

What is Advanced Cash Flow Statement Analysis?

Worksheet

Advanced cash flow statement analysis evaluates operating, investing and financing cash flows together - most importantly free cash flow (FCF = Operating Cash Flow Capital Expenditures) - to judge a company's real cash-generating ability beyond reported net income.

$$\text{Free Cash Flow} = \text{Operating CF} - \text{Capital Expenditures}$$

Questions

1. OCF = \$400,000, CapEx = \$120,000. What is free cash flow?
 - A) \$520,000
 - B) \$280,000
 - C) \$400,000
 - D) \$120,000
2. Which method starts with net income and adjusts for non-cash items?
 - A) Direct method
 - B) Indirect method
 - C) Accrual method
 - D) Equity method
3. Rising net income but falling operating cash flow most likely signals:
 - A) Strong cash management
 - B) A healthy dividend policy
 - C) Potential earnings quality issues
 - D) Lower tax expense
4. An increase in accounts receivable (a working capital item) in the indirect method is:
 - A) Added to net income
 - B) Subtracted from net income
 - C) Ignored
 - D) Added to CapEx
5. A company reports operating cash flow of \$500,000 and capital expenditures of \$150,000. Calculate free cash flow.
6. Net income is \$200,000, depreciation & amortization is \$40,000, and working capital increased (used cash) by \$30,000. Find operating cash flow using the indirect method.
7. A company has OCF of \$210,000, CapEx of \$90,000, and pays \$20,000 in mandatory debt principal repayments. Find free cash flow to equity.
8. Define: What is free cash flow (FCF)?
9. Define: Why does OCF matter more than net income?
10. Define: What is the indirect method?

Answer Key

1. B) $\$280,000 - \text{FCF} = \text{OCF}$ $\text{CapEx} = 400,000 - 120,000 = \$280,000$.
2. B) Indirect method - The indirect method reconciles net income to cash flow from operations.
3. C) Potential earnings quality issues - A growing gap between net income and OCF is a classic earnings-quality red flag.
4. B) Subtracted from net income - A rise in receivables means cash hasn't been collected yet, so it's subtracted from net income.
5. $\text{FCF} = \text{OCF} - \text{CapEx}$ $\text{FCF} = 500,000 - 150,000 = \$350,000$
6. $\text{OCF} = \text{Net income} + \text{D\&A}$ $\text{Increase in working capital}$ $\text{OCF} = 200,000 + 40,000 - 30,000 = \$210,000$
7. $\text{FCF (to firm)} = \text{OCF} - \text{CapEx} = 210,000 - 90,000 = \$120,000$ $\text{FCF to equity} = \text{FCF (to firm)} - \text{Mandatory debt repayment}$ $\text{FCF to equity} = 120,000 - 20,000 = \$100,000$
8. Cash left over after a company pays for operating expenses and capital expenditures: $\text{FCF} = \text{OCF} - \text{CapEx}$.
9. Net income includes non-cash items and accounting judgment; OCF shows the actual cash a company generated.
10. It starts from net income and adjusts for non-cash items (D&A) and working capital changes to arrive at operating cash flow.

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