

# The Statement of Cash Flows

Chapter 13

## Learning Objective 1

Identify the purposes of the Statement of Cash Flows

### Statement of Cash Flows

- ▶ Shows where cash came from and how it was spent
- ▶ Reports why cash increased or decreased during the period
- ▶ Communicating link between the Income Statement and cash reported on the Balance Sheet

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### Use of Cash-Flow Information

Predict future cash flows

Evaluate management decisions

Predict ability to pay debts and dividends

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### Cash Equivalents

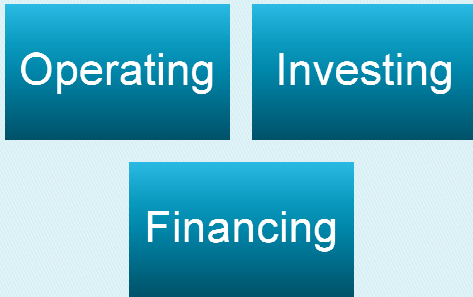
- ▶ Highly liquid investments
- ▶ Can convert into cash quickly

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## Learning Objective 2

Distinguish among operating, investing, and financing cash flows

## Basic Cash Flow Activities



## Operating Activities

- ▶ Most important category
- ▶ Create revenues, expenses, gains and losses
- ▶ Transactions that make up net income
- ▶ Also affect current assets and current liabilities on the Balance Sheet

## Investing Activities

- ▶ Transactions that increase and decrease long-term assets
- ▶ Includes loans receivable

## Financing Activities

- ▶ Increases and decreases in long-term liabilities and owner's equity

## Operating, Investing & Financing Activities and the Balance Sheet

Current assets	Current liabilities
Long-term assets	Long-term liabilities
	Owners' equity

## Exercise 13-13

(a) O	+	(i) I	+
(b) NIF		(j) F	+
(c) F	-	(k) O	+
(d) NIF		(l) F	-
(e) N		(m) F	+
(f) O	+	(n) O	+
(g) O	-	(o) O	+
(h) O	-	(p) F	-

## Format for Operating Activities

- ▶ Indirect method
- ▶ Direct method

## Learning Objective 3

Prepare the Statement of Cash Flows by the indirect method

## Cash Flow Steps

- ▶ Need Income Statement and beginning and ending Balance Sheets
- ▶ Step 1: Lay out statement format
- ▶ Step 2: Compute the change in cash from the Balance Sheets
- ▶ Step 3: Take the following figures from the Income Statement—
  - Net Income, depreciation, any gains or losses
- ▶ Step 4: Complete the Statement

## Cash Flows from Operating Activities: Indirect Method

- ▶ Begins with net income—an accrual based number
- ▶ Adjustments are made to convert to a cash amount

## Changes in Current Assets (other than cash) and Current Liabilities

- ▶ Current Asset ↑
- ▶ Current Liability ↑
- ▶ Cash ↓
- ▶ Cash ↑
  
- ▶ Current Asset ↓
- ▶ Current Liability ↓
- ▶ Cash ↑
- ▶ Cash ↓

### Statement of Cash Flows (partial)

Statement of Cash Flows (partial)	
<b>Cash flows from operating activities</b>	
Net Income	
Adjustments to reconcile net income to net cash provided by operating activities	
+ Depreciation expense	
+ Loss on sale of long-term assets	
- Gain on sale of long-term assets	
- Increases in current assets other than cash	
+ Decreases in current assets other than cash	
+ Increases in current liabilities	
- Decreases in current liabilities	
<b>Net cash provided by operating activities</b>	



## Exercise 13-15

Cash flows from operating activities		
Net Income		\$42,000
Adjustments to reconcile net income to net cash provided by operating activities:		
+ Depreciation expense	11,000	
+ Loss on sale of land	7,000	
- Increases in current assets other than cash	(8,000)	
- Decreases in current liabilities	(20,000)	(10,000)
<b>Net cash provided by operating activities</b>		<b>\$ ?</b>

## Cash Flows from Investing Activities

- ▶ Sales and acquisitions of long-term assets
- ▶ Analyze accounts to determine activity
- ▶ If gain or loss appears on the Income Statement, a long-term asset has been sold

## Plant Assets, Net

Beginning balance	Depreciation	From Income Statement
Acquisitions	Sales	
Ending balance		

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Cash		??????	
	Gain on sale of plant asset			\$\$\$\$
	Plant assets			\$\$\$\$

## Computing Cash Flows from Investing Activities

### Cash Receipts:

#### From sales of plant assets:

Beginning plant asset, net	+	Acquisition	-	Depreciation expense	-	Book value of asset sold	=	Ending plant assets, net
Cash receipt	=	Book value of asset sold	+	Gain on sale	or			
					-	Loss on sale		

### Cash Payments:

#### For acquisitions of plant assets:

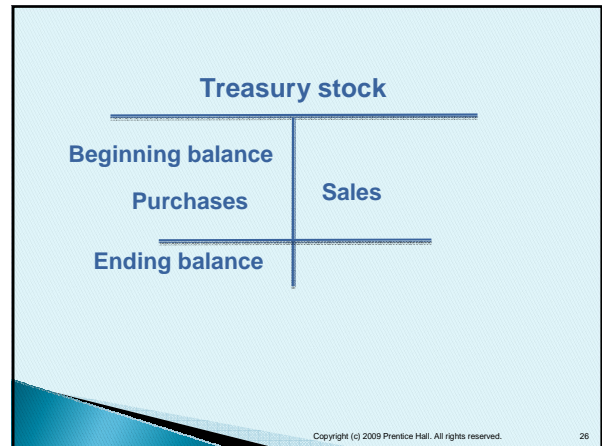
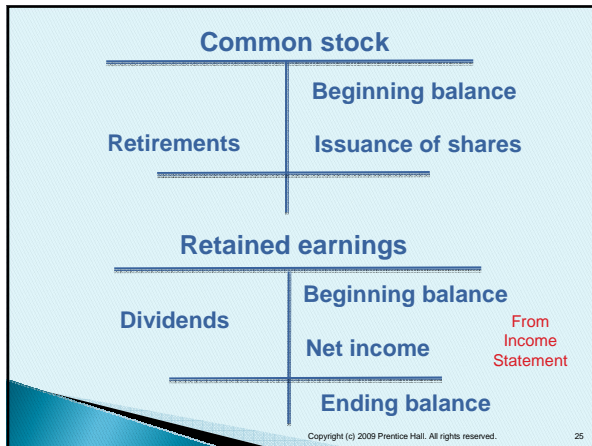
Beginning plant asset, net	+	Acquisition	-	Depreciation expense	-	Book value of asset sold	=	Ending plant assets, net
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## Cash Flows from Financing Activities

- ▶ Issuance of and payments on long-term notes payable
- ▶ Issuances of stock and purchases of treasury stock
- ▶ Analyze accounts to determine activity

## Long-term notes payable

	Beginning balance
Payments	New notes issued
	Ending balance



**Computing Cash Flows from Financing Activities**

**Cash Receipts:**

**From issuance of notes payable:**

Beginning notes payable	+	Cash receipt from issuance of note payable	-	Payment of note payable	=	Ending notes payable
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**From issuance of stock:**

Beginning stock	+	Cash receipt from issuance of stock	=	Ending stock
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**Computing Cash Flows from Financing Activities**

**Cash Payments:**

**Of notes payable:**

Beginning notes payable	+	Cash receipt from issuance of note payable	-	Payment of note payable	=	Ending notes payable
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**To purchase treasury stock:**

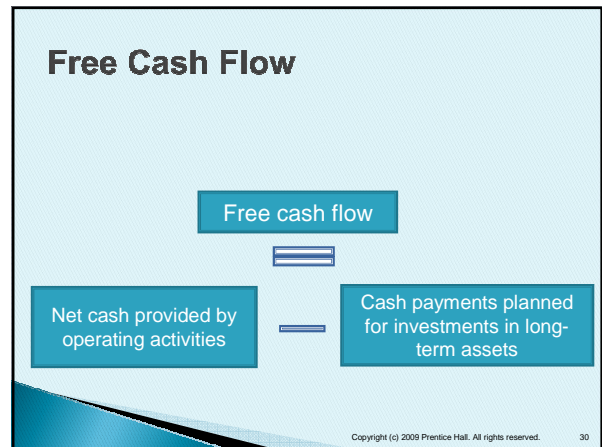
Beginning treasury stock	+	Cost of treasury stock purchases	=	Ending treasury stock
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**Of Dividends**

Beginning Retained earnings	+	Net Income	-	Dividends	=	Ending Retained earnings
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- ## Noncash Investing and Financing
- ▶ Investing and financing activities that do not affect cash
  - ▶ Report in separate schedule or in a note
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## Learning Objective 4

Prepare the Statement of Cash Flows by the direct method

## The Direct Method

- ▶ Preferred by FASB
- ▶ Provides clearer information about cash receipts and payments
- ▶ Normally not used by private companies
- ▶ Only operating activities presentation changes

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### Statement of Cash Flows (partial)

#### Cash flows from operating activities

##### Receipts:

Collections from customers

Interest received

Dividends received on investments

Total cash receipts

##### Payments:

To suppliers

To employees

For interest and income taxes

Total cash payments

**Net cash provided by operating activities**

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## Converting Income Statement Amounts to Cash Flows

#### Cash receipts:

Collection from customers	=	Sales	+	Decrease in accounts receivable
			or	
			-	Increase in accounts receivable

#### Cash payments:

To suppliers	=	Cost of goods sold	+	Increase in inventory	A	+	Decrease in accounts payable
			or		N	or	
			-	Decrease in inventory	D	-	Increase in accounts payable

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## Converting Income Statement Amounts to Cash Flows (continued)

#### Cash payments:

For other operating expenses	=	Operating expenses	+	Increase in prepaid expenses	A	+	Decrease in accrued liabilities
			or		N	or	
			-	Decrease in prepaid expenses	D	-	Increase in accrued liabilities
For interest	=	Interest expense	+	Decrease in interest payable			
			or				
			-	Increase in interest payable			
For income taxes	=	Income tax expense	+	Decrease in income tax payable			
			or				
			-	Increase in income tax payable			

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# End of Chapter 13