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
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

<table>
<thead>
<tr>
<th>Net Income</th>
<th>$ 902,322.68</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Adjustment to Reconcile to Cash Provided by Operations:</strong></td>
<td></td>
</tr>
<tr>
<td>Decrease in Account Receivable</td>
<td>$32,417.73</td>
</tr>
<tr>
<td>Increase in Inventories</td>
<td>($3,452.33)</td>
</tr>
<tr>
<td>Increase in Prepaid Expenses</td>
<td>($3,007.71)</td>
</tr>
<tr>
<td>Decrease in Other Current Assets</td>
<td>$10,255.96</td>
</tr>
<tr>
<td>Increase in Account Payable</td>
<td>$220,569.78</td>
</tr>
<tr>
<td>Decrease in Accrued Expenses</td>
<td>($6,737.52)</td>
</tr>
<tr>
<td>Increase in Advance Deposits</td>
<td>$3,380.14</td>
</tr>
<tr>
<td>Increase in Other Liabilities</td>
<td>$16,153.60</td>
</tr>
<tr>
<td>Depreciation</td>
<td>$638,276.26</td>
</tr>
<tr>
<td>Amortization</td>
<td>$33,600.00</td>
</tr>
<tr>
<td>*Loss on sale of equipment</td>
<td>$3,000.00</td>
</tr>
<tr>
<td>*Gain on sale of furnishings</td>
<td>($1,500.00)</td>
</tr>
</tbody>
</table>

| Net Cash Provided by Operating Activities | $ 1,845,278.59 |

*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

### Cash Flow from Investing Activities

<table>
<thead>
<tr>
<th>Purchase Land, FF&amp;E, &amp; Building</th>
<th>$(890,045.98)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sale of equipments</td>
<td>$4,000.00</td>
</tr>
<tr>
<td>Sale of furnishings</td>
<td>$2,400.00</td>
</tr>
</tbody>
</table>

**Net Cash Provided by Investing Activities**  
$(883,645.98)$

- **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

<table>
<thead>
<tr>
<th>Cash Flow from Financing Activities</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Proceeds from Debt or Equity Financing</strong></td>
<td>$</td>
</tr>
<tr>
<td><strong>Repurchase of Stock</strong></td>
<td>$ (615,000.00)</td>
</tr>
<tr>
<td><strong>Dividend Paid</strong></td>
<td>$ (263,387.08)</td>
</tr>
<tr>
<td><strong>Net Cash Provided by Financing Activities</strong></td>
<td>$ (878,387.08)</td>
</tr>
</tbody>
</table>

- 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