**Statement of Cash Flows Script**

Slide 1: In this presentation, I will talk about the Statement of Cash Flows. This is the last statement prepared, as we need to have completed balance sheets in order to complete. Before we begin, you may wish to review the presentations on the Income Statement and Balance Sheet to be more familiar with the items contained therein.

Slide 2: Why do we prepare this statement? Rarely, if ever, does the amount of cash in the bank equal net income reported for a period, and this statement helps us to understand why. In essence, this statement reconciles the amount of net income on the income statement to the amount of cash in the cash ledger.

Some of the reasons net income and cash aren’t equal can be as a result of credit sales and purchases – these affect net income, but, don’t affect cash.

Borrowing and repayment of loans affect cash but don’t affect net income, as do purchases and disposals of PP&E.

Changes in contributed capital – like sales of stock – affect cash, but not net income. Dividends affect cash similarly.

This statement shows us **sources** of funds – where cash is coming from – and **uses** of funds – where cash is going. Thinking in terms of sources and uses has always helped me when I’m preparing this statement and when my students and I are working on this topic.

Slide 3: We will be focusing on the Indirect Method of preparation – it’s what I have seen used most often when I was “in the business” and, to me, makes the most sense.

We can see here, with no numbers, how the statement is laid-out. There are three main sections: Cash Flow from Operating Activities, Cash Flow from Investing Activities and Cash Flow from Financing Activities. These are summed together and that figure provides the ‘change in cash’ we see towards the bottom of the statement.

Slide 4: On this page, I have some financial and other information we will use to prepare the statement. In order to prepare the statement, we must have the current period income statement, the current period balance sheet, the prior period balance sheet, plus any other information related to things like purchases and disposals of PP&E, changes in contributed capital, payment of dividends, and so forth. You can see just that type of information in the “other information” section.

We will go through and do the three main sections first, then complete the statement over the next few slides. Remember, as with most topics in Accounting, it takes a lot of practice and repetition, so I’d suggest you print out this page (from “Cash Flow Financials and Statement”) and get out some paper and your calculator and work along.

Slide 5: Since we are reconciling Net Income to Cash, we want to start with Net Income. To this, we will add some items and deduct some items. The first addition is depreciation expense. This expense affects net income but does not affect cash – we don’t write out a check to depreciation each period.

Similarly, we add decreases in current assets, such as inventory and prepaids shown here. We spend the cash up front for inventory and prepaids; the adjustments to reflect usage do not affect cash. In our cash here, we (1) debit COGS & credit Inventory and (2) debit insurance expense & credit prepaid insurance. The increase in unearned revenue is also a source of cash. Finally, we add back the loss on disposal; we want to negate its effect on net income because we will account for the cash involved later.

We deduct increases in current assets as these are uses of cash – just like the A/R increase here. In addition, we deduct decreases in current liabilities, as these are also uses of cash.

Summing all of these together provides us with Net Cash Flow from Operating Activities.

Slide 6: In the next section, we only have two items to deal with – a purchase and a disposal. The purchase of PP&E is a use of cash and the sale is a source of cash. Adding the two together gives us our Net Cash Flow from Investing Activities (investing is PP&E assets, if you will). 99% of the time, we will just be looking at PP&E, although there are other investments in assets companies can make, such as loans to subsidiaries.

Slide 7: In this section, we look at Financing activities. This includes changes in notes payable, changes in long term debt, changes in paid in capital and payment of dividends. Since there are no notes in our financials, we’ll move to long term debt.

A decrease in long term debt arises out of a use of cash. An increase in paid in capital is a source of cash and the payment of dividends is a use of cash. Summing all of these gives us the Net Cash Flow from Financing Activities.

Slide 8: Here, I’ve listed the cash flows from the three sections and added them together to arrive at Change in Cash.

We add Change in Cash to the beginning cash balance – in our case, the cash from the Year 1balance sheet. As you can see, that sum is equal to the amount of cash on the Year 2 balance sheet. We have successfully reconciled Year 2 Net Income to Year 2 Cash.

Slide 9: If you’d like a larger version of this, you can print it from “Cash Flow Financials and Statement…

…just think about how much information we have to now explain that 20,000 change in cash. We can discuss 11 changes that contributed to this overall change.

I hope this helps you to better understand this important part of the financial statements.