Preparing the statement of cash flows: 
Challenges you’ll face and resources you’ll need

The three categories of key business financial statements are not created equal. While the income statement and balance sheet are static, the statement of cash flows is dynamic. It not only tells whether you are generating enough working capital to run the business, it also reveals the trends in your cash and expenses.

Creating a statement of cash flows is like taking a video of your business in action rather than a still photo.

“Cash is king. There’s no better metric in an organization to define performance,” says Dominick Fatibene, senior product marketing manager at Workiva. "History has shown us that profitable organizations that don't have positive cash flow don't survive."

In fact, the modern statement of cash flows was the 1863 brainchild of management at a British company that had been reporting handsome profits — yet was forced to declare bankruptcy.

While the statement of cash flows serves as the backbone of some of your company’s most critical operating, investing, and financing metrics, there is no best way to create that spine. Accounting and finance pros create their own systems for pulling, reconciling, and approving data. For example, you may see some examples of a monthly checklist that offers suggestions for adding structure and reliability, but no guide substitutes for the judgment calls, challenges, and opportunities to improve that you encounter aplenty with cash flow accounting.

THE STATEMENT OF CASH FLOWS PROCESS
At its core, a statement of cash flows reveals how much cash your company generated and spent during a specific period. You can choose between two cash flow preparation methodologies: the direct or indirect cash flow methods. However, a recent flash poll by Journal of Accountancy and FM magazines found only 27% of respondents' organizations use the direct cash flow method, which requires a reconciliation of revenue and cash receipts.

Assuming your company is part of the overwhelming majority, your indirect approach to reporting operating cash flow includes an assessment starting with net income and making additions and deductions based on noncash items primarily deriving from the balance sheet. This is a process that requires access to the income statement and balance sheet, a deep understanding of accounting, and coordination between stakeholders. Not to mention this methodology tends to be the “easier” way of calculating cash flows.
Managing data and reviews consumes 75% of accounting and finance's time — leaving little time for analysis.


If they can find the staff bandwidth, many companies attempt to examine their cash flows each month rather than wait for a quarterly or annual analysis. The statement shows how you are doing generating cash in three sections:

1) **Operating activities.** How much cash are your company's principal revenue-generating activities producing? How do your current assets (cash accounts, accounts receivable, etc.) size up against current liabilities (i.e., working capital)? Remember, a unique aspect of the statement of cash flows is that an increase in an account balance does not always lead to an increase in cash. For example, more accounts payable benefits your cash position, but more accounts receivable worsens it.

2) **Investing activities.** What is your cash flow from buying or selling noncurrent assets like property, plant, and equipment (PP&E) or long-term financial assets? Buying PP&E reduces your company's cash flow; issuing a long-term security investment helps it.

3) **Financing activities.** These cash flows affect the size and composition of equity capital or debt. Examples include taking out or repaying a bank loan, issuing or buying back shares, and paying dividends.

The bottom line: Boosting your company's debt or issuing stock increases its cash flow.

While your process for generating the statement of cash flows may use some individualized steps, your team almost certainly will:

- Obtain a finalized income statement and balance sheet for the period, as well as the prior-period balance sheet for comparisons.
- Gather data from other important documents and sources such as:
  - Contracts for material transactions.
  - Legal and investment files.
  - Treasury data on debt, dividends, etc.
  - Operations information about PP&E.
  - Financial statement account reconciliations.
  - Accounting reports showing noncash intercompany transactions and adjustments, depreciation, etc.
- Calculate changes in assets, liabilities, and equity between the current and prior-period balance sheets.
- Record those balance sheet changes in the correct classification section of the statement of cash flows.
- Identify potential noncash items like depreciation and income tax expenses, and make corresponding adjustments.
Perform final calculations of cash flow.

Perform supplemental analyses that accompany the statement of cash flows, such as:

- Metrics (turns, days, ratios, etc.).
- Non-GAAP analysis for company management (free cash flow, adjusted operating cash flow, days receivable ratio, etc.).

**POTENTIAL PITFALLS OF PREPARING CASH FLOW STATEMENTS**

So, what hurdles stand between your team and an accurate, actionable statement of cash flows that leaves you time for other priorities?

**Remote workforce:** The global pandemic has only accelerated the trend for accounting and finance teams to work from home and may have made remote work the new reality for many. In one study, three of four CFOs said they will move previously on-site positions to at-home permanently after COVID-19. Other research shows CFOs are becoming less worried about losing productivity from the WFH trend.

Still, your team might have to scramble to keep productivity and efficiency from sliding — when it comes to preparing the statement of cash flows and any other remote work. As gaps open between your workflows now and the collaborative and manual processes you were used to, the risks of process breakdown and inaccuracy rise. Preparing the statement of cash flows is a highly intensive and manual process that requires a large degree of collaboration across an organization. If you were used to hearing about open items during a daily stand-up that has gone virtual, the impact of losing that habit should not be minimized.

"Teams have had to learn quickly how to maintain the same level of productivity working in a remote setting," Fatibene points out.

**Regulatory oversight:** Over the last three decades, errors in statements of cash flows have been a leading source of comment letters from the SEC. Many companies have been rapped for inconsistent reporting of restricted cash, misclassification of cash receipts for either financing or investing, and erroneous reporting of gross or net cash flows, to name just a few areas. Often, these errors are driven by the manual nature of the process for gathering data to produce the statement of cash flows.

Also, PCAOB inspection reports have found fault with how companies report cash flow often enough that more frequent PCAOB inspections lead to "future cash flow realizations."

**Gaps in guidance:** Thirty-one years of mandated statements of cash flow from U.S. companies is not such a long time, and standardizing guidance is quite difficult given varying accounting methodologies for the elements of cash flow. With that said, FASB ASC Topic 230, Statement of Cash Flows, has some shortcomings in helping you decide whether a cash receipt or payment should properly be classified as operating, investing, or financing. FASB continues to update guidance for the treatment of accounts and the statement of cash flows, but there is still a great deal open for interpretation by an organization's technical accounting team.

**Late starts:** Compared with the income statement and balance sheet, production of the statement of cash flows is highly dependent upon the completion of the aforementioned statements, which may take up to 10 days after the last day of the period. A late start means a compressed timeline at many companies. In turn, tight
deadlines prioritize tight processes, hurried organization and staff collaboration, and abbreviated reviews of data — creating unnecessary risk from potentially clumsy work that can negatively impact credibility.

Nearly 70% of global business leaders and finance professionals claim their organization has made a significant business decision based on inaccurate financial data.

Source: Mistrust in the Numbers, Blackline.

Obsolete processes: Preparing the statement of cash flows is a major undertaking that requires connecting the income statement and balance sheet to various supplemental systems and contributors. Your team then must perform often complex calculations across functions and review them before finalizing the statement of cash flows. These realities gravitate toward connected systems, but even some major corporations can’t move past the artifacts from the old way of doing things. Manual steps, disconnected systems, desktop-based spreadsheets, email-based team communication, and obsolete review processes continue to add time, risk, and stress to calculating cash flows.

What is your top concern about your financial close reporting process?

Manual tasks are the top concern for finance & accounting – 2x the next closest factor


RESOURCES TO IMPROVE YOUR CASH FLOW PROCESS

Automating the preparation of the statement of cash flows will remain a topic of great debate, probably for many years. Even if an organization uses software to facilitate the preparation of the statement of cash flows, there are still manual and offline pieces that require a human touch. Plus, each organization will have their own way of doing things based on the factors discussed above, so there is no neat and tidy, one-size-fits-all process. That’s why software that’s purely dedicated to producing the statement of cash flows doesn’t exist. However, prudent investment in the right combination of currently available technologies can automate steps, streamline the process, and drive increased control.

We recommend two technology areas that organizations can invest in to drive more efficient, accurate, and collaborative processes to streamline the preparation of the statement of cash flows.

ERPs and consolidation software: ERPs are more commonly known as systems of record because they store and maintain data, and complementary software can also be used to consolidate and organize data within the systems of record. ERPs and consolidation systems can be used to manage and organize the data used in the financial statements. In some cases, yes, they can even help prepare those financial statements — but often at the expense of requesting IT resources, initial query building, and wrangling with rigid report builders.

Connected reporting platforms: Connected reporting platforms provide a central location to perform work and prepare financial statements that cannot be prepared in an ERP or consolidation system. Because they are made for the reporting function, you have more freedom of formatting and can present data in all the ways you need. The statement of cash flows,
for example, can be prepared directly in one of these platforms by allowing teams to pull in data, execute analysis, and prepare end reports in a collaborative and secure environment.

Workiva is an example of a connected reporting platform that enables the execution of this work through:

- Integrations and connections to other systems.
- A data preparation layer that enables you to organize and summarize massive volumes of data.
- Workflow management to automate manual tasks and steps.
- Real-time collaboration across the process.
- Security and control to assign permissions and increase process governance.
- Connected data across the process, from system of record to final output.

The Workiva connected reporting platform, for example, enables companies to pull data from disparate systems and sources, and decide how to combine it themselves. Users can assign individualized privileges to contributors and auditors; update data once across financial statements, charts, and tables; and track changes across a document’s full life — features that dovetail with a more efficient calculation of cash flow.

4 CRITICAL SKILLS
There’s no question that technology is one part of the puzzle. But what about human processes? Emphasizing these skills will pay off in a more sharply focused, streamlined approach to generate the statement of cash flows:

**Project management:** Facilitating data collection and analysis from groups ranging from operations to tax to treasury to FP&A requires a special mindset.

**Communication:** Numbers and narrative may come from far-reaching corners of the organization. Everyone involved in the process should be treated as a stakeholder.

**Transformative thought processes:** Hunger for continuous improvement is a valuable characteristic in the office of finance. Your company needs team members who concentrate every quarter on how to improve the financial statement process.

**An analytical mind:** Lots of people can compile data — not everyone can analyze it for actionable trends.

“As a B2B technology company,” Fatibene summarizes, “we have seen that customers that maintain checklist SOPs and operating procedures around cash flow tasks and items can enjoy more efficiency and more accuracy. A formalized approach to tracking the ‘asks’ helps you streamline the process.”