STATEMENT OF CASH FLOWS - COMMON DEFICIENCIES

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A number of accountants fall short in complying with FASB Accounting Standards Codification (FASB ASC) 230, *Statement of Cash Flows*, when preparing the statement of cash flows, according to recent research.

It's important to detail common deficiencies and discuss authoritative guidance pertaining to those matters. The most common errors encountered with the preparation of the statement of cash flows include:

- Presenting cash flows "net" when "gross" is required
- Classification of depreciation as an investing cash flow
- Failure to balance the statement of cash flows
- Improper classification and presentation of related party loans receivable and payable
- Improper presentation of cash overdrafts
- Failure to disclose interest and income taxes paid when using the indirect method to determine cash flows from operations
- Improper presentation of noncash investing and financing transactions

Presenting cash flows 'net' when 'gross' is required

"Information about the gross amounts of cash receipts and cash payments during a period is more relevant than information about the net amounts of cash receipts and payments," FASB ASC 230-10-45-7 says. This statement is generally accepted as requiring the gross amounts of cash flows unless another exception applies, such as the permitted use of the indirect method to determine cash flows from operations.

Another exception noted in FASB ASC 230-10-45-7 is that, if the original maturity of the asset or liability is three months or less, the net amount of related receipts and payments provides sufficient information.

Classification of depreciation as an investing cash flow

Research indicates that some accountants improperly classify depreciation as a cash flow from investing activities. Since depreciation is a noncash expense, it should not be presented as cash flow from investing activities.

Further, FASB ASC 230-10-45-28b explicitly notes that depreciation should be in the reconciliation of net income and net cash flow from operating activities. It appears that certain accounting software programs are placing either depreciation expense or the change in accumulated depreciation in the investing section of the (obviously non-U.S. GAAP) software provided statement of cash flows.

Failure to balance the statement of cash flows

Research noted instances in which the total amounts of cash and cash equivalents at the beginning and end of the period shown in the statement of cash flows were not the same amounts as similarly titled line items or subtotals shown in the statements of financial position as of those dates as required by FASB ASC 230-10-45-4. Simply put, the statement of cash flows was out of balance in what can only be attributed to a lack of diligence.

Improper classification and presentation of related party loans receivable and payable

Advances and loans to related parties constitute investing activities, and repayment of these advances also should be reflected in the investing section of the statement of cash flows. Advances and loans from related parties constitute financing activities, and repayment of these advances also should be reflected in the financing section of the statement of cash flows. Research indicates improper classification of these advances and loans, including presentation on a “net” basis or presentation within cash flows from operations.

Improper presentation of cash overdrafts

Changes in cash overdraft positions from one period to the next need to be reflected in the financing section of the statement of cash flows. Research shows that changes in cash overdraft positions are being improperly presented as a component of cash and cash equivalents or improperly reflected in the operating section of the statement of cash flows.

Failure to disclose interest and income taxes paid when using the indirect method to determine cash flows from operations

FASB ASC 230-10-50-2 states: “If the indirect method is used, amounts of interest paid (net of amounts capitalized) and income taxes paid during the period shall be disclosed.”

Surprisingly, this straightforward disclosure requirement is frequently missed.

Accountants should be particularly aware of this requirement when preparing financial statements for companies that do not pay income taxes or interest on a regular basis (such as a highly profitable pass-through entity). These entities may irregularly pay income taxes and/or interest, and accountants will miss the disclosure if they merely “roll forward” prior-year financial statements.

Improper presentation of noncash investing and financing transactions

The investing and financing sections of the statement of cash flows should not reflect noncash transactions. Rather, noncash investing and financing transactions should be disclosed separately as required by FASB ASC 230-10-50-3.

Research noted failure to disclose noncash investing and financing transactions as well as presenting noncash investing and financing transactions on the statement of cash flows.

Common noncash investing and financing transactions that are not properly treated include:

- Capital leases
- Accrued shareholder distributions
- Noncash loan refinancing
- Conversion of debt to equity
- Noncash acquisition of fixed assets by financing

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