

6 STATEMENT OF CASH FLOWS

1. **Statement of Cash Flows** shows the changes in cash for the same period of time as that covered by the income statement. Shows all sources (receipts) of cash and all of the uses (payments of cash)

a. Cash inflows and outflows are either

i. **Operating Activities:** Includes cash inflows and outflows related to the normal course of business operations—the cash effect of all items on the income statement

1. INFLOWS

a. Sales of goods/services

b. Return on loans (interest received) and on equity securities (dividends received)

2. OUTFLOWS

a. To suppliers for inventory

b. Employees for services

c. Government for taxes

d. Lenders for interest

e. Others for expenses

ii. **Investing Activities:** Include cash inflows and outflows related to the purchase and sales of long-term assets (Including PPE intangibles) & investments

1. INFLOWS

a. Sale of property, plant, and equipment

b. Sale of investments in other entities

c. From collection of *principal* loans to other entities

i. Considered operating activity because it would effect the net income

2. OUTFLOWS

a. To purchase property, plant, and equipment

b. To purchase investments in other entities

c. Making loans to other entities

iii. **Financing Activities:** Represents cash that is either paid to or received from owners and creditors

1. INFLOWS

a. From sale of company's stock to its stockholders

b. From borrowing money (Bank loan)

2. OUTFLOWS

a. To stockholders as dividends

b. To creditors as the repayment of *principal* funds borrowed (NOTE! The interest payment would be considered operating activity because it would effect net income

iv.

b. Helps to assess

i. Ability to generate future cash flows

- ii. Ability to pay dividends and meet obligations
 - iii. Why net income is different from operating cash flows
 - iv. Cash investing and financing transactions
- 2. Operating Activities Section
 - a. Main Purpose: Convert net income from an accrual basis to a cash basis
 - i. Net cash provided (used) by operating activities represents what the net income of the company would have been if they used a cash accounting basis and not accrual accounting
 - ii. This conversion can be done in two methods
 - 1. Direct Method (FASB preferred)
 - 2. Indirect Method
 - b. Non-Cash revenues and expenses
 - i. Depreciation Expense
 - ii. Losses
 - iii. Gains
- 3. Indirect Method
 - a. Exceptions
 - i. Cash
 - ii. Investments = investing activity (loans made by the company)
 - iii. Notes Payable – financing activity (amounts borrowed from creditors)
- 4. **INVESTING ACTIVITIES CALCULATIONS**
 - a. PPE always in cash unless specified otherwise
- 5. **FINANCING ACTIVITIES CALCULATIONS**
 - a. Find dividends by the Retained earnings equation
 - i. $\text{Beg RE} + \text{Net Income} - \text{Dividends} = \text{End RE}$
- 6. Significant Noncash Activities
 - a. Insurance of common stock to purchase assets
 - b. Conversion of bonds into common stock
 - c. Issuance of debt to purchase assets
 - d. Exchanges on long-lived assets
- 7. **Cash Flow Analysis**
 - a. Positive cash flow provided by operating activities
 - b. Negative cash flow from investing activities
 - i. Positive – selling off its long-term assets
 - c. Financing cash flow can be either positive or negative
- 8. Liquidity – Ability of a business to pay its debts as they come due
 - a. Measure using current ratio—a ratio that partially corrects this problem with the current ratio is the current cash debt coverage ratio
 - i. $\frac{\text{Net cash flow provided by operating activities}}{\text{average current liabilities}}$
 - b. Average current liabilities are equal to
 - i. $\frac{\text{Current liabilities at Jan 1} + \text{Current liabilities at Dec 31}}{2}$