Statement of Cash Flows

- Understand the purpose of the SCF
- Distinguish between its three sections
- Understand the difference between the direct and indirect methods for the Operations section
- Understand the adjustments to Net Income required to derive Cash Flow from Operations
- Practice these concepts

Statement of Cash Flows

Beginning Balance

Assets = Liabilities + S.E.

$\boxed{\Delta \text{Cash}}$ $+\Delta \text{OA} = \Delta \text{Liabilities} + \Delta \text{CC} + \boxed{\text{NI}} - \text{Div}$

Assets = Liabilities + S.E.

Ending Balance

$\Rightarrow$ **ΔCash +/- "other stuff" = NI**

Statement of Cash Flows

- Fixed claimants (lenders)
- Residual claimants (shareholders)
- Managers

Why do we need a separate financial statement?

Statement of Cash Flows

- Direct or indirect statements
- Categorize transactions into one of the following:
  - **Operating Activities**
    - cash provided by the sale of goods or service, including interest and dividends received
    - cash used to pay operating expenses, including interest expense
  - **Investing Activities**
    - cash used to buy long-term assets and investments
    - cash obtained by selling long-term assets and investments
  - **Financing Activities**
    - cash provided by issuing stock or debt instruments
    - cash used to repay debt principal and repurchase stock
    - cash used to pay dividends, but NOT interest paid on debt

Statement of Cash Flows

- Direct: start from cash transactions
  - Investing and Financing sections ==> always direct
- Indirect: start from NI, back out accruals
  - Cash flow *amount* from operations ==> same as direct
  - **Key difference:** *Presentation* in the cash flow from operations section

Statement of Cash Flows

- What events affect cash flow from operations and net income equally?
- What events affect cash flow from operations but NOT net income?
- What events affect net income but NOT cash flow from operations?

Statement of Cash Flows

Direct	*Indirect*
Beginning Cash	**Beginning Cash**
+ Cash rcv'd from customers	Net Income
+ Interest received	+ Increase in payables
- Cash paid to suppliers	- Increase in receivables
- Cash paid to employees	+/- other adjustments
- Interest paid	
+/- other adjustments	
= Cash from Operations	**= Cash from Operations**
+/- Cash from Investing	**+/- Cash from Investing**
+/- Cash from Financing	**+/- Cash from Financing**
= Ending Cash	**= Ending Cash**

Statement of Cash Flows

Balance sheet equation: **Differences:**

A(t) = L(t) + E(t) => Δ A = Δ L + Δ E

Decompose:

Cash + CA + NCA = CL + NCL + CC + OE + RE

Note that RE = NI - Div, thus after rearranging,

Cash = NI - CA + CL - NCA + NCL + OE + CC -Div

Accounts we know:

Cash = NI - netAR - Inventory - OCA + CL - netPPE

ONCA NCL + OE + CC - Div

Statement of Cash Flows

$\text{Cash} = \text{Cash}_{\text{operations}} + \text{Cash}_{\text{investing}} + \text{Cash}_{\text{financing}}$

$\text{Cash}_{\text{operations}} = \text{NI} + \underline{\text{DepExp}} - \text{netAR} - \text{nventory} - \text{OCA}$
$+ \text{CL} - \underline{\text{Gain(Loss)}}$

$\text{Cash}_{\text{investing}} = - \text{netPPE} + \underline{\text{Gain(Loss)}} - \underline{\text{DepExp}} - \text{ONCA} + \text{OE}$
$= - \textit{Acquisitions} + \textit{Disposals} - \text{ONCA} + \text{OE}$

$\text{Cash}_{\text{financing}} = \text{NCL} + \text{CC} - \text{Div}$

Special Rules for Significant Noncash Transactions

Some transactions are omitted from the SCF but disclosed elsewhere (such as at the bottom of the SCF) so long as they are material:

- Acquisition of assets by assuming liabilities (including capital lease obligations) or by issuing equity securities
- Exchanges of non-monetary assets
- Refinancing of long-term debt
- Conversion of debt or preferred stock to common stock
- Issuance of equity securities to retire debt