The Indirect Method: A Summary

The adjustments to net income explained in our preceding discussion are summarized as follows:

Net income

Add: Depreciation
- Decrease in accounts receivable
- Decrease in inventories
- Decrease in prepaid expenses
- Increase in accounts payable
- Increase in accrued expenses payable
- Increase in deferred income taxes payable
- Nonoperating losses deducted in computing net income

Deduct: Increase in accounts receivable
- Increase in inventories
- Increase in prepaid expenses
- Decrease in accounts payable
- Decrease in accrued expenses payable
- Decrease in deferred income taxes payable
- Nonoperating gains added in computing net income

Net cash provided by (used in) operating activities

LO7 **Compute net cash flows from operating activities using the *indirect* method.**

Indirect Method May Be Required in a Supplementary Schedule

The FASB recommends use of the *direct method* in presenting net cash flows from operating activities. The majority of companies, however, elect to use the indirect method. One reason is that the FASB requires companies opting for the direct method to meet an additional reporting requirement.

Companies using the direct method are required to provide a *supplementary schedule* showing the computation of net cash flows from operating activities by the indirect method. However, no supplementary computations are required of companies that present the indirect method computations in their cash flow statements because this same information is already presented in the body of the statement under the indirect method. In the opinion of these authors, this reporting requirement undermines the FASB's efforts to encourage use of the direct method.

The Statement of Cash Flows: A Second Look

We have now completed our explanation of Allison Corporation's statement of cash flows. We have analyzed each type of cash flow by reconciling amounts included in the other two financial statements—the income statement and the balance sheet—to determine the