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**CHAPTER 5****STATEMENT OF CASH FLOWS IN DETAIL****5-1  
INTRODUCTION**

Cash is the lifeblood of any ongoing concern. Cash is the fuel that keeps the business afloat. As was stated in Chapter 2, the Balance Sheet and the Statement of Income are prepared using the accrual method of accounting, where revenues are recorded when earned and expenses are recorded when incurred. The Statement of Cash Flows departs from the accrual treatment and gives a simple picture of the cash flowing into the project (actual receipts) and the cash flowing out of the project (actual disbursements). An example of a Statement of Cash Flows can be found in Chapter 2, Exhibit 2-7. The Statement of Cash Flows documents transactions that the project made during the reporting period that may not be shown clearly on the Statement of Income or the other primary financial statements. A HUD project experiences changes in cash flows throughout the accounting period. Examples of various activities that create cash flows include:

- o cash received for rents,
- o cash received by the project for services rendered,
- o cash disbursed to meet the project's obligations,
- o cash disbursed to purchase plant assets,
- o cash received from the sale of plant assets, and
- o cash disbursed to pay dividends.

The cash position of a project is an important factor in evaluating its financial health and stability. The cash position of a project changes constantly. The Statement of Cash Flows categorizes these changes as follows:

- o cash flows from operating activities,
- o cash flows from investing activities, and
- o cash flows from financing activities.

There are two methods of presenting the Statement of Cash Flows. The preferred method is the direct method, which details the flow of cash in the Operating Activities section, The less popular method is the indirect method which uses the net cash provided by

recommended by the AICPA (Statement of Accounting Standards (SAS) No. 95) and is required for HUD projects. This chapter will discuss the Statement of Cash Flows using the direct method.

- Objective            At the end of this chapter, the reader should be able to:
1.    Define the various types of cash flow activities and discuss their use in monitoring the project.
  2.    Understand the various transactions that affect cash flows and discuss their use in monitoring the project.
  3.    Compare net cash from operating activities with net income and understand their relationship.

5-2  
OPERATING  
ACTIVITIES  
SECTION

- What it is            The Operating Activities section of a HUD project usually has the greatest impact on cash flows.
- Why it is important    The Operating Activities section details the flow of cash resulting from the day to day operations of the project.
- What it relates to    The cash flows from Operating Activities section relates to the Statement of Income.

Cash Received From  
Operations

- What it is            Cash received from operations consists of rental revenue and other miscellaneous revenue received.
- Components           There are two main components of cash receipts:
- o    cash received from operating the project, and
  - o    cash disbursed to meet obligations resulting from operating the project.

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- What it does            Cash received from operations measures the amount of revenue that is received from tenants and other sources.
- Why it is important    Cash received from operations gives the Asset Management/Loan Management staff an idea of a project's

ability to pay out disbursements and its status as an ongoing concern.

How it is used      The Asset Management staff can compare these figures to the potential amount of money that could have been received (from the Statement of Income) to measure the effectiveness of collections.

Cash Disbursements  
For Project  
Operations

What they are      Cash disbursements to meet project obligations consist of disbursements made in conjunction with rental operations.

Why they are important      These disbursements are important because they can indicate compliance with HUD requirements regarding allowable costs and price levels. They can also show if the project is able to meet the obligations that are generated in conjunction with rental revenue. If not, a rent increase may be necessary.

Examples      Examples of cash disbursements to meet project operations include:

- o cash payments for merchandise or supplies,
- o cash payments to project employees for salaries and wages, and
- o other cash payments that are neither financing or investing activities.

How they are used      The Asset Management staff compares these costs with the amounts disbursed on similar projects to see if they are in line.

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5-3  
FINANCING  
ACTIVITIES  
SECTION

What it is      The Financing Activities section details the flows of cash resulting from a project's financing activities.

Examples      The following are examples of items that might appear in the Financing Activities Section:

- o mortgage principal and interest payments,
- o capital contributions by owners,
- o cash received from the issue of stocks or bonds,

- o cash paid to retire bonds,
- o cash paid for dividends declared,
- o cash disbursed to repay amounts borrowed,
- o cash payments for MIP, taxes and insurance, and
- o cash payments for repayment of debt (i.e., mortgage payable).

How it is used      The Asset Management staff reviews the Financing Activities Section and determines if the transactions are in accordance with HUD requirements. The Asset Management staff will also check to see if the amounts are in line with similar projects.

5-4  
 INVESTING  
 ACTIVITIES  
 SECTION

What it is      The Investing Activities section details the flows of cash from a project's investing activities.

Examples      The following are examples of items that might appear in the Investing Activities section:

- o cash paid for the purchase of plant assets,
- o cash received from the sale of plant assets,
- o cash receipts from monies borrowed,
- o cash disbursed for monies lent,
- o cash received from return on monies invested,

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- o cash disbursed to acquire investments,
- o cash received from repayments on monies lent, and
- o cash disbursed for repayments on monies borrowed.

How they are used      The Asset Management staff reviews the amounts in this section and determines if the expenditures are HUD approved. The Asset Management staff will also check to see if the transactions are in line with the requirements of the regulatory agreement.

5-5  
 RECONCILING  
 NET INCOME TO  
 NET CASH FLOW  
 FROM  
 OPERATIONS

What it is      The AICPA Statement of Accounting Standards (SAS) No. 95 requires a reconciliation of net income to net cash

provided (or used) by operating activities. This reconciliation is a way of analyzing net income as it relates to operations and excluding any amounts included in net income that did not provide cash inflows or outflows from operating activities.

Why it is important      The reconciliation of net income to net cash provided by operations is important because it reconciles the net income (HUD 92410) to the net cash flow from operating activities.

Types of Adjustments      There are three types of adjustments necessary to reconcile net income to net cash provided by operations:

- o changes in noncash current assets and current liabilities,
- o changes in items that relate to operating activities but do not create cash inflows or outflows, and
- o gains or losses resulting from transactions that do not relate to operating activities.

Changes in Noncash Current Assets and Current Liabilities

What they are      Changes in noncash current assets and current liabilities have an impact on net income but do not affect cash flows from operating

activities. These changes include decreases and increases in:

- o accounts receivable,
- o prepaid items (i.e., MIP, Insurance, Taxes),
- o accounts payable,
- o accrued expenses,
- o tenant security deposits payable, and
- o deferred income (rent received in advance).

Why they are important      The changes listed above are important to the Asset Management/Loan Management staff because they are an indication of items that affect net income but are not the result of activities involving the day to day operations of the project.

Example      An example of how the net income can be more clearly analyzed by eliminating the items listed above is increases in accounts receivable. The increase in the adjustment for accounts receivable balance in HUD projects is usually due to rental revenue that will be

collected at a later point in time. While this revenue has an impact on net income, it is not reflected on the Statement of Cash Flows. Therefore the increase in accounts receivable must be deducted from net income to reflect its absence from the net cash flows from Operating Activities section. On the other hand, a decrease to accounts payable is reflected in the Statement of Cash Flows but is not the result of a transaction which occurred in the current period. Therefore this amount must be added back to net income to account for its inclusion in the Operating Activities section of the Statement of Cash Flows.

How they  
are used

Changes in noncash current assets and current liabilities can be analyzed to provide a clearer picture of how net cash flows from operating activities has affected the net income of a project. If there is an insufficient net cash flow from operating activities, the Asset Management staff should review the changes in noncash current assets and current liabilities to see if the deficit is the result of increases or decreases in noncash current assets and current liabilities. For example, an increase in accrued year-end revenues would increase net income, however, there is no corresponding increase to net cash flow. Conversely, accrued expenses decrease net income, but have no impact on net cash flow.

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Changes in  
Operating Items  
that do not  
Create Cash Flows

What they  
are

Changes in operating items that do not create cash flows are generally expenses that are directly related to operations but do not require the use of cash.

Example

Depreciation is an example of an expense item that affects operating activities but does not require the use of cash.

Why they are  
important

Adjustments to net income for changes in operating items that do not require cash are important because they provide a clearer picture of net income as it relates to cash flows from operations.

How they  
are used

The Asset Management staff can review adjustments made to net income for changes in operating items that do not require the use of cash to determine the amount of income that is generated or offset by noncash items during the

current period.

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Gains or Losses from  
Non Operating  
Activities

What they are	The gains or losses from non-operating activities are transactions that affect net income but are not the result of operations.
Example	Interest earned on investments is an example of a non-operating activity that affects net income.
Why they are important	The adjustments for gains or losses from activities other than operating are important in that they have an effect on net income that is achieved from a source other than operations.
How they are used	The gains and losses from activities other than operations can be reviewed to evaluate the financial efficiency of activities outside the day to day operations of the project. If major losses are identified here the Asset Management staff should investigate the events surrounding these transactions.

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5-7  
CHAPTER  
SUMMARY

Chapter 5 presents a description of the inflow and outflow of cash from the HUD project. The information provided here will enable the Asset Management/Loan Management staff to understand the cash position of the project and evaluate its financial health and stability. In addition, the Asset Management staff should be able to reconcile net income to net cash provided (or used) by operations and understand how they interrelate. Certain cash receipts and payments may have characteristics that fall into more than one category. The preparer of the Statement of Cash Flows should record the activity in the section that pertains most to its function with regard to the overall goals of the project.

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ACCOUNTING KNOWLEDGE QUIZ

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QUESTIONS

1. List the various Sections of the Statement of Cash Flows.

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2. The Operating Activities section of the Statement of Cash Flows relates to the \_\_\_\_\_.

3. What does cash provided from operations consist of?

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4. What is the Asset Management/Loan Management staff's primary objective when reviewing the Statement of Cash Flows from Operating Activities section?

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5. What is the Asset Management staffs primary objective when reviewing the Financing Activities and Investing Activities sections of the Statement of Cash Flows?

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6. Place a check mark next to the activities that are shown on the Statement of Cash Flows.

- (a) Withdrawals by owners
- (b) Additional capital contributions
- (c) Fixed asset purchases
- (d) Payments of mortgage principal



- \_\_\_\_\_ (e) Proceeds from borrowing
7. The cash position of a project is an important factor in determining its \_\_\_\_\_.
  8. A way of analyzing net income as it relates to net cash flow from operations is known as \_\_\_\_\_ net income to net cash flows from operations.
  9. The three types of adjustments necessary when reconciling net income to net cash flow from operations are:
    - a. \_\_\_\_\_
    - b. \_\_\_\_\_
    - c. \_\_\_\_\_
  10. Four examples of noncash current assets and liabilities are:
    - a. \_\_\_\_\_
    - b. \_\_\_\_\_
    - c. \_\_\_\_\_
    - d. \_\_\_\_\_
  11. \_\_\_\_\_ is an example of an expense item that effects operating activities but does not require the use of cash.
  12. \_\_\_\_\_ on investments is an example of non-operating activities that affect net income.

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ANSWERS

1.
  - a. Operating Activities section (p.5-1)
  - b. Investing Activities section (p.5-1)
  - c. Financing Activities section (p.5-1)
2. Statement of Income (p. 5-2)
3. Cash provided from operations consists of rental revenue and other revenue miscellaneous ived. (p. 5-2)
4. The Asset Management staff compares these figures (actual amount of received) to money the potential amount of money that could have been Statement of received (from the Income) to measure the effectiveness of collections. (p. 5-3)
5. The Asset Management staff reviews transactions in these statements if the expenand determines ditures are in accordance with HUD requirements. (p. 5-4)

6. All of them are shown on the Statement of Cash Flows. (p. 5-4, 5-5, and 5-6)
  7. Financial health and stability as an ongoing concern. (p. 5-1)
  8. Reconciling. (p. 5-5)
  9.
    - a. Changes in noncash current assets and liabilities. (p. 5-5)
    - b. Changes in items that relate to operating activities. (p. 5-5)
    - c. Gains or losses from transactions that do not relate to operating activities (p. 5-5)
  10.
    - a. Accounts receivable (p. 5-6)
    - b. Prepaid expenses (p. 5-6)
    - c. Accounts payable (p. 5-6)
    - d. Deferred income (p. 5-6)
  11. Depreciation or consumption of prepaid expenses. (p. 5-6)
  12. Interest, gains or losses on sales of plant assets. (p. 5-7)
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