

# Chapter 11: Statement of Cash Flows

The Statement of Cash Flows is a financial statement that measures how an organization uses their cash.

This statement has four main purposes:

- To predict future cash flows
- Evaluate management decisions
- Determine the ability to pay interest or dividends
- Show the relationship between net income and cashflows with the business

This image provides an overview of the structure and contents of the Statement of Cash Flows

<b>Statement of Cash Flows</b>	
Cash flows from operating activities	\$XXX
Cash flows from investing activities	XXX
Cash flows from financing activities	XXX
	<hr/>
Net increase (decrease) in cash	XXX
Cash at beginning of year	XXX
	<hr/>
Cash at end of year	\$XXX
	<hr/> <hr/>

(Source: Pearson Education)

The statement of cash flows measures three different types of business activities:

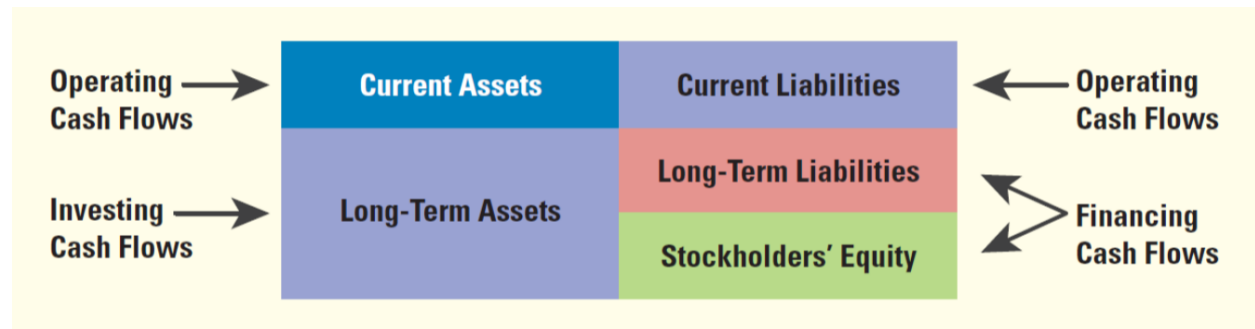
- Operating: cash flows involved in everyday operations
- Investing: cash flows related to long term assets
- Financing: cash flows resulting from long term liabilities and equity

Examples of Inflows and Outflows in each cycle:

- Operating:
  - o Inflow: any revenue related account like sales revenue
  - o Outflow: expenses like paying rent
- Investing:
  - o Outflow: Buying a building
  - o Inflow: Selling PPE

- Financing:
  - o Issuing debt
  - o Paying debt

The following graphic is helpful in identifying which cash transactions go under which type of cash flow



**Types of Cash flows:**

Direct: everyday transactions like paying employees

Indirect: these cash flows reconcile the difference between net income and net cash. For example, depreciation decreases net income without impacting cash. So, to get an accurate picture of net income in relation to net cash we would have to add depreciation back into cash.

## Preparing the Statement of Cash Flows:

You will follow the formula in the image below.

<b>Cash flows from operating activities:</b>
Net income
Adjustments to reconcile net income to net cash provided by operating activities:
+ Depreciation/depletion/amortization 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
Net cash provided by (used for) operating activities
<b>Cash flows from investing activities:</b>
+ Sales of long-term assets (investments, land, building, equipment, and so on)
– Purchases of long-term assets
+ Collections of notes receivable
– Loans to others
Net cash provided by (used for) investing activities
<b>Cash flows from financing activities:</b>
+ Issuance of stock
+ Sale of treasury stock
– Purchase of treasury stock
+ Borrowing (issuance of notes or bonds payable)
– Payment of notes or bonds payable
– Payment of dividends
Net cash provided by (used for) financing activities
<b>Net increase (decrease) in cash during the year</b>
+ Cash at December 31, 2017
= Cash at December 31, 2018

(Source: Pearson Education)

Note: I would not memorize this. Think about how each situation impacts cash and that will be how you add or subtract. Do pay special attention what you do with the indirect cash flows like depreciation and gains and losses (i.e. memorize).

The following video shows a great way to think about this formula and how to create a statement of cash flows:

<https://www.youtube.com/watch?v=pt9cB30gxmg&feature=youtu.be>

### **Common Questions and Difficulty Points:**

1. Computing statement of cash flows: This can be tricky to think about. I highly recommend the video I posted above. The formula in that video is a shortened version of the image I posted and will tell you what to do in every situation except depreciation and gains and losses. You will want to memorize and understand this formula.

### **Notes for the Final:**

1. Statement of Cash Flows and Equity are the only new sections on the final. As such, make sure you know how to deal with them.
2. There will be a FSA portion on the exam. Review your ratios!
3. Review complicated calculations like bonds (Week 11), depreciation (Week 10), treasury stock (Week 13), bank recs (Week 7), etc
4. Go and look to see what you got wrong on the previous exams and build your review from there.
5. Complete the practice final, practice multiple choice, and old quizzes. Identify problem areas. If you need more problems, do the party favors!
6. If you are having trouble with a particular topic, you can look at the resources I have created for each topic or go to edspira.com for a video explanation

### **Link for Prior Week Resources:**

[https://www.baylor.edu/support\\_programs/index.php?id=967950](https://www.baylor.edu/support_programs/index.php?id=967950)

### **Works Cited**

Pearson Education

*Financial Accounting* by Harrison, Horngren, and Thomas, 12th Edition, Prentice Hall

Edspira.com