

ACT2111 Tutorial-Ch14

ACT2111 Teaching Team

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- Financing activities
- Noncash activities

Preparing statement of cash flows

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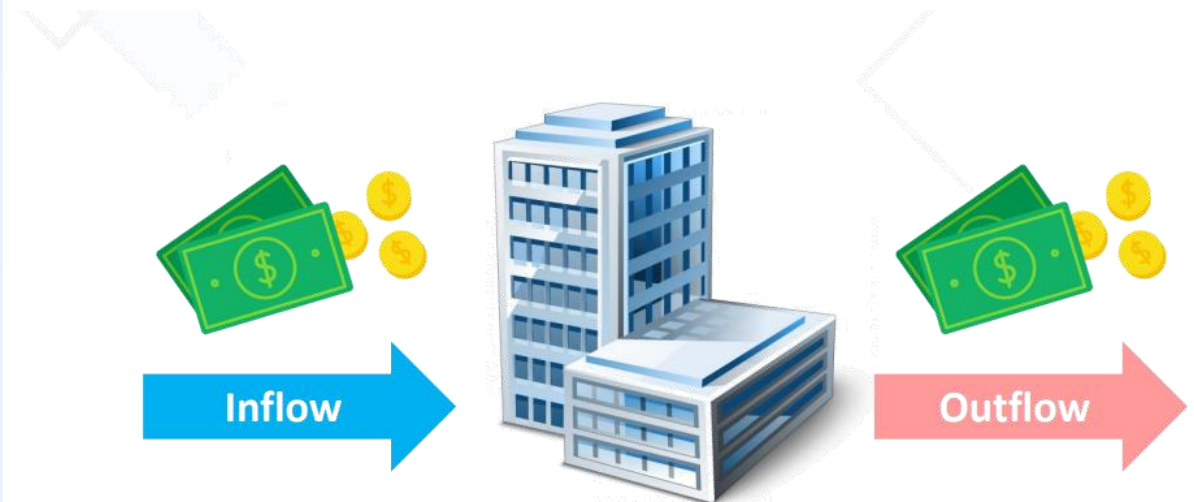
2. Difficulties in tutorial questions



Statement of cash flow

Computer Services International Statement of Cash Flows—Indirect Method For the Year Ended December 31, 2020		
Cash flows from operating activities		
Cash receipts from customers		€ 517,000
Less: Cash payments:		
To suppliers	€139,000	
For operating expenses	115,000	
For interest expense	42,000	
For income taxes	<u>49,000</u>	<u>345,000</u>
Net cash provided by operating activities		€172,000
Cash flows from investing activities:		
Purchase of building	(120,000)	
Purchase of equipment	(25,000)	
Disposal of plant assets	<u>4,000</u>	
Net cash used by investing activities		(141,000)
Cash flows from financing activities:		
Issuance of ordinary shares	20,000	
Payment of cash dividends	<u>(29,000)</u>	
Net cash used by financing activities		<u>(9,000)</u>
Net increase in cash		22,000
Cash at beginning of period		<u>33,000</u>
Cash at end of period		€ 55,000
Note 1		
Non-cash investing and financing activities		
Issuance of bonds payable to purchase land		€ 110,000

- provides a summary of cash inflows and cash outflows during the reporting period
- Net cash flow (or the change in cash) = cash inflow - cash outflow



Classification of transactions

Cash flow from Operating activities

Cash receipts and cash payments for transactions relating to revenue and expense activities

- Information source
 - Income Statement
 - Statement of Financial Position (2 years)
 - Additional information from the accounting records
- Common Related accounts

Cash Flows from Operating Activities

Cash Inflows

Sale of goods or services
Collection of interest and dividends

Cash Outflows

For inventory
For operating expenses
For interest
For income taxes

Cash flow from Investing activities

Cash transactions involving the purchase and sale of long-term assets and current investments

- Information source
 - Statement of Financial Position(2 years)
 - Additional information from the accounting records
- Common Related accounts

Cash Flows from Investing Activities

Cash Inflows

Sale of investments
Sale of long-term assets
Collection of notes receivable

Cash Outflows

Purchase of investments
Purchase of long-term assets
Lending with notes receivable

Classification of transactions

Cash flow from

Financing activities

Inflows and outflows of cash resulting from the external financing of a business

- Information source
 - Statement of Financial Position (2 years)
 - Additional information from the accounting records

- Common Related accounts

Cash Flows from Financing Activities

Cash Inflows

Issuance of bonds or notes payable
Issuance of stock

Cash Outflows

Repayment of bonds or notes payable
Acquisition of treasury stock
Payment of dividends

Common mistakes

- Dividends payment
 - Dividend income
A revenue in I/S – Operating activity
 - Dividend paid out
Not expense; related to equity financing – Financing activity
- interest payment
 - interest income
A revenue in I/S – Operating activity
 - Interest expense
An expense in I/S – Operating activity

Classification of transactions

Noncash activities

Transactions not involving cash

☐ Examples of **significant non-cash activities**

- ☐ Purchase of plant assets by issuing debt
- ☐ Purchase of plant assets by issuing shares
- ☐ Conversion of bonds into ordinary shares
- ☐ Exchanges of plant assets

Preparing Statement of cash flow

Step 1

Step 2

Step 3

Step 4

Computer Services International	
Statement of Cash Flows—Indirect Method	
For the Year Ended December 31, 2020	
Cash flows from operating activities	
	?
Cash flows from investing activities	
	?
Cash flows from financing activities	
	?
Net increase in cash	22,000
Cash at beginning of period	33,000
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Non-cash investing and financing activities	
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3 steps

- Cash flow from operating activities
- Cash flow from investing activities
- Cash flow from financing activities

2 methods

- Indirect method
- Direct method
(applying to operating cash flow)

Preparing Statement of cash flow

Step 1 operating cash flow

Indirect method

➤ Basic formula

Net income

Starting point

+ Depreciation expense
+ Amortization expense

+ Loss on sale of assets
- Gain on sale of assets

- Increase in a current asset
+ Decrease in a current asset
+ Increase in a current liability
- Decrease in a current liability

= Net cash flows from operating activities

Destination

➤ Reasons behind the 3 adjustments

Noncash item:

Revenue and expense items that do not affect cash.

Adjustment: adding back non-cash expenses

Nonoperating items:

Gains and losses that do not affect operating cash flows.

Adjustment: adding back losses and deduct gains

Changes in current assets and current liabilities:

These changes represent the noncash portion of some revenues and expenses. (see following page)

Preparing Statement of cash flow

Step 1 operating cash flow

Indirect method

Changes in current assets and current liabilities:

These changes represent the noncash portion of some revenues and expenses.

➤ Common cases

Changes in current assets

- Account receivable
- Inventory
- Prepaid expenses

Changes in current liabilities

- Accounts payable
- Income taxes payable

➤ Principles for adjustment

Summary: Adjustments for changes in current assets

- ☐ Increasing current assets reduces cash available to the company
- ☐ Reducing current assets increases cash available to the company



Summary: Adjustments for changes in current liabilities

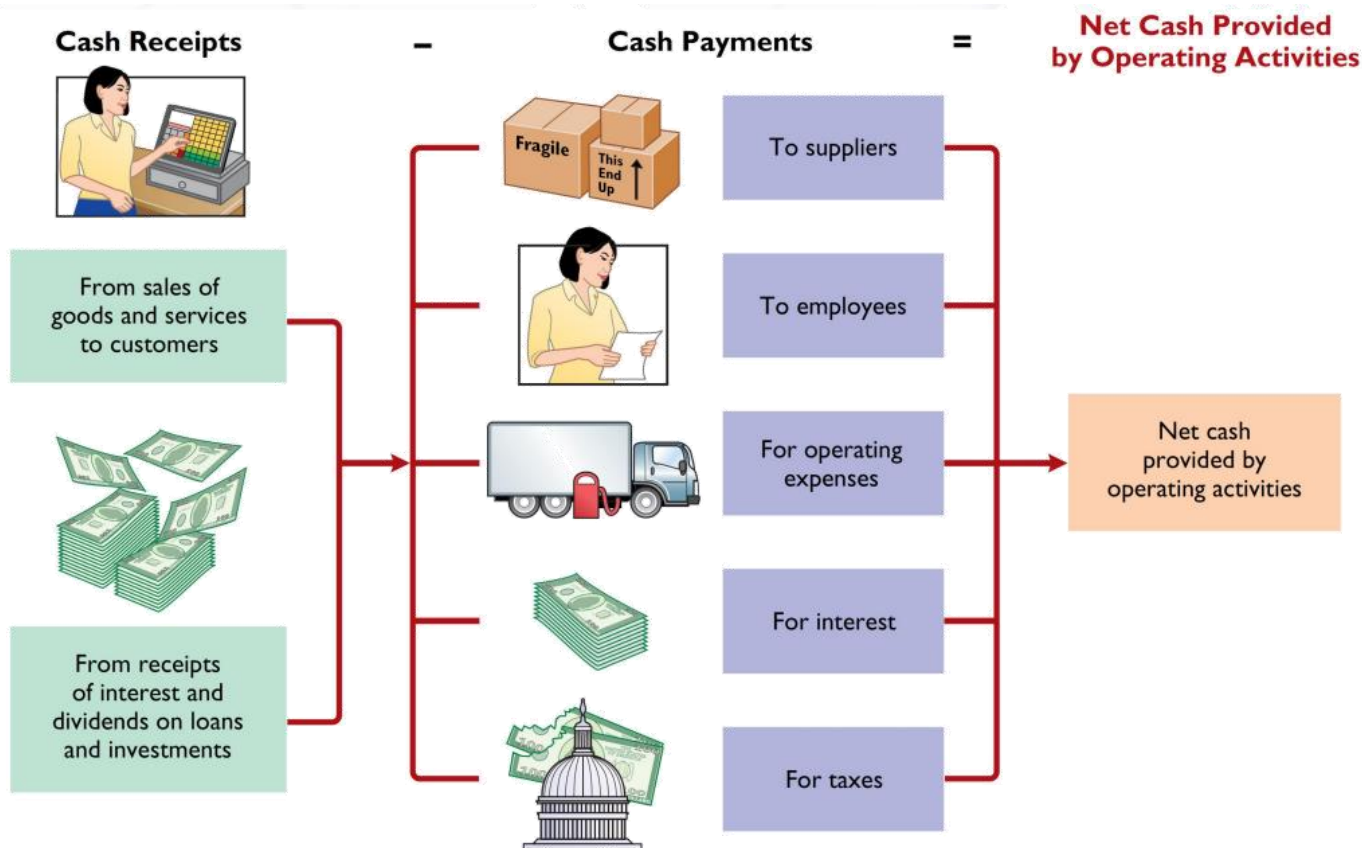
- ☐ Increasing current liabilities increases cash available to the company
- ☐ Reducing current liabilities reduces cash available to the company



Preparing Statement of cash flow

Step 1 operating cash flow

Direct method



➤ Formulas

1. Cash receipts from customers

$$\text{Cash Receipts from Customers} = \text{Sales Revenue} \begin{cases} + & \text{Decrease in Accounts Receivable} \\ & \text{or} \\ - & \text{Increase in Accounts Receivable} \end{cases}$$

2. Cash payments to suppliers

$$\text{Cash Payments to Suppliers} = \text{Cost of Goods Sold} \begin{cases} + & \text{Increase in Inventory} \\ & \text{or} \\ - & \text{Decrease in Inventory} \end{cases} \begin{cases} + & \text{Decrease in Accounts Payable} \\ & \text{or} \\ - & \text{Increase in Accounts Payable} \end{cases}$$

3. Cash Payments for Operating Expenses

$$\text{Cash Payments for Operating Expenses} = \text{Operating Expenses} \begin{cases} + & \text{Increase in Prepaid Expenses} \\ & \text{or} \\ - & \text{Decrease in Prepaid Expenses} \end{cases} \begin{cases} + & \text{Decrease in Accrued Expenses Payable} \\ & \text{or} \\ - & \text{Increase in Accrued Expenses Payable} \end{cases}$$

4. Cash receipts for Interest

5. Cash Payments for Income Taxes

$$\text{Cash Payments for Income Taxes} = \text{Income Tax Expense} \begin{cases} + & \text{Decrease in Income Taxes Payable} \\ & \text{or} \\ - & \text{Increase in Income Taxes Payable} \end{cases}$$

Preparing Statement of cash flow

Step 2 investing cash flow

Summary: Cash flows from investing activities

- ❑ We report the actual cash received or paid for a long-term asset, which is usually not the same as the change in the account in the statement of financial positions



➤ Common cases

- Purchase of land, building and equipment
Cash outflow – minus corresponding cash paid out
- Disposal of plant asset, land and so on
Cash inflow – plus corresponding cash received
- When no cash is exchanged in the transaction
noncash activity – no record for cash inflow/outflow

Cash flows from investing activities:

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Net cash used by investing activities		(141,000)

Note 1

Non-cash investing and financing activities

Issuance of bonds payable to purchase land	<u>€ 110,000</u>
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Preparing Statement of cash flow

Step 3 financing cash flow

Summary: Cash flows from financing activities

- ❑ This section is determined by changes in non-current liability and equity accounts + additional information



➤ Common cases

- Increase in bond payable
Cash inflow – plus corresponding cash received
- Increase in share capital
Cash inflow – plus corresponding cash received
- Paying out dividend
Cash outflow – minus corresponding cash paid out
- When no cash is exchanged in the transaction
noncash activity – no record for cash inflow/outflow

Cash flows from financing activities:

Issuance of ordinary shares	20,000
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Preparing Statement of cash flow

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- **Net total change in cash** should be align with the **change in the cash account in the statement of financial position**
- **Free cash flow:** the net cash provided by operating activities after adjustment for capital expenditures and dividends

Free Cash Flow	=	Net Cash Provided by Operating Activities	–	Capital Expenditures	–	Cash Dividends
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Difficulties in tutorial questions

E14.7 (LO 2, 3) Meera Ltd.'s comparative statements of financial position are presented below.

Meera Ltd.		
Comparative Statements of Financial Position		
December 31		
	2020	2019
Land	£ 20,000	£ 26,000
Buildings	70,000	70,000
Accumulated depreciation—buildings	(15,000)	(10,000)
Accounts receivable	20,800	23,400
Cash	17,660	10,700
Total	<u>£113,460</u>	<u>£120,100</u>
Share capital—ordinary	£ 75,000	£ 72,000
Retained earnings	26,090	20,000
Accounts payable	12,370	28,100
Total	<u>£113,460</u>	<u>£120,100</u>

Additional information:

1. Net income was £22,590. Dividends declared and paid were £16,500.
2. All other changes in non-current account balances had a direct effect on cash flows, except the change in accumulated depreciation. The land was sold for £5,000.

Instructions

- a. Prepare a statement of cash flows for 2020 using the indirect method.
- b. Compute free cash flow.

Difficulties in tutorial questions

E14.8 (LO 2) Here are comparative statements of financial position for Syal SE.

Syal SE		
Comparative Statements of Financial Position		
December 31		
Assets	2020	2019
Land	€ 73,000	€100,000
Equipment	260,000	200,000
Accumulated depreciation—equipment	(66,000)	(34,000)
Inventory	170,000	187,000
Accounts receivable	85,000	71,000
Cash	73,000	33,000
Total	<u>€595,000</u>	<u>€557,000</u>
Equity and Liabilities		
Share capital—ordinary (€1 par)	€216,000	€174,000
Retained earnings	194,000	136,000
Bonds payable	150,000	200,000
Accounts payable	35,000	47,000
Total	<u>€595,000</u>	<u>€557,000</u>

Additional information:

1. Net income for 2020 was €103,000.
2. Depreciation expense was €32,000.
3. Cash dividends of €45,000 were declared and paid.
4. Bonds payable amounting to €50,000 were redeemed for cash €50,000.
5. Ordinary shares were issued for €42,000 cash.
6. No equipment was sold during 2020.
7. Land was sold for its book value of €27,000.

Instructions

Prepare a statement of cash flows for 2020 using the indirect method.

Thanks for your listening!