

Financial Accounting

Module 14: Statement of Cash Flows



Module Learning Outcomes

Prepare a Statement of Cash Flows

- 14.1: Define cash flows and the purpose of the Statement of Cash Flows
- 14.2: Understand how a statement of Cash Flows is prepared using the indirect method
- 14.3: Prepare a Statement of Cash Flow

Statement of Cash Flows

Learning Outcomes: Statement of Cash Flows

14.1: Define cash flows and the purpose of the Statement of Cash Flows

14.1.1: Explain the purpose of the Statement of Cash Flows

14.1.2: List and describe the elements of the Statement of Cash Flows





14.1.3: Distinguish between the Direct and Indirect methods of preparing a Statement of Cash Flows

14.1.4: Calculate cash flows from operating activities by the direct method

Explain the Purpose of the Statement of Cash Flows

Operating Section

- Uses Income Statement for net income and noncash expenses like depreciation and amortization.
- Uses CURRENT ASSET and CURRENT LIABILITY section of Balance Sheet.
- Tells investors how much cash the business can generate from day-to-day business operations



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Explain the Purpose of the Statement of Cash Flows

Statement of Cash Flows provides cash receipt and cash payment information and reconciles the change in cash for a period of time.

Cash receipts and cash payments are summarized and categorized as operating, investing, or financing activities. It indicates where cash came from and where cash went for a period of time.

Provides useful information to management, investors, creditors, and other interested parties and information about the effects on cash of the operating, investing, and financing activities of a company during an accounting period.



List and Describe the elements of the Statement of Cash Flow

Statement of cash flows classifies cash receipts and disbursements as operating, investing, and financing cash flows. Both inflows and outflows are included within each category.

1. **Operating activities** generally include the cash effects (inflows and outflows) of transactions and other events that enter into the determination of net income.

Cash inflows from operating activities affect items that appear on the income statement and include:

- a. cash receipts from sales of goods or services;
- b. interest received from making loans;
- c. dividends received from investments in equity securities;
- d. cash received from the sale of trading securities; and
- e. other cash receipts that do not arise from transactions defined as investing or financing activities, such as amounts received to settle lawsuits, proceeds of certain insurance settlements, and cash refunds from suppliers.

List and Describe the elements of the Statement of Cash Flow (cont'd)

2. Investing activities include transactions involving the acquisition or disposal of noncurrent assets.

Cash inflows from investing activities include cash received from: (1) the sale of property, plant, and equipment; (2) the sale of available-for-sale and held-to-maturity securities; and (3) the collection of long-term loans made to others.

Cash outflows for investing activities include cash paid: (1) to purchase property, plant, and equipment; (2) to purchase available-for-sale and held-to-maturity securities; and (3) to make long-term loans to others.



List and Describe the elements of the Statement of Cash Flow (cont'd)

3. Financing activities generally include the cash effects (inflows and outflows) of transactions and other events involving creditors and owners.

Cash inflows from financing activities include cash received from issuing capital stock and bonds, mortgages, and notes, and from other short- or long-term borrowing.

Cash outflows for financing activities include payments of cash dividends or other distributions to owners (including cash paid to purchase treasury stock) and repayments of amounts borrowed. Payment of interest is not included because interest expense appears on the income statement and is, therefore, included in operating activities. Cash payments to settle accounts payable, wages payable, and income taxes payable are not financing activities. These payments are included in the operating activities section.

Distinguish Between the Direct and Indirect Methods of Preparing a Statement of Cash Flows

Cash flows from operating activities show the net amount of cash received or disbursed during a given period for items that normally appear on the income statement. You can calculate these cash flows using either the direct or indirect method. The direct method deducts from cash sales only those operating expenses that consumed cash. This method converts each item on the income statement directly to a cash basis. Alternatively, the indirect method starts with accrual basis net income and indirectly adjusts net income for items that affected reported net income but did not involve cash.

The direct method converts each item on the income statement to a cash basis.

Beginning balance	\$ 1,750
Accrual basis sales	<u>45,785</u>
Balance before payments	47,535
Less: Ending balance	1,735
Cash payments from customers	<u>\$ 45,800</u>

Calculate Cash Flows from Operating Activities Using the Direct Method

The direct method of presenting the statement of cash flows presents the specific cash flows associated with items that affect cash flow. Items that typically do so include:

- Cash collected from customers
- Interest and dividends received
- Cash paid to employees
- Cash paid to suppliers
- Interest paid
- Income taxes paid



Practice Question 1

In a company's Statement of Cash Flows, which of these activities generate positive cash flow from a financing activity?

- A. A \$100,000 increase in value of a parcel of land.
- B. A company acquiring additional treasury stock.
- C. A company issuing 10,000 shares of additional stock.
- D. A company paying the shareholders dividends.

Indirect Method of Preparing a Statement of Cash Flows

Learning Outcomes: Indirect Method of Preparing a Statement of Cash Flows

14.2: Understand how a statement of Cash Flows is prepared using the indirect method

14.2.1: Identify Cash Flows using the indirect method

14.2.2: Calculate cash flows from investing activities

14.2.3: Calculate cash flows from financing activities

Identify Cash Flows Using the Indirect Method

The direct method deducts from cash sales only those operating expenses that consumed cash. This method converts each item on the income statement directly to a cash basis. Alternatively, the indirect method starts with accrual basis net income and indirectly adjusts net income for items that affected reported net income but did not involve cash.

Cash flows from investing and financing are prepared the same way under the direct and indirect methods for the statement of cash flows.

Cash Flows from Operating Activities: Net Income

+ Depreciation Expense (from income statement)

+ Losses (from income statement)

– Gains (from income statement)

+ Amortization, depletion (from income statement)

+ DECREASE in Current Assets (other than cash)

– INCREASE in Current Assets (other than cash)

+ Increase in Current Liabilities

– Decrease in Current Liabilities

Net cash provided by Operating Activities

Identify Cash Flows Using the Indirect Method

Net income for the year was \$500,000 ✓
Accounts Receivable decreased by \$200,000 ✓
Accounts Payable decreased by \$75,000
Prepaid Insurance increased by \$10,000
Depreciation for the year was \$47,000 ✓

Cordova Tubing, Inc.
Statement of Cash Flows
For year ended December 31, 20X0

Net Income		500,000
+ Depreciation	47,000	
↓ A/R	200,000	
↑ Prepaid Ins.	(10,000)	

Calculate Cash Flows from Investing Activities

Investing activities would include any changes to long-term assets including fixed assets (also called property, plant, and equipment), long-term investments in notes receivable, or stocks or bonds of other companies, and intangible assets (patents, trademarks, etc.). Where would we find this information? We would look on the balance sheet. If there was a change in any long-term asset (increase or decrease during the year), we need to account for that item in the Investing section.

Cash flows from Investing activities:

+ cash received from sale of long-term assets

– cash paid for purchase of new long-term assets

Net cash provided (used) by Investing Activities

Month	month 1	month 2	month 3	month 4	month 5	month 6	month 7	month 8	month 9	month 10	month 11	month 12
Cash position at the start	40'000	35'700	31'900	26'100	22'100	78'300	13'500	15'200	17'900	11'600	57'600	78'800
Operational cash flow												
incoming payments from buyer A										300'000	150'000	
incoming payments from buyer B												20'000
other income												500
total in	0	0	0	0	0	0	0	0	0	300'000	150'000	20'500
Purchase of raw material						60'000	160'000	80'000				
Bulking and transport						1'000	3'000	1'000				
Cleaning, processing, packaging							20'000	10'000	2'500			
Office cost	800	300	300	500	300	300	800	300	300	500	300	300
Personnel cost	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	3'500	6'500
Certification cost								7'500				
External services			2'000				1'000					2'000
total out	4'300	3'800	5'800	4'000	3'800	64'800	188'300	102'300	6'300	4'000	3'800	8'800
CP before external finance	35'700	31'900	26'100	22'100	18'300	13'500	-174'800	-87'100	11'600	307'600	203'800	90'500
Financial cash flow												
loans from bank					60'000		190'000	105'000				
total in	0	0	0	0	60'000	0	190'000	105'000	0	0	0	0
repayment of loans and interest										250'000	125'000	
total out	0	0	0	0	0	0	0	0	0	250'000	125'000	0
Total cash flow												
total monthly cash flow	-4'300	-3'800	-5'800	-4'000	56'200	-64'800	1'700	2'700	-6'300	46'000	21'200	11'700
Cash position at the end	35'700	31'900	26'100	22'100	78'300	13'500	15'200	17'900	11'600	57'600	78'800	90'500

Calculate Cash Flows from Financing Activities

Financing activities would include any changes to long-term liabilities (and short-term notes payable from the bank) and equity accounts (common stock, paid in capital accounts, treasury stock, etc.). We would get most of the information from the balance sheet, but it may be necessary to use the Statement of Retained Earnings as well for any information on dividends. As with investing, if there has been a change in a long-term liability or equity (increase or decrease during the year), we must account for the item in the Financing section of the statement of cash flows.

Cash flows from Financing activities:

+ cash received from long-term liabilities

– cash paid on long-term liabilities

+ cash received from issuing stock

– cash paid for dividends

– cash paid to purchase treasury stock

Net cash provided (used) by Financing Activities

Preparing a Statement of Cash Flows

Learning Outcomes: Preparing a Statement of Cash Flows

14.3: Prepare a Statement of Cash Flow

14.3.1: Prepare a Statement of Cash Flows in Proper Form (both direct and indirect)

14.3.2: Demonstrate the use of a worksheet to create the Statement of Cash Flows

14.3.3: Explain required disclosures, including non-cash activities

Prepare a Statement of Cash Flows In Proper Form (both from Direct and Indirect Method)

Accountants follow specific procedures when preparing a statement of cash flows.

1. After determining the change in cash, the first step is to calculate the cash flows from operating activities, using either the direct or indirect method.
2. The second step is to analyze all of the noncurrent accounts and additional data for changes resulting from investing and financing activities.
3. The third step is to arrange the information gathered in steps 1 and 2 into the proper format for the statement of cash flows.



Prepare a Statement of Cash Flows In Proper Form (both from Direct and Indirect Method)

Rumble Corp.Statement of Cash Flowsfor the year ended 12/31/x1

	In millions	
Cash flows from operating activities		
Net income		\$ 2,610
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation and amortization	125	
Decrease in Accounts Receivable	15	
Gain on sale of equipment	(90)	
Increase in Accounts Payable	32	
Increase in income taxes payable	80	
Increase in other liabilities	18	
Total adjustments		180
Net cash from operating activities		\$2,790
Cash flows from investing activities		
Purchase of property, plant, and equipment	(580)	
Proceeds from sale of equipment	150	
Net cash used in investing activities		(430)
Proceeds from issuance of common stock	1,000	
Proceeds from issuance of long-term debt	500	
Dividends paid	(460)	
Net cash used in financing activities		1,040
Net increase in cash and cash equivalents		3,400
Cash and cash equivalents at beginning of period		1,640
Cash and cash equivalents at end of period		\$5,040
Supplemental information:		
Cash paid for interest		\$ 310
Cash paid for income taxes		\$ 1,700

Prepare a Statement of Cash Flows In Proper Form (both from Direct and Indirect Method)

Step Two:

Cash flows from investing activities		
Purchase of property, plant, and equipment	(580)	
Proceeds from sale of equipment	150	
Net cash used in investing activities		(430)

Prepare a Statement of Cash Flows In Proper Form (both from Direct and Indirect Method)

Step 3:

Cash flows from financing activities		
Proceeds from issuance of common stock	1,000	
Proceeds from issuance of long-term debt	500	
Dividends paid	(460)	
Net cash used in financing activities		1,040
Net increase in cash and cash equivalents		3,400
Cash and cash equivalents at beginning of period		1,640
Cash and cash equivalents at end of period		\$5,040
Supplemental information:		
Cash paid for interest		\$ 310
Cash paid for income taxes		\$ 1,700

Demonstrate the Use of a Worksheet to Create the Statement of Cash Flows

In order to ensure accuracy and make the process as efficient as possible, accountants have developed a worksheet process to create the statement of cash flows. We'll demonstrate that process here using the indirect method because that is its most common use and the indirect method is the most common presentation.

Panel B – Statement of Cash Flows

Cash Flows from Operating Activities:

Net Income

Adjustments to Reconcile Net Income to Net Cash Provided by Operating Activities

Depreciation Expense – Plant Assets

Decrease in accounts receivable

Gain on sale of equipment

Increase in Accounts Payable

Increase in Wages Payable

Increase in Income Taxes Payable

Net Cash Provided by Operating Activities

Cash Flows from Investing Activities:

Cash Paid for Acquisition of Plant Assets

Proceeds from sale of equipment

Net Cash Used for Investing Activities

Cash Flows from Financing Activities:

Cash Receipt from Issuance of Common Stock

Proceeds from issuance of long-term debt

Cash Payment of Dividends

Net Cash Provided by Financing Activities

Net Increase (Decrease) in Cash:

Total

Demonstrate the Use of a Worksheet to Create the Statement of Cash Flows

Operating Activities

Fiscal year is January-December. All values USD millions.	2015	2016	2017	2018	2019	
Net Income before Extraordinaries	752.21M	692.16M	521.76M	531.45M	423.64M	
Depreciation, Depletion & Amortization	198.07M	209.56M	222.19M	264.86M	232.54M	
Depreciation and Depletion	195.27M	202.56M	217.99M	264.46M	231.64M	
Amortization of Intangible Assets	2.8M	7M	4.2M	400,000	900,000	
Deferred Taxes & Investment Tax Credit	(16.48M)	(165,000)	50.86M	(33.98M)	21.55M	
Deferred Taxes	(16.48M)	(165,000)	50.86M	(33.98M)	21.55M	
Investment Tax Credit	-	-	-	-	-	
Other Funds	174.68M	228.06M	266.25M	239.04M	248.98M	
Funds from Operations	1.11B	1.13B	1.06B	1B	926.7M	
Extraordinaries	-	-	-	-	-	
Changes in Working Capital	(8.35M)	44.73M	(55.99M)	204.54M	(58.43M)	
Receivables	(13.67M)	(45.93M)	(18.15M)	9.92M	44.9M	
Accounts Payable	138.82M	38.24M	10.13M	196.19M	(18.46M)	
Other Assets/Liabilities	21.71M	(32.65M)	(27.38M)	29.5M	(26.17M)	
Net Operating Cash Flow	1.1B	1.17B	1.01B	1.21B	868.27M	

Demonstrate the Use of a Worksheet to Create the Statement of Cash Flows

Investing Activities

	2015	2016	2017	2018	2019	5-year trend
Capital Expenditures	(259.97M)	(256.26M)	(206.29M)	(213.52M)	(181.44M)	
Capital Expenditures (Fixed Assets)	(259.97M)	(256.26M)	(206.29M)	(213.52M)	(181.44M)	
Capital Expenditures (Other Assets)	-	-	-	-	-	
Net Assets from Acquisitions	(59.91M)	-	-	-	(7M)	
Sale of Fixed Assets & Businesses	-	-	-	-	-	
Purchase/Sale of Investments	11.51M	40.01M	6.92M	(10.01M)	10.01M	
Purchase of Investments	-	-	-	(10.01M)	-	
Sale/Maturity of Investments	11.51M	40.01M	6.92M	-	10.01M	
Other Uses	(3.75B)	(3.66B)	(3.59B)	(3.76B)	(3.85B)	
Other Sources	3.14B	3.49B	3.23B	3.33B	3.52B	
Net Investing Cash Flow	(915.85M)	(392.73M)	(562.47M)	(662.27M)	(508.13M)	

Demonstrate the Use of a Worksheet to Create the Statement of Cash Flows

Financing Activities

	2015	2016	2017	2018	2019	5-year trend
Cash Dividends Paid - Total	(249.26M)	(252.32M)	(251.86M)	(245.81M)	(237.22M)	
Common Dividends	(249.26M)	(252.32M)	(251.86M)	(245.81M)	(237.22M)	
Preferred Dividends	-	-	-	-	-	
Change in Capital Stock	(1.52B)	(449.56M)	(453.91M)	(387.08M)	(292.93M)	
Repurchase of Common & Preferred Stk.	(1.54B)	(465.34M)	(465.26M)	(390.61M)	(296.52M)	
Sale of Common & Preferred Stock	20.18M	15.78M	11.35M	3.53M	3.59M	
Proceeds from Stock Options	-	-	-	-	-	
Other Proceeds from Sale of Stock	20.18M	15.78M	11.35M	3.53M	3.59M	
Issuance/Reduction of Debt, Net	1.4B	(78.26M)	155.51M	618.13M	(182.07M)	
Change in Current Debt	469.47M	(145.81M)	212.81M	(135.36M)	(563.45M)	
Change in Long-Term Debt	927.69M	67.56M	(57.3M)	753.48M	381.38M	
Issuance of Long-Term Debt	2.62B	1.26B	1.36B	2.1B	2.4B	
Reduction in Long-Term Debt	(1.69B)	(1.19B)	(1.42B)	(1.35B)	(2.02B)	
Other Funds	14.88M	45.75M	8.46M	-	-	
Other Uses	-	-	-	-	-	
Other Sources	14.88M	45.75M	8.46M	-	-	
Net Financing Cash Flow	(251.82M)	(721.82M)	(511.81M)	(11.72M)	(512.82M)	

Practice Question 2

Chadwick is asked by his fellow classmate to give an example of an investing or financing activity that takes place without generating or consuming cash, otherwise known as a noncash expense. Which of the following is an example of a noncash expense?

- A. Sale of common stock
- B. Depreciation
- C. Sale of a building
- D. Payment of taxes

Quick Review

- What is the purpose of the Statement of Cash Flows?
- What are each of the elements of the Statement of Cash Flows?
- What is the difference between the Direct and Indirect methods of preparing a Statement of Cash Flows?
- How are cash flows from operating activities by the direct method calculated?
- How are cash Flows identified using the indirect method?
- How are cash flows from investing activities calculated?
- How are cash flows from financing activities calculated?
- How is a Statement of Cash Flows in Proper Form (both direct and indirect) prepared?
- How is a worksheet used to create the Statement of Cash Flows?
- What are the required disclosures, including non-cash activities?