



Title: Statement of Cash Flow  
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# Statement of Cash Flows (SCF)

# Cash vs. Accrual Accounting

- Cash basis accounting
  - Recognizes revenue when cash is received and expenses when cash is paid
  - Beginning cash + cash revenue – cash payments = ending cash
- Accrual basis accounting
  - Recognizes revenue when earned and expenses when incurred



# Overview of Financial Statements

- Balance sheet
  - provides a point-in-time statement of overall financial position of a hotel - “snapshot” of financial health of a hotel
- Income statement
  - Assess hotel’s operating performance over a period of time
  - Reports the profitability of a hotel’s operating activities
- Prepared on accrual basis accounting and include noncash revenues & expenses
  - Neither can answer questions regarding cash inflows and outflows during an operating period

# Purpose of Statement of Cash Flows

- Report and identify the effects of cash receipts and cash disbursements on hotel's business activities during a period of time
  - Allows an evaluation of hotel's liquidity & solvency
  - Provides basis for the evaluation of managers' performance on cash management
  - Provides basis for cash budgeting
  - Provides a foundation to predict hotel's future cash flows

# Cash Flow Activity Levels

- Operating activities
  - Relate to hotel's primary revenue generating activities; such activities are usually included in determining income.
- Investing activities
  - Include buying and selling fixed assets, buying and selling securities/investments not classified as cash equivalents, etc.
- Financing activities
  - Include borrowing and paying long-term debt, issuing stocks, paying dividends, etc.

# Questions that SCF can answer

- How much did the cash position increase/decrease from operating activities?
- Did normal operation activities generate the major portion of cash inflows?
- How much cash was invested in capital assets?
- How much cash was recovered from the disposal of FF&E items?
- How much cash was received from the sale of long-term investments?
- How much cash was obtained by incurring long-term liabilities?
- How much cash was paid to reduce long-term liabilities?
- How much cash was received through the sale of ownership equity?
- What amount of cash did the proprietor or the partners withdraw?
- What amount was paid out as dividends?

# Preparation of SCF

- Cash include cash on hand, cash in the bank, and cash equivalents.
  - Cash equivalents are short-term, highly liquid investments, e.g. demand deposits, money market funds, marketable securities, treasury bills, etc.
- Two methods in reporting operating activities
  - Direct & indirect approach
  - The indirect approach is far more widely used
- The investing and financing sections are prepared the same way regardless of the method used to determine cash flow from operating activities
- Preparation of SCF requires information from balance sheet and income statement



# Direct Method

- The **direct** method for determining cash flows from operations includes major classes of gross cash receipts and cash payments.
  - **Cash flow from operating activities (direct method)**

## Cash receipts

cash collected from customers, lessees, licensees, etc. (increase)

other operating cash receipts (increase)

## Cash payments

cash paid to employees, suppliers of goods or services (decrease)

interest, income taxes paid (decrease)

other operating cash payments (decrease)

**Net cash flow, operating activities**

# Indirect Method

- The indirect method makes adjustments to accrual-basis net income and convert it to a cash basis
  - Typical noncash items included in income statement
    - Depreciation & amortization
  - Items in income statement but not related to operating activities
    - Gain or loss on disposal of long-lived assets
  - Items related to operating activities but appear on the balance sheet
    - Analysis of changes in current assets and current liabilities

# General Rules for Determining Net Cash Flows from Operating Activities

- Depreciation /amortization expenses are **ADDED** to Net Income
- Loss on disposal of long-term asset is **ADDED** to Net Income
  - Cash proceeds received from the sale are recorded in 'investing activities'
- Gain on disposal of long-term asset is **DEDUCTED** from Net Income
  - Cash proceeds received from the sale are recorded in 'investing activities'
- Changes in current assets, such as accounts receivable, inventories, & prepaid items
  - A Current Asset Increase is **DEDUCTED** from Net Income
  - A Current Asset Decrease is **ADDED** to Net Income
- Changes in current liabilities, such as accounts payable, accrued liabilities, & deferrals
  - A Current Liability Increase is **ADDED** to Net Income
  - A Current Liability Decrease is **DEDUCTED** from Net Income

# Statement of Cash Flows Example

Rocky Mountain Hotel,  
Statement Of Cash Flow 2012

# Operating Activities

Net Income		\$	902,322.68	
Adjustment to Reconcile to Cash Provided by Operations:				
Decrease in Account Receivable	\$32,417.73			
Increase in Inventories	(\$3,452.33)			<b>Current Assets↑ CF↓</b>
Increase in Prepaid Expenses	(\$3,007.71)			<b>Current Assets↓ CF↑</b>
Decrease in Other Current Assets	\$10,255.96			
Increase in Account Payable	\$220,569.78			
Decrease in Accrued Expenses	(\$6,737.52)			<b>Current Liabilities↑ CF↑</b>
Increase in Advance Deposits	\$3,380.14			<b>Current Liabilities↓ CF↓</b>
Increase in Other Liabilities	\$16,153.60			
Depreciation	\$638,276.26			<b>Add back Depre. &amp; amort.</b>
Amortization	\$33,600.00			
*Loss on sale of equipment	\$3,000.00			<b>Add back loss on sale</b>
*Gain on sale of furnishings	(\$1,500.00)			<b>Deduct gain on sale</b>
<b>Net Cash Provided by Operating Activities</b>		\$	<b>1,845,278.59</b>	

\*The \$3,000 loss on sale of equipment (book value \$7,000 but sold at \$4,000) is added back because the loss reduced NI but did not reduce cash; \$4,000 cash received from the sale is recorded in 'investing activities'

\*The \$1,500 gain on sale of furnishings (book value \$900 but sold at \$2,400) is deducted because the gain increased the NI. The \$2,400 cash received from the sale is recorded in 'investing activities'

# Investing Activities

<b>Cash Flow from Investing Activities</b>			
	Purchase Land, FF&E, & Building	\$ (890,045.98)	
	Sale of equipments	\$4,000.00	
	Sale of furnishings	\$2,400.00	
	<b>Net Cash Provided by Investing Activities</b>		<b>\$ (883,645.98)</b>

- ✓ Items included in this section:
  - ✓ Transactions that affect non current asset accounts
    - ✓ Purchase or disposal of short-term or long-term investments
    - ✓ Purchase or disposal of long term assets

# Financing Activities

<b>Cash Flow from Financing Activities</b>				
	Proceeds from Debt or Equity Financing	\$	-	
	Repurchase of Stock	\$	(615,000.00)	
	Dividend Paid	\$	(263,387.08)	
	<b>Net Cash Provided by Financing Activities</b>			\$ (878,387.08)

✓ Focus on long term liability and stockholders' equity accounts

# Cash Flow Statement

## Cash flow from operating activities (indirect method)

Net income

increase in current assets (-)

decrease in current assets (+)

increase in current liabilities (+)

decrease in current liabilities (-)

gain on disposal of long term assets (-)

loss on disposal of long term assets (+)

depreciation & amortization (+)

**Net cash flow, operating activities** A

## Cash flow from investing activities

purchase of long-term assets (-)

sale of long-term assets (+)

purchase of investment (-)

sale of investment (+)

**Net cash flow, investing activities** B

## Cash flow from financing activities

reduction of long-term debts (-)

borrow additional long-term debts (+)

redeem capital stock (-)

dividends paid (-)

**Net cash flow, financing activities** C

**Net cash flow increase / decrease (A + B + C)**

+ Cash balance at the beginning of the year

= Cash balance at the end of the year



# In-class Exercise

- Prepare the **operating activities** section of a statement of cash flows using **indirect method**, based on the following information:
  - Net income for the year is \$43,900
  - Accounts receivable increased by \$10,420
  - Inventory increased by \$1,875
  - Depreciation expense for the year is \$8,000
  - Accounts payable decreased by \$5,782
  - Other current liabilities increased by \$3,500
  - Taxes payable decreased by \$1,970
  - Old equipment with a book value of \$2,200 was sold for \$1,325
  - Marketable securities were sold for \$24,000 at a gain of \$4,800