SCF Entry Map: Determining how an event affects the indirect statement of cash flows (SCF)

CFO: cash from operations
OCI: other comprehensive income
SCF: statement of cash flows

Is this an operating event?

Yes

Does the event affect income or cash from operations?

Yes

Definite Reconciliation Effects
Some combination of income, CFO and one or more reconciliation adjustments are affected

Are the income and cash from operations effects the same?

Yes

Event has same effect on net income and net cash from operations but no effect on the adjustments

Route 2

Example Recognizing revenue at time of cash sale

No

Possible Redundant Reconciliation Effects
The entry for this event can’t help explain why net income differs from net cash from operations because it affects neither income nor cash. Nevertheless, the entry may have redundant offsetting effects on two or more reconciliation adjustments because of GAAP requirements, legacy practices or system constraints

Yes

Event almost surely does not affect the reconciliation
Either its effects offset in a single adjustment or the company doesn’t include redundant adjustments for entries that don’t affect income, cash, or working capital accounts

Route 4

Example Recognizing revenue when customers are billed

No

Event may have redundant offsetting effects on two or more adjustments
This will almost surely be true if it affects two or more working capital accounts that have related adjustments reported separately

Route 6

Example Purchasing inventory on account

No

Yes

Definite Reconciliation Effects
Adjustment is needed to remove gain or loss from SCF operating section

Definite Reconciliation Effects
Does event affect cash?

Yes

Direct cash flow reported in financing or investing section

Example Selling land for cash and not recognizing a gain or loss

No

This event doesn’t affect the direct or indirect cash flow statements

Supplementary disclosure is required if this is a significant investing AND financing event

Route 7

Example Recognizing and asset and liability when a building is purchased with 100% debt financing

No

This event doesn’t affect the investing or financing section of the cash flow statement

Supplementary disclosure is required if this is a significant investing AND financing event

Example Selling land for cash and not recognizing a gain or loss

Route 5

Example Recognizing OCI when a pension liability decreases

Does the event affect income through gain or loss?

Yes

Does the event affects income through gain or loss?

No

Definite Reconciliation Effects
Adjustment is needed to remove gain or loss from SCF operating section

Does event affect cash?

Yes

Direct cash flow reported in financing or investing section

Example Selling land for cash and not recognizing a gain or loss

No

This event doesn’t affect the direct or indirect cash flow statements

Supplementary disclosure is required if this is a significant investing AND financing event

Route 1

Example Recognizing revenue at time of cash sale

No

Event almost surely does not affect the reconciliation
Either its effects offset in a single adjustment or the company doesn’t include redundant adjustments for entries that don’t affect income, cash, or working capital accounts

Route 8

Example Recognizing revenue when customers are billed

No

Event affects net income and/or net cash from operations and one or more adjustments

Route 3

Example Recognizing revenue when customers are billed

Yes

Example Recognizing revenue at time of cash sale

Does event affect working capital accounts?

Yes

Example Purchasing inventory on account

No

Example Recognizing revenue when customers are billed

Route 6

Example Recognizing revenue at time of cash sale

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Creating Indirect SCF Statements

WORKING CAPITAL ADJUSTMENTS

**Beginning Balance**

**Net effect of Period’s Operating Entries**

- Effects of operating entries that **must** be included in the reconciliation adjustments: these entries affect either income or cash from operations.

- Effects of operating entries that **can** (but need not) be included in the reconciliation adjustments: these entries affect neither income nor cash from operations.

**Step 2** Insider determines net effect of a few excluded non-operating entries

**Ending Balance**

Non-Working Capital Accounts

**Beginning Balance**

**Net effect of Period’s Operating Entries**

- Effects of operating entries that **must** be included in the reconciliation adjustments: these entries affect income but not cash from operations.

- Effects of operating entries that **can** (but need not) be included in the reconciliation adjustments: these entries affect neither income nor cash from operations.

**Step 3** Insider determines net effect of operating entries by deducting the net effect of non-operating entries from net change in account

**Ending Balance**

Common Approach for Creating Working Capital Adjustments

Most entries that affect working capital accounts are operating entries. Among these are: (1) entries that affect income or cash from operations, whose effects **must** be included in the reconciliation adjustments, and (2) entries that don’t affect either income or cash from operations, but whose effects **can** (but need not) be included in offsetting reconciliation adjustments.

To a far lesser degree, non-operating entries (such as acquiring another company) can also affect working capital accounts. However, because these entries don’t affect operations, their effects **can’t** be included in reconciliation adjustments, which pertain to the operating section.

The easiest way for companies to create the working capital adjustments is to **exclude** the effects that shouldn’t be included — the non-operating entries’ effects.

NON-WORKING CAPITAL ADJUSTMENTS

**Beginning Balance**

**Step 1** Insider determines net effect of a few included operating entries

**Net effect of Period’s Operating Entries**

**Step 2** Insider determines net effect of a few excluded non-operating entries

**Ending Balance**

Common Approach for Creating Non-working Capital Adjustments

Generally, only a few of the entries that affect non-working capital accounts are operating entries. Among these are: (1) entries that affect income, but not cash from operations, whose effects **must** be included in the reconciliation adjustments and (2) entries that don’t affect either income or cash from operations, but whose effects **can** (but need not) be included in offsetting reconciliation adjustments.

The easiest way for companies to create the non-working capital adjustments is to **include** the effects that should be included — the effects of operating entries that affect income but not cash from operations.

**Assumption**

As outsiders, absent evidence to the contrary, we will assume companies include the effects of these entries in offsetting reconciliation adjustments when (and only when) the offset is to a working capital account. An implication of this assumption is that the working capital adjustments reflect the net effects of all operating entries. This is a standard assumption in the exercises.