to do so [citation omitted]." *In re Packard* (1953), 174 Ohio St. 349, 356; *BTA Decision and Order* at 12-13.

The Court's adherence to this principle is just as true today as it was almost a century ago in *Brown*, supra. The Court continues to accord this same deference to long-standing administrative interpretations: "[i]t is a fundamental tenet of administrative law that an agency's interpretation of a statute that it has a duty to enforce will not be overturned unless the interpretation is unreasonable." *State ex rel. Clark v. Great Lakes Constr. Co.* (2003), 99 Ohio St.3d 320, at ¶10. Similarly, "[l]egislative inaction in the face of long-standing [administrative] interpretation suggests legislative intent to retain the existing law." *Maitland v. Ford Motor Co.* (2004), 103 Ohio St.3d 43, at ¶26.

The merits of UBS's alternative construction must be decided against this backdrop of judicial deference to long-standing administrative interpretations; only if such construction of the statute is required from a plain reading of the statute, would it provide a proper basis for setting aside the Commissioner's long-standing one. As we show above, a textual reading of the statute should compel adoption of the Commissioner's interpretation, even if it were not a long-standing, and, until this case, universally accepted one. But we submit that the Commissioner's construction is not just one based on a plain reasonable reading of the statutory language, it is compelling for another fundamental reason: the manifestly absurd results that are created under UBS's interpretation, wholly contrary to the General Assembly's objective under tax apportionment statutes.

D. The Commissioner's interpretation results in a far "fairer" measure of a securities broker's Ohio business activity than does UBS's alternative interpretation, and accords with Ohio decisional law recognizing that the goal in construing an apportionment statute is to "best effectuate the purpose of the legislation to tax the fair value of the business transacted in Ohio."

The Ohio case law establishes a further guide to statutory interpretation compelling this Court's rejection of UBS's alternative construction of the dealer-in-intangibles-tax apportionment statute in effect for the tax years at issue: tax apportionment statutes shall be construed, if possible, to effectuate the legislative intent that the taxpayers' Ohio business activity be fairly measured. *Rio Indal v. Lindley* (1980), 62 Ohio St.2d 283, 286 ("[o]ur objective is to best effectuate the purpose of the legislation to tax the fair value of the business transacted in Ohio. We believe this construction achieves this objective."); *Champion Spark Plug Co. v. Lindley* (1982), 70 Ohio St. 2d 82, 84-85; *Wesnovtek Corp v. Wilkins* (2005), 105 Ohio St.3d 312, 313 ("[i]n order to fairly tax corporations that do business in more than one state, the statutory framework measures the extent of a corporation's Ohio business activity [citation omitted]").

As we detail in Section B. 5, UBS's approach would unreasonably and unfairly reduce UBS's Ohio apportionment percentage to an incredibly small fraction of any reasonable measure of its Ohio's fair-share percentage. It would do so by vastly over-weighting a relatively minor revenue-generating aspect of UBS's securities business. Borrowing from the words of the Court in *Rio Indal*, UBS's construction "not only ignores the object of the *** apportionment statute *** it subverts it" by so grossly distorting the apportionment fraction that the measure of Ohio business activity is reduced, for each of the tax years, from over 3.2% to 1/5 of 1%. *Rio Indal*, 62 Ohio St.2d at 285-286; see also, the more generalized established principle, applicable to all legislative enactment: "*** if the language of a statute fairly permits or unless restrained by the clear language thereof," the statute must be construed so as to avoid unreasonable or absurd consequences ***,"*City of Canton v. Imperial Bowling Lane* (168), 16 Ohio St. 2d 47, paragraph four of the syllabus).

Thus, for this additional compelling statutory-construction reason, the BTA should affirm the Commissioner's interpretation. Under UBS's construction, the objective of the legislation not only would be ignored, it would be subverted.

<u>Proposition of Law No. 2</u>:

By filing a petition for reassessment pursuant to R.C. 5725.15 and R.C. 5711.31, a dealer in intangibles may contest a deficiency assessment issued by the Tax Commissioner in response to the Commissioner's audit of the taxpayer's return, but the filing of the petition does not additionally grant to the taxpayer the right to a review and redetermination by the Commissioner of the originally assessed tax liability as reported by the taxpayer. *Wright Aeronautical Corp. v. Glander* (1949), 151 Ohio St. 29, paragraph one of the syllabus, **followed**; Accord, *Internat. Business Machines Corp. v. Zaino* (2002), 94 Ohio St.3d 152.

UBS's administrative appeal below was a petition for reassessment. It is from the Commissioner's final determination of that petition that UBS appealed to the Board and then to this Court. The course of conduct of the Commissioner and UBS in the Tax Commissioner's administrative proceedings establishes that the nature of UBS's administrative appeal below was as a petition for reassessment. The Commissioner's course of conduct included notifying the state treasurer of UBS's petition for reassessment, as required by law. We detail the evidentiary record reflecting the actions of the parties, including numerous written communications that expressly refer to the proceedings as entailing a petition for reassessment, in sections A.1 and 2 and B. 6 of the Statement of Case and Facts.

As applied to the dealers in intangibles tax, the pertinent statutes for "petitions for reassessment" are R.C. 5725.15 and R.C. 5711.31. As provided in the last paragraph of R.C. 5725.15, whenever the Commissioner's assessment valuation exceeds the valuation amount reported by the taxpayer dealer in intangibles on its report (i.e., the dealer in intangibles tax return), the dealer may contest the increase by "proceed[ing] as provided in section 5711.31 of the Revised Code." In turn, R.C. 5711.31 provides that the dealer may file a "petition for reassessment" concerning such increased assessment.

The statutory language presently contained in R.C. 5711.31, in pertinent part, mirrors the statutory language of Section 5394 of the General Code that was at issue in *Wright Aeronautical, supra*. The only pertinent change in the relevant statutory language is that in the General Code section the term "petition for reassessment" is labeled as an "application for review and redetermination." We have attached to the appendix of this brief a copy of the General Code provision for the Court to compare for itself the relevant statutory language.

In applying the same relevant language in Section 5394 as is currently set forth in R.C. 5711.31, the Court in *Wright Aeronautical* set forth the following law as paragraph one of the syllabus:

> Section 5394, General Code, does not grant a right to a review and redetermination by the Tax Commissioner to a taxpayer, except where property has been assessed which is not listed in or is omitted from a return, or where the value of the property listed has been increased, or where a claim duly made for deduction from book value, or depreciated book value has been refused.

Accordingly, in applying the syllabus law, the Court affirmed the BTA's determination denying the taxpayer's claim to a refund of the taxes that it had reported as due and owing with its return. The Court upheld the BTA's ruling for both substantive and jurisdictional reasons, including the jurisdictional failure of the taxpayer to have sought a refund of the previously paid taxes by filing an application for final assessment pursuant to Section 5395, General Code (now re-codified as R.C. 5711.26). *Id.* at 43.

In the present case, by filing a petition for reassessment, but not filing an application for final assessment, UBS has followed the same jurisdictionally limiting path as did the taxpayer in *Wright Aeronautical.* The petition for reassessment granted UBS a right to the Tax Commissioner's review and redetermination of the increase in the assessment. But, it did not additionally grant UBS a right to the Commissioner's review and redetermination of the originally assessed liability as determined pursuant to UBS's returns. Accordingly, *Wright Aeronautical* should be controlling here.

We also rely upon the Court's recent decision in *IBM* (2002), *supra. IBM* is of particular guidance for it establishes the Court's continued adherence to the distinctions between refund claims and petitions for reassessment under the tax law relating to the rights granted taxpayers to the Commissioner's review and redetermination of tax liabilities. To be sure, *IBM* involves R.C. 5733.11(B), the "petition for reassessment" statute of the corporate franchise tax law, rather than R.C. 5711.31, so it is not directly controlling here, but the decision's clear jurisdictional distinction between "petitions for reassessment" and "refund claims" strongly buttresses the continuing vitality of *Wright Aeronautical, supra.*

In *IBM,* the Court held that by filing a petition for reassessment pursuant to R.C. 5733.11(B) a corporate franchise taxpayer may contest a deficiency assessment, but that, by so doing, "no refund of the money paid with the filing of the franchise tax returns is available ***." 94 Ohio St.3d at 155. Instead, "if IBM wanted a refund on the amounts it paid with its returns it should have filed for a refund under R.C. 5733.12(B)." *Id.* So, likewise, UBS here should have filed for a refund under the application for final assessment statute, R.C. 5711.26, which would have granted UBS a right to the Commissioner's review and redetermination of any previously paid assessment liability as well as a right to the Commissioner's review and redetermination of the increase in that assessment liability upon audit.

In sum, even if UBS's statutory interpretation challenge were substantively correct, the claim for refund of the taxes that it voluntarily reported and paid per its returns for the subject tax years would be properly denied for this jurisdictional reason. Only the increased liability imposed pursuant to the amended assessment certificates would be appropriately granted here. By filing its petition for reassessment, UBS was not granted a right to the Commissioner's review and redetermination of that prior assessment liability.

Finally, we note here the proper course for UBS to have followed in order to have the right to the Commissioner's review of UBS' dealer-in-intangibles tax liability it reported on its returns for the tax years. Namely, in order to properly contest its own self-reporting of its DIT liability on its timely-filed returns for the 1999-2001 tax years, UBS had two separate ways to have achieved that objective.

First, UBS could have timely filed an application for final assessment pursuant to R.C. 5711.26. This is so, regardless of whether or not the Commissioner had already issued his amended assessment certificates. The availability of this remedy regarding the dealer-in-intangibles tax is expressly set forth in R.C. 5711.26, in pertinent part, as follows:

> *** **[T]he tax commissioner** may, within the time limit in section 5711.25 of the Revised Code, and **shall, upon application filed within such time limitation in accordance with the requirements of this section, finally assess the taxable property required to be returned by any** taxpayer, financial institution, **dealer in intangibles,** or domestic insurance company **as to which a preliminary <u>or</u> amended assessment** has been made by or certified to a county treasrurer or certified to the auditor of state ***. (Emphasis and underlining added.)

Second, UBS could have filed amended DIT returns for those tax years prior to the Commissioner's issuance of the amended assessment certificates increasing its DIT liability upon audit. See *Lincoln Elec. Co. v. Limbach* (1993), 66 Ohio St.3d 176, motion to clarify granted (1993), 67 Ohio St.3d 1205. UBS chose neither course. In fact, at no time has UBS ever filed an application for final assessment or an amended return for any of the tax years, and the time for timely doing so has long passed.

CONCLUSION

For all these reasons, the BTA acted reasonably and lawfully in affirming, on substantive grounds, the Commissioner's determination of UBS' Ohio apportionment fraction for the 1999-2001 tax years. Consequently, on these substantive grounds, the BTA's decision upholding the Commissioner's final determination should be affirmed.

As a protective matter, in the event that the Court determines that the BTA's affirmance of the Commissioner on substantive grounds was unreasonable or unlawful, the BTA's alternative basis for affirmance of the Commissioner's final determination, on jurisdictional grounds, is reasonable and lawful to a partial extent and should be affirmed to that extent.

Namely, the BTA reasonably and lawfully held that UBS did not obtain the right to a reduction of the dealer-in-intangibles tax liability that it had reported and paid per its timely filed returns for the subject tax years. Therefore, in the event that the Court determines that the BTA's affirmance of the Commissioner on substantive grounds is unreasonable or unlawful, the reduction in UBS' assessment liability should be limited to the amount of additional tax assessed by the Commissioner pursuant to his issuance of amended assessment certificates upon audit.

Respectfully submitted,

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Statement of Financial Accounting Standards No. 95

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FAS95 Summary

Statement of Cash Flows

November 1987

Financial Accounting Standards Board
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Statement of Financial Accounting Standards No. 95

Statement of Cash Flows

November 1987

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FAS 95: Statement of Cash Flows

FAS 95 Summary

This Statement establishes standards for cash flow reporting. It supersedes APB Opinion No. 19, *Reporting Changes in Financial Position*, and requires a statement of cash flows as part of a full set of financial statements for all business enterprises in place of a statement of changes in financial position.

This Statement requires that a statement of cash flows classify cash receipts and payments according to whether they stem from operating, investing, or financing activities and provides definitions of each category.

This Statement encourages enterprises to report cash flows from operating activities directly by showing major classes of operating cash receipts and payments (the direct method). Enterprises that choose not to show operating cash receipts and payments are required to report the same amount of net cash flow from operating activities indirectly by adjusting net income to reconcile it to net cash flow from operating activities (the indirect or reconciliation method) by removing the effects of (a) all deferrals of past operating cash receipts and payments and all accruals of expected future operating cash receipts and payments and (b) all items that are included in net income that do not affect operating cash receipts and payments. If the direct method is used, a reconciliation of net income and net cash flow from operating activities is required to be provided in a separate schedule.

This Statement requires that a statement of cash flows report the reporting currency equivalent of foreign currency cash flows, using the current exchange rate at the time of the cash flows. The effect of exchange rate changes on cash held in foreign currencies is reported as a separate item in the reconciliation of beginning and ending balances of cash and cash equivalents.

This Statement requires that information about investing and financing activities not resulting in cash receipts or payments in the period be provided separately.

This Statement is effective for annual financial statements for fiscal years ending after July 15, 1988. Restatement of financial statements for earlier years provided for comparative purposes is encouraged but not required.

INTRODUCTION

1. This Statement establishes standards for providing a statement of cash flows in general-purpose financial statements. This Statement supersedes APB Opinion No. 19, *Reporting Changes in Financial Position*, and requires a business enterprise to provide a statement of cash flows in place of a statement of changes in financial position. It also requires that specified information about noncash investing and financing transactions and other events be provided separately.

2. Opinion 19 permitted but did not require enterprises to report cash flow information in the statement of changes in financial position. Since that Opinion was issued, the significance of information about an enterprise's cash flows has increasingly been recognized. In FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, paragraph 13, the Board says, "A full set of financial statements for a period should show: . . . Cash flows during the period." Moreover, certain problems have been identified in current practice, including the ambiguity of terms such as *funds*, lack of comparability arising from diversity in the focus of the statement (cash, cash and short-term investments, quick assets, or working capital) and the resulting differences in definitions of funds flows from operating activities (cash or working capital), differences in the format of the statement (sources and uses format or activity format), variations in classifications of specific items in an activity format, and the reporting of net changes in amounts of assets and liabilities rather than gross inflows and outflows. The lack of clear objectives for the statement of changes in financial position has been suggested as a major cause of that diversity.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Scope

3. A business enterprise 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. This Statement supersedes or amends the accounting pronouncements listed in Appendix D.

Purpose of a Statement of Cash Flows

4. The primary purpose of a statement of cash flows is to provide relevant information about the cash receipts and cash payments of an enterprise during a period.

5. 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 to (a)assess the enterprise's ability to generate positive future net cash flows; (b) assess the enterprise'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; and (d) assess the effects on an enterprise's financial position of both its cash and noncash investing and financing transactions during the period.

6. To achieve its purpose of providing information to help investors, creditors, and others in making those assessments, a statement of cash flows should report the cash effects during a period of an enterprise's operations, its investing transactions, and its financing transactions. Related disclosures should report the effects of investing and financing transactions that affect an enterprise's financial position but do not directly affect cash flows during the period. 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 should be provided.

Focus on Cash and Cash Equivalents

7. A statement of cash flows shall explain the change during the period in cash [1] and cash equivalents. The statement shall use descriptive terms such as *cash* or *cash and cash equivalents* rather than ambiguous terms such as *funds*. The total amounts of cash and cash equivalents at the beginning and end of the period shown in the statement of cash flows shall be the same amounts as similarly titled line items or subtotals shown in the statements of financial position as of those dates.

8. For purposes of this Statement, cash equivalents are short-term, highly liquid investments that are both:

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 [2] of three months or less qualify under that definition.

9. Examples of items commonly considered to be cash equivalents are Treasury bills, commercial paper, money market funds, and federal funds sold (for an enterprise with banking operations). Cash purchases and sales of those investments generally are part of the enterprise'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.

10. Not all investments that qualify are required to be treated as cash equivalents. An

enterprise shall establish a policy concerning which short-term, highly liquid investments that satisfy the definition in paragraph 8 are treated as cash equivalents. For example, an enterprise 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 enterprise 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. An enterprise 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.

Gross and Net Cash Flows

11. 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 9, but also for certain other classes of cash flows specified in paragraphs 12, 13, and 28.

12. 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 enterprise 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 enterprise's operating, investing, and financing activities.

13. Items that qualify for net reporting because their turnover is quick, their amounts are large, and their maturities are short are cash receipts and payments pertaining to (a) investments (other than cash equivalents), (b) loans receivable, and (c) debt, providing that the original maturity of the asset or liability is three months or less.[3]

Classification of Cash Receipts and Cash Payments

14. A statement of cash flows shall classify cash receipts and cash payments as resulting from investing, financing, or operating activities.[4]

Cash Flows from Investing Activities

15. 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 enterprise (other than materials that are part of the enterprise's inventory).

16. Cash inflows from investing activities are: [5]

a. Receipts from collections or sales of loans made by the enterprise and of other entities' debt instruments (other than cash equivalents) that were purchased by the enterprise
b. Receipts from sales of equity instruments of other enterprises and from returns of investment in those instruments
c. Receipts from sales of property, plant, and equipment and other productive assets.

17. Cash outflows for investing activities are:

a. Disbursements for loans made by the enterprise and payments to acquire debt instruments of other entities (other than cash equivalents)
b. Payments to acquire equity instruments of other enterprises
c. Payments at the time of purchase or soon before or after purchase [6] to acquire property, plant, and equipment and other productive assets.[7]

Cash Flows from Financing Activities

18. Financing activities include obtaining resources from owners and providing them with a return on, and a return of, their investment; 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.

19. Cash inflows from financing activities are:

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

20. Cash outflows for financing activities are:

a. Payments of dividends or other distributions to owners, including outlays to reacquire the enterprise's equity instruments
b. Repayments of amounts borrowed
c. Other principal payments to creditors who have extended long-term credit.[8]

Cash Flows from Operating Activities

21. Operating activities include all transactions and other events that are not defined as investing or financing activities in paragraphs 15-20. 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.

22. Cash inflows from operating activities are:

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
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; proceeds of insurance settlements except for those that are directly related to investing or financing activities, such as from destruction of a building; and refunds from suppliers.

23. Cash outflows for operating activities are:

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
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
e. 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.

24. Certain cash receipts and payments may have aspects of more than one class of cash flows. For example, a cash payment may pertain to an item that could be considered either inventory or a productive asset. If so, the appropriate classification shall depend on the activity that is likely to be the predominant source of cash flows for the item. For example, the acquisition and sale of equipment to be used by the enterprise or rented to others generally are investing activities. However, equipment sometimes is acquired or produced to be used by the enterprise or rented to others for a short period and then sold. In those circumstances, the acquisition or production and subsequent sale of those assets shall be considered operating activities.

Foreign Currency Cash Flows

25. A statement of cash flows of an enterprise 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.[9] The statement shall report the effect of

exchange rate changes on cash balances held in foreign currencies as a separate part of the reconciliation of the change in cash and cash equivalents during the period.

Content and Form of the Statement of Cash Flows

26. A statement of cash flows for a period shall report net cash provided or used by operating, investing, and financing activities [10] and the net effect of those flows on cash and cash equivalents during the period in a manner that reconciles beginning and ending cash and cash equivalents.

27. In reporting cash flows from operating activities, enterprises 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). Enterprises that do so should, at a minimum, separately report the following classes of operating cash receipts and payments:[11]

a. Cash collected from customers, including lessees, licensees, and the like
b. Interest and dividends received
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
f. Income taxes paid
g. Other operating cash payments, if any.

Enterprises 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) above) into payments for costs of inventory and payments for selling, general, and administrative expenses.

28. Enterprises that choose not to provide information about major classes of operating cash receipts and payments by the direct method as encouraged in paragraph 27 shall determine and report the same amount for net cash flow from operating activities indirectly by adjusting net income to reconcile it to net cash flow from operating activities (the indirect or reconciliation method). That requires adjusting net income to remove (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,[12] and (b) the effects of all items whose cash effects are investing or financing cash flows, such as depreciation, amortization of goodwill, and 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 is a financing activity).

29. The reconciliation of net income to net cash flow from operating activities described in paragraph 28 shall be provided regardless of whether the direct or indirect method of reporting net cash flow from operating activities is used. That 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. Enterprises are encouraged to provide further breakdowns of those categories that they consider meaningful. For example, changes in receivables from customers for an enterprise's sale of goods or services might be reported separately from changes in other operating receivables. In addition, if the indirect method is used, amounts of interest paid (net of amounts capitalized) and income taxes paid during the period shall be provided in related disclosures.

30. If the direct method of reporting net cash flow from operating activities is used, the reconciliation of net income to net cash flow from operating activities shall be provided in a separate schedule. 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. If the reconciliation is presented in the statement of cash flows, all adjustments to net income to determine net cash flow from operating activities shall be clearly identified as reconciling items.

31. Except for items described in paragraphs 12 and 13, 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 enterprise's stock.

Information about Noncash Investing and Financing Activities

32. Information about all investing and financing activities of an enterprise 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 reported in related disclosures. 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. 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 an asset by entering into a capital lease; and exchanging noncash assets or liabilities for other noncash assets or liabilities. Some transactions are part cash and part noncash; only the cash portion shall be reported in the statement of cash flows.

Cash Flow per Share

33. 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 enterprise's performance, as reporting per share amounts might imply.

Effective Date and Transition

34. The provisions of this Statement shall be effective for annual financial statements for fiscal years ending after July 15, 1988. Earlier application is encouraged. This Statement need not be applied in financial statements for interim periods in the initial year of application, but cash flow information for those interim periods shall be restated if reported with annual financial statements for that fiscal year. Restatement of comparative annual financial statements for earlier years is encouraged but not required.

The provisions of this Statement need not be applied to immaterial items.

This Statement was adopted by the affirmative votes of four members of the Financial Accounting Standards Board. Messrs. Lauver, Leisenring, and Swieringa dissented.

Messrs. Lauver, Leisenring, and Swieringa dissent to this Statement's requirements to classify interest and dividends received and interest paid as cash flows from operating activities. They believe that interest and dividends received are returns on investments in debt and equity securities that should be classified as cash inflows from investing activities. They believe that interest paid is a cost of obtaining financial resources that should be classified as a cash outflow for financing activities.

Messrs. Lauver, Leisenring, and Swieringa also dissent to this Statement's requirement to classify certain cash receipts and payments according to the nature of an earlier transaction rather than according to the nature of the cash receipts and payments. Under this Statement, an enterprise that sells merchandise in one year for an installment note receivable and receives principal payments on the note in subsequent years will classify those principal payments as operating cash inflows. They believe that those principal payments should be classified as cash inflows from investing activities because they represent a return of the enterprise's investment in the installment note. Classifying those principal payments as operating cash inflows denies receipt of the installment note as a noncash investing activity, is inconsistent with the enterprise's recovery of its investment in that note, and is inconsistent with the treatment of the receipt of principal payments on other investments in debt instruments as cash inflows from investing activities. They also note that this Statement will result in similar inconsistencies for the purchase of inventory in exchange for a note payable.

Messrs. Lauver and Swieringa also dissent to this Statement's permitted use of the indirect method of reporting net cash flow from operating activities. They believe that by permitting the continued use of the indirect method, the Board has foregone the opportunity to make a significant contribution to the quality of financial reporting and to enhanced user understanding of cash flows from operating activities. Reporting information about cash received from customers, cash paid to suppliers and employees, income taxes paid, and other operating receipts and payments (the direct method) provides a description of the operating activities of an entity during a period that is both more informative and more consistent with the primary purpose of a statement of cash flows, which is described in paragraph 4 of this Statement as "to provide relevant information about the cash receipts and cash payments of an enterprise during a period."

Because the indirect method does not result in reporting separately major classes of gross operating cash flows, Messrs. Lauver and Swieringa believe that method is inconsistent with the conclusion in paragraph 11 that " generally, information about 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." Further, permitting use of the indirect method makes this Statement internally inconsistent because major classes of gross cash flows from investing and financing activities are required to be reported separately while major classes of gross operating cash flows are not. In addition, presenting a reconciliation of net income and net cash flow from operating activities within the statement of cash flows rather than in a separate schedule results in including the effects of certain noncash transactions and other events within the statement of cash flows. Messrs. Lauver and Swieringa believe that is confusing and counter to the primary purpose of a statement of cash flows.

Mr. Lauver believes the internal inconsistencies in the provisions of this Statement concerning the classification of cash flows identified in the preceding paragraphs result from putting other objectives ahead of the Statement's stated objective of providing relevant information about cash receipts and payments. He believes that by adopting the view that the cash effects of transactions and events that enter into the determination of net income are cash flows from operating activities (paragraph 21), this Statement, in spite of comments to the contrary (paragraph 33), attempts to establish net cash from operating activities as an alternative performance indicator, an objective that he believes is undesirable. Further, that objective makes each of the three categories misleading by excluding from investing and financing categories cash receipts and payments that stem from investing and financing activities and ought to be included in those categories. The result is that none of the three required categories of cash flows is aptly named and all of them are, therefore, likely to be misunderstood.

Mr. Lauver observes that a statement of cash flows involves no issues of recognition, measurement, or estimation; by definition it includes only the effects of identifiable, unquestioned transactions. In that circumstance, the financial reporting function involves only two tasks. The first is to aggregate similar cash receipts and payments to facilitate communication and understanding and to do so consistently. The second is to accurately characterize the various aggregations so that they are unlikely to be misunderstood. He believes this Statement fails to do either.

Members of the Financial Accounting Standards Board:

Dennis R. Beresford, *Chairman*
Victor H. Brown
Raymond C. Lauver
James J. Leisenring
David Mosso
C. Arthur Northrop
Robert J. Swieringa

Appendix A: BACKGROUND INFORMATION

35. As part of its work on the conceptual framework, the FASB issued a Discussion Memorandum in December 1980, *Reporting Funds Flows, Liquidity, and Financial Flexibility*, which discussed funds flow reporting issues. Major issues raised in the Discussion Memorandum relating to funds flow reporting included (a) the concept of funds that should be adopted as the focus of the funds flow statement, (b) the reporting of transactions that have no direct impact on funds, (c) the approaches for presenting information about funds flows, (d) the presentation of information about funds flows from operations, (e) the separation of funds flow information about investing activities into outflows for maintenance of operating capacity, expansion of operating capacity, or nonoperating purposes, and (f) summary indicators of funds flows. The Board received 190 letters of comment in response to the Discussion Memorandum. In May 1981, a public hearing was held to discuss the issues raised in the Discussion Memorandum. Thirty-two individuals and organizations appeared at the hearing.

36. In November 1981, the Board issued an Exposure Draft of a proposed concepts Statement, *Reporting Income, Cash Flows, and Financial Position of Business Enterprises*. That Exposure Draft discussed the role of a funds statement and guides for reporting components of funds flows, concluding that funds flow reporting should focus on cash rather than on working capital. One hundred twenty-six comment letters were received in response to the November 1981 Exposure Draft. After considering those comment letters, the Board decided not to issue a final Statement on that subject. Instead, the Board chose to consider the subject in connection with its study of recognition and measurement concepts. In December 1983, the Board issued another Exposure Draft of a concepts Statement, *Recognition and Measurement in Financial Statements of Business Enterprises*, which also discussed the role of the cash flow statement. One hundred four comment letters were received on that Exposure Draft. In December 1984, the Board issued FASB Concepts Statement No. 5, *Recognition and Measurement in Financial Statements of Business Enterprises*, which includes general guidance on a statement of cash flows and concludes that, in concept, a cash flow statement should be part of a full set of financial statements.

37. During its deliberations on the 1981 Exposure Draft, the FASB decided that detailed cash flow reporting issues should be addressed only at the standards level, but deferred consideration of the standards project until the results of a voluntary initiative by the Financial Executives Institute(FEI) were assessed. In late 1981, the FEI encouraged its members to change to a focus on cash and short-term investments in their funds statements. It also encouraged enterprises to experiment with alternative formats, such as grouping items by operating, investing, and financing activities. That experimentation with cash flow reporting in statements of changes in financial position was in keeping with the existing authoritative literature, Opinion 19, which allowed flexibility in the focus and form of the statement.

38. In 1984, the Financial Executives Research Foundation of the FEI published *The Funds Statement: Structure and Use*, a research study on funds statements that solicited views of both preparers and users on virtually all of the issues pertaining to funds flows discussed in the Discussion Memorandum and that analyzed the results of the experimentation encouraged by the FEI. The study pointed out several areas of diversity in current practice, including different definitions of *funds*, different definitions of *cash* and *cash flow from operations*, and different forms of presentation in the statement.

39. In April 1985, the Board added to its agenda a cash flow reporting project of limited scope to (a) establish the objectives of a statement of cash flows, (b) define the few major components of cash flows to be presented in the statement, and (c) decide whether to require a statement of cash flows as part of a full set of financial statements for all enterprises.

40. In May 1985, the FASB staff organized a Task Force on Cash Flow Reporting. In June 1985, the FASB staff met with the task force to discuss appropriate objectives for a statement of cash flows. In November 1985, the staff met again with the task force to discuss the identification and definition of the major elements of cash flows, the classification of certain transactions, the reporting of noncash transactions, and the methods for presenting cash flow from operating activities. In March 1986, an Advisory Group on Cash Flow Reporting by Financial Institutions was organized. In April 1986, the FASB staff met with the advisory group to discuss whether a statement of cash flows should be included in a complete set of financial statements of a financial institution as well as other cash flow reporting issues related to financial institutions. In March and April 1986, the staff communicated with the FASB Small Business Advisory Group and the Technical Issues Committee of the Private Companies Practice Section of the American Institute of Certified Public Accountants (AICPA) on whether a statement of cash flows should be required of small businesses as part of a full set of financial statements.

41. The Board issued an Exposure Draft, *Statement of Cash Flows*, in July 1986. It proposed standards for cash flow reporting to require a statement of cash flows as part of a full set of financial statements of all business enterprises in place of a statement of changes in financial position.

42. The Board received more than 450 comment letters in response to that Exposure Draft. In

December 1986, the FASB staff met with an informal group of securities analysts who specialize in financial institutions to discuss users' needs for information about a financial institution's cash flows. In January 1987, the FASB staff held a special meeting to discuss the numerous comments received on the manner of reporting cash flows from operating activities. Representatives of the Financial Analysts Federation, the Financial Executives Institute, the National Association of Accountants, and the Robert Morris Associates participated in that meeting. In February 1987, the FASB staff met with the task force to discuss comments received on the Exposure Draft, and in March 1987, the staff met with the Advisory Group on Cash Flow Reporting by Financial Institutions.

43. The Board considered the comment letters and information obtained at those meetings in developing this Statement. Appendix B discusses the basis for the Board's conclusions, including changes made to the provisions of the 1986 Exposure Draft.

Appendix B

BASIS FOR CONCLUSIONS

CONTENTS

Appendix B: BASIS FOR CONCLUSIONS

Introduction

44. This appendix discusses factors deemed significant by members of the Board in reaching the conclusions in this Statement. It includes descriptions of alternatives considered by the Board with reasons for accepting some and rejecting others. Individual Board members gave greater weight to some factors than to others.

Need for Cash Flow Information

45. The Board decided to require a statement of cash flows as part of a full set of financial statements on the basis of the objectives and concepts set forth in FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, and Concepts Statement 5.

46. Paragraph 37 of Concepts Statement 1 states that:

> Financial reporting should provide information to help present and potential investors and creditors and other users in assessing the amounts, timing, and uncertainty of prospective cash receipts from dividends or interest and the proceeds from the sale, redemption, or maturity of securities or loans. The prospects for those cash receipts are affected by an enterprise's ability to generate enough cash to meet its obligations when due and its other cash operating needs, to reinvest in operations, and to pay cash dividends. . . .

Paragraph 39 states that:

> . . . since an enterprise's ability to generate favorable cash flows affects both its ability to pay dividends and interest and the market prices of its securities, expected cash flows to investors and creditors are related to expected cash flows to the enterprise in which they have invested or to which they have loaned funds.

Paragraph 49 states that:

> Financial reporting should provide information about how an enterprise obtains and spends cash, about its borrowing and repayment of borrowing, about its capital [equity] transactions, including cash dividends and other distributions of enterprise resources to owners, and about other factors that may affect an enterprise's liquidity or solvency.

47. Paragraph 13 of Concepts Statement 5 states that the "amount and variety of information that financial reporting should provide about an entity require several financial statements." A full set of financial statements for a period should show cash flows during the period. Paragraph 52 describes the role of information in the statement of cash flows as follows:

> It provides useful information about an entity's activities in generating cash through operations to repay debt, distribute dividends, or reinvest to maintain or expand operating capacity; about its financing activities, both debt and equity; and about its investing or spending of cash. Important uses of information about an entity's current cash receipts and payments include helping to assess factors such as the entity's liquidity, financial flexibility, profitability, and risk.

Statements of Cash Flows and Other Information on Liquidity, Financial Flexibility, Profitability, and Risk

48. The statement of cash flows is not the only financial statement that provides information on liquidity, financial flexibility, profitability, and risk. Concepts Statement 5 discusses the complementary role of the other financial statements:

> A statement of financial position provides information about an entity's assets, liabilities, and equity and their relationships to each other at a moment in time. The statement delineates the entity's resource structure—major classes and amounts of assets—and its financing structure—major classes and amounts of liabilities and equity. [paragraph 26]
>
> Important uses of information about an entity's financial position include helping users to assess factors such as the entity's liquidity, financial flexibility, profitability, and risk. [paragraph 29]
>
> Financial statements complement each other. For example:
>
> a. Statements of financial position include information that is often used in assessing an entity's liquidity and financial flexibility, but a statement of financial position provides only an incomplete picture of either liquidity or financial flexibility unless it is used in conjunction with at least a cash flow statement. . . .
>
> c. Statements of cash flows commonly show a great deal about an entity's current cash receipts and payments, but a cash flow statement provides an incomplete basis for assessing prospects for future cash flows because it cannot show interperiod relationships. Many current cash receipts, especially from operations, stem from activities of earlier periods, and many current cash payments are intended or expected to result in future, not current, cash receipts. Statements of earnings and comprehensive income, especially if used in conjunction with statements of financial position, usually provide a

better basis for assessing future cash flow prospects of an entity than do cash flow statements alone. [paragraph 24, subparagraphs b and d and footnote references omitted]

Cash Instead of Working Capital

49. In light of those objectives and concepts, which were reinforced by the Board's observation of a trend in practice toward statements of changes in financial position that focused on cash flows, the Board concluded that a statement of cash flows should be required to help investors, creditors, and others assess future cash flows, provide feedback about actual cash flows, evaluate the availability of cash for dividends and investment and the enterprise's ability to finance growth from internal sources, and identify the reasons for differences between income and net cash flows. Nearly all of the respondents to both the Discussion Memorandum and the Exposure Draft [13] agreed with those objectives of a statement of cash flows.

50. To achieve those objectives requires that the statement focus on flows of cash rather than flows of working capital. An overwhelming majority of respondents agreed with that focus. Many made negative comments on the usefulness of working capital as a concept of funds, generally questioning its relevance since positive working capital does not necessarily indicate liquidity nor does negative working capital necessarily indicate illiquidity.

Cash and Cash Equivalents

51. Cash is the most useful concept of funds because decisions of investors, creditors, and others focus on assessments of future cash flows. However, enterprises commonly invest cash in excess of immediate needs in short-term, highly liquid investments, and whether cash is on hand, on deposit, or invested in a short-term financial instrument that is readily convertible to a known amount of cash is largely irrelevant to users' assessments of liquidity and future cash flows. The Board therefore decided that a statement of cash flows should focus on the aggregate of cash and cash equivalents.

52. Respondents to the Exposure Draft generally agreed with the focus on cash and cash equivalents. Many, however, asked the Board to provide more guidance on which short-term, highly liquid investments qualify as cash equivalents. Others questioned whether particular instruments, such as marketable equity securities that management intends to hold for only a short period of time, might qualify.

53. The Board agreed to provide more guidance on the short-term, highly liquid investments that qualify as cash equivalents. In developing the guidance in paragraph 8 of this Statement, the Board noted 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.

54. Some respondents to the Exposure Draft expressed concern that a reader of the financial statements might not be able to relate the amount of cash and cash equivalents in the statement of cash flows to a line item in the statement of financial position. The Board agreed that being able to trace the change in cash and cash equivalents in the statement of cash flows to related amounts in successive statements of financial position is desirable. It therefore decided to require that the total amounts of cash and cash equivalents at the beginning and end of the period shown in the statement of cash flows be the same amounts as similarly titled line items or subtotals in the statements of financial position as of those dates.

55. Banks and other financial institutions commonly carry three-month 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 a statement of cash flows, which would require segregating them from other items in their trading and investment accounts.

56. The Board noted that the reason for focusing a statement of cash flows on cash and cash equivalents is to recognize and accommodate common practices in cash management. Accordingly, the Board agreed 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 that decision will result in differences between enterprises in the items treated as cash equivalents, the Board decided that each enterprise should disclose its policy for treating items as cash equivalents.

Scope

57. Respondents from financial institutions, particularly commercial banks, generally said that a statement of cash flows would not be useful for their industry. Some commentators specifically mentioned that a statement of cash flows would be particularly useful for small businesses, but a few asked that small businesses be exempted from at least some provisions of the Exposure Draft. A few respondents to the Exposure Draft referred to the fact that investment companies were permitted to provide a statement of changes in net assets rather than a statement of changes in financial position and asked that they be exempted from a requirement to provide a statement of cash flows.

Financial Institutions

58. Financial institutions, particularly commercial banks, have long contended that their statements of changes in financial position are not meaningful. In response to the Exposure

Draft, most asserted that a statement of cash flows would be equally meaningless. Banks[14] generally have contended that the nature of their business and the resulting nature of their cash flows are significantly different from the cash flows of nonfinancial enterprises and that those differences render information about a bank's cash flows virtually meaningless. Banks who responded to the Exposure Draft generally said that their cash flows are much more complex and interrelated than those of other enterprises and that a bank's cash flows are much larger in relation to net income and net assets than are the cash flows of a nonfinancial enterprise. They commented that a bank creates money through its lending activities. That, they said, makes cash the "product" of a bank's earning activities, just as finished goods are the product of a manufacturer's earning activities. Accordingly, banks often asserted that a statement of cash flows for a bank is analogous to a combined statement of cash and inventory flows for a nonfinancial company. For those reasons, banks argued that a statement of cash flows would not prove helpful in evaluating their liquidity.

59. The Board considered, but was not persuaded by, the arguments that a statement of cash flows of a financial institution, especially a bank, would not provide useful information. The Board concluded that the differences between the activities of banks and the activities of other business enterprises do not warrant excluding banks from a requirement to provide a statement of cash flows as part of a full set of financial statements. The Board recognizes that banks are unique in some ways, just as each other kind of business enterprise has unique attributes. While a bank is unique in the sense that cash can be viewed as its product, a bank needs cash for essentially the same reasons a manufacturer does—to invest in its operations, to pay its obligations, and to provide returns to its investors. To survive, a bank—like a manufacturer—must generate positive (or at least neutral) cash flows from its operating, investing, and financing activities over the long run.

60. A bank raises cash from depositors, money market operations and other purchases of funds, issuing long-term debt and equity securities, loan repayments by borrowers, investment sales and maturities, and net interest and fees earned. It uses cash to meet deposit withdrawals, liability maturities, loan commitments, and for investment and other purposes. Those cash flows are integral to a bank's investing (largely lending) activities and its financing (largely borrowing and deposit gathering) activities and should be reflected in its financial statements. As is true for nonbank enterprises, a bank's net cash flow from operating activities may differ significantly from its net income because of noncash revenue and expense items, such as interest accruals, depreciation, amortization of goodwill, provision for probable credit losses, and deferred income taxes. While the cash flows of a bank may be larger, the turnover faster, and the reliance on borrowed funds greater than for a nonfinancial enterprise, the Board decided that the substance of a bank's cash flows is similar to that of a nonfinancial enterprise. Concerning the relative size of a bank's cash flows, the Board noted that a bank's assets and liabilities also are much larger in relation to its equity than is common for nonfinancial enterprises; that does not mean that the gross amounts of a bank's assets, liabilities, and changes in them are unimportant information.

61. The Board considered the argument that the solvency of a bank depends more on

maintaining an adequate spread between the cost of funds and interest received than on adequate cash flows. The Board noted that maintenance of an adequate margin between expenses and revenues is essential to the viability of all enterprises and is not unique to banks and other financial institutions.

62. The Board also considered the argument that other information such as interest rate sensitivities and maturity schedules of loans and borrowings is more useful than a statement of cash flows in assessing a bank's liquidity, financial flexibility, profitability, and risk and that this other information should therefore be substituted for a statement of cash flows. The Board acknowledged the potential usefulness of that information but rejected the argument for substitution, noting that, as Concepts Statement 5 states, the assessment of liquidity, financial flexibility, profitability, and risk for any enterprise requires more information than just a statement of cash flows.[15]

63. The Board also considered the proposal in the AICPA Exposure Draft of a proposed Statement of Position, *Reporting Funds Flows, Liquidity, and Financial Flexibility for Banks* (October 1, 1985), cited by several respondents to the Exposure Draft, that a funds flow statement for banks should focus on changes in "earning assets" (for example, loans and investments in securities) rather than cash. The Board rejected that proposal, noting that a statement with that focus would not be a statement of cash flows and would be analogous to providing a statement for a manufacturing company that focused on changes in inventories and fixed assets as if they constituted "funds."

64. Banks who responded to the Exposure Draft generally said that they do not now have the systems in place to obtain all the information on gross cash flows pertaining to loans and various other items that would be needed to comply with the provisions of the Exposure Draft. If the Board decided not to exempt them from a requirement to provide a statement of cash flows, the banks asked to be permitted to report net rather than gross cash flows for more items than the Exposure Draft permitted. They also asked for more flexibility in designating items as cash equivalents.

65. After considering the comments of financial institutions and other enterprises on the Exposure Draft, the Board decided to permit all enterprises to report net rather than gross cash flows for the items specified in paragraphs 12-13 and discussed in paragraphs 78-80 of this appendix. The Board also decided to permit all enterprises a specified degree of flexibility to establish a policy on what items are treated as cash equivalents, as provided in paragraph 10 and discussed in paragraphs 52-56 of this appendix.

Small Businesses

66. The Board considered information provided by its Small Business Advisory Group and others in deciding whether small businesses should be exempted from providing a statement of cash flows. Many commentators said that cash flow information is particularly useful for small

businesses, and very few asked that small business be exempted from a requirement to provide a statement of cash flows as part of a full set of financial statements. The Board concluded that a statement of cash flows is useful to those who use the financial statements of small businesses and that no exemption should be provided.

Investment Companies

67. As mentioned in paragraph 57, a few respondents to the Exposure Draft asked that investment companies be permitted to substitute a statement of changes in net assets for a statement of cash flows. The Board noted that the content and format of the two statements are quite different. While the Board recognizes that information about some investment companies' cash flows may be less important than similar information for other kinds of enterprises, the Board decided that information about cash flows is still relevant and that investment companies should not be exempted from a requirement to provide a statement of cash flows.

Not-for-Profit Organizations

68. The Exposure Draft did not include not-for-profit organizations within its scope. A few respondents to that document said that a statement of cash flows is also useful for not-for-profit organizations and suggested that those organizations be included in the scope of the final Statement.

69. Exclusion of not-for-profit organizations from the scope of this document means only that the Board has not yet decided whether not-for-profit organizations should be required to provide a statement of cash flows. The Board has completed work on concepts of financial reporting for not-for-profit organizations and is currently considering certain standards issues. The FASB staff is currently working with a task force of the AICPA that is developing a paper on financial statement display for not-for-profit organizations. That paper will consider, among other things, whether not-for-profit organizations should report cash receipts and payments and, if so, how. Upon consideration of that paper, the Board will decide whether to add to its agenda a project on financial statement display for not-for-profit organizations.

Noncash Transactions

70. Noncash transactions commonly recognized in financial statements include conversion of debt to equity, acquisition of assets by assuming liabilities including capital lease obligations, and some of the nonmonetary transactions addressed in APB Opinion No. 29, *Accounting for Nonmonetary Transactions*. Those transactions result in no cash inflows or outflows in the period in which they occur but generally have a significant effect on the prospective cash flows of a company. For example, a capitalized lease obligation requires future lease payments in cash, and conversion of debt to equity generally will eliminate nondiscretionary payments of interest on the debt. The net effect on assets and liabilities of assuming debt to acquire an asset is similar to that of borrowing cash to buy the asset.

71. Many respondents to the Discussion Memorandum said that certain types of noncash transactions should be treated as cash flow equivalents and that they should be included in the body of the statement. That generally is the way in which those transactions have been reported in the statement of changes in financial position under Opinion 19. Other respondents, however, said that noncash transactions should be disclosed in the notes to a statement of cash flows because to include them in the statement would complicate it and limit its ability to provide meaningful information about cash flows.

72. The Exposure Draft required noncash investing and financing transactions to be disclosed either in the statement of cash flows or in a separate schedule to provide more complete information about an enterprise's investing and financing activities during the period. If included in the statement of cash flows, the Exposure Draft required that the reporting distinguish between activities that involved cash receipts and payments in the current period and those that did not.

73. A majority of the respondents to the Exposure Draft who addressed this issue urged that noncash transactions be excluded from the statement of cash flows and reported in a separate schedule. They generally said that to include those transactions within the statement would unduly complicate it and detract from its objective of providing information about an enterprise's cash receipts and cash payments during a period.

74. The Board agreed that excluding noncash transactions from the statement of cash flows would better achieve the statement's objective without resulting in implementation difficulties. This Statement thus requires that information about noncash investing and financing transactions be reported in related disclosures. If there are only a few such 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.

Emphasis on Gross Cash Receipts and Cash Payments

75. The Board decided that, in general, meaningful assessments of cash flows require reporting of gross, rather than net, cash receipts and cash payments.[16] For example, reporting only the net change in property, plant, and equipment would obscure the investing activities of the enterprise by not disclosing separately the capital expenditures and proceeds from sales of assets.

76. For a few items, information on both cash receipts and cash payments may be no more relevant than information about only the net change. For example, the gross payments and receipts from purchasing and selling short-term, highly liquid investments—cash equivalents—are, in essence, merely movements from one form of "cash" to another and thus are not meaningfully reported as cash flows. For other items, the gross cash flows may be frequent and large in relation to other cash flows, and for others, such as demand deposits in a bank, the

enterprise is holding or disbursing cash on behalf of its customers. For items with those characteristics, the net cash flow during a period generally is sufficient to assess an enterprise's liquidity.

77. The Exposure Draft noted that the issue of which cash flows should be reported gross and which can be netted without unduly obscuring useful information is of special significance to banks and other financial institutions. For those enterprises as well as for nonfinancial enterprises, the Board decided that information about gross cash flows should generally be presumed to be relevant. However, reporting only net cash flows is acceptable for certain items. Examples include assets and liabilities in which the amounts are turned over very quickly, sometimes overnight, or in which an enterprise receives and pays cash for the convenience of a customer (for example, the demand deposits of a bank or the customer accounts payable of a broker-dealer). The Exposure Draft indicated that those items are common for financial institutions. Accordingly, the Exposure Draft discussed the very limited netting of cash flows that it permitted in the context of financial institutions.

78. Many respondents to the Exposure Draft said that nonfinancial enterprises also may have items for which the turnover is quick, the maturities are short, and the amounts are large. Short-term debt such as revolving credit arrangements and commercial paper obligations were frequently cited examples. Respondents generally expressed the view that net reporting of those items also should be permitted. In addition, as discussed in paragraph 64, financial institutions who responded to the Exposure Draft generally asked the Board to permit more reporting of net cash flows for items such as loans, investments, and short-term debt.

79. The Board generally agreed that nonfinancial as well as financial enterprises may have items for which the gross cash flows are not sufficiently relevant to require reporting them. For very short-term investments, loans, and debt, relatively insignificant differences in the maturities of items may result in large differences in gross cash flows between enterprises or between periods that are not particularly meaningful. For example, an enterprise that issues seven-day commercial paper and rolls it over every week would report financing cash inflows and outflows four times those of an enterprise that issues one-month paper. While all gross cash flows are potentially relevant, the large reported differences in situations such as that described may not be sufficiently meaningful to require reporting of gross cash flows. The Board therefore decided to permit cash flows stemming from all investments, loans, and debt with original maturities of three months or less to be reported net.

80. Some respondents specifically asked that cash flows stemming from credit card receivables be reported net. The Board noted that credit card receivables, including those with extended payment terms, might be considered to fall within the category of loans with original, scheduled maturities of three months or less since they generally may, at the customer's option, be paid in full when first billed without incurring interest charges. As a practical expedient, the Board decided to permit cash flows stemming from credit card receivables to be reported net.

Classification of Cash Receipts and Payments

81. The Board believes that a statement of cash flows is more useful if cash flows are classified into meaningful groups. The usefulness of classification in financial statements is addressed by Concepts Statement 5, paragraph 20:

> Classification in financial statements facilitates analysis by grouping items with essentially similar characteristics and separating items with essentially different characteristics. Analysis aimed at objectives such as predicting amounts, timing, and uncertainty of future cash flows requires financial information segregated into reasonably homogeneous groups. For example, components of financial statements that consist of items that have similar characteristics in one or more respects, such as continuity or recurrence, stability, risk, and reliability, are likely to have more predictive value than if their characteristics are dissimilar.

82. A popular classification of cash (or funds) flows in the past has been to separate sources from uses of cash (or funds). Many companies, especially smaller ones and financial institutions, continue to use that classification, which enables investors, creditors, and others to identify the total funds (however defined) obtained and disposed of during the period. The disadvantage of a sources and uses classification is that it does not focus on categories of related cash flows. Investors, creditors, and others consider the relationships among certain components of cash flows to be important to their analysis of financial performance. Also, the sources and uses classification has sometimes led to a listing of changes in balance sheet amounts that explains little about the enterprise's ability to meet obligations and pay dividends or about its needs for external financing.

83. Classification of cash flows according to whether they stem from operating, investing, or financing activities has become more popular in recent years. One reason the Board cited for adding this project to its agenda was that transactions were not being classified comparably across companies and that clearer guidelines for classification of cash flows were necessary.

84. The Board decided that grouping cash flows provided by or used in operating, investing, and financing activities enables significant relationships within and among the three kinds of activities to be evaluated. It links cash flows that are often perceived to be related, such as cash proceeds from borrowing transactions and cash repayments of borrowings. Thus, the statement reflects the cash flow effects of each of the major activities of the enterprise. Those relationships and trends in them provide information useful to investors and creditors. Almost all of the respondents to the Exposure Draft agreed that cash flows should be classified as operating, investing, and financing.

85. The Exposure Draft provided general guidelines for classifying cash flows. Some

respondents asked the Board to provide more precise definitions. Others asked that enterprises be given more flexibility to classify their cash flows in accordance with what they consider to be the nature of their business.

86. While there is widespread agreement that the classification of cash flows according to whether they stem from operating, investing, or financing activities provides useful information, the Board notes that the three categories are not clearly mutually exclusive. For items at the margin, a reasonable case often may be made for alternative classifications. Paragraphs 88-90 and 93-96 discuss certain of those items. The Board concluded that, in general, comparability across enterprises in classifying similar items is desirable. This Statement therefore provides somewhat more precise definitions of the three categories of cash flows than did the Exposure Draft.

87. Notwithstanding the desirability of reasonably clear and precise definitions of the three categories of cash flows, the Board recognizes that the most appropriate classification of items will not always be clear. In those circumstances, the appropriate classification generally should depend on the nature of the activity that is likely to be the predominate source of cash flows for the item. For example, the presumption is that the acquisition or production of productive assets is an investing activity. However, productive assets are sometimes acquired or produced to be a direct source of the enterprise's revenues, such as assets to be rented to others for a short period and then sold. In those circumstances, the nature of those assets may be similar to inventory in a retailing business. Accordingly, the acquisition or production and subsequent sale of such assets are appropriately classified as operating activities.

Interest Paid and Received

88. The Exposure Draft required interest paid and interest and dividends received to be classified as cash flows from operating activities. That classification is consistent with the view that, in general, cash flows from operating activities should reflect the cash effects of transactions and other events that enter into the determination of net income.

89. Some respondents to the Exposure Draft favored classifying interest paid as a cash outflow for financing activities and interest and dividends received as cash inflows from investing activities. Those respondents generally said that interest paid, like dividends paid, is a direct consequence of a financing decision and thus should be classified as a cash outflow for financing activities. That is, both interest and dividends are returns *on* the capital provided by creditors and investors, and both should be classified with returns *of* those amounts because the distinction between returns *of* and returns *on* investment is largely irrelevant in the context of cash flows. Respondents made similar comments for interest and dividends received.

90. The Board considered those views and, as mentioned in paragraph 86, noted that a reasonable case can be made for alternative classifications of certain items. However, the Board also noted that virtually all enterprises classify interest received and paid as operating cash flows under Opinion 19. In particular, interest received and paid were commonly considered to be

operating cash flows of banks and other financial institutions. In addition, the Board perceived widespread support for the notion that operating cash flows should, insofar as possible, include items whose effects are included in determining net income to facilitate an understanding of the reasons for differences between net income and net cash flow from operating activities and net income. The Board therefore was not convinced that changing the prevalent practice in classifying interest received and paid would necessarily result in a more meaningful presentation of cash flows. This Statement does, however, require that the amount of interest paid during a period (net of amounts capitalized) be disclosed, which will permit users of financial statements who wish to consider interest paid as a financing cash outflow to do so.

Income Taxes Paid

91. The Exposure Draft required all income taxes paid to be classified as operating cash outflows. A few respondents suggested allocating income taxes paid to investing and financing transactions.

92. The Board decided that allocation of income taxes paid to operating, investing, and financing activities would be so complex and arbitrary that the benefits, if any, would not justify the costs involved. This Statement requires that the total amount of income taxes paid be disclosed for reasons discussed in paragraph 121.

Installment Sales and Purchases

93. A somewhat difficult classification issue arises for installment sales and purchases of inventory by an enterprise for which cash inflows or outflows may occur several years after the date of the transaction. Those transactions can be viewed as having aspects of both operating and investing activities (for a sale by the enterprise) or operating and financing activities (for a purchase by the enterprise). The Exposure Draft treated cash flows stemming from installment sales and purchases in accordance with that view. Only cash flows occurring "soon before or after" the time of sale or purchase would have been operating cash flows. Subsequent principal payments on the related notes would have been investing cash inflows or financing cash outflows.

94. Some respondents to the Exposure Draft suggested that the classification of a cash receipt or payment should be determined by the original purpose for which it is received or paid. Thus, all cash flows related to the sale or purchase of inventory would be operating cash flows regardless of when they were received or paid. Those respondents generally pointed out that, under the approach in the Exposure Draft, cumulative net cash flow from operating activities over the life of an enterprise that finances most of its sales under installment plans might be negative. They considered that to be an inappropriate and confusing result.

95. The Board agreed that all cash collected from customers or paid to suppliers from the sale or purchase of inventory should be classified as operating cash flows. That classification is consistent with the notion that operating cash flows generally should include items that are

included in net income.

96. A related issue involves principal payments on a seller-financed mortgage on productive assets. Some have argued that all such principal payments should be classified as investing cash outflows rather than financing cash outflows. They said that they consider that classification to be more consistent with classifying all principal receipts and payments on sales and purchases of inventory as operating cash flows. The Board decided, however, that all principal payments on mortgages should be classified as financing cash outflows. The reason for that conclusion is largely pragmatic—the Board believes that it would be unduly burdensome to require enterprises to keep track of seller-financed versus third-party mortgages throughout the generally long period of time that a mortgage is outstanding. Some also consider all principal payments on mortgages to be financing cash outflows.

Maintenance and Expansion Investment Expenditures

97. The Board considered whether to require further classification of investment expenditures into expenditures for maintenance of existing capacity and expenditures for expansion into new capacity. That further classification would provide information designed to be used by investors, creditors, and others in calculating an amount sometimes described as "discretionary cash flow," with the idea that maintenance expenditures are nondiscretionary and only the cash remaining after such expenditures is free for discretionary purposes, such as paying dividends.

98. Most respondents said that the cash flows related to investing activities should not be allocated between those for maintenance of capacity and those for expansion. They said that those allocations would necessarily be arbitrary and the costs to compile the information would exceed the benefits provided.

99. The Board noted that substantial implementation difficulties would result if all enterprises were required to distinguish between expenditures for maintenance and those for expansion and that the subjectivity involved in making that distinction could result in numbers that would be unreliable. Accordingly, the Board decided not to require that disclosure.

Foreign Currency Cash Flows

100. The purpose of a statement of changes in financial position under Opinion 19 was to explain all important changes in financial position, regardless of whether they directly affected cash or working capital. That purpose suggested that the effects of changes in exchange rates on items reported in the statement of changes in financial position should be disclosed if material. Opinion 19 permitted a degree of flexibility in the statement of changes in financial position, and enterprises used alternative formats and terminology to report the effects of exchange rate changes.

101. The purpose of a statement of cash flows, on the other hand, is to report cash receipts and

cash payments during a period, classified into meaningful categories. The effects of exchange rate changes on assets and liabilities denominated in foreign currencies, like those of other price changes, may affect the amount of a cash receipt or payment. But exchange rate changes do not themselves give rise to cash flows, and their effects on items other than cash thus have no place in a statement of cash flows. To achieve its objective, a statement of cash flows should reflect the reporting currency equivalent of cash receipts and payments that occur in a foreign currency. Because the effect of exchange rate changes on the reporting currency equivalent of cash held in foreign currencies affects the change in an enterprise's cash balance during a period but is not a cash receipt or payment, the Board decided that the effect of exchange rate changes on cash should be reported as a separate item in the reconciliation of beginning and ending balances of cash.

102. Some respondents to the Exposure Draft objected to the requirement to report the reporting currency equivalent of foreign currency cash receipts and payments. They generally said that they do not obtain cash flow information from their foreign subsidiaries but rather prepare the consolidated statement of changes in financial position from the consolidated balance sheet and income statement, perhaps supplemented by certain information about gross increases and decreases in asset and liability accounts after translation to U.S. dollars. Other respondents supported the Exposure Draft's requirement only for foreign subsidiaries whose functional currency is other than the reporting currency. For foreign subsidiaries whose functional currency is the reporting currency, they generally favored some variation of a method that would include in the statement of cash flows the effects of exchange rate changes on all items classified as cash flows from operating, investing, and financing activities.

103. The Board noted that exchange rate changes affect only the amount of a cash receipt or payment (that is, the effects of rate changes are not themselves cash flows) regardless of whether the asset or liability on which an effect arises is held directly by a domestic enterprise, by a foreign subsidiary whose functional currency is the reporting currency, or by a foreign subsidiary whose functional currency is other than the reporting currency. Accordingly, this Statement clarifies that the requirement to report the reporting currency equivalents of cash receipts and payments denominated in foreign currencies applies to all such cash flows.

104. The Board considered the assertions that the requirements concerning reporting cash receipts and payments that occur in a foreign currency would be unduly burdensome because they would require enterprises to obtain cash flow information from their foreign subsidiaries. Although Opinion 19 did not directly address how to report the effects of exchange rate changes, the Board noted that Opinion 19 did require the reporting of gross funds flows, including, for example, both outlays to acquire property, plant, and equipment and proceeds from disposing of property, plant, and equipment. That is, while Opinion 19 required that the effects of exchange rate changes be included in a statement of changes in financial position, it did not necessarily provide that those effects should be reported in a way that results in line items that are not funds flows but rather are net changes, or gross increases and decreases, in translated asset and liability accounts. The Board therefore believes that full compliance with Opinion 19 would require

obtaining some information about the cash flows of foreign subsidiaries. As exchange rates change, the methods that some respondents advocate might report, for example, an asset acquisition or disposition in a period in which none occurred and might even report an asset acquisition when in fact a disposition occurred. Whether or not Opinion 19 intended that result, it is inappropriate in a statement intended to report cash receipts and payments.

105. The Board is aware that enterprises use various approximation techniques to meet the present requirements of reporting foreign-currency denominated assets, liabilities, revenues, expenses, and other items in the income statement and the statement of financial position. For example, appropriately weighted average exchange rates generally are used to translate revenues and expenses. Such methods also are acceptable in complying with the provisions of this Statement concerning foreign-currency-denominated cash flows provided that it is reasonable to expect that the results are substantially the same as if more precise data were used.

Reporting Net Cash Flow from Operating Activities

106. The Board considered two principal alternatives for reporting net cash flow from operating activities. The *direct method* shows as its principal components operating cash receipts and payments, such as cash received from customers and cash paid to suppliers and employees, the sum of which is *net cash flow from operating activities*. The *indirect method* starts with net income and adjusts it for revenue and expense items that were not the result of operating cash transactions in the current period to reconcile it to *net cash flow from operating activities*. The indirect method thus does not disclose operating cash receipts and payments. Paragraph 10 of Opinion 19 permitted either method, but the indirect method prevailed in practice under that Opinion.

107. The principal advantage of the direct method is that it shows operating cash receipts and payments. Knowledge of the specific sources of operating cash receipts and the purposes for which operating cash payments were made in past periods may be useful in estimating future operating cash flows. The relative amounts of major classes of revenues and expenses and their relationship to other items in the financial statements are presumed to be more useful than information only about their arithmetic sum—net income—in assessing enterprise performance. Likewise, amounts of major classes of operating cash receipts and payments presumably would be more useful than information only about their arithmetic sum—net cash flow from operating activities—in assessing an enterprise's ability to generate sufficient cash from operating activities to pay its debt, to reinvest in its operations, and to make distributions to its owners.

108. The principal advantage of the indirect method is that it focuses on the differences between net income and net cash flow from operating activities. Concepts Statement 1, paragraph 43, states that:

> The primary focus of financial reporting is information about an enterprise's performance provided by measures of earnings [comprehensive income] and its

> components. Investors, creditors, and others who are concerned with assessing the prospects for enterprise net cash inflows are especially interested in that information. Their interest in an enterprise's future cash flows . . . leads primarily to an interest in information about its earnings [comprehensive income] rather than information directly about its cash flows. Financial statements that show only cash receipts and payments during a short period, such as a year, cannot adequately indicate whether or not an enterprise's performance is successful.

Some investors and creditors may assess future cash flows in part by first estimating future income based in part on reports of past income and then converting those future income estimates to estimates of future cash flows by allowing for leads and lags between cash flows and income. Information about similar leads and lags in the past are likely to be helpful in that process. Identifying differences between income items and related cash flows also can assist investors and creditors who want to identify the differences between enterprises in the measurement and recognition of noncash items that affect income.

109. Many providers of financial statements have said that it would be costly for their companies to report gross operating cash receipts and payments. They said that they do not presently collect information in a manner that will allow them to determine amounts such as cash received from customers or cash paid to suppliers directly from their accounting systems.

110. The Exposure Draft said that the Board recognized the advantages of both approaches and concluded that neither method provided benefits sufficient to justify requiring one and prohibiting the other. Enterprises therefore would have been permitted to use either method.

111. A majority of respondents to the Exposure Draft asked the Board to require use of the direct method. Those respondents, most of whom were commercial lenders, generally said that amounts of operating cash receipts and payments are particularly important in assessing an enterprise's external borrowing needs and its ability to repay borrowings. They indicated that creditors are more exposed to fluctuations in net cash flow from operating activities than to fluctuations in net income and that information on the amounts of operating cash receipts and payments is important in assessing those fluctuations in net cash flow operating activities. They also pointed out that the direct method is more consistent with the objective of a statement of cash flows—to provide information about cash receipts and cash payments—than the indirect method, which does not report operating cash receipts and payments.

112. Both commercial lenders and equity analysts who responded to the Exposure Draft asked that more detail on cash flows from operating activities be required. Some said that degree of detail is more important than manner of presentation.

113. Most of the providers of financial statements who addressed the issue supported allowing a choice between the direct and indirect methods. They generally said that requiring the direct method would impose excessive implementation costs and that they believe that the indirect

method provides more meaningful information.

114. Because of the extensive attention in the comment letters on the Exposure Draft to the manner of reporting operating cash flows, the Board gave particular consideration to that issue in its deliberations leading to the issuance of this Statement. As mentioned in paragraph 42, the FASB staff held a special meeting with representatives of interested groups of constituents to obtain more information about the benefits and costs of the direct and indirect methods. Because most enterprises said that they cannot now obtain amounts of gross operating cash receipts and payments directly from their accounting systems, the Board considered means by which those amounts might be determined indirectly. Together with other efforts, the FASB staff commissioned an informal interview survey of a limited number of enterprises concerning the potential costs they might incur in indirectly determining amounts of operating cash receipts and payments.

Indirectly Determining Amounts of Operating Cash Receipts and Payments

115. 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 enterprise'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.[17] The more detailed the categories of operating cash receipts and payments to be reported, the more complex the procedure for determining them.

116. Based on information available to the Board during its deliberations, it seems likely that amounts of operating cash receipts and payments at the minimum level of detail specified in paragraph 27 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 must be segregated. Within the total amount of operating receivables, information on receivables from customers for an enterprise'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.

117. 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. The Board understands, however, that determining operating cash payments in more detail than the minimum specified in paragraph 27 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.

118. The Board believes that many enterprises may well be able to determine amounts of operating cash receipts and payments at the minimum level of detail that this Statement encourages (paragraph 27) indirectly at reasonable cost by the procedure discussed in the foregoing paragraphs. But few, if any, companies have experimented with the procedure, and the degree of difficulty encountered in applying it undoubtedly would vary depending on the nature of an enterprise's operations and the features of its current accounting system.

Conclusion on Reporting Net Cash Flow from Operating Activities

119. The Board believes that both the direct and the indirect methods provide potentially important information. The more comprehensive and presumably more useful approach would be to use the direct method in the statement of cash flows and to provide a reconciliation of net income and net cash flow from operating activities in a separate schedule—thereby reaping the benefits of both methods while maintaining the focus of the statement of cash flows on cash receipts and payments. This Statement therefore encourages enterprises to follow that approach. But most providers and users of financial statements have little or no experience and only limited familiarity with the direct method, while both have extensive experience with the indirect method. Not only are there questions about the ability of enterprises to determine gross amounts of operating cash receipts and payments, as already discussed, but also little information is available on which specific categories of operating cash receipts and payments would be most meaningful.

120. Major change in financial reporting often is the result of an evolutionary process, which may involve interactions between the voluntary efforts of providers of financial statements and the actions of standards setters. Many areas of financial reporting, and reporting cash flows in particular, have benefited from the voluntary efforts of enterprises to improve their reporting practices. The Board decided that further movement toward a more comprehensive approach to reporting operating cash flows should be permitted to develop as both providers and users of financial statements gain experience with information on cash flows prepared in accordance with the provisions of this Statement.

121. To provide information about the gross amounts of at least those operating cash flows that are likely to be readily available, this Statement requires enterprises that use the indirect method of reporting net cash flow from operating activities to disclose amounts of interest and income taxes paid. The Board believes that that information usually will be readily available. This Statement also requires enterprises that use the indirect method to report separately changes in inventory, receivables, and payables. With that information, users may be able to make their

own rough approximations of operating cash receipts and payments at a minimum level of detail using the indirect procedure discussed in paragraphs 116 and 117.

Cash Flow per Share

122. The Board considered whether cash flow per share should be reported. The Board concluded that reporting cash flow per share would falsely imply that cash flow, or some component of it, is a possible alternative to earnings per share as a measure of performance. The Board also noted other problems with calculating cash flow per share, including differing opinions about the appropriate numerator for the indicator (for example, whether it should be net cash flow from operating activities or an amount after deducting principal repayments on debt) and the appropriate denominator for the indicator (for example, whether it should be the same as the number of shares outstanding used for the earnings per share calculation).

123. A major problem in reporting cash flow per share data is investor understanding. Investors over many years have become accustomed to seeing operating data per share computed only for earnings. Moreover, the measurement problems associated with reporting earnings on a per share basis have been considered and largely settled. To report other data on a per share basis invites the danger that investors, creditors, and others may confuse those measures with the conventional accounting measure of earnings per share.

124. Earnings per share focuses attention on earnings available for common stockholders, and that concept guides the calculation of, and adjustments to, the numerator and denominator of the ratio. Earnings is suitable for the numerator of the ratio because the concepts underlying its calculation, such as capital maintenance (the distinction between the return *of* capital and return *on* capital), focus on return to stockholders *on* their investment. Net cash flow from operating activities is not comparable to net income because recovery of capital is not a factor in its calculation, and net cash flow from operating activities includes both returns *on* and returns *of* investment.

125. A majority of the respondents to the Exposure Draft who addressed the issue agreed that cash flow per share should not be reported. A few, however, asked whether the Board intended to preclude reporting of per unit amounts of cash flow distributable under the terms of a partnership agreement or other agreement between an enterprise and its owners. Reporting a contractually determined per unit amount 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 Statement.

Effective Date and Transition

126. The Exposure Draft would have been effective for fiscal years ending after June 30, 1987 and would have required enterprises to effect the change in accounting by restating financial statements for earlier years presented for comparative purposes.

127. Some respondents to the Exposure Draft said that restatement of prior years' financial statements for their companies would be difficult and expensive, if not virtually impossible, because certain data on gross cash flows were not collected for earlier periods. The major problem areas mentioned were foreign subsidiaries' cash flows and gross cash flows pertaining to loans and deposits of banks. Because of the need to develop systems for gathering that information, those respondents generally asked that the effective date of a final Statement be deferred at least a year from that in the Exposure Draft. A few banks asked that the effective date be deferred until years ending after December 15, 1989. They said that they needed additional time to get data-gathering systems in place by the beginning of the year of adoption.

128. The Board recognizes that some enterprises will need to develop data-gathering systems and thus decided to make this Statement effective for fiscal years ending after July 15, 1988 and not to require its application in interim statements during the year of adoption. The Board, however, decided against a further delay of the effective date. The Board noted that reasonable approximations are generally acceptable.

129. The Board also was persuaded by respondents that requiring restatement of prior years' financial statements might be unduly burdensome for some enterprises and thus decided to encourage but not require restatement. However, not restating prior years' statements of changes in financial position to comply with the provisions of this Statement may result in a significant degree of noncomparability and may also make for an awkward presentation. For example, an enterprise that formerly presented its statement of changes in financial position in a sources and uses format and considered "funds" to be working capital might find it difficult to present those statements on the same page as a statement of cash flows. The Board therefore expects that enterprises with the ability to restate generally will do so.

Appendix C: ILLUSTRATIVE EXAMPLES

130. This appendix provides illustrations for the preparation of statements of cash flows. Example 1 illustrates a statement of cash flows under both the direct method and the indirect method for a domestic manufacturing company. Example 2 illustrates a statement of cash flows under the direct method for a manufacturing company with foreign operations. Example 3 illustrates a statement of cash flows under the direct method for a financial institution. These illustrations are intended as examples only. Also, the illustrations of the reconciliation of net income to net cash provided by operating activities may provide detailed information in excess of that required for a meaningful presentation. Other formats or levels of detail may be appropriate for particular circumstances.

Example 1

131. Presented below is a statement of cash flows for the year ended December 31, 19X1 for Company M, a U.S. corporation engaged principally in manufacturing activities. This statement of cash flows illustrates the direct method of presenting cash flows from operating activities, as encouraged in paragraph 27 of this Statement.

COMPANY M
CONSOLIDATED STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 19X1
Increase(Decrease) in Cash and Cash Equivalents

Cash flows from operating activities:		
Cash received from customers	$13,850	
Cash paid to suppliers and employees	(12,000)	
Dividend received from affiliate	20	
Interest received	55	
Interest paid (net of amount capitalized)	(220)	
Income taxes paid	(325)	
Insurance proceeds received	15	
Cash paid to settle lawsuit for patent infringement	(30)	
Net cash provided by operating activities		$1,365
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Capital expenditures	(1,000)	
Payment for purchase of Company S, net of cash acquired	(925)	
Net cash used in investing activities		(1,175)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under capital lease obligation	(125)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	
Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600

Cash and cash equivalents at end of year		$1,665

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

Net income		$ 760
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	$ 445	
Provision for losses on accounts receivable	200	
Gain on sale of facility	(80)	
Undistributed earnings of affiliate	(25)	
Payment received on installment note receivable for sale of inventory	100	
Change in assets and liabilities net of effects from purchase of Company S:		
Increase in accounts receivable	(215)	
Decrease in inventory	205	
Increase in prepaid expenses	(25)	
Decrease in accounts payable and accrued expenses	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		605
Net cash provided by operating activities		$1,365

Supplemental schedule of noncash investing and financing activities:

The Company purchased all of the capital stock of Company S for $950. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	$1,580
Cash paid for the capital stock	(950)
Liabilities assumed	$ 630

A capital lease obligation of $850 was incurred when the Company entered into a lease for new equipment.

Additional common stock was issued upon the conversion of $500 of long-term debt.

Disclosure of accounting policy:
For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

132. Presented below is Company M's statement of cash flows for the year ended December 31, 19X1 prepared using the indirect method, as described in paragraph 28 of this Statement.

Company M
Consolidated Statement of Cash Flows
For the Year Ended December 31, 19X1
Increase (Decrease) in Cash and Cash Equivalents

Cash flows from operating activities:		
Net income		$ 760
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	$ 445	
Provision for losses on accounts receivable	200	
Gain on sale of facility	(80)	
Undistributed earnings of affiliate	(25)	
Payment received on installment note receivable for sale of inventory	100	
Change in assets and liabilities net of effects from purchase of Company S:		
Increase in accounts receivable	(215)	
Decrease in inventory	205	
Increase in prepaid expenses	(25)	
Decrease in accounts payable and accrued expenses	(250)	
Increase in interest and income taxes payable	50	
Increase in deferred taxes	150	
Increase in other liabilities	50	
Total adjustments		605
Net cash provided by operating activities		1,365
Cash flows from investing activities:		
Proceeds from sale of facility	600	
Payment received on note for sale of plant	150	
Capital expenditures	(1,000)	
Payment for purchase of Company S, net of cash acquired	(925)	
Net cash used in investing activities		(1,175)
Cash flows from financing activities:		
Net borrowings under line-of-credit agreement	300	
Principal payments under capital lease obligation	(125)	
Proceeds from issuance of long-term debt	400	
Proceeds from issuance of common stock	500	

Dividends paid	(200)	
Net cash provided by financing activities		875
Net increase in cash and cash equivalents		1,065
Cash and cash equivalents at beginning of year		600
Cash and cash equivalents at end of year		$1,665

Supplemental disclosures of cash flow information:

Cash paid during the year for:	
Interest (net of amount capitalized)	$220
Income taxes	325

Supplemental schedule of noncash investing and financing activities

The Company purchased all of the capital stock of Company S for $950. In conjunction with the acquisition, liabilities were assumed as follows:

Fair value of assets acquired	$1,580
Cash paid for the capital stock	(950)
Liabilities assumed	$ 630

A capital lease obligation of $850 was incurred when the Company entered into a lease for new equipment.

Additional common stock was issued upon the conversion of $500 of long-term debt.

Disclosure of accounting policy:

For purposes of the statement of cash flows, the Company considers all highly liquid debt instruments purchased with a maturity of three months or less to be cash equivalents.

133. Summarized below is financial information for the current year for Company M, which provides the basis for the statements of cash flows presented in paragraphs 131 and 132:

Company M
Consolidated Statement of Financial Position

	1/1/X1	12/31/X1	Change
Assets:			
Cash and cash equivalents	$ 600	$ 1,665	$1,065
Accounts receivable (net of allowance for losses of $600 and $450)	1,770	1,940	170
Notes receivable	400	150	(250)
Inventory	1,230	1,375	145
Prepaid expenses	110	135	25
Investments	250	275	25
Property, plant, and equipment, at cost	6,460	8,460	2,000
Accumulated depreciation	(2,100)	(2,300)	(200)
Property, plant, and equipment, net	4,360	6,160	1,800
Intangible assets	40	175	135
Total assets	$8,760	$11,875	$3,115
Liabilities:			
Accounts payable and accrued expenses	$1,085	$ 1,090	$ 5
Interest payable	30	45	15
Income taxes payable	50	85	35
Short-term debt	450	750	300
Lease obligation	—	725	725
Long-term debt	2,150	2,425	275
Deferred taxes	375	525	150
Other liabilities	225	275	50
Total liabilities	4,365	5,920	1,555
Stockholders' equity:			
Capital stock	2,000	3,000	1,000
Retained earnings	2,395	2,955	560
Total stockholders' equity	4,395	5,955	1,560
Total liabilities and stockholders' equity	$8,760	$11,875	$3,115

Company M
Consolidated Statement of Income
For the Year Ended December 31, 19X1

Sales	$13,965
Cost of sales	(10,290)
Depreciation and amortization	(445)
Selling, general, and administrative expenses	(1,890)
Interest expense	(235)
Equity in earnings of affiliate	45
Gain on sale of facility	80
Interest income	55
Insurance proceeds	15
Loss from patent infringement lawsuit	(30)
Income before income taxes	1,270
Provision for income taxes	(510)
Net income	$ 760

134. The following transactions were entered into by Company M during 19X1 and are reflected in the above financial statements:

a. Company M wrote off $350 of accounts receivable when a customer filed for bankruptcy. A provision for losses on accounts receivable of $200 was included in Company M's selling, general, and administrative expenses.
b. Company M collected the third and final annual installment payment of $100 on a note receivable for the sale of inventory and collected the third of four annual installment payments of $150 each on a note receivable for the sale of a plant. Interest on these notes through December 31 totaling $55 was also collected.
c. Company M received a dividend of $20 from an affiliate accounted for under the equity method of accounting.
d. Company M sold a facility with a book value of $520 and an original cost of $750 for $600 cash.
e. Company M constructed a new facility for its own use and placed it in service. Accumulated expenditures during the year of $1,000 included capitalized interest of $10.
f. Company M entered into a capital lease for new equipment with a fair value of $850. Principal payments under the lease obligation totaled $125.
g. Company M purchased all of the capital stock of Company S for $950. The acquisition was recorded under the purchase method of accounting. The fair values of Company S's assets

and liabilities at the date of acquisition are presented below:

Cash	$ 25
Accounts receivable	155
Inventory	350
Property, plant, and equipment	900
Patents	80
Goodwill	70
Accounts payable and accrued expenses	(255)
Long-term note payable	(375)
Net assets acquired	$950

h. Company M borrowed and repaid various amounts under a line-of-credit agreement in which borrowings are payable 30 days after demand. The net increase during the year in the amount borrowed against the line-of-credit totaled $300.
i. Company M issued $400 of long-term debt securities.
j. Company M's provision for income taxes included a deferred provision of $150.
k. Company M's depreciation totaled $430, and amortization of intangible assets totaled $15.
l. Company M's selling, general, and administrative expenses included an accrual for incentive compensation of $50 that has been deferred by executives until their retirement. The related obligation was included in other liabilities.
m. Company M collected insurance proceeds of $15 from a business interruption claim that resulted when a storm precluded shipment of inventory for one week.
n. Company M paid $30 to settle a lawsuit for patent infringement.
o. Company M issued $1,000 of additional common stock of which $500 was issued for cash and $500 was issued upon conversion of long-term debt.
p. Company M paid dividends of $200.

135. Based on the financial data from the preceding example, the following computations illustrate a method of indirectly determining cash received from customers and cash paid to suppliers and employees for use in a statement of cash flows under the direct method.

Cash received from customers during the year:

Customer sales		$13,965
Collection of installment payment for sale of inventory		100
Gross accounts receivable at beginning of year	$2,370	
Accounts receivable acquired in purchase of Company S	155	
Accounts receivable written off	(350)	
Gross accounts receivable at end of year	(2,390)	

Excess of new accounts receivable over collections from customers			(215)
Cash received from customers during the year			$13,850

Cash paid to suppliers and employees during the year:

Cost of sales			$10,290
General and administrative expenses		$1,890	
Expenses not requiring cash outlay (provision for uncollectible accounts receivable)		(200)	
Net expenses requiring cash payments			1,690
Inventory at beginning of year		(1,230)	
Inventory acquired in purchase of Company S		(350)	
Inventory at end of year		1,375	
Net decrease in inventory from Company M's operations			(205)
Adjustments for changes in related accruals:			
Account balances at beginning of year			
Accounts payable and accrued expenses	$1,085		
Other liabilities	225		
Prepaid expenses	(110)		
Total		1,200	
Accounts payable and accrued expenses acquired in purchase of Company S		255	
Account balances at end of year			
Accounts payable and accrued expenses	1,090		
Other liabilities	275		
Prepaid expenses	(135)		
Total		(1,230)	
Additional cash payments not included in expense			225
Cash paid to suppliers and employees during the year			$12,000

Example 2

136. Presented below is a consolidating statement of cash flows for the year ended December 31, 19X1 for Company F, a multinational U.S. corporation engaged principally in manufacturing activities, which has two wholly owned foreign subsidiaries— Subsidiary A and Subsidiary B. For Subsidiary A, the local currency is the functional currency. For Subsidiary B, which operates in a highly inflationary economy, the U.S. dollar is the functional currency.

Company F
Consolidating Statement of Cash Flows
For the Year Ended December 31, 19X1
Increase (Decrease) in Cash and Cash Equivalents

	Parent Company	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Cash flows from operating activities:					
Cash received from customers	$4,610 [a]	$888 [a]	$561 [a]	$(430)	$5,629
Cash paid to suppliers and employees	(3,756) [a]	(806) [a]	(370) [a]	430	(4,502)
Interest paid	(170)	(86)	(135)	—	(391)
Income taxes paid	(158)	(25)	(21)	—	(204)
Interest and dividends received	57	—	—	(22)	35
Miscellaneous cash received (paid)	—	45	(5)	—	40
Net cash provided by operating activities	583	16	30	(22)	607
Cash flows from investing activities:					
Proceeds from sale of equipment	150	116	14	—	280
Payments for purchase of equipment	(450)	(258)	(15)	—	(723)
Net cash used in investing activities	(300)	(142)	(1)	—	(443)
Cash flows from financing activities:					
Proceeds from issuance of short-term debt	20	75	—	—	95
Intercompany loan	(15)	—	15	—	—
Proceeds from issuance of long-term debt	—	165	—	—	165
Repayment of long-term debt	(200)	(105)	(35)	—	(340)
Payment of dividends	(120)	(22)	—	22	(120)
Net cash provided by (used in) financing activities	(315)	113	(20)	22	(200)
Effect of exchange rate changes on cash	—	9 [b]	(5) [b]	—	4
Net change in cash and cash equivalents	(32)	(4)	4	—	(32)

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	Parent Company	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Cash and cash equivalents at beginning of year	255	15	5	—	275
Cash and cash equivalents at end of year	$ 223	$ 11	$ 9	$ —	$ 243

[a] The computation of this amount is provided in paragraph 145.

[b] The computation of this amount is provided in paragraph 146.

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

	Parent Company	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Net income	$417	$50	$(66)	$(37)	$364
Adjustments to reconcile net income to net cash provided by operating activities:					
Depreciation and amortization	350	85	90	—	525
(Gain) loss on sale of equipment	(115)	—	25	—	(90)
Writedown of facility to net realizable value	50	—	—	—	50
Exchange gain	—	—	(115)	—	(115)
Provision for deferred taxes	90	—	—	—	90
Increase in accounts receivable	(85)	(37)	(9)	—	(131)
(Increase) decrease in inventory	(80)	(97)	107	15	(55)
Increase (decrease) in accounts payable and accrued expenses	(41)	16	(6)	—	(31)
Increase (decrease) in interest and taxes payable	(3)	(1)	4	—	—
Net cash provided by operating activities	$583	$16	$30	$(22)	$607

Disclosure of accounting policy:

Cash in excess of daily requirements is invested in marketable securities consisting of Treasury bills with maturities of three months or less. Such investments are deemed to be cash equivalents for purposes of the statement of cash flows.

137. Summarized below is financial information for the current year for Company F, which provides the basis for the statement of cash flows presented in paragraph 136.

Company F
Consolidating Statement of Financial Position
December 31, 19X1

	Parent Company	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Assets:					
Cash and cash equivalents	$ 223	$ 11	$ 9	$ —	$ 243
Accounts receivable	725	95	20	—	840
Intercompany loan receivable	15	—	—	(15)	—
Inventory	630	281	96	(15)	992
Investments	730	—	—	(730)	—
Property, plant, and equipment, net	3,305	1,441	816	—	5,562
Other assets	160	11	—	—	171
Total assets	$5,788	$1,839	$941	$(760)	$7,808
Liabilities:					
Accounts payable and accrued expenses	$ 529	$ 135	$ 38	$ —	$ 702
Interest payable	35	11	4	—	50
Taxes payable	45	5	2	—	52
Short-term debt	160	135	—	—	295
Intercompany debt	—	—	15	(15)	—
Long-term debt	1,100	315	40	—	1,455
Deferred taxes	342	—	—	—	342

Total liabilities	2,211	601	99	(15)	2,896
Stockholders' equity:					
Capital stock	550	455	275	(730)	550
Retained earnings	3,027	554	567	(15)	4,133
Cumulative translation adjustment	—	229	—	—	229
Total stockholders' equity	3,577	1,238	842	(745)	4,912
Total liabilities and stockholders' equity	$5,788	$1,839	$941	$(760)	$7,808

Company F
Consolidating Statement of Income
For the Year Ended December 31, 19X1

	Parent Company	Subsidiary A	Subsidiary B	Eliminations	Consolidated
Revenues	$4,695	$925	$570	$(430)	$5,760
Cost of sales	(3,210)	(615)	(406)	415	(3,816)
Depreciation and amortization	(350)	(85)	(90)	–	(525)
General and administrative expenses	(425)	(110)	(65)	–	(600)
Interest expense	(165)	(90)	(135)	–	(390)
Interest and dividend income	57	–	–	(22)	35
Gain (loss) on sale of equipment	115	–	(25)	–	90
Miscellaneous income (expense)	(50)	45	(5)	–	(10)
Exchange gain	–	–	115	–	115
Income before income taxes	667	70	(41)	(37)	659
Provision for income taxes	(250)	(20)	(25)	–	(295)
Net income	$ 417	$ 50	$ (66)	$ (37)	$ 364

138. The U.S. dollar equivalents of one unit of local currency applicable to Subsidiary A and to Subsidiary B are as follows:

	Subsidiary A	Subsidiary B
1/1/X1	.40	.05
Weighted average	.43	.03
12/31/X1	.45	.02

The computation of the weighted-average exchange rate for Subsidiary A excludes the effect of Subsidiary A's sale of inventory to the parent company at the beginning of the year discussed in paragraph 142(a).

139. Comparative statements of financial position for the parent company and for each of the foreign subsidiaries are presented below.

COMPARATIVE STATEMENTS OF FINANCIAL POSITION

	Parent Company			Subsidiary A Local Currency			Subsidiary A U.S. Dollars			Subsidiary B Local Currency			Subsidiary B U.S. Dollars		
	1/1/X1	12/13/X1	Change	1/1/X1	12/31/X1	Change	1/1/X1	12/31/X1	Change	1/1/X1	12/31/X1	Change	1/1/X1	12/31/X1	Change
Assets															
Cash and cash equivalents	$ 255	$ 223	$ (32)	LC 38	LC 25	LC (13)	$ 15	$ 11	$ (4)	LC 100	LC 449	LC 349	$ 5	$ 9	$ 4
Accounts receivable	640	725	85	125	210	85	50	95	45	700	1,000	300	35	20	(15)
Intercompany loan receivable	–	15	15	–	–	–	–	–	–	–	–	–	–	–	–
Inventory	550	630	80	400	625	225	160	281	121	2,900	3,200	300	203	96	(107)
Investments	730	730	–	–	–	–	–	–	–	–	–	–	–	–	–
Property, plant, and equipment, net	3,280	3,305	25	3,075	3,202	127	1,230	1,441	211	6,200	5,900	(300)	930	816	(114)
Other assets	170	160	(10)	25	25	–	10	11	1	–	–	–	–	–	–
Total assets	$5,625	$5,788	$163	LC3,663	LC4,087	LC424	$1,465	$1,839	$374	LC9,900	LC10,549	LC 649	$1,173	$941	$(232)
Liabilities:															
Accounts payable and accrued expenses	$ 570	$ 529	$ (41)	LC 263	LC 300	LC 37	$ 105	$ 135	$ 30	LC2,100	LC 1,900	LC(200)	$ 105	$ 38	$ (67)
Interest payable	40	35	(5)	15	24	9	6	11	5	200	200	–	10	4	(6)
Taxes payable	43	45	2	25	12	(13)	10	5	(5)	–	120	120	–	2	2
Short-term debt	140	160	20	125	300	175	50	135	85	–	–	–	–	–	–
Intercompany debt	–	–	–	–	–	–	–	–	–	–	500	500	–	15	15
Long-term debt	1,300	1,100	(200)	550	700	150	220	315	95	3,000	2,000	(1,000)	150	40	(110)
Deferred taxes	252	342	90	–	–	–	–	–	–	–	–	–	–	–	–
Total liabilities	2,345	2,211	(134)	978	1,336	358	391	601	210	5,300	4,720	(580)	265	99	(166)
Stockholders' equity:															
Capital stock	550	550	–	1,300	1,300	–	455	455	–	1,375	1,375	–	275	275	–
Retained earnings	2,730	3,027	297	1,385	1,451	66	526	554	28	3,225	4,454	1,229	633	567	(66)
Cumulative translation adjustment	–	–	–	–	–	–	93	229	136	–	–	–	–	–	–
Total stockholders' equity	3,280	3,577	297	2,685	2,751	66	1,074	1,238	164	4,600	5,829	1,229	908	842	(66)
Total liabilities and stockholders' equity	$5,625	$5,788	$163	LC3,663	LC4,087	LC424	$1,465	$1,839	$374	LC9,900	LC10,549	LC649	$1,173	$941	$(232)

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140. Statements of income in local currency and U.S. dollars for each of the foreign subsidiaries are presented below.

STATEMENTS OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 19X1

	Subsidiary A		Subsidiary B	
	Local Currency	U.S. Dollars	Local Currency	U.S Dollars
Revenues	LC2,179	\$ 925 [a]	LC19,000	\$ 570
Cost of sales	(1,458)	(615) [b]	(9,667)	(406)
Depreciation and amortization	(198)	(85)	(600)	(90)
General and administrative expenses	(256)	(110)	(2,167)	(65)
Interest expense	(209)	(90)	(4,500)	(135)
Gain (loss) on sale of equipment	–	–	150	(25)
Miscellaneous income (expense)	105	45	(167)	(5)
Exchange gain	–	–	–	115
Income before income taxes	163	70	2,049	(41)
Provision for income taxes	(47)	(20)	(820)	(25)
Net income	LC 116	\$ 50	LC 1,229	\$ (66)

141. The following transactions were entered into during the year by the parent company and are reflected in the above financial statements:

a. The parent company invested cash in excess of daily requirements in Treasury bills. Interest earned on such investments totaled \$35.
b. The parent company sold excess property with a net book value of \$35 for \$150.
c. The parent company's capital expenditures totaled \$450.
d. The parent company wrote down to its estimated net realizable value of \$25 a facility with a net book value of \$75.
e. The parent company's short-term debt consisted of commercial paper with maturities not exceeding 60 days.
f. The parent company repaid long-term notes of \$200.
g. The parent company's depreciation totaled \$340, and amortization of intangible assets totaled \$10.
h. The parent company's provision for income taxes included deferred taxes of \$90.
i. Because of a change in product design, the parent company purchased all of Subsidiary A's beginning inventory for its book value of \$160. All of the inventory was subsequently sold by the parent company.

j. The parent company received a dividend of $22 from Subsidiary A. The dividend was credited to the parent company's income.

k. The parent company purchased from Subsidiary B $270 of merchandise of which $45 remained in the parent company's inventory at year-end. Intercompany profit on the remaining inventory totaled $15.

l. The parent company loaned $15, payable in U.S. dollars, to Subsidiary B.

m. Company F paid dividends totaling $120 to shareholders.

142. The following transactions were entered into during the year by Subsidiary A and are reflected in the above financial statements. The U.S. dollar equivalent of the local currency amount based on the exchange rate at the date of each transaction is included. Except for the sale of inventory to the parent company (transaction (a) below), Subsidiary A's sales and purchases and operating cash receipts and payments occurred evenly throughout the year.

a. Because of a change in product design, Subsidiary A sold all of its beginning inventory to the parent company for its book value of LC400 ($160).

b. Subsidiary A sold equipment for its book value of LC275 ($116) and purchased new equipment at a cost of LC600 ($258).

c. Subsidiary A issued an additional LC175 ($75) of 30-day notes and renewed the notes at each maturity date.

d. Subsidiary A issued long-term debt of LC400 ($165) and repaid long-term debt of LC250 ($105).

e. Subsidiary A paid a dividend to the parent company of LC50 ($22).

143. The following transactions were entered into during the year by Subsidiary B and are reflected in the above financial statements. The U.S. dollar equivalent of the local currency amount based on the exchange rate at the date of each transaction is included. Subsidiary B's sales and operating cash receipts and payments occurred evenly throughout the year. For convenience, all purchases of inventory were based on the weighted-average exchange rate for the year. Subsidiary B uses the FIFO method of inventory valuation.

a. Subsidiary B had sales to the parent company as follows:

	Local Currency	U.S. Dollars
Intercompany sales	LC9,000	$ 270
Cost of sales	(4,500)	(180)
Gross profit	LC4,500	$ 90

b. Subsidiary B sold equipment with a net book value of LC200 ($39) for LC350 ($14). New equipment was purchased at a cost of LC500 ($15).

c. Subsidiary B borrowed $15 (LC500), payable in U.S. dollars, from the parent company.
d. Subsidiary B repaid LC1,000 ($35) of long-term debt.

144. Statements of cash flows in the local currency and in U.S. dollars for Subsidiary A and Subsidiary B are presented below.

STATEMENTS OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 19X1
Increase (Decrease) in Cash

	Subsidiary A		Subsidiary B	
	Local Currency	U.S. Dollars	Local Currency	U.S Dollars
Cash flows from operating activities:				
Cash received from customers	LC2,094 [a]	$888 [a]	LC18,700 [a]	$561 [a]
Cash paid to suppliers and employees	(1,902) [a]	(806) [a]	(12,334) [a]	(370) [a]
Interest paid	(200)	(86) [b]	(4,500)	(135) [b]
Income taxes paid	(60)	(25) [b]	(700)	(21) [b]
Miscellaneous receipts (payments)	105	(45) [b]	(167)	(5) [b]
Net cash provided by operating activities	37	16	999	30
Cash flows from investing activities:				
Proceeds from sale of equipment	275	116 [c]	350	14 [c]
Payments for purchase of equipment	(600)	(258) [c]	(500)	(15) [c]
Net cash used in investing activities	(325)	(142)	(150)	(1)
Cash flows from financing activities:				
Net increase in short-term debt	175	75 [c]	–	–
Proceeds from intercompany loan	–	–	500	15 [c]
Proceeds from issuance of long-term debt	400	165 [c]	–	–
Repayment of long-term debt	(250)	(105) [c]	(1,000)	(35) [c]
Payment of dividends	(50)	(22) [c]	–	–
Net cash provided by (used in) financing activities	275	113	(500)	(20)
Effect of exchange rate changes on cash	–	9 [d]	–	(5) [d]
Net increase (decrease) in cash	(13)	(4)	349	4
Cash at beginning of year	38	15	100	5
Cash at end of year	LC 25	$ 11	LC 449	$ 9

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

	Subsidiary A		Subsidiary B	
	Local Currency	U.S. Dollars	Local Currency	U.S Dollars
Net income	LC116	$50	LC1,229	$(66)
Adjustments to reconcile net income to net cash provided by operating activities:				
Depreciation and amortization	198	85 [a]	600	90 [b]
(Gain) loss on sale of equipment	–	–	(150)	25 [b]
Exchange gain	–	–	–	(115) [c]
Increase in accounts receivable	(85)	(37) [a]	(300)	(9) [a]
Increase decrease in inventory	(225)	(97) [a]	(300)	107 [d]
Increase (decrease) in accounts payable and accrued expenses	37	16[a]	(200)	(6) [a]
Increase (decrease) in interest and taxes payable	(4)	(1)[a]	120	4 [a]
Net cash provided by operating activities	LC 37	$16	LC 999	$30

145. Presented below is the computation of cash received from customers and cash paid to suppliers and employees as reported in the consolidating statement of cash flows for Company F appearing in paragraph 136.

		Subsidiary A		Subsidiary B	
	Parent Company	Local Currency	U.S. Dollars	Local Currency	U.S. Dollars
Cash received from customers during the year:					
Revenues	$4,695	LC2,179	$925	LC19,000	$570
Increase in accounts receivable	(85)	(85)	(37)	(300)	(9)
Cash received from customers	$4,610	LC2,094	$888	LC18,700	$561
Cash paid to suppliers and employees during the year:					
Cost of sales	$3,210	LC1,458	$615	LC 9,667	$406

Effect of exchange rate changes on cost of sales	–	–	–	–	(116) [a]
General and administrative expenses	425	256	110	2,167	65
Total operating expenses requiring cash payments	3,635	1,714	725	11,834	355
Increase in inventory	80	225	97	300	9
(Increase) decrease in accounts payable and accrued expenses	41	(37)	(16)	200	6
Cash paid to suppliers and employees	$3,756	LC1,902	$806	LC12,334	$370

146. Presented below is the computation of the effect of exchange rate changes on cash for Subsidiary A and Subsidiary B:

COMPUTATION OF EFFECT OF EXCHANGE RATE CHANGES ON CASH

	Subsidiary A		Subsidiary B	
Effect on beginning cash balance:				
Beginning cash balance in local currency	LC 38		LC100	
Net change in exchange rate during the year	× .05		× (.03)	
Effect on beginning cash balance		$2		$(3)
Effect from operating activities during the year:				
Cash provided by operating activities in local currency	LC 37		LC 999	
Year-end exchange rate	× .45		× .02	
Operating cash flows based on year-end exchange rate	$ 16 [a]		$ 20	
Operating cash flows reported in the statement of cash flows	16		30	
Effect from operating activities during the year		0		(10)
Effect from investing activities during the year:				
Cash used in investing activities in local currency	LC(325)		LC(150)	
Year-end exchange rate	× .45		× .02	
Investing cash flows based on year-end exchange rate	$(146)		$(3)	
Investing cash flows reported in the statement of cash flows	(142)		(1)	
Effect from investing activities during the year		(4)		(2)
Effect from financing activities during the year:				
Cash provided by (used in) financing activities in local currency	LC 275		LC(500)	
Year-end exchange rate	× .45		× .02	

Financing cash flows based on year-end exchange rate	$124		$(10)	
Financing cash flows reported in the statement of cash flows	113		(20)	
Effect from financing activities during the year		11		10
Effect of exchange rate changes on cash		$ 9		$(5)

Example 3

147. Presented below is a statement of cash flows for Financial Institution, Inc., a U.S. corporation that provides a broad range of financial services. This statement of cash flows illustrates the direct method of presenting cash flows from operating activities, as encouraged in paragraph 27 of this Statement.

FINANCIAL INSTITUTION, INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 19X1
Increase (Decrease) in Cash and Cash Equivalents

Cash flows from operating activities:		
Interest received	$5,350	
Fees and commissions received	1,320	
Financing revenue received under leases	60	
Interest paid	(3,925)	
Cash paid to suppliers and employees	(795)	
Income taxes paid	(471)	
Net cash provided by operating activities		$ 1,539
Cash flows from investing activities:		
Proceeds from sales of trading andinvestment securities	22,700	
Purchase of trading and investment securities	(25,000)	
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	260	
Net cash used in investing activities		(12,683)

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	(240)	
Net cash provided by financing activities		10,965
Net decrease in cash and cash equivalents		(179)
Cash and cash equivalents at beginning of year		6,700
Cash and cash equivalents at end of year		$ 6,521

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	
Gain on sale of trading and investment securities	(100)	
Gain on sale of equipment	(50)	
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	55	
Total adjustment		483
Net cash provided by operating activities		$1,539

Supplemental schedule of noncash investing and financing activities:

Conversion of long-term debt to common stock	$ 500

Disclosure of accounting policy:

For purposes of reporting cash flows, cash and cash equivalents include cash on hand, amounts due from banks, and federal funds sold. Generally, federal funds are purchased and sold for one-day periods.

148. Summarized below is financial information for the current year for Financial Institution, Inc., which provides the basis for the statement of cash flows presented in paragraph 147:

FINANCIAL INSTITUTION, INC.
STATEMENT OF FINANCIAL POSITION

	1/1/X1	12/31/X1	Change
Assets:			
Cash and due from banks	$ 4,400	$ 3,121	$(1,279)
Federal funds sold	2,300	3,400	1,100
Total cash and cash equivalents	6,700	6,521	(179)
Investment and trading securities	9,000	11,400	2,400
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
Plant, property, and equipment, net	525	665	140
Total assets	$52,585	$64,389	$11,804
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	0	80	80
Long-term debt	2,000	2,300	300
Deferred taxes	–	58	58
Total liabilities	49,400	59,793	10,393
Stockholders' equity:			
Common stock	1,250	2,100	850
Treasury stock	0	(175)	(175)
Retained earnings	1,935	2,671	736
Total stockholders' equity	3,185	4,596	1,411
Total liabilities and stockholders' equity	$52,585	$64,389	$11,804

FINANCIAL INSTITUTION, INC.
STATEMENT OF INCOME
FOR THE YEAR ENDED DECEMBER 31, 19X1

Revenues:		
Interest income	$5,500	
Fees and commissions	1,300	
Gain on sale of investment securities	100	
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

149. The following transactions were entered into by Financial Institution, Inc., during 19X1 and are reflected in the above financial statements:

a. Financial Institution sold trading and investment securities with a book value of $22,600 for $22,700 and purchased $25,000 in new trading and investment securities.
b. Financial Institution had a net decrease in short-term loans receivable (those with original maturities of 3 months or less) of $2,250. Financial Institution made longer term loans of $36,300 and collected $26,550 on those loans. Financial Institution wrote off $250 of loans as uncollectible.
c. Financial Institution purchased property for $500 to be leased under a direct financing lease. The first annual rental payment of $131 was collected. The portion of the rental payment representing interest income totaled $52.
d. Financial Institution purchased equipment for $1,000 to be leased under a leveraged lease. The cost of the leased asset was financed by an equity investment of $400 and a long-term nonrecourse bank loan of $600. The first annual rental payment of $90, of which $28 represented principal, was collected and the first annual loan installment of $74, of which $20 represented principal, was paid. Pretax income of $8 was recorded.
e. Financial Institution purchased new property, plant, and equipment for $450 and sold property, plant, and equipment with a book value of $210 for $260.

f. Customer deposits with Financial Institution consisted of the following:

	1/1/X1	12/31/X1	Increase
Demand deposits	$ 8,000	$ 8,600	$ 600
NOW accounts and savings accounts	15,200	17,600	2,400
Certificates of deposit	14,800	16,800	2,000
Total deposits	$38,000	$43,000	$5,000

Sales of certificates of deposit during the year totaled $63,000; certificates of deposit with principal amounts totaling $61,000 matured. For presentation in the statement of cash flows, Financial Institution chose to report gross cash receipts and payments for both certificates of deposit with maturities of three months or less and those with maturities of more than three months.

g. Short-term borrowing activity for Financial Institution consisted of repayment of a $200 90-day note and issuance of a 90-day note for $250 and a 6-month note for $100.
h. Financial Institution repaid $200 of long-term debt and issued 5-year notes for $600 and 10-year notes for $400.
i. Financial Institution issued $850 of common stock, $500 of which was issued upon conversion of long-term debt and $350 of which was issued for cash.
j. Financial Institution acquired $175 of treasury stock.
k. Financial Institution declared dividends of $320. The fourth quarter dividend of $80 was payable the following January.
l. Financial Institution's provision for income taxes included a deferred provision of $58.
m. In accordance with paragraph 7, footnote 1, of this Statement, interest aid includes amounts credited directly to demand deposit, NOW, and savings accounts.

Appendix D: AMENDMENTS TO EXISTING PRONOUNCEMENTS

150. This Statement supersedes Opinion 19 and the three AICPA Accounting Interpretations of Opinion 19.

151. This Statement amends the following pronouncements as follows:

a. APB Opinion No. 28, *Interim Financial Reporting*. In paragraph 33, the two references to the phrase *funds flow data* are replaced by the phrase *cash flow data*.
b. FASB Statement No. 7, *Accounting and Reporting by Development Stage Enterprises*. In paragraph 11(c), the phrase *A statement of changes in financial position, showing the sources and uses of financial resources* is replaced by the phrase *A statement of cash flows, showing the cash inflows and cash outflows*. Footnote 8 is deleted.

152. Many pronouncements issued by the Accounting Principles Board (APB) and the FASB contain references to the phrase (a) *a complete set of financial statements that present financial position, results of operations, and changes in financial position*, (b) *statement of changes in financial position*, or (c) *changes in financial position*. All such references appearing in paragraphs that establish standards or the scope of a pronouncement are hereby replaced by references to the phrase (a) *a complete set of financial statements that present financial position, results of operations, and cash flows*, (b) *statement of cash flows*, or (c) *cash flows*, respectively. That conclusion requires amendments to the following existing pronouncements:

a. APB Opinion No. 20, *Accounting Changes*, paragraph 3.
b. APB Opinion No. 22, *Disclosure of Accounting Policies*, paragraphs 6, 7, 8, and 12.
c. Opinion 28, paragraph 2.
d. Statement 7, paragraph 10.
e. FASB Statement No. 14, *Financial Reporting for Segments oj a Business Enterprise*, paragraphs 3 and 7 (as amended by FASB Statement No. 24, *Reporting Segment Information in Financial Statements That Are Presented in Another Enterprise's Financial Report)*.
f. Statement 24, paragraphs 1 and 5 and footnote 2.
g. FASB Statement No. 69, *Disclosures about Oil and Gas Producing Activities*, footnote 3.
h. FASB Technical Bulletin No. 82-1, *Disclosure of the Sale or Purchase of Tax Benefits through Tax Leases*, paragraph 4.

153. Some pronouncements issued by the APB or FASB contain references to the phrase (a) *a complete set of financial statements*, (b) *a full set of financial statements*, or (c) *a complete set of annual financial statements* without a specific reference to the phrase *changes in financial position*. Because this Statement redefines what constitutes a complete or full set of financial statements, this Statement effectively amends the intent of those pronouncements even though the terminology in those pronouncements was not changed. The affected pronouncements are as follows:

a. Statement 7, footnote 6.
b. FASB Statement No. 21, *Suspension of the Reporting of Earnings per Share and Segment Information by Nonpublic Enterprises*, footnote 4.
c. FASB Statement No. 36, *Disclosure of Pension Information*, paragraph 8.
d. FASB Statement No. 57, *Related Party Disclosures*, footnote 2.
e. Statement 69, paragraphs 7, 8, and 41.

Footnotes

FAS95, Footnote 1--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.

FAS95, Footnote 2--*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 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.

FAS95, Footnote 3--For this purpose, 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 enterprise's sale of goods or services--also are considered to be loans with original maturities of three months or less.

FAS95, Footnote 4--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 whether or not the debt is intended as a hedge of an investment, and the purchase or sale of a futures contract is an investing activity without regard to whether the contract is intended as a hedge of a firm commitment to purchase inventory.

FAS95, Footnote 5—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.

FAS95, Footnote 6--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. Incurring directly related debt to the seller is a financing transaction, and subsequent payments of principal on that debt thus are financing cash outflows.

FAS95, Footnote 7--Payments to acquire productive assets include interest capitalized as part of the cost of those assets.

FAS95, Footnote 8--Refer to footnote 6 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.

FAS95, Footnote 9--Paragraph 12 of FASB Statement No. 52, *Foreign Currency Translation*, recognizes the general impracticality of translating revenues, expenses, gains, and losses at the exchange rates on dates they are recognized and permits an appropriately weighted average exchange rate for the period to be used to translate those elements. This Statement applies that provision to cash receipts and cash payments.

FAS95, Footnote 10--Separate disclosure of cash flows pertaining to extraordinary items or discontinued operations reflected in those categories is not required. An enterprise that nevertheless chooses to report separately operating cash flows of discontinued operations shall do so consistently for all periods affected, which may include periods long after sale or liquidation of the operation.

FAS95, Footnote 11--Paragraphs 115-118 in Appendix B and paragraph 135 in Appendix C, respectively, discuss and illustrate a method by which those major classes of gross operating cash receipts and payments generally may be determined indirectly.

FAS95, Footnote 12--Adjustments to net income 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 described in paragraph 7, footnote 1, is a cash outflow of the payor and a cash inflow of the payee when the entry is made.

FAS95, Appendix B, Footnote 13--Unless otherwise indicated, references throughout this appendix to *respondents* generally include respondents to both the Discussion Memorandum and the 1986 Exposure Draft.

FAS95, Appendix B, Footnote 14--For convenience and because most of the controversy over funds statements for financial institutions has focused on commercial banks, this section uses the term *banks*. Most of the points discussed, however, apply also to thrifts and other kinds of financial institutions.

FAS95, Appendix B, Footnote 15--The Board is considering in another project on its agenda the kinds of information about financial instruments that should be disclosed in the financial statements of both financial and nonfinancial enterprises to help in assessing, among other things, liquidity, financial flexibility, profitability, and risk.

FAS95, Appendix B, Footnote 16--Presenting cash flow from operating activities by the indirect method, which this Statement permits, results in net reporting of operating cash receipts and payments. The basis for the Board's decision to permit continued use of the indirect method is discussed in paragraphs 106-121.

FAS95, Appendix B, Footnote 17--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.

FAS95, Par. 140, Appendix C, Footnote a--This amount was computed as follows:

Sale to parent company at beginning of year	LC 400 @.40 = $160
Sales to customers	LC1,779 @.43 = 765
Total sales in U.S. dollars	$925

FAS95, Par. 140, Appendix C, Footnote b--This amount was computed as follows:

Cost of sale to parent company at beginning of year	LC 400 @ .40 = $160
Cost of sales to customers	LC1,058 @ .43 = 455
Total cost of sales in U.S. dollars	$615

FAS95, par. 144, *Statement of Cash Flows*, Footnote a—The computation of this amount is provided in paragraph 145.

FAS95, Par. 144, *Statement of Cash Flows*, Footnote b—This amount represents the U.S. dollar equivalent of the foreign currency cash flow based on the weighted-average exchange rate for the year.

FAS95, Par. 144, *Statement of Cash Flows*, Footnote c--This amount represents the U.S. dollar equivalent of the foreign currency cash flow based on the exchange rate in effect at the time of the cash flow.

FAS95, Par. 144, *Statement of Cash Flows*, Footnote d--The computation of this amount is provided in paragraph 146.

FAS95, Par. 144, *Reconciliation of net income to net cash provided by operating activities*, Footnote a—This amount represents the U.S. dollar equivalent of the foreign currency amount based on the weighted-average exchange rate for the year.

FAS95, Par. 144, *Reconciliation of net income to net cash provided by operating activities,* Footnote b—This amount represents the U.S. dollar equivalent of the foreign currency amount based on historical exchange rates.

FAS95, Par. 144, *Reconciliation of net income to net cash provided by operating activities*, Footnote c--This amount represents the U.S. dollar equivalent of the foreign currency cash flow based on the exchange rate in effect at the time of the cash flow.

FAS95, Par. 144, *Reconciliation of net income to net cash provided by operating activities,* Footnote d—This amount represents the difference between beginning and ending inventory after remeasurement into U.S. dollars based on historical exchange rates.

FAS95, Appendix C, Footnote a--This adjustment represents the difference between cost of sales remeasured at historical exchange rates ($406) and cost of sales translated based on the weighted-average exchange rate for the year ($290). The adjustment is necessary because cash payments for inventory, which were made evenly throughout the year, were based on the weighted-average exchange rate for the year.

FAS95, Par. 146, Appendix C, Footnote a--This amount includes the effect of rounding.

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or tradition. **3.** *Hist.* Disobedience of a legal command or summons.

rebus sic stantibus (**ree**-bəs sik **stan**-tə-bəs). [Law Latin "things standing thus"] *Civil & int'l law.* The principle that all agreements are concluded with the implied condition that they are binding only as long as there are no major changes in the circumstances. See CLAUSA REBUS SIC STANTIBUS.

rebut, *vb.* To refute, oppose, or counteract (something) by evidence, argument, or contrary proof <rebut the opponent's expert testimony> <rebut a presumption of negligence>.

rebuttable presumption. See PRESUMPTION.

rebuttal, *n.* **1.** In-court contradiction of an adverse party's evidence. **2.** The time given to a party to present contradictory evidence or arguments. Cf. CASE-IN-CHIEF.

rebuttal evidence. See EVIDENCE.

rebuttal witness. See WITNESS.

rebutter. 1. *Common-law pleading.* The defendant's answer to a plaintiff's surrejoinder; the pleading that followed the rejoinder and surrejoinder, and that might in turn be answered by the surrebutter. **2.** One who rebuts.

recall, *n.* **1.** Removal of a public official from office by popular vote. **2.** A manufacturer's request to consumers for the return of defective products for repair or replacement. **3.** Revocation of a judgment for factual or legal reasons. — **recall,** *vb.*

recall election. See ELECTION.

recall exclusion. See *sistership exclusion* under EXCLUSION (3).

recant (ri-**kant**), *vb.* **1.** To withdraw or renounce (prior statements or testimony) formally or publicly <the prosecution hoped the eyewitness wouldn't recant her corroborating testimony on the stand>. **2.** To withdraw or renounce prior statements or testimony formally or publicly <under grueling cross-examination, the witness recanted>. — **recantation,** *n.*

recapitalization, *n.* An adjustment or recasting of a corporation's capital structure — that is, its stocks, bonds, or other securities — through amendment of the articles of incorporation or merger with a parent or subsidiary. • An example of recapitalization is the elimination of unpaid preferred dividends and the creation of a new class of senior securities. — **recapitalize,** *vb.* Cf. REORGANIZATION (2).

> ***leveraged recapitalization.*** Recapitalization whereby the corporation substitutes debt for equity in the capital structure, usu. to make the corporation less attractive as a target for a hostile takeover. — Also termed *leveraging up.*

reception. 1. At common law, lawful seizure of another's property for a second time to secure the performance of a duty; a second distress. See DISTRESS. **2.** Peaceful retaking, without legal process, of one's own property that has been wrongfully taken.

recapture, *n.* **1.** The act or an instance of retaking or reacquiring; recovery. **2.** The lawful taking by the government of earnings or profits exceeding a specified amount; esp., the government's recovery of a tax benefit (such as a deduction or credit) by taxing income or property that no longer qualifies for the benefit. **3.** *Int'l law.* The retaking of a prize or booty so that the property is legally restored to its original owner. See POSTLIMINIUM (2). — **recapture,** *vb.*

recapture clause. 1. A contract provision that limits prices or allows for the recovery of goods if market conditions greatly differ from what the contract anticipated. **2.** A commercial-lease provision that grants the landlord both a percentage of the tenant's profits above a fixed amount of rent and the right to terminate the lease — and thus recapture the property — if those profits are too low.

receding market. See *bear market* under MARKET.

receipt, *n.* **1.** The act of receiving something <my receipt of the document was delayed by two days>. **2.** A written acknowledgment that something has been received <keep the receipt for the gift>.

> ***accountable receipt.*** A receipt coupled with an obligation.
>
> ***warehouse receipt.*** See WAREHOUSE RECEIPT.

3. (*usu. pl.*) Something received; INCOME <po... the daily receipts in the ledger>.

requires them to be destroyed at the end of five years instead of being sold as waste paper.

See notes, G.C. § 5398, citing State ex rel. Greenward Realty Co. v. Zangerle.

SEC. **5394. Appeal to commissioner from assessment; hearing; certificate of determination; notice by tax commissioner; "taxpayer" defined.** Whenever the assessor shall assess any property not listed in or omitted from a return, or whenever the assessor shall assess any item or class of taxable property listed in a return by the taxpayer in excess of the value or amount thereof as so listed, or without allowing a claim duly made for deduction from the net book value of accounts receivable, or depreciated book value of personal property used in business, so listed, the assessor shall give notice thereof to the taxpayer by mail. Within thirty days after the mailing of such notice such taxpayer may make application in writing to the tax commissioner for review and redetermination of the assessments so made. The mailing of the notice herein prescribed shall be prima facie evidence of the receipt of the same by the person to whom such notice is addressed. Upon the filing of such application, the tax commissioner shall fix a time and a place not more than fifty miles distant from the taxpayer's residence or at the office of the tax commissioner in Columbus if such taxpayer consents thereto in writing, at which the taxpayer may be heard, and shall give reasonable notice thereof by mail to the taxpayer. Upon such hearing the commissioner may make such correction in the assessment, including any penalty, as he may deem lawful and proper or he may affirm the assessment. In either event he shall transmit a certificate of his determination to the taxpayer, and if no appeal is taken therefrom as provided by law, or upon the final determination of an appeal which may be taken, he shall transmit to the auditor of state or to the proper county auditor, a copy of such certificate as the case may require, who shall make up or correct his records, tax lists and duplicates, as the case may require, in accordance therewith.

The decision of the commissioner upon such application for review or redetermination shall be final with respect to the assessment of all taxable property listed in the return of the taxpayer and shall constitute to that extent the final determination of the commissioner with respect to such assessment; but nothing herein shall be so construed, nor shall the final judgment of the board of tax appeals or any court to which such final determination may be appealed be deemed to preclude the subsequent assessment in the manner authorized by law of any taxable property which such taxpayer failed to list in such return or which the assessor has not theretofore assessed.

When an application for review and redetermination is filed pursuant to this section, the tax commissioner shall notify the auditor and treasurer of state or the auditor and treasurer of each county on the tax list or lists, or duplicate or duplicates on which any part of such assessment is entered. After receipt of such notice the treasurer of state or the treasurer of any such county may accept any amount tendered as taxes with respect to the assessment concerning which such application is then pending, and if such tender is not accepted no penalty shall be assessed because of the non-payment thereof. The acceptance of such tender, however, shall be without prejudice to the claim for taxes upon the balance of such assessment. As used in this section, the word "taxpayer" shall include financial institutions and dealers in intangibles, as defined respectively in sections 5407 and 5414-1 of the General Code.

HISTORY.—114 v. 714 (743); 115 v. 569; 119 v. 34 (41), § 1. Eff. 7-4-41. Former § 5394 repealed, 103 v. 786 (803), § 68.

See G.C. §§ 5377, 5392, 5395, 5414-5, 5414-15, 5611, 5611-1 which refer to this section.

References to Page's Digest and Ohio Jurisprudence

Review and correction of assessment, in general: PAGE Taxation § 233 et seq.; O-JUR Taxation § 257 et seq.

Powers of auditor: PAGE Taxation § 236.

Change of valuation: PAGE Taxation § 238.

County board of revision, powers: PAGE Taxation § 227; O-JUR Taxation § 259.

Review of proceedings: PAGE Taxation § 230.

Review by tax commission: PAGE Taxation § 248; O-JUR Taxation § 262.

State tax commission: PAGE Taxation § 225; O-JUR Taxation § 169.

Notice of assessment: PAGE Taxation § 188; O-JUR Taxation § 268.

See note, G.C. § 5392-1, citing Pollak Steel Co. v. Tax Comm.

See note, G.C. § 5377, citing Leimbach v. Evatt.

See notes, G.C. § 5395, citing Sherbrook Distrib. Co. v. Evatt.

Where taxpayer fails to make claim in writing at time of making his return for deduction from depreciated book value of personal property and taxing authorities do not assess any item or class of property listed in return in excess of value or amount thereof as so listed, no duty rests upon tax commissioner to make final assessment certificate. Where no final assessment certificate is made preliminary assessment becomes final by operation of law: Willys-Overland Motors, Inc. v. Evatt, 141 O.S. 402, 25 O.O. 543, 48 N.E.(2d) 468 [affirming 24 O.O. 512 (B.T.A.)].

General Code § 5394 provides the procedure for a review by the tax commissioner, where a tax assessor assesses any item or class of taxable property listed in a return by the taxpayer in excess of the value or amount thereof as so listed or without allowing a claim duly made for deduction from net book value of accounts receivable, or depreciated book value of personal property used in business: Niles Bank Co. v. Evatt, 145 O.S. 179, 30 O.O. 375, ... N.E.(2d) ....

When the tax commissioner assesses credits in excess of the value listed in the return, the taxpayer has the right to appeal under G.C. § 5394: Black-Clawson Co. v. Evatt, 20 O.O. 148, 6 O.Supp. 95 (B.T.A.).

§ 5725.14 Annual return of resources by dealer in intangibles; gross receipts; consolidated returns.

Each dealer in intangibles shall return to the tax commissioner between the first and second Mondays of March, annually, a report exhibiting in detail, and under appropriate heads, his resources and liabilities at the close of business on the thirty-first day of December next preceding.

If a dealer in intangibles maintains separate business offices, whether within this state only or within and without this state, said report shall also show the gross receipts from business done at each such office during the year ending on the thirty-first day of December next preceding.

"Gross receipts" as used in this section and section 5725.15 of the Revised Code, means, in the case of a dealer in intangibles principally engaged in the business of lending money or discounting loans, the aggregate amount of loans effected or discounted; in the case of a dealer in intangibles principally engaged in the business of selling or buying stocks, bonds, and other similar securities either on his own account or as agent for another, gross receipts means the aggregate amount of all commissions charged plus one per cent of the aggregate amount of all other receipts.

As used in this section and section 5725.15 of the Revised Code business is considered done at an office when it originates at such office, but the receipts from business originating at one office and consummated at another office shall be divided equitably between such offices.

An incorporated dealer in intangibles which owns or controls fifty-one per cent or more of the common stock of another incorporated dealer in intangibles may, under uniform regulations prescribed by the tax commissioner, make a consolidated return for the purpose of sections 5725.01 to 5725.26, inclusive, of the Revised Code. In such case the parent corporation making such return is not required to include in its resources any of the stocks, securities, or other obligations of its subsidiary dealers, nor permitted to include in its liabilities any of its own securities or other obligations belonging to its subsidiaries.

HISTORY: GC § 5414-4; 114 v 714 (751); 115 v 574; 119 v 34; 122 v 375; 124 v 449, § 3; Bureau of Code Revision. Eff 10-1-53.

Cross-References to Related Sections

Assessment of capital and shares of dealer in intangibles, RC § 5725.15.

Failure of dealer in intangibles to make report, RC § 5725.17.

Ohio Administrative Code

Consolidated returns by incorporated dealers in intangibles. OAC 5703-3-06.

ORC Ann. 1.42 (2007)

§ 1.42. Common and technical use

Words and phrases shall be read in context and construed according to the rules of grammar and common usage. Words and phrases that have acquired a technical or particular meaning, whether by legislative definition or otherwise, shall be construed accordingly.

TITLE 57. TAXATION
CHAPTER 5711. LISTING PERSONAL PROPERTY

Go to the Ohio Code Archive Directory

ORC Ann. 5711.26 (2007)

§ 5711.26. Making certain final assessments

Except for taxable property concerning the assessment of which an appeal has been filed under *section 5717.02 of the Revised Code*, the tax commissioner may, within the time limitation in *section 5711.25 of the Revised Code*, and shall, upon application filed within such time limitation in accordance with the requirements of this section, finally assess the taxable property required to be returned by any taxpayer, financial institution, dealer in intangibles, or domestic insurance company as to which a preliminary or amended assessment has been made by or certified to a county treasurer or certified to the auditor of state or as to which the preliminary assessment is evidenced by a return filed with a county auditor for any prior year; and the commissioner may finally assess the taxable property of a taxpayer, financial institution, dealer in intangibles, or domestic insurance company who has failed to make a return to a county auditor or to the department of taxation in any such year. Application for final assessment shall be filed with the tax commissioner in person or by certified mail. If the application is filed by certified mail, the date of the United States postmark placed on the sender's receipt by the postal employee to whom the application is presented shall be treated as the date of filing. The application shall have attached thereto and incorporated therein by reference a true copy of the most recent preliminary or amended assessment, whether evidenced by certificate or return, to which correction is sought through the issuance of a final assessment certificate. The application shall also have attached thereto and incorporated therein by reference evidence establishing that the taxes, and any penalties and interest thereon, due on such preliminary or amended assessment have been paid. By filing such application within the time prescribed by *section 5711.25 of the Revised Code*, the taxpayer has waived such time limitation and consented to the issuance of his assessment certificate after the expiration of such time limitation.

For the purpose of issuing a final assessment the commissioner may utilize all facts or information he possesses, and shall certify in the manner prescribed by law a final assessment certificate in such form as the case may require, giving notice thereof by mail to the taxpayer, financial institution, dealer in intangibles, or domestic insurance company. Such final assessment certificate shall set forth, as to each year covered, the amount of the final assessment as to each class of property and the amount of the corresponding preliminary or last amended assessment. If no preliminary or amended assessment was made, the amount listed in the taxpayer's return for each such class of property shall be shown. If the amount of any final assessment of any such class for any year exceeds the amount of the preliminary or amended assessment of such class for such year, the difference shall be designated a "deficiency," and if no preliminary or amended assessment has been made, each item in the final assessment certificate shall be so designated. If the final assessment of any such class for any such year is less in amount than the preliminary or amended assessment thereof for such year, the difference shall be designated an "excess." The commissioner shall add to each such deficiency assessment the penalty provided by law, computed on the amount of such deficiency.

A copy of the final assessment certificate shall be transmitted to the treasurer of state or the proper county auditor, who shall make any corrections to his records and tax lists and duplicates required in accordance therewith and proceed as prescribed by *section 5711.32* or *5725.22 of the Revised Code.*

An appeal may be taken from any assessment authorized by this section to the board of tax appeals as provided by *section 5717.02 of the Revised Code*. When such an appeal is filed and the notice of appeal filed with the commissioner has attached thereto and incorporated therein by reference a true copy of any assessment authorized by this section as required by *section 5717.02 of the Revised Code*, the commissioner shall notify the treasurer of state or the auditor and treasurer of each county having any part of such assessment entered on the tax list or duplicate.

Upon the final determination of an appeal which may be taken from an assessment authorized by this section, the commissioner shall notify the treasurer of state or the proper county auditor of such final determination. The notification may be in the form of a corrected assessment certificate. Upon receipt of the notification, the treasurer of state or the county auditor shall make any corrections to his records and tax lists and duplicates required in accordance therewith and proceed as prescribed by *section 5711.32* or *5725.22 of the Revised Code*.

The assessment certificates mentioned in this section, and the copies thereof, shall not be open to public inspection.

TITLE 57. TAXATION
CHAPTER 5711. LISTING PERSONAL PROPERTY

ORC Ann. 5711.31 (2007)

§ 5711.31. Notice of assessment; petition for reassessment; final determination

Whenever the assessor assesses any property not listed in or omitted from a return, or whenever the assessor assesses any item or class of taxable property listed in a return by the taxpayer in excess of the value or amount thereof as so listed, or without allowing a claim duly made for deduction from the net book value of accounts receivable, or depreciated book value of personal property used in business, so listed, the assessor shall give notice of such assessment to the taxpayer by mail. The mailing of the notice of assessment shall be prima-facie evidence of the receipt of the same by the person to whom such notice is addressed. With the notice, the assessor shall provide instructions on how to petition for reassessment and request a hearing on the petition.

Within sixty days after the mailing of the notice of assessment prescribed in this section, the party assessed may file with the tax commissioner, in person or by certified mail, a written petition for reassessment, signed by the party assessed, or by that party's authorized agent having knowledge of the facts. If the petition is filed by certified mail, the date of the United States postmark placed on the sender's receipt by the postal employee to whom the petition is presented shall be treated as the date of filing. The petition shall have attached thereto and incorporated therein by reference a true copy of the notice of assessment complained of, but the failure to attach a copy of such notice and incorporate it by reference does not invalidate the petition. The petition also shall indicate the objections of the party assessed, but additional objections may be raised in writing if received prior to the date shown on the final determination by the commissioner.

Upon receipt of a properly filed petition, the commissioner shall notify the treasurer of state or the auditor and treasurer of each county having any part of the assessment entered on the tax list or duplicate.

If the petitioner requests a hearing on the petition, the commissioner shall assign a time and place for the hearing and notify the petitioner of such time and place, but the commissioner may continue the hearing from time to time as necessary.

The commissioner may make corrections to the assessment, as the commissioner finds proper. The commissioner shall serve a copy of the commissioner's final determination on the petitioner in the manner provided in *section 5703.37 of the Revised Code*. The commissioner's decision in the matter is final, subject to appeal under *section 5717.02 of the Revised Code*. The commissioner also shall transmit a copy of the commissioner's final determination to the treasurer of state or applicable county auditor. In the absence of any further appeal, or when a decision of the board of tax appeals or of any court to which the decision has been appealed becomes final, the commissioner shall notify the treasurer of state or the proper county auditor of such final determination. If the final determination orders correction of the assessment, the notification may be in the form of a corrected assessment certificate. Upon receipt of the notification, the treasurer of state or the proper county auditor shall make any corrections to the treasurer's or auditor's records and tax lists and duplicates required in accordance therewith and proceed as prescribed by *section 5711.32* or *5725.22 of the Revised Code.*

The decision of the commissioner upon such petition for reassessment shall be final with respect to the assessment of all taxable property listed in the return of the taxpayer and shall constitute to that extent the final determination of the commissioner with respect to such assessment. Neither this section nor a final judgment of the board of tax appeals or any court to which such final determination may be appealed shall preclude the subsequent assessment in the manner authorized by law of any taxable property which such taxpayer failed to list in such return, or which the assessor has not theretofore assessed.

As used in this section, "taxpayer" includes financial institutions, dealers in intangibles, and domestic insurance companies as defined in *section 5725.01 of the Revised Code.*

TITLE 57. TAXATION
CHAPTER 5725. FINANCIAL INSTITUTIONS; DEALERS IN INTANGIBLES; INSURANCE COMPANIES
DEALERS IN INTANGIBLES

ORC Ann. 5725.13 (2006)

§ 5725.13. Taxable property of dealers in intangibles

The following property shall be listed and assessed at its fair value and taxed only in the manner prescribed in sections 5725.01 to 5725.26, inclusive, of the Revised Code:

(A) The shares of the stockholders in an incorporated dealer in intangibles having an actual place of business in this state, to the extent represented by capital employed in this state;

(B) The shares of the stockholders, partners, or members of an unincorporated dealer in intangibles having an actual place of business in this state, the capital stock of which is divided into shares held by the owners, to the extent represented by capital employed in this state;

(C) The property representing capital employed in this state by an unincorporated dealer in intangibles whose capital stock is not divided into shares, having an actual place of business in this state.

ORC Ann. 5725.14 (2006)

§ 5725.14. Annual return of resources by dealer in intangibles; gross receipts; consolidated returns

(A) As used in this section and *section 5725.15 of the Revised Code*:

(1) "Billing address" of a customer means one of the following:

(a) The customer's address as set forth in any notice, statement, bill, or similar acknowledgment shall be presumed to be the address where the customer is located with respect to the transaction for which the dealer issued the notice, statement, bill, or acknowledgment.

(b) If the dealer issues any notice, statement, bill, or similar acknowledgment electronically to an address other than a street address or post office box address or if the dealer does not issue such a notice, statement, bill, or acknowledgment, the customer's street address as set forth in the records of the dealer at the time of the transaction shall be presumed to be the address where the customer is located.

(2) "Commissions" includes but is not limited to brokerage commissions, asset management fees, and similar fees charged in the regular course of business to a customer for the maintenance and management of the customer's account.

(3) "Gross receipts" means one of the following:

(a) In the case of a dealer in intangibles principally engaged in the business of lending money or discounting loans, the aggregate amount of loans effected or discounted;

(b) In the case of a dealer in intangibles principally engaged in the business of selling or buying stocks, bonds, or other similar securities either on the dealer's own account or as agent for another, the aggregate amount of all commissions charged.

(B) Each dealer in intangibles shall return to the tax commissioner between the first and second Mondays of March, annually, a report exhibiting in detail, and under appropriate heads, the dealer's resources and liabilities at the close of business on the thirty-first day of December next preceding. In the case of an unincorporated dealer in intangibles, such report shall also exhibit the amount or value as of the date of conversion of all property within the year preceding the date of listing, and on or after the first day of November converted into bonds or other securities not taxed to the extent such nontaxable bonds or securities may be shown in the dealer's resources on such date, without deduction for indebtedness created in the purchase of such nontaxable bonds or securities.

If a dealer in intangibles maintains separate business offices, whether within this state only or within and without this state, the report shall also show the gross receipts from business done at each such office during the year ending on the thirty-first day of December next preceding.

For the purposes of this section and *section 5725.15 of the Revised Code*, business is considered done at an office when it originates at such office, but the receipts from business originating at one office and consummated at another office shall be divided equitably between such offices.

(C) For the purposes of this section and *section 5725.15 of the Revised Code*, in the case of a dealer in intangibles principally engaged in the business of selling or buying stocks, bonds, or other similar securities either on the dealer's own account or as agent for another, the dealer's capital, surplus, and undivided profits employed in this state shall bear the same ratio to the dealer's total capital, surplus, and undivided profits employed everywhere as the amount described in division (C)(1) of this section bears to the amount described in division (C)(2) of this section:

(1) The sum of the commissions earned during the year covered by the report from transactions with respect to brokerage accounts owned by customers having billing addresses in this state;

(2) The sum of the commissions earned during that year from transactions with respect to brokerage accounts owned by all of the dealer's customers.

(D) An incorporated dealer in intangibles which owns or controls fifty-one per cent or more of the common stock of another incorporated dealer in intangibles may, under uniform regulations prescribed by the tax commissioner, make a consolidated return for the purpose of sections 5725.01 to 5725.26, inclusive, of the Revised Code. In such case the parent corporation making such return is not required to include in its resources any of the stocks, securities, or other obligations of its subsidiary dealers, nor permitted to include in its liabilities any of its own securities or other obligations belonging to its subsidiaries.

ORC Ann. 5725.15 (2006)

§ 5725.15. Tax commissioner to ascertain and assess all shares and capital of dealer in intangibles

Upon receiving the report required by *section 5725.14 of the Revised Code*, the tax commissioner shall ascertain and assess all the shares of such dealers in intangibles, the capital stock of which is divided into shares, representing capital employed in this state, and the value of the property representing the capital, not divided into shares, employed in this state by such dealer in intangibles, according to the aggregate fair value of the capital, surplus, and undivided profits as shown in such report, including in the case of an unincorporated dealer, the value of property converted into nontaxable bonds or securities within the preceding year, without deduction for indebtedness created in the purchase of such non-taxable bonds or securities.

If a dealer has separate offices, whether within this state only or within and without this state, the commissioner shall find the amount of capital employed in each office in this state, which shall bear the same ratio to the entire capital of such dealer, wherever employed, as the gross receipts of such office bears to the entire gross receipts of such dealer, wherever arising.

The aggregate book value of the capital, surplus, and undivided profits of a dealer in intangibles as shown in such report shall be taken as the fair value thereof for the purpose of the assessment required by this section, unless the commissioner finds that such book value is greater or less than the then fair value of said capital, surplus, and undivided profits. Claim for any deduction from book value of capital, surplus, and undivided profits must be made in writing by the dealer in intangibles at the time of making his return.

Whenever the commissioner assesses the fair value of the capital, surplus, and undivided profits of a dealer in intangibles at an amount in excess of the book value thereof as shown by its report, or disallows any claim for deduction from book value of such capital, surplus, and undivided profits, he shall give notice and proceed as provided in *section 5711.31 of the Revised Code.*

TITLE 57. TAXATION
CHAPTER 5725. FINANCIAL INSTITUTIONS; DEALERS IN INTANGIBLES; INSURANCE COMPANIES
DOMESTIC INSURANCE COMPANIES

ORC Ann. 5725.22 (2006)

§ 5725.22. Treasurer of state to maintain intangible property tax lists; collection and payment of taxes

The treasurer of state shall maintain an intangible property tax list of taxes levied by *section 5707.03 of the Revised Code* and certified by the tax commissioner pursuant to *sections 5711.13, 5725.08, 5725.16*, and *5727.15 of the Revised Code*, and a separate list of taxes levied by *section 5725.18 of the Revised Code* and certified by the superintendent of insurance pursuant to *section 5725.20 of the Revised Code*. Upon receipt of any assessment certified to him, the treasurer of state shall compute the taxes at the rates prescribed by law and enter the taxes on the proper tax list. He shall collect and the taxpayer shall pay all such taxes and any interest applicable thereto. Payments may be made by mail, in person, or by any other means authorized by the treasurer of state. The treasurer of state shall render a daily itemized statement to the tax commissioner of the amount of taxes collected and the name of the domestic insurance company or assessment certificate number of the person from whom collected. The treasurer of state may adopt rules concerning the methods and timeliness of payment.

Each tax bill issued pursuant to this section shall separately reflect the taxes due, interest, if any, due date, and any other information considered necessary. The last day on which payment may be made without penalty shall be at least twenty but not more than thirty days from the date of mailing the tax bill. The treasurer of state shall mail the tax bill, and the mailing thereof shall be prima-facie evidence of receipt thereof by the taxpayer.

The treasurer of state shall refund taxes as provided in this section, but no refund shall be made to a taxpayer having a delinquent claim certified pursuant to this section that remains unpaid. The treasurer of state may consult the attorney general regarding such claims. Refunds shall be paid from the tax refund fund created by *section 5703.052 [5703.05.2] of the Revised Code.*

(A) Within twenty days after receipt of any preliminary assessment certified to him, the treasurer of state shall issue a tax bill, but if such preliminary assessment reflects a late filed tax return, the treasurer of state shall add interest as provided in division (A) of *section 5725.221 [5725.22.1] of the Revised Code* and issue a tax bill.

(B) Within twenty days after receipt of any amended or final assessment certified to him, the treasurer of state shall ascertain the difference between the total taxes computed on such assessment and the total taxes computed on the most recent assessment certified for the same tax year. If the difference is a deficiency, the treasurer of state shall add interest as provided in division (B)(1) of *section 5725.221 [5725.22.1] of the Revised Code* and issue a tax bill. If the difference is an excess, the treasurer of state shall add interest as provided in division (B)(2) of *section 5725.221 [5725.22.1] of the Revised Code* and certify the name of the taxpayer and the amount to be refunded to the director of budget and management for payment to the taxpayer. If the taxpayer has a deficiency for one tax year and an excess for another tax year, or any combination thereof for more than two tax years, the treasurer of state may determine the net result after adding interest, if applicable, and, depending on such result, proceed to mail a tax bill or certify a refund.

(C) If a taxpayer fails to pay all taxes and interest, if any, on or before the due date shown on the tax bill but makes payment within ten calendar days of such date, the treasurer of state shall add a penalty equal to five per cent of the taxes due. If payment is not made within ten days of such date, the treasurer of state shall add a penalty equal to ten per cent of the taxes due. The treasurer of state shall prepare a delinquent claim for each tax bill on which penalties were added and certify such claims to the attorney general for collection. The attorney general shall transmit a copy of each claim to the tax commissioner or the superintendent of insurance and proceed to collect the delinquent taxes, penalties, and interest thereon in the manner prescribed by law.

ORC Ann. 5725.26 (2007)

§ 5725.26. Tax on real estate of financial institutions and dealers in intangibles

The real estate of a financial institution or dealer in intangibles shall be taxed in the place where it is located, the same as the real estate of persons is taxed, but the taxes provided for in Chapters 5725. and 5733. of the Revised Code, shall be in lieu of all other taxes on the other property and assets of such institution or dealer, except personal property taxable under Chapter 5711. of the Revised Code and leased, or held for the purpose of leasing, to others if the owner or lessor of the property acquired it for the sole purpose of leasing it to others.

For reports required to be filed under *section 5725.14 of the Revised Code* in 2003 and thereafter, nothing in this section shall be construed to exempt the property of any dealer in intangibles under *section 5725.13 of the Revised Code* from the tax imposed under *section 5707.03 of the Revised Code*.

TITLE 57. TAXATION
CHAPTER 5733. CORPORATION FRANCHISE TAX

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ORC Ann. 5733.01 (2007)

§ 5733.01. Tax charged against corporations, business trusts and certain limited liability companies

(A) The tax provided by this chapter for domestic corporations shall be the amount charged against each corporation organized for profit under the laws of this state and each nonprofit corporation organized pursuant to Chapter 1729. of the Revised Code, except as provided in *sections 5733.09* and *5733.10 of the Revised Code*, for the privilege of exercising its franchise during the calendar year in which that amount is payable, and the tax provided by this chapter for foreign corporations shall be the amount charged against each corporation organized for profit and each nonprofit corporation organized or operating in the same or similar manner as nonprofit corporations organized under Chapter 1729. of the Revised Code, under the laws of any state or country other than this state, except as provided in *sections 5733.09* and *5733.10 of the Revised Code*, for the privilege of doing business in this state, owning or using a part or all of its capital or property in this state, holding a certificate of compliance with the laws of this state authorizing it to do business in this state, or otherwise having nexus in or with this state under the Constitution of the United States, during the calendar year in which that amount is payable.

TITLE 57. TAXATION
CHAPTER 5733. CORPORATION FRANCHISE TAX

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ORC Ann. 5733.12 (2007)

§ 5733.12. Crediting of payments; filing of refund applications

(B) Except as otherwise provided under divisions (C) and (D) of this section, an application to refund to the corporation the amount of taxes imposed under *section 5733.06 of the Revised Code* that are overpaid, paid illegally or erroneously, or paid on any illegal, erroneous, or excessive assessment, with interest thereon as provided by *section 5733.26 of the Revised Code*, shall be filed with the tax commissioner, on the form prescribed by the commissioner, within three years from the date of the illegal, erroneous, or excessive payment of the tax, or within any additional period allowed by division (C)(2) of section 5733.031 [5733.03.1], division (D)(2) of section 5733.067 [5733.06.7], or division (A) of *section 5733.11 of the Revised Code*. For purposes of division (B) of this section, any payment that the applicant made before the due date or extended due date for filing the report to which the payment relates shall be deemed to have been made on the due date or extended due date.

On the filing of the refund application, the commissioner shall determine the amount of refund to which the applicant is entitled. If the amount is not less than that claimed the commissioner shall certify the amount to the director of budget and management and treasurer of state for payment from the tax refund fund created by *section 5703.052 [5703.05.2] of the Revised Code*. If the amount is less than that claimed, the commissioner shall proceed in accordance with *section 5703.70 of the Revised Code*.

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ORC Ann. 5751.01 (2007)

§ 5751.01. Definitions

As used in this chapter:

e taxpayer, required to register or pay tax under this chapter. "Taxpayer" does not include excluded persons.

(E) "Excluded person" means any of the following:

(4) A dealer in intangibles, as defined in *section 5725.01 of the Revised Code,* that paid the dealer in intangibles tax levied by division (D) of *section 5707.03 of the Revised Code* based on one or more measurement periods that include the entire tax period under this chapter;

Annual report of resources and liabilities of dealers in intangibles to department; "gross receipts" defined; receipts of business; consolidated return may be made, when.

Sec. 5414-4. Each dealer in intangibles shall return to the department of taxation between the first and second Mondays of March, annually, a report *** exhibiting in detail, and under appropriate heads, his resources and liabilities at the close of business on the thirty-first day of December, next preceding. In the case of an unincorporated dealer in intangibles, such report shall also exhibit the amount or value as of the date of conversion of all property within the year preceding the date of listing and on or after the first day of November converted into bonds or other securities not taxed to the extent such non-taxable bonds or securities may be shown in his resources on such date, without deduction for indebtedness created in the purchase of such non-taxable bonds or securities.

If a dealer in intangibles maintains separate business offices, whether within this state only or within and outside of this state said report shall also show the gross receipts from business done at each such office during the year ending on the thirty-first day of December next preceding.

The term "gross receipts" as used in this and the succeeding section shall, in the case of a dealer in intangibles, principally engaged in the business of lending money or discounting loans, mean the aggregate amount of loans effected or discounted; in the case of a dealer in intangibles, principally engaged in the business of selling or buying stocks, bonds and other similar securities either on his own account or as agent for another, said term as so used means the aggregate amount of all commissions charged plus one per centum of the aggregate amount of all other receipts.

Within the meaning of this and the succeeding section, business shall be considered to be done at an office when it originates at such office; but the receipts from business originating at one office and consummated at another office shall, for the purpose of such sections, be divided equitably between such offices.

An incorporated dealer in intangibles which owns or controls fifty-one per centum or more of the common stock of another incorporated dealer or dealers in intangibles may under uniform regulations to be prescribed by the tax commissioner make a consolidated return or returns for the purpose of this chapter. In such case the parent corporation making such return shall not be required to include in its resources any of the stocks, securities or other obligations of its subsidiary dealers, not permitted to include in its liabilities any of its own securities or other obligations belonging to its subsidiaries.

SEC. 5389. [Determination of true value of accounts receivable; "income yield" defined.] In the case of accounts receivable, the book value thereof less book reserves, if any, shall be listed and shall be taken as the true value thereof unless the assessor shall find that such net book value is greater or less than the then true value of such accounts receivable in money. In the case of personal property used in business, the book value thereof, if any, less book depreciation, at such time or times, shall be listed and such depreciated book value shall be taken to be the true value of such property, unless the assessor shall find that such depreciated book value is greater or less than the then true value of such property in money. Claim for any deduction from net book value of accounts receivable or depreciated book value of personal property must be made in writing by the taxpayer at the time of making return; and when such return is made to the county auditor and required by this chapter to be transmitted to the commissioner for assessment, the county auditor shall, as deputy of the commissioner, investigate such claim and shall enter thereon, or attach thereto, in such form as the commissioner may prescribe, his findings and recommendations with respect thereto; when such return is made to the commissioner such claim for deduction from depreciated book value of personal property shall be referred to the auditor of each county wherein the property affected thereby is listed as such deputy, for investigation and report.

"Income yield" as used in section 5388 of the General Code and elsewhere in this title means the aggregate amount paid as income by the obligor, trustee or other source of payment to the owner or owners, or holder or holders of an investment, whether including the taxpayer or not, during such year, and includes the following:

In the case of an obligation bearing interest, the amount of interest separately charged and paid during such year, if any, exclusive of payments on the principal; in the case of shares of stock, the dividends so paid or distributed, other than distributions in liquidation, whether such payment or distribution is in cash, notes, debentures, bonds, other property or shares of stock, excepting stock of like kind and character of the corporation declaring the dividend; in the case of annuities or other obligations for periodical installment payments including both principal and interest, not separately charged and paid, four per centum of half the principal used to purchase the same, or, if there be no such principal, or the annuity or obligation was purchased and payments made thereunder prior to January 1, 1933, four per centum of half of the present worth of such annuity or periodical installment payments if commuted, which shall be calculated, as of the date on which such investment is required by this chapter to be first listed, with interest at four per centum per annum and, in the case of annuities for life or lives, according to the combined annuity four per cent table; in the case of equitable interest in lands, divided into shares evidenced by transferable certificates, the cash distributions of income so made; in the case of an equitable interest in a fund made up in whole or in part of investments, the entire distribution of income by the trustee to the owner of the equitable interest to the extent represented by the net income received by the trustee from investments, deposits not taxed at the source, current accounts receivable and other taxable intangibles as defined in this title; in the case of royalties under patents and copyrights, five per centum of half of the value of such patents or copyrights, which value shall be calculated by the use of Hoskold's formula, applied to the gross royalties paid during such year, with sinking fund at four per centum per annum and interest at eight per centum per annum, and assuming for the purpose of every such calculation a remaining life of seventeen years as to patents and of twenty-eight years as to copyrights. At the request of the commissioner or of any county auditor, the superintendent of insurance shall, upon being furnished with a statement of the facts, compute, upon a basis equivalent to that herein prescribed, the income yield of any investment to which the interest is not charged and paid separately from the principal thereof, and the assessor shall be governed by the computation so made.

HISTORY.—R.S. § 2739a; 83 v. 80; 114 v. 714 (721); 115 v. 565, § 1; 116 v. Pt. II 253; 118 v. 657; 119 v. 34 (38), § 1. Eff. 7-4-41.

See G.C. § 5389-1 which refers to this section.

CERTIFICATE OF SERVICE

The undersigned hereby certifies that a true copy of the Brief of Appellee was sent by regular U.S. mail to Thomas J. Kenny, Varnum, Riddering, Schmidt & Howlett, L.L.P. 39500 High Pointe Blvd. Suite 350, Novi, Michigan 48375 and Edward J. Bernert Baker & Hostetler LLP, 65 East State Street, Suite 2100, Columbus, Ohio 43215, Attorneys for Appellant, on this 28th day of December, 2007.

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Assistant Attorney General