

LO 6 Use information from the statement of cash flows to make decisions.

- A statement of cash flows helps investors and creditors observe trends related to a company's use of operating income and its use of external sources of capital.
- Used with the statement of comprehensive income and the balance sheet, the statement of cash flows is a valuable source of information.

EXPANDED MATERIAL**LO 7 Analyze financial statements to prepare the operating activities in a statement of cash flows using the direct approach.**

- Use a work sheet to adjust all the items in the statement of comprehensive income from accrual basis to cash basis.
- Eliminate expenses not involving cash and eliminate the effects of non-operating activities.
- Adjust the remaining figures from an accrual basis to a cash basis.

Key Terms & Concepts

- cash equivalents, 559
- direct method, 568
- financing activities, 560
- indirect method, 569
- investing activities, 560
- non-cash transactions, 561
- operating activities, 559
- statement of cash flows, 558

Review Problems**Classifying Cash Flows**

Anna Dimetros is the bookkeeper for Duke, Inc., a London-based company. Anna has collected the following cash flow information about Duke for the most current year of operations. The cash balance at the beginning of the year was £105,000.

Cash receipts:

Cash received from issuance of stock	£ 50,000
Cash received from customers	252,300
Cash received from interest at bank	4,600
Cash received from borrowing at bank	25,000
Total cash receipts	<u>£331,900</u>

Cash payments:

Cash paid for wages of employees	£134,600
Cash paid to stockholders as dividends	5,500
Cash paid to bank for interest	7,200
Cash paid to bank to repay earlier loan	10,000
Cash paid for income tax	23,500
Cash paid for operating expenses	128,100
Cash paid for equipment	15,000
Total cash payments	<u>£323,900</u>

Required:

1. From the information provided, classify the cash flows for Duke according to operating, investing, and financing activities.
2. Determine the ending cash balance.

Solution:

1. Cash flows from operating activities		
Cash receipts from:		
Customers	£252,300	
Bank (interest)	<u>4,600</u>	£256,900
Cash payments to:		
Employees (wages)	£(134,600)	
Bank (interest)	<u>(7,200)</u>	
Government (income tax)	<u>(23,500)</u>	
Various entities (operating expenses).	<u>(128,100)</u>	<u>(293,400)</u>
Net cash flows from operating activities		£ (36,500)
Cash flows from investing activities		
Cash payments to:		
Purchase equipment		
Net cash flows from investing activities	<u>£ (15,000)</u>	<u>(15,000)</u>
Cash flows from financing activities		
Cash receipts from:		
Issuance of stock	£ 50,000	
Borrowing at bank	<u>25,000</u>	£ 75,000
Cash payments to:		
Stockholders (dividends).	£ (5,500)	
Repay earlier loan	<u>(10,000)</u>	<u>(15,500)</u>
Net cash flows from financing activities		<u>59,500</u>
Total net cash flows for period		<u>£ 8,000</u>
2. Beginning cash balance		
Total net cash flows for period		<u>8,000</u>
Ending cash balance		<u>£113,000*</u>

*Alternatively, beginning balance (£105,000) + receipts (£331,900) – payments (£323,900) = ending balance (£113,000).

Preparing a Statement of Cash Flows

Snow Corporation produces MP3 players. Comparative statements of comprehensive income (ignore other comprehensive income) and balance sheets for the years ended December 31, 2018 and 2017, are presented.

Snow Corporation Comparative Statements of Comprehensive Income For the Years Ended December 31, 2018 and 2017		
	2018	2017
Net sales revenue	€600,000	€575,000
Cost of goods sold	<u>500,000</u>	<u>460,000</u>
Gross margin	€100,000	€115,000
Operating expenses	<u>66,000</u>	<u>60,000</u>
Operating income	€ 34,000	€ 55,000
Interest expense	<u>4,000</u>	<u>3,000</u>
Income before income tax	€ 30,000	€ 52,000
Income tax	<u>12,000</u>	<u>21,000</u>
Net income	<u>€ 18,000</u>	<u>€ 31,000</u>

Snow Corporation Comparative Balance Sheets December 31, 2018 and 2017		
	2018	2017
Assets		
Current assets:		
Cash and cash equivalents	€ 11,000	€ 13,000
Accounts receivable (net)	92,000	77,000
Inventory	103,000	92,000
Prepaid expenses	6,000	5,000
Total current assets	<u>€212,000</u>	<u>€187,000</u>
Property, plant, and equipment:		
Land	€ 69,000	€ 66,000
Machinery and equipment	172,000	156,000
Accumulated depreciation, machinery and equipment	(113,000)	(102,000)
Total property, plant, and equipment	<u>€128,000</u>	<u>€120,000</u>
Total assets	<u>€340,000</u>	<u>€307,000</u>
Liabilities and Equity		
Current liabilities:		
Accounts payable	€ 66,000	€ 78,000
Dividends payable	2,000	0
Income tax payable	3,000	5,000
Total current liabilities	<u>€ 71,000</u>	<u>€ 83,000</u>
Long-term debt	75,000	42,000
Total liabilities	<u>€146,000</u>	<u>€125,000</u>
Equity:		
Common stock, no par	€ 26,000	€ 26,000
Retained earnings	168,000	156,000
Total equity	<u>€194,000</u>	<u>€182,000</u>
Total liabilities and equity	<u>€340,000</u>	<u>€307,000</u>

The following additional information is available.

- Dividends declared during 2018 were €6,000.
- The market price per share of stock on December 31, 2018, was €14.50.
- Equipment worth €16,000 was acquired by the issuance of a long-term note (€10,000) and by paying cash (€6,000).
- Land was acquired for €3,000 cash.
- Depreciation of €11,000 was included in operating expenses for 2018.
- There were no accruals or prepaid amounts for interest.

Required:

Analyze the data provided to prepare a statement of cash flows. Use the indirect method to report cash flows from operating activities.

Solution:

Snow Corporation Statement of Cash Flows (Indirect Method) For the Year Ended December 31, 2018		
Operating activities		
Income before income tax	€ 30,000	
Add (deduct) adjustments to cash basis:		
Interest expense	4,000	
Depreciation expense	11,000	
Increase in accounts receivable	(15,000)	
Increase in inventory	(11,000)	
Increase in prepaid expenses	(1,000)	
Decrease in accounts payable	(12,000)	
Interest paid	(4,000)	
Income tax paid in cash	<u>(14,000)</u>	
Net cash flows from operating activities		€(12,000)
Investing activities		
Purchased land	€ (3,000)	
Purchased machinery and equipment	<u>(6,000)</u>	
Net cash flows from investing activities		(9,000)
Financing activities		
Borrowing of long-term debt	€ 23,000	
Payments for cash dividends	<u>(4,000)*</u>	
Net cash flows from financing activities		<u>19,000</u>
Net decrease in cash		€ (2,000)
Beginning cash balance		<u>13,000</u>
Ending cash balance		<u><u>€ 11,000</u></u>
*Cash dividends declared (€6,000) less increase in dividends payable (€2,000)		

Note:

Non-cash transaction:

Equipment was purchased by issuing a long-term note for €10,000.

The statement of cash flows for Snow Corporation shows that although reported net income was positive for 2018, the net cash flows generated from operating activities were negative. Only by borrowing cash was Snow Corporation able to pay dividends and purchase land and equipment. Even then, the cash account decreased by €2,000 during the period.

Put it on Paper**DISCUSSION QUESTIONS**

1. What is the main purpose of a statement of cash flows?
2. What are cash equivalents, and how are they treated on a statement of cash flows?
3. Distinguish among cash flows from operating, investing, and financing activities, providing examples for each type of activity.
4. How are significant non-cash investing and financing transactions to be reported?
5. Describe the six-step process that can be used to prepare a statement of cash flows by analyzing the statement of comprehensive income and comparative balance sheets.
6. How are depreciation and similar non-cash items treated on a statement of cash flows?
7. What supplemental disclosures are likely to be required in connection with a statement of cash flows?
8. How might investors and creditors use a statement of cash flows?

PRACTICE EXERCISES**PE 13-1****LO 2****Categories of Cash Inflows and Outflows**

Which one of the following is *not* one of the three main sections in the statement of cash flows for a company?

- a. Earning activities
- b. Financing activities
- c. Operating activities
- d. Investing activities

PE 13-2**LO 2****Identifying Operating Activities**

Which one of the following is an example of an operating activity?

- a. Cash payments to repay principal amounts borrowed
- b. Cash payments to suppliers for inventory purchases
- c. Cash receipts from sale of a business segment
- d. Cash receipts from issuance of own stock

PE 13-3**LO 2****Identifying Investing Activities**

Which one of the following is an example of an investing activity?

- a. Cash payments to lenders for interest expense
- b. Cash receipts from borrowing notes
- c. Cash receipts from sale of goods or services
- d. Cash payments to purchase property, plant, and equipment

PE 13-4**LO 2****Identifying Financing Activities**

Which one of the following is an example of a financing activity?

- a. Cash payments to purchase debt or equity securities of other entities (other than trading securities)
- b. Cash payments to stockholders as dividend
- c. Cash receipts from dividend revenue
- d. Cash receipts from collection of principal on loans made to other entities

PE 13-5

LO 3

Computing Net Change in Cash for the Period

Beehive Company had a beginning cash balance of \$3,000. In addition, the company reported the following amounts of cash provided by (used in) each category of the statement of cash flows:

Operating activities	\$ 30,700
Investing activities	(32,100)
Financing activities	3,000

Using the above information, compute the company's ending cash balance.

PE 13-6

LO 3

Computation of Cash from Operating Activities

Using the following information, compute the amount of cash provided by operating activities.

Payments for miscellaneous expenses	\$1,131
Payment to stockholders as dividends	450
Payment for income tax	235
Payment for interest	143
Collections on account	4,686
Payments for inventory	2,974

PE 13-7

LO 3

Solving for Cash from Investing Activities

Using the following information, compute the amount of cash provided by (used in) investing activities:

Cash from operating activities	\$200,000
Cash from financing activities	150,000
Beginning cash balance	26,000
Ending cash balance	29,000

PE 13-8

LO 4

Identifying Non-cash Flow Items and Non-operating Activity Items

Using the following statement of comprehensive income accounts, identify the items that are non-cash items and/or should not be included in the operating activities section of the statement of cash flows. (These items will be added to or subtracted from income before income tax to compute cash flow from operating activities.)

Sales revenues	\$ 31,000
Gain on sale of land	900
Cost of goods sold	(21,000)
General and administrative expenses	(3,500)
Depreciation expense	(2,250)
Interest expense	(850)
Income tax expense	(2,000)

PE 13-9

LO 4

Using Income Tax Payable to Compute Cash Paid for Income Tax

Using the following information, compute cash paid for income tax.

Income tax expense	\$7,000
Income tax payable, beginning balance	1,500
Income tax payable, ending balance	1,700

PE 13-10**LO 4****Indirect Method**

Using the following information, prepare the operating activities section of the statement of cash flows using the indirect method.

	Statement of Comprehensive Income		Adjustments	Cash Flows from Operations
Sales	\$ 33,440	–340	(increase in accounts receivable)	\$ 33,100
Cost of goods sold	(21,452)	–103	(increase in inventory)	(21,410)
		+145	(increase in accounts payable)	
Miscellaneous expenses	(4,770)	+130	(decrease in prepaid expenses)	(4,640)
Depreciation expense	(4,603)	+4,603	(not a cash flow item)	0
Interest expense	(462)	–24	(decrease in interest payable)	(486)
Loss on sale of land	(1,130)	+1,130	(not an operating activity)	0
Income tax expense	(469)	+14	(increase in income tax payable)	(455)
Net income	<u>\$ 554</u>	<u>+5,555</u>	Net adjustment	<u>\$ 6,109</u>

PE 13-11**LO 5****Computing Cash Paid for Property, Plant, and Equipment**

Lora Company reported the following information related to its long-term assets:

Property, plant, and equipment, beginning balance	\$235,000
Property, plant, and equipment, ending balance	265,000
Accumulated depreciation, beginning balance	86,000
Accumulated depreciation, ending balance	84,000
Depreciation expense	14,500

In addition, the company disclosed that it sold equipment with a historical cost of \$30,000 for \$26,000. Using this information, compute cash paid for property, plant, and equipment.

PE 13-12**LO 5****Computing Gain on Sale of Property, Plant, and Equipment**

Refer to the data in PE 13-11. Compute the gain on the sale of equipment.

PE 13-13**LO 5****Computing Cash from Financing Activities**

Using the following information, compute the amount of cash from financing activities:

1. Arthur Company purchased \$15,000 of its own common stock to be held in the treasury.
2. Arthur paid cash dividends of \$5,350 to its stockholders.
3. Arthur repaid \$28,000 of long-term debt.

PE 13-14**LO 6****Using Information from the Statement of Cash Flows to Make Decisions**

Using the following information about McAuliffe Company, decide whether you would want to loan money to the company.

	2016	2017	2018
Net income	\$ 2,045	\$ 1,295	\$ 2,540
Cash provided by (used in) operating activities	121	(2,223)	(7,000)
Cash provided by (used in) investing activities	(6,000)	(1,450)	(2,303)
Cash provided by (used in) financing activities	3,710	5,500	9,200

EXERCISES

E 13-1

LO 2

Classification of Cash Flows

Indicate whether each of the following items would be associated with a cash inflow (I), cash outflow (O), or non-cash item (N) and under which category each would be reported on a statement of cash flows: operating activities (OA); investing activities (IA); financing activities (FA); or not on the statement (NOS). An example is provided.

Item	Classified as	Reported under
Example: Sales Revenue	I	OA
1. Fees collected for services		
2. Interest paid		
3. Proceeds from sale of equipment		
4. Cash (principal) received from bank on long-term note		
5. Purchase of treasury stock for cash		
6. Collection of loan made to company officer		
7. Cash dividends paid		
8. Income tax paid		
9. Depreciation expense		
10. Wages paid to employees		
11. Cash paid for inventory purchases		
12. Proceeds from sale of common stock		
13. Interest received on loan to company officer		
14. Purchase of land by issuing stock		
15. Utility bill paid		

E 13-2

LO 2

Classification of Cash Flows

The following items summarize certain transactions that occurred during the past year for Alta Inc. Show in which section of the statement of cash flows the information would be reported by placing an X in the appropriate column. (Assume that the direct method is used to report operating cash flows.)

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

E 13-3

LO 3

Transaction Analysis

The Vicky Company had the following selected transactions during the past year:

- Sold (issued) 1,000 shares of common stock, \$15 par, for \$55 per share.
- Collected \$220,000 of accounts receivable.

- c. Paid dividends to current stockholders in the amount of \$75,000 (assume dividends were declared earlier, establishing a dividends payable account).
- d. Received \$5,000 interest on a note receivable from a company officer.
- e. Paid the current year's insurance Expense (or Prepaid Insurance) of \$3,500.
- f. Recorded depreciation expense of \$7,000.

Complete the following:

1. Prepare appropriate journal entries for each of the above transactions. (Omit explanations.)
2. For each transaction, indicate the amount of cash inflow or outflow and also how each cash flow would be classified on a statement of cash flows.

E 13-4**Transaction Analysis****LO 3**

Following are the transactions of Donald Company:

- a. Sold equipment for \$10,700. The original cost was \$30,000; the carrying amount is \$10,000.
- b. Purchased equipment costing \$80,000 by paying cash of \$50,000 and signing a \$30,000 long-term note with 10% interest.
- c. Received \$11,200 of the principal and \$950 in interest on a long-term note receivable.
- d. Received \$8,600 in cash dividends on stock held as a trading security.
- e. Purchased treasury stock for \$4,000.

Complete the following:

1. Prepare journal entries for each of the transactions. (Omit explanations.)
2. For each transaction, indicate the amount of cash inflow or outflow. Then, note how each transaction would be classified on a statement of cash flows.

E 13-5**Computing Cash Provided by Operating Activities (Direct Method)****LO 3**

Rena Company completed its first year of operations on December 31, 2018. Its initial statement of comprehensive income showed that Rena had revenues of \$390,000 and operating expenses of \$156,000. Accounts receivable and accounts payable at year-end were \$96,000 and \$50,000, respectively. Assume that accounts payable is related to operating expenses. (Ignore income taxes.)

Compute net cash provided by operating activities using the direct method.

E 13-6**Computing Cash Payments (Direct Method)****LO 3**

Suppose a recent statement of comprehensive income for Smart Burger Corporation shows cost of goods sold \$2,263.9 million and operating expenses (including depreciation expense of \$560 million) \$5,258.8 million. The comparative balance sheets for the year show that inventory increased \$8.55 million, prepaid expenses increased \$32.65 million, accounts payable (merchandise suppliers) increased \$69.8 million, and accrued expenses payable increased \$95.3 million.

Using the direct method, compute (a) cash payments to suppliers and (b) cash payments for operating expenses.

E 13-7**Preparing a Simple Cash Flow Statement****LO 3**

Assume you have access to the ledger (specifically, the detail of the cash account) for Smith Company, represented by the following T-account:

Cash			
Beg. bal.	29,870	(2)	60,000
(1)	146,000	(3)	63,000
(4)	4,750	(5)	5,000
(6)	45,300	(7)	11,500
(8)	17,200	(9)	25,000
End. bal.	78,620		

The transactions that are represented by posting entries (1) through (9) in the cash account are as follows:

1. Collections on account
2. Payments for wages and salaries

3. Payments for inventory
4. Proceeds from sale of equipment
5. Payments of dividends
6. Proceeds from new bank loan
7. Payments for other cash operating expenses
8. Proceeds from sale of amortized cost securities
9. Payments for income tax

From these data, prepare a statement of cash flows for Smith for the year ended December 31, 2018.

E 13-8**Net Cash Flows (Direct Method)****LO 2****LO 3**

Based on the following information, determine the net increase (decrease) in cash for Luke Corp. for the year ended December 31, 2018. Use the direct method to report cash flows from operating activities. Assume that interest received and dividends paid are classified as operating and financing cash flows, respectively.

Cash received from interest revenue	\$ 30,000
Cash paid for dividends	85,000
Cash collected from customers	805,000
Cash paid for wages	555,000
Depreciation expense for the period	110,000
Cash received from issuance of common stock	355,000
Cash paid for retirement of bonds at par	205,000
Cash received on sale of equipment at carrying amount	45,000
Cash paid for land	215,000

E 13-9**Adjustments to Cash Flows from Operations (Indirect Method)****LO 4**

Assume that you are using the indirect method of preparing a statement of cash flows. For each of the changes listed, indicate whether it would be added to or subtracted from income before income tax in computing net cash flows provided by (used in) operating activities. If the change does not affect net cash flows provided by (used in) operating activities, so indicate.

1. Increase in accounts receivable (net)
2. Decrease in accounts payable
3. Increase in securities classified as cash equivalents
4. Gain on sale of equipment
5. Decrease in inventory
6. Increase in prepaid insurance
7. Depreciation
8. Increase in wages payable

E 13-10**Cash Flows from Operations (Indirect Method)****LO 4**

Neil Brown is the proprietor of a small company. The results of operations for last year are shown, along with selected balance sheet data. From the information provided, determine the amount of net cash flows provided from operations using the indirect method. Assume that there is no income tax incurred.

Sales revenue	\$600,000	
Cost of goods sold	<u>410,000</u>	
Gross margin		\$190,000
Operating expenses:		
Wages expense	\$ 60,000	
Utilities expense	4,000	
Rent expense	41,300	
Insurance expense	<u>14,500</u>	<u>119,800</u>
Net income		<u>\$ 70,200</u>

	Beginning of Year	End of Year
Accounts receivable (net)	\$45,000	\$42,000
Inventory	37,000	38,000
Prepaid insurance	2,000	1,600
Accounts payable	17,000	20,000
Wages payable	11,000	9,800

E 13-11**LO 4****Cash Flows Provided by Operations (Indirect Method)**

The following information was taken from the comparative financial statements of Imperial Corporation for the years ended December 31, 2017 and 2018. Assume that there is no income tax incurred. If the item has alternative classification, **do not** classify it as operating cash flows.

Sales revenue	\$600,000	
Cost of goods sold	<u>400,000</u>	
Gross margin		\$200,000
Operating expenses:		
Depreciation expense	\$65,000	
Other operating expense	<u>41,500*</u>	(106,500)
Operating income		93,500
Non-operating losses:		
Interest expense		(3,500)
Net income		<u>\$90,000</u>
*All paid in cash		

	Dec. 31, 2018	Dec. 31, 2017
Accounts receivable (net)	\$35,000	\$48,000
Inventory	55,000	47,000
Accounts payable	61,000	64,400
Interests payable	3,000	2,000

Use the indirect method to compute cash flows provided by operating activities in 2018.

E 13-12**LO 4****LO 5****Net Cash Flows (Indirect Method)**

Given the following selected data for Micky Corporation and using the indirect method to report cash flows from operating activities, determine the net increase (decrease) in cash for the year ended December 31, 2018. Assume that there is no income tax incurred. If the item has alternative classification, **do not** classify it as operating cash flows.

Net income	\$ 96,000
Increase in accounts receivable (net)	11,000
Decrease in accounts payable	6,000
Decrease in inventory	4,000
Increase in prepaid assets	8,000
Increase in wages payable	16,000
Increase in bonds payable	101,000
Dividends declared and paid	41,000
Decrease in dividends payable	3,000
Increase in equipment	21,000
Increase in accumulated depreciation	6,000
Additional information:	
Disposed of equipment with historical cost \$20,000 and with no carrying amount.	

E 13-13

LO 4

LO 5

Statement of Cash Flows (Indirect Method)

Western Company provides the following financial information. Prepare a statement of cash flows for 2018, using the indirect method to report cash flows from operating activities.

Western Company Comparative Balance Sheets December 31, 2018 and 2017		
	2018	2017
Assets		
Cash and cash equivalents.	\$ 9,000	\$ 18,000
Accounts receivable (net).	66,000	72,000
Inventory	150,000	120,000
Plant and equipment (net).	525,000	450,000
Total assets	<u>\$750,000</u>	<u>\$660,000</u>
Liabilities and Equity		
Accounts payable.	\$120,000	\$108,000
Capital stock.	450,000	435,000
Retained earnings	180,000	117,000
Total liabilities and equity	<u>\$750,000</u>	<u>\$660,000</u>

Western Company Statement of Comprehensive Income For the Year Ended December 31, 2018	
Sales	\$825,000
Cost of goods sold	450,000
Gross margin	<u>\$375,000</u>
Operating expenses.	270,000
Net income.	<u>\$105,000</u>

Note: Dividends of \$42,000 were declared and paid during 2018. Depreciation expense for the year was \$45,000. There is no other comprehensive income.

E 13-14

LO 6

Cash Flow Patterns

Below are financial statement data for the following companies:

- Tesla Motors, Inc.
- Coca-Cola
- ExxonMobil
- Under Armour

Use the financial statement data to match each company with its numbers. All numbers are in millions.

	Net Income	Cash Flows from		
		Operating Activities	Investing Activities	Financing Activities
1	\$(282,267)	\$(249,605)	\$(233,819)	\$715,435
2	11,100	30,344	(23,824)	(7,037)
3	232,573	44,104	(847,475)	440,078
4	2,951	10,528	(6,186)	(5,113)

Consider the following information as you match the companies:

1. Start-ups have high positive financing cash flows relative to investing cash flows.
2. Companies with lots of property, plant, and equipment have cash from operations that is greater than net income because of lots of depreciation expense.
3. Older companies with good cash flow are spending money on investing but still have plenty left over for a net cash outflow from financing activities.

PROBLEMS

P 13-1

LO 3

LO 4

Analysis of the Cash Account

The following information, in T-account format, is provided for Jupiter Company for the year 2018. If the item has alternative classification, classify it as operating cash flows.

Cash Account			
Beg. Bal.	16,300	(b)	46,500
(a)	164,000	(c)	31,000
(d)	7,000	(f)	38,800
(e)	24,000	(g)	2,100
		(h)	2,300
End. Bal.	90,600		

Additional information:

- a. Sales revenue for the period was \$160,000. Accounts receivable (net) decreased \$4,000 during the period.
- b. Net purchases of \$49,000 were made during 2018, all on account. Accounts payable increased \$2,500 during the period.
- c. The equipment account increased by \$21,000 during the year.
- d. One piece of equipment that cost \$10,000, with a net carrying amount of \$6,000, was sold for a \$1,000 gain.
- e. The company borrowed \$24,000 from its bank during the year.
- f. Various operating expenses were all paid in cash, except for depreciation of \$2,400. Total operating expenses were \$41,200.
- g. Interest expense for the year was \$1,700. The interest payable account decreased by \$400 during the year.
- h. Income tax expense for the year was \$3,500. The income taxes payable account increased by \$1,200 during the year.

Required:

1. From the information given, reconstruct the journal entries that must have been made during the year (omit explanations).
2. Prepare a statement of cash flows for Jupiter Company for the year ended December 31, 2018.

P 13-2

LO 3

Analyzing Cash Flows

The following information was provided by the treasurer of Sandy, Inc., for the year 2018. If the item has alternative classification, **do not** classify it as operating cash flows.

- a. Cash sales for the year were \$45,000; sales on account totaled \$55,000.
- b. Cost of goods sold was 50% of total sales.
- c. All inventory is purchased on account.
- d. Depreciation on equipment was \$31,000 for the year.
- e. Amortization of intangible assets was \$2,000.
- f. Collections of accounts receivable were \$33,000.

- g. Payments on accounts payable for inventory equaled \$34,000.
- h. Rent expense paid in cash was \$11,000.
- i. The company issued 20,000 shares of \$10-par stock for \$240,000.
- j. Land valued at \$101,000 was acquired by issuance of a bond with a par value of \$100,000.
- k. Equipment was purchased for cash at a cost of \$80,000.
- l. Dividends of \$45,000 were declared but not yet paid.
- m. The company paid \$15,000 of dividends that had been declared the previous year.
- n. A machine used on the assembly line was sold for \$10,000. The machine had a carrying amount of \$7,000.
- o. Another machine with a carrying amount of \$500 was scrapped and was reported as an ordinary loss. No cash was received on this transaction.
- p. The cash account increased \$191,000 during the year to a total of \$274,000.

Required:

- 1. Compute the beginning balance in the cash account.
- 2. How much cash was provided by (or used in) operating activities?
- 3. How much cash was provided by (or used in) investing activities?
- 4. How much cash was provided by (or used in) financing activities?
- 5. Would all the above items, (a) through (p), be reported on a statement of cash flows? Explain.

P 13-3**LO 4****Cash Flows from Operations (Indirect Method)**

Gordon Enterprises reported a net loss of \$80,000 for the year just ended. Relevant data for the company follow. Assume that there is no income tax incurred. If the item has alternative classification, **do not** classify it as operating cash flows.

	Beginning of Year	End of Year
Cash and cash equivalents	\$100,000	\$ 40,000
Accounts receivable (net)	160,000	130,000
Inventory	246,000	260,000
Prepaid expenses	15,000	9,000
Accounts payable	110,000	120,000
Accrued liabilities	20,000	8,000
Dividends payable	50,000	70,000
Depreciation for the year, \$86,000		
Dividends declared, \$70,000		

Required:

- 1. Using the indirect method, determine the net cash flows provided by (used in) operating activities for Gordon Enterprises.
- 2. **Interpretive Question:** Explain how Gordon Enterprises can pay cash dividends during a year when it reports a net loss.

P 13-4**LO 4****Cash Flows from Operations (Indirect Method)**

The following combined comprehensive income and statement of retained earnings, along with selected balance sheet data, are provided for Liu Company. Assume that interest received and dividends paid are classified as operating and financing cash flows, respectively.

Liu Company
Combined Statement of Comprehensive Income and Statement of Retained Earnings
For the Year Ended December 31, 2018

Net sales revenue		\$110,000
Other revenues		8,000*
Total revenues		<u>\$118,000</u>
Expenses:		
Cost of goods sold	\$60,000	
Selling and administrative expenses	20,200	
Depreciation expense	10,400	
Interest expense	<u>6,200</u>	
Total expenses		96,800
Income before income tax		\$ 21,200
Income tax		<u>9,360</u>
Net income		\$ 11,840
Retained earnings, January 1, 2018		<u>33,500</u>
		\$ 45,340
Dividends declared and paid		<u>4,000</u>
Retained earnings, December 31, 2018		<u>\$ 41,340</u>
*Gain on sale of equipment (cost, \$15,000; carrying amount, \$2,000; sales price, \$10,000). There is no other comprehensive income.		

	Beginning of Year	End of Year
Accounts receivable (net)	\$14,300	\$13,000
Inventory	18,800	20,000
Prepaid expenses	2,950	3,100
Accounts payable	9,200	9,000
Interest payable	2,750	3,000
Income tax payable	4,200	4,500

Required:

Using the indirect method, compute the net cash flows from operations for Liu Company for 2018.

P 13-5**LO 5****Calculation of Cash Flow Effects Using Changes in Equity Accounts**

The following account balances relate to the equity accounts of Cindy Ltd. at year-end.

	2018	2017
Capital stock—ordinary, 12,000 and 11,000 shares, respectively, for 2018 and 2017 ...	£130,000	£110,000
Capital stock—preference, 15,000 shares	200,000	200,000
Retained earnings	450,000	400,000

A small share dividend was declared and issued in 2018. The market value of the shares was £10,000. Cash dividends were £20,000 in both 2018 and 2017. The ordinary shares have no par or stated value.

Required:

1. What was the amount of net income reported by Cindy Ltd. in 2018?
2. Determine the amounts of any cash inflows or outflows related to the ordinary shares and dividend accounts in 2018.
3. Indicate where each of the cash inflows or outflows identified in (2) would be classified on the statement of cash flows.

P 13-6

LO 5

Preparing the Operating Activities Section (Indirect Method)

The statement of comprehensive income for Titanic Company reported the following condensed information.

Titanic Company
Statement of Comprehensive Income (Partial)
For the Year Ended December 31, 2018

Service revenue	£600,000
Operating expenses	400,000
Income from operations	200,000
Income tax expense	30,000
Net income	<u>£170,000</u>

Titanic's balance sheet contained these comparative data at December 31.

	2018	2017
Accounts receivable	£60,000	£70,000
Accounts payable	30,000	45,000
Income taxes payable	15,000	8,000

Titanic has no depreciable assets but only operating expense records in accounts payable.

Required:

Prepare the operating activities section of the statement of cash flows using the indirect method.

P 13-7

LO 4

LO 5

Statement of Cash Flows (Indirect Method)

Jessie Company's comparative balance sheets for 2017 and 2018 are provided. If the item has alternative classification, **do not** classify it as operating cash flows.

Jessie Company
Comparative Balance Sheets
December 31, 2018 and 2017

	2018	2017
Assets		
Cash and cash equivalents	\$ 34,000	\$ 12,000
Accounts receivable (net)	66,500	53,000
Inventory	102,000	117,000
Equipment	57,000	32,000
Accumulated depreciation—equipment	(21,000)	(12,000)
Total assets	<u>\$238,500</u>	<u>\$202,000</u>
Liabilities and Equity		
Accounts payable	\$ 51,700	\$ 46,300
Income tax payable	4,800	3,700
Long-term notes payable	72,000	52,000
Capital stock	62,000	62,000
Retained earnings	48,000	38,000
Total liabilities and equity	<u>\$238,500</u>	<u>\$202,000</u>

The following additional information is available:

- Net income for the year 2018 (as reported on the statement of comprehensive income) was \$52,000, and the income tax expense was \$2,500.
- Dividends of \$42,000 were declared and paid.
- Equipment that cost \$8,000 and had a carrying amount of \$1,000 was sold during the year for \$2,500.

Required:

Based on the information provided, prepare a statement of cash flows for Jessie Company for the year ended December 31, 2018. Use the indirect method to report cash flows from operating activities.

P 13-8

LO 4

LO 5

Statement of Cash Flows (Indirect Method)

Financial statement data for Bankhead, Inc., are provided. (All numbers are shown rounded to the nearest thousand, with 000's omitted.)

If the item has alternative classification, **do not** classify it as operating cash flows.

Bankhead, Inc.
Statement of Comprehensive Income and Statement of Retained Earnings
For the Year Ended December 31, 2018

Sales revenue	\$2,900
Cost of goods sold	2,060
Gross margin	<u>\$ 840</u>
Operating expenses:	
Sales and administrative expenses	\$ 220
Depreciation expense	34
Other expenses	162
Total operating expenses	<u>\$ 416</u>
Income before income tax	<u>\$ 424</u>
Income tax	106
Net income	<u>\$ 318</u>
Dividends paid	50
Increase in retained earnings	<u>\$ 268</u>

Bankhead, Inc.
Comparative Balance Sheets
December 31, 2018 and 2017

	2018	2017
Assets		
Cash and cash equivalents	\$1,566	\$1,224
Accounts receivable (net)	912	896
Inventory	490	1,960
Land	2,900	2,600
Store fixtures	510	510
Accumulated depreciation, store fixtures	(144)	(110)
Total assets	<u>\$6,234</u>	<u>\$7,080</u>
Liabilities and Equity		
<i>Liabilities:</i>		
Accounts payable	\$ 340	\$ 732
Short-term notes payable	1,148	1,470
Long-term debt	1,648	2,048
Total liabilities	<u>\$3,136</u>	<u>\$4,250</u>
<i>Equity:</i>		
Common stock	\$290	\$290
Paid-in capital in excess of par	1,100	1,100
Retained earnings	1,708	1,440
Total equity	<u>\$3,098</u>	<u>\$2,830</u>
Total liabilities and equity	<u>\$6,234</u>	<u>\$7,080</u>

Required:

1. Prepare a statement of cash flows for Bankhead, Inc. for the year ended December 31, 2018.
2. **Interpretive Question:** Comment on the difference between net income and net cash flows from operations.

P 13-9

LO 4

LO 5

LO 6

Unifying Concepts: Analysis of Operating, Investing, and Financing Activities

Jonathan Beecher is the manager and one of three brothers who own the Mile High Sporting Goods Company in Denver, Colorado. Jonathan is pleased that sales were up last year and that his new, small company has been able to expand and open a second store in Denver. After reviewing the balance sheet, however, Jonathan is concerned that Cash shows a negative balance. He can't understand how his company can show net income, based on increased sales, yet have a negative Cash position. He is concerned about what his banker is going to say when they meet next month to discuss a loan for the company to expand to a third store. Jonathan provides the following financial information and asks for your help.

**Mile High Sporting Goods Company
Statement of Comprehensive Income
For the Year Ended December 31, 2018**

Sales		\$420,000
Less cost of goods sold		<u>192,000</u>
Gross margin		\$228,000
Operating expenses:		
Salary and wages	\$82,000	
Depreciation	13,600	
Other operating expenses	<u>28,400</u>	<u>124,000</u>
Income before income tax		\$104,000
Income tax		<u>24,600</u>
Net income		<u>\$ 79,400</u>

**Mile High Sporting Goods Company
Comparative Balance Sheets
As of December 31, 2018 and 2017**

	2018	2017
Assets		
<i>Current assets:</i>		
Cash	\$ (5,800)	\$ 8,600
Accounts receivable (net)	7,600	6,200
Inventory	120,000	102,000
Total current assets	<u>\$121,800</u>	<u>\$116,800</u>
<i>Other assets:</i>		
Property, plant, and equipment	\$189,600	\$92,600
Less accumulated depreciation	(38,400)	(24,800)
Total other assets	<u>\$151,200</u>	<u>\$ 67,800</u>
Total assets	<u>\$273,000</u>	<u>\$184,600</u>
Liabilities and Equity		
<i>Current liabilities:</i>		
Accounts payable	\$ 16,400	\$ 20,800
Wages payable	2,600	6,400
Income tax payable	2,000	4,800
Total current liabilities	<u>\$ 21,000</u>	<u>\$ 32,000</u>
<i>Other liabilities:</i>		
Notes payable	70,000	50,000
Total liabilities	<u>\$ 91,000</u>	<u>\$ 82,000</u>
<i>Equity:</i>		
Capital stock	\$ 80,000	\$ 80,000
Retained earnings	102,000	22,600
Total equity	<u>\$182,000</u>	<u>\$102,600</u>
Total liabilities and equity	<u>\$273,000</u>	<u>\$184,600</u>

Required:

- Using the indirect method, compute the net cash flows from operations. Also determine net cash flows for investing and financing activities.
- Interpretive Question:** Is Mile High Sporting Goods Company in a good liquidity position? As Mr. Beecher's banker, would you loan him more money to fund the company's expansion?

ANALYTICAL ASSIGNMENTS

AA 13-1*Discussion***Analyzing Cash Flow Patterns**

Paula Dalton is a security analyst for DJM, Inc. She claims that she can tell a great deal about companies by analyzing their cash flow patterns. Specifically, she looks at the negative or positive cash flow trends in the three categories on cash flow statements. Paula thinks this information is even more valuable than net income trend data from statements of comprehensive income. She illustrates her theory with the following patterns of cash flows for Abbott Company over the past three years.

	2018	2017	2016
Net income.....	–	+	+
Cash flows from:			
Operating activities.....	–	–	+
Investing activities.....	+	+	+
Financing activities.....	+	+	+

How do you think Paula would analyze these results? Do you agree that analyzing cash flow patterns provides superior analytical information?

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

Your finance professor said that the indirect method is a better way to prepare the statement of cash flows because it starts with a known number—net income. However, in your accounting course, your professor teaches that the direct method gives you more information on *how* the cash is used and, therefore, contains more useful information. Which professor do you agree with?

AA 13-3*Real Company Analysis***Philips**

Locate the 2015 financial statements of Philips in Appendix B and consider the following questions:

- Does Philips present the three cash flow statement categories—operating, investing, and financing—in the same order as that illustrated in the chapter?
- In fiscal year 2015, Philips subtracted €116 million in arriving at cash flow from operations relating to an increase in receivables and other current assets. Why would an increase in receivables be subtracted?
- In fiscal year 2015, Philips spent €1,941 million on various investing activities. Were the cash flows from operations sufficient to pay for these investments?
- Did Philips pay any cash dividends to common stockholders during fiscal year 2015? Did Philips make any other payments to common stockholders during the year?

AA 13-4*Real Company Analysis***Analyzing Cash Flow Patterns for Three Taiwanese Companies**

Visit the websites of the following companies: President Chain Store Corporation (PCSC), Tatung Co., Taiwan Mobile Co., Ltd. (Company codes as registered at Taiwan Stock Exchange are 2912, 2371, and 3045, respectively.) Analyze the cash flow patterns of each company in the recent years.

EXPANDED MATERIAL

Review Problems

Preparing a Statement of Cash Flows

Required:

Given the data on pages 592–593, prepare a statement of cash flows for Snow Corporation in 2018 using the direct method to report cash flows from operating activities.

Solution:

Snow Corporation Statement of Cash Flows (Direct Method) For the Year Ended December 31, 2018			
Operating activities			
Cash receipts from customers			€ 585,000
Cash payments for:			
Inventory	€523,000		
Operating expenses	56,000		
Interest expense	4,000		
Income tax expense	<u>14,000</u>	(597,000)	
Net cash flows from operating activities			€ (12,000)
Investing activities			
Purchased land	€ (3,000)		
Purchased machinery and equipment	<u>(6,000)</u>		
Net cash flows from investing activities			(9,000)
Financing activities			
Borrowing of long-term debt	€ 23,000		
Payments for cash dividends	<u>(4,000)*</u>		
Net cash flows from financing activities		19,000	
Net decrease in cash		€ (2,000)	
Beginning cash balance		13,000	
Ending cash balance		<u>€ 11,000</u>	

*Put it on Paper***DISCUSSION QUESTIONS**

9. Describe the process of converting from accrual revenues to cash receipts.

10. Distinguish between the indirect and direct methods of reporting net cash flows provided by (used in) operating activities.

PRACTICE EXERCISES

PE 13-15

LO 7

Using Accounts Receivable to Compute Cash Collections

Assume that all of the company's sales are on account. The accounts receivable balance at the beginning of the year was \$1,512, and the ending balance was \$1,481. During the year, the company had sales of \$5,526. Compute the amount of cash collections on sale.

PE 13-16

LO 7

Using Inventory and Accounts Payable to Compute Cash Paid for Inventory

Using the following information and assuming that all inventory is purchased on account, compute cash paid for inventory:

Cost of goods sold	\$37,343
Inventory, beginning balance	3,610
Inventory, ending balance	3,482
Accounts payable, beginning balance	3,076
Accounts payable, ending balance	3,218

PE 13-17

LO 7

Direct Method

Refer to the data in PE 13-10. Prepare the operating activities section of the statement of cash flows using the direct method.

EXERCISES

E 13-15

LO 7

Determining Cash Receipts and Payments

Assuming the following data, compute:

1. Cash collected from customers
2. Cash paid for wages and salaries
3. Cash paid for inventory purchases
4. Cash paid for income tax

	Statement of Comprehensive Income Amount for Year	Balance Sheet	
		Beg. of Year	End of Year
Sales revenue (all on account)	\$455,000		
Accounts receivable (net)		\$33,000	\$38,000
Wages and salaries expense	100,000		
Wages and salaries payable		16,000	13,000
Cost of goods sold	225,000		
Accounts payable		28,500	26,000
Inventory		27,000	30,000
Income tax expense	45,000		
Income tax payable		24,000	25,500

E 13-16

LO 7

Cash Flows from Operating Activities (Direct Method)

The 2018 accounting records of Green Corp. reveal these transactions and events.

Payment of interest	£10,000	Collection of accounts receivable	£190,000
Cash sales	60,000	Payment of salaries and wages	55,000
Receipt of dividend revenue	15,000	Depreciation expense	13,000
Payment of income taxes	12,000	Proceeds from disposal of plant assets ..	12,000
Net income	47,000	Purchase of equipment for cash	25,000
Payment of accounts payable for merchandise	110,000	Loss on disposal of plant assets	3,000
Payment for land	80,000	Payment of dividends	20,000
		Payment of operating expenses	30,000

Required:

Prepare the cash flows from operating activities section using the direct method. (Not all of the items will be used.)

E 13-17**Cash Flows from Operations (Direct Method)****LO 7**

Given the data in E 13-10, show how the amount of net cash flows from operating activities would be calculated using the direct method.

E 13-18**Cash Flows Provided by Operations (Direct Method)****LO 7**

Given the data in E 13-11, show how the amount of cash provided by operations for 2018 is computed using the direct method.

E 13-19**Statement of Cash Flows (Direct Method)****LO 7**

By analyzing the information in E 13-13, prepare a statement of cash flows. Use the direct method to report cash flows from operating activities.

PROBLEMS

P 13-10**Transaction Analysis****LO 7**

Kitty Corporation reports the following summary data for the current year:

- Sales revenue totaled \$130,750.
- Interest revenue for the period was \$1,100.
- Interest expense for the period was \$2,900.
- Cost of goods sold for the period was \$83,000.
- Operating expenses, all paid in cash (except for depreciation of \$7,500), were \$24,000.
- Income tax expense for the period was \$6,500.
- Accounts receivable (net) increased by \$5,000 during the period.
- Accounts payable increased by \$2,500 during the period.
- Inventory at the beginning and end of the period was \$17,500 and \$12,500, respectively.
- Cash increased during the period by \$2,500.

Assume all other current asset and current liability accounts remained constant during the period. If the item has alternative classification, classify it as operating cash flows.

Required:

- Compute the amount of cash collected from customers.
- Compute the amount of cash paid for inventory.
- Compute the amount of cash paid for operating expenses.
- Compute the amount of cash flows provided by (used in) operations.
- Interpretive Question:** What must have been the combined amount of cash flows provided by (used in) investing and financing activities?

P 13-11**Cash Flows from Operations (Direct Method)****LO 7**

Given the data in P 13-6, compute the net cash flows from operations for Titanic Company for 2018 using the direct method.

P 13-12**Cash Flows from Operations (Direct Method)****LO 7**

Sunday Shoppers, Inc., shows the following information in its accounting records at year-end. Assume that there is no income tax incurred. Assume that interest received and dividends paid are classified as operating and financing cash flows, respectively.

Sales revenue	\$743,000
Interest revenue	24,000
Cost of goods sold	383,000
Wages expense	190,000
Depreciation expense	42,000
Other (cash) operating expenses	71,000
Dividends declared	30,000

Selected balance sheet data are as follows:

	Beginning of Year	End of Year
Accounts receivable (net)	\$ 66,000	\$ 77,000
Interest receivable	12,000	9,000
Inventory	213,000	222,000
Accounts payable	44,000	47,000
Wages payable	35,000	37,000
Dividends payable	28,000	33,000

Required:

- Using the direct method, compute the net cash flows provided by (used in) operating activities for Saturday Shoppers, Inc.
- Interpretive Question:** Explain the main differences between the net amount of cash flows from operations and income (loss) before income tax.

P 13-13

Cash Flows from Operations (Direct Method)

LO 7

Given the data in P 13-4, compute the net cash flows from operations for Liu Company for 2018 using the direct method.

P 13-14

Computation of Net Income from Cash Flows from Operations (Direct Method)

LO 7

The following partially completed work sheet is provided for ATM Corporation, which uses the direct method in computing net cash flows from operations.

ATM Corporation Partial Work Sheet—Cash Flows from Operations (Direct Method) For the Year Ended December 31, 2018				
	Adjustments			
	Accrual Basis	Debits	Credits	Cash Basis
Net sales revenue				\$153,000
Expenses:				
Cost of goods sold				\$ 78,000
Depreciation				0
Loss on sale of equipment				0
Other (cash) expenses				26,000
Total expenses				\$104,000
Net income (net cash flows from operations)				\$ 49,000

Key Items:

- Decrease in Accounts Receivable (net), \$5,000
- Loss on sale of equipment, \$2,000

3. Increase in Inventory, \$15,000
4. Increase in Accounts Payable, \$3,000
5. Depreciation for the year, \$10,000
6. Decrease in Prepaid Expenses, \$1,000
7. Increase in Accrued Liabilities, \$2,500

Required:

Complete the work sheet with the key items above and compute the net income (loss) to be reported by ATM Corporation on its statement of comprehensive income for 2018.

P 13-15**LO 7****Statement of Comprehensive Income from Cash Flow Data**

Picnic Corporation computed the amount of cash flows from operations using both the direct and indirect methods, as follows.

Direct method:	
Collections from customers	\$ 527,000
Payments to suppliers	(170,000)
Payments for operating expenses	(198,000)
Cash flows provided by operating activities	<u>\$ 159,000</u>
Indirect method:	
Net income	\$ 97,000
Depreciation	62,100
Gain on sale of equipment	(4,000)
Decrease in inventory	2,400
Decrease in accounts receivable (net)	3,600
Decrease in accounts payable	(6,800)
Increase in miscellaneous accrued payable	4,700
Cash flows provided by operating activities	<u>\$ 159,000</u>

Required:

Using the data provided, prepare a statement of comprehensive income for Picnic Corporation for the year 2018. Ignore other comprehensive income.

P 13-16**LO 7****Statement of Cash Flows (Direct Method)****Required:**

Given the data in P 13-8, compute the net cash flows from operations using the direct method.