GAAP earnings vs. cash flows

Amazon letters: 1997, 2001 · Difficulty: Intro

> *"When forced to choose between optimizing the appearance of our GAAP accounting and maximizing the present value of future cash flows, we'll take the cash flows." (1997)*

1. Net income is $25 million. The company recorded $40 million of depreciation and paid $60 million in cash for new equipment. Ignoring everything else, by how much did cash change ($ millions; use a minus sign for a decrease)? _____

2. Why can GAAP net income differ from the cash a company generates?

   A. GAAP ignores revenue earned on account

   B. Net income always equals cash flow

   C. Cash flows include only income taxes

   D. Accrual accounting records revenues when earned and expenses when incurred, not when cash is received or paid

Source: Jeffrey P. Bezos, Letters to Amazon.com Shareholders: 1997, 2001 (ir.aboutamazon.com). Quotation © Amazon.com, Inc., all rights reserved; reproduced in part for non-commercial teaching. Numbers in the questions are made up unless stated.