

CHAPTER 13

DISCUSSION QUESTIONS

1. The main purpose of a statement of cash flows is to provide information about the cash receipts and cash payments of an entity during a period of time. The statement of cash flows also explains the changes in the balance sheet accounts and the cash effects of the accrual-basis amounts reported in the statement of comprehensive income. In addition to operating activities, it also provides information about an entity's investing and financing activities. This information should assist investors and creditors in assessing an entity's ability to generate positive future cash flows.
2. Cash equivalents are short-term, highly liquid investments that can be converted easily and quickly to cash. Examples include U.S. Treasury bills, money market funds, and commercial paper. Cash equivalents are to be included as cash (i.e., added to cash) on a statement of cash flows.
3. Cash flows from *operating activities* include those items that enter into the determination of net income. Examples are cash receipts from the sale of goods or services and from interest, and cash payments for inventory, wages, taxes, interest, etc.

Cash flows from *investing activities* result from transactions and events involving the purchase or sale of securities (other than trading securities), property, plant, and equipment, and other assets not generally held for resale, and the making and collecting of loans. Examples include the proceeds from the sale of equipment, the purchase of a building, the sale of a business segment, the collection of the principal amount on a loan to another entity, and the purchase of another entity's equity securities (not held as trading securities).

Cash flows from *financing activities* result from transactions and events whereby resources are obtained from or paid to owners (equity financing) and creditors (debt financing). Examples include cash received from the sale (issuance) of stock, cash received from a bank loan or by issuing bonds, dividend payments to stockholders, or cash used to repurchase an entity's own stock (treasury stock).
4. Significant non-cash investing and financing transactions shall be excluded from a statement of cash flows and shall be disclosed elsewhere in the financial statements. Because they do not involve cash, they should not be reported in the body of the statement itself.
5. By analyzing the statement of comprehensive income and comparative balance sheets, the following six-step process can be used to prepare a statement of cash flows.
 - (1) Start with the item "Income before income tax"
 - (2) Calculate and report separately operating cash flows for income tax payments.
 - (3) Add back interest expense and deduct interest revenue. Calculate and report operating cash flows (separately) for the payments of interests, and the receipts of interests
 - (4) Add back operating expenses not involved with cash outflow: depreciation expense
 - (5) Deduct all the gains and add back all the losses resulting from investing and financing activities.
 - (6) Adjust changes in non-cash current assets and current liability accounts
6. Depreciation and similar non-cash items should not be reported on a statement of cash flows. The indirect method starts with income before income tax. Because these items have been included in income before income tax, they must be added to or subtracted from it. With the direct method, they are simply ignored.
7. Any significant non-cash transactions (e.g., the purchase of a building or the retirement of long-term debt by issuing stock) shall be disclosed elsewhere in the financial statements.
8. Investors and creditors might use a statement of cash flows to better assess the amounts, timing, and uncertainties of future cash flows. This knowledge can help them to

Chapter 13

notice a company's shifts in operating, investing, and financing policies. It provides answers to specific questions, such as: Why weren't dividend payments larger? How was

a new building financed? Why is the company short on cash when earnings have increased?

PRACTICE EXERCISES

PE 13–1 (LO2) Categories of Cash Inflows and Outflows

The correct answer is A. Answers B, C, and D are the main categories of the statement of cash flows. Those activities that might be classified as “earning activities” are presented mainly in the operating activities section of the statement of cash flows.

PE 13–2 (LO2) Identifying Operating Activities

The correct answer is B.

- a. This is an example of a financing activity.
- b. This is an example of an operating activity.
- c. This is an example of an investing activity.
- d. This is an example of a financing activity.

PE 13–3 (LO2) Identifying Investing Activities

The correct answer is D.

- a. This is an example of an operating or a financing activity.
- b. This is an example of a financing activity.
- c. This is an example of an operating activity.
- d. This is an example of an investing activity.

PE 13–4 (LO2) Identifying Financing Activities

The correct answer is B.

- a. This is an example of an investing activity.
- b. This is an example of a financing or an operating activity.
- c. This is an example of an operating or an investing activity.
- d. This is an example of an investing activity.

Chapter 13
PE 13–5 (LO3) Computing Net Change in Cash for the Period

The ending cash balance is \$4,600, as shown below.

Cash provided by (used in):

Operating activities.....	\$ 30,700
Investing activities.....	(32,100)
Financing activities.....	3,000
Net increase in cash and cash equivalents	\$ 1,600
Beginning cash balance	3,000
Ending cash balance.....	<u>\$ 4,600</u>

PE 13–6 (LO3) Computation of Cash from Operating Activities

Cash provided by operating activities is \$203, as shown below.

Collections on account.....	\$ 4,686
Payments for inventory	(2,974)
Payments for miscellaneous expenses.....	(1,131)
Payment for interest.....	(143)
Payment for taxes	(235)
Net cash flows from operating activities.....	<u>\$ 203</u>

Alternative answers: Under IFRS, payment for interest and payments to stockholders as dividends could be classified as either operating or financing activities.

PE 13–7 (LO3) Solving for Cash from Investing Activities

Cash used in investing activities is (\$398,000), as shown below.

Ending cash balance.....	\$ 29,000
Less: Beginning cash balance.....	(26,000)
Change in cash account for the year.....	<u>\$ 3,000</u>
 Cash from (used in) operating activities	 \$ 200,000
Cash from (used in) financing activities	150,000
Cash from (used in) investing activities.....	(347,000)
Change in cash account for the year.....	<u>\$ 3,000</u>

PE 13–8 (LO4) Identifying Non-cash Flow Items and Non-operating Activity Items

The gain on sale of land \$900 would be subtracted from income before income tax, and depreciation expense (\$2,250) would be added back to income before income tax when computing cash from operating activities. Gain on sale of land relates to investing activities (not operating activities), and depreciation expense is a non-cash item.

PE 13–9 (LO4) Using Income Tax Payable to Compute Cash Paid for Income Tax

Cash paid for income tax is \$6,300, as shown below.

Income Statement	Adjustments	Cash Flows from Operations
Income tax expense \$ (7,000)	+200 (increase in income tax payable)	\$<u>(6,800)</u>

Another way to consider this problem is to make a T-account with the information provided and solve for the unknown, as shown below:

Income Tax Payable		
Income tax paid during the period	Beg. bal. 6,800	1,500
	Amount related to Income tax expense	7,000
	End. bal.	1,700

PE 13–10 (LO4) Indirect Method
Operating activities:
Income before income tax

.....	\$1,023
Add: Interest expense	\$ 462
Depreciation expense	4,603
Loss on sale of land.....	1,130
Increase in accounts payable	145
Decrease in prepaid expenses.....	130
Less: Increase in accounts receivable	(340)
Increase in inventory	(103)
Interest paid	(486)
Income tax paid in cash.....	<u>(455)</u>
Net cash flows from operating activities.....	<u>5,086</u>
	<u>\$6,109</u>

Chapter 13
PE 13–11 (LO5) Computing Cash Paid for Property, Plant, and Equipment

The amount of cash paid for property, plant, and equipment during the year was \$60,000, as shown, using the following T-account:

Property, Plant, and Equipment		
Beg. bal.	235,000	
Cash paid for property, plant, and equipment	60,000	Historical cost of equipment sold
End. bal.	265,000	30,000

To reconcile the account, we can only assume that cash paid for property, plant, and equipment was \$60,000.

PE 13–12 (LO5) Computing Gain on Sale of Property, Plant, and Equipment

The gain on the sale of equipment during the year is \$12,500.

First, we need to compute the book value of the equipment sold during the year. The equipment had a historical cost of \$30,000 and accumulated depreciation of \$16,500 as computed using the following T-account:

Accumulated Depreciation		
Accumulated depreciation of equipment sold	16,500	Beg. bal. 86,000
		Depreciation expense for the year 14,500
		End. bal. 844,000

To reconcile the account, we can only assume that the accumulated depreciation related to equipment sold during the year was \$16,500.

The carrying amount of the equipment sold was \$13,500 (\$30,000 – \$16,500). So the gain on the sale of equipment during the year was \$12,500 (\$26,000 sales price – \$13,500 carrying amount).

PE 13–13 (LO5) Computing Cash from Financing Activities

Financing activities:

Cash paid to purchase treasury stock.....	\$(15,000)
Cash payments for dividends	(5,350)
Cash payments to repay long-term debt	<u>(28,000)</u>
Net cash flows from financing activities	<u>\$(48,350)</u>

PE 13–14 (LO6) Using Information from the Statement of Cash Flows to Make Decisions

You probably would feel some apprehension about loaning money to this company. The company has experienced positive earnings over the past three years, but it is having a cash flow problem. Cash from operating activities has declined drastically over the past three years, and cash from financing activities has increased over the same three years. The company is using external funding to fund its operations. Such a strategy might work in the short run, but if operations do not improve and begin generating cash, the company will not be able to repay its long-term borrowing commitments. An important thing to remember as a potential lender is that net income does *not* repay loans—cash does.

EXERCISES

E 13–1 (LO2) Classification of Cash Flows

<u>Item</u>	<u>Classified as</u>	<u>Reported under</u>
1. Fees collected for services	I	OA
2. Interest paid..... or FA		OUS GAAP:OA/IFRS:OA
3. Proceeds from sale of equipment.....	I	IA
4. Cash (principal) received from bank on long-term note.....	I	FA
5. Purchase of treasury stock for cash	O	FA
6. Collection of loan made to company officer.....	I	IA
7. Cash dividends paid		OUS GAAP:FA/IFRS:OA
8. Income tax paid	O	OA
9. Depreciation expense	N	NOS*
10. Wages paid to employees	O	OA
11. Cash paid for inventory purchases	O	OA
12. Proceeds from sale of common stock.....	I	FA
13. Interest received on loan to company officer.....		IUS GAAP:OA/IFRS:OA
14. Purchase of land by issuing stock	N	NOS**
15. Utility bill paid.....	O	OA

*Ignored with direct method; added back to income before income tax with indirect method

**Shall be disclosed elsewhere in the financial statements

Classification of Cash Flows

<u>Transaction</u>	<u>Reported in Statement of Cash Flows</u>			<u>Not Reported in Statement of Cash Flows</u>
	<u>Operating</u>	<u>Investing</u>	<u>Financing</u>	
a. Collections from customers.....	X			
b. Depreciation expense				X*
c. Wages and salaries paid.	X			
d. Cash dividends paid				X
e. Income tax paid	X			
f. Utilities paid.....	X			
g. Building purchased in exchange for stock				X**
h. Stock of Western Co. purchased.....		X		
i. Inventory purchased for cash.....	X			
j. Interest paid on Alta's note to local bank	X			
k. Interest received from a customer note	X			
l. Delivery truck sold at no gain or loss.....			X	

*Depreciation is ignored when using the direct method.

**This information would be reported in a supplemental note or schedule but not on the statement itself.

Chapter 13
E 13–3 (LO3) Transaction Analysis

1.	a.	Cash	55,000
		Common Stock (1,000 shares × \$15 par)	15,000
		Paid-In Capital in Excess of Par	40,000
	b.	Cash	220,000
		Accounts Receivable.....	220,000
	c.	Dividends Payable	75,000
		Cash.....	75,000
	d.	Cash	5,000
		Interest Revenue.....	5,000
	e.	Insurance Expense	3,500
		Cash.....	3,500
	f.	Depreciation Expense.....	7,000
		Accumulated Depreciation.....	7,000
2.	a.	The \$55,000 cash inflow would be classified as a financing activity.	
	b.	The \$220,000 cash inflow would be classified as an operating activity.	
	c.	The \$75,000 cash outflow would be classified as a financing activity.	
	d.	The \$5,000 cash inflow would be classified as an operating activity.	
	e.	The \$3,500 cash outflow would be classified as an operating activity.	
	f.	Depreciation is a non-cash item. The \$7,000 would be added back as an adjustment to income before income tax under the indirect method and ignored when using the direct method.	

E 13–4 (LO2) Transaction Analysis

1.	a.	Cash	10,700
		Accumulated Depreciation—Equipment.....	20,000
		Gain on Sale of Equipment	700
		Equipment	30,000
		<i>(\$10,700 proceeds – \$10,000 book value = \$700 gain)</i>	
	b.	Equipment.....	80,000
		Cash.....	50,000
		Notes Payable	30,000
	c.	Cash	12,150
		Notes Receivable	11,200

	Interest Revenue.....	950
d.	Cash	8,600
	Dividend Revenue.....	8,600
e.	Treasury Stock.....	4,000
	Cash.....	4,000

2. a. The \$10,700 cash receipt is reported under investing activities; with the indirect method, the \$700 gain is subtracted from income before income tax under operating activities.
- b. The \$50,000 cash payment is reported under investing activities; \$30,000 of the transaction shall be disclosed elsewhere in the financial statements since it is a significant non-cash transaction.
- c. The \$950 cash receipt from interest is reported under operating activities with the direct method; the \$11,200 cash receipt from repayment of a note is reported under investing activities.
- d. The \$8,600 cash receipt from dividend revenue is reported under operating activities.
- e. The \$4,000 cash payment for treasury stock is reported under financing activities.

Chapter 13
E 13-5 (LO3) Computing Cash Provided by Operating Activities (Direct Method)

Revenues	\$390,000
Deduct: Increase in accounts receivable	<u>96,000</u>
Cash receipts from customers*	\$294,000
Operating expenses.....	156,000
Deduct: Increase in accounts payable	<u>50,000</u>
Cash payments for operating expenses**	(106,000)
Net cash provided by operating activities	<u>\$ 188,000</u>

Accounts Receivable

Balance, Beginning of year	0		
Revenues for the year	390,000	Cash receipts for year	294,000
Balance, End of year	96,000		

Accounts Payable

		Balance, Beginning of year	0
Payments for the year	106,000	Operating expenses for year	156,000
		Balance, End of year	50,000

E13-6 (LO3) Computing Cash Payments (Direct Method)
(a) Cash payments to suppliers

Cost of goods sold.....	\$2,263.9
Add: Increase in inventory	<u>8.55</u>
Cost of purchases	\$2,272.45
Deduct: Increase in accounts payable.....	<u>69.8</u>
Cash payments to suppliers.....	<u>\$2,202.65</u>

(b) Cash payments for operating expenses

Operating expenses exclusive	
of depreciation.....	\$4,698.8
(\$5,258.8 – \$560)	
Add: Increase in prepaid expenses	\$ 32.65

Deduct: Increase in accrued expenses payable.....	<u>95.3</u>	<u>(62.65)</u>
Cash payments for operating expenses	<u><u>\$4,636.15</u></u>	

E 13-7 (LO3) Preparing a Simple Cash Flow Statement

Smith Company
Statement of Cash Flows
For the Year Ended December 31, 2018

Operating activities:

Collections from customers	\$146,000
Payments for wages and salaries.....	(60,000)
Payments for inventory	(63,000)
Payments for other cash operating expenses.....	(11,500)
Payments for income tax	<u>(25,000)</u>
Net cash flows from operating activities.....	<u><u>\$13,500</u></u>

Investing activities:

Proceeds from sale of equipment	\$ 4,750
Proceeds from sale of held-to-maturity securities.....	<u>17,200</u>
Net cash flows from investing activities	21,950

Financing activities:

Proceeds from new bank loan	\$ 45,300
Payments of dividends	<u>(5,000)</u>
Net cash flows from financing activities	<u>40,300</u>
Net increase in cash.....	\$ 48,750
Beginning cash balance	29,870
Ending cash balance.....	<u>\$78,620</u>

E 13–8 (LO2, LO3) Net Cash Flows (Direct Method)

Luke Corp.
Statement of Cash Flows
For the Year Ended December 31, 2018

Operating activities:**Cash receipts from:**

Customers.....	\$ 805,000
Interest	<u>30,000</u>

\$ 835,000

Cash payments for:

Wages.....	(555,000)
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Net cash flows from operating activities.....

\$ 280,000

Investing activities:

Cash receipt from sale of equipment.....	\$ 45,000
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Cash payment for land	<u>(215,000)</u>
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Net cash flows from investing activities

(170,000)

Financing activities:

Cash received from issuance of common stock.....	\$ 355,000
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Cash paid to retire bonds.....	(205,000)
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Cash payments for dividends	<u>(85,000)</u>
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Net cash flows from financing activities

65,000

Net increase in cash.....

\$ 175,000

Adjustments to Cash Flows from Operations (Indirect Method)

	<u>Adjustment to Income before Income Tax</u>
1. Increase in Accounts Receivable	Subtracted
2. Decrease in Accounts Payable	Subtracted
3. Increase in securities classified as cash equivalents	Does not affect cash flows from operations; would be included as cash equivalent
4. Gain on sale of equipment	Subtracted (proceeds reported as investing activity)
5. Decrease in inventory	Added
6. Increase in prepaid insurance	Subtracted
7. Depreciation	Added (non-cash item)
8. Increase in wages payable	Added

E 13–10 (LO4) Cash Flows from Operations (Indirect Method)

Net income	\$70,200
Add (deduct) adjustments to cash basis:	
Decrease in accounts receivable	3,000
Increase in inventory	(1,000)
Decrease in prepaid insurance	400
Increase in accounts payable	3,000
Decrease in wages payable.....	(1,200)
Net cash flows from operating activities	<u>\$74,400</u>

The following spreadsheet may be helpful in explaining the adjustments:

	Income Statement		Adjustments	Cash Flows from Operations
Sales revenue	\$600,000	3,000	Cash collected from customers	\$603,000
Cost of goods sold	–410,000	–1,000	Cash paid for inventory	–408,000
		3,000		
Wages expense	–60,000	–1,200	Cash paid for wages	–61,200
Utilities expense	–4,000	0	Cash paid for utilities	–4,000
Rent expense	–41,300	0	Cash paid for rent	–41,300
Insurance expense	–14,500	400	Cash paid for insurance	–14,100
Net income	<u>\$ 70,200</u>		Cash from operating activities	<u>\$74,400</u>

E 13–11 (LO4) Cash Flows Provided by Operations (Indirect Method)

Operating activities:

Net income.....	\$ 90,000
Add (deduct) adjustments to cash basis:	
Interest expense.....	3,500
Depreciation	65,000
Decrease in accounts receivable.....	13,000
Increase in inventory	(8,000)
Decrease in accounts payable.....	(3,400)
Interest paid	(2,500)
Net cash flows from operating activities	<u>\$157,600</u>

The following spreadsheet may be helpful in explaining the adjustments:

	Statement of Comprehensive Income		Adjustments	Cash Flows from Operations
Sales revenue	\$600,000	13,000	Cash collected from customers	\$613,000
Cost of goods sold	–400,000	–8,000	Cash paid for inventory	–411,400
		–3,400		
Depreciation expense	–65,000	65,000	Cash paid for depreciation	0
Interest expense	–3,500	+ 1,000	Cash paid for interest	–2,500
Other expenses	–41,500	0	Cash paid for other expenses	–41,500
Net income	\$ 90,000		Cash from operating activities	\$157,600

E 13-12 (LO4, LO5) Net Cash Flows (Indirect Method)

Operating activities:

Net income	\$ 96,000
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Add (deduct) adjustments to cash basis:

Depreciation	26,000*
Increase in accounts receivable	(11,000)
Decrease in inventory	4,000
Increase in prepaid assets	(8,000)
Decrease in accounts payable	(6,000)
Increase in wages payable	<u>16,000</u>
Net cash flows from operating activities	<u>\$117,000</u>

Investing activities:

Cash payment for equipment	<u>\$ (41,000)**</u>
Net cash flows from investing activities	<u>(41,000)</u>

Financing activities:

Cash receipts from issuance of bonds	\$101,000
Cash payments for dividends	<u>(44,000)***</u>
Net cash flows from financing activities	<u>57,000</u>
Net increase in cash	<u>\$133,000</u>

*Increase in accumulated depreciation \$6,000 plus disposal of equipment with accumulated depreciation \$20,000

**Increase in equipment \$21,000 plus disposal of equipment with historical cost \$20,000

***Dividends declared and paid (\$41,000) plus decrease in Dividends Payable (\$3,000).

E 13–13 (LO4, LO5) Statement of Cash Flows (Indirect Method)

Western Company
Statement of Cash Flows
(Indirect Method)
For the Year Ended December 31, 2018

Operating activities:

Net income.....	\$105,000
Add (deduct) adjustments to cash basis:	
Depreciation	45,000
Decrease in accounts receivable.....	6,000
Increase in inventory.....	(30,000)
Increase in accounts payable	<u>12,000</u>
Net cash flows from operating activities	\$138,000

Investing activities:

Cash payments for plant and equipment.....	<u>(\$120,000)*</u>
Net cash flows from investing activities.....	(120,000)

Financing activities:

Cash payments for dividends	\$(42,000)
Cash receipts from issuance of capital stock	<u>15,000</u>
Net cash flows from financing activities	<u>(27,000)</u>
Net decrease in cash and cash equivalents.....	\$ (9,000)
Cash and cash equivalents at beginning of period	<u>18,000</u>
Cash and cash equivalents at end of period.....	<u>\$ 9,000</u>

*Increase in plant and equipment (\$75,000) plus depreciation (\$45,000) = \$120,000 cash paid for plant and equipment.

The following spreadsheet may be helpful in explaining the adjustments:

	Income Statement		Adjustments	Cash Flows from Operations
Sales revenue	\$825,000	6,000	Cash collected from customers	\$831,000
Cost of goods sold	–450,000	–30,000	Cash paid for inventory	–468,000
		12,000		
Depreciation expense	–45,000	45,000	Cash paid for depreciation	0
Other expenses	–225,000	0	Cash paid for other expenses	–225,000
Net income	<u>\$105,000</u>		Cash from operating activities	<u>\$138,000</u>

E13-13 (LO4, LO5) (Continued)

Western Company
Statement of Cash Flows
(Direct Method)

For the Year Ended December 31, 2018

Operating activities:**Cash receipts from:**

Customers	\$ 831,000 ¹
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Cash payments for:

Inventory.....	(468,000) ²
Operating expenses.....	<u>(225,000)³</u>

Net cash flows from operating activities.....	\$138,000
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Investing activities:

Cash payments for plant and equipment.....	<u>\$ (120,000)⁴</u>
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Net cash flows from investing activities.....	(120,000)
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Financing activities:

Cash payments for dividends	\$ (42,000)
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Cash receipts from issuance of capital stock	<u>15,000</u>
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Net cash flows from financing activities	<u>(27,000)</u>
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Net decrease in cash and cash equivalents.....	\$ (9,000)
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Cash and cash equivalents at beginning of period	18,000
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Cash and cash equivalents at end of period.....	<u>\$ 9,000</u>
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Computations:

¹Sales of \$825,000 plus beginning Accounts Receivable (\$72,000) minus ending Accounts Receivable (\$66,000) = \$831,000 cash collected from customers.

²Cost of goods sold of \$450,000 plus ending inventory (\$150,000) minus beginning inventory (\$120,000) plus beginning accounts payable (\$108,000) minus ending accounts payable (\$120,000) = (\$468,000) cash paid for inventory.

³Operating expenses (\$270,000) less depreciation (\$45,000) = (\$225,000) cash payments for operating expenses.

⁴Increase in plant and equipment (\$75,000) plus depreciation (\$45,000) = (\$120,000) cash paid for plant and equipment.

E13-14 (LO6) **Cash Flow Patterns**

1. Tesla Motors, Inc. is a start-up company that, as is typical of start-up companies, is reporting a loss from operations. The company has a significant cash inflow from financing and is investing that money in the business.

2. ExxonMobil has a very large amount of fixed assets resulting in a lot of depreciation expense being reported every year. The primary difference between ExxonMobil's net income of \$45,220 million and its \$59,725 million in cash from operations relates to depreciation.
3. Under Armour is a very profitable company that pays only a small dividend. Therefore, its cash flow from financing activities will rarely be negative.
4. Coca-Cola, on the other hand, is famous for paying a dividend (hence the negative cash flow from financing). It is a profitable company that continues to expand and regularly pays a dividend.

PROBLEMS

P 13–1 (LO3, LO4) Analysis of the Cash Account

1. a.	Accounts Receivable	160,000	
	Sales.....		160,000
	Cash.....	164,000	
	Accounts Receivable		164,000
b.	Inventory	49,000	
	Accounts Payable		49,000
	Accounts Payable.....	46,500	
	Cash		46,500
c.	Equipment.....	31,000	
	Cash		31,000
	<i>Equipment purchases (\$31,000) less equipment sales (\$10,000) = increase in equipment account (\$21,000).</i>		
d.	Cash.....	7,000	
	Accumulated Depreciation—Equipment	4,000	
	Equipment.....		10,000
	Gain on Sale of Equipment.....		1,000
e.	Cash.....	24,000	
	Notes Payable.....		24,000
f.	Operating Expenses.....	41,200	
	Accumulated Depreciation—Equipment.....		2,400
	Cash		38,800
g.	Interest Expense.....	1,700	
	Interest Payable.....		1,700
	Interest Payable	2,100	
	Cash		2,100
h.	Income Tax Expense	3,500	
	Income Taxes Payable		3,500
	Income Taxes Payable	2,300	
	Cash		2,300

P 13–1 (LO3, LO4) (Continued)**2.**

Jupiter Company
Statement of Cash Flows
For the Year Ended December 31, 2018

Cash flows from operating activities:

Cash collected from customers.....	\$164,000
Cash payments for inventory.....	(46,500)
Cash payments for operating expenses	(38,800)
Cash payment for interest.....	(2,100)
Cash payment for taxes.....	<u>(2,300)</u>
Net cash flows provided by operating activities ..	\$ 74,300

Cash flows from investing activities:

Purchase of equipment.....	\$ (31,000)
Sale of equipment	<u>7,000</u>
Net cash flows used in investing activities.....	(24,000)

Cash flows from financing activities:

Proceeds from bank loan	<u>\$ 24,000</u>
Net cash flows provided by financing activities...	<u>24,000</u>
Net increase in cash.....	<u>\$ 74,300</u>
Beginning cash balance.....	<u>16,300</u>
Ending cash balance.....	<u>\$ 90,600</u>

P 13-2 (LO3) Analyzing Cash Flows

1.	Beginning balance in cash account.....	\$ X
	Increase in cash during the year.....	<u>191,000</u>
	Ending balance in cash account.....	<u><u>\$274,000</u></u>
	X + \$191,000 = \$274,000	
	X = <u><u>\$ 83,000</u></u>	
2.	Cash flows from operating activities:	
	Cash receipts from:	
	Customers	\$ 78,000 ¹
	Cash payments for:	
	Inventory	(34,000)
	Rent	<u>(11,000)</u>
	Net cash flows provided by operating activities ..	<u><u>\$ 33,000</u></u>
	¹ Cash sales of \$45,000; collections of accounts receivable, \$33,000.	
3.	Cash flows from investing activities:	
	Cash payment for purchase of equipment.....	\$ (80,000)
	Cash receipt from sale of machine	<u>10,000</u>
	Net cash flows used in investing activities.....	<u><u>\$(70,000)</u></u>
4.	Cash flows from financing activities:	
	Cash receipt from sale of stock	\$240,000
	Cash payment for dividends	<u>(15,000)</u>
	Net cash flows provided by financing activities...	<u><u>\$225,000</u></u>
5.	No. The land valued at \$101,000 was acquired by issuing a \$100,000 bond at a premium of \$1,000. Since this is a non-cash transaction, it would not be reported on a statement of cash flows. The machine that was scrapped provided no cash and therefore also would not be reported on a statement of cash flows. The depreciation and amortization expenses also do not involve cash. They would be ignored when using the direct method and added back as an adjustment to net income when using the indirect method.	

P 13–3 (LO4) Cash Flows from Operations (Indirect Method)

1. Net loss.....	\$ (80,000)
-------------------------	--------------------

Add (deduct) adjustments to cash basis:

Depreciation	86,000
Decrease in accounts receivable.....	30,000
Increase in inventory	(14,000)
Decrease in prepaid expenses.....	6,000
Increase in accounts payable	10,000
Decrease in accrued liabilities	(12,000)
Net cash flows provided by operating activities	<u>\$ 26,000</u>

Note: The amount of cash dividends paid was \$50,000 (\$70,000 declared + \$50,000 payable at beginning of year – \$70,000 payable at year-end). However, dividends are classified as a financing activity, not as an operating activity.

- 2. Gordon Enterprises can pay \$50,000 in cash dividends, even though the company reported a \$80,000 net loss, because the cash flows from operations were positive (positive \$26,000). The positive cash flows come primarily from the collection of receivables and the addition of depreciation (a non-cash item) to net income. Also, other investing and financing activities may have generated some positive cash flows. Finally, the company probably used some of the beginning cash balance to pay the dividends (the cash and cash equivalents balance decreased \$60,000).**

P 13–4 (LO4) Cash Flows from Operations (Indirect Method)**Indirect method:**

Income before income tax	\$21,200
Add (deduct) adjustments to cash basis:	
Interest expense.....	\$6,200
Depreciation	10,400
Decrease in accounts receivable.....	1,300
Increase in inventory	(1,200)
Increase in prepaid expenses	(150)
Decrease in accounts payable.....	(200)
Gain on sale of equipment.....	(8,000)
Interest paid	(5,950)
Income tax paid in cash	<u>(9,060)</u>
Net cash flows from operations.....	<u>\$14,540</u>

The following spreadsheet may be helpful in explaining the adjustments:

Sales Revenue	\$110,000	1,300	\$111,300	Cash collected from customers
Other Revenues	8,000	-8,000	0	Eliminate gain on sale
Cost of Goods Sold	-60,000	-1,200	-61,400	Cash paid for inventory
		-200		
S & A Expenses	-20,200	-150	-20,350	Cash paid for S & A expenses
Depreciation Expense	-10,400	10,400	0	Cash paid for depreciation
Interest Expense	-6,200	250	-5,950	Cash paid for interest expense
Tax Expense	<u>-9,360</u>	300	<u>-9,060</u>	Cash paid for taxes
Net Income	\$ 11,840		\$ 14,540	Cash from operating activities

P 13–5 (LO5) Calculation of Cash Flow Effects Using Changes in Equity Accounts

1. Net income can be determined by analyzing the retained earnings account.

Retained earnings beginning of year.....	£400,000
Add: Net income (plug)	<u>80,000*</u>
	480,000
Less: Cash dividends.....	20,000
Share dividends	10,000
Retained earnings, end of year	£450,000

*(£450,000 + £10,000 + £20,000 – £400,000)

2. Cash inflow from the issue of ordinary shares was £10,000 (£130,000 – £110,000 – £10,000).

Capital Stock	
	110,000
	10,000
	10,000
	130,000
	Share Dividend
	Shares Issued for Cash

Cash outflow for dividends was £20,000. The share dividend does not use cash.

- (c) Both of the above activities (issue of ordinary shares for cash and payment of cash dividends) would be classified as financing activities on the statement of cash flows.

P 13–6 (LO5) Preparing the Operating Activities Section (Indirect Method)

Titanic Company
Partial Statement of Cash Flows
For the Year Ended December 31, 2018

Cash flows from operating activities

Net income	£170,000
Adjustments to reconcile net income to net cash provided by operating activities:	
Decrease in accounts receivable.....	£ 10,000
Decrease in accounts payable.....	(15,000)
Increase in income taxes payable	7,000
Net cash provided by operating activities	2,000
	£172,000

P 13–7 (LO4, LO5) Statement of Cash Flows (Indirect Method)

Please Notice the Revision of Question P13-17 in the textbook

1. In the balance sheet, please revise the Cash \$32,500 in 2018 to \$34,000
2. In the balance sheet, please revise the Accumulated depreciation-equipment (23,000) in 2018 to (21,000)
3. In the balance sheet, please revise the total assets 235,000 in 2018 to 238,500
4. In the balance sheet, please revise the Accumulated depreciation-equipment (16,000) in 2017 to (12,000)
5. In the balance sheet, please revise the total assets 198,000 in 2017 to 202,000
6. In the additional information, please the dividend 40,000 to 42,000.

**Jessie Company
Statement of Cash Flows
(Indirect Method)
For the Year Ended December 31, 2018**

Cash flows from operating activities:

Income before income tax	\$ 54,500
--------------------------------	-----------

Add (deduct) adjustments to cash basis:

Depreciation	16,000 ¹
Increase in accounts receivable	(13,500)
Decrease in inventory	15,000
Increase in accounts payable	5,400
Gain on sale of equipment	(1,500)
Income tax paid in cash.....	<u>(1,400)²</u>
Net cash flows provided by operating activities	\$ 74,500

Cash flows from investing activities:

Cash receipts from sale of equipment	\$ 2,500
Cash payments for purchase of equipment.....	<u>(33,000)³</u>
Net cash flows used in investing activities.....	(30,500)

Cash flows from financing activities:

Cash receipts from borrowing (long-term note payable)	\$ 20,000
Cash payments for dividends	<u>(42,000)</u>
Net cash flows used in financing activities	(22,000)
Net increase in cash and cash equivalents.....	\$ 22,000
Cash and cash equivalents at beginning of year.....	<u>12,000</u>
Cash and cash equivalents at end of year	\$ 34,000

¹Accumulated depreciation beginning balance (\$12,000) + depreciation expense (X) – write-off on sale (\$7,000) = accumulated depreciation ending balance (\$21,000); therefore, X = \$14,000 depreciation for current year.

²Income tax payable beginning balance (\$3,700) + income tax expense (\$2,500) – income tax paid in cash (X) = income tax payable ending balance (\$4,800); therefore, X = \$1,400 income tax paid in cash during year

³Equipment beginning balance (\$32,000) + purchase (X) – sale (\$8,000) = equipment ending balance (\$57,000); therefore, X = \$33,000 purchase of equipment during year.

P 13–8 (LO4, LO5) Statement of Cash Flows (Indirect Method)

1.

Bankhead, Inc.
Statement of Cash Flows
(Indirect Method)
For the Year Ended December 31, 2018
(Dollars in Thousands)

Cash flows from operating activities:

Income before income tax	\$424
Add (deduct) adjustments to cash basis:	
Depreciation	34
Increase in accounts receivable	(16)
Decrease in Inventory	1,470
Decrease in accounts payable	(392)
Income tax paid	<u>(106)</u>
Net cash flows provided by operating activities	\$1,414

Cash flows from investing activities:

Cash payment to purchase land	\$ (300)
Net cash flows used in investing activities.....	(300)

Cash flows from financing activities:

Cash payments to reduce short-term borrowing .	\$ (322)
Cash payments to reduce long-term borrowing...	(400)
Cash payments for dividends	<u>(50)</u>
Net cash flows used in financing activities	(772)
Net increase in cash and cash equivalents.....	\$ 342
Cash and cash equivalents at beginning of year.....	1,224
Cash and cash equivalents at end of year	<u>\$1,566</u>

2. Net cash flows from operations is significantly higher than reported net income primarily because Bankhead has sold inventory this period that it has not replaced. Inventory levels are down significantly, which has generated large amounts of cash. Bankhead will have to use some of that cash to purchase more inventories in the future if it is to maintain the same level of sales.

P 13–9 (LO4, LO5, LO6) Unifying Concepts: Analysis of Operating, Investing, and Financing Activities

1. Cash flows from operating activities:

Income before income tax	\$104,000
Add (deduct) adjustments to cash basis:	
Depreciation	13,600
Increase in accounts receivable	(1,400)
Increase in Inventory	(18,000)
Decrease in accounts payable	(4,400)
Decrease in wages payable	(3,800)
Income tax paid in cash	<u>(27,400)¹</u>
Net cash flows provided by operating activities ..	<u>\$ 62,600</u>

Cash flows from investing activities:

Cash used to purchase property, plant, and equipment (increase in property, plant, and equipment account)	<u>\$ (97,000)</u>
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Cash flows from financing activities:

Cash provided by borrowing (increase in notes payable account)	<u>\$ 20,000</u>
--	------------------

¹ Income tax	\$ 24,600
Income tax payable decrease	<u>2,800</u>
Cash paid for income tax	<u>\$ 27,400</u>

- 2.** Mile High Sporting Goods Company is not in as good a liquidity position as it was last year. Net cash flows provided by operations are less than accrual net income, and the end-of-year cash position is now negative, having decreased \$14,400 from the end of last year. This decrease is the result of the company opening a new store, which required significant cash flows to purchase additional equipment (\$97,000) and inventory (\$18,000). The company was able to use operations to fund part of the expansion but also had to increase its borrowing (\$20,000) and decrease its cash position.

As Mr. Beecher's banker, you might not want to lend more money just now, but if sales keep increasing and the company manages its expenses carefully, it is likely that the company will produce sufficient future cash flows to pay its obligations.

In the short run, Mile High needs some cash (collect receivables, delay payables, borrow, or have the owners put more money into the business). Otherwise, the company might not have a chance to be profitable in the long run.

ANALYTICAL ASSIGNMENTS

AA 13–1 Analyzing Cash Flow Patterns

Discussion

Abbott Company has gone from a company producing positive cash flows to one using up cash to operate the company. The negative cash flows from operations preceded the reporting of negative income by one year. This indicates that perhaps current non-cash operating assets such as Accounts Receivable were increasing and producing net income but not producing cash.

The positive financing cash flows mean that Abbott is either borrowing or selling stock to provide cash to run the business. Financing inflows can only continue so long. If the inflows are from debt, the source of debt will diminish. If the inflows are from stock, the decline in income will make the sale of stock less desirable.

The positive investing cash flows mean that the financing inflows are not being used to make additional investments. Instead, the investment assets are being liquidated to provide operating cash.

In summary, Abbott Company seems to be heading into difficult financial times. Cash is being obtained from whatever sources possible to meet operating needs. To completely analyze the company, Paula should obtain and review the balance sheets and the statement of comprehensive incomes. These statements can be used to determine the reasonableness of the assumptions made above. All three statements are useful for analyzing a company, as each statement provides information that can be used to examine the health of an organization.

AA 13–2 *You Decide: Which method is better at reporting information on the statement of cash flows—the indirect or direct method?*

Judgment Call

Issues to be discussed with this question are:

1. The indirect method is probably more common but often harder to understand.
2. The direct method doesn't allow for an easy reconciliation with the statement of comprehensive income as does the indirect method.
3. Both methods result in the same "cash provided by operations" number and so it really doesn't matter. Either method is fine.

AA 13–3 Philips

Real Company Analysis

1. Yes. Most companies present the cash flow categories in the order of operating, investing, and financing.
2. An increase in receivables from the beginning to the end of the year indicates that less cash was received from customers than was reported as sales on the statement of comprehensive income. Since the statement of cash flows begins with a statement of comprehensive income figure (income from continuing operations) that includes sales, that figure must be reduced—hence the subtraction.
3. In fiscal year 2015, Philips spent €1,941 million on various investing activities. Cash flows from operations were €1,167 million, which was more than sufficient to pay for these investments.
4. Philips paid cash dividends of €298 million to common stockholders during fiscal year 2015. In addition, Philips made some other large payments to common stockholders during the year. The total cash paid for treasury share transaction during the year was €506 million.

AA 13–4 Analyze Cash Flow Patterns for Four Taiwanese Companies

Real Company Analysis

PCSC fits the cash flow pattern #2-1. It earned net profit and had positive cash flows from operating activities, but the latter is greater than the former because of adding back a huge amount of depreciation expense. It had negative cash flows from investing activities due to capital expenditures, and it also had negative cash flows from financing activities due to a huge amount of cash dividends and repayment of debts.

Tatung fits the cash flow pattern #2-2. It earned net loss but had positive cash flows from operating activities because of a huge amount of depreciation expense. Tatung both had negative cash flow from investing activities and financing activities due to investment in financial assets and repayment of debts respectively.

Taiwan Mobile fits the cash flow pattern #4. It earned net profit and also had positive cash flows from operating activities, but the latter is greater than the former, primarily because of adding back depreciation expense. It had negative cash flows from investing activities due to capital expenditures and acquisition of concession license; however, it had positive cash flows from financing activities because the amount from borrowing new debts is greater than the amount of cash dividends paid to shareholders.

EXPANDED MATERIAL

DISCUSSION QUESTIONS

9. The process of converting from accrual revenues to cash receipts involves adjusting the beginning and ending receivable balances. We use Sales Revenue and Accounts Receivable to illustrate the process.

Sales revenue.....	\$100,000
+ Beginning accounts receivable.....	50,000
- Ending accounts receivable.....	<u>(40,000)</u>
= Cash received from customers.....	<u>\$110,000</u>

Alternatively, the decrease in the Accounts Receivable balance could be added to Sales Revenue to derive the \$110,000 cash received from customers.

10. The net cash flows provided by (used in) operating activities can be calculated by either the direct or the indirect method. The direct method reports all operating cash receipts and payments. The difference is the net cash flows from operations. The indirect method reconciles income before income tax, as reported on the statement of comprehensive income, with net cash flows from operations, as calculated on the cash flows statement. Thus, with the indirect method, accrual income before income tax is converted to a cash basis on the statement itself.

PRACTICE EXERCISES

PE 13–15 (LO7) Using Accounts Receivable to Compute Cash Collections

The company collected \$4,557 from its customers, as shown below.

Sales on account	\$5,526
Add: Beginning accounts receivable	1,512
Less: Ending accounts receivable	(1,481)
Collections on account	<u>\$5,557</u>

Another way to consider this problem is to make a T-account with the information provided and solve for the unknown, as shown below.

Accounts Receivable		
Beg. bal.	1,512	
Sales	5,526	Collections ??
End. bal.	1,481	

To reconcile the Accounts Receivable account, we can only assume that cash collections of \$5,557 occurred.

PE 13–16 (LO7) Using Inventory and Accounts Payable to Compute Cash Paid for Inventory

To solve this problem, consider the following four T-accounts:

Inventory	Accounts Payable	Cost of Goods Sold
3,610	3,076	37,343 ¹
37,215 ²	37,215 ²	
3,482	37,073 ³	3,218

Cash
37,073 ³

¹Cost of inventory sold during the period

²Inventory purchased during the period (solved for based on the beginning and ending Inventory balances and the cost of goods sold)

³Cash paid for inventory during the period (solved for based on the beginning and ending Accounts Payable balances and the inventory purchased during the period)

PE 13–16 (LO7) (Continued)

Alternatively, one can compute the amount of cash paid for inventory (\$37,073) by analyzing the change in the Inventory and Accounts Payable balances, as follows:

	<u>Income Statement</u>	<u>Adjustments</u>	<u>Cash Flows from Operations</u>
Cost of goods sold	\$ (37,343)	+128 (decrease in inventory) +142 (increase in accounts payable)	\$ (37,073)

PE 13–17 (LO7) Direct Method

Operating activities:

Collections from customers	\$ 33,100
Payments for inventory	\$ (21,410)
Payments for miscellaneous expenses	(4,640)
Payments for interest	(486)
Payments for taxes	<u>(455)</u>
Net cash flows from operating activities.....	<u>\$ 6,109</u>

EXERCISES

E 13–15 (LO7) Determining Cash Receipts and Payments

1. Cash collected from customers = **\$448,000**

Accounts Receivable			
Beg. bal.	33,000		
Sales	455,000	Cash collections	450,000
End. bal.	38,000		

2. Cash paid for wages and salaries = **\$103,000**

Wages and Salaries Payable			
		Beg. bal.	16,000
Cash payments	103,000	Wages and salaries exp.	100,000
		End. bal.	13,000

3. Cash paid for inventory purchases = **\$228,000**

Inventory			
Beg. bal.	27,000		
Net purchases	228,000	Cost of goods sold	225,000
End. bal.	30,000		

Accounts Payable			
		Beg. bal.	28,500
Cash payments	230,500	Net purchases	228,000
		End. bal.	26,000

4. Cash paid for income tax = **\$43,500**

Income Tax Payable			
		Beg. bal.	24,000
Cash payments	43,500	Income tax exp.	45,000
		End. bal.	25,500

E3-16(LO7) Cash Flows from Operations (Direct Method)**Cash flows from operating activities**

Cash receipts from Customers	£250,000*
Dividend revenue	15,000*
	£265,000*
Less cash payments:	
To suppliers	110,000
For salaries and wages.....	55,000
For operating expenses.....	30,000
For income taxes.....	12,000
For interest	10,000
Net cash provided by operating activities	217,000
	£48,000*

*£60,000 + £190,000

E 13–17 (LO7) Cash Flows from Operations (Direct Method)

Sales revenue	\$600,000
+ Beginning accounts receivable	45,000
– Ending accounts receivable	<u>(42,000)</u>
Total cash receipts	\$603,000
Cost of goods sold.....	
+ Ending inventory.....	38,000
– Beginning inventory	<u>(37,000)</u>
Purchases	\$411,000
+ Beginning accounts payable	17,000
– Ending accounts payable.....	<u>(20,000)</u>
Cash paid to suppliers for inventory	\$408,000
Wages expense	\$ 60,000
+ Beginning wages payable	11,000
– Ending wages payable	<u>(9,800)</u>
Cash paid to employees	61,200
Utilities expense (no adjustments required)	4,000
Rent expense (no adjustments required).....	41,300
Insurance expense	\$ 14,500
+ Ending prepaid insurance.....	1,600
– Beginning prepaid insurance.....	<u>(2,000)</u>
Cash paid for insurance	14,100

Chapter 13

Total cash payments		528,600
Net cash flows from operating activities.....		<u>\$ 74,400</u>

The following spreadsheet may be helpful in explaining the adjustments:

	Income Statement		Adjustments	Cash Flows from Operations
Sales revenue	\$ 600,000	3,000	Cash collected from customers	\$603,000
Cost of goods sold	-410,000	-1,000	Cash paid for inventory	-408,000
		3,000		
Wages expense	-60,000	-1,200	Cash paid for wages	-61,200
Utilities expense	-4,000	0	Cash paid for utilities	-4,000
Rent expense	-41,300	0	Cash paid for rent	-41,300
Insurance expense	-14,500	400	Cash paid for insurance	-14,100
Net income	\$ 70,200		Cash from operating activities	<u>\$ 74,400</u>

E 13–18(LO7) Cash Flows Provided by Operations (Direct Method)**Operating activities**

Cash receipts from:			
Custom-			
ers			\$ 613,000 ¹
Cash payments for:			
Inventory			\$ (411,400) ²
Operating expenses			(41,500)
Interest expense			<u>(2,500)³</u>
Net cash flows from operating activities.....			<u>(455,400)</u>
<u>\$ 157,600</u>			
¹Sales revenue.....			\$ 600,000
+ Beginning accounts receivable			48,000
– Ending accounts receivable			<u>(35,000)</u>
Cash collected from customers.....			<u>\$ 613,000</u>
²Cost of goods sold			\$ 400,000
+ Ending inventory.....			55,000
– Beginning inventory			<u>(47,000)</u>
Purchases.....			\$ 408,000
+ Beginning accounts payable			64,400
– Ending accounts payable.....			<u>(61,000)</u>
Cash paid for inventory.....			<u>\$ 411,400</u>
³Interest expense.....			\$ 3,500
+ Beginning interest payable			2,000
– Ending interest payable			<u>(3,000)</u>
Interest paid in cash			<u>\$ 2,500</u>

The following spreadsheet may be helpful in explaining the adjustments:

	Income Statement		Adjustments	Cash Flows from Operations
Sales revenue	\$600,000	13,000	Cash collected from customers	\$613,000
Cost of goods sold	–400,000	–8,000	Cash paid for inventory	–411,400
		–3,400		
Depreciation expense	–65,000	65,000	Cash paid for depreciation	0
Interest expense	–3,500	+ 1,000	Cash paid for interest	–2,500
			Cash paid for other expenses	
Other expenses	–41,500	0		–41,500
			Cash from operating activities	
Net income	\$ 90,000			\$157,600

E 13–19 (LO7) Statement of Cash Flows (Direct Method)

**Western
Company
Statement of Cash Flows
(Direct Method)
For the Year Ended December 31, 2018**

Operating activities:

Cash receipts from:	
Customers.....	\$ 831,000¹
Cash payments for:	
Inventory	(468,000)²
Operating expenses	(225,000)³
Net cash flows from operating activities.....	\$ 138,000

Investing activities:

Cash payments for plant and equipment.....	\$ (120,000)⁴
Net cash flows from investing activities	(120,000)

Financing activities:

Cash payments for dividends	\$ (42,000)
Cash receipts from issuance of capital stock	15,000
Net cash flows from financing activities	(27,000)
Net decrease in cash and cash equivalents	\$ (9,000)
Cash and cash equivalents at beginning of period.....	18,000
Cash and cash equivalents at end of period	<u>\$ 9,000</u>

Computations:

¹Sales of \$825,000 plus beginning Accounts Receivable (\$72,000) minus ending Accounts Receivable (\$66,000) = \$831,000 cash collected from customers.

²Cost of goods sold of \$450,000 plus ending inventory (\$150,000) minus beginning inventory (\$120,000) plus beginning accounts payable (\$108,000) minus ending accounts payable (\$120,000) = (\$468,000) cash paid for inventory.

³Operating expenses (\$270,000) less depreciation (\$45,000) = (\$225,000) cash payments for operating expenses.

⁴Increase in plant and equipment (\$75,000) plus depreciation (\$45,000) = (\$120,000) cash paid for plant and equipment.

E 13–19 (LO7) (Continued)

The following spreadsheet may be helpful in explaining the adjustments:

	Income Statement		Adjustments	Cash Flows from Operations
Sales revenue	\$825,000	6,000	Cash collected from customers	\$831,000
Cost of goods sold	–450,000	–30,000	Cash paid for inventory	–468,000
		12,000		
Depreciation expense	–45,000	20,500	Cash paid for depreciation	0
Other expenses	–270,000	0	Cash paid for other expenses	–270,000
Net income	<u>\$ 105,00</u> 0		Cash from operating activities	<u>\$ 93,000</u>

PROBLEMS

P 13–10 (LO7) Transaction Analysis

1.	Sales revenue	\$ 130,750
	Increase in accounts receivable	(5,000)
	Cash collected from customers	<u><u>\$125,750</u></u>
2.	Cost of goods sold.....	\$ 83,000
	+ Ending inventory.....	<u>15,000</u>
	Goods available for sale	\$ 98,000
	- Beginning inventory.....	(20,000)
	Purchases for period	\$ 78,000
	- Increase in accounts payable	(2,500)
	Cash paid for inventory	<u><u>\$ 75,500</u></u>
3.	Operating expenses	\$ 24,000
	- Depreciation (non-cash expense).....	(7,500)
	Cash paid for operating expenses.....	<u><u>\$ 16,500</u></u>
4.	Operating activities:	
	Cash collected from customers.....	\$125,750
	Cash received from interest.....	1,100
	Cash paid for inventory.....	(75,500)
	Cash paid for operating expenses	(16,500)
	Cash paid for interest.....	(2,900)
	Cash paid for income taxes	(6,500)
	Cash flows provided by operations.....	<u><u>\$ 25,450</u></u>
5.	Cash flows used in investing and financing activities = <u><u>\$22,950*</u></u>	

*Cash flows provided by operations (\$25,450) less increase in cash during the period (\$2,500) = cash flows used in investing and financing activities (\$22,950).

P 13-11 (LO7) Cash Flows from Operations (Direct Method)

Titanic Company
Partial Statement of Cash Flows
For the Year Ended December 31, 2018

Cash flows from operating activities

Cash receipts from customers.....	£610,000 (1)
Less cash payments:	
For operating expenses	£415,000 (2)
For income taxes.....	<u>23,000</u> (3) <u>438,000</u>
Net cash provided by operating activities.....	<u>£172,000</u>

(1) Computation of cash receipts from customers

Service revenue.....	£600,000
Add: Decrease in accounts receivable	
($£60,000 - £70,000$)	<u>10,000</u>
Cash receipts from customers.....	<u>£610,000</u>

(2) Computation of cash payments for operating expenses

Operating expenses	£400,000
Add: Decrease in accounts payable (£30,000 –	
£45,000)	<u>15,000</u>

Cash payments for operating expenses

£415,000

(3) Income tax expense £ 30,000

Deduct: Increase in income taxes payable	
($£15,000 - £8,000$)	<u>7,000</u>
Cash payments for income taxes	<u>£ 23,000</u>

P 13–12 (LO7) Cash Flows from Operations (Direct Method)

1.	Sales revenue	\$ 743,000
	+ Beginning accounts receivable	66,000
	- Ending accounts receivable	<u>(77,000)</u>
	Cash collected from customers.....	\$732,000
	 Interest revenue	 \$ 24,000
	+ Beginning interest receivable.....	12,000
	- Ending interest receivable	<u>(9,000)</u>
	Cash collected from interest.....	27,000
	Total cash receipts from operations	\$759,000
	 Cost of goods sold.....	 \$ 383,000
	+ Ending inventory.....	222,000
	- Beginning inventory	<u>(213,000)</u>
	Purchases	\$ 392,000
	+ Beginning accounts payable	44,000
	- Ending accounts payable.....	<u>(47,000)</u>
	Cash paid for inventory	\$389,000
	 Wages expense	 \$ 190,000
	+ Beginning wages payable	35,000
	- Ending wages payable	<u>(37,000)</u>
	Cash paid for wages	188,000
	 Cash paid for other operating expenses.....	 71,000
	Total cash payments for operations	\$648,000
	Net cash flows provided by operating activities	\$111,000

- 2.** The \$111,000 net cash flows from operations differs from the \$81,000 net income ($\$743,000 + \$24,000 - \$383,000 - \$190,000 - \$42,000 - \$71,000 = \$81,000$) because depreciation (a non-cash item) must be added back to net income and because net income must be adjusted from an accrual basis to a cash basis, as shown in part (1). Note that dividends do not enter into the computation of either amount; they are a financing activity.

P 13–13 (LO7) Cash Flows from Operations (Direct Methods)**Direct method:**

Cash collected from customers.....	\$111,300
Cash paid for inventory	(61,400)
Cash paid for S & A expenses	(20,350)
Cash paid for interest expense	(5,950)
Cash paid for income tax.....	(9,060)
Cash from operating activities.....	\$ 14,540

P 13–14 (LO7) Computation of Net Income from Cash Flows from Operations (Direct Method)

ATM Corporation
Partial Work Sheet—Cash Flows from Operations
(Direct Method)
For the Year Ended December 31, 2018

	<u>Accrual Basis</u>	<u>Adjustments</u>		<u>Cash Basis</u>
		<u>Debits</u>	<u>Credits</u>	
Net sales revenue.....	<u>\$148,000</u>		<u>\$5,000¹</u>	<u>\$153,000</u>
Expenses:				
Cost of goods sold	\$ 66,000	\$15,000 ³	3,000 ⁴	\$ 78,000
Depreciation	10,000		10,000 ⁵	—
Loss on sale of equipment.....	2,000		12,000 ²	—
Other (cash) expenses	<u>29,500</u>		1,000 ⁶	
			2,500 ⁷	<u>26,000</u>
Total expenses.....	<u>\$107,500</u>			<u>\$104,000</u>
Net income	<u>\$ 40,500</u>		Net cash flows from operations....	<u>\$ 49,000</u>

Key:¹Accounts Receivable (net) decrease²Loss on sale of equipment³Inventory increase⁴Accounts Payable increase⁵Depreciation for the year⁶Prepaid Expenses decrease⁷Accrued Liabilities increase

P 13–15 (LO7) Statement of Comprehensive Income from Cash Flow Data

Picnic Corporation
Statement of Comprehensive Income
For the Year 2018

Revenues	\$523,400 ¹
Cost of goods sold.....	<u>165,600²</u>
Gross margin.....	<u>\$357,800</u>
Operating expenses.....	\$202,700 ³
Depreciation	<u>62,100⁴</u>
Total operating expenses	<u>264,800</u>
Operating income.....	<u>\$ 93,000</u>
Gain on sale of equipment	<u>4,000⁵</u>
Net income.....	<u><u>\$ 97,000</u></u>

Computations:

¹Cash collections from customers (\$527,000) adjusted for decrease in Accounts Receivable (\$3,600) equals accrual revenue amount (\$523,400) for the period.

²Cash payments to suppliers (\$170,000) adjusted for decrease in Accounts Payable (\$6,800) equals purchases; purchases adjusted for decrease in Inventory (\$2,400) equals cost of goods sold (\$165,600).

³Cash payments for operating expenses (\$198,000) adjusted for increase in Miscellaneous Accrued Payable (\$4,700) equals operating expenses (\$202,700).

⁴Depreciation is a valid expense on the statement of comprehensive income.

⁵The gain on sale of equipment should be reported on the statement of comprehensive income.

P 13–16 (LO7) Statement of Cash Flows (Direct Method)**1.**

Bankhead, Inc.
Statement of Cash Flows
(Direct Method)
For the Year Ended December 31, 2018
(Dollars in Thousands)

Cash flows from operating activities:**Cash receipts from:**

Customers	\$2,884
Cash payments for:	
Inventory.....	(982)
Sales and administrative expenses.....	(220)
Other cash expenses.....	(162)
Income taxes	<u>(106)</u>
Net cash flows provided by operating activities	\$1,414

Cash flows from investing activities:

Cash payment to purchase land.....	\$ (300)
Net cash flows used in investing activities	(300)

Cash flows from financing activities:

Cash payments to reduce short-term borrowing .	\$ (322)
Cash payments to reduce long-term borrowing ..	(400)
Cash payments for dividends.....	<u>(50)</u>
Net cash flows used in financing activities	(772)
Net increase in cash and cash equivalents	\$ 342
Cash and cash equivalents at beginning of year	1,224
Cash and cash equivalents at end of year.....	\$ 1,56
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2. The main difference is the presentation of cash flows from operating activities. Using the direct method, the operating activities section of a statement of cash-flows is, in effect, a cash-basis statement of comprehensive income. Unlike the indirect method, the direct method does not start with net income. Instead, this method directly reports the major classes of operating cash receipts and payments of an entity during a period.