

STATEMENT OF CASH FLOWS

History

**CAP → APB (opinions) → FASB (SFAS) 1974, Norfolk, Conn
knew that SCFP was a problem**

**Statement of Changes in Financial Position prepared
on a working capital basis**

**WT Grant example, Efficient market hypothesis (finance
topic for sure)**

PURPOSE

The statement of cash flows summarizes all of a company's cash inflows and outflows during a period, thereby explaining the change in its cash balance.

DEFINITION OF CASH

In a statement of cash flows, cash is broadly defined to include cash and cash equivalents, such as Treasury bills, commercial paper, and money market funds.

PREPARATION

The change in the cash balance must equal the changes in all other noncash balance sheet accounts. This principle ensures that properly analyzing the changes in all noncash balance sheet accounts always quantifies the cash inflows and outflows that explain the change in the cash balance.

Three areas of the Statement of Cash flows:

Operating Activities	-Current Assets/Current Liabilities
Investing Activities	-Long Term Assets
Financing Activities	-Long Term Liabilities

Some Details:

- Direct method vs. Indirect method (also Journal entry method):
- Cash Equivalents
- Transactions that bypass Cash go on Separate Schedule

EXAMPLE OF STATEMENT OF CASH FLOWS

*Aspen Corporation
Comparative Balance Sheets
(in millions of dollars)*

<i>Assets</i>	<i>Year 2</i>	<i>Year 1</i>
Cash	\$ 13	\$ 6
Accounts receivable	8	9
Inventory	21	15
Long-term investments	20	6
Property, plant and equipment	200	189
Less accumulated depreciation	<u>98</u>	<u>95</u>
Property, plant and equipment, net.....	<u>102</u>	<u>94</u>
Total assets.....	<u>\$164</u>	<u>\$130</u>
 <i>Liabilities & Stockholders' Equity</i>		
Accounts payable.....	\$ 16	\$ 10
Accrued liabilities	1	3
Income taxes payable	4	1
Bonds payable.....	36	20
Stockholders' equity:		
Common stock.....	43	42
Retained earnings	<u>64</u>	<u>54</u>
Total liabilities and equity.....	<u>\$164</u>	<u>\$130</u>

What we are proving is the move from 12/31/y1 of \$6 to 12/31/y2 of \$13

EXAMPLE OF STATEMENT OF CASH FLOWS (continued)

Aspen Corporation
Income Statement, Year 2
(in millions of dollars)

Sales	\$300
Cost of goods sold	<u>100</u>
Gross margin	200
Selling and administrative expenses	<u>175</u>
Net operating income	25
Non-operating items:	
Gain on sale of equipment	<u>4</u>
Income before taxes	29
Income taxes	<u>10</u>
Net income	<u><u>\$ 19</u></u>

Note: The gain on sale of equipment consisted of the sale of equipment that had cost \$7 million new for \$6 million in cash. The equipment had accumulated depreciation of \$5 million. (See below)

1	A	B	C	D	E	F
2	General Journal					
3						Page 3
4		date	description	post ref.	Dr.	Cr.
5	1		Acc Dep		\$5,000,000.00	
6	2		Cash		\$6,000,000.00	
7	3		Equipment			\$ 7,000,000.00
8	4		Gain on Sale			\$ 4,000,000.00
9	5					

ANALYZING CHANGES IN NONCASH BALANCE SHEET ACCOUNTS

<i>Asset and Contra-Asset Accounts</i>	<i>Year 2</i>	<i>Year 1</i>	<i>Change</i>
Accounts receivable	\$8	\$9	-1
Inventory	\$21	\$15	+6
Long-term investments	\$20	\$6	+14
Property, plant and equipment	\$200	\$189	+11
Accumulated depreciation	\$98	\$95	+3
 <i>Liabilities, & Stockholders' Equity</i>			
Accounts payable	\$16	\$10	+6
Accrued liabilities	\$1	\$3	-2
Income taxes payable	\$4	\$1	+3
Bonds payable	\$36	\$20	+16
Common stock	\$43	\$42	+1
Retained earnings	\$64	\$54	+10

Operating Activities Indirect Method

Start with:	Net Income	
Rule #1-Add back Depreciation	+ Depreciation	
Rule #2-CA are inversely related	↑ -	↓ +
Rule #3-CL are directly related	↑ +	↓ -
Rule #4-Taxes Payable are directly related	↑ +	↓ -
Rule #5-Gains/ losses are inversely related	↑ -	↓ +

*Aspen Corporation
Statement of Cash Flows
For the Year Ended December 31, Year 2*

Operating Activities

	Net income	\$19
	Adjustments to convert net income to a cash basis:	
Rule 1	Depreciation	\$ 8
Rule 2	Decrease in accounts receivable.....	1
Rule 3	Increase in inventory.....	(6)
Rule 4	Increase in accounts payable.....	6
Rule 5	Increase in income taxes payable.....	3
	Gain on sale of equipment.....	<u>(4)</u>
	Net cash provided by operating activities	<u>25</u>

Investing activities

	Additions to property, plant and equipment.....	\$(18)
	Increase in long-term investments.....	(14)
	Proceeds from sale of equipment.....	<u>6</u>
	Net cash used for investing activities	(26)

Financing activities

	Increase in bonds payable.....	\$ 16
	Increase in common stock.....	1
	Cash dividends	<u>(9)</u>
	Net cash provided by financing activities	<u>8</u>

	Net increase in cash (net cash flow)	7
	Cash, beginning balance	<u>6</u>
	Cash, ending balance.....	<u>\$13</u>