

# Toward Business Literacy: Accounting Outlines



## Statement of Cash Flows

Information on **amounts, timing and uncertainty** of cash flows is useful for:

- **Employees:** Ability to pay workers and fund pensions
- **Creditors:** Cash is available to pay debts and obligations
- **Stockholders:** Cash flows are sufficient to maintain dividend
- **Suppliers/vendors:** Cash flow can enable future purchases/acquisitions

**Direct method:** Find cash receipts and outlays directly from account totals

- Operating cash receipts:

Beginning A/R balance + Sales on account – End A/R balance

- Operating cash outlays:

Beginning A/P balance + Purchases on account – Ending A/P balance

- Cash payments for Operating Expenses

Total expenses + Increase in prepaid assets – increase in accrued payable

**Indirect method:** Starts with Net Income and ends in a change in Cash. Uses:

- Income Statement (Net Income, Depreciation expense, Gains/Losses)
- Balance Sheet (Current Assets/Liabilities)
- Selected transaction data reveal investing and financing flows

Sections include:

- **Operations:** Start with what assets produce less what it takes to produce- this is Net Income
  - Add back items such as depreciation and losses on asset sales (subtract gains): these are non-cash items included in Net Income
  - Look at changes in Current Assets and Current Liabilities
    - If Asset balance is up, cash is down (ex: cash for supplies)
    - If Asset balance is down, cash is up (ex: collect receivables)
    - If Liability balance is up, cash is up (ex: purchases on credit)
    - If Liability balance is down, cash is down (ex: paid payables)
- **Investing:** Taking what is obtained by financing (below) and operations (above) to purchase assets or securities (reduce cash). Assets that are not productive or profitable are sold (increase cash).
  - It is important to analyze T-Accounts (if not given journals)
  - Show entire proceeds/price from asset sales/purchases
- **Financing:** Obtaining resources in the capital markets (stock and bonds)
  - Positive flows: Sell stock and issue bonds
  - Negative flows: Purchase treasury stock, retire bonds, pay shareholders dividends
  - Pay attention to Retained Earnings account; remember:
    - Beginning RE + Net Income – Dividends = Ending RE

Show net effect on cash for each section (positive or negative) → add to beginning cash balance to arrive at ending cash balance. Non-cash transactions such as the acquisition of an asset by assuming a liability, etc. are in a section at the end.