

Week 4 - DQ 3

What are the differences between the direct and indirect method of presenting a statement of cash flows?

Response #1 Both direct method and indirect method report in the same manner when it comes to cash flows from investing activities and cash flows from financing activities. The two methods differ on the cash flows from operating activities. The direct method reports the sources of the operating cash and its uses. Reporting the sources and uses of cash in the statement of cash flow is the advantage of this method. Though, its disadvantage is that the data needed may not be available and may be costly. Indirect method, on the other hand, reports the operating cash flows from net income and adjusting it for revenues and expenses that do not involve the receipt or payment of cash. With this method, it focuses the differences of net income and cash flows from operations, which shows the relationship between the income statement, balance sheet, and the statement of cash flows. In this method, the data needed are readily available, and less costly. (Warren, C. S., Reeve, J. M., & Fess, P. E. (2005). Accounting (21st ed.). 5191 Natorp Boulevard, Mason, Ohio 45040: Thomson South-Western)

Response #2 The direct method is also known as the income statement method, it reports major classes of operating cash receipts and payments. using this method of preparing a cash statement starts with money received and then subtracts money spent, to calculate net cash flow.

The indirect method is known as the reconciliation method, it focuses on net income and the net cash flow from operations. With this method you start out with net income, add back the depreciation, then calculate changes in the balance sheet items. Ending with the same net cash flow produced by the direct method.

Response #3 The difference between the direct and indirect method of presenting a statement of cash flows is the direct method gives the subtotals of cash paid and cash received whereas the indirect method tells why the figures are different. The indirect method shows where the figures changed and how much they changed instead of a total net figure that the direct method only shows.

Response #4 The direct method deducts operating cash payments from operating cash receipts to determine the net cash flow from operating activities. The indirect method adjusts net income for items that affected the reported net income but did not affect the company's cash. Instead of determining operating net income with the cash receipts and cash disbursements from operating activities, the company starts with the net income, adds

back noncash related charges to the net income in reported on the income statement and then deducts noncash credits. Both methods are used for the purpose of determining net cash provided by and used through operating activities. These amounts are the same despite the method used.