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Notes – Topic 10

Statement of Cash Flows

I. Format
   a. Cash provided by (used in) operating / investing / financing
   b. Net Increase (decrease) in cash
   c. Cash at beginning and end of period.

II. Balance Sheet
   a. Everything must reconcile to change in cash.
   b. Accounts Receivable, Inventory, etc. Non-Cash Operating Assets & Liabilities

III. Generating
   a. Compute change in cash (comparative balance sheet)
   b. Derive cash flows from operating activities
      i. Direct Method
         1. Prefered by FASB
         2. Find cash collections and distributions
         3. Most of operating revenue is from sales, meaning collections from Accounts Receivable.
         4. Primary outflow is payments to Accounts Payable.
         5. Collections from Customers
            a. Sales + Beginning A/R = Potential Collections
            b. Potential Collections – Ending A/R = Collections
            c. OR: Sales – Increase in A/R = Collections
         6. Payment to Suppliers
            a. Assuming all Trade A/P transactions are related to inventory.
            b. Ending Inventory + COGS = Inventory to Account For
            c. That – Beginning Inventory = Purchases
            d. Beginning A/P + Purchases – Ending A/P = Cash Paid
         7. Payments to Employees
            a. Beginning Wages Payable + Wage Expense = Payables
            b. Payables – Ending Wages Payable = Paid
            c. OR: Wage Expense – Increase in Wages Payable = Paid
         8. In General
            a. Income Statement Amount + Decrease in Asset = Paid
            b. Income Statement Amount + Increase in Liability = Paid
            c. If no "Payable" or "Receivable" account is involved, the income statement amount applies directly.
         9.
      ii. Indirect Method
         1. Most commonly used
         2. Take net income from income statement (accrual basis) and make adjustments to it.
         3. Add changes not requiring cash (Depreciation, Non-Operating losses, etc)
         4. Deduct credits to income (revenue) not requiring cash (Non-operating gains, Amortization of bond premium, etc)
         5. Adjust for changes in current assets and liabilities
            a. Positive changes in non-cash current assets decrease cash.
            b. Positive Changes in non-cash current liabilities increase cash.
            c. Increase in A/P, for example, needs to be added back. It affected net income (lowered it) but it didn't affect cash.
   c. Identify cash flow effects from investing (Long-Term Assets)
      i. Increases in Liabilities and Stockholders Equity increase cash inflows.

    ii. Decreases in Assets (non-cash) increase cash inflows.
    iii. Increase in net Property Plant and Equipment = Acquisitions – Disposals – Depreciation. The ”Disposals” value matters for cash flows.

d. Identify cash flow effects from financing (Debt and Equity)
    i. Same increases and decreases as investing.
    ii. Increase in Stockholders Equity = New Issuance + Income – Dividends. Want to know the “New Issuance” amount.
e. Classify flows by activity type
f. Disclose significant non-cash activity for investing and financing (dividends, for example)