What's Behind Cash Flow Statements: SCF Entry Map

Learning Objectives

After completing this module you will be able to:

- See patterns of entries' effects on statements of cash flow by using the SCF Entry Map and the relative importance of each route on the map.
- Explain redundant SCF reconciliation entry effects on indirect cash flow statements.

Key take-aways:

- The purposes of SCF Entry Map is to help you: determine how any entry affects the statement of cash flow, recognize similarities and differences in entries' cash flow statement effects, and use the Record-Keeping and Reporting Map to see patterns of any entry's effects on all statements.
- Answering questions about an entry guides you down the correct SCF Entry Map route. There's an example and a brief description of how the entry affects the statement of cash flows at the end of each route. There is a scenic route video for each route, which uses examples to explain how and why the SCF is affected by entries on the route.
- Route 3 on the map includes operating entries with different effects on income and cash from operations. It's an important route for analyzing real companies' statements and is the most important route based on Bischoff Global Sportswear's entries studied in *Navigating Accounting*. Route 3 covers 10 of 19 entries introduced in the balance sheet and income statement chapters and 38 of Bischoff's 78 entries in later chapters.
- Routes 1 – 5 are also relatively important route for analyzing real companies' statements and based on the number of Bischoff Global Sportswear's entries studied in *Navigating Accounting*. Routes 1 – 5 cover 18 of 19 entries introduced in the balance sheet and income statement chapters and 64 of Bischoff's 78 entries. Routes 6 – 8 mostly pertain to entries covered in later chapters that generally have relatively small effects on cash flow statements.
- Routes 4 and 8 include operating entries with possible redundant reconciliation effects. An entry's reconciliation effects are redundant when they have offsetting effects on two or more reconciliation adjustment line items on a cash flow statement, but don't affect net income or net cash from operations. The effects are redundant because no adjustment is needed to reconcile the entry's income and cash effects when they are the same. An operating entry's effects are not considered redundant when they offset within a

You may customize this work, as long as you credit G. Peter & Carolyn R. Wilson and respect the Creative Commons Attribution-Noncommercial-Share Alike United States license. © 1991–2012 NavAcc LLC.
www.navigatingaccounting.com

single reconciliation adjustment line item because they have no effect on the numbers reported in the reconciliation. By contrast, redundant effects do affect reported numbers on two or more reconciliation adjustments. Entries may have redundant offsetting effects because of GAAP requirements, legacy practices or system constraints.

- Route 5 describes a very different type of reconciliation adjustment: *gains and losses*. Most entries that affect net income are operating entries. But net income can also be affected by gains and losses associated with investing or financing entries, such as selling property for a gain or loss. In this example, the cash flows associated with selling property are classified as investing cash flows so the cash received is an investing cash flow, not an operating cash flow. The gain in net income is associated with an investing activity rather than an operating activity. Thus, one of the reasons net income differs from net cash from operations is it includes a gain that has nothing to do with operations. The reconciliation adjustment reverses gains or losses recognized in net income, which reconciles the entries' net income effects to their $0 effect on net cash from operations. The adjustment reverses the income effect, so gain adjustments are negative and loss adjustments are positive. Investing or financing cash flows are also affected by these entries, so they affect two sections of the cash flow statements.
- Route 1: Investing or financing cash entries with no gains or losses.
- Route 2: Operating entries with the same effect on income and cash from operations.
- Route 3: Operating entries with different effects on income and cash from operations.
- Route 4: Operating entries that affect working capital, but not income or cash from operations.
- Route 5: Investing or financing entries that affect cash and income through gains or losses.
- Route 6: Investing, financing, and/or foreign exchange gain/loss entries that don't affect income or cash.
- Route 7: Investing or financing entries that affect income through gains or losses, but not cash.
- Route 8: Operating entries that don't affect cash, net income, or working capital accounts.

Key terms:

- **Reconciliation adjustment** - A line item in the operating section of an indirect method cash flow statement that partially explains why net income differs from net cash from operating activities.
- **Redundant SCF reconciliation entry effects** - An operating entry's reconciliation effects are redundant when they have offsetting effects on two or more reconciliation adjustment line items on a statement of cash flow (SCF), but don't affect net income or net cash from operations.

Key formulas:

- **Reconciliation Equation** net cash from operations = net income + reconciliation adjustments

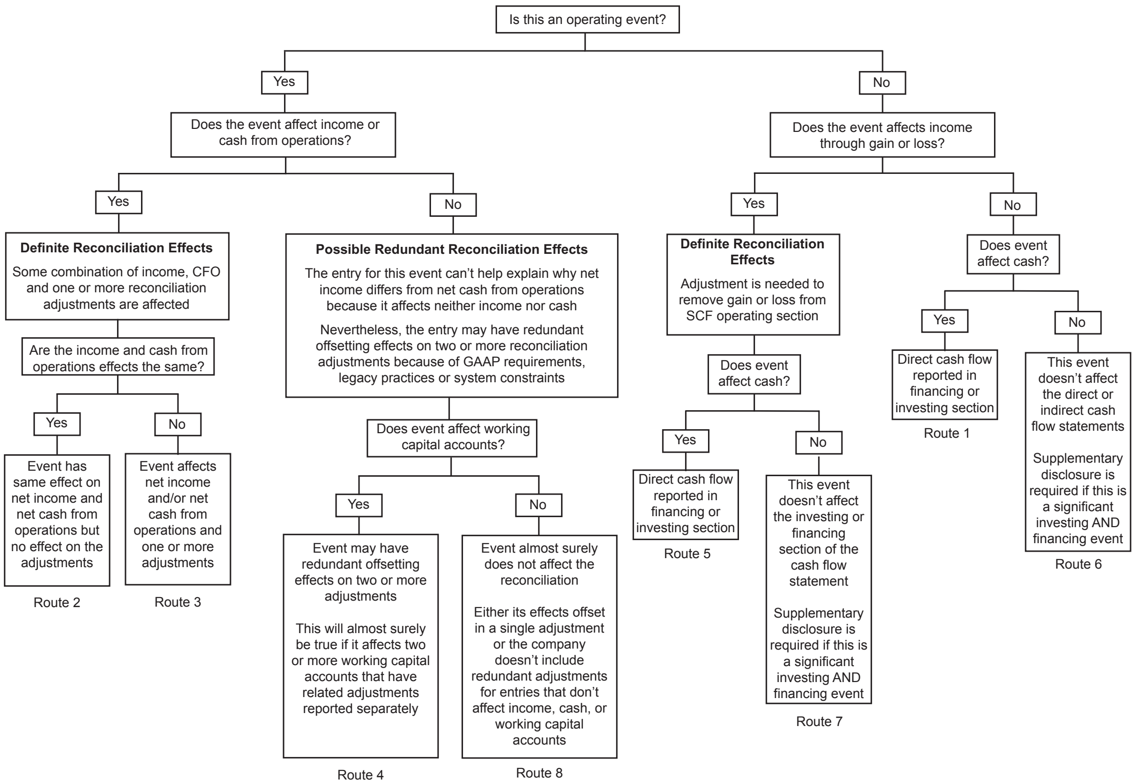
© 1991–2012 NavAcc LLC, G. Peter & Carolyn R. Wilson

Figure 1 Statement of Cash Flow Entry Map

This figure illustrates how to use the SCF Entry Map.

Using SCF Entry Map routes

- Answering questions about an entry guides you down the correct route
- There is a brief description of how the entry affects the statement of cash flows at the end of each route
- There is a scenic route video for each route in the SCF Entry Map, which use examples to explain how and why the SCF is affected by entries on the route



© 1991–2012 NavAcc LLC, G. Peter & Carolyn R. Wilson

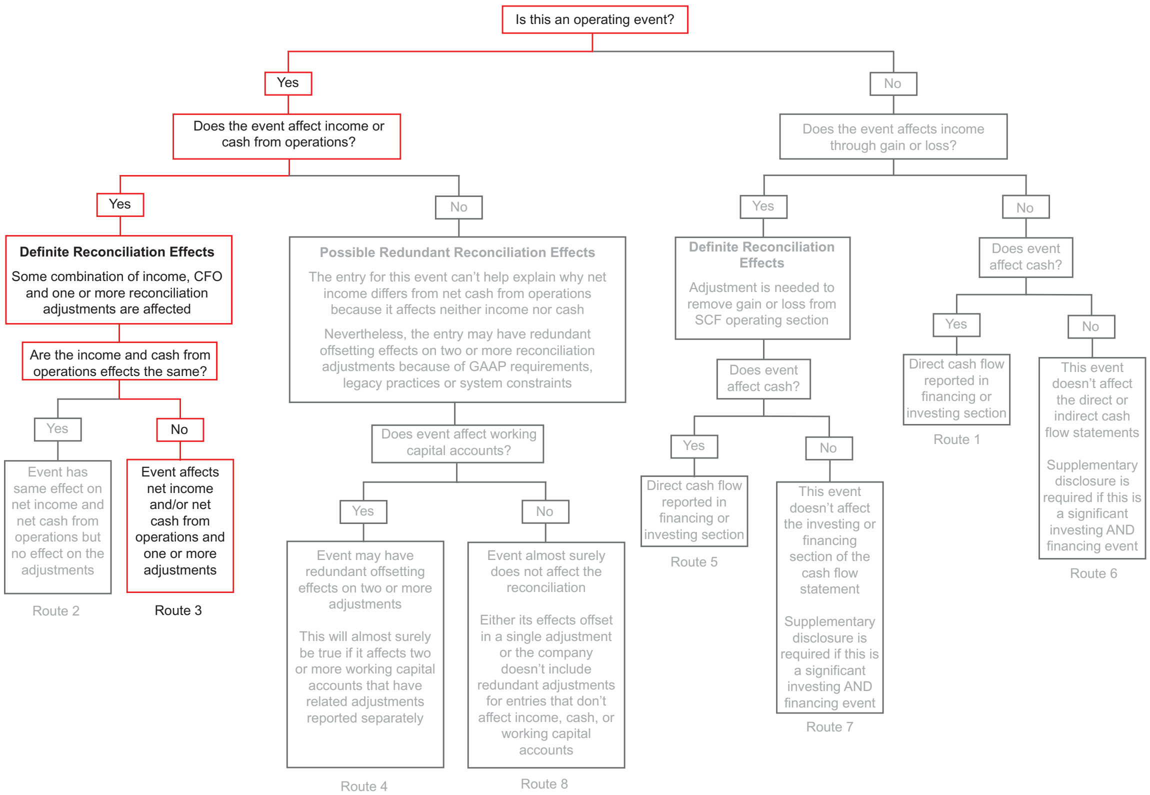
Figure 2 SCF Entry Map Example–Route 3

This figure illustrates using the map for a revenue entry.

EasyLearn E2: Recognize revenue at time of sale on account

	Assets	=		Owners' Eq
+	AR	=	+	Rev
+	+ $150	=	+	+ $150

	Debit	Credit
Accounts receivable	$150	
Revenues, net		$150



© 1991–2012 NavAcc LLC, G. Peter & Carolyn R. Wilson

Figure 3 SCF Entry Map Example Interpretation

This figure illustrates using the map to interpret a revenue entry.

Interpretation

- Reconciliation adjustments typically reflect the net effects of multiple entries but here we isolate the effects of E2
  - **Income effect**: E2 increases net income by $150, reflecting the increase in net assets associated with the sale
  - **Cash effect:** E2 has $0 effect on net cash from operations because cash inflow related to the sale will occur when the receivable is collected
  - **Adjustment:** The income effect of E2 is $150 more than the $0 cash effect because a receivable rather than cash increases when the $150 of revenues is recognized
  - **Math:** Subtracting the $150 increase in accounts receivable from the $150 net income effect reconciles it to the $0 net cash from operations effect
- The ($130) receivables adjustment reported on the SCF differs from the ($150) adjustment related to E2, indicating other entries affect this adjustment

Assets		=	Owners' Eq	
+	AR	=	+	Rev
+	+ $150	=	+	+ $150

EASYLEARN COMPANY
INDIRECT CASH FLOW STATEMENT
December 1 - 31, 2012

Operating Activities		**E2**
Net Income	$90	$150
Receivables	($130)	($150)
Accounts payable	$45	
Net cash from operations	$5	$0
Financing Activities		
Sale of common stock	$1	
Net cash from financing	$1	
Change in cash	$6	$0
Beginning Cash balance	$0	
Ending cash balance	$6	

© 1991–2012 NavAcc LLC, G. Peter & Carolyn R. Wilson

Figure 4 SCF Entry Map Example–Route 3 R&R Regions

This figure illustrates connecting the route to the regions on the Record-Keeping & Reporting Map and statements.

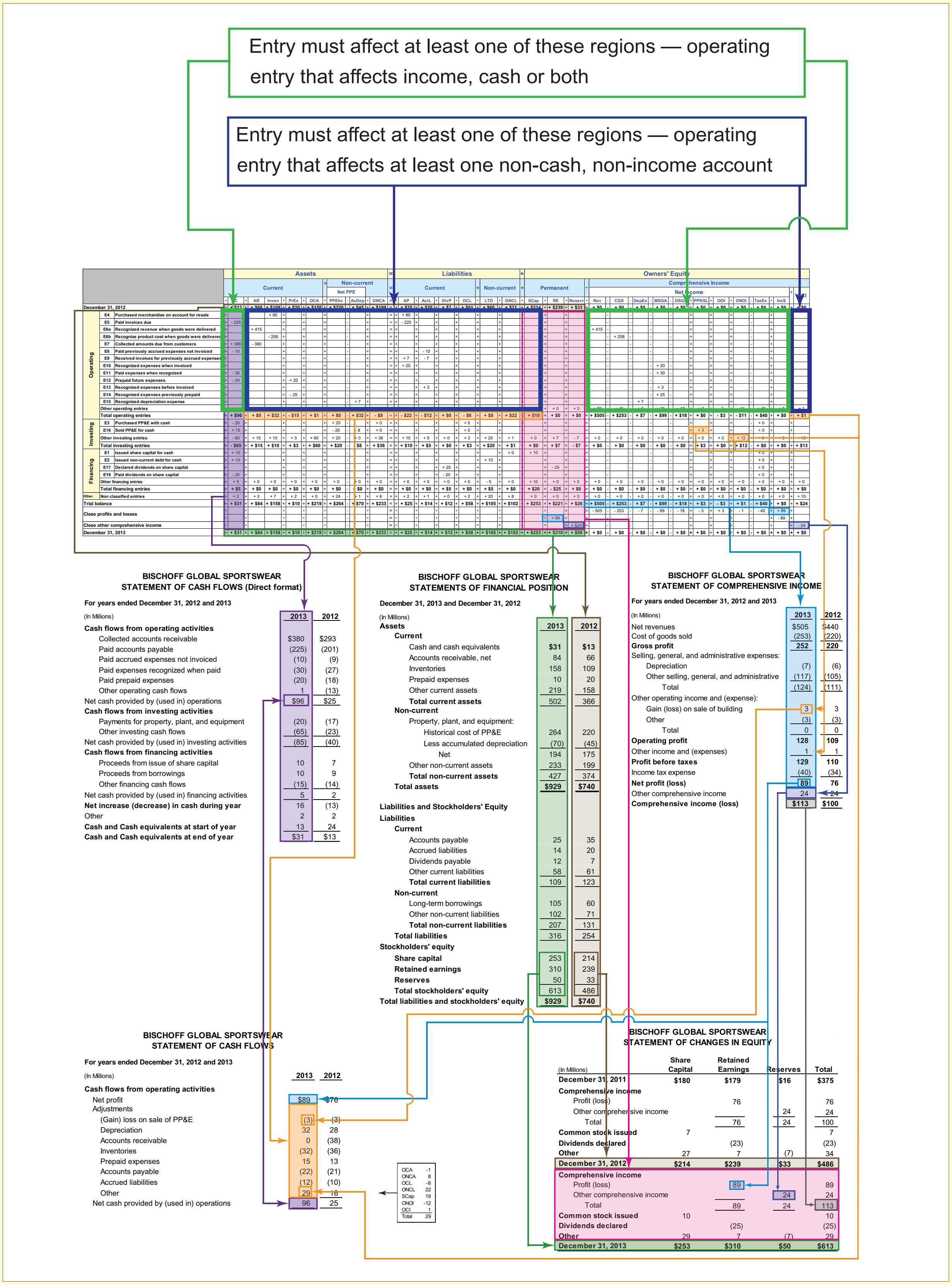


Figure 4 SCF Entry Map Example–Redundant Adjustments

This figure illustrates redundant SCF reconciliation entry effects.

Bischoff E9: Received invoices for previously accrued expenses

During 2013, BGS received $7 million of invoices for services received and previously expensed in 2012.

For example, at the end of 2012, BGS recorded an adjusting entry to expense advertisements that ran the last day of 2012. At that time, BGS was obligated to pay the advertiser but had not yet been invoiced.

E9 Received invoices for previously accrued expenses

=	Liabilities			
=	+	AP	+	AcrL
=	+	+ $7	+	- $7

	Debit	Credit
Accrued liabilities	$7	
Accounts payable		$7

BGS's policy is to accrue obligations in "Accrued liabilities" when it has not received an invoice and recognize obligations in "Accounts payable" when it receives an invoice.

BISCHOFF GLOBAL SPORTSWEAR
STATEMENT OF CASH FLOWS

For years ended December 31, 2012 and 2013

(In Millions)	2013	E9
Cash flows from operating activities		
Net profit	$89	$0
Adjustments		
(Gain) loss on sale of PP&E	(3)	
Depreciation	32	
Accounts receivable	0	
Inventories	(32)	
Prepaid expenses	15	
Accounts payable	(22)	7
Accrued liabilities	(12)	(7)
Other	29	
Net cash provided by (used in) operations	96	0
Cash flows from investing activities		
Payments for property, plant, and equipment	(20)	
Proceeds from disposal of property, plant, and equipment	15	
Other investing cash flows	(80)	
Net cash provided by (used in) investing activities	(85)	0
Cash flows from financing activities		
Proceeds from issue of share capital	10	
Proceeds from borrowings	10	
Payment of dividends	(20)	
Other financing cash flows	5	
Net cash provided by (used in) financing activities	5	0
Net increase (decrease) in cash during year	16	0
Other	2	
Cash and Cash equivalents at start of year	13	
Cash and Cash equivalents at end of year	$31	

Offsetting redundant adjustments — don't help explain why net income differs from net cash from operations

© 1991–2012 NavAcc LLC, G. Peter & Carolyn R. Wilson

Figure 5 Accounting is not a spectator sport — it's game time

This figure lists Scenic route menus for additional information.

What should you do next?

Accounting is not a spectator sport – it's game time

Tackle the exercises → Check the solutions → Identify things you don't know → Take corrective actions

Seek additional information as needed

Scenic route menus

Scenic 1-3, 5, 7 & 8: Entry Map routes 1-3, 5, 7 & 8

- Introduction
- Characteristics of route's entries
- Example
  - Entry
  - SCF effects
- Scope
- R&R Map
- Take aways

Scenic 4: Entry Map route 4

- Introduction
- Characteristics of route 4 entries
- Example 1
  - Entry
  - SCF effects
- Example 2
  - Entry
  - SCF effects
- Scope
- R&R Map
- Take aways

Scenic 6: Entry Map route 6

- Introduction
- Characteristics of route 6 entries
- Example
  - Entry
  - SCF effects
- Noncash investing and financing disclosures
- Scope
- R&R Map
- Take aways

Scenic 9: Redundant reconciliation entry effects

- Introduction
- Definition
- Example
- Historical perspective
- Creating SCFs
- Affected line items
  - Multiple
  - Single
- Take aways

© 1991–2012 NavAcc LLC, G. Peter & Carolyn R. Wilson