

***The Statement of Cash Flow...***

***A Simple, Logical Approach in  
Understanding Concepts and Preparation***

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For many introductory accounting courses the Statement of Cash Flow creates many challenges for students. Many times students are confused with the concepts and are further perplexed with the preparation process of this statement. The following presentation may assist with these introductory accounting students with understanding the concepts and preparation of this financial statement.

Why is the Statement of Cash Flow Important?

- Cash is what pays the bills
- Need to sell your products and services and collect cash from your customers to:
  - Pay employees
  - Pay suppliers
  - Pay bank loans
  - Pay taxes
  - Purchase new fixed assets

Analyzing and recognizing where a company's cash is coming from and where it is being spent may assist in determining future profit potential and/or future financial problems.

### **Sections of the Statement of Cash Flow (indirect method)**

1. Cash flow from **Operations** (report cash from daily operations of the business)
  - Net Income
  - Non-Cash Expenses
  - Changes in Current Assets/Current Liabilities
2. Cash flow from **Investing** (investments in yourself/investments in others)
  - Purchase/Sale of Fixed Assets
  - Purchase/Sale of Equity/Debt, Loans, and Collection of Loans
3. Cash flow from **Financing** ((cash received/paid to finance the operations of the company)
  - Equity Financing (issuing/retiring shares, treasury stock, cash dividends)
  - Debt Financing (borrowing cash/repaying loans)

To assist students with recognizing these three sections, a simple mnemonic can be used:

**"Oh if I only had the cash"**

Where:

**"O" – Operations**

**"I" – Investing**

**"F" – Financing**

Once the sections of the Statement of Cash Flow can be understood the next concept that needs to be mastered is the preparation. By utilizing a Balance Sheet comparison (Beginning Balance Sheet to Ending Balance Sheet) and reflecting the changes in each balance sheet account, the change in each account can be categorized as either a "Source of Cash" or a "Use of Cash". A "Source of Cash" would have a positive (+) impact to the Statement while a "Use of Cash" would have a negative (-) impact on the Statement. The following diagram can be presented to master this process:

**Source of Cash (+)**

↓ **Asset (or)**

↑ **Liability/Equity**

**Use of Cash (-)**

↑ **Asset (or)**

↓ **Liability/Equity**

To apply the above changes, it is best to present the balance sheet comparison as shown on the attached exhibit (Exhibit 1). The following steps would then be applied:

1. By presenting the beginning and ending balance sheet amounts, the change in the account would be computed. The change in the account should only be computed. There should be no reflection made to either the account increasing or decreasing.
2. The change in the balance sheet account would then be categorized as either a "Source (+)" or a "Use (-)" of cash as reflected above (Source of Cash: ↓ Asset (or) ↑ Liability/Equity) or (Use of Cash: ↑ Asset (or) ↓ Liability/Equity).
3. Once the above two steps have been completed, identifying where the changes need to be presented on the statement is the final step. By utilizing the "Oh if I only had the cash" (Operations, Investing, and Financing) is process can be completed.
4. It should be noted, that some changes in the balance sheet comparison could impact multiple parts of the cash flow statement (i.e. Retained Earnings-Net Income (Source-Operations) and Dividends (Use-Financing)). In these situations, a columnar presentation should be presented:

Beginning Retained Earnings	\$xx.xx	
Add: Net Income	xx.xx	↑ Liability/Equity (Source (+)-Operations)
Less: Dividends	<u>(xx.xx)</u>	↓ Liability/Equity (Use (-) – Financing)
Ending Retained Earnings	\$xx.xx	

The same approach can be used with other accounts with "dual" activity (i.e. equipment purchase/retirement, accumulated depreciation, etc)