Learning Module 4: Analyzing Statements of Cash Flows 1

Q.474 Which of the following statements is *least likely* accurate?

A. US GAAP allows the recognition of interest expenses as operating or financing expenses.

B. IFRS allows the recognition of interest expenses as operating or financing expenses.

C. Interest expenses are always classified as operating activity under US GAAP.

The correct answer is **A.**

Interest expenses are always classified as operating expenses under US GAAP. However, they can be classified as either operating or financing expenses under IFRS.

Further information:

IFRS Requirements

- Interest received may be classified as either an operating activity or investing activity.
- Interest paid may be classified as either an operating activity or financing activity.
- Dividends received may be classified as either an operating activity or investing activity.
- Dividends paid may be classified as either an operating activity or a financing activity.
- Income tax expense is generally classified as an operating activity, but a portion may be allocated to investing or financing activities if it is specifically identifiable with those activities.
- Bank overdrafts are classified as part of 'cash and cash equivalents.'
- Either the direct or indirect method may be used for reporting cash flow from operating activities, although the direct method is encouraged.

US GAAP Requirements

- Interest received must be classified as an operating activity.
- Interest paid must be classified as an operating activity.
- Dividends received must be classified as an operating activity.
- Dividends paid must be classified as a financing activity.
- Income tax expense must be classified as an operating activity.
- Bank overdrafts are not considered a part of 'cash and cash equivalents' but instead classified as financing activities.
- Either the direct or indirect method may be used for reporting cash flow from operating activities, although the direct method is encouraged. Unlike under IFRS, however, a reconciliation of net income to cash flow from operating activities must be provided regardless of the method used.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Q.477 The accountant of a small firm has recorded the following information for the year 2016:

Book value of plant, property and equipment (PPE) at the beginning of the year:	$\$100,000$
Book value of plant, property and equipment (PPE) at the end of the year:	$\$130,000$
Sale of a plant during the year	$\$8,000$
The book value of the plant on the date of the sale	$\$15,000$
Depreciation charged during the year:	$\$20,000$

From the given data, the cash flow from investing activities is *closest to* a:

A. cash inflow of $8,000.

B. cash inflow of $15,000.

C. cash outflow of $57,000.

The correct answer is **C.**

$$\begin{aligned}\text{Cash flow} &= \text{Cash received from the sale of the plant} - \text{Cash paid on the purchas}\\ \text{Cash paid on the purchase} &= \text{Closing book value} + \text{The book value of the plant on the date of the s}\\ &= \$130,000 + \$15,000 + \$20,000 - \$100,000 = \$65,000\\ \text{Cash flow} &= \$8,000 - \$65,000 = -\$57,000\end{aligned}$$

A is incorrect. Considers only the sale of the plant.

B is incorrect. Contradicts option C.

CFA Level I, Volume 2, Topic 5 - Financial Statement Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.2062 Firm A reports under US GAAP, and Firm B follows IFRS. Both firms sell identical assets held for investment purposes for the same price of $2.5 million. Assuming that the income tax on the sale of the investment is $275,000, which firm is *most likely* to report lower cash flows from operating activities?

A. Firm A.

B. Firm B.

C. Both firms will always have identical cash flows from operations.

The correct answer is **A.**

Firm A, which reports under US GAAP, is more likely to report lower cash flows from operating activities compared to Firm B, which follows IFRS. This difference arises from the distinct accounting treatments under US GAAP and IFRS regarding the classification of income taxes related to the sale of investment assets. Under US GAAP, firms are required to classify the cash flows related to income taxes as operating activities. This means that the income tax expense of $275,000 from the sale of the investment would reduce the cash flows from operating activities reported by Firm A. In contrast, IFRS provides firms with the flexibility to classify cash flows related to income taxes as either operating or investing activities, depending on the nature of the underlying transaction. Therefore, Firm B has the option to report the income tax expense under investing activities, potentially leaving its cash flows from operating activities unaffected by this tax expense. This flexibility under IFRS can lead to a higher reported cash flow from operating activities for Firm B when compared to Firm A, which does not have this option under US GAAP.

B is incorrect. It suggests that Firm B is more likely to report lower cash flows from operating activities. However, given the flexibility under IFRS to classify income tax cash flows related to the sale of investment assets as either operating or investing activities, Firm B may not necessarily report lower cash flows from operating activities compared to Firm A. This flexibility allows Firm B to potentially report higher operating cash flows by classifying the tax expense under investing activities.

C is incorrect. It suggests that both firms will always have identical cash flows from operations. This overlooks the significant impact of the different accounting standards (US GAAP and IFRS) on the classification of income tax cash flows. As explained, US GAAP requires all income tax cash flows to be reported as operating activities, while IFRS allows for flexibility in classification. This difference can lead to variations in the reported cash flows from operating activities between firms reporting under these two different frameworks, especially in scenarios involving the sale of investment assets and the associated tax expenses.

CFA Level I, Topic 4 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1. LOS d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Q.2063 Which of the following is *least likely* accurate regarding the presentation of cash flow statements?

A. In the direct method, we start by listing cash payments and receipts.

B. Under the direct method, adjustments related to depreciation and amortization are necessary.

C. The starting point of the indirect method of presenting the statement of cash flows is ''Net income.''

The correct answer is **B.**

In reality, the direct method focuses on the actual cash flows from operating activities, including cash received from customers and cash paid to suppliers and employees. It does not require adjustments for non-cash items like depreciation and amortization because it reports the cash transactions directly, without starting from net income or any other accrual-based measure. This is a fundamental distinction from the indirect method, which starts with net income and then adjusts for non-cash transactions, including depreciation and amortization, to arrive at the cash flow from operating activities.

A is incorrect. It accurately describes the direct method of cash flow presentation. The direct method involves listing the major categories of gross cash receipts and gross cash payments. This method provides information that may be useful in estimating future cash flows and is considered more intuitive as it shows the actual cash flows associated with operating activities. This includes cash received from customers, cash paid to suppliers, cash paid for salaries, and other operating cash payments. The direct method offers a clearer picture of how operating activities impact the cash position of a company.

C is incorrect. It links the cash flow statement to the income statement and balance sheet, providing a comprehensive view of a company's financial health.

CFA Level I, Volume 2, Topic 4 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1. LOS b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.2068 Petrobras, an oil shipping company, reported interest expense of $24 million and taxes of $10 million. Interest payable increased by $8 million, while taxes payable decreased by $3 million over the period. How much cash did the company pay for interest and taxes?

A. $16 million for interest and $7 million for taxes.

B. $16 million for interest and $13 million for taxes.

C. $32 million for interest and $13 million for taxes.

The correct answer is **B.**

Note that if interest payable increases (decreases) during the year, then interest expense on an accrual basis will be higher (lower) than the amount of cash paid for interest. Thus, in this case:

$$\begin{aligned}\text{Interest paid} &= \text{Interest expense} - \text{Increase in interest payable}\\ &= \$24 - \$8 = \$16\end{aligned}$$

Moreover, if taxes payable or deferred tax liabilities increase (decrease) during the year, income tax expense on a cash basis will be lower (higher) than on an accrual basis. Thus, in this case:

$$\begin{aligned}\text{Taxes paid} &= \text{Tax expense} + \text{decrease in taxes payable}\\ &= \$10 + \$3 = \$13\end{aligned}$$

CFA Level I, Volume 2, Topic 4 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.2069 Assume, for this question, that Alaska Tex recently changed its accounting standard from US GAAP to IFRS and earned $500,000 in net income in 2016. The interest expenses are related to financing activity. Using the accounts given in the following table, calculate the cash flow from operations using the indirect method after making appropriate adjustments to net income.

	2016	2015
Depreciation Exp.	100,000	80,000
Gain on Sale of Land	55,000	
Interest Exp.	37,000	22,000
Plant	450,000	370,000
Accounts Receivable	170,000	135,000
Inventory	90,000	115,000
Wages Payable	87,000	69,000
Taxes Payable	85,000	63,000

A. $538,000

B. $590,000

C. $612,000

The correct answer is **C.**

To calculate CFO using the indirect method, we need to adjust Net Income for non-cash charges and non-operating activities and, since we are assuming that Alaska reports under IFRS, we need to add back Interest expense related to financing activities to the Net Income and subtract the same interest expense from cash flow from financing activities.
Net Income to be used for the calculation of CFO = $500,000 + $100,000 - $55,000 + $37000 = $582,000.

Then:

Net Income	500,000
Depreciation Expense	100,000
Gain on Sale of Land	(55,000)
Interest Expenses	37,000
Increase in Accounts Receivable	(35,000)
Decrease in Inventory	25,000
Increase in Wages Payable	18,000
Increases i Taxes Payable	22,000
Total CFO	612,000

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.2070 Atlas Corp. is a fast-moving consumers firm based in Italy whose financial data is provided in the following table. For this question only, assume that Loss on the sale of land is $5 million.

(In million $)	2005	2004
Accounts Receivable	96	85
Inventory	75	65
Gross Land	85	96
Gross Plant	46	31
Accumulated Depreciation	11	6
Net Plant	35	25

The cash from the sale of land using the given data is *closest to*:

A. -$16 million.

B. $6 million.

C. $16 million.

The correct answer is **B.**

To determine the cash received from the sale of land for Atlas Corp., we need to analyze the change in the gross land value from the financial data provided and account for the loss on the sale of land. The gross land value decreased from $96 million in 2004 to $85 million in 2005, indicating a decrease of $11 million. This decrease represents the book value of the land that was sold. Additionally, it is given that there was a loss on the sale of land amounting to $5 million. The loss on sale indicates that the land was sold for less than its book value. To find the actual cash received from the sale, we subtract the loss from the decrease in the book value of the land:

$$\text{Cash from sale of Land} = \$11 \text{ (Decrease in Land)} - \$5 \text{ (Loss on sale of Land)} = \$6 \text{ million}$$

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.2071 Atlas Corp. is a fast-moving consumers firm based in Italy whose financial data is provided in the following table. For this question only, assume that Loss on the sale of Land is $5 million. Calculate the cash flow from investing activities using the given data.

(In million $)	2005	2004
Accounts Receivable	96	85
Inventory	75	65
Gross Land	85	96
Gross Plant	46	31
Accumulated Depreciation	11	6
Net Plant	35	25

A. $-9 million.

B. $-1 million.

C. $6 million.

The correct answer is **A.**

Cash flow from investing activities is calculated by determining the change in gross assets accounts. First, we will calculate the cash received from the sale of Land.

$$\text{Cash from sale of Land} = \$11 \text{ (Decrease in Land)} - \$5 \text{ (Loss on sale of Land)} = \$6 \text{ million}$$

Secondly, we will calculate:

$$\begin{aligned}\text{Cash paid for the new plant} = {} & \$46 \text{ million(Ending gross Plant)} + \$0\text{(Gross cost of the old asset sol}\\ & - \$31 \text{ million(Beginning gross assets)} = \$15 \text{ million}\end{aligned}$$

Therefore,

$$\text{Total Cash flow from Investing activities} = \$6 \text{ million(Cash received from the sale of land)} - \$15 \text{ n}$$

Notes: Accounts receivable and inventory are ignored in the calculation of investing activities as they are part of operating activities. Also, only the gross asset values are used, not net assets values.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.2073 A firm recently adjusted its capital structure, and some of the accounts related to its balance sheet are given in the following table:

Year	2015	2014
Dividends Payable	$69,000	$24,000
Bonds	$160,000	$90,000
Common Shares	$250,000	$300,000

Assuming that the company recently paid dividends of $100,000, the cash flow from financing activities is *closest to*:

A. -$35,000.

B. $15,000.

C. $70,000.

The correct answer is **A.**

To calculate the cash flow from financing activities we need to calculate the net cash effect of dividends, bonds, and shares.

Step 1

$$\text{Cash dividends} = \$45,000(\text{Increase in Dividends payable}) - \$100,000 = -\$55,000$$

Step 2

$$\text{Cash from the issuance of the bond} = \$160,000(\text{Ending Bonds payable}) + 0(\text{Bond repaid}) - \$90,0$$

Step 3

$$\text{Cash paid for repurchase of stock} = \$300,000(\text{Beginning shares}) + \$0(\text{Shares issued}) - \$250,000$$

Step 4

Total Cash flow from financing activities (using the following table) = -$35,000

Cash Dividends	(55,000)
Cash Received from Sale of Bond	70,000
Cash Paid for Repurchase of Shares	(50,000)
Cash Flow from Financing Activities	(35,000)

B is incorrect. It does not consider cash paid for the repurchase of shares.

C is incorrect. It is the cash from the issuance of the bond.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.2074 Which of the following transactions is *most likely* considered an investing activity under IFRS?

A. Interest received.

B. Dividend paid on shares.

C. Increase in accounts receivables.

The correct answer is **A.**

Under International Financial Reporting Standards (IFRS), interest received is classified as either an operating activity or an investing activity, depending on the nature of the income and the company's operations. This classification flexibility allows companies to align the presentation of their cash flows with the nature of their business. In many cases, interest received is considered an investing activity because it represents returns on investments such as loans, debt securities, or other financial assets.

B is incorrect. Dividend paid on shares is typically classified under financing activities, not investing activities. Financing activities involve transactions with shareholders and creditors that affect the equity and debt structure of the company. Dividends paid to shareholders are distributions of profit and represent cash outflows related to financing activities.

C is incorrect. An increase in accounts receivables is considered an operating activity, not an investing activity. Operating activities are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities. An increase in accounts receivables typically results from sales on credit, which are part of the company's day-to-day operations. This reflects the principle that operating activities involve the cash effects of transactions that enter into the determination of net profit or loss.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.2075 Which of the following financing activity is *most likely* considered an operating activity under IFRS?

A. Issuance of corporate debt.

B. Cash paid for reacquiring preferred shares.

C. Interest paid on a long-term corporate bond.

The correct answer is **C.**

Dividend payments and interest payments can be considered operating or financing activities under IFRS.

A and B are incorrect. Issuance of debt and repurchase on stocks are only financing activities under US GAAP and IFRS.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.2080 Beverly Drinks reported the cost of goods sold of $120 million for the current year. Total assets increased by $75 million while inventory declined by $26 million. Also, total liabilities increased by $65 million while accounts payable increased by $2 million. The amount of purchases made during the year is *closest* to:

A. $92 million.

B. $94 million

C. $146 million

The correct answer is **B.**

The amount of purchases is calculated as the cost of goods sold less decrease in inventory.

In this case, we have:

$$\begin{aligned}\text{Amount of purchases} &= \text{Cost of goods sold less (plus) decrease (increase) in inventory}\\ &= \$120\text{ million} - \$26\text{ million}\\ &= \$94\text{ million}\end{aligned}$$

A is incorrect. It represents the cash paid to the supplier (Purchases from suppliers, $94 million less increase in accounts payable).

C is incorrect. Contradicts option B. It adds a decrease in the inventory to the cost of goods sold.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.2081 An analyst gathered the following information from a company’s 2018 financial statements (in $ millions):

Balances as of Year Ended 31 Dec	2017	2018
Retained Earnings	150	175
Accounts Receivable	68	73
Inventory	75	78
Accounts Payable	66	59

In 2018, the company paid cash dividends of $40 million and recorded $55 million in depreciation expense. The company considers dividends paid a financing activity. Given this information, the company’s 2018 cash flow from operations (in $ millions) was *closest to*:

A. $105

B. $110

C. $112

The correct answer is **A.**

$$\begin{aligned}\text{Net income for 2018} &= \text{Increase in retained earnings} + \text{Dividends paid}\\ &= \$25 + \$40 = \$65\end{aligned}$$

Depreciation of $55 is a non-cash expense and is added back to net income.

Increases in accounts receivable, $5, and in inventory, $3, are uses of cash. Thus, they ought to be subtracted from net income.

The decrease in accounts payable is also a use of cash and, therefore, a subtraction from net income.

Thus, cash flow from operations is:

$$\$65 + \$55 - \$5 - \$3 - \$7 = \$105$$

B is incorrect. Adds the increase in accounts receivable to the net income.

C is incorrect. Adds the accounts payable to the net income.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.2082 Under IFRS, dividends received is *most likely* classified as:

A. either financing or investing activities.

B. either operating or financing activities.

C. either operating or investing activities.

The correct answer is **C.**

Under International Financial Reporting Standards (IFRS), dividends received by a company can be classified as either operating or investing activities. This classification flexibility allows companies to align the presentation of dividends received with the nature of their business operations. For instance, if a company receives dividends from investments that are integral to its main business operations, it might classify these dividends as operating activities. Conversely, if the dividends are received from investments that are not central to the company's primary business, they might be classified as investing activities.

A is incorrect. This option suggests that dividends received can be classified as either financing or investing activities under IFRS. However, this is not accurate. Financing activities typically involve changes in the size and composition of the contributed equity and borrowings of the entity. Dividends received are not related to these financing activities but are instead returns on investments in other entities.

B is incorrect. This option proposes that dividends received can be classified as either operating or financing activities. As previously explained, financing activities are related to transactions and other events that change the equity and debt structure of the company. Dividends received are returns on investments and do not affect the company's equity and debt structure directly. Therefore, classifying dividends received as financing activities does not align with the definitions and classifications provided by IFRS.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Q.2085 Mavi Inc. is a male fashion brand based in Italy. Ahmed is an analyst working on the cash flow statement of Mavi using the direct method.

Sales	150
COGS	90
Interest Expenses	30
Dep. Expenses	25
Decrease in Acc. Rec.	10
Increase in Acc. Pay.	20
Increase in Int. Pay.	20

Using the financial data provided in the table above, the value of Mavi's Cash Interest that should be used when calculating cash flow from operating activities is *closest to*:

A. $10

B. $30

C. $70

The correct answer is **A.**

Under the direct method of calculating cash flow from operations, we calculate the cash interest.

$$\text{Mavi's Cash interest} = \$30 \text{ (Interest expense)} - \$20 \text{ (Increase in interest payable)} = \$10$$

Insights

Cash collections from customers consist of sales made for cash (cash sales) and cash collected from credit customers. The activity in the accounts receivable and sales accounts is used to determine the cash collections from customers as follows:

$$\text{Cash collections from customers} = \text{Sales} + \text{decrease in Acc Receivables} \;\; \text{Or, Sales} - \text{increase in Acc. Receivables}$$

Cash payments to suppliers represent the amount paid by the company for merchandise it plans to sell to its customers. It is determined using the following two steps:

Step 1: Establish the cost of purchases, where;

$$\text{Cost of purchases} = \text{COGS} + \text{Increase in inventory Or, COGS} - \text{decrease in inventory}$$

.

Step 2: Establish the cash payment to suppliers, where;.

$$\text{Cash payment to suppliers} = \text{Cost of purchases} + \text{decrease in accounts payable Or, Cost of purcha} - \text{increase in accounts payable}$$

.

In this case, we have no inventory. Thus, cost of purchases = COGS

Cash paid for interest represents amounts paid by the company for interest. The amount is calculated by taking interest expense and increasing it by the amount of any decrease in the balance of the interest payable account or decreasing it by the amount of an increase in the balance of the interest payable account:.

Cash paid for interest/Cash interest = Interest expense + decrease in interest payable Or, Interest − increase in interest payable

.

B is incorrect. It represents the interest expense.

C is incorrect. It adds the increase in interest payable to the interest expense..

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.2086 Mavi Inc. is a male fashion brand based in Italy. Ahmed is an analyst working on the cash flow statement of Mavi using the direct method. Using the financial data provided in the following table, Mavi's cash flow from operating activities *closest to*:

Sales	150
COGS	90
Interest Expenses	30
Dep. Expenses	25
Decrease in Acc. Rec.	10
Increase in Acc. Pay.	20
Increase in Int. Pay.	20

A. $50

B. $80

C. $135

The correct answer is **B.**

Under the direct method of cash flow from operations, we will add all cash receipts and payments. In the example, we will add Cash collection, less Cash paid to supplier and Cash interest.

Mavi's Cash flow from Operation = $110 (Using the following table). Note: We do not consider Depreciation expense in the direct method of calculating cash flow from operating activities.

Cash Collection (Sales + Decrease in Acc. Rec.)	160
Cash Paid to Suppliers (COGS - Increase in Acc. Pay.)	(70)
Cash Interest (Int Exp. - Increase Int. Pay.)	(10)
Cash Flow from Operating Activities	80

Insights

Cash collections from customers consist of sales made for cash (cash sales) and cash collected from credit customers. The activity in the accounts receivable and sales accounts is used to determine the cash collections from customers as follows:

$$\text{Cash collections from customers} = \text{Sales} + \text{decrease in Acc Receivables Or, Sales} - \text{increase in Acc. Receivables}$$

Cash payments to suppliers represent the amount paid by the company for merchandise it plans to sell to its customers. It is determined using the following two steps:

Step 1: Establish the cost of purchases, where;

$$\text{Cost of purchases} = \text{COGS} + \text{Increase in inventory Or, COGS} - \text{decrease in inventory}$$

Step 2: Establish the cash payment to suppliers, where;

$$\text{Cash payment to suppliers} = \text{Cost of purchases} + \text{decrease in accounts payable Or, Cost of purcha} - \text{increase in accounts payable}$$

In this case, we have no inventory. Thus, cost of purchases = COGS

Cash paid for interest represents amounts paid by the company for interest. The amount is calculated by taking interest expense and increasing it by the amount of any decrease in the balance of the interest payable account or decreasing it by the amount of an increase in the balance of the interest payable account:

$$\text{Cash paid for interest/Cash interest} = \text{Interest expense} + \text{decrease in interest payable Or, Interest} - \text{increase in interest payable}$$

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.3803 Consider the information given below.

	2019	2018
Accounts Receivables	$75 Million	$100 Million
Revenues	$50 Million	$60 Million

Based solely on the information above, the amount of cash received from clients in 2019 is *closest to*:

A. $75 Million

B. $85 Million

C. $150 Million

The correct answer is **A.**

$$\begin{aligned}\text{Cash received} &= \text{Beginning Accounts Receivables} + \text{Revenues}\\ &\quad - \text{Ending Accounts Receivables}\\ &= \$100 + \$50 - \$75 = \$75\end{aligned}$$

The cash received from clients in 2019 is $ 75 Million.

A decrease in accounts receivable implies that the cash collected during that period exceeded the revenue on an accrual basis. In this case, the $75 million cash collected exceeded the $50 Million Revenue for that period.

B is incorrect. The ending accounts receivable has been left out.

C is incorrect. The Revenue for 2018 has been used in place of the Revenue for 2019.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.3804 At its fiscal year-end 2019, a company reported $120 million in revenue, $90 Million in expenses. If the company equally reported a $20 million increase in its accounts receivable, the cash received from its customers for that fiscal year is *closest to*:

A. $100 million.

B. $120 million.

C. $140 million.

The correct answer is **A.**

The accounts receivable has increased. This implies that the company collected less cash, than it reported as, from its customers.

To determine the cash received, we subtract the increase in accounts receivable from the revenues collected for that period.

$$\text{Cash received from customers} = \begin{array}{l}\text{Revenue} \\ \text{less (plus) increase (decrease)} \\ \text{in accounts receivable}\end{array}$$

$$\$120 - \$20 = \$100 \text{ Million}$$

B is incorrect. It is the revenue and not the cash collected from customers.

C is incorrect. The increase in accounts receivable has been added to revenue instead of being subtracted.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.3807 Below is a company's financial performance for the year 2018.

Revenue	$\$235,000,000$
Cost of goods sold	$\$100,000,000$
Operating expenses	$\$35,000,000$
Other expenses	$\$10,000,000$

The company maintained its revenue and operating costs in 2019 due to long-term contracts with its suppliers and customers. Its other expenses, however, increased by 15%. The company's gross profit for the year 2019 is *closest to*:

A. $88,500,000

B. $100,000,000

C. $135,000,000

The correct answer is **C.**

$$\text{Gross profit} = \text{Revenue} - \text{Cost of goods sold}$$
$$\$235,000,000 - \$100,000,000 = \$135,000,000$$

We do not take into account expenses when we are calculating gross profit. Operating expenses will be considered when calculating the operating profit. All expenses will be considered when calculating the net income.

A is incorrect. It represents the net income.

$$\begin{aligned}\text{Net Income} &= \text{Revenue} - \text{Cost of goods sold} - \text{All expenses}\\ \text{Net Income} &= 235,000,000 - 100,000,000 - 35,000,000 - \left(\frac{115}{100} \times 10,000,000\right)\\ &= 88,500,000\end{aligned}$$

B is incorrect. It is the net income for 2018 as it has not factored in the 15% increase in other expenses that were seen in 2019.

Q.3808 A company that is compliant with the US GAAP reports its cash flows using the indirect method. In 2019, the company reported a net income of $300,000 and revenue of $700,000. The company's income tax payable decreased by $70,000, while its interest expenses payable increased by $80,000. If the company reported using the direct method, the amount of cash paid for operating expenses is *closest to*:

A. $390,000

B. $410,000

C. $690,000

The correct answer is **A.**

To convert cash from indirect to direct method when there are no non-cash expenses/revenues, we first determine the total operating expenses, then we increase and reduce the operating expenses as per the formula:

$$\begin{aligned}\text{Total cash operating expenses} &= \text{Total operating expenses} + \text{Decrease in income tax payable}\\ &- \text{Increase in interest expense payable.}\\ \text{Total operating expenses} &= \text{Total Revenue} - \text{Net Income}\\ \text{Total operating expenses} &= \$700,000 - \$300,000 = \$400,000\\ \text{Total cash operating expenses} &= \$400,000 + \$70,000 - \$80,000 = \$390,000\end{aligned}$$

B is incorrect. The signs in the equations have been mixed up.

C is incorrect. Revenue has been used, instead of total operating expenses to calculate the total cash operating expenses.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4c: demonstrate the conversion of cash flows from the indirect to direct method

Q.3851 A provision for doubtful accounts was created by Alpha LLC for the year 2014. What is the *most appropriate* treatment for doubtful accounts while preparing operating cash flows under the indirect method?

A. Added to net income.

B. Deducted from net income.

C. Neither added nor deducted from net income.

The correct answer is **A.**

When preparing operating cash flows under the indirect method, a provision for doubtful accounts, being a non-cash expense, should be added back to net income. This adjustment is necessary because the provision for doubtful accounts reduces net income on the income statement, but it does not involve an actual outflow of cash in the period it is recognized. The indirect method starts with net income and then adjusts for all non-cash transactions, changes in working capital, and other items to arrive at cash flow from operating activities.

B is incorrect. Deducting the provision for doubtful accounts from net income would be double-counting the expense, as it has already been accounted for in the calculation of net income.

C is incorrect. This option suggests that the provision for doubtful accounts should neither be added nor deducted from net income, which is not accurate. Ignoring the provision for doubtful accounts in the calculation of cash flows from operating activities would result in an inaccurate representation of the company's cash operations.

CFA Level I, Volume 2, Topic 4 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows 1, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.4673 When considering the relationship between current assets and operating activities, how does an increase in prepaid expenses *most likely* affect the cash flow statement?

A. Indicates a cash inflow from operations.

B. Represents a cash outflow from operations.

C. Has no impact on the cash flow statement.

The correct answer is **B.**

An increase in prepaid expenses is an outflow of cash in the operating section of the cash flow statement. This is because prepaid expenses involve paying for services or goods that will benefit future periods, thus reducing the cash available for current operations.

A is incorrect. Prepaid expenses require an outlay of cash, and thus, it is a cash outflow, not an inflow.

C is incorrect. Prepaid expenses are current assets, and an increase definitely affects the cash flow statement by showing the cash that has been used in advance for future expenses.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4a: describe how the cash flow statement is linked to the income statement and the balance sheet

---

Q.4674 Considering the accrual basis of accounting, what does an increase in accounts payable *most likely* suggest about a company's cash outflows?

A. The company is paying off suppliers quickly.

B. The company is delaying payments to suppliers.

C. The company's expenses are lower than in previous periods.

The correct answer is **B.**

An increase in accounts payable usually indicates that a company is delaying payments to its suppliers. This suggests that the company is conserving cash, as the expenses are recorded but the cash outflow is deferred to a later period.

A is incorrect. If the company were paying off suppliers quicker, accounts payable would decrease rather than increase.

C is incorrect. An increase in accounts payable does not necessarily reflect a decrease in total expenses. It primarily indicates the timing of cash payments related to accrued expenses.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4a: describe how the cash flow statement is linked to the income statement and the balance sheet

---

Q.4675 Which of the following is *most likely* an impact of recognizing revenue on an accrual basis when it exceeds the actual cash collected from customers?

A. Increases accounts receivable balance.

B. Leads to an increase in cash balance.

C. Decreases accounts receivable balance.

The correct answer is **A.**

Recognizing revenue on an accrual basis that exceeds cash collections results in an increase in accounts receivable. This indicates that the company has earned revenues for which it has not yet received payment.

B is incorrect. An increase in revenue recognition without corresponding cash inflows does not increase the actual cash balance; it increases the accounts receivable.

C is incorrect. Recognizing revenue without an equivalent cash collection increases the accounts receivable balance, not decreases it.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4a: describe how the cash flow statement is linked to the income statement and the balance sheet

---

Q.4677 Which of the following *most likely* details how the ending retained earnings balance is determined on the balance sheet?

A. By subtracting net income from dividends paid.

B. By adding net income to the beginning retained earnings and then subtracting dividends paid.

C. By adding dividends paid to the beginning retained earnings and then subtracting net income.

The correct answer is **B.**

Ending retained earnings is determined by adding net income to the beginning retained earnings balance and then subtracting any dividends paid during the period.

A is incorrect. Retained earnings are not derived by subtracting net income from dividends; it's the net income that contributes to an increase in retained earnings.

C is incorrect. Dividends paid are subtracted from the sum of the beginning retained earnings and net income to arrive at the ending balance and are not added.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4a: describe how the cash flow statement is linked to the income statement and the balance sheet

---

Q.4678 When a company receives advance payments for services or products to be delivered in the future, how is this reported in the financial statements? As an increase in:

A. assets and expenses.

B. liabilities and revenue.

C. assets and liabilities.

The correct answer is **C.**

When a company receives payments in advance for future services or products, it records the cash as an increase in assets (specifically as cash or cash equivalents) and also recognizes a liability (deferred revenue) for the obligation to deliver those services or products.

A is incorrect. Advance payments do not immediately increase expenses. The expense is recognized when the service is rendered, or the product is delivered.

B is incorrect. Although a liability is indeed increased (deferred revenue), revenue is not recognized until the service is performed or the goods are delivered; thus, there is no immediate increase in revenue.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4a: describe how the cash flow statement is linked to the income statement and the balance sheet

Q.4679 Kenya Tea Development Agency (KTDA) reported an increase in inventory of USD 169,000 and a cost of goods sold (COGS) of USD 11,345,000. If the beginning inventory was USD 3,856,000, the cash paid to suppliers, assuming the increase in accounts payable was USD 300,000 is *closest to:*

A. USD 11,846,000

B. USD 11,514,000

C. USD 11,214,000

The correct answer is **C.**

Cash paid to suppliers is calculated by adjusting the purchases, which are COGS plus the increase in inventory, by the increase in accounts payable.

$$
\begin{aligned}
\text{Purchases from suppliers} &= \text{COGS} + \text{Increase in inventory} \\
&= \text{USD } 11{,}345{,}000 + \text{USD } 169{,}000 \\
&= \text{USD } 11{,}514{,}000
\end{aligned}
$$

Therefore,

$$
\begin{aligned}
\text{Cash paid to suppliers} &= \text{Purchases from suppliers} - \text{Increase in accounts payable} \\
&= \text{USD } 11{,}514{,}000 - \text{USD } 300{,}000 \\
&= \text{USD } 11{,}214{,}000
\end{aligned}
$$

A is incorrect. It suggests an addition of accounts payable to purchases, which is not the correct treatment in the cash flow statement.

B is incorrect. It only represents the purchases from suppliers without adjusting for the change in accounts payable.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.4680 A company's net income for the year ended December 31, 2023, is USD 3,521,000. If depreciation expense is USD 1,100,000 and there's a gain on sale of equipment of USD 220,000, the net cash from operating activities using the indirect method, considering there are no other adjustments is *closest to:*

A. USD 3,401,000

B. USD 4,401,000

C. USD 4,543,000

The correct answer is **B.**

Under the indirect method, net cash from operating activities starts with net income, then adds back non-cash expenses like depreciation, and subtracts gains from the sale of assets.

$$\begin{aligned}\text{Net cash from operating activities} &= \text{Net income} + \text{Depreciation expense} \\ &- \text{Gain on sale of equipment Net cash from operating activities} \\ &= \text{USD } 3{,}521{,}000 + \text{USD } 1{,}100{,}000 - \text{USD } 220{,}000 \\ &= \text{USD } 4{,}401{,}000\end{aligned}$$

A is incorrect. It underestimates the impact of non-cash depreciation expense, which must be added back to net income.

C is incorrect. It does not account for the gain on the sale of equipment as a deduction from net income.

opic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.4681 If a company has beginning retained earnings of USD 3,305,000 and an ending retained earnings of USD 4,106,000, the amount of dividends that the company paid during the year if the net income was USD 3,521,000 is *closest to:*

A. USD 2,720,000

B. USD 2,800,000

C. USD 3,000,000

The correct answer is **A.**

Dividends paid can be calculated using the change in retained earnings and net income.

$$\begin{aligned}\text{Dividends paid} &= \text{Beginning retained earnings + Net income - Ending retained earnings}\\ &= \text{USD } 3{,}305{,}000 + \text{USD } 3{,}521{,}000 - \text{USD } 4{,}106{,}000\\ &= \text{USD } 2{,}720{,}000\end{aligned}$$

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, ***LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data***

Q.4682 Consider a company whose accounts receivable increased by USD 39,000 during the year, and the revenue reported was USD 25,456,000. The amount that the company received from its customers is *closest to:*

A. USD 25,417,000

B. USD 25,495,000

C. USD 25,380,000

The correct answer is **A.**

Cash received from customers is calculated by adjusting the revenue for the change in accounts receivable.

$$
\begin{aligned}
\text{Cash received from customers} &= \text{Revenue - Increase in accounts receivable} \\
&= \text{USD } 25{,}456{,}000 - \text{USD } 39{,}000 \\
&= \text{USD } 25{,}417{,}000
\end{aligned}
$$

B is incorrect. It suggests an incorrect calculation, possibly adding the increase in accounts receivable to the revenue, which is not how cash received from customers is calculated.

C is incorrect. It suggests a different value that does not correlate with the provided figures for revenue and the increase in accounts receivable.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.4683 Consider the following snippet of the income statement of a hypothetical company, Atlas Energy Group.

Atlas Energy Group Income Statement Year Ended 31 December 2023 (in thousands)	
Revenue	$75,000
Cost of Goods Sold	$35,000
Research and Development	$5,000
Selling and Administrative Expenses	$8,000
Depreciation Expense	$4,500
Interest Expense	$2,500
Income Tax Expense	$6,000
Net Income	$14,000

If Atlas Energy Group had an increase in inventory of $3 million, a decrease in accounts receivable of $1.5 million, and depreciation is the only non-cash expense, what was the net cash from operating activities using the indirect method?

A. $15 million

B. $17 million

C. $18 million

The correct answer is **B.**

To calculate the net cash from operating activities using the indirect method, we start with the net income and adjust for non-cash expenses and changes in working capital components.

$$\begin{aligned}\text{Net Cash from Operating Activities} &= \text{Net Income} + \text{Depreciation Expense}\\ &\quad + \text{Decrease in Accounts Receivable} - (\text{Increase in Inventory}\\ &= 14 + 4.5 + 1.5 - 3 = \$17 \text{ million}\end{aligned}$$

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.4684 Consider the following snippet of the income statement of a hypothetical company, Nova Innovations'.

Nova Innovations Balance Sheet as of 31 December 2023 (in thousands)		
Assets	2023	2022
Cash and Cash Equivalents	$15,000	$10,000
Accounts Receivable, net	$18,000	$20,000
Inventory	$12,000	$10,000
Prepaid Expenses	$2,000	$1,500
Property, Plant and Equipment, net	$45,000	$40,000
Intangible Assets, net	$8,000	$8,500
Total Assets	$100,000	$90,000
Liabilities and Shareholders' Equity		
Accounts Payable	$11,000	$9,000
Accrued Liabilities	$7,000	$8,000
Long-term Debt	$25,000	$30,000
Shareholders' Equity	$57,000	$43,000
Total Liabilities and Shareholders' Equity	$100,000	$90,000

Considering the changes in Nova Innovations' balance sheet from 2022 to 2023, if the only investments were capital expenditures of $10.5 million and there were no sales of the total cash used in investing activities is *closest to*:

A. 5.5 million

B. 9.0 million

C. 10.5 million

The correct answer is **A.**

The total cash used in investing activities can be calculated from the changes in property, plant, and equipment, as well as from capital expenditures and any sales of assets. Given no assets were sold:

$$\text{Cash Used in Investing Activities} = \text{Capital Expenditures} - (\text{Increase in Property, Plant, and Equip}$$

However, note that:

$$\begin{aligned}\text{Increase in Property, Plant, and Equipment, net} &= \text{Ending PPE, net} - \text{Beginning PPE, net}\\ &= 45\text{ million} - 40\text{ million}\\ &= \$5\text{ million}\end{aligned}$$

Therefore,

$$\text{Cash Used in Investing Activities} = \$10\text{ million} - \$5\text{ million} = \$5.5\text{ million}$$

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.4685 Which of the following *most likely* explains how depreciation expense is treated in the calculation of net cash flow from operating activities using the indirect method?

A. Added back to net income.

B. Subtracted from net income.

C. Ignored because it does not affect cash flow.

The correct answer is **A.**

Depreciation expense is a non-cash charge against income, which means it reduces net income but does not affect cash flow. Therefore, in the indirect method of calculating cash flows from operating activities, depreciation expense must be added back to net income.

B is incorrect. Subtracting depreciation would doubly reduce the cash flow, which is not representative of actual cash outflows.

C is incorrect. Even though depreciation does not directly affect cash flow, it impacts the reported net income and thus must be adjusted for in the cash flow statement.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

---

Q.4686 If a company reports an increase in inventory, which of the following is most likely the effect on the cash flow from operating activities using the indirect method? The cash flow from operating activities:

A. increases

B. decreases

C. remains constant.

The correct answer is **B.**

An increase in inventory represents an investment in working capital, which is a use of cash. In the indirect method, an increase in inventory is subtracted from net income because it represents cash that has been tied up in inventory and not available for other uses.

A is incorrect. An increase in inventory reduces, not increases, the cash available from operating activities.

C is incorrect. Changes in inventory levels directly affect cash flow from operations; it is a critical component of working capital changes that must be accounted for in the cash flow statement.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4b: describe the steps in the preparation of direct and indirect cash flow statements, including how cash flows can be computed using income statement and balance sheet data

Q.4687 Which of the following *most likely* explains why it is necessary to add back depreciation expense when calculating cash flow using the indirect method?

A. Depreciation represents an outflow of cash that must be replenished.

B. Depreciation increases cash flow directly and must be accounted for.

C. Depreciation does not affect cash flow; thus, it is added to reconcile net income with actual cash flow.

The correct answer is **C.**

Depreciation does not affect cash flow thus it is added to reconcile net income with actual cash flow. Depreciation is a non-cash accounting entry that reduces reported earnings but does not impact cash; therefore, it needs to be added back to net income in the cash flow statement.

A is incorrect. Depreciation does not represent an actual cash outflow, so there is no cash that needs to be "replenished". It is an accounting mechanism for allocating the cost of a tangible asset over its expected life.

B is incorrect. Depreciation does not increase cash flow directly; it is purely an accounting entry meant to spread the cost of an asset over its useful life. It does not involve the movement of cash.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4c: demonstrate the conversion of cash flows from the indirect to direct method.

Q.4688 In 2023, Apex Ventures reported a net income of USD 50 million. An excerpt of its balance sheet is given below.

Apex Ventures Balance Sheet Summary	31 Dec 2022	31 Dec 2023	Change
Common Stock	USD 200 million	USD 210 million	USD 10 million
Additional Paid-in Capital	USD 150 million	USD 200 million	USD 50 million
Retained Earnings	USD 120 million	USD 150 million	USD 30 million
Total Stockholders' Equity	USD 470 million	USD 560 million	USD 90 million

The amount of common stock and dividends reported in the statement of cash flows for the year 2023 are *closest to*:

A. Issuance of common stock totaling USD 60 million; dividends of USD 20 million.

B. Issuance of common stock totaling USD 60 million; dividends of USD 10 million.

C. Issuance of common stock totaling USD 60 million; dividends of USD 30 million.

The correct answer is **A.**

To calculate the total issuance of common stock, we add an increase in common stock and additional paid-in capital, which signifies an equity issuance during the year:

USD 10 million (Common Stock) + USD 50 million (Additional Paid-in Capital) = USD 60 million.

To calculate dividends paid, consider the following:

$$\begin{aligned}\text{Dividends Paid} &= \text{Beginning Retained Earnings + Net Income - Ending Retained Earnings}\\ &= \text{USD 120 million + USD 50 million - USD 150 million}\\ &= \text{USD 20 million}\end{aligned}$$

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4c: demonstrate the conversion of cash flows from the indirect to direct method.

Q.4689 In 2023, a technology company operating under US GAAP reported the following cash payments and other relevant financial data in (millions):

	2022	2023
Revenue	$65	$60
Cost of goods sold	$25	$23
Inventory	$20	$25
Accounts receivable	$15	$12
Accounts payable	$10	$9

Other cash payments for the year 2023 included:

- Salaries: USD 10 million
- Interest expense: USD 4 million
- Income taxes: USD 6 million

Based only on the information in Exhibit 2, the company's operating cash flow for 2023 is *closest to*:

A. USD 14 million.

B. USD 17 million.

C. USD 26 million.

The correct answer is **A.**

Recall that:

Operating cash flows = Cash received from customers – (Cash paid to suppliers
+ Cash paid to employees + Cash paid for other operating expenses
+ Cash paid for interest + Cash paid for income taxes)

We need to calculate each of the above variables:

Cash received from customers = Revenue + Decrease in accounts receivable
= USD 60 + (USD 15 - USD 12)
= USD 63 million

Cash paid to suppliers = Cost of goods sold + Increase in inventory
+ Decrease in accounts payable
= USD 23 + (USD 25 - USD 20) - (USD 10 - USD 9)
= USD 29 million

Therefore,

$$\begin{aligned}\text{Operating cash flows} &= \text{Cash received from customers} - (\text{Cash paid to suppliers} \\ &\quad + \text{Cash paid to employees} + \text{Cash paid for other operating expenses} \\ &\quad + \text{Cash paid for interest} + \text{Cash paid for income taxes}) \\ &= 63 - 29 - 10 - 4 - 6 \\ &= 14 \text{ million}\end{aligned}$$

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4c: demonstrate the conversion of cash flows from the indirect to direct method.

Q.4690 Which classification option for interest received is available under IFRS but not under US GAAP?

A. Operating activity only.

B. Operating or investing activity

C. Financing activity.

The correct answer is **B.**

Under IFRS, interest received can be classified as either an operating or investing activity, offering flexibility based on the nature of the business. Under US GAAP, interest received must always be classified as an operating activity.

A is incorrect. Both IFRS and US GAAP allow the classification of interest received as an operating activity.

C is incorrect. Neither IFRS nor US GAAP allows interest received to be classified as a financing activity.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Q.4691 Under IFRS, dividends paid is *most likely* classified on the cash flow statement as:

A. a financing activity.

B. an operating or financing activity.

C. an investing or financing activity.

The correct answer is **B.**

IFRS provides flexibility in classifying dividends paid, allowing it to be considered either an operating or financing activity, depending on the company's policy and the nature of the dividends.

A is incorrect. It is too restrictive and does not reflect the flexibility IFRS offers.

C is incorrect. There is no option under IFRS to classify dividends paid as an investing activity.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Q.4692 Which of the following is *most likely* a significant difference in how bank overdrafts are classified under IFRS and US GAAP?

A. Both standards treat them as financing activities.

B. IFRS includes them in cash and cash equivalents, while US GAAP treats them as financing activities.

C. IFRS treats them as financing activities, while US GAAP treats them as part of cash and cash equivalents.

The correct answer is **B.**

Under IFRS, bank overdrafts can be considered part of cash and cash equivalents if they are an integral part of the company's cash management. Under US GAAP, bank overdrafts are not considered cash equivalents and are treated as financing activities.

A is incorrect. It does not correctly reflect the treatment under IFRS.

C is incorrect. It reverses the classifications.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Q.4693 How does US GAAP require income tax expense to be classified on the cash flow statement?

A. Always as a financing activity.

B. Always as an operating activity.

C. As an operating, investing, or financing activity based on the tax's nature.

The correct answer is **B.**

Under US GAAP, income tax expense is consistently classified as an operating activity regardless of its connection to investing or financing activities.

A is incorrect. It describes the IFRS approach, not US GAAP.

C is incorrect. Income tax expense is not classified as a financing activity under US GAAP.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)

Q.4694 Which of the following statements is *most likely* true regarding the direct method of reporting cash flow from operating activities in both IFRS and US GAAP? The direct method is:

A. required under both standards.

B. discouraged under both standards.

C. encouraged but not required under both standards.

The correct answer is **C.**

Both IFRS and US GAAP encourage the direct method for reporting cash flows from operating activities because it provides more useful information to users. However, neither standard mandates its use.

A is incorrect. Neither standard requires the direct method.

B is incorrect. Neither standard discourages its use; they both encourage it.

CFA Level I, Volume 2, Topic 5 - Financial Statements Analysis, Learning Module 4: Analyzing Statements of Cash Flows, LOS 4d: contrast cash flow statements prepared under International Financial Reporting Standards (IFRS) and US generally accepted accounting principles (US GAAP)
