

March 1, 2005

TRACKING THE NUMBERS

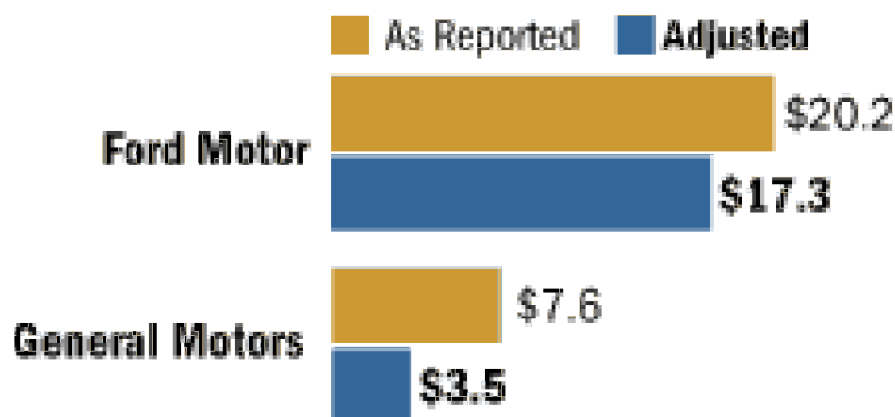
Outside Audit Little Campus Lab Shakes Big Firms

Georgia Tech Crew's Report Spurs Change in Accounting For Operating Cash Flow

By **DIYA GULLAPALLI** Staff Reporter of **THE WALL STREET JOURNAL** *March 1, 2005; Page C3*

Car Makers' Cash

If car companies move customer-related notes receivable into the operating section of their cash-flow statement, from the investing section, they'll report lower operating cash flow; 2003 figures, in billions.



Source: Georgia Tech Financial Analysis Lab

From the modest offices of the Georgia Tech Financial Analysis Lab in Atlanta, cash-flow sleuthing is starting to rattle a slew of corporate titans.

Last April, the lab issued a report chastising dozens of

companies, including **General Motors** Corp. and **Ford Motor** Co., for treating customer-related loans as an "investing" activity rather than an "operating" one. The treatment had the effect of boosting "cash flow from operating activities," one of the most closely watched portions of a company's financial filings because it is supposed to reveal how much cash is being generated from

a company's core business. Robust operating cash flow is a comforting thing to investors. Soon after, the lab's report was the subject of an article in The Wall Street Journal¹.

In January, the Securities and Exchange Commission sent letters to about a dozen companies, mostly in the automotive industry, asking them to correct this classification. Although the SEC isn't requiring any restatements, it is asking that companies shift the receivables, or customer IOUs, into operating cash flow for coming annual reports as well as the two years prior that appear on the statements.



Charles Mulford

In general, the receivables stem from forms of vendor financing. Many companies lend their customers money to buy their products. In the case of auto makers, the customers in question are auto dealers.

"Presenting cash receipts from receivables generated by the sale of inventory as investing activities in the company's consolidated statements of cash flows is not in accordance" with generally accepted accounting principles, wrote Carol Stacey, chief accountant for the SEC's division of corporation finance, in her letter to the companies.

When disclosing the change, Ms. Stacey asked the companies to explain the impact and explicitly state that it was prompted because of concerns raised by SEC staff.

If GM had classified customer-related notes receivable as an operating activity in 2003, the company's \$7.6 billion of operating cash flow in 2003 would have been \$4.1 billion lower, according to Charles Mulford, Georgia Institute of Technology accounting professor and head of the lab.

GM confirmed that it had received the SEC letter and would be reclassifying its customer-related loans as operating activities. "At the time, we did think we were fully within accounting principles and legal requirements," says Toni Simonetti, a GM spokeswoman. "We do plan to comply with this clarification and will change the way we account for and apply these transactions to our cash-flow statement."

Prof. Mulford estimated that Ford's \$20.2 billion of 2003 cash flow from operating activities would have been \$2.9 billion lower, based on data he culled from footnotes. Yesterday Ford said in a written statement: "Ford did receive a comment letter from the SEC regarding our consolidated statement of cash flow," and "the change will be explained and reflected in our upcoming 2004 10-K report."

The SEC's Ms. Stacey says her staff brought the issue to her attention, and she also has read the report by the Georgia Tech lab. Her division includes 250 staffers, while the Georgia Tech outfit has just four researchers.

"We thought the way the companies were reporting didn't reflect true economic reality," says Prof. Mulford, co-author of the recently published "Creative Cash Flow Reporting: Uncovering Sustainable Financial Performance." "Now to have the SEC agree with us, I feel vindicated."

Write to Diya Gullapalli at diya.gullapalli@wsj.com²

URL for this

article:<http://online.wsj.com/article/0,,SB110964409606666>

Copyright 2005 Dow Jones & Company, Inc. All Rights Reserved

QUESTIONS:

- 1.) Define the terms operating cash flows, investing cash flows, and financing cash flows, on the basis of the items that should be included in each of these sections of the statement of cash flows.
- 2.) Define at least one use of the amount of operating cash flow in ratios used for financial statement analysis.
- 3.) Is the subtotal for operating cash flows more important than the sub-total for investing cash flows? Why or why not?
- 4.) What is the nature of the items that were misclassified by Ford Motor Company and General Motors Corp.? How could these companies have argued that their treatment was appropriate?
- 5.) Is it likely that transferring these items into the operating cash flow section of the statement of cash flows will continue to have a negative impact on the amount of these companies' operating cash flow into the foreseeable future? Why or why not?

Reviewed By: Judy Beckman, University of Rhode Island