Statement of cash flow

Finance

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There are two methods for preparing and presenting statement of cash flow; the direct method and the indirect method, the main difference lying in the presentation of the operating section. The sections of investing and financing are the same in both methods. In the direct method, cash flows from operating activities encompass amounts such as cash from customers and cash paid to suppliers. On the contrary, the indirect method shows the net income, followed by the adjustments required to convert the total net income to the total cash from operating activities (Brahmasrene, Strupeck & Whitten, 2004). In addition, the direct method must provide reconciliation of net income and the cash provided by operating activities, a process which is achieved automatically in the indirect method of cash flow statement. The indirect method is found to be more effective in relaying cash flow information. Thus, it is preferred to the direct method in most corporations (Brahmasrene, Strupeck & Whitten, 2004).

Whereas the direct method or the income statement method reports the main categories of operating cash receipts and payments, the indirect method places emphasis on net income and the net cash flow from operations (Taulli, 2004). This method begins with net income then adds depreciation, and calculates changes in balance sheet items. To obtain the net cash flow, the direct method starts with money received then subtracts money spent. In this case, depreciation is excluded since, although it is an expense, it is not money spent or received (Taulli, 2004).

References

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