

# Statement of Cash Flows

by Sophia



## WHAT'S COVERED

This lesson will cover the statement of cash flows, including its definition, structure, and purpose.

Our discussion breaks down as follows:

## 1. Statement of Cash Flows

Before we begin our discussion on the statement of cash flows, let's take a step back to review the definition of **financial statements**. These are reports providing financial information about a business at a given time.

The **statement of cash flows**, then, is a financial statement that reports cash receipts and cash payments for a specific period, providing information about the business and cash.

It generally covers one year or less, similar to our income statement, and it tells us how the business used cash--meaning the cash payments that were made--as well as how the business generated cash, or cash receipts.

The statement of cash flows can be thought of as a modified income statement. So, if we were to prepare our income statement on the cash basis, the amounts would look very similar to what is in the statement of cash flows.

The statement of cash flows is categorized by type of activity and cash performance is outlined in three main business areas.

- Operating: Activities found on the income statement.
- Investing: Sale or purchase of long-term assets, loaning money, and collecting principal of monies loaned.
- Financing: Cash from financing and cash paid to owners.

We get information from the balance sheet, both the current year balance sheet as well as last year's balance sheet, to create the statement of cash flows. We also get information from our income statement, and lastly, we get transaction-specific information for our cash transactions.



## TERMS TO KNOW

### Financial Statements

Reports providing financial information about a business at a given time.

### Statement of Cash Flows

A financial statement that reports cash receipts and cash payments for a specific period.

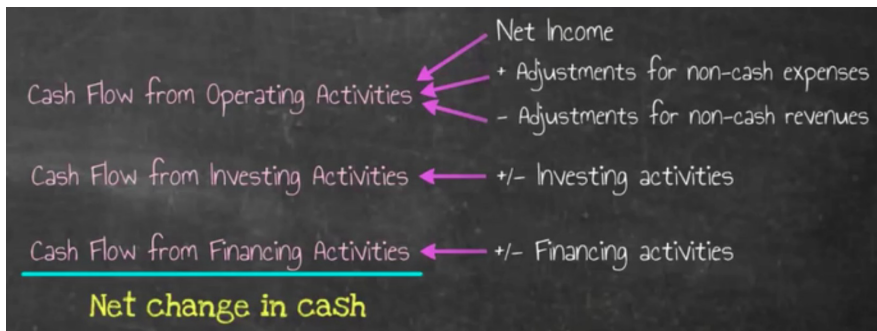
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## 2. Statement of Cash Flows Formula

To find the statement of cash flows, we can follow this formula:

1. Cash Flow From Operating Activities: We start by adding net income and adjustments for non-cash expenses, then subtracting out adjustments for non-cash revenues.
2. Cash Flow From Investing Activities: Next, we add or subtract the investing activities that occurred during the period.
3. Cash Flow From Financing Activities: Then we look at additions or subtractions--cash payments or cash received--for financing activities, which gives us our cash flow from financing activities.

We add all three of these together--the cash flow from operating, cash flow from investing, and cash flow from financing--to provide the net change in cash over the period.



Lastly, we add our beginning cash balance to net change in cash to give us our ending cash balance for the period. It's important to note that the ending cash balance should equal the cash on our balance sheet.



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## 3. Statement of Cash Flows: Example

Now we're going to walk through an example of preparing our statement of cash flows in those three main areas.

Here is our statement of cash flows. The starting point for our statement of cash flows is the header, where we list our company name, "Statement of Cash Flows," and then, because the statement of cash flows is period-based, "For the Period Ending...", in this case, December 31, 2012.

Company ABC Statement of Cash Flows For the period ending December 31, 2012		
<b>Cash flows from operating activities</b>		
Net income		
Adjustments to reconcile net income		
cash provided by operating activities		
Depreciation expense		
Increase in current assets		
Decrease in current assets		
Increase in current liabilities		
Decrease in current liabilities		
<b>Net cash provided by operating activities</b>		
<b>Cash flows from investing activities</b>		
Purchase of equipment		
Loan made to Company ABC		
<b>Net cash used by investing activities</b>		
<b>Cash flows from financing activities</b>		
Loan received from Major Bank		
Owner draws		
<b>Net cash provided by financing activities</b>		
<b>Net increase in cash</b>		
Beginning cash balance		
Ending cash balance		

### 3a. Operating Activities

Now, the first section of the statement of cash flows comprises cash flows from operating activities.

To calculate this, we start with our net income and make what we call "adjustments" to reconcile net income to cash provided by operating activities. This means we're going to adjust our net income for any non-cash items, so that we can only pull the cash flow piece out of our net income to calculate net cash provided by operating activities.

We start with our net income of \$200,000.

Then, in this example, we need to take out the following items:

- Depreciation expense. Since that's a non-cash item, and it was deducted to get to our net income, we need to add it back on our statement of cash flows.
- Changes in current assets. In this section, adjustments are made inversely to what is indicated there. Therefore, an increase in current assets means we would deduct that amount out, whereas a decrease in current assets means we would add that amount back in.
- Changes in current liabilities. These are direct adjustments that move in the same direction, which means that if there's an increase in a current liability item, we would add it back here, while any decrease in a current liability item would be subtracted.

Company ABC Statement of Cash Flows For the period ending December 31, 2012			
<b>Cash flows from operating activities</b>			
Net income			\$ 200,000
Adjustments to reconcile net income			
cash provided by operating activities			
Depreciation expense	\$ 15,000		
Increase in current assets	(10,000)		
Decrease in current assets	7,500		
Increase in current liabilities	20,000		
Decrease in current liabilities	(12,500)	20,000	
Net cash provided by operating activities			<u>220,000</u>
<b>Cash flows from investing activities</b>			
Purchase of equipment			
Loan made to Company ABC			
Net cash used by investing activities			
<b>Cash flows from financing activities</b>			
Loan received from Major Bank			
Owner draws			
Net cash provided by financing activities			
Net increase in cash			
Beginning cash balance			
Ending cash balance			

We total all of our net income adjusting items, which equals \$20,000, then we add this to our net income to get to net cash provided by operating activities (\$220,000).

### 3b. Investing Activities

The next section of the statement of cash flows is cash flows from investing activities. This represents all transactions involving sale or purchase of long-term assets, loaning money, and collecting principal amounts of monies loaned.

So, in this example, we have a purchase of equipment and a loan made to ABC Company. These are both going to be outflows.

Since we purchased equipment, we had to spend cash, so we have to subtract that in this section.

The same applies to a loan made to another company. In this case, we gave another company cash in exchange for agreeing to this loan, which means we had net cash used.

Now, remember, in the previous section, we had net cash *provided*, because it was a positive cash flow. Now, we have net cash *used* by investing activities, resulting in a \$75,000 outflow.

Company ABC			
Statement of Cash Flows			
For the period ending December 31, 2012			
<b>Cash flows from operating activities</b>			
Net income			\$ 200,000
Adjustments to reconcile net income			
cash provided by operating activities			
Depreciation expense	\$ 15,000		
Increase in current assets	(10,000)		
Decrease in current assets	7,500		
Increase in current liabilities	20,000		
Decrease in current liabilities	(12,500)	20,000	
<b>Net cash provided by operating activities</b>		<b>220,000</b>	
<b>Cash flows from investing activities</b>			
Purchase of equipment	(50,000)		
Loan made to Company ABC	(25,000)		
<b>Net cash used by investing activities</b>		<b>(75,000)</b>	
<b>Cash flows from financing activities</b>			
Loan received from Major Bank			
Owner draws			
<b>Net cash provided by financing activities</b>			
<b>Net increase in cash</b>			
Beginning cash balance			
Ending cash balance			

### 3c. Financing Activities

The next section is cash flows from financing activities. This represents all of our cash received from financing to fund operations, as well as paid to owners in drawings.

So, in our example, we received money from a loan; that's an inflow of cash. In addition, the owners pulled \$30,000 out of the business; that's an outflow of cash.

Therefore, the net cash provided by financing activities was \$170,000.

Company ABC Statement of Cash Flows For the period ending December 31, 2012		
<b>Cash flows from operating activities</b>		
Net income		\$ 200,000
Adjustments to reconcile net income		
cash provided by operating activities		
Depreciation expense	\$ 15,000	
Increase in current assets	(10,000)	
Decrease in current assets	7,500	
Increase in current liabilities	20,000	
Decrease in current liabilities	(12,500)	20,000
<b>Net cash provided by operating activities</b>		<b>220,000</b>
<b>Cash flows from investing activities</b>		
Purchase of equipment	(50,000)	
Loan made to Company ABC	(25,000)	
<b>Net cash used by investing activities</b>		<b>(75,000)</b>
<b>Cash flows from financing activities</b>		
Loan received from Major Bank	200,000	
Owner draws	(30,000)	
<b>Net cash provided by financing activities</b>		<b>170,000</b>
<b>Net increase in cash</b>		
Beginning cash balance		
Ending cash balance		

Now we total together our cash flow provided by operating activities, cash flow used by investing activities, as well as net cash provided by financing activities, to get to the net increase in cash.

Company ABC Statement of Cash Flows For the period ending December 31, 2012		
<b>Cash flows from operating activities</b>		
Net income		\$ 200,000
Adjustments to reconcile net income		
cash provided by operating activities		
Depreciation expense	\$ 15,000	
Increase in current assets	(10,000)	
Decrease in current assets	7,500	
Increase in current liabilities	20,000	
Decrease in current liabilities	(12,500)	20,000
<b>Net cash provided by operating activities</b>		<b>220,000</b>
<b>Cash flows from investing activities</b>		
Purchase of equipment	(50,000)	
Loan made to Company ABC	(25,000)	
<b>Net cash used by investing activities</b>		<b>(75,000)</b>
<b>Cash flows from financing activities</b>		
Loan received from Major Bank	200,000	
Owner draws	(30,000)	
<b>Net cash provided by financing activities</b>		<b>170,000</b>
<b>Net increase in cash</b>		<b>315,000</b>
Beginning cash balance		
Ending cash balance		

Finally, we add the beginning balance in cash to arrive at our ending cash balance of \$435,000, which should equal the cash on our balance sheet.



Company ABC Statement of Cash Flows For the period ending December 31, 2012		
<b>Cash flows from operating activities</b>		
Net income		\$ 200,000
Adjustments to reconcile net income		
cash provided by operating activities		
Depreciation expense	\$ 15,000	
Increase in current assets	(10,000)	
Decrease in current assets	7,500	
Increase in current liabilities	20,000	
Decrease in current liabilities	(12,500)	20,000
<b>Net cash provided by operating activities</b>		<b>220,000</b>
<b>Cash flows from investing activities</b>		
Purchase of equipment	(50,000)	
Loan made to Company ABC	(25,000)	
<b>Net cash used by investing activities</b>		<b>(75,000)</b>
<b>Cash flows from financing activities</b>		
Loan received from Major Bank	200,000	
Owner draws	(30,000)	
<b>Net cash provided by financing activities</b>		<b>170,000</b>
<b>Net increase in cash</b>		<b>315,000</b>
Beginning cash balance		120,000
<b>Ending cash balance</b>		<b>435,000</b>



## SUMMARY

Today we learned about the **statement of cash flows**, which is the financial statement that reports cash receipts and cash payments for a specific period. These items are reported within **operating activities**, **investing activities**, and **financing activities**. We learned the **statement of cash flows formula**, and put it into practice by exploring an **example of preparing a statement of cash flows**.

Source: Adapted from Sophia instructor Evan McLaughlin.



## TERMS TO KNOW

### Financial Statements

Reports providing financial information about a business at a given time.

### Statement of Cash Flows

A financial statement that reports cash receipts and cash payments for a specific period.