

## **ACCT-1105 - Chapter 16**

### **Summary of Statement of Cash Flows**

The Statement of Cash Flows shows the sources (inflows or receipts) and uses (outflows or payments) of cash during a period and indicates the cash balance at the end of the period.

The cash flow statement provides important information about a company's cash position. It not only shows how a company obtained its cash and where it spent it, but also helps in providing information necessary in making business decisions such as:

- Does the company have enough cash to pay current bills and upcoming debts
- Does the company have enough cash to fund an expansion
- Can the company meet unexpected obligations and take advantage of unexpected opportunities

The statement of cash flows reports not only cash, but cash equivalents.

Cash Equivalents-an investment readily convertible into a known amount of cash which is sufficiently close to its maturity date so its market value is unaffected by interest rate changes.

The sources and uses of cash are divided into three categories:

- Operating Activities-transactions and events that affect net income (includes payments and receipts of **interest**)
- Investing Activities-transactions and events that affect long-term assets (this includes "investments" in securities as well as plant assets such as equipment.) Also includes short-term securities.
- Financing Activities-transactions and events that affect long-term liabilities and equity

### **Methods of Preparation**

Two acceptable methods of preparing the statement of cash flows exist. Under either method, the reporting of investing and financing activities is the same. It is the operating activities section that is affected by the method chosen.

- Direct Method-lists each major item of operating cash flows to determine the net cash inflow or outflow for operating activities
- Indirect Method-starts with net income and adjusts it to determine a cash-basis net income

The indirect method is the most widely used of the two methods.

*See handout on indirect method.*

### **Proving the Cash Balance**

The end of the statement of cash flows proves the statement by proving the ending cash balance. The beginning cash balance plus or minus the net increase or decrease in cash as shown on the statement of cash flows should balance to the ending cash balance as shown in the ledger.