AccountMate
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Article # 1131

Technical Note: Understanding the Effects of Cash Flow Category Assignment

Difficulty Level: Intermediate Level AccountMate User

Version(s) Affected: AccountMate 7 for SQL, Express and LAN
AccountMate 6.5 for SQL, MSDE and LAN

Module(s) Affected: GL

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DESCRIPTION

In addition to the Balance Sheet and Income Statement reports, the Statement of Cash Flows is an important tool used by management to analyze the company's operations.

The Statement of Cash Flows provides information about the cash receipts and cash payments of a company during a given accounting period. It also provides information about all the investing and financing activities of the company during that period. The Statement of Cash Flows explains the changes in cash and cash equivalents during the period.

To generate a Statement of Cash Flows in AccountMate, each GL Account ID must be assigned a cash flow category in the **Chart of Account Maintenance** function. Although these cash flow categories are pre-defined in the system, you can change their captions in the **GL Module Setup** function.

AccountMate recognizes the need for some accounts to be included in the computation in more than one section of the Statement of Cash Flows. To address this requirement, the system provides two category fields. For example, pieces of machinery purchased with cash could have two cash flow categories such as Property, Plant and Equipment (PPE) and Acquisition of PPE for Cash in the **Cash Flow 1** and **Cash Flow 2 Category** fields, respectively.

This Technical Note provides guidelines for the proper assignment of cash flow categories using the Direct and Indirect methods of Statement of Cash Flows presentations. It also provides answers to common questions concerning assignment of cash flow categories.

SOLUTION

Statement of Cash Flow Captions Computation

The following table provides information illustrating AccountMate's formula to calculate the value for each column in the Statement of Cash Flows report. The formula's variables are the cash flow categories assigned to a GL Account ID in the **Chart of**

Accounts Maintenance function. Note that the system adds or subtracts a combination of cash flow categories to generate the value. You can use this tabular presentation as your guide when assigning cash flow categories to your GL Account ID.

Note: *The Statement of Cash Flows captions are default values that can be amended and customized in the* **GL Module Setup** *function's* **Cash Flow Captions** *tab.*

A. *Direct Method*

Statement of Cash Flow Captions	Formula		Effects on Cash
Cash flows from Operating Activities			
Cash received from customers	+	Sales + Provision for Losses on Accounts Receivable	Increase
	-	Accounts Receivable + Trade Notes Receivable + Allowance for Losses on Accounts Receivable	
Cash paid to suppliers and employees	±	Cost of Sales + Accounts Payable + Selling and Administration Expenses + Other Liabilities	Decrease
	-	Inventory + Other Assets	
Interest paid	-	Interest Expense - Interest Payable	Decrease
Interest received	+	Interest Income	Increase
	-	Interest Receivable	
Income taxes paid	-	Current Taxes + Deferred Taxes + Income Taxes Payable + Deferred Taxes Liability	Decrease
Cash flows from Investing Activities:			
Purchase of investment securities	-	Purchase of Investment Securities	Decrease

Proceeds from sale of investments	+	Gain (Loss) on Sales of Investments – Investments	Increase
Acquisition of PPE	-	Acquisition of PPE for Cash + Cost of PPE Acquired Under Capital Lease	Decrease
Proceeds from sale of PPE	+	Gain (Loss) on Sale of PPE + Depreciation Expense	Increase
	-	Property, Plant and Equipment (PPE) + Accumulated Depreciation	
Purchase of intangible assets	-	Acquisition of Intangibles	Decrease
Proceeds from sale of intangible assets	+	Gain (loss) on Sale of Intangibles + Amortization Expense	Increase
	-	Intangible Assets	
Cash flows from Financing Activities:			
Net borrowings	+	Short-term debt	Increase
Principal payments for capital lease obligations	-	Lease obligation	Decrease
Proceeds from issuance of long-term debt	+	Cost of PPE Acquired Under Capital Lease + Long-term Debt	Increase
	-	Payment of Retirement of Long-term Debt	
Retirement of long-term debt	-	Payment of Long-term Debt Retirement + Gain (Loss) on Long-term Debt	Decrease
Proceeds from issuance of stock	+	Capital Stock	Increase
Dividends paid	-	Retained Earnings	Decrease

B. *Indirect Method*

Statement of Cash Flow Captions	Formula		Effects on Cash **
Cash flows from Operating Activities:			
Net income (loss)			
Adjustments to reconcile net income to net cash provided by operating activities			
Depreciation	+	Depreciation Expense	Increase
Amortization	+	Amortization Expense	Increase
Provision for losses on accounts receivable	+	Provision for Losses on Accounts Receivable	Increase
Gain (loss) on sale of investment securities	-	Gain on Sale of Investments	Decrease
	+	Loss on Sale of Investments	Increase
Gain (loss) on sale of property	-	Gain on Sale of PPE	Decrease
	+	Loss on Sale of PPE	Increase
Gain (loss) on sale of intangible assets	-	Gain on Sale of Intangibles	Decrease
	+	Loss on Sale of Intangibles	Increase
Gain (loss) on retirement of long term debt	-	Gain on Retirement of Long Term Debt	Decrease
	+	Loss on Retirement of Long Term Debt	Increase
(Increase) decrease in accounts receivable	-	Accounts Receivable + Provision for Losses on Accounts Receivable	Decrease
	+	Allowance for Losses on Accounts Receivable	Increase
(Increase) decrease in notes receivable	-	Trade Notes Receivable End	Decrease
	+	Trade Notes	Increase

		Receivable Beginning	
(Increase) decrease in interest receivable	-	Interest Receivable End	Decrease
	+	Interest Receivable Beginning	Increase
(Increase) decrease in inventory	-	Inventory End	Decrease
	+	Inventory Beginning	Increase
(Increase) decrease in other assets	-	Other Assets End	Decrease
	+	Other Assets Beginning	Increase
Increase (decrease) in accounts payable	+	Accounts Payable End	Increase
	-	Accounts Payable Beginning	Decrease
Increase (decrease) in interest payable	+	Interest Payable End	Increase
	-	Interest Payable Beginning	Decrease
Increase (decrease) in income taxes payable	+	Income Taxes Payable End	Increase
	-	Income Taxes Payable Beginning	Decrease
Increase (decrease) in deferred taxes	+	Deferred Taxes Liability End	Increase
	-	Deferred Taxes Liability Beginning	Decrease
Increase (decrease) in other liabilities	+	Other Liabilities End	Increase
	-	Other Liabilities Beginning	Decrease

C. *Notes*

The formulas used to calculate the Cash flows from Investing and Financing activities captions using the Indirect method are the same as those used in the Direct method.

** See the Cash Flow Captions to determine which has a "+" or "-" effect on Cash. For example, an increase in accounts payable will have a positive effect

on cash while a decrease will have a negative effect; thus, + / (-).

Tips for Determining Proper Cash Flow Category Assignments

Q. What is the importance of cash flow categories?

A. Cash flow categories can be assigned to each GL Account ID record. These cash flow categories are necessary to generate a Statement of Cash Flows in AccountMate. Non-assignment of a cash flow category in a GL Account ID record results in an inaccurate report.

For example, if you failed to assign your Depreciation GL Account ID with a cash flow category, this transaction will not appear in the Statement of Cash Flows Report. Depreciation has a positive effect on cash; omitting this account will understate the value of your Cash and Cash Equivalents in the report.

Q. What basis should be used to decide what cash flow category should be assigned to a GL Account ID?

A. The cash flow categories should correspond to the nature of transactions posted to the GL Account ID. Management, investors and creditors relying on misleading reports may come up with wrong business decisions.

For instance, assigning "Payment of Retirement of Long-Term Debt" cash flow category to a Depreciation Expense GL Account ID, will result to incorrect values under the Cash Flows from Operating and Financing Activities captions. The Depreciation GL Account ID should have a "Depreciation" Cash Flow Category.

Q. Can I assign the same cash flow category in Cash Flow 1 and 2 fields for a particular GL Account ID?

A. No GL Account ID should have duplicate cash flow categories; otherwise, the cash flow amount computation will either be overstated for the duplicate cash flow category assignment or understated for the correct cash flow category that should be assigned.

Q. Is it possible for a GL Account ID to have two different cash flow categories?

A. Yes, you can assign two different cash flow categories to a GL Account ID when you want to show under two sections the effects of the transactions posted in that GL Account ID.

For example, if the operating equipment is paid for in cash, the Property, Plant and Equipment GL Account ID can have a "Property, Plant and Equipment" Cash Flow Category 1 and "Acquisition of PPE for Cash" Cash Flow Category 2.

Q. For those GL Account IDs that have two different cash flow categories, will it matter whether I assign a category as Cash Flow 1 or Cash Flow 2?

A. No, it doesn't. As long as the cash flow category captions you assign to the GL Account ID are correct, the order in which you assign them does not matter.

Though assigning cash flow categories in AccountMate is quick and simple, an in-depth knowledge of basic accounting will complement your understanding of how AccountMate handles cash flow transactions.