I. **Appendix 14A: The direct method of determining the net cash provided by operating activities (Slide #1 is a title slide for the appendix)**

*Learning Objective 4: Use the direct method to determine the net cash provided by operating activities.*

2

#### Computing net cash provided by operating activities

* + 1. The direct method computes net cash provided by operating activities by **reconstructing the income statement on a cash basis** from top to bottom.

3

* + - 1. The amount of net cash provided by operating activities under the direct method will **always agree** with the amount computed using the indirect method.

#### Similarities and differences in the handling of data

* + 1. The adjustments for accounts that affect **revenue** are the **same** in the direct and indirect methods.
       1. In either case, **increases** in the accounts are **deducted** and **decreases** in the accounts are **added**.

4

* + 1. The adjustments for accounts that affect **expenses** are handled in **opposite ways** for the direct and indirect methods. Under the **indirect method**, the adjustments are made to **net income**, whereas under the **direct method** the adjustments are made to the **expense accounts** themselves. For example:
       1. In the indirect method, an **increase in prepaid expenses** is **deducted** from net income. However, in the direct method an **increase in prepaid expenses** is **added** to operating expenses.

4

* + 1. Regarding **gains and losses** on sale of assets, **no adjustments are needed** at all under the direct method.

5

* + - 1. These gains and losses are **ignored** because they are not part of sales, cost of goods sold, operating expenses, or income taxes.

iv When a company uses the direct method it must prepare a reconciliation between net income and the net cash provided by operating activities. If it uses the indirect method it must disclose the amount of interest and income taxes paid during the year.

6