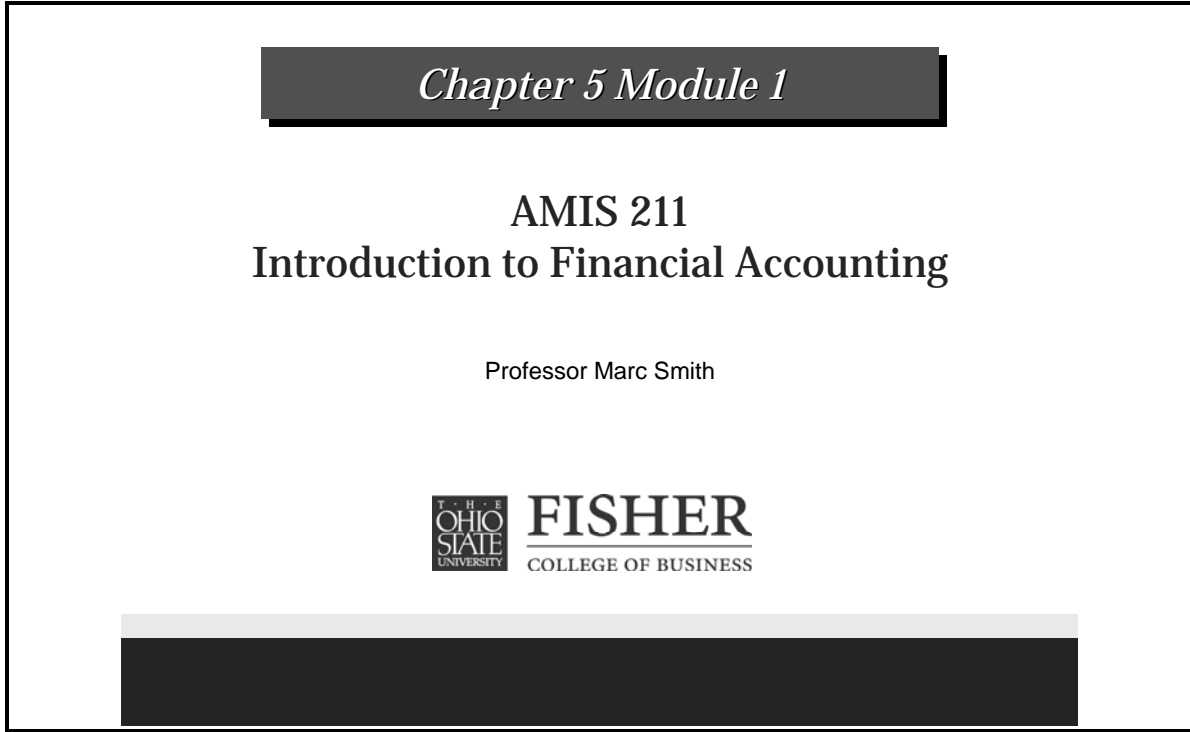


**Chapter 5, Module 1**

**Slide 1**

A rectangular box with a black border containing the slide's content. At the top, a dark grey bar contains the text "Chapter 5 Module 1" in white italicized font. Below this, the text "AMIS 211" and "Introduction to Financial Accounting" is centered in a bold serif font. Underneath, "Professor Marc Smith" is centered in a smaller serif font. The Fisher College of Business logo is centered below that, featuring a square with "T H E OHIO STATE UNIVERSITY" and the word "FISHER" in large letters above "COLLEGE OF BUSINESS". At the bottom of the box, there are two horizontal bars: a light grey one on top and a dark grey one on the bottom.

Hi everyone. Welcome back.

In this chapter, let's spend a little bit of time talking about the Statement of Cash Flows.

Now, we briefly introduced the Cash Flow Statement in a previous chapter; but let's get a little bit more in depth with what we find on the Cash Flow Statement and how to do some of the calculations.

So, that said; let's go ahead and jump right into it.

Go to the next slide with me.

Slide 2

***Chapter 5 Module 1: Statement of Cash Flows***

**STATEMENT OF CASH FLOWS**

The *statement of cash flows* shows the changes in cash for the same period of time as that covered by the income statement. The cash flow statement shows all sources (i.e., receipts) of cash and all of the uses (i.e., payments) of cash.

It provides information about:

- cash receipts (inflows)
- cash payments (outflows)

And, I think we will find in this module it is pretty much a review of what we had seen previously about the Cash Flow Statement.

But, let's start with the definition.

The Statement of Cash Flows is the financial statement that shows the changes in cash for a period of time. It is typically the same period as that covered by the Income Statement—from January through December, here is what happened to our cash.

The Cash Flow Statement provides information about the cash that has come in—the cash receipts or cash inflows—as well as the cash that we have spent—the cash outflows or cash disbursements.

Go ahead to the next slide with me.

Slide 3

*Chapter 5 Module 1: Statement of Cash Flows*

**QUESTION:** How does the statement of cash flows differ from the other major financial statements?

**ANSWER:** The other financial statements (i.e., the income statement and balance sheet) are based on **ACCRUAL ACCOUNTING** (the realization principle and the matching concept) whereas the cash flow statement simply shows all of the increases and decreases in **CASH**

And, let's answer a question.

How does the Statement of Cash Flows differ from the other major financial statements—specifically: the Income Statement and Balance Sheet?

How will the Cash Flow Statement be different from the other statements that we have spent a lot more time talking about?

The answer is this:

The other statements—the Income Statement and Balance Sheet—are Accrual-based financial statements. That is: they follow GAAP. They follow the Realization and Matching concepts.

The Cash Flow Statement is—as the name suggests—based on cash. It is simply the cash coming in and the cash going out.

Remember: the Income Statement, for example, does not reflect cash. It does not mean because we have recorded revenues of \$100.00 that we in fact

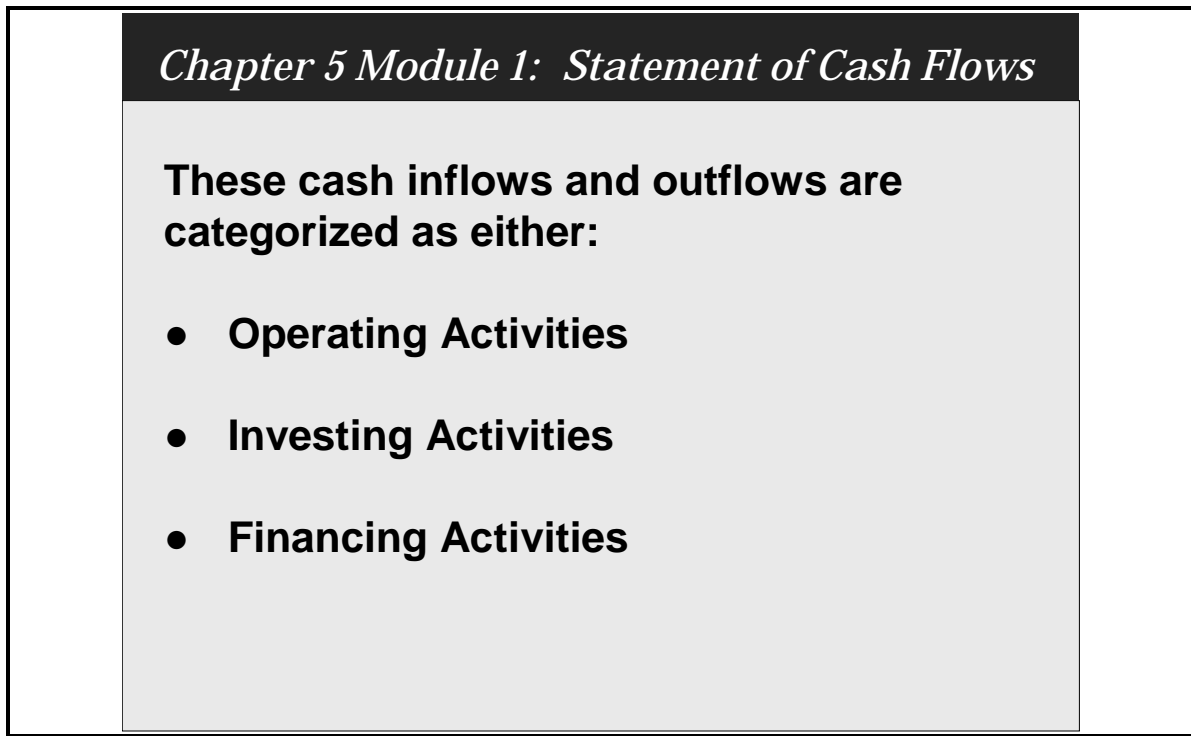
have collected \$100.00 in cash. We could have sold—and most likely did sell—on account.

So, the Cash Flow Statement differs because it does not follow those Accrual Accounting concepts that we talked a lot about in previous discussions.

It is a Cash-Based Statement as the name suggests.

Go ahead to the next slide.

**Slide 4**

A rectangular box with a black border containing text about cash flow categories. The top part of the box has a dark background with white text. The main body of the box has a light gray background with black text.

*Chapter 5 Module 1: Statement of Cash Flows*

**These cash inflows and outflows are categorized as either:**

- **Operating Activities**
- **Investing Activities**
- **Financing Activities**

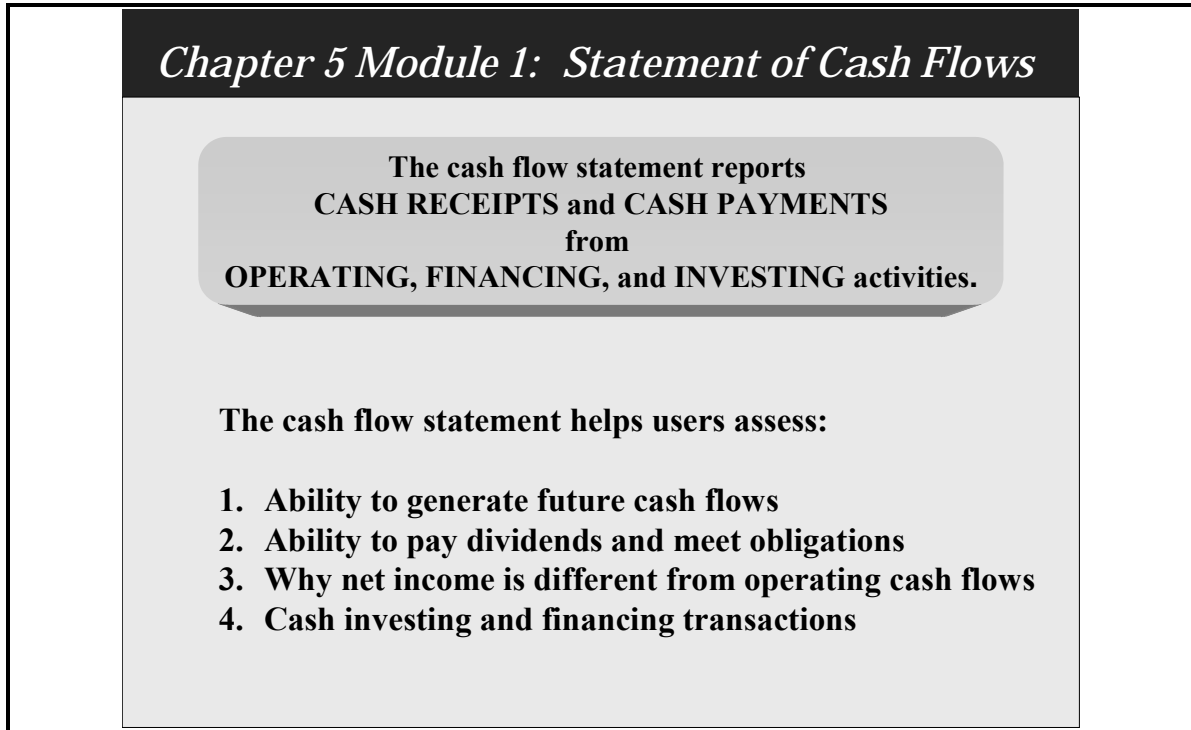
And, you remember from when we previously talked about the Cash Flow Statement: this Statement divides the inflows and outflows of cash into three (3) categories.

Remember they are 1) the Operating Activities, 2) the Investing Activities, and 3) the Financing Activities.

So, depending on what the cash was either received for or spent on, it will be categorized into one of these three (3) categories.

Go ahead to the next slide with me.

**Slide 5**

A rectangular box with a black border containing text about the Statement of Cash Flows. The title is in a dark header bar, and the main content is in a light gray rounded rectangle.

***Chapter 5 Module 1: Statement of Cash Flows***

**The cash flow statement reports  
CASH RECEIPTS and CASH PAYMENTS  
from  
OPERATING, FINANCING, and INVESTING activities.**

**The cash flow statement helps users assess:**

- 1. Ability to generate future cash flows**
- 2. Ability to pay dividends and meet obligations**
- 3. Why net income is different from operating cash flows**
- 4. Cash investing and financing transactions**

And, here is a review of what we just said in the little box.

The Statement of Cash Flows divides the cash receipts and cash payments into Operating, Investing, and Financing categories or activities.

The purpose of the Cash Flow Statement is to help the users of financial statements answer a couple of different questions.

1) It gives a feel for the company's ability to generate cash flows.

We look at what they are doing currently in terms of bringing in cash and spending cash and what will they be able to do in future. Are they going to be able to continue to generate enough cash to be able to pay its bills?

Another important piece of information the Cash Flow Statement provides is 2) it tells the company's ability to pay its debts or to pay its Owners dividends.

It also gives us a good feel for 3) why Net Income—the Accrual number from the Income Statement—is different from Operating cash flows.

And, finally 4) it gives a feel for what the cash Investing and Financing Activities are all about.

The key point here: the Cash Flow Statement lets users of financial statements get a feel for the cash position of the company.

Having a lot of income is fantastic but if you do not have the cash to go with it, it does you no good because you won't have the cash to pay your bills.

Go ahead to the next slide with me.

**Slide 6**

<p><b><i>Chapter 5 Module 1: Operating Activities</i></b></p> <p><b>The <i>operating activities</i> section of the statement of cash flows includes the cash inflows and outflows related to the normal course of business operations.</b></p> <p><b>Said another way, the <i>operating activities</i> section is the cash effect of all items appearing on the income statement (the cash effect of transactions that create revenues and expenses and thus enter into the determination of net Income)</b></p> <p><b>Involve Income Statement Items</b></p>
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And, let's go through those three different types of Activities one more time.

The Operating Activities:

That represents the cash inflows and outflows that are related to the normal course of the company's operations. Through the normal course of business, the cash in and out would be classified as Operating.

Thinking of it in a slightly different way:

The Operating cash flows are the cash effects of those items that impact Net Income. It is the cash effects of the Revenues and Expenses that we find on the Income Statement.

Now, remember: just having revenues of \$100.00 does not mean cash of \$100.00. So, we are going to have to dig in there a little bit and figure out what the cash effect was.

But, those items on the Income Statement—their cash effect is classified in the Operating Activities section.

So, as a little reminder: remember that Operating Activities involve the cash effect of Income Statement items.

Go to the next slide with me.

Slide 7

*Chapter 5 Module 1: Operating Activities*

**QUESTION:** If the income statement reports sales revenue of \$1 million, does that mean the company collected \$1 million dollars from customers?

**ANSWER:** No!!! Sales could have been made on account

**QUESTION:** Which income statement item does NOT have a cash effect?

**ANSWER:** Depreciation (called a non-cash expense)

And, answer a question for me.

I think we have kind-of answered it already. But, let's go through it one more time.

If the Income Statement reports Sales Revenue of \$1,000,000—yes or no—does that mean that the company collected \$1,000,000 of cash from its customers?

Just based on the previous five minutes of discussion that we have had here, we should know that the answer is: “No, of course not.”

Reporting sales of \$1,000,000 very likely means: some of those sales were made on account or made on credit. So, we did not collect the cash at the time that we made the sale. We just will collect the cash at a future point in time.

So, that kind of brings me to another question:

Which Income Statement item—and there is more than one but we will focus on just one for right now—which major Income Statement item does not have a cash effect?

Which item on the Income Statement that we have already talked about does not impact cash in any way?

Think about it for a second.

The answer is: Depreciation.

Depreciation simply represents the using up of buildings and equipment. It does not cause a cash outflow.

Depreciation, thus, is referred to as a non-cash expense.

Keep that in mind because that is going to become very important over the next couple of modules as we start digging into some of these problems and understanding exactly what these different categories of cash flows tell us.

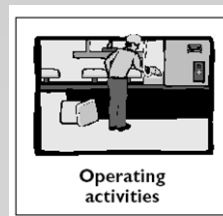
Depreciation is a non-cash expense. It means: no cash changes hands to depreciate an asset.

Go ahead to the next slide with me.

Slide 8

*Chapter 5 Module 1: Operating Activities*

- **Cash inflows:**
  - From sale of goods or services
  - From return on loans (interest received) and on equity securities (dividends received)
  
- **Cash outflows:**
  - To suppliers for inventory
  - To employees for services
  - To government for taxes
  - To lenders for interest
  - To others for expenses



And, for our Operating Activities, let's list out the common examples of inflows and outflows.

Common examples of cash inflows that are Operating Activities:

The major one is the cash that we receive from our Customers—from selling goods to them or providing services to them.

Another example of a cash inflow that is considered Operating would be: any cash that we get as a return on loans that we have made. For example, interest that we receive when we lend money to the bank by keeping it in a savings account.

It would also be: any return that we get on investments that we have made. When we buy stock in another company, we may receive a dividend. That would be Dividend Revenue and the cash that we get for those would be an Operating cash inflow.

For outflows:

The most common Operating cash outflow would be to our Suppliers—the cash we spend to purchase our inventory.

Other examples of outflows include any cash that we pay for expense items: cash paid to Employees for salaries, cash paid to the Government for taxes, cash paid to our Creditors as interest, cash paid for any expense.

So, the cash effects of our Income Statement are the cash inflows and outflows that make up the Operating Activity section of the Cash Flow Statement.

Let's go ahead to the next slide.

Slide 9

<p><b><i>Chapter 5 Module 1: Investing Activities</i></b></p> <p><b>The <i>investing activities</i> section of the statement of cash flows includes the cash inflows and outflows related to the purchase and sale of long-term assets and investments.</b></p> <ul style="list-style-type: none"><li>• <b>Long-term assets include P-P-E &amp; intangibles</b></li><li>• <b>Investments represent both stock and bonds of other companies that we own as well as loans that we have made (i.e., lending money to customers)</b></li></ul> <p><b>Involve Investments and Long-Term Asset Items</b></p>
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And, let's look at our Investing Activities—the second category of cash flows on this financial statement.

Remember: Investing Activities represent cash inflows and outflows related to buying and selling long-term assets and investments.

Now remember: long-term assets include things like property, plant, and equipment (P-P-E)—land, building, and equipment; and intangibles—things like patents and trademarks and copyrights.

Investments are when we buy stock or bonds in another company. So the cash that is either paid to buy those investments or the cash that we may receive if we sell them; that is classified as an Investing Activity.

Investments also include making loans to other entities—be it another organization or a customer. That is considered an investment. And the loans that we make and then get paid back are considered an Investing Activity.


As a little reminder: Investing Activities involve long-term assets and investments—so they relate to long-term assets and investments.

Let's go ahead to the next slide.

### Slide 10

*Chapter 5 Module 1: Investing Activities*

- **Cash inflows:**
  - From sale of property, plant, and equipment
  - From sale of investments in other entities
  - From collection of principal on loans to other entities  
(NOTE: The interest received would be considered an operating activity since it would effect net income)
- **Cash outflows:**
  - To purchase property, plant, and equipment
  - To purchase investments in other entities
  - Making loans to other entities



The illustration shows a delivery truck with two signs on its side that say 'CASH'. Below the truck, the text 'Investing activities' is written.

And, let's list out common examples of inflows and outflows that are Investing Activities.

And, we have already done this in a previous module a couple of chapters ago. But, let's just go through it again so that we can refresh ourselves.

The inflows:

That is the cash paid from selling these items—cash paid from selling land, building, and equipment or intangibles.

It is cash paid from selling investments in other organizations.

It is cash that we get back from people that we have made loans to—so cash that is repaid to us for loans that we have made.

Note something very important here: that only is for the principle of the loan.

The interest that we earn—the interest that we get repaid is classified as an Operating Activity because: the interest affects Net Income. The interest is an Expense item. So, the cash that we get for interest is Operating Activity.

The cash, that is the repayment of principle for loans that we have made; that cash, is classified as Investing Activity.

Now, all you have to do is turn these three things around to get the common three examples of outflows:

It is cash that is spent to purchase: P-P-E and intangibles.

It is cash that is spent to purchase, or buy investments in other organizations.

It is cash that you give when you are giving a loan. And, if you make a loan to me, you are going to give me \$100.00. That would be considered an Investing outflow.

Okay! We have seen Operating Activities. We have seen Investing Activities.

Let's go to the next slide and let's look at our Financing Activities.

Slide 11

***Chapter 5 Module 1: Financing Activities***

**The *financing activities* section of the statement of cash flows represents cash that is either paid to or received from owners and creditors.**

**Involve Long-Term Liability and Stockholders' Equity Items**

Financing Activities are cash that is either received from or paid to our Owners and Creditors.

As a little reminder: your Investing Activities involve long-term liabilities and stockholders' equity items.

So, it relates to long-term debt—money that we get and give to our Creditors. And, it relates to stockholders equity—cash that we get and give to our Owners.

If you would go to the last slide, let's list out some common examples of Financing Activities.

Slide 12

*Chapter 5 Module 1: Financing Activities*

- **Cash inflows:**
  - From sale of company's own stock to its stockholders
  - From borrowing money (i.e., a bank loan)
- **Cash outflows:**
  - To stockholders as dividends
  - To creditors as the repayment of principle of funds borrowed (**NOTE:** The interest payment would be considered an operating activity since it would effect net income)



Common Financing inflows include: cash that we get from selling our own stock. When we sell stock to our Owners, they give us cash. That is a Financing inflow.

They also include cash that we get from borrowing. If you go to the bank and you borrow money, the cash that they give you is a Financing inflow.

The common Financing outflows:

Cash paid to our Stockholders in the form of a dividend.

And, of course, the cash that we have to give to our Creditors as the repayment of principle of loans borrowed.

Please note: Just like when we made the loans and we got the cash back—when we borrow the money and have to pay it back, the principle repayment is a Financing Activity.

However, because the interest affects Net Income—it is an expense—the interest piece of what we pay back is considered an Operating Activity.

That is a key point. You will want to make sure you are comfortable with that idea.