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Accounting

Essential Guide to Accounting for Financial Analysts.

Overviews of accounting fundamentals and company financial statements for effective financial analysis

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Table of Contents.

Accounting and Financial Statements

Introduction

Company financial statements offer a clear and accurate picture of a business's financial health and performance.

Financial statements are used by internal management to make informed decisions, by investors to assess profitability and stability, and in regulatory compliance. These statements also help companies secure financing, ensure transparency, and build trust with stakeholders.

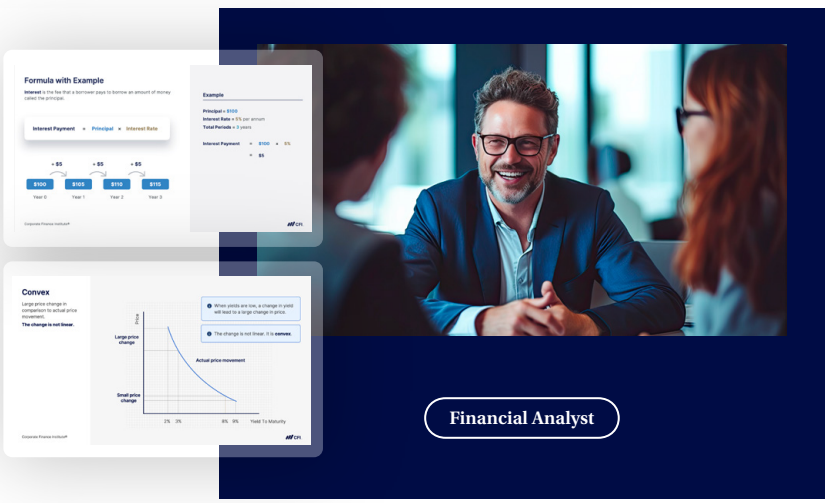
Understanding financial accounting is essential for effectively analyzing and interpreting these statements. Accounting provides an accurate record of business activities, while financial statements reflect the current state of the business.

A variety of finance career paths require accounting knowledge, for example:

Financial Planning & Analysis (FP&A)	Investment Banking	Commercial Lending
FP&A analysts need to **forecast a future state** of company financials. They must start with **financial statements** prepared by accountants.	Investment banking analysts must determine the **value of companies.** To do so, they need to understand the **current financial state** of companies and their ability to **generate revenue and profit.**	Commercial banking analysts must **assess potential loans** to business clients. Evaluating financial statements helps them **understand a company's ability to repay a loan.**

Whether you're a current or aspiring financial analyst, or just looking to familiarize yourself with financial accounting, this guide is for you. It summarizes several fundamental accounting concepts, the three core financial statements, and the individual sections within each statement.

We also encourage you to review the basics and building blocks of the accounting process in **Accounting Fundamentals**, a CFI course taught by Scott Powell, CFI Co-Founder, Chief Content Officer, and co-author of this guide.



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Section 1.

Overview of Company Financial Statements
Balance Sheet
Income Statement
Statement of Cash Flows
Summary Comparison
Accounting Standards

Overview of Company Financial Statements

Section 1

Companies use different accounts to keep track of their financial transactions. The **primary accounts** are:

1. Assets
2. Liabilities
3. Shareholders' Equity
4. Revenue
5. Expenses

Company transactions always affect **multiple accounts,** whether it's separate accounts for assets and liabilities, or within the same general account, such as two different asset accounts.

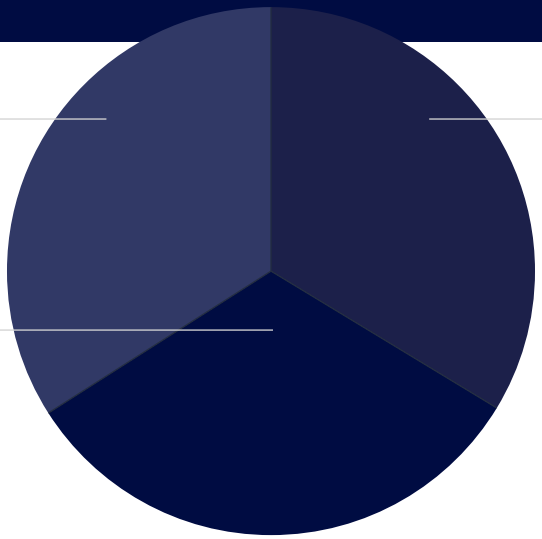
Activity in these accounts over a period of time are summarized and reported in **three main financial statements:**

Income Statement

The income statement illustrates the revenue, expenses, and profitability of a company.

Cash Flow Statement

The cash flow statement shows cash movements from operating, investing, and financing activities.



Balance Sheet

The balance sheet shows a company's assets, liabilities, and shareholders' equity at a particular point in time.

Each of the financial statements provides important information for both internal and external stakeholders of a company.

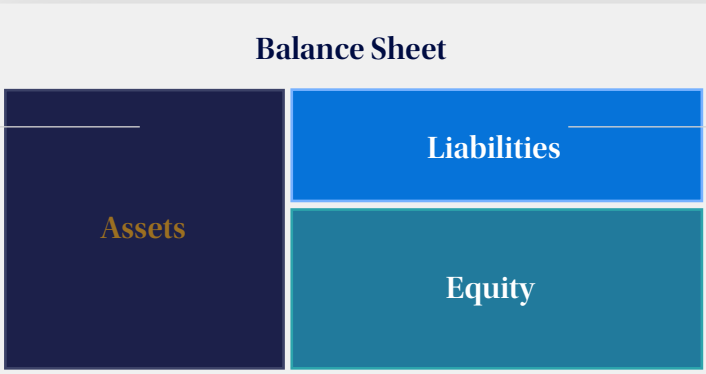
Balance Sheet

Section 1

A balance sheet displays a company's assets, liabilities, and shareholders' equity at a point in time.

A balance sheet is divided into **two sides** (or sections).

The left side of the balance sheet outlines all of a company's **assets.**



The right side of the balance sheet outlines the company's **liabilities** and **shareholders' equity.**

The Accounting Equation

The left and right sides of a balance sheet must always balance: **assets must equal liabilities plus shareholders' equity.**

Assets = Liabilities + Shareholders' Equity

The assets section typically begins with cash and equivalents, which should equal the balance found at the end of the cash flow statement.

The balance sheet then displays the **ending balance** in each of the company's major accounts from period to period. **Net income** (profit or loss) from the income statement is represented in the balance sheet as a change in **retained earnings** (adjusted for payment of **dividends**).

The Balance Sheet

Key Features of a Balance Sheet:

- Shows the financial position of a business.
- Expressed as a "snapshot" or financial picture of the company at a specified point in time. For example, "as of December 31, 2023."
- Assets = Liabilities + Shareholders' Equity.

Income Statement

Section 1

When an investor or analyst needs to understand a company's profit and loss, they often start with the income statement.

The income statement shows the performance of the business for each reporting period, displaying...

Sales Revenue

at the very top.

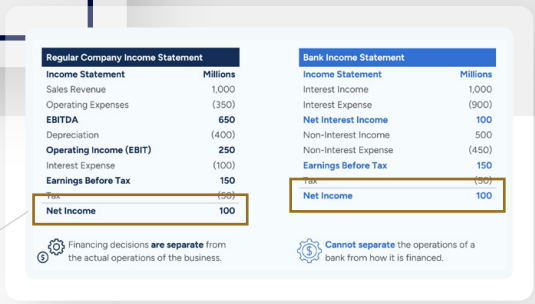
Income Statement

Statement of operation / profit and loss

- Revenues
- Expenses
- Profit or Loss

Profit or loss, referred to as **net income (or net loss)**, is determined by taking all revenues and subtracting all expenses from both operating and non-operating activities.

First, the statement deducts the cost of goods sold (**COGS**) from sales revenue to find gross profit. From there, other operating expenses are deducted and other income is added to calculate **net income**.



Net income is located at the bottom of the statement — this is where the expression "the bottom line" originated. *Going forward, this guide uses the term 'net income' for net profit (or loss) displayed on an income statement.*

"the bottom line"

Accrual Accounting

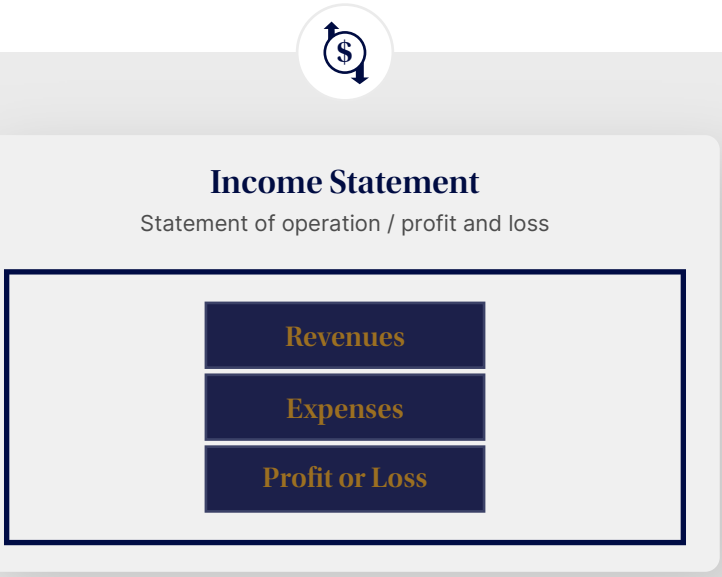
Recording revenues a company has earned but not yet received and expenses incurred but not yet paid.

Income Statement

Section 1

Key Features of an Income Statement:

- Shows revenues, expenses, and net income.
- Expressed over a period of time, such as a year, a quarter, or year-to-date.
- Uses accrual accounting and the matching principle to represent figures (not presented on a cash basis).
- Used in financial analysis to assess a company's profitability.



Matching Principle

Dictates that companies report **expenses** at the same time as the related **revenues**. Revenues and expenses are **matched on the income statement** for the period reported.

Cash Flow Statement

Section 1

“Cash is king” is an old saying about business.

Since the income statement and balance sheet are based on **accrual accounting**, those financials don’t directly measure what happens to cash over a period. Therefore, companies typically provide a **cash flow** statement used by management, investors, and other stakeholders.

A statement of cash flows takes...

net income

and adjusts it for any...

non-cash expenses

Cash inflows and outflows are calculated using changes in the balance sheet. The cash flow statement displays the **change in cash per period**, as well as the beginning and ending balance of cash.

Key Features of a Cash Flow Statement:

- Shows the increases and decreases in cash.
- Expressed over a period of time, such as a year, a quarter, or year-to-date.
- Undoes accrual accounting principles to show pure cash movements.
- Includes three sections:
  1. Cash from operations
  2. Cash used in investing
  3. Cash from financing
- Shows the net change in the cash balance from the start to the end of the period.

Comparing Financial Statements

Section 1

Summary Comparison

The three core financial statements provide a comprehensive view of a company's financial health and performance. Effective financial analysis relies on understanding the differences and relationships among the income statement, balance sheet, and cash flow statement.

The table below provides a summary comparison of the three core statements in terms of time, purpose, measures, and starting and ending points. The following sections of this guide cover each statement and its key components in detail.

	Income Statement	Balance Sheet	Cash Flow
Time	Period of time	A point in time	Period of time
Purpose	Profitability	Financial position	Cash movements
Measures	Revenue, expenses, profitability	Assets, liabilities, shareholders' equity	Increases and decreases in cash
Starting Point	Revenue	Cash balance	Net income
Ending Point	Net income	Retained earnings	Cash balance

Accounting Standards

Section 1

Guiding Principles

Within this guide, references are made to certain **accounting standards**, which are guiding principles that determine the policies and practices of financial accounting.

Accounting standards improve the **transparency** of financial reporting and create company **accountability** for the financial information it reports.

Generally Accepted Accounting Principles (GAAP)

Primary accounting standard adopted by the **Financial Accounting Standards Board (FASB).**

GAAP was developed in the **United States** and forms the basis of accepted accounting standards for preparing and reporting financial statements in the US.

International Financial Reporting Standards (IFRS)

Accounting rules for companies **based outside the US.** Issued and maintained by the International Accounting Standards Board (IASB), IFRS standards are intended to achieve **uniformity** of approach and identity of meaning. Accounting standards of a specific country are strongly influenced by these standards and governance arrangements.

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Section 2.

Components of a Balance Sheet

Assets

Current Assets

Non-Current Assets

Liabilities

Current Liabilities

Non-Current Liabilities

Shareholders' Equity

Components of a Balance Sheet

Section 2

Assets = Liabilities + Equity

A balance sheet provides a snapshot of a company's financial position at a specific point in time that shows:

1. What the company owns **(assets)**
2. What it owes **(liabilities)**
3. Shareholders' equity **(owners' claim on assets after liabilities are paid)**

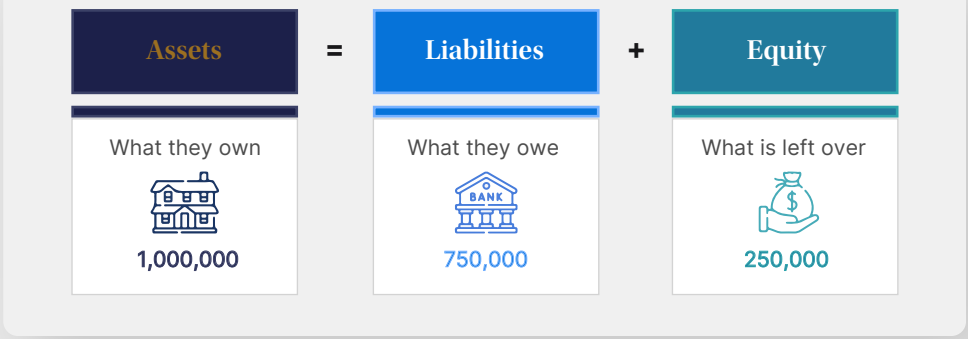
Remember,

a balance sheet aligns with the accounting equation: **Assets = Liabilities + Equity**. A balance sheet must always balance: assets must equal liabilities plus shareholders' equity.

Assets = **Liabilities** + **Equity**

Example

Suppose you have a mortgage on a home valued at **$1 million (an asset)**, but your outstanding balance on the mortgage is **$750,000 (a liability)**. That leaves you **$250,000 in equity**. In other words, if you sold your house for $1 million and paid off the mortgage, you would be left with a residual value of $250,000 (shareholders' equity).



Components of a Balance Sheet

Section 2

Assets = Liabilities + Equity

Here's the same concept illustrated in a simple balance sheet. The left side of the balance sheet outlines all of a company's **assets**. On the right side, the balance sheet outlines the company's **liabilities** and **shareholders' equity**.

Simplified Balance Sheet

Expected to convert into cash < 1 year

Expected to be held > 1 year

Expected to be paid in < 1 year

Expected to be paid in > 1 year

Assets		Liabilities	
Current assets		**Current liabilities**	
Cash	20,000	Accounts payable	2,000
Accounts receivable	3,000	Accrued expenses	1,000
Inventory	60,000	**Total current liabilities**	**3,000**
Prepaid expenses	11,000	**Non-current liabilities**	
Total current assets	**94,000**	Bank loan	111,000
Non-current assets			
Property Plant & Equipment	110,000		
Intangible assets	10,000	**Shareholders' Equity**	
Total non-current assets	120,000	Common shares	89,000
Total assets	**214,000**	Retained earnings	11,000
		Total common equity	100,000
		Total liabilities & Equity	**214,000**

Companies use a system called *double-entry accounting* to ensure the two sides of a balance sheet always balance.

For every transaction, one account is debited and another is credited by an equal amount, ensuring that **total assets always equals the sum** of liabilities and shareholders' equity. This system helps maintain accurate and consistent financial records.

Double-Entry Accounting	A system where every financial transaction is recorded in at least two accounts, ensuring the accounting equation (Assets = Liabilities + Equity) **remains balanced.**

Assets

Section 2

Assets are listed in **order of liquidity.**

Current assets can be liquidated quickly and are used in the short term.

Assets are resources owned by the company that have value and can provide future economic benefits, such as cash, equipment, inventory, and buildings.

Assets are typically listed from the most to the least liquid. A company's **liquidity** is a measure of how easily it can meet its **short-term financial obligations**. Therefore, cash is usually listed at the top of the asset section, while capital assets, such as **Property, Plant & Equipment** (**PP&E**), are usually listed last.

Current Assets

Current assets are all assets that a company expects to **convert to cash** within one year. Examples of current assets include cash and cash equivalents, accounts receivable, inventory, and marketable securities.

Cash and Cash Equivalents	Accounts Receivable	Inventory	Marketable Securities
Cash and **cash equivalents** are the **most liquid of all assets**, so this line item appears first on a balance sheet. Cash equivalents are assets with short-term maturities of less than three months, such as bank certificates of deposit, banker's acceptances, Treasury bills, commercial paper, and other money market instruments. Companies typically disclose the details of equivalents in the **footnotes** to the balance sheet.	**Accounts Receivable**, or AR, represents the **money owed** to a company from customers who have bought products or services on credit. This account is reduced by estimating how much might *not* be collected, known as **doubtful accounts**. When the company receives payment from customers, the **AR balance decreases**, and the **cash balance increases** by the same amount.	**Inventory** includes amounts for raw materials, work-in-progress goods, and finished goods. Inventory represents a **significant investment**. Proper management of inventory reflects a company's financial health, as it directly impacts the **cost of goods sold (COGS)** on the income statement and, ultimately, **profitability.**	**Marketable securities** are assets that a company can **convert to cash** on relatively short notice, such as investments in publicly traded stocks or bonds.

Section 2

Non-Current Assets

Property, Plant, and Equipment (PP&E)

PP&E captures the company's **tangible capital assets** used in the production or supply of goods and services. For example, company-owned land, buildings, vehicles, and equipment are all classified as PP&E.

In general, PP&E are **illiquid assets**, meaning assets that are not easily convertible into cash. While land, buildings, or equipment can all be sold, a company can sell **inventory** or **investments**, such as bonds or stock shares, much more quickly and easily.

Intangible Assets

Intangible assets include all of the company's intangible assets, which may or may not be separately identifiable. **Identifiable** intangible assets include patents, licenses, and secret formulas. **Unidentifiable** intangible assets include brand and goodwill.

Liabilities

Section 2

Liabilities are ordered by **due dates.**

Current liabilities are obligations that a company must meet within the short term.

Liabilities on a balance sheet are the amounts a company owes to others, including debts, loans, and other financial obligations.

They represent what the company **must pay** in the future. Liabilities are typically listed in order of due dates, from shortest to longest term.

Current Liabilities

Current liabilities are **financial obligations** that a company **must pay off within one year.** Liabilities are transactions that generate an expectation of a future outflow of cash or other economic resources. The most common types of current liabilities are accounts payable, short-term debt, and the current portion of long-term debt.

Accounts payable, or AP, represents the money a company owes to its suppliers for goods or services it bought on credit. When the company pays off these bills, both the Accounts Payable balance and the cash balance **decrease** by the same amount.

Short-Term Debt

Short-term debt refers to **short-term loans** or financial obligations that a company needs to pay back within a year or its normal business cycle, whichever is longer. Short-term debt can include **borrowed cash** that is due soon.

Current Portion of Long-Term Debt

Long-term debt is debt with a maturity of longer than one year. The **current portion of long-term debt** is the amount of principal and interest a company **must pay within one year's time**. For example, if a company borrowed $1 million with a 10-year term requiring equal annual principal payments, the current portion of this long-term debt is $100,000 (excluding interest payments).

Note that the current portion of long-term debt is different from **short-term** and current debt, which is debt with a maturity of less than one year. However, some companies consolidate the two amounts into a generic current debt line item on the balance sheet.

Liabilities

Section 2

Non-Current Liabilities

A non-current liability refers to the **financial obligations** on a company's balance sheet that are not expected to be paid within one year. Non-current liabilities are due in the long term, compared to short-term liabilities, which are due within one year. Bonds payable and long-term debt are examples of non-current liabilities.

Bonds Payable	Long-Term Debt
The **bonds payable** line item includes the amortized amount of any bonds the company has issued.	**Long-term debt** includes the **total amount of long-term debt** (excluding the current portion, if that account is present under current liabilities). This account is derived from the debt schedule, which outlines all of the company's outstanding debt, the interest expense, and the principal repayment for every period.

Shareholders' Equity

Section 2

Shareholders' equity refers to the **owners' claim** on the assets of a company after it pays off all its debts. Shareholders' equity typically includes **share capital** and **retained earnings.**

Share Capital

Share capital is the **value of funds** that shareholders have invested in the company. When a company is first formed, shareholders will typically put in cash. For example, suppose an investor starts a company and seeds it with $10 million. Cash (an asset) rises by $10 million, and share capital (an equity account) rises by $10 million, balancing out the balance sheet.

Retained Earnings

Retained earnings (RE) is the total amount of **net income** the company decides to keep. Every period, a company may pay out **dividends** from its net income. The remaining net income is added to (deducted from, if a loss) the beginning retained earnings balance.

Retained Earnings Formula

RE = Beginning Period RE + Net Income / Loss – Cash Dividends

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Section 3.

Components of an Income Statement

Sales Revenue
Cost of Goods Sold (COGS)
Gross Profit
Selling, General, and Administrative (SG&A) Expenses
Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA)
Depreciation and Amortization
Operating Income (EBIT)
Interest and Other Expenses
Earnings Before Tax (EBT)
Income Taxes
Net Income
Earnings Per Share (EPS)

Components of an Income Statement

Section 3

Income statements are aggregated into total values for quarterly and annual results.

According to the *matching principle*, revenues and expenses are matched on the **income statement** for the period reported, meaning companies report **expenses** at the same time as related **revenues**.

The accrual accounting method is used in income statements to ensure that:

- Revenues are recorded when earned (even if the customer hasn't paid yet).
- Expenses are recorded when incurred (even if the company hasn't paid for them yet).
- The income statement provides a clear picture of a company's profitability for the reporting period by aligning revenue and expense.

Note

Some income statement line items **differ among industries** or types of businesses. For example, financial statements for banks differ somewhat from other business types due to the unique nature of banking operations.

Simplified Income Statement

Revenue ← Also called **Sales or Turnover**

Direct operating costs
(e.g., cost of goods sold)

Gross profit

Indirect operating costs
(e.g., R&D, administration, selling, distribution)

EBITDA
Earnings before interest taxes, depreciation, and amortization

(e.g., depreciation and amortization)

EBIT
Earnings before interest and taxes

Cost of debt financing
(e.g., interest, bank charges)

EBT
Earnings before taxes

Tax

Net Income

Components of an Income Statement

Section 3

Sales Revenue

Sales **revenue**, or a company's revenue from sales or services, is displayed at the top of an income statement. Often referred to as the **"top line,"** sales revenue is the starting point from which a company's costs are deducted to calculate net income.

Cost of Goods Sold (COGS)

Cost of goods sold (COGS) is the next line item after sales revenue. COGS represents the **direct costs** associated with selling products or services to generate revenue. Direct costs typically include labor, parts, materials, and an allocation of other expenses, such as depreciation.

Direct Materials
(I.e., materials used in manufacturing)

Direct Labor
(I.e., professional services delivered)

Other Allocations
(I.e., overhead, costs, related to production)

Gross Profit

Gross profit serves as the financial metric used in determining the gross profitability of a business operation. It shows how well sales cover the direct costs related to the production of goods or provision of services. **Gross profit** is calculated by subtracting Cost of Goods Sold (or Cost of Sales) from Sales Revenue.

Gross Profit = Sales Revenue – Cost of Goods Sold

Components of an Income Statement

Section 3

Selling, General, and Administrative (SG&A) Expenses

SG&A expenses include all other **indirect costs** associated with running the business. Selling expenses include marketing, advertising, and promotion, which are often grouped together. Other indirect costs include salaries and wages, rent and office expenses, insurance, travel expenses, and sometimes depreciation and amortization, along with other operational expenses. Note that some income statements present depreciation and amortization in its own section.

Earnings Before Interest, Tax, Depreciation and Amortization (EBITDA)

While not usually present on income statements, **EBITDA** is a metric used by some companies to convey their **operating performance.** Many company leaders, and some equity analysts and investors, view EBITDA as a loose proxy for **cash flow** from company operations.

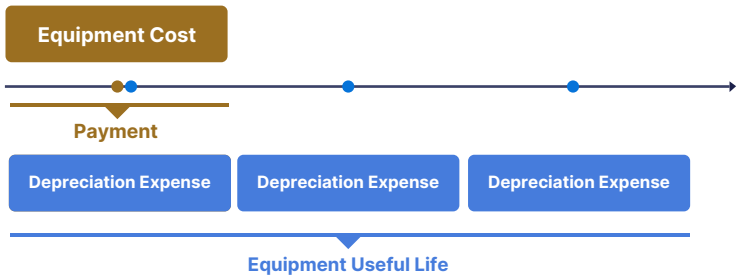
However, EBITDA is not a recognized measure under either GAAP or IFRS accounting standards. Some investors are skeptical of EBITDA because it excludes a company's interest or tax expenses, as well as the natural decline in the value of capital assets over time (depreciation).

EBITDA = Net Income + Interest + Taxes + Depreciation + Amortization

Depreciation & Amortization Expenses

Depreciation and **amortization** (D&A) are **non-cash expense methods** used in accounting. Depreciation gradually reduces the cost of a company's physical long-term assets, such as property, plant, and equipment (PP&E), over the time these assets are used to help the company make money. **Amortization** spreads the cost of intangible assets like trademarks, patents, and copyrights, over the projected life of the asset.

Depreciation Expense is an example of the matching principle. The cost of a fixed asset is allocated over its useful life as it generates economic benefits over that time.



Components of an Income Statement

Section 3

Operating income represents what's earned from regular business operations before any non-operating income, non-operating expenses, interest, or taxes (EBIT) are subtracted from revenue.

EBIT is a term commonly used in finance and stands for **Earnings Before Interest and Taxes.**

Operating Income = Revenue – COGS – SG&A – D&A

Note

Note that expense line items appearing after operating income are *non-operating expenses* related to a company's income taxes, financing, and investment activities.

Interest and Other Expenses

Companies commonly break out **interest expense** and **interest income** as a separate line item in the income statement to reconcile the difference between EBIT and EBT. Interest expense is determined by a **debt schedule**.

Other expenses are often unique to a specific industry. Examples of other expenses include fulfillment, technology, **research and development** (R&D), **stock-based compensation** (SBC), **impairment charges**, gains/losses on the sale of investments, and foreign exchange impacts.

EBT (Pre-Tax Income)

EBT stands for **Earnings Before Tax**, also known as pre-tax income. EBT is calculated by subtracting interest expense and other non-operating expenses from operating income.

EBT = Operating Income – Interest Expense

Components of an Income Statement

Section 3

Income Taxes

Income taxes refer to the **relevant taxes charged** on pre-tax income. A company's total tax expense may include current and future taxes.

Net Income

Net income is calculated by **subtracting** income taxes from pre-tax income. This is the amount that flows into retained earnings on the balance sheet after deductions of any dividends paid to shareholders.

Net Income = Pre-Tax Income – Income Taxes

Earnings Per Share

Earnings per share (EPS) indicates a company's ability to generate **net income** for common shareholders. EPS is calculated by **dividing** the net income available to common shareholders by the average **outstanding shares** over the reporting period.

EPS = (Net Income – Preferred Dividends) / Average Shares Outstanding

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Section 4.

Components of a Cash Flow Statement

Cash Flow Statement Sections

Cash from Operations

Cash from Investing

Cash from Financing

Net Increase/(Decrease) in Cash and Closing Cash Balance

Components of a Cash Flow Statement

Section 4

A cash flow statement breaks down the cash generated and spent by a company during a reporting period.

It also connects the income statement and balance sheet by showing how cash moved **in and out** of the business.

Cash Flow Definitions

Cash flow

Inflows and outflows of cash and cash equivalents recorded on a cash basis, meaning when cash is **actually received or paid.**

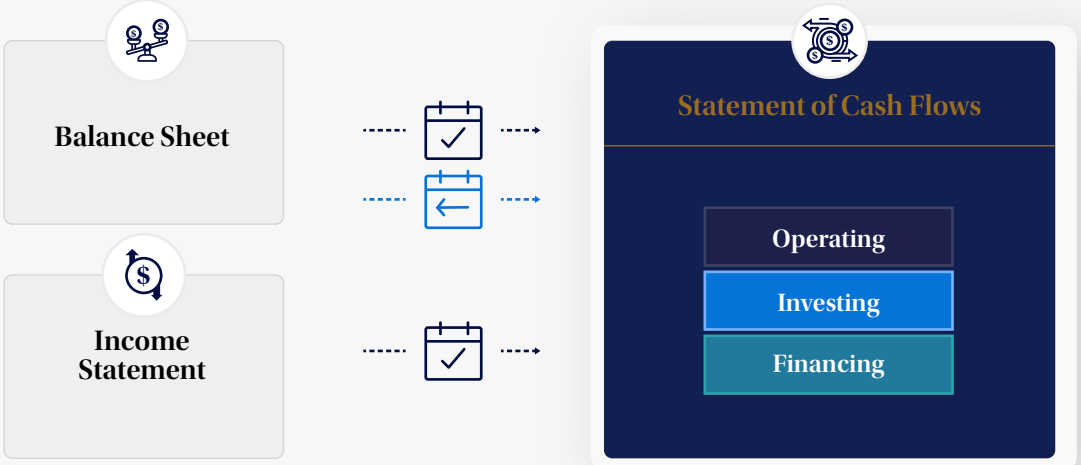
Cash balance

Cash **on hand** and demand deposits (cash balance on the balance sheet).

Cash equivalents

Cash **held** as bank deposits, short-term investments, and easily convertible assets, such as overdrafts and cash equivalents with short-term maturities of less than three months.

Much of a company's success depends on efficient cash flow management.



Components of a Cash Flow Statement

Section 4

What Can a Cash Flow Statement Tell Us?

Much of a company's success depends on its ability to manage cash flows efficiently. A cash flow statement helps us understand how well a company generates cash from its operations, investments to fuel growth, and manages its debt and equity. It gives us a sense of the company's liquidity, financial health, overall performance, and whether the company generates enough cash to sustain its operations and growth.

Cash Flow Statement Sections

A cash flow statement organizes a company's cash-related transactions into three categories.

1. **Cash from Operations:** Cash flows from operating the business, such as sales revenue collected or expenses paid.
2. **Cash from Investing:** Cash flows from non-current assets that support the business, such as PP&E or business acquisitions.
3. **Cash from Financing:** Cash flows from transactions related to shares or debt, such as paying dividends, share issuances or buybacks, and borrowing or repaying loans.
4. **Net Increase/(Decrease) in Cash:** Sum of cash flows from operating, investing, and financing activities, which shows the net change in cash for the period.

Simplified Cash Flow Statement

Cash from Operations	Cash from Investing	Cash from Financing
(+) Net Income	**(-)** Capital Expenditures (CapEx)	**(+)** Equity and Debt Issuances
(+) Depreciation & Amortization and Other Non-Cash Expenses	**(-)** Long-Term Investments & Business Acquisitions	**(-)** Share Buybacks & Dividends
(-) Increase in Net Working Capital	**(+)** Divestitures	**(-)** Debt Repayment
Net Increase/(Decrease) in Cash		
Closing Cash Balance		

Components of a Cash Flow Statement

Section 4

1

Cash from Operations

Operating activities refer to a company's **day-to-day business operations**. Cash from operations, or operating cash flows, include cash inflow from collected sales revenue and outflow from expenses paid during the reporting period.

Companies use one of two ways to present cash flow from operations: the **direct method or the indirect method**. Most use the indirect method:

Indirect method: Presents operating cash flows as a reconciliation from **net income to cash.** For the rest of this section on cash flow statements, **assume the indirect method is used**.	**Direct method:** Presents operating cash flows in a **list**: cash inflow from sales and cash outflow for operating expenses. This is a simple but **rarely used method**.

The operating cash flow section includes adjustments for both cash and non-cash items to show how net income translates into **actual cash flow**.

(+) Net Income
Cash flow statements start with **net income**, which is the profit or loss shown on the income statement. However, net income doesn't always reflect the company's actual cash situation because it includes non-cash items and other accounting adjustments. To get a clearer picture of the cash flow from operating activities, we adjust net income by removing non-cash items and accounting for changes in the company's working capital.

(+) Depreciation and Amortization (D&A)
D&A accounting methods allocate the costs of assets over their useful lives as the value of these assets declines. **Depreciation** involves tangible assets such as **buildings, machinery, and equipment**, whereas amortization involves **intangible assets**, such as patents, copyrights, and software.

D&A are non-cash expenses, so companies add these expenses back to net income on the cash flow statement.

(–) Increase in Net Working Capital
Working capital is the difference between a company's current assets (like inventory and accounts receivable) and current liabilities (like accounts payable). Changes in these items can affect the company's cash flow.

For example, if a company buys more inventory, it uses cash, so the increase in inventory is **subtracted from net income**. Similarly, if the company's accounts receivable (money owed by customers) goes up, it means sales were made on credit, not cash, so this increase is also subtracted from net income.

On the other hand, if a company's accounts payable (money owed to suppliers) increases, it means the company has bought goods or services on credit but hasn't yet paid for them. This situation is considered a cash inflow and is added to net income. Conversely, a decrease in accounts payable would be subtracted.

Components of a Cash Flow Statement

Section 4

2

Cash from Investing

Cash flows from investing reflect **non-current assets** like property, plant, and equipment (PP&E), and other investments, such as business acquisitions.

(–) Capital Expenditures (CapEx)
CapEx are the costs to **buy, maintain, or upgrade** PP&E like property, buildings, factories, equipment, and technology. These investments result in cash outflows, meaning they reduce the total cash available as shown on the cash flow statement.

(–) Long-Term Investments & Business Acquisitions
This line item shows the **cash spent on purchasing long-term assets,** such as stocks, bonds, or entire companies. These activities are typically cash outflows, as they involve significant investments in assets that are expected to provide benefits over a long period. This section helps to show how a company is using its cash to expand or invest in other businesses for future growth.

(+) Divestitures
Divestitures show the **cash received** from selling assets or business units. These transactions result in cash inflows, as they involve the company getting cash in exchange for selling its assets or parts of its business. This section indicates how a company is liquidating assets or exiting certain businesses to raise cash or focus on its core operations.

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Components of a Cash Flow Statement

Section 4

3

Cash from Financing

Cash flows from financing activities show the **cash received or spent** by the company as it relates to its financial structure. Examples include share issuances or buybacks, debt issuance or repayment, and dividend payments to investors.

(+) Share Issuance
When a company issues shares, or sells more shares of its stock to investors, the proceeds from the share issuance are a **cash inflow.**

(+) Debt Issuance
Companies use debt issuances to **raise large amounts of cash** by selling bonds or other debt securities to investors who are willing to act as lenders. The funds raised by issuing debt is a cash inflow.

(–) Share Buybacks
When a company **buys back shares** of its stock from investors, it pays cash for those shares, which is a cash outflow.

(–) Debt Repayment
When a company **pays investors back** the principal amount they borrowed these repayments are a cash outflow.

(–) Dividend Payment
When a company pays dividends, it **distributes cash** to its investors, which is a cash outflow.

Net Increase/(Decrease) in Cash and Closing Cash Balance

Net increase/(decrease) in cash represents the **overall change in the company's cash position** during the period after accounting for cash flows from operating, investing, and financing activities. Adding net increase/(decrease) to the "opening cash balance" will determine the closing cash balance, which shows the total cash available at the end of the period. The closing cash balance is reported under current assets on the balance sheet.

Net Change in Cash = Cash from Operations + Cash from Investing + Cash from Financing

Closing Cash Balance = Beginning Cash Balance + Net Change in Cash

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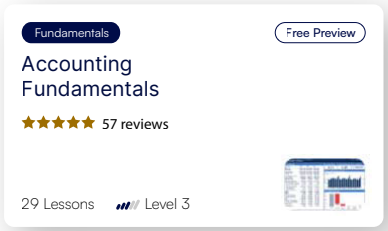

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Scott Powell
CPA, CFA®, FMVA®

Co-Founder and Chief Content Officer

Scott has a passion for teaching with over 30 years of experience in delivering learning solutions for financial services clients spanning commercial and investment banking, capital markets, and asset management. His client roster has included JP Morgan, Bank of America Merrill Lynch, Credit Suisse, Royal Bank of Scotland, TD, and HSBC, among others. Now based in Vancouver, Scott spent a significant portion of his career in London, New York, and Hong Kong.

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For nearly a decade, Duncan has designed and taught courses in financial modeling to employees working in accounting, financial valuation, investment banking, equity research, and private equity. Duncan has extensive experience providing financial modeling consulting services to large corporations and institutions. Prior to teaching, Duncan held senior equity research positions with top banks and brokerages. He holds an Engineering degree, Master of Finance degree, and a CFA Charter.

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For over a decade before joining CFI, Jeff taught financial modeling and valuation to thousands of learners worldwide. Prior to his career in financial education, Jeff worked as an equity research analyst covering approximately 50 companies with a combined market cap of $500 billion. His background also includes working in corporate development, leading M&A due diligence and financial planning and analysis, and investment banking and restructuring.

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