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kieso
weygandt
warfield
team for success

**IFRS
EDITION**

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ACCOUNTING

INTERMEDIATE

SECOND EDITION

WILEY

Statement of Cash Flows			
Preparation of the Statement	Illustrations—Tax Consultants Inc.	Special Problems in Statement Preparation	Use of a Worksheet
<ul style="list-style-type: none"> • Usefulness of statement • Classification of cash flows • Cash and cash equivalents • Format of statement • Steps in preparation 	<ul style="list-style-type: none"> • Change in cash • Operating cash flows • Cash flows from investing and financing • Statement of cash flows—2015 • Illustrations—2016 and 2017 • Sources of information • Direct method 	<ul style="list-style-type: none"> • Adjustments to net income • Accounts receivable (net) • Other working capital changes • Net losses • Disclosures 	<ul style="list-style-type: none"> • Preparation of worksheet • Analysis of transactions • Preparation of final statement

Intermediate Accounting
IFRS 2nd Edition
Kieso, Weygandt, and Warfield

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

- 1. Describe the purpose of the statement of cash flows.**
- Identify the major classifications of cash flows.
- Prepare a statement of cash flows.
- Differentiate between net income and net cash flow from operating activities.
- Determine net cash flows from investing and financing activities.
- Identify sources of information for a statement of cash flows.
- Contrast the direct and indirect methods of calculating net cash flow from operating activities.
- Discuss special problems in preparing a statement of cash flows.
- Explain the use of a worksheet in preparing a statement of cash flows.

PREPARATION OF STATEMENT OF CASH FLOWS

Primary purpose:

To provide information about a company's cash receipts and cash payments during a period.

Secondary objective:

To provide cash-basis information about the company's operating, investing, and financing activities.

PREPARATION OF STATEMENT OF CASH FLOWS

Usefulness of the Statement of Cash Flows

Provides information to help assess:

1. Entity's ability to generate future cash flows.
2. Entity's ability to pay dividends and meet obligations.
3. Reasons for the difference between net income and net cash flow from operating activities.
4. Cash and noncash investing and financing transactions during the period.

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. **Identify the major classifications of cash flows.**
3. Prepare a statement of cash flows.
4. Differentiate between net income and net cash flow from operating activities.
5. Determine net cash flows from investing and financing activities.
6. Identify sources of information for a statement of cash flows.
7. Contrast the direct and indirect methods of calculating net cash flow from operating activities.
8. Discuss special problems in preparing a statement of cash flows.
9. Explain the use of a worksheet in preparing a statement of cash flows.

PREPARATION OF STATEMENT

Classification of Cash Flows

**Operating
Activities**

**Income
Statement Items**

**Investing
Activities**

**Changes in
Investments and
Non-Current
Asset Items**

**Financing
Activities**

**Changes in
Equity and Non-
Current Liability
Items**

Classification of Cash Flows

Operating

Cash inflows

From sales of goods or services.

From returns on loans (interest) and on equity securities (dividends).

Cash outflows

To suppliers for inventory.

To employees for services.

To government for taxes.

To lenders for interest.

To others for expenses.

**Income
Statement
Items**

ILLUSTRATION 23-1

Classification of Typical
Cash Inflows and
Outflows



Classification of Cash Flows

Investing

Cash inflows

From sale of property, plant, and equipment.

From sale of debt or equity securities of other entities.

From collection of principal on loans to other entities.

Cash outflows

To purchase property, plant, and equipment.

To purchase debt or equity securities of other entities.

To make loans to other entities.

Financing

Cash inflows

From sale of equity securities.

From issuance of debt (bonds and notes).

Cash outflows

To shareholders as dividends.

To redeem long-term debt or reacquire share capital.

**Generally
Investments
and Non-
Current Asset
Items**

**Generally
Equity and
Non-Current
Liability Items**

ILLUSTRATION 23-1

Classification of Typical Cash
Inflows and Outflows

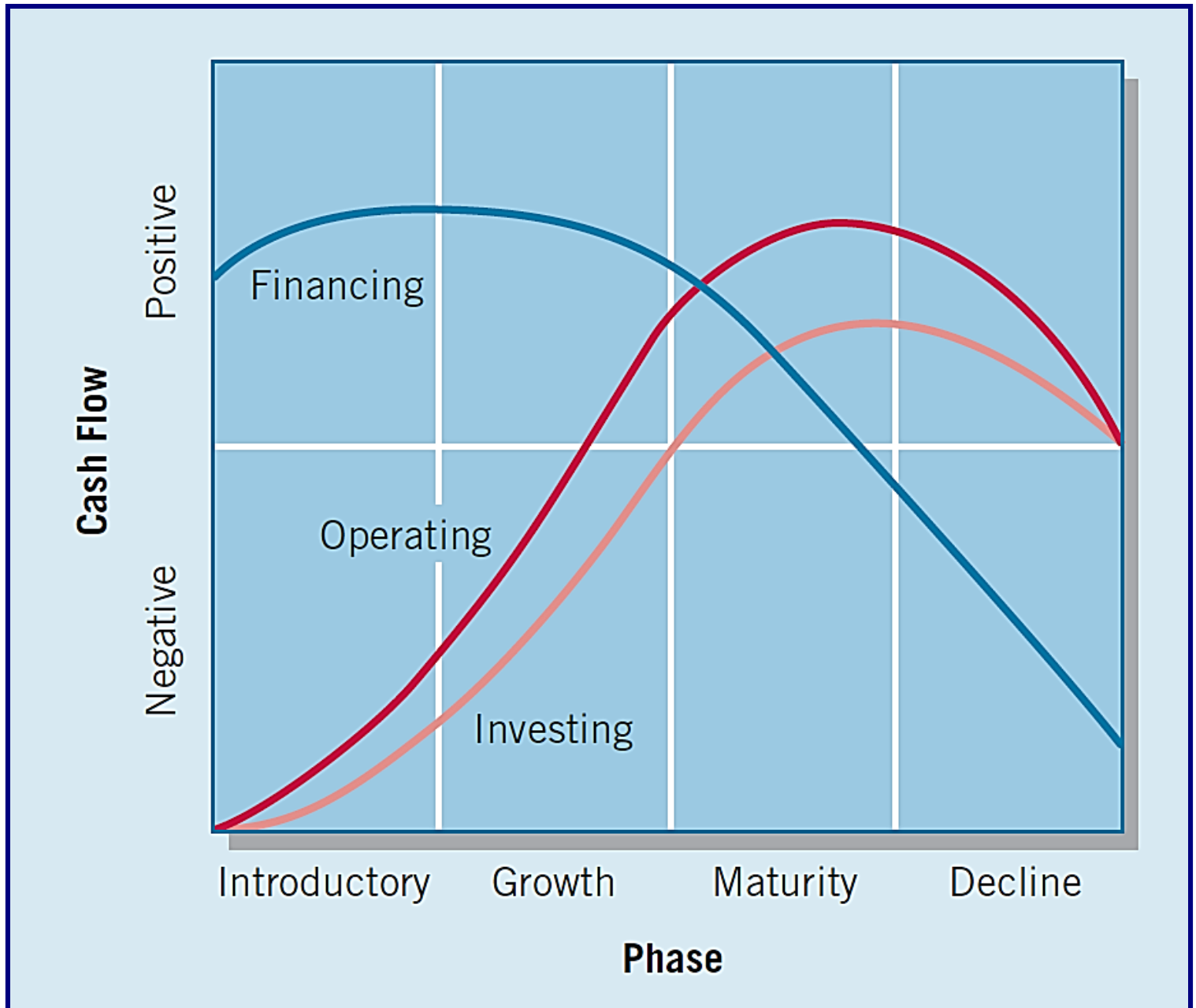
Cash and Cash Equivalents

The basis recommended by the IASB for the statement of cash flows is actually “cash and cash equivalents.” **Cash equivalents** are short-term, highly liquid investments that are both:

- ◆ Readily convertible to known amounts of cash, and
- ◆ So near their maturity that they present insignificant risk of changes value in (e.g., due to changes in interest rates).

Generally, only investments with original maturities of **three months or less** qualify under this definition.

Product Life Cycle



Format of the Statement of Cash Flows

Presentation:

1. Operating activities.
2. Investing activities.
3. Financing activities.



Direct Method

Indirect Method

Report inflows and outflows from investing and financing activities **separately**.

Format of the Statement of Cash Flows

COMPANY NAME STATEMENT OF CASH FLOWS PERIOD COVERED		
Cash flows from operating activities		
Net income		XXX
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
(List of individual items)	<u>XX</u>	<u>XX</u>
Net cash provided (used) by operating activities		XXX
Cash flows from investing activities		
(List of individual inflows and outflows)	<u>XX</u>	
Net cash provided (used) by investing activities		XXX
Cash flows from financing activities		
(List of individual inflows and outflows)	<u>XX</u>	
Net cash provided (used) by financing activities		<u>XXX</u>
Net increase (decrease) in cash		XXX
Cash at beginning of period		<u>XXX</u>
Cash at end of period		<u><u>XXX</u></u>

ILLUSTRATION 23-2

Steps in Preparation

Three Sources of Information:

1. Comparative statements of financial position.
2. Current income statement data.
3. Selected transaction data.

Three Major Steps:

- Step 1. Determine change in cash.
- Step 2. Determine net cash flow from operating activities.
- Step 3. Determine net cash flows from investing and financing activities.

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. Identify the major classifications of cash flows.
3. **Prepare a statement of cash flows.**
4. Differentiate between net income and net cash flow from operating activities.
5. Determine net cash flows from investing and financing activities.
6. Identify sources of information for a statement of cash flows.
7. Contrast the direct and indirect methods of calculating net cash flow from operating activities.
8. Discuss special problems in preparing a statement of cash flows.
9. Explain the use of a worksheet in preparing a statement of cash flows.

ILLUSTRATIONS— Tax Consultants Inc.

Illustration: Tax Consultants Inc. started on January 1, 2015, when it issued 60,000 shares of \$1 par value common stock for \$60,000 cash. The company rented its office space, furniture, and equipment, and performed tax consulting services throughout the first year.

The comparative statements of financial position at the beginning and end of the year 2015 appear in Illustration 23-3. Illustration 23-4 shows the income statement and additional information for Tax Consultants.

ILLUSTRATIONS— Tax Consultants Inc.

TAX CONSULTANTS INC.			
COMPARATIVE STATEMENTS OF FINANCIAL POSITION			
<u>Assets</u>	<u>Dec. 31, 2015</u>	<u>Jan. 1, 2015</u>	<u>Change Increase/Decrease</u>
Accounts receivable	\$36,000	\$-0-	\$36,000 Increase
Cash	49,000	-0-	49,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	
<u>Equity and Liabilities</u>			
Ordinary shares (\$1 par)	\$60,000	\$-0-	\$60,000 Increase
Retained earnings	20,000	-0-	20,000 Increase
Accounts payable	5,000	-0-	5,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	

ILLUSTRATION 23-3

Comparative statements of financial position, Tax Consultants Inc., Year 1

ILLUSTRATIONS— Tax Consultants Inc.

TAX CONSULTANTS INC. INCOME STATEMENT FOR THE YEAR ENDED DECEMBER 31, 2015

Revenues	\$125,000
Operating expenses	<u>85,000</u>
Income before income taxes	40,000
Income tax expense	<u>6,000</u>
Net income	<u><u>\$ 34,000</u></u>

ILLUSTRATION 23-4

Income Statement, Tax
Consultants Inc., Year 1

Additional Information: Examination of selected data indicates that a dividend of \$14,000 was declared and paid during the year.

ILLUSTRATIONS— Tax Consultants Inc.

Step 1: Determine the Change in Cash

TAX CONSULTANTS INC.			
COMPARATIVE STATEMENTS OF FINANCIAL POSITION			
<u>Assets</u>	<u>Dec. 31, 2015</u>	<u>Jan. 1, 2015</u>	<u>Change Increase/Decrease</u>
Accounts receivable	\$36,000	\$-0-	\$36,000 Increase
Cash	49,000	-0-	49,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	
Equity and Liabilities			
Ordinary shares (\$1 par)	\$60,000	\$-0-	\$60,000 Increase
Retained earnings	20,000	-0-	20,000 Increase
Accounts payable	5,000	-0-	5,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	

ILLUSTRATION 23-3

Comparative statements of financial position, Tax Consultants Inc., Year 1

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. Identify the major classifications of cash flows.
3. Prepare a statement of cash flows.
4. **Differentiate between net income and net cash flow from operating activities.**
5. Determine net cash flows from investing and financing activities.
6. Identify sources of information for a statement of cash flows.
7. Contrast the direct and indirect methods of calculating net cash flow from operating activities.
8. Discuss special problems in preparing a statement of cash flows.
9. Explain the use of a worksheet in preparing a statement of cash flows.

ILLUSTRATIONS— Tax Consultants Inc.

Step 2: Determine the Net Cash Flow from Operating Activities

- ◆ Company must determine revenues and expenses on a **cash basis**.
- ◆ **Eliminate** the effects of income statement transactions do not result in an increase or decrease in cash.
- ◆ Convert net income to net cash flow from operating activities through either a **direct** method or an **indirect** method.

ILLUSTRATIONS— Tax Consultants Inc.

Step 2: Determine the Net Cash Flow from Operating Activities

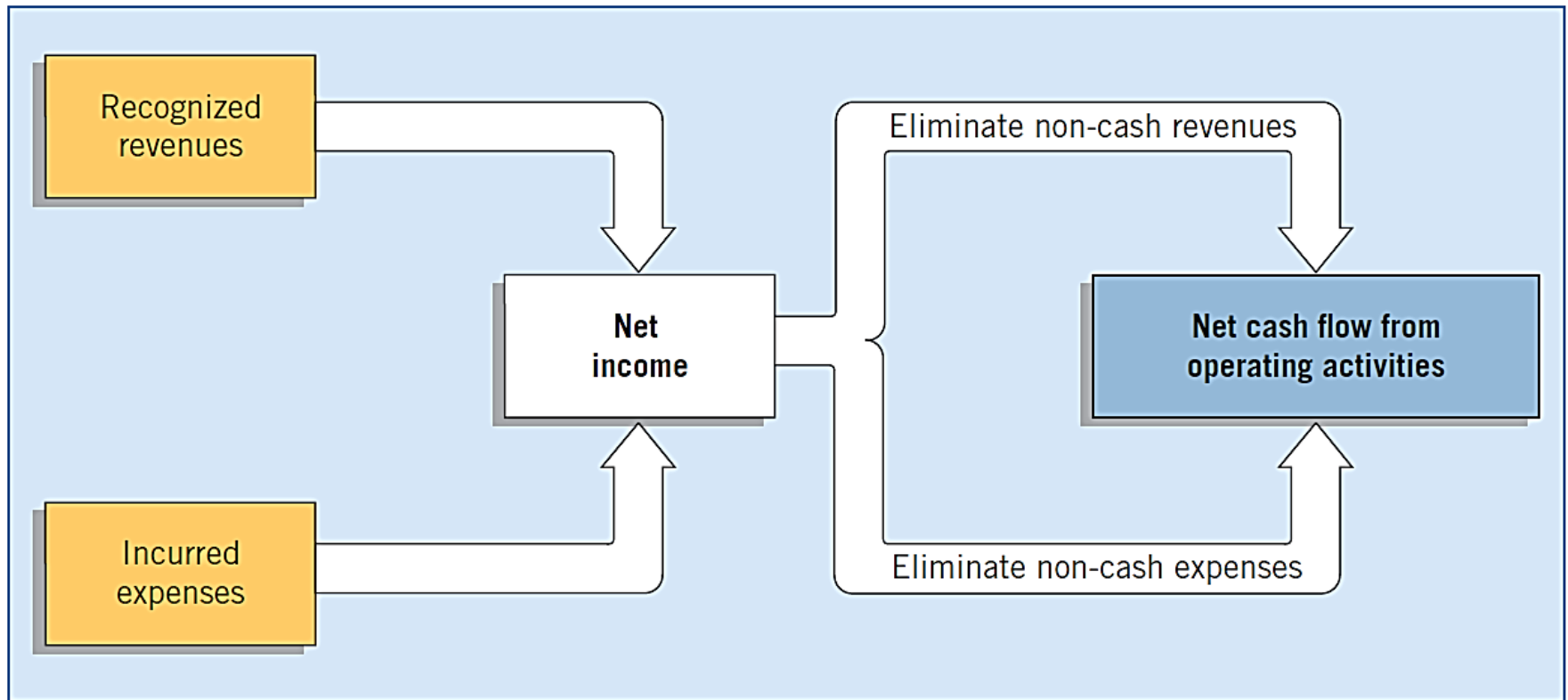


ILLUSTRATION 23-5

Net Income versus Net Cash Flow from Operating Activities

ILLUSTRATIONS— Tax Consultants Inc.

Increase in Accounts Receivable—Indirect Method

Accounts receivable increased by \$36,000 (from \$0 to \$36,000) during the year.

ILLUSTRATION 23-6

Accounts Receivable

1/1/15	Balance	0	Receipts from customers	89,000
	Revenues	125,000		
12/31/15	Balance	36,000		

When the Accounts Receivable balance **increases**, cash receipts are **lower** than revenue earned under the accrual basis.

ILLUSTRATIONS— Tax Consultants Inc.

Increase in Accounts Receivable—Indirect Method

ILLUSTRATION 23-6

Accounts Receivable

1/1/15	Balance	0	Receipts from customers	89,000
	Revenues	125,000		
12/31/15	Balance	36,000		

The increase in accounts receivable is subtracted from net income to arrive at net cash provided by operating activities.

ILLUSTRATION 23-7

Net income		\$ 34,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	\$(36,000)	
Increase in accounts payable	5,000	(31,000)
Net cash provided by operating activities		<u>\$ 3,000</u>

ILLUSTRATIONS— Tax Consultants Inc.

Increase in Accounts Payable—Indirect Method

Accounts payable increased by \$5,000 during the year.

When accounts payable increase during the year, expenses on an accrual basis exceed those on a cash basis.

Net income		\$ 34,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	\$(36,000)	
Increase in accounts payable	<u>5,000</u>	<u>(31,000)</u>
Net cash provided by operating activities		<u><u>\$ 3,000</u></u>

ILLUSTRATION 23-7

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. Identify the major classifications of cash flows.
3. Prepare a statement of cash flows.
4. Differentiate between net income and net cash flow from operating activities.
5. **Determine net cash flows from investing and financing activities.**
6. Identify sources of information for a statement of cash flows.
7. Contrast the direct and indirect methods of calculating net cash flow from operating activities.
8. Discuss special problems in preparing a statement of cash flows.
9. Explain the use of a worksheet in preparing a statement of cash flows.

Step 3: Determine Net Cash Flows from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION			ILLUSTRATION 23-3
<u>Assets</u>	<u>Dec. 31, 2015</u>	<u>Jan. 1, 2015</u>	<u>Change Increase/Decrease</u>
Accounts receivable	\$36,000	\$—	\$36,000 Increase
Cash	49,000	—	49,000 Increase
Total	<u>\$85,000</u>	<u>\$—</u>	
Equity and Liabilities			
Ordinary shares (\$1 par)	\$60,000	\$—	\$60,000 Increase
Retained earnings	20,000	—	20,000 Increase
Accounts payable	5,000	—	5,000 Increase
Total	<u>\$85,000</u>	<u>\$—</u>	

TAX CONSULTANTS INC.
Statement Of Cash Flows
For The Year Ended
December 31, 2015
Increase (Decrease) In Cash

Cash flows from operating activities

Adjustments to reconcile net income to net
cash provided by operating activities:

Net cash provided by operating activities _____
Cash flows from financing activities _____

Net cash provided by financing activities _____

Net increase in cash
Cash, January 1, 2015
Cash, December 31, 2015

ILLUSTRATION 23-8

Step 3: Determine Net Cash Flows from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION			ILLUSTRATION 23-3
<u>Assets</u>	<u>Dec. 31, 2015</u>	<u>Jan. 1, 2015</u>	<u>Change Increase/Decrease</u>
Accounts receivable	\$36,000	\$-0-	\$36,000 Increase
Cash	49,000	-0-	49,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	
<u>Equity and Liabilities</u>			
Ordinary shares (\$1 par)	\$60,000	\$-0-	\$60,000 Increase ←
Retained earnings	20,000	-0-	20,000 Increase
Accounts payable	5,000	-0-	5,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	

TAX CONSULTANTS INC.
Statement Of Cash Flows
For The Year Ended
December 31, 2015
Increase (Decrease) In Cash

Cash flows from operating activities

Adjustments to reconcile net income to net
cash provided by operating activities:

Increase in accounts receivable \$(36,000)

Net cash provided by operating activities _____
Cash flows from financing activities _____

Net cash provided by financing activities _____

Net increase in cash
Cash, January 1, 2015
Cash, December 31, 2015

ILLUSTRATION 23-8

Step 3: Determine Net Cash Flows from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION			ILLUSTRATION 23-3
<u>Assets</u>	<u>Dec. 31, 2015</u>	<u>Jan. 1, 2015</u>	<u>Change Increase/Decrease</u>
Accounts receivable	\$36,000	\$-0-	\$36,000 Increase
Cash	49,000	-0-	49,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	
<u>Equity and Liabilities</u>			
Ordinary shares (\$1 par)	\$60,000	\$-0-	\$60,000 Increase
Retained earnings	20,000	-0-	20,000 Increase
Accounts payable	5,000	-0-	5,000 Increase
Total	<u>\$85,000</u>	<u>\$-0-</u>	

TAX CONSULTANTS INC.
Statement Of Cash Flows
For The Year Ended
December 31, 2015
Increase (Decrease) In Cash

Cash flows from operating activities

Adjustments to reconcile net income to net
cash provided by operating activities:

Increase in accounts receivable \$(36,000)

Net cash provided by operating activities

Cash flows from financing activities

Issuance of ordinary shares 60,000

Net cash provided by financing activities

Net increase in cash

Cash, January 1, 2015

Cash, December 31, 2015

ILLUSTRATION 23-8

Step 3: Determine Net Cash Flows from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION			ILLUSTRATION 23-3
<u>Assets</u>	Dec. 31, 2015	Jan. 1, 2015	Change Increase/Decrease
Accounts receivable	\$36,000	\$—	\$36,000 Increase
Cash	49,000	—	49,000 Increase
Total	<u>\$85,000</u>	<u>\$—</u>	
<u>Equity and Liabilities</u>			
Ordinary shares (\$1 par)	\$60,000	\$—	\$60,000 Increase
Retained earnings	20,000	—	20,000 Increase
Accounts payable	5,000	—	5,000 Increase
Total	<u>\$85,000</u>	<u>\$—</u>	

TAX CONSULTANTS INC. Statement Of Cash Flows For The Year Ended December 31, 2015 Increase (Decrease) In Cash

Cash flows from operating activities		
Net income		\$ 34,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	\$(36,000)	
Net cash provided by operating activities		
Cash flows from financing activities		
Issuance of ordinary shares	60,000	
Payment of cash dividends	<u>(14,000)</u>	
Net cash provided by financing activities		
Net increase in cash		
Cash, January 1, 2015		
Cash, December 31, 2015		

ILLUSTRATION 23-8

Statement of Cash Flows—2015

ILLUSTRATION 23-8

**TAX CONSULTANTS INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015
INCREASE (DECREASE) IN CASH**

Cash flows from operating activities		
Net income		\$ 34,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	\$(36,000)	
Increase in accounts payable	5,000	(31,000)
Net cash provided by operating activities		3,000
Cash flows from financing activities		
Issuance of ordinary shares	60,000	
Payment of cash dividends	(14,000)	
Net cash provided by financing activities		46,000
Net increase in cash		49,000
Cash, January 1, 2015		—
Cash, December 31, 2015		\$ 49,000

Illustration—2016

ILLUSTRATION 23-9
Comparative Statements
of Financial Position, Tax
Consultants Inc., Year 2

TAX CONSULTANTS INC.
COMPARATIVE STATEMENTS OF FINANCIAL POSITION
AS OF DECEMBER 31

<u>Assets</u>	<u>2016</u>	<u>2015</u>	<u>Change Increase/Decrease</u>
Land	\$ 70,000	\$ -0-	\$ 70,000 Increase
Buildings	200,000	-0-	200,000 Increase
Accumulated depreciation—buildings	(11,000)	-0-	11,000 Increase
Equipment	68,000	-0-	68,000 Increase
Accumulated depreciation—equipment	(10,000)	-0-	10,000 Increase
Accounts receivable	26,000	36,000	10,000 Decrease
Prepaid expenses	6,000	-0-	6,000 Increase
Cash	37,000	49,000	12,000 Decrease
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	
 <u>Equity and Liabilities</u>			
Share capital—ordinary (\$1 par)	\$ 60,000	\$ 60,000	\$ -0-
Retained earnings	136,000	20,000	116,000 Increase
Bonds payable	150,000	-0-	150,000 Increase
Accounts payable	40,000	5,000	35,000 Increase
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

Illustration—2016

TAX CONSULTANTS INC.
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2016

Revenues		\$492,000
Operating expenses (excluding depreciation)	\$269,000	
Depreciation expense	<u>21,000</u>	<u>290,000</u>
Income from operations		202,000
Income tax expense		<u>68,000</u>
Net income		<u><u>\$134,000</u></u>

Additional Information

- (a) The company declared and paid an \$18,000 cash dividend.
- (b) The company obtained \$150,000 cash through the issuance of long-term bonds.
- (c) Land, building, and equipment were acquired for cash.

ILLUSTRATION 23-10

Income Statement, Tax
Consultants Inc., Year 2

Step 1: Determine the Change in Cash

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			
Assets	2016	2015	Change Increase/Decrease
Land	\$ 70,000	\$ -0-	\$ 70,000 Increase
Buildings	200,000	-0-	200,000 Increase
Accumulated depreciation—buildings	(11,000)	-0-	11,000 Increase
Equipment	68,000	-0-	68,000 Increase
Accumulated depreciation—equipment	(10,000)	-0-	10,000 Increase
Accounts receivable	26,000	36,000	10,000 Decrease
Prepaid expenses	6,000	-0-	6,000 Increase
Cash	37,000	49,000	12,000 Decrease
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

ILLUSTRATION 23-9

Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
Assets	2016	2015	Change Increase/Decrease
Land	\$ 70,000	\$ -0-	\$ 70,000 Increase
Buildings	200,000	-0-	200,000 Increase
Accumulated depreciation—buildings	(11,000)	-0-	11,000 Increase
Equipment	68,000	-0-	68,000 Increase
Accumulated depreciation—equipment	(10,000)	-0-	10,000 Increase
Accounts receivable	26,000	36,000	10,000 Decrease
Prepaid expenses	6,000	-0-	6,000 Increase
Cash	37,000	49,000	12,000 Decrease
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	



Accounts receivable decreased during the period because **cash receipts (cash-basis revenues) are higher than revenues reported on an accrual basis.**

Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
Assets	2016	2015	Change Increase/Decrease
Land	\$ 70,000	\$ -0-	\$ 70,000 Increase
Buildings	200,000	-0-	200,000 Increase
Accumulated depreciation—buildings	(11,000)	-0-	11,000 Increase
Equipment	68,000	-0-	68,000 Increase
Accumulated depreciation—equipment	(10,000)	-0-	10,000 Increase
Accounts receivable	26,000	36,000	10,000 Decrease
Prepaid expenses	6,000	-0-	6,000 Increase
Cash	37,000	49,000	12,000 Decrease
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

When prepaid expenses (assets) increase during a period, expenses on an accrual-basis income statement are lower than they are on a cash-basis income statement.

Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method

To convert net income to net cash flow from operating activities, the increase of \$6,000 must be deduct from net income.

Net income		\$134,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Decrease in accounts receivable	10,000	
Net cash provided by operating activities		<u><u> </u></u>

ILLUSTRATION 23-11

Computation of Net Cash Flow from Operating Activities, Year 2—Indirect Method

Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
	<u>2016</u>	<u>2015</u>	<u>Change Increase/Decrease</u>
<u>Equity and Liabilities</u>			
Share capital—ordinary (\$1 par)	\$ 60,000	\$ 60,000	\$ -0-
Retained earnings	136,000	20,000	116,000 Increase
Bonds payable	150,000	-0-	150,000 Increase
Accounts payable	40,000	5,000	35,000 Increase
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

When accounts payable increase, the company incurred a greater amount of expense than the amount of cash it disbursed.

Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method

Tax Consultants must add the 2016 increase of \$35,000 in **accounts payable to net income**, to convert to net cash flow from operating activities.

Net income		\$134,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Decrease in accounts receivable	10,000	
Increase in prepaid expenses	(6,000)	
	<hr/>	
Net cash provided by operating activities		<hr/> <hr/>


ILLUSTRATION 23-11

Computation of Net Cash Flow from Operating Activities, Year 2—Indirect Method

Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method

TAX CONSULTANTS INC.
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2016

ILLUSTRATION 23-10

Revenues			\$492,000
Operating expenses (excluding depreciation)	\$269,000		
Depreciation expense	<u>21,000</u>		<u>290,000</u>
Income from operations			202,000
Income tax expense			<u>68,000</u>
Net income			<u><u>\$134,000</u></u>

Depreciation expense of \$21,000 (also represented by the increase in accumulated depreciation) is a **non-cash charge**.

Step 2: Determine Net Cash Flow from Operating Activities—Indirect Method

Tax Consultants adds depreciation expense back to net income, to arrive at net cash flow from operating activities.

Net income		\$134,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Decrease in accounts receivable	10,000	
Increase in prepaid expenses	(6,000)	
Increase in accounts payable	35,000	60,000
Net cash provided by operating activities		<u><u>\$194,000</u></u>

ILLUSTRATION 23-11

Computation of Net Cash Flow from Operating Activities, Year 2—Indirect Method

Step 3: Determine Net Cash Flow from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
Assets	2016	2015	Change Increase/Decrease
Land	\$ 70,000	\$ -0-	\$ 70,000 Increase
Buildings	200,000	-0-	200,000 Increase
Accumulated depreciation—buildings	(11,000)	-0-	11,000 Increase
Equipment	68,000	-0-	68,000 Increase
Accumulated depreciation—equipment	(10,000)	-0-	10,000 Increase
Accounts receivable	26,000	36,000	10,000 Decrease
Prepaid expenses	6,000	-0-	6,000 Increase
Cash	37,000	49,000	12,000 Decrease
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

The company purchased land of \$70,000 during the period.

Step 3: Determine Net Cash Flow from Investing and Financing Activities

The purchase of land for cash is an investing activity, reported as a use of cash.

Cash flows from investing activities		
Net cash used by investing activities	_____	
Cash flows from financing activities		
Net cash provided by financing activities	_____	_____

ILLUSTRATION 23-12

Statement of Cash Flows, Tax Consultants Inc., Year 2

Step 3: Determine Net Cash Flow from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
Assets	2016	2015	Change Increase/Decrease
Land	\$ 70,000	\$ -0-	\$ 70,000 Increase
Buildings	200,000	-0-	200,000 Increase
Accumulated depreciation—buildings	(11,000)	-0-	11,000 Increase
Equipment	68,000	-0-	68,000 Increase
Accumulated depreciation—equipment	(10,000)	-0-	10,000 Increase
Accounts receivable	26,000	36,000	10,000 Decrease
Prepaid expenses	6,000	-0-	6,000 Increase
Cash	37,000	49,000	12,000 Decrease
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

Tax Consultants acquired an office building using \$200,000 cash.

Step 3: Determine Net Cash Flow from Investing and Financing Activities

The purchase of a building for cash is an investing activity, reported as a use of cash.

Cash flows from investing activities		
Purchase of land	(70,000)	
Net cash used by investing activities		_____
Cash flows from financing activities		
Net cash provided by financing activities		_____

ILLUSTRATION 23-12

Statement of Cash Flows, Tax Consultants Inc., Year 2

Step 3: Determine Net Cash Flow from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
Assets	2016	2015	Change Increase/Decrease
Land	\$ 70,000	\$ -0-	\$ 70,000 Increase
Buildings	200,000	-0-	200,000 Increase
Accumulated depreciation—buildings	(11,000)	-0-	11,000 Increase
Equipment	68,000	-0-	68,000 Increase
Accumulated depreciation—equipment	(10,000)	-0-	10,000 Increase
Accounts receivable	26,000	36,000	10,000 Decrease
Prepaid expenses	6,000	-0-	6,000 Increase
Cash	37,000	49,000	12,000 Decrease
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

Tax Consultants acquired equipment using \$68,000 cash.

Step 3: Determine Net Cash Flow from Investing and Financing Activities

The purchase of equipment for cash is an investing activity, reported as a use of cash.

Cash flows from investing activities		
Purchase of land	(70,000)	
Purchase of building	(200,000)	
	<hr/>	
Net cash used by investing activities		
Cash flows from financing activities		
	<hr/>	
Net cash provided by financing activities		<hr/>

ILLUSTRATION 23-12

Statement of Cash Flows, Tax Consultants Inc., Year 2

Step 3: Determine Net Cash Flow from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
	<u>2016</u>	<u>2015</u>	<u>Change Increase/Decrease</u>
<u>Equity and Liabilities</u>			
Share capital—ordinary (\$1 par)	\$ 60,000	\$ 60,000	\$ -0-
Retained earnings	136,000	20,000	116,000 Increase
Bonds payable	150,000	-0-	150,000 Increase
Accounts payable	40,000	5,000	35,000 Increase
Total	<u><u>\$386,000</u></u>	<u><u>\$ 85,000</u></u>	

Tax Consultants acquired received \$150,000 from the issuance of bonds.

Step 3: Determine Net Cash Flow from Investing and Financing Activities

The cash received from the issuance of these bonds represents an inflow of cash from a financing activity.

Cash flows from investing activities		
Purchase of land	(70,000)	
Purchase of building	(200,000)	
Purchase of equipment	<u>(68,000)</u>	
Net cash used by investing activities		
Cash flows from financing activities		
	<u> </u>	
Net cash provided by financing activities		<u> </u>

ILLUSTRATION 23-12

Statement of Cash Flows, Tax Consultants Inc., Year 2

Step 3: Determine Net Cash Flow from Investing and Financing Activities

TAX CONSULTANTS INC. COMPARATIVE STATEMENTS OF FINANCIAL POSITION AS OF DECEMBER 31			ILLUSTRATION 23-9
	<u>2016</u>	<u>2015</u>	<u>Change Increase/Decrease</u>
<u>Equity and Liabilities</u>			
Share capital—ordinary (\$1 par)	\$ 60,000	\$ 60,000	\$ -0-
Retained earnings	136,000	20,000	116,000 Increase
Bonds payable	150,000	-0-	150,000 Increase
Accounts payable	40,000	5,000	35,000 Increase
Total	<u>\$386,000</u>	<u>\$ 85,000</u>	

Two factors explain the increase in retained earnings: (1) net income of \$134,000 increased retained earnings, and (2) dividends of \$18,000 decreased retained earnings.

Step 3: Determine Net Cash Flow from Investing and Financing Activities

Payment of the dividends is a financing activity that involves a cash outflow.

Cash flows from investing activities	
Purchase of land	(70,000)
Purchase of building	(200,000)
Purchase of equipment	<u>(68,000)</u>
Net cash used by investing activities	
Cash flows from financing activities	
Issuance of bonds	150,000
	<u> </u>
Net cash provided by financing activities	<u> </u>

ILLUSTRATION 23-12

Statement of Cash Flows, Tax Consultants Inc., Year 2

TAX CONSULTANTS INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2016
INCREASE (DECREASE) IN CASH

ILLUSTRATION 23-12

Cash flows from operating activities		
Net income		\$ 134,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	\$ 21,000	
Decrease in accounts receivable	10,000	
Increase in prepaid expenses	(6,000)	
Increase in accounts payable	<u>35,000</u>	<u>60,000</u>
Net cash provided by operating activities		194,000
Cash flows from investing activities		
Purchase of land	(70,000)	
Purchase of building	(200,000)	
Purchase of equipment	<u>(68,000)</u>	
Net cash used by investing activities		(338,000)
Cash flows from financing activities		
Issuance of bonds	150,000	
Payment of cash dividends	<u>(18,000)</u>	
Net cash provided by financing activities		<u>132,000</u>
Net decrease in cash		(12,000)
Cash, January 1, 2016		<u>49,000</u>
Cash, December 31, 2016		<u><u>\$ 37,000</u></u>

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. Identify the major classifications of cash flows.
3. Prepare a statement of cash flows.
4. Differentiate between net income and net cash flow from operating activities.
5. Determine net cash flows from investing and financing activities.
6. **Identify sources of information for a statement of cash flows.**
7. Contrast the direct and indirect methods of calculating net cash flow from operating activities.
8. Discuss special problems in preparing a statement of cash flows.
9. Explain the use of a worksheet in preparing a statement of cash flows.

Sources of Information for the Statement of Cash Flows

1. Comparative statements of financial position.
2. An analysis of the Retained Earnings account.
3. Write-downs, amortization charges, and similar “book” entries, such as depreciation, because they have no effect on cash.

Indirect Method—Additional Adjustments

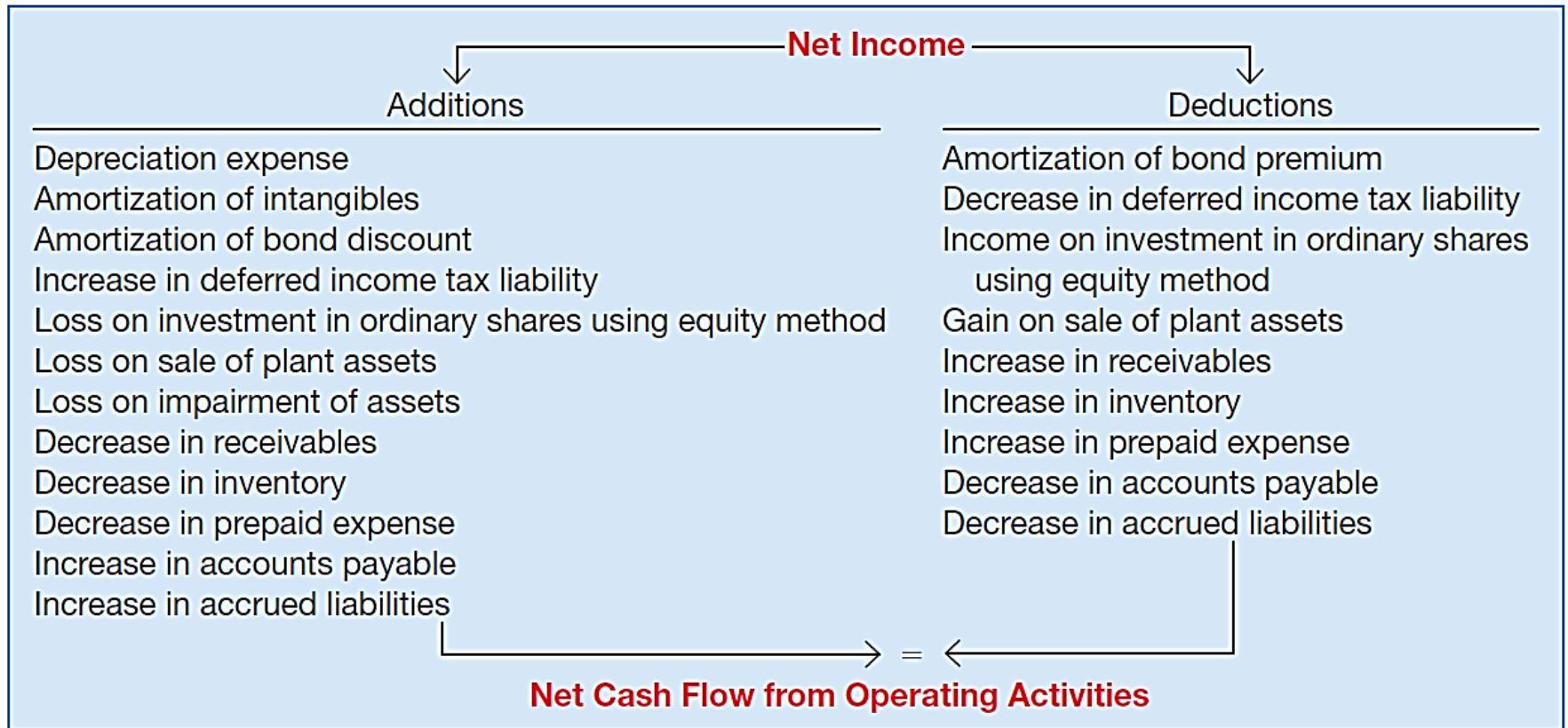


ILLUSTRATION 23-17

Adjustments Needed to Determine Net Cash Flow from Operating Activities—Indirect Method

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. Identify the major classifications of cash flows.
3. Prepare a statement of cash flows.
4. Differentiate between net income and net cash flow from operating activities.
5. Determine net cash flows from investing and financing activities.
6. Identify sources of information for a statement of cash flows.
7. **Contrast the direct and indirect methods of calculating net cash from operating activities.**
8. Discuss special problems in preparing a statement of cash flows.
9. Explain the use of a worksheet in preparing a statement of cash flows.

Net Cash Flow from Operating Activities— Direct Method

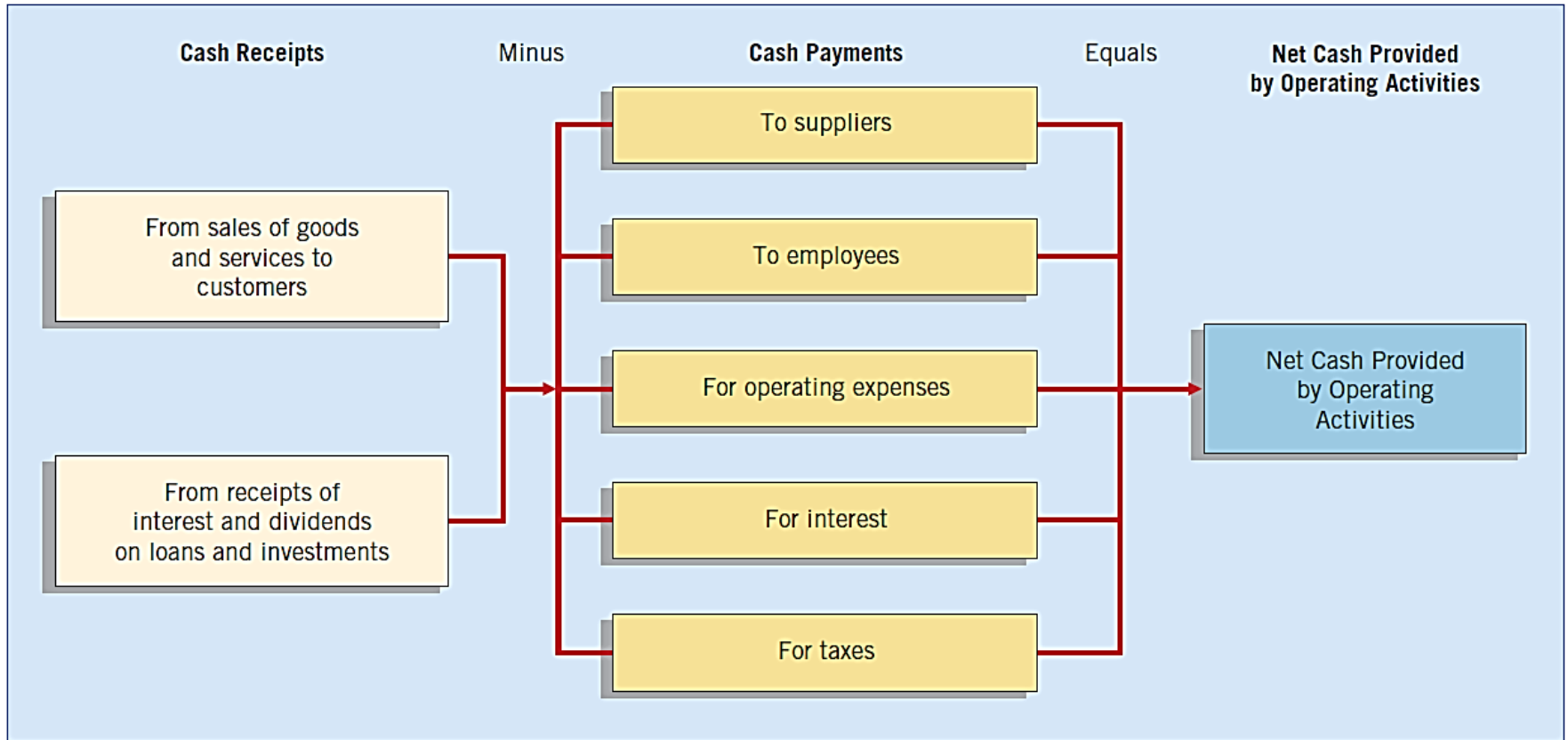


ILLUSTRATION 23-21

Major Classes of Cash Receipts and Payments

Direct Method Example

Drogba Company, which began business on January 1, 2015, has the following selected statement of financial position information.

	December 31, 2015	January 1, 2015
	<u> </u>	<u> </u>
Property, plant, and equipment (net)	€ 90,000	€-0-
Inventory	160,000	-0-
Accounts payable	60,000	-0-
Accrued expenses payable	20,000	-0-
Accounts receivable	15,000	-0-
Prepaid expenses	8,000	-0-
Cash	159,000	-0-

ILLUSTRATION 23-19
Statement of Financial Position
Accounts, Drogba Co.

Direct Method Example

Drogba's December 31, 2015, income statement and additional information are as follows.

ILLUSTRATION 23-20
Income Statement, Drogba Co.

Sales revenue		€780,000
Cost of goods sold		<u>450,000</u>
Gross profit		330,000
Operating expenses	€160,000	
Depreciation	<u>10,000</u>	<u>170,000</u>
Income before income taxes		160,000
Income tax expense		<u>48,000</u>
Net income		<u><u>€112,000</u></u>

Additional Information

- (a) Dividends of €70,000 were declared and paid in cash.
- (b) The accounts payable increase resulted from the purchase of merchandise.
- (c) Prepaid expenses and accrued expenses payable relate to operating expenses.

Operating Activities — Direct Method

Accounts receivable increased €15,000. Thus, ***cash receipts from customers*** are computed as follows.

Illustration 23-22

Cash receipts from customers	=	Sales revenue	{ + Decrease in accounts receivable or - Increase in accounts receivable
-------------------------------------	---	---------------	--

Accounts Receivable

1/1/15	Balance	59,000		Receipts from customers	765,000
	Sales revenue	780,000			
12/31/15	Balance	15,000			

Operating Activities — Direct Method

Drogba Company reported cost of goods sold on its income statement of €450,000. In 2015, Drogba Company's inventory increased €160,000. The company computes purchases as follows.

Cost of goods sold	€450,000
Add: Increase in inventory	160,000
Purchases	<u>€610,000</u>

Accounts Payable

	1/1/15	Balance	0
		Purchases	610,000
	12/31/15	Balance	60,000

Operating Activities — Direct Method

Drogba determines *cash payments to suppliers* by adjusting purchases for the change in accounts payable.

Accounts Payable

		1/1/15	Balance	0
Payments to suppliers	550,000		Purchases	610,000
		12/31/15	Balance	60,000

$$\text{Cash Payments to Suppliers} = \text{Cost of Goods Sold} \left\{ \begin{array}{l} + \text{ Increase in Inventory} \\ \text{or} \\ - \text{ Decrease in Inventory} \end{array} \right\} \left\{ \begin{array}{l} + \text{ Decrease in Accounts Payable} \\ \text{or} \\ - \text{ Increase in Accounts Payable} \end{array} \right\}$$

ILLUSTRATION 23-23

Formula to Compute Cash Payments to Suppliers

Operating Activities — Direct Method

Drogba reported **operating expenses of €160,000** on its income statement. To determine the ***cash paid for operating expenses***, it must adjust this amount for any changes in

- ◆ prepaid expenses and
- ◆ accrued expenses payable.

$$\begin{array}{l} \text{Cash payments} \\ \text{for operating} \\ \text{expenses} \end{array} = \text{Operating} \\ \text{expenses} \left\{ \begin{array}{l} + \text{ Increase in} \\ \text{prepaid expense} \\ \text{or} \\ - \text{ Decrease in} \\ \text{prepaid expense} \end{array} \right. \left\{ \begin{array}{l} + \text{ Decrease in accrued} \\ \text{expenses payable} \\ \text{or} \\ - \text{ Increase in accrued} \\ \text{expenses payable} \end{array} \right.$$

ILLUSTRATION 23-24

Formula to Compute Cash Payments
for Operating Expenses

Operating Activities — Direct Method

Prepaid Expenses

	1/1/15	Balance	0
	12/31/15	Balance	8,000

Accrued Expenses Payable

	1/1/15	Balance	0
	12/31/15	Balance	20,000

Operating expenses	€160,000
Add: Increase in prepaid expenses	8,000
Deduct: Increase in accrued expenses payable	20,000
Cash payments for operating expenses	€148,000

Operating Activities — Direct Method

The income statement for Drogba shows income tax expense of €48,000. *Cash paid for income taxes* is computed by taking the expense and adjusting by the change in the payable.

Income Tax Payable

		1/1/15	Balance	0
Payments for income tax	48,000		Income tax expense	48,000
		12/31/15	Balance	0

Operating Activities — Direct Method

Presentation of the direct method for reporting net cash flow from operating activities.

DROGBA COMPANY STATEMENT OF CASH FLOWS (PARTIAL)

Cash flows from operating activities		
Cash received from customers		€765,000
Cash payments:		
To suppliers	€550,000	
For operating expenses	148,000	
For income taxes	<u>48,000</u>	<u>746,000</u>
Net cash provided by operating activities		€ <u><u>19,000</u></u>

ILLUSTRATION 23-26

Operating Activities Section—Direct Method, 2016

Operating Activities — Direct Method

When companies use the direct method they are required to provide in a separate schedule the reconciliation of net income to net cash provided by operating activities.

DROGBA COMPANY RECONCILIATION

Net income		€112,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	€ 10,000	
Increase in accounts receivable	(15,000)	
Increase in inventory	(160,000)	
Increase in prepaid expenses	(8,000)	
Increase in accounts payable	60,000	
Increase in accrued expense payable	20,000	(93,000)
Net cash provided by operating activities		€ 19,000

Operating Activities — Direct Method

A separate schedule reconciling net income to net cash provided by operating activities is required when using the direct method.

DROGBA COMPANY RECONCILIATION

Net income		€112,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	€ 10,000	
Increase in accounts receivable	(15,000)	
Increase in inventory	(160,000)	
Increase in prepaid expenses	(8,000)	
Increase in accounts payable	60,000	
Increase in accrued expense payable	20,000	(93,000)
Net cash provided by operating activities		€ 19,000

ILLUSTRATION 23-27

Reconciliation of Net Income to Net Cash
Provided by Operating Activities, 2016

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. Identify the major classifications of cash flows.
3. Prepare a statement of cash flows.
4. Differentiate between net income and net cash flow from operating activities.
5. Determine net cash flows from investing and financing activities.
6. Identify sources of information for a statement of cash flows.
7. Contrast the direct and indirect methods of calculating net cash flow from operating activities.
8. **Discuss special problems in a statement of cash flows.**
9. Explain the use of a worksheet in preparing a statement of cash flows.

SPECIAL PROBLEMS IN STATEMENT PREPARATION

Adjustments to Net Income

Depreciation and Amortization

- ◆ Amortization of limited-life intangible assets.
- ◆ Amortization of bond discount or premium.

Postretirement Benefit Costs

- ◆ Company must adjust net income by the difference between cash paid and the expense reported.

Adjustments to Net Income

Changes in Deferred Income Taxes

- ◆ Affect net income but have no effect on cash.

Equity Method of Accounting

- ◆ Net increase in the investment account does not affect cash flows.
- ◆ Company must deduct the net increase from net income to arrive at net cash flow from operating activities.

Adjustments to Net Income

Loss and Gains

- ◆ A loss is added to net income to compute net cash flow from operating activities because the loss is a noncash charge in the income statement.
- ◆ Company reports a gain in the statement of cash flows as part of the cash proceeds from the sale of equipment under **investing activities**, thus it deducts the gain from net income to avoid double-counting—once as part of net income and again as part of the cash proceeds from the sale.

Adjustments to Net Income

Share-Based Compensation

- ◆ Cash is not affected by recording the expense.
- ◆ The company must increase net income by the amount of compensation expense from share options in computing net cash flow from operating activities.

SPECIAL PROBLEMS

Accounts Receivable (Net)

Indirect Method

Because an increase in Allowance for Doubtful Accounts results from a charge to bad debt expense, a company should add back an increase in Allowance for Doubtful Accounts to net income to arrive at net cash flow from operating activities.

	2015	2014	Change Increase/Decrease
Accounts receivable	€105,000	€90,000	€15,000 Increase
Allowance for doubtful accounts	(10,000)	(4,000)	6,000 Increase
Accounts receivable (net)	€ 95,000	€86,000	9,000 Increase

ILLUSTRATION 23-28

Accounts Receivable Balances, Redmark Co.

Accounts Receivable (Net)

Indirect Method

One method of presenting this information in the statement of cash flows:

ILLUSTRATION 23-29
Presentation of Allowance for Doubtful Accounts—
Indirect Method

REDMARK CO.
STATEMENT OF CASH FLOWS (PARTIAL)
FOR THE YEAR 2015

Cash flows from operating activities		
Net income		€40,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	€(15,000)	
Increase in allowance for doubtful accounts	<u>6,000</u>	<u>(9,000)</u>
		<u>€31,000</u>

Accounts Receivable (Net)

Indirect Method

Alternate method (net approach) of presenting this information in the statement of cash flows:

ILLUSTRATION 23-30
Net Approach to
Allowance for Doubtful
Accounts—Indirect
Method

REDMARK CO.
STATEMENT OF CASH FLOWS (PARTIAL)
FOR THE YEAR 2015

Cash flows from operating activities	
Net income	€40,000
Adjustments to reconcile net income to net cash provided by operating activities:	
Increase in accounts receivable (net)	<u>(9,000)</u>
	<u>€31,000</u>

Accounts Receivable (Net)

Direct Method

Company should not net Allowance for Doubtful Accounts against Accounts Receivable.

ILLUSTRATION 23-31
Income Statement,
Redmark Co.

REDMARK CO.		
INCOME STATEMENT		
FOR THE YEAR 2015		
Sales revenue		€100,000
Expenses		
Salaries	€46,000	
Utilities	8,000	
Bad debts	<u>6,000</u>	<u>60,000</u>
Net income		<u><u>€ 40,000</u></u>

Accounts Receivable (Net)

Direct Method

Company should not net Allowance for Doubtful Accounts against Accounts Receivable.

ILLUSTRATION 23-31

REDMARK CO. INCOME STATEMENT FOR THE YEAR 2015		
Sales revenue		€100,000
Expenses		
Salaries	€46,000	
Utilities	8,000	
Bad debts	<u>6,000</u>	<u>60,000</u>
Net income		<u>€ 40,000</u>

REDMARK CO.
STATEMENT OF CASH FLOWS (PARTIAL)
FOR THE YEAR 2015

ILLUSTRATION 23-32
Bad Debts—Direct
Method

Cash flows from operating activities		
Cash received from customers		€85,000
Salaries paid	€46,000	
Utilities paid	<u>8,000</u>	<u>54,000</u>
Net cash provided by operating activities		<u>€31,000</u>

Cash sales should be reported at **€85,000** ($€100,000 - 9,000 - 6,000$).

Increase in Accounts Receivable

LO 8

SPECIAL PROBLEMS

Other Working Capital Changes

Some changes in working capital, although they affect cash, do not affect net income.

- ◆ Purchase of short-term non-trading equity securities.
- ◆ Issuance of a short-term non-trade note payable for cash.
- ◆ Cash dividend payable.

SPECIAL PROBLEMS

Net Losses

Illustration: If the net loss is £50,000 and the total amount of charges to add back is £60,000, then net cash provided by operating activities is £10,000.

Net income (loss)		£(50,000)
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation of plant assets	£55,000	
Amortization of patents	<u>5,000</u>	<u>60,000</u>
Net cash provided by operating activities		<u><u>£ 10,000</u></u>

ILLUSTRATION 23-33

Computation of Net Cash Flow from Operating Activities—Cash Inflow

Disclosures

Significant Non-Cash Transactions

Common noncash transactions that a company should report or disclose:

1. Acquisition of assets by assuming liabilities (including finance lease obligations) or by issuing equity securities.
2. Exchanges of non-monetary assets.
3. Refinancing of long-term debt.
4. Conversion of debt or preference shares to ordinary shares.
5. Issuance of equity securities to retire debt.

Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Describe the purpose of the statement of cash flows.
2. Identify the major classifications of cash flows.
3. Prepare a statement of cash flows.
4. Differentiate between net income and net cash flow from operating activities.
5. Determine net cash flows from investing and financing activities.
6. Identify sources of information for a statement of cash flows.
7. Contrast the direct and indirect methods of calculating net cash flow from operating activities.
8. Discuss special problems in preparing a statement of cash flows.
9. **Explain the use of a worksheet in preparing a statement of cash flows.**

USE OF A WORKSHEET

A worksheet involves the following steps.

Step 1. Enter the statement of financial position accounts and their beginning and ending balances in the statement of financial position accounts section.

Step 2. Enter the data that explain the changes in the statement of financial position accounts and their effects on the statement of cash flows in the reconciling columns of the worksheet.

Step 3. Enter the increase or decrease in cash on the cash line and at the bottom of the worksheet. This entry should enable the totals of the reconciling columns to be in agreement.



STATEMENT OF CASH FLOWS

As in IFRS, the statement of cash flows is a required statement for U.S. GAAP. In addition, the content and presentation of a U.S. GAAP statement of cash flows is similar to one used for IFRS. However, the disclosure requirements related to the statement of cash flows are more extensive under U.S. GAAP.



Relevant Facts

Following are the key similarities and differences between U.S. GAAP and IFRS related to the statement of cash flows.

Similarities

- Both U.S. GAAP and IFRS require that companies prepare a statement of cash flows.
- Both U.S. GAAP and IFRS require that the statement of cash flows should have three major sections—operating, investing, and financing—along with changes in cash and cash equivalents.
- Similar to U.S. GAAP, the cash flow statement can be prepared using either the indirect or direct method under IFRS. For both U.S. GAAP and IFRS, most companies use the indirect method for reporting net cash flow from operating activities.



GLOBAL ACCOUNTING INSIGHTS

Relevant Facts

Similarities

- The definition of cash equivalents used in U.S. GAAP is similar to that used in IFRS.

Differences

- Under U.S. GAAP, bank overdrafts are classified as financing activities. A major difference in the definition of cash and cash equivalents is that in certain situations, bank overdrafts are considered part of cash and cash equivalents under IFRS.



GLOBAL ACCOUNTING INSIGHTS

Relevant Facts

Differences

- Under U.S. GAAP, companies may present non-cash investing and financing activities in the cash flow statement. IFRS requires that non-cash investing and financing activities be excluded from the statement of cash flows. As indicated in the chapter, these non-cash activities should be reported elsewhere. This requirement is interpreted to mean that non-cash investing and financing activities should be disclosed in the notes to the financial statements instead of in the financial statements.
- One area where there can be substantive differences between U.S. GAAP and IFRS relates to the classification of interest, dividends, and taxes. U.S. GAAP requires that except for dividends paid (which are classified as a financing activity), these items are all reported as operating activities. IFRS provides more alternatives for disclosing these items.



GLOBAL ACCOUNTING INSIGHTS

On the Horizon

Presently, the IASB and the FASB are involved in a joint project on the presentation and organization of information in the financial statements. With respect to the cash flow statement specifically, the notion of cash equivalents will probably not be retained. The definition of cash in the existing literature would be retained, and the statement of cash flows would present information on changes in cash only. In addition, the IASB and FASB favor presentation of operating cash flows using the direct method only.

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