

# **ACCT 101: Cash Flows**

## **Session 9**

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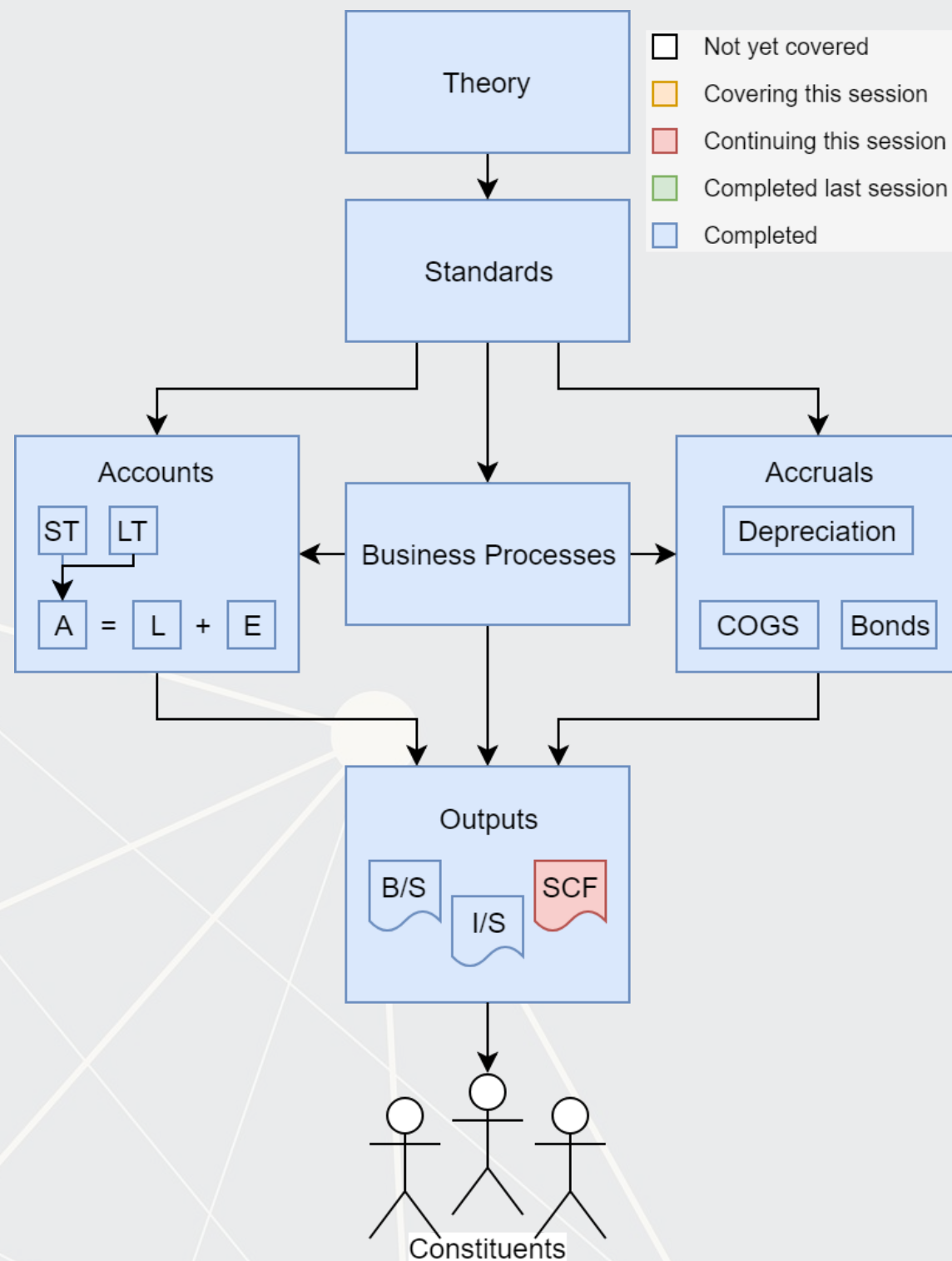
# Frontmatter



# Quiz 2

- 7.5% of overall grade
- 1 hour to complete
  - When finished, revise or turn in at the front
- 20 minute break after
- Class will resume after the break

# Learning objectives



## Cash Flows

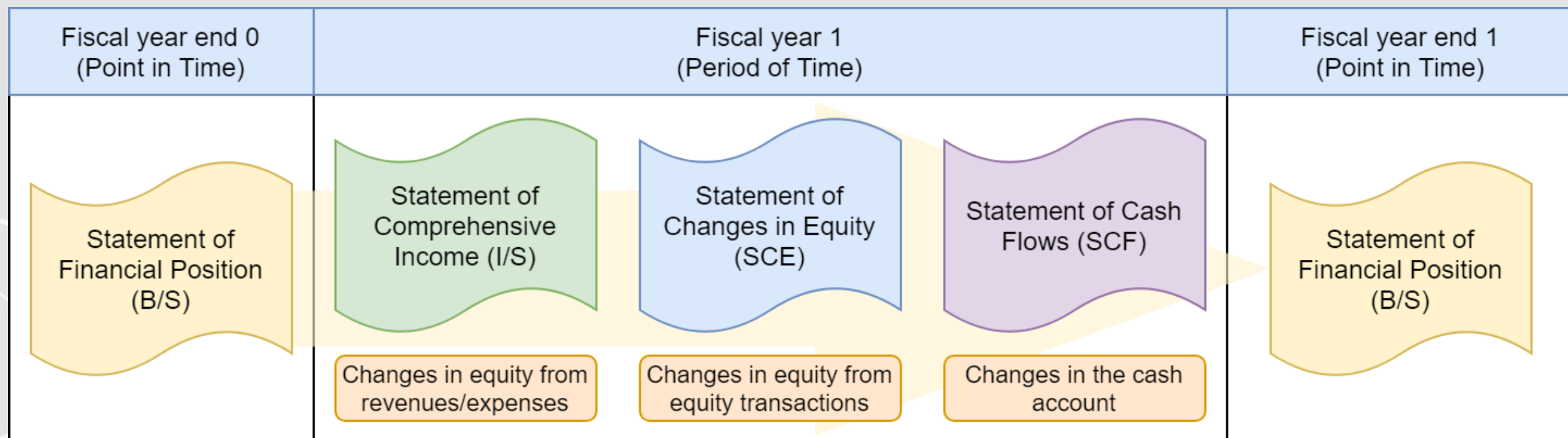
1. Understand why we have a Statement of Cash Flows
2. Identify cash flows from:
  - Operations
  - Investing
  - Financing
3. Identify significant non-cash activities
4. Apply the *indirect method*



# Statement of Cash Flows

# What is the SCF?

- Categorizes and presents all *cash* receipts and *cash* payments
  - Cash *inflows*: where cash came in from
  - Cash *outflows*: where cash went out to
- Describes cash changes over a period

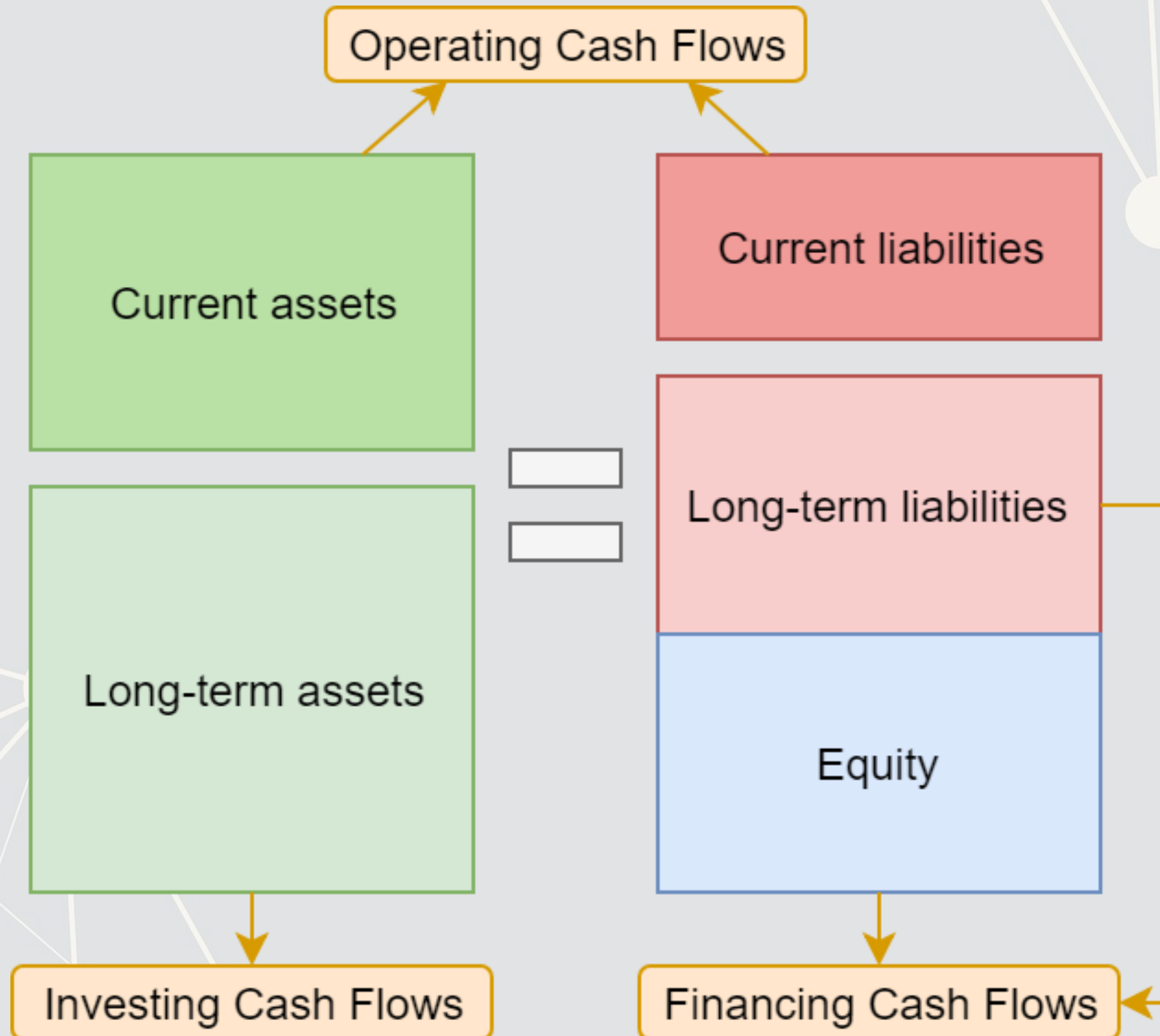




# Why use an SCF?

- Helpful in assessing companies'...
  - Ability to generate future cash flows
  - Ability to pay dividends
  - Difference between net income and change in cash
  - Investing and financing activities during the period
  - Value using DCF models (finance)
- Provides information on three types of cash flows, accounting for all cash flows of the company
  - Operating activities
  - Investing activities
  - Financing activities

# SCF and the balance sheet





# Special cases: Interest and dividends

- IFRS, under IAS 7.31
  - *Pick any categorization*
    - Dividends paid/received can be any cash flow type
    - Interest paid/received can be any cash flow type
    - Keep it the same year-after-year
- US GAAP specifies where to put these – follow this if you don't have a strong opinion on where to put interest and dividends
  - Inflows from dividends or interest: operating activities
  - Interest payments: operating activity
  - Dividend payments: financing activity

# Operating activities

- Cash from standard business transactions
- Useful in:
  - Identifying *sustainable* cash flows
  - Management of current assets and current liabilities
    - I.e., working capital
  - Identifying liquidity issues
    - Important for loans!



# Operating activities

## Inflows

- Sales
- Short term investments (selling)
- Other revenues

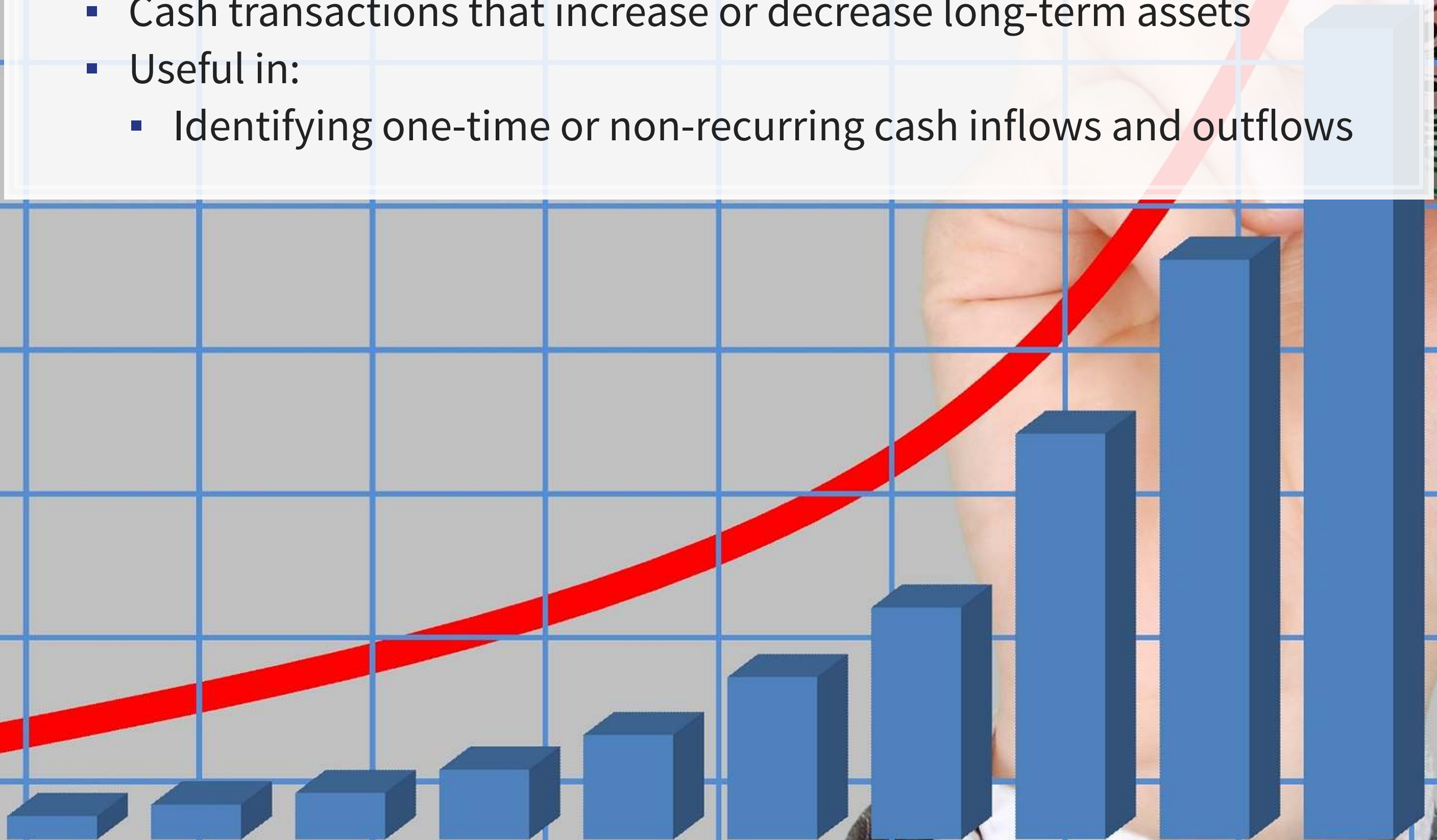
## Outflows

- Short term investments (buying)
- Business expenses
  - Paying suppliers and employees
  - Taxes
  - Maintenance expense

Focus on changes in current assets, changes in current liabilities, and the income statement

# Investing activities

- Cash transactions that increase or decrease long-term assets
- Useful in:
  - Identifying one-time or non-recurring cash inflows and outflows





# Investing activities

## Inflows

- PP&E disposal
- Selling investments in other firms
- Collection of principal on loans made

## Outflows

- Purchasing PP&E
- Purchasing investments in other firms
- Making loans

Focus on PP&E



# Financing activities

- Cash-based increases and decreases in long-term liabilities and shareholders' equity
- Useful in:
  - Predicting future claims on cash
  - Identifying how a company is financed
    - Internally vs. externally





# Financing activities

## Inflows

- Receiving loans
- Issuing stock
- Selling treasury shares

## Outflows

- Paying back loans
- Buying treasury shares

Focus on long term liabilities and shareholders' equity

# Significant non-cash activities

- Includes:
  - Issuing common stock in exchange for PP&E
  - Bond conversion (Bond → equity)
  - Debt issuance for PP&E
  - PP&E exchange
- Useful in:
  - Determining other future claims on cash
  - Getting a more complete picture of financing and investments
- Reported at the bottom of SCF or in supplementary schedule



# Practice: Identifying cash flows

What type of cash flows are each of the following?

[Operating/Investing/Financing/Non-cash/None]

If it is a cash flow, is it an inflow or outflow?

1. Reissued treasury shares for a warehouse
2. Paid off a note payable
3. Paid interest on a bond
4. Issued new shares for \$10 each
5. Paid accounts payable
6. Recorded \$10,000 depreciation on PP&E
7. Sold machinery at a loss
8. Sold land
9. Paid a dividend
10. Bought a warehouse
11. Sold goods for cash

# Operating cash flows



# Operating cash flows

Two equivalent methods:

## Indirect method

- Backs out operating cash flow by starting with net income and adjusting out accruals
- Most commonly used
- Easiest to do

## Direct method

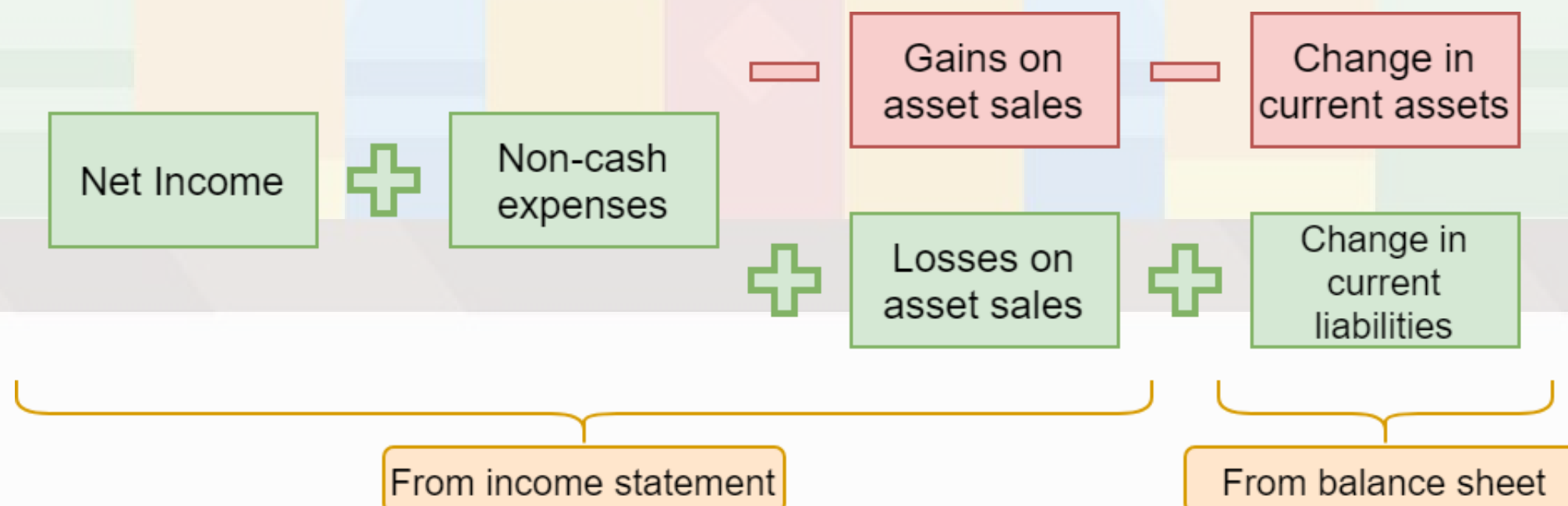
- Tracks and reports exactly where operating cash flows came from
- Preferred by IFRS
- Most useful for investors

- Both methods will get you to the same operating cash flow amount

We will cover the direct method next week when we construct an SCF

# Indirect method

1. Start with net income
2. Add back non-cash expenses (i.e., pure accruals)
  - Depreciation, depletion, amortization
  - Bond discount amortization
  - Bad debt expense, warranty expense
3. Subtract out any gains from asset sales
4. Add back any losses from asset sales
5. Subtract changes in non-cash current assets
6. Add changes in current liabilities





# Indirect method: Calculation

- Steps 1 through 4 are available in the income statement
- Steps 5 and 6 can be calculated by comparing balance sheets
  - Current year versus prior year balance sheets
  - Compare change in accounts such as...
    - A/R
    - Inventory
    - Prepaid expenses
    - Accounts Payable
    - Unearned revenue

# Practice: Indirect method

You find the following information in Kopi Corp's 20X9 and 20X8 financial statements. Based on this information, what is their operating cash flow for 20X9?

	Dec 31, 20X9	Dec 31, 20X8
Revenue	33,000	64,500
COGS	4,500	6,000
Gross profit	28,500	58,500
Depreciation expense	15,000	15,000
Operating expenses	20,000	13,000
Net income before tax	(6,500)	30,500
Tax expense	0	3,000
Net income	(6,500)	27,500

	Dec 31, 20X9	Dec 31, 20X8
Cash	45,000	40,000
A/R	4,000	10,000
Inventory	0	4,500
Accounts payable	2,000	10,000
Utilities Payable	1,000	5,000
Salaries Payable	2,000	2,000



# End matter





# For next week

- Reading
  - Chapter 11 (Cash flows)
- Take a week and relax (or work on the project)
- Extra practice available
  - Cash flows eLearn quiz

