

BACHELOR of ECONOMICS



**Thammasat University
Faculty of Economics
Bachelor of Economics (International Program)**

AC201 Fundamental Accounting

Semester 2/2015

Course Package OY 06

Topic:

Reporting and Interpreting
Statement of Cash Flows

Session:

Session OY 06

Instructor:

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REPORTING AND INTERPRETING STATEMENT OF CASH FLOWS

Chapter Take-Aways

1. Classify cash flow statement items as part of net cash flows from operating, investing, and financing activities.

The statement has three main sections: Cash Flows from Operating Activities, which are related to earning income from normal operations; Cash Flows from Investing Activities, which are related to the acquisition and sale of productive assets; and Cash Flows from Financing Activities, which are related to external financing of the enterprise. The net cash inflow or outflow for the year is the same amount as the increase or decrease in cash and cash equivalents for the year on the balance sheet. Cash equivalents are highly liquid investments with original maturities of three months or less.

2. Report and interpret cash flows from operating activities—Indirect method.

The indirect method for reporting cash flows from operating activities reports a conversion of net income to net cash flow from operating activities. The conversion involves additions and subtractions for (1) noncurrent accruals including expenses (such as depreciation expense) and revenues which do not affect current assets or current liabilities and (2) changes in each of the individual current assets (other than cash and short-term investments) and current liabilities (other than short-term debt to financial institutions and current maturities of long-term debt, which relate to financing), which reflect differences in the timing of accrual basis net income and cash flows.

3. Analyze and interpret the quality of income ratio.

Quality of income ratio ($\text{Cash Flow from Operating Activities} \div \text{Net Income}$) measures the portion of income that was generated in cash. A higher quality of income ratio indicates greater ability to finance operating and other cash needs from operating cash inflows. A higher ratio also indicates that it is less likely that the company is using aggressive revenue recognition policies to increase net income.

4. Report and interpret cash flows from investing activities.

Investing activities reported on the cash flow statement include cash payments to acquire fixed assets and short- and long-term investments and cash proceeds from the sale of fixed assets and short- and long-term investments.

5. Analyze and interpret the capital acquisitions ratio.

The capital acquisitions ratio ($\text{Cash Flow from Operating Activities} \div \text{Cash Paid for Property, Plant, and Equipment}$) reflects the portion of purchases of property, plant, and equipment financed from operating activities without the need for outside debt or equity financing or the sale of other investments or fixed assets. A high ratio benefits the company because it provides the company with opportunities for strategic acquisitions.

6. Report and interpret cash flows from financing activities.

Cash inflows from financing activities include cash proceeds from issuance of short- and long-term debt and common stock. Cash outflows include cash principal payments on short- and long-term debt, cash paid for the repurchase of the company's stock, and cash dividend payments. Cash payments associated with interest are a cash flow from operating activities.

7. Understand the format of the cash flow statement and additional cash flow disclosures.

The statement of cash flows splits transactions that affect cash into three categories: Operating, Investing, and Financing Activities. The operating section is most often prepared using the indirect method that begins with Net Income and adjusts the amount to eliminate non-cash transactions. Noncash investing and financing activities are investing and financing activities that do not involve cash. They include, for example, purchases of fixed assets with long-term debt or stock, exchanges of fixed assets, and exchanges of debt for stock. These transactions are disclosed only as supplemental disclosures to the cash flow statement along with cash paid for taxes and interest under the indirect method.

Key Ratios

Quality of income ratio indicates what portion of income was generated in cash. It is computed as follows:

$$\text{Quality of Income Ratio} = \text{Cash Flow from Operating Activities} \div \text{Net Income}$$

Capital acquisitions ratio measures the ability to finance purchases of plant and equipment from operations. It is computed as follows:

$$\text{Cash Acquisitions Ratio} =$$

$$\text{Cash Flow from Operating Activities} \div \text{Cash Paid for Property, Plant, and Equipment}$$

Finding Financial Information

Balance Sheet

***Changes In Assets, Liabilities, and
Stockholders' Equity***

Income Statement

Net Income and Noncurrent Accruals

Statement of Cash Flows

Cash Flows From Operating Activities

Cash Flows From Investing Activities

Cash Flows From Financing Activities

Separate Schedule (or note)

Non-cash investing and financing activities

Interest and taxes paid

Notes

***Under Summary of Significant Accounting
Policies***

Definition of cash equivalents

Under a Separate Note

If not listed on cash flow statement:

Non-cash investing and financing activities

Interest and taxes paid

Chapter Outline

Notes

LO 1 – Classify cash flow statement items as part of net cash flows from operating, investing, and financing activities.

I. Classification of the Statement of Cash Flows

A. Cash and Cash Equivalents

1. Statement of cash flows explains how cash on the balance sheet at the beginning of the period has become the cash reported at the end of the period
2. “Cash” includes cash and cash equivalents – Short-term, highly liquid investments that are both:
 - a. Readily convertible to known amounts of cash
 - b. So near to maturity there is little risk that their value will change if interest rates change
3. Generally, only investments with original maturities (to the entity holding the investment) of three months or less qualify as a cash equivalent

B. Cash Flows from Operating Activities – Indirect and Direct Methods

1. Cash flows from operating activities (cash flows from operations) – Cash inflows and outflows directly related to earnings from normal operations
2. Two alternative approaches for presenting the operating activities section of the statement:
 - a. Direct method – reports components of cash flows from operating activities as gross receipts and gross payments
 - i. Although the FASB recommends the direct method, it is rarely used in the U.S.; it is more expensive to implement than the indirect method
 - ii. Both the FASB and the IASB are considering a proposal to require this method
 - b. Indirect method – adjusts net income to compute cash flows from operating activities
 - c. The two methods are simply alternative ways to arrive at the same number
 - d. The total amount of cash flows from operating activities is always the same, regardless of whether it is computed using the direct or indirect method
 - e. Difference between the inflows and outflows is called net cash inflow (outflow) from operating activities

C. Cash Flows from Investing Activities

1. Cash flows from investing activities – Cash inflows and outflows related to the acquisition or sale of productive facilities and investments in the securities of other companies
2. Difference between these cash inflows and outflows is called net cash inflow (outflow) from investing activities

- D. Cash Flows from Financing Activities
1. Cash flows from financing activities – Cash inflows and outflows related to external sources of financing (owners and creditors) for the enterprise
 2. Difference between these cash inflows and outflows is called net cash inflow (outflow) from financing activities
- E. Net Increase (Decrease) in Cash
1. The combination of the net cash flows from operating activities, investing activities, and financing activities must equal the net increase (decrease) in cash for the reporting period
 2. Net cash provided by (used in) operating activities
+ Net cash provided by (used in) investing activities
+ Net cash provided by (used in) financing activities
+ Net increase in cash and cash equivalents
+ Cash and cash equivalents at beginning of period
Cash and cash equivalents at end of period
- F. Relationships to the Balance Sheet and Income Statement
1. To prepare the statement of cash flows, we need the following data:
 - a. Comparative balance sheets used in calculating the cash flows from all activities (operating, investing, and financing)
 - b. A complete income statement used primarily in calculating cash flows from operating activities
 - c. Additional details concerning selected accounts where the total change amount in an account balance during the year does not reveal the underlying nature of the cash flows
 2. Approach to preparing and understanding cash flow statement focuses on changes in balance sheet accounts; relies on manipulation of balance sheet equation:
$$\text{Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$
$$\text{Cash} + \text{Noncash Assets} = \text{Liabilities} + \text{Stockholders' Equity}$$
$$\text{Cash} = \text{Liabilities} + \text{Stockholders' Equity} - \text{Noncash Assets}$$
$$\Delta \text{Cash} = \Delta \text{Liabilities} + \Delta \text{Stockholders' Equity} - \Delta \text{Noncash Assets}$$
 3. Any transaction that changes cash must be accompanied by a change in liabilities, stockholders' equity, or noncash assets
 4. Next, compute the change in each balance sheet account (Ending Balance – Beginning Balance) and classify each change as relating to operating (O), investing (I), or financing (F) activities by marking it with the corresponding letter

- a. The accounts that should be marked with an O include the following:
 - i. Most current assets (other than short-term investments, which relate to investing activities, and cash)
 - ii. Most current liabilities (other than amounts owed to investors and financial institutions, all of which relate to financing activities)
 - iii. Retained Earnings because it increases by the amount of net income: Retained Earnings also decreases by dividends declared and paid, which is a financing outflow noted by an F
- b. The balance sheet accounts related to investing activities should be marked with an I; these include all of the remaining assets on the balance sheet:
 - i. Short-Term Investments
 - ii. Property, Plant, and Equipment, net
- c. The balance sheet accounts related to financing activities should be marked with an F; these include all of the remaining liability and stockholders' equity accounts on the balance sheet:
 - i. Contributed Capital
 - ii. Retained Earnings (for decreases resulting from dividends declared and paid)

LO 2 – Report and interpret cash flows from operating activities using the indirect method.

- II. Reporting & Interpreting Cash Flows from Operating Activities
 - A. Reporting Cash Flows from Operating Activities– Indirect Method
 - 1. The indirect method starts with net income and converts it to cash flows from operating activities
 - 2. This involves adjusting net income for the differences in the timing of accrual basis net income and cash flows
 - 3. The general structure of the operating activities section is:
 - Net income
 - Adjustments to reconcile net income to cash flow from operating activities:
 - + Depreciation and amortization expense
 - Gain on sale of long-term asset
 - + Loss on sale of long-term asset
 - + Decreases in operating assets
 - + Increases in operating liabilities
 - Increases in operating assets
 - Decreases in operating liabilities
 - Net Cash Flow from Operating Activities

4. Completing the operating section using the indirect method involves two steps:
 - a. Step 1: Adjust net income for depreciation and amortization expense and gains and losses on sale of investing assets such as property, plant, and equipment and investments
 - i. Recording depreciation and amortization expense does not affect the cash account (or any other operating asset or liability); it affects a noncurrent investing asset (property, plant, and equipment, net)
 - ii. Since depreciation and amortization expense are subtracted in computing net income but do not affect cash, we always add each back to convert net income to cash flow from operating activities
 - iii. Gains on sales of property, plant, and equipment are subtracted and losses on such sales are added to convert net income to cash flow from operating activities
 - b. Step 2: Adjust net income for changes in assets and liabilities marked as operating (O)
 - i. Each change in operating assets (other than cash and short-term investments) and operating liabilities (other than amounts owed to owners and financial institutions) causes a difference between net income and cash flow from operating activities
 - ii. General rules for converting net income to cash flow from operating activities:
 - Add the change when an operating asset decreases or an operating liability increases
 - Subtract the change when an operating asset increases or an operating liability decreases
 - iii. Change in Accounts Receivable
 - When sales revenues are recorded, accounts receivable increases, and when cash is collected from customers, accounts receivable decreases
 - An increase (reduced collections) is subtracted; a decrease is added
 - iv. Change in Inventory
 - Purchases of goods increase the balance in inventory, and recording merchandise sold decreases the balance in inventory
 - An increase (extra purchases) is subtracted from net income to convert to cash flow from operating activities; a decrease is added

v. Change in Prepaid Expenses

- Cash prepayments increase the balance in prepaid expenses, and recording of expenses decreases the balance in prepaid expenses
- A decrease (lower prepayments) is added to net income; an increase is subtracted

vi. Change in Accounts Payable

- Purchases on account increase accounts payable and cash paid to suppliers decreases accounts payable
- A decrease (extra payments) is subtracted; an increase is added

vii. Change in Accrued Expenses

- Recording accrued expenses increases the balance in the liability accrued expenses and cash payments for the expenses decrease accrued expenses
- An increase (lower cash paid) is added; a decrease is subtracted

B. Interpreting Cash Flows from Operating Activities

1. The operating activities section of the cash flow statement focuses attention on the firm's ability to generate cash internally through operations and its management of current assets and current liabilities (also called working capital)
2. A common rule of thumb followed by financial and credit analysts is to avoid firms with rising net income but falling cash flow from operations
3. Rapidly rising inventories or receivables often predict a slump in profits and the need for external financing

LO 3 – Analyze and interpret the quality of income ratio.

C. Key Ratio Analysis: Quality of Income Ratio

1. Quality of Income Ratio = Cash Flow from Operating Activities ÷ Net Income
2. Ratio measures how much cash each dollar of net income generates
3. All other things equal, a higher quality of income ratio indicates greater ability to finance operating and other cash needs from operating cash inflows
4. A higher ratio also indicates it is less likely the company is using aggressive revenue recognition policies to increase net income

5. When this ratio does not equal 1.0, analysts must establish the sources of the difference to determine the significance of the findings; four potential causes:
 - a. Corporate lifecycle (growth or decline in sales)
 - i. When sales are increasing, receivables and inventory normally increase faster than accounts payable..
 - ii. This often reduces operating cash flows below income, which, in turn, reduces the ratio
 - iii. When sales are declining, the opposite occurs, and the ratio increases.
 - b. Seasonality – seasonal (from quarter to quarter) variations in sales and purchases of inventory can cause the ratio to deviate from 1.0 during particular quarters
 - c. Changes in revenue and expense recognition - aggressive revenue recognition or failure to accrue appropriate expenses will inflate net income and reduce the ratio
 - d. Changes in management of operating assets and liabilities
 - i. Inefficient management will increase operating assets and decrease liabilities, reducing operating cash flows and the quality of income ratio.
 - ii. More efficient management, such as shortening of payment terms, will have the opposite effect
6. The quality of income ratio can be interpreted only based on an understanding of the company's business operations and strategy
 - a. For example, a low ratio for a quarter can be due simply to normal seasonal changes
 - b. However, it also can indicate obsolete inventory, slowing sales, or failed expansion plans
 - c. To test for these possibilities, analysts often analyze this ratio in tandem with the accounts receivable turnover and inventory turnover ratios

LO 4 – Report and interpret cash flows from investing activities.

- III. Reporting & Interpreting Cash Flows from Investing Activities
 - A. Reporting Cash Flows from Investing Activities
 1. Preparing this section of the cash flow statement requires an analysis of the related accounts
 - a. Property, plant, and equipment;
 - i. Outflow – Purchase of property, plant, and equipment for cash
 - ii. Inflow – Sale of property, plant, and equipment for cash

- b. Intangible assets;
 - i. Outflow – Purchase of intangible assets for cash
 - ii. Inflow – Sale of intangible assets for cash
 - c. Investments in the securities of other companies
 - iii. Outflow – Purchase of investment securities for cash
 - iv. Inflow – Sale (maturity) of investment securities for cash
 - d. Hints:
 - i. Only purchases paid for with cash or cash equivalents are included
 - ii. The amount of cash that is received from the sale of assets is included, regardless of whether the assets are sold at a gain or loss
- B. Interpreting Cash Flows from Investing Activities – There are common ways to assess a company's ability to internally finance its expansion:
- 1. Capital acquisitions ratio
 - 2. Free cash flow

LO 5 – Analyze and interpret the capital acquisitions ratio.

- C. Key Ratio Analysis: Capital Acquisitions Ratio
- 1. Capital Acquisitions Ratio = $\text{Cash Flow from Operating Activities} \div \text{Cash Paid for Property, Plant, and Equipment}$
 - 2. Ratio measures degree was the company able to finance purchases of property, plant, and equipment with cash provided by operating activities
 - 3. A high ratio indicates less need for outside financing for current and future expansion
- D. Financial Analysis: Free Cash Flow
- 1. Free Cash Flow = $\text{Cash Flows from Operating Activities} - \text{Dividends} - \text{Capital Expenditures}$
 - 2. Managers and analysts often calculate free cash flow as a measure of firm's ability to pursue long-term investment opportunities
 - 3. Any positive free cash flow is available for additional capital expenditures, investments in other companies, and mergers and acquisitions
 - 4. Free cash flow also can represent a hidden cost to shareholders
 - a. Managers may use free cash flow to pursue unprofitable investments just for the sake of growth or to obtain perquisites that do not benefit shareholders
 - b. Shareholders would be better off if free cash flow were paid as additional dividends or used to repurchase the company's stock on the open market

LO 6 – Report and interpret cash flows from financing activities.

IV. Reporting & Interpreting Cash Flows from Financing Activities

A. Reporting Cash Flows from Financing Activities

1. Preparing this section of the cash flow statement requires an analysis of the related accounts
 - a. Short-term debt (notes payable)
 - i. Inflow – Borrowing cash from banks or other financial institutions
 - ii. Outflow – Repayment of loan principal Outflow
 - b. Long-term debt Issuance of bonds for cash
 - i. Inflow – Issuance of bonds for cash
 - ii. Outflow – Repayment of bond principal
 - c. Common stock and additional paid-in capital
 - i. Inflow – Issuance of stock for cash
 - ii. Outflow – Repurchase (retirement) of stock with cash
 - d. Retained earnings
 - i. Outflow - Payment of cash dividends
 - e. Hints:
 - i. Cash repayments of principal are cash flows from financing activities
 - ii. Interest payments are cash flows from operating activities
 - iii. Dividend payments are cash flows from financing activities
 - iv. If debt or stock is issued for other than cash, it is not included in this section

LO 7 – Understand the format of the cash flow statement and additional cash flow disclosures.

V. Completing the Statement and Additional Disclosures

A. Statement Structure

Net increase or decrease in cash and cash equivalents + cash and cash equivalents at beginning of period = cash and cash equivalents at end of period

B. Noncash Investing and Financing Activities

1. Transactions that do not have direct cash flow effects
2. Reported as a supplement to the statement of cash flows in narrative or schedule form

C. Supplemental Cash Flow Information

If use the indirect method of reporting cash flows from operations, must provide: cash paid for interest and cash paid for income taxes

- VI. Chapter Supplement A: Reporting Cash Flows from Operating Activities – Direct Method
- A. Direct method – presents a summary of all operating transactions that result in either a debit or a credit to cash
 - B. Prepared by adjusting each revenue and expense on the income statement from the accrual basis to the cash basis
 - C. The following adjustments must commonly be made to convert income statement items to the related operating cash flow amounts:
 - 1. Converting Sales Revenues to Cash Inflows:
 $\text{Sales Revenue} + \text{Decrease in Accounts Receivable (A)} \text{ (or } - \text{ Increase in Accounts Receivable (A))} = \text{Collections from customers}$
 - 2. Converting Cost of Goods Sold to Cash Paid to Suppliers:
 $\text{Cost of Goods Sold} + \text{Increase in Inventory (A)} \text{ (or } - \text{ Decrease in Inventory (A))} - \text{Increase in Accounts Payable (L)} \text{ (or } + \text{ Decrease in Accounts Payable (L))} = \text{Payments to suppliers of inventory}$
 - 3. Converting Operating Expense to Cash Outflow:
 $\text{Other Expenses} + \text{Increase in Prepaid Expenses (A)} \text{ (or } - \text{ Decrease in Prepaid Expenses (A))} - \text{Increase in Accrued Expenses (L)} \text{ (or } + \text{ Decrease in Accrued Expenses (L))} = \text{Payments to suppliers of services (e.g., rent, utilities, wages, interest)}$
- VII. Chapter Supplement B: Adjustments for Gains and Losses on Sale of Long-Term Assets – Indirect Method
- A. Whenever a company sells property, plant, and equipment (PPE), it records three things:
 - 1. Decreases in the PPE accounts for the assets sold,
 - 2. An increase in the Cash account for the cash received on disposal, and
 - 3. A gain if the cash received is more than the book value of the assets sold (or a loss if the cash received is less than the book value of the assets sold)
 - B. The only part of this transaction that qualifies for the statement of cash flows is the cash received on disposal
 - 1. This cash inflow is classified as an investing activity, just like the original equipment purchase
 - 2. Since a gain on sale are included in net income, the gain on sale is subtracted (or the loss is added) as an adjustment to net income in the operating activities section as an adjustment to net income in the operating activities section
 - 3. The proceeds from the disposal or sale are listed as a cash inflow in the investing activities section

- VIII. Chapter Supplement C: T-account Approach (Indirect Method)
- A. Changes in cash must equal the sum of the changes in all other balance sheet accounts
1. Based on this idea, we used the following three steps to prepare the statement of cash flows:
 - a. Determine the change in each balance sheet account.
From this year's ending balance, subtract this year's beginning balance (i.e., last year's ending balance)
 - b. Identify the cash flow category or categories to which each account relates
 - c. Create schedules that summarize operating, investing, and financing cash flows
 2. Instead of creating separate schedules for each section of the statement, many accountants prefer to prepare a single large T-account to represent the changes that have taken place in cash subdivided into the three sections of the cash flow statement



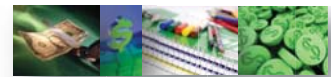
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REPORTING AND INTERPRETING STATEMENT OF CASH FLOWS

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1



Definition

- The following terms are used in this Standard with the meanings specified:
 - **Cash** comprises cash on hand and demand deposits.
 - **Cash equivalents** are short-term, highly liquid investments that are readily convertible to known amounts of cash and which are subject to an insignificant risk of changes in value.
 - **Cash flows** are inflows and outflows of cash and cash equivalents.
 - **Operating activities** are the principal revenue-producing activities of the entity and other activities that are not investing or financing activities.
 - **Investing activities** are the acquisition and disposal of long-term assets and other investments not included in cash equivalents.
 - **Financing activities** are activities that result in changes in the size and composition of the contributed equity and borrowings of the entity.

2



Fundamental Principle

● Fundamental Principle in IAS 7

- ✱ All entities that prepare financial statements in conformity with IFRSs are required to present a statement of cash flows. [IAS 7.1]
- ✱ The statement of cash flows analyses changes in cash and cash equivalents during a period.
 - ✱ Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of changes in value.
 - ✱ Guidance notes indicate that an investment normally meets the definition of a cash equivalent when it has a maturity of three months or less from the date of acquisition.
 - ✱ Equity investments are normally excluded, unless they are in substance a cash equivalent (e.g. preferred shares acquired within three months of their specified redemption date).
 - ✱ Bank overdrafts which are repayable on demand and which form an integral part of an entity's cash management are also included as a component of cash and cash equivalents. [IAS 7.7-8]

3



Statement Presentation

● Presentation of the Statement of Cash Flows

- ✱ Cash flows must be analyzed between operating, investing and financing activities.
- ✱ Key principles for the preparation of a statement of cash flows are as follows:
 - ✱ operating activities are the main revenue-producing activities of the entity that are not investing or financing activities, so operating cash flows include cash received from customers and cash paid to suppliers and employees
 - ✱ investing activities are the acquisition and disposal of long-term assets and other investments that are not considered to be cash equivalent
 - ✱ financing activities are activities that alter the equity capital and borrowing structure of the entity
- ✱ Interest and dividends received and paid may be classified as operating, investing, or financing cash flows, provided that they are classified consistently from period to period
- ✱ Cash flows arising from taxes on income are normally classified as operating, unless they can be specifically identified with financing or investing activities

4



Operating Cash Flows – Direct Method

- For operating cash flows, the direct method of presentation is encouraged, but the indirect method is acceptable.
- The direct method shows each major class of gross cash receipts and gross cash payments.
 - ✱ The operating cash flows section of the statement of cash flows under the direct method would appear something like this:

✱ Cash receipts from customers	XX,XXX
✱ Cash paid to suppliers	XX,XXX
✱ Cash paid to employees	XX,XXX
✱ Cash paid for other operating expenses	XX,XXX
✱ Interest paid	XX,XXX
✱ Income taxes paid	XX,XXX
✱ Net cash from operating activities	XX,XXX

5



Operating Cash Flows – Indirect Method

- The indirect method adjusts accrual basis net profit or loss for the effects of non-cash transactions.
 - ✱ The operating cash flows section of the statement of cash flows under the indirect method would appear something like this:

✱ <i>Profit or loss (Net income)</i>	XX,XXX
✱ Add back depreciation	XX,XXX
✱ Add decrease in current assets	XX,XXX
✱ Deduct increase in current assets	XX,XXX
✱ Add increase in current liabilities	XX,XXX
✱ Deduct decrease in current liabilities	<u>XX,XXX</u>
✱ <i>Net cash from operating activities</i>	<u>XX,XXX</u>

6



Investing and Financing Cash Flows

- Cash flows from investing and financing activities should be reported gross by major class of cash receipts and major class of cash payments.
- Investing and financing transactions which do not require the use of cash should be excluded from the statement of cash flows, but they should be separately disclosed elsewhere in the financial statements.

7



Preparation of Statement of Cash Flows



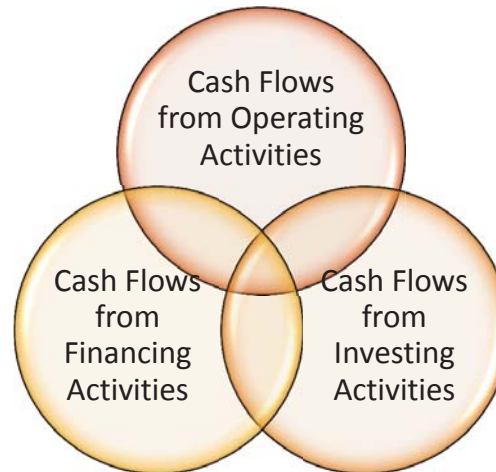
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Statement of Cash Flows

Statement of Cash Flows

- The statement of cash flows analyses **changes in cash** and cash equivalents during **a period**.
- Cash and cash equivalents comprise cash on hand and demand deposits, together with short-term, highly liquid investments that are readily convertible to a known amount of cash, and that are subject to an insignificant risk of changes in value.



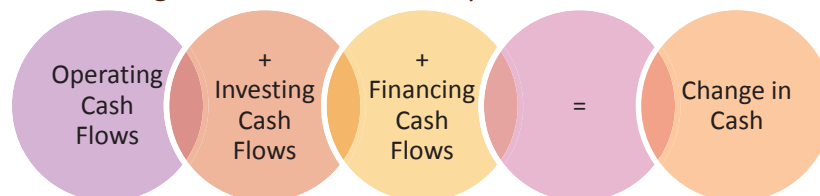
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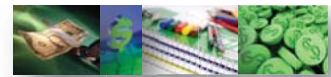
Cash Flows Categories

Categories of Cash Flows

- Cash flows must be analyzed between operating, investing and financing activities.
- Operating activities** are the main revenue-producing activities of the enterprise that are not investing or financing activities, so operating cash flows include cash received from customers and cash paid to suppliers and employees.
- Investing activities** are the acquisition and disposal of long-term assets and other investments that are not considered to be cash equivalents.
- Financing activities** are activities that alter the equity capital and borrowing structure of the enterprise.



10



Statement of Cash Flows

• *Statement of cash flows*

- It reports all major cash receipts (inflows) and cash payments (outflows) during the period in the categories of operating, investing, and financing activities.



Operating

- Activities that involve the production or purchase of merchandise and the sale of goods and services to customers, including expenditures related to administering the business.



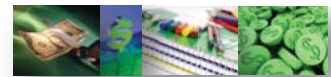
Investing

- Transactions that involve purchasing and selling of long-term assets, including making and collecting notes receivable.



Financing

- Transactions with owners and creditors that include obtaining cash from issuing debt, repaying amounts borrowed, and obtaining cash from or distributing cash to owners.



Statement of Cash Flows (Cont.)

• **Cash is defined as including both cash and cash equivalents.**

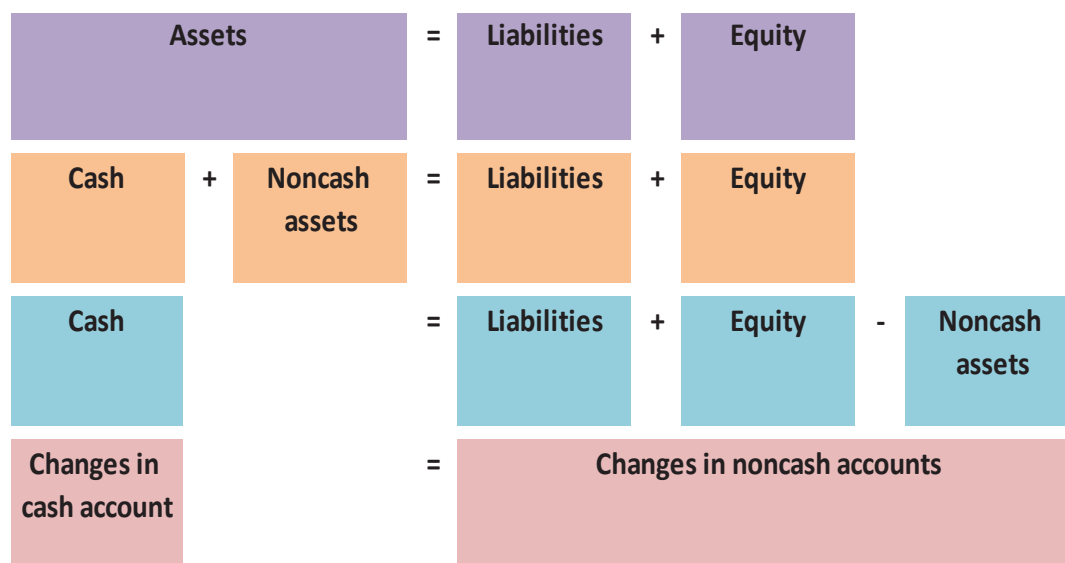
- Cash equivalents are investments that can be quickly converted to cash; they have a maturity of 90 days or less when they are purchased.
 - They include money market accounts, commercial paper, and government treasury bills.
 - A company invests in cash equivalents to earn interest on cash that would otherwise be temporarily idle.

• **Purposes of the statement of cash flows:**

- The primary purpose of the statement of cash flows is to provide information about a company's cash receipts and cash payments during an accounting period.
- A secondary purpose is to provide information about a company's operating, investing, and financing activities during the accounting period.



Relationship between Cash and Noncash Accounts



13

Company Name Statement of Cash Flows Period Covered (in Baht)	
Cash flows from operating activities: [List of individual inflows and outflows] Net cash flows from operating activities	①
Cash flows from investing activities: [List of individual inflows and outflows] Net cash flows from investing activities	②
Cash flows from financing activities: [List of individual inflows and outflows] Net cash flows from financing activities	③
Net increase (decrease) in Cash	① + ② + ③
Cash (and equivalents) balance at beginning of period	+ Beg. B/L
Cash (and equivalents) balance at end of period	= End. B/L

Same as cash balance on the balance sheet



Statement of Cash Flows Preparation

- To prepare the statement of cash flows,

Comparative Statement of Financial Position

- Used in calculating the cash flows from all activities (operating, investing, and financing).

Statement of Comprehensive income

- Used primarily in calculating cash flows from operating activities

Additional Details

- Concerning selected accounts where the total change amount in an account balance during the year does not reveal the underlying nature of the cash flows.

15



Cash Flows from Operating Activities

CASH FLOWS FROM OPERATING ACTIVITIES



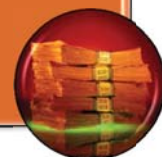
- Presentation of net cash from operating activities for the statement of cash flows **that lists major operating cash receipts less major operating cash payments.**

Direct
Method



- Presentation that reports **net income and then adjusts it by adding and subtracting items to yield net cash from operating activities** on the statement of cash flows.

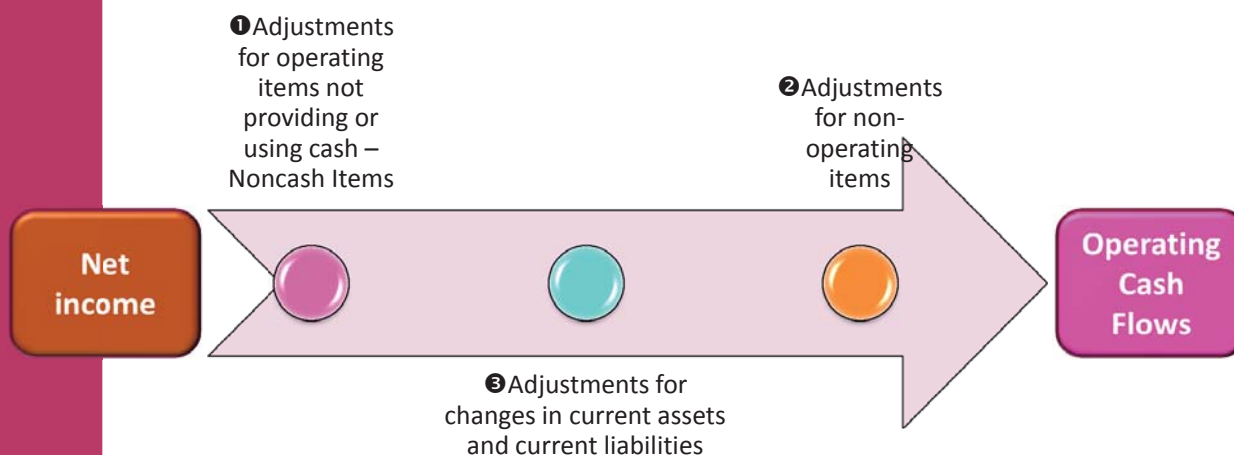
Indirect
Method



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Indirect Method -- OCF



	Changes in Account Balance During the Year	
	Increase	Decrease
Current Assets	Subtract from NI	Add to NI
Current Liabilities	Add to NI	Subtract from NI

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Indirect Method -- OCF

Company Income Statement For the Years Ended December 31, 20XX (In Baht)		
Sales and other revenue	Adjusted by	Δreceivable and unearned revenue
Cost of goods sold	Adjusted by	Δinventory and payable
Other operating expenses	Adjusted by	Δprepaid expenses and payable
Depreciation expense	Adjusted by	add back noncash expenses
Other gains (losses)	Adjusted by	add back losses and subtract gains
Net income		
Adjustments:		
+ (-) Noncash expense (revenue)		
- (+) Gain (Loss) related to nonoperating activities		
- (+) Increase (Decrease) in noncash current assets		
+ (-) Increase (Decrease) in current liabilities		
Operating cash flows		

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Indirect Method -- OCF

- **Net income or net loss**
 - Additions to net income:
 - + Depreciation, depletion, and amortization.
 - + All losses from sale of noncurrent assets.
 - + Decreases in current assets (other than cash).
 - + Increases in current liabilities.
 - Deductions from net income:
 - - All gains from sale of noncurrent assets.
 - - Increases in current assets (other than cash).
 - - Decreases in current liabilities.



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Adjustments to Net Income

- **Adjustments to net income:**
 - ✱ Depreciation and other noncash expenses
 - ✱ Depreciation expense, amortization expense, and depletion expense for these assets appear on the Statement of income as allocations of the costs of the original purchases to the current accounting period.
 - ✱ Even though depreciation expense appears on the Statement of income, it involves no outlay of cash and so does not affect cash flows in the current period.
 - ✱ Gains and losses
 - ✱ Gains and losses that appear on the Statement of income do not affect cash flows from operating activities and need to be removed from this section of the statement of cash flows.
 - ✱ The cash receipts generated by the disposal of the assets that resulted in the gains or losses are included in the investing activities section of the statement of cash flows.
 - ✱ The gains or losses must be removed from net income.

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Adjustments to Net Income (Cont.)

- ✳ Changes in current assets
 - ✳ Decreases in current assets other than cash have positive effects on cash flows, and increases in current assets have negative effects on cash flows.
 - ✳ A decrease in a current asset frees up invested cash, thereby increasing cash flows.
 - ✳ An increase in a current asset consumes cash, thereby decreasing cash flows.
- ✳ Changes in current liabilities
 - ✳ The effect of changes in current liabilities have on cash flows is the opposite of the effect of changes in current assets.
 - ✳ An increase in a current liability represents a postponement of a cash payment, which frees up cash and increases cash flows in the current period.
 - ✳ A decrease in a current liability consumes cash, which decreases cash flows.

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Investing and Financing Activities

- **Investing activities:**
 - ✳ To determine cash flows from investing activities, accounts involving cash receipts and cash payments from investing activities are examined individually.
 - ✳ The objective is to explain the change in each account balance from one year to the next.
 - ✳ Although, investing activities center on the long-term assets shown on the balance sheet, they also include any short-term investments shown under current assets on the balance sheet and any investment gains and losses on the Statement of income.
- **Financing activities:**
 - ✳ Determining cash flows from financing activities is very similar to determining cash flows from investing activities, but the accounts analyzed relate to short-term borrowings, long-term liabilities, and shareholders' equity.

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Illustration

- Use the following information to prepare statement of cash flows:

Genesis Income Statement For the Years Ended December 31, 2008 (In Baht)			
Sales			590,000
Cost of goods sold	300,000		
Wages and other operating expenses	216,000		
Interest expense	7,000		
Depreciation expense	24,000	(547,000)	
			43,000
Other gains (losses)			
Gain on retirement of bonds	16,000		
Loss on sale of plant assets	(6,000)	10,000	
Income before taxes			53,000
Income taxes expense		(15,000)	
Net income			38,000

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Genesis Balance Sheet As of December 31, 2008 and 2007 (In Baht)				
	2008	2007	Changes	Sign
Assets				
Current assets				
Cash	17,000	12,000	5,000	↑
Accounts receivable	60,000	40,000	20,000	↑
Merchandise inventory	84,000	70,000	14,000	↑
Prepaid expenses	6,000	4,000	2,000	↑
Total current assets	167,000	126,000	41,000	
Noncurrent assets				
Plant assets	250,000	210,000	40,000	↑
Less: Accumulated depreciation	(60,000)	(48,000)	(12,000)	↑
Plant assets, net	190,000	162,000	28,000	
Total assets	357,000	288,000	69,000	
Liabilities				
Current liabilities				
Accounts payable	35,000	40,000	(5,000)	↓
Interest payable	3,000	4,000	(1,000)	↓
Income taxes payable	22,000	12,000	10,000	↑
Total current liabilities	60,000	56,000	4,000	
Long-term bonds payable	90,000	64,000	26,000	↑
Total liabilities	150,000	120,000	30,000	
Equity				
Common stock	95,000	80,000	15,000	↑
Retained earnings	112,000	88,000	24,000	↑
Total equity	207,000	168,000	39,000	
Total liabilities and equity	357,000	288,000	69,000	

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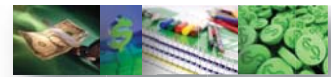
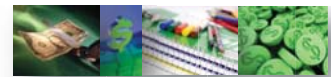


Illustration (Cont.)

Additional information:

- The accounts payable balances result from merchandise inventory purchases.
- Purchased plant assets costing 70,000 Baht by paying 10,000 Baht cash and issuing 60,000 Baht of bonds payable.
- Sold plant assets with an original cost of 30,000 Baht and accumulated depreciation of 12,000 Baht for 12,000 Baht cash, yielding a 6,000 Baht loss.
- Received cash of 15,000 Baht from issuing 3,000 shares of ordinary share.
- Paid 18,000 Baht cash to retire bonds with a 34,000 Baht book value, yielding a 16,000 Baht gain.
- Declared and paid cash dividends of 14,000 Baht.

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Indirect Method -- OCF

Adjustments to Net Income:

① Noncash Items

- Depreciation expense (I/S) +24,000 Baht

② Nonoperating Items

- Loss on sale of plant assets (I/S) +6,000 Baht
- Gain on retirement of bonds (I/S) -16,000 Baht

③ Changes in CA & CL

- Increase in accounts receivable (B/S) -20,000 Baht
- Increase in merchandise inventory (B/S) -14,000 Baht
- Increase in prepaid expenses (B/S) -2,000 Baht
- Decrease in accounts payable (B/S) -5,000 Baht
- Decrease in interest payable (B/S) -1,000 Baht
- Increase in income taxes payable (B/S) +10,000 Baht

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Cash Flows from Investing Activities

Plant Assets		
Beg. B/L	210,000	
Acquisition	70,000	Sale 30,000
End. B/L	250,000	

Accumulated Depreciation		
	Beg. B/L	48,000
Sale 12,000	Dep. Exp.	24,000
	End. B/L	60,000

Cash Received from Sale of Plant Assets:

Book value of plant assets sold:

Asset cost	30,000	
Less: Accumulated depreciation	<u>-12,000</u>	18,000
+ Gain (- Loss) on sale of plant assets		<u>-6,000</u>
Cash received from sale of plant assets		12,000

Cash Paid for Purchase of Plant Assets:

Book value of plant assets purchase	70,000
- Debt issuance in exchange	<u>-60,000</u>
Cash paid for purchase of plant assets	10,000

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Cash Flows from Financing Activities

Bonds Payable		
	Beg. B/L	64,000
Retired Bonds 34,000	Issued Bonds	60,000
	End. B/L	90,000

Cash Paid to Retire Bonds

Book value of bonds retired	34,000
+ Gain (- Loss) on retirement of bonds	<u>16,000</u>
Cash paid to retire bonds	18,000

Common Stock		
	Beg. B/L	80,000
	Issued Stock	15,000
	End. B/L	95,000
Retained Earnings		
	Beg. B/L	88,000
Cash Dividends 14,000	Net income	38,000
	End. B/L	112,000

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Genesis Statement of Cash Flows For the Years Ended December 31, 2008 (In Baht)		
Cash flows from operating activities		
Net income		38,000
Adjustments:		
Depreciation expense	24,000	
Loss on sale of plant assets	6,000	
Gain on retirement of bonds	(16,000)	
Increase in accounts receivable	(20,000)	
Increase in merchandise inventory	(14,000)	
Increase in prepaid expenses	(2,000)	
Decrease in accounts payable	(5,000)	
Decrease in interest payable	(1,000)	
Increase in income taxes payable	10,000	(18,000)
Net cash flows from operating activities		20,000
Cash flows from investing activities		
Cash received from sale of plant assets	12,000	
Cash paid for purchase of plant assets	(10,000)	
Net cash flows from investing activities		2,000
Cash flows from financing activities		
Cash received from issuing stock	15,000	
Cash paid to retire bonds	(18,000)	
Cash paid for dividends	(14,000)	
Net cash flows from financing activities		(17,000)
Net change in cash		5,000
Cash balance at beginning of period		12,000
Cash balance at end of period		17,000



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STATEMENTS OF CASH FLOWS

PRESIDENT BAKERY PUBLIC COMPANY LIMITED

For the years ended 31 December 2011 and 2010

**Example of Financial Statement
Presentation & Disclosure:
Statement of Cash Flows**
[Source: www.farmhouse.co.th]

(Unit: Baht)

SEPARATE FINANCIAL STATEMENTS

Cash flows from operating activities

	2011	2010
Profit before tax	926,681,160	738,851,657
Adjustments to reconcile profit before tax to net cash provided by (paid from) operating activities:		
Depreciation and amortisation	411,071,194	375,694,250
Gain from disposals of property, plant and equipment	(3,872,902)	(1,714,952)
Share of income from investment in joint venture	-	-
Unrealised loss on exchange	259,065	241,898
Provision for long term employee benefits	4,030,557	-
Allowance for doubtful accounts	94,966	-
Interest income	(10,890,068)	(4,071,842)
Dividend income	(585,000)	(585,000)
Interest expenses	11,574,920	9,162,712

STATEMENTS OF CASH FLOWS

PRESIDENT BAKERY PUBLIC COMPANY LIMITED

For the years ended 31 December 2011 and 2010

(Unit: Baht)

	SEPARATE FINANCIAL STATEMENTS	
	2011	2010
Income from operating activities before changes in operating assets and liabilities	1,338,363,892	1,117,578,723
Decrease (increase) in operating assets		
Trade and other receivables	(177,637,529)	(77,492,414)
Inventories	(21,590,685)	(24,000,873)
Other current assets	1,755,544	(3,660,938)
Other non-current assets	184,851	(736,091)
Increase (decrease) in operating liabilities		
Trade and other payables	89,023,670	108,385,125
Other current liabilities	31,024,748	18,359,718
Other non-current liabilities	340,294	(69,244)
Provision for long-term employee benefits	(1,618,300)	-
Cash from operating activities	1,259,846,485	1,138,364,006
Cash paid for interest expenses	(11,574,920)	(9,162,712)
Cash paid for corporate income tax	(109,362,129)	(113,359,730)
Net cash from operating activities	1,138,909,436	1,015,841,564

STATEMENTS OF CASH FLOWS (CONTINUED)

PRESIDENT BAKERY PUBLIC COMPANY LIMITED

For the years ended 31 December 2011 and 2010

(Unit: Baht)

	SEPARATE FINANCIAL STATEMENTS	
	2011	2010
Cash flows from investing activities		
Purchase of other long-term investment	(15,000,000)	-
Acquisition of property, plant and equipment	(522,266,666)	(399,154,065)
Proceeds from disposals of property, plant and equipment	4,813,542	3,950,011
Increase in advance payments for purchase of assets	(13,675,309)	(15,347,413)
Increase in intangible assets	(125,899)	(270,000)
Interest income	10,890,068	4,071,842
Dividend income	585,000	585,000
Net cash used in investing activities	(534,779,264)	(406,164,625)

STATEMENTS OF CASH FLOWS (CONTINUED)

PRESIDENT BAKERY PUBLIC COMPANY LIMITED

For the years ended 31 December 2011 and 2010

(Unit: Baht)

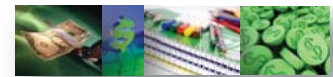
**SEPARATE
FINANCIAL STATEMENTS**

	2011	2010
Cash from financing activities		
Increase (decrease) in bank overdrafts	78	(486,841)
Decrease in liabilities under finance lease agreements	(52,180,486)	(45,503,644)
Increase in long-term loans from directors	6,850,649	12,638,431
Decrease in long-term loans from employees	(4,253,329)	(4,055,012)
Dividend payments	(343,350,000)	(273,150,000)
Net cash used in financing activities	(392,933,088)	(310,557,066)
Net increase in cash and cash equivalents	211,197,084	299,119,873
Cash and cash equivalents at beginning of year	385,066,986	85,947,113
Cash and cash equivalents at end of year	596,264,070	385,066,986

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AC201-BE-2-2015



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Statement of cash flows

-- presents the changes in the cash balance during the accounting period.

CASH FLOWS = Changes in cash balance [Cash Inflows and Cash Outflows]

CASH BALANCE = Amount of cash at any given point in time.

CASH FLOW ITEMS

Cash flow items must be categories into three categories

-- OPERATING, INVESTING, AND FINANCING

Examples of Cash Flows from Operating Activities

Cash received from sales or services

Cash paid for wages, rent, insurance, utilities, etc.

Cash paid for merchandises and/or raw materials

Examples of Cash Flows from Investing Activities

Cash paid for the acquisition of PPE

Cash received from sale of PPE

Cash paid in lending transactions -- Notes receivable

Cash received from lending transactions -- Notes collected

Examples of Cash Flows from Financing Activities

Cash received from borrowing transactions

Cash received from bonds issuance

Cash received from share issuance (Ordinary shares/Preferred shares)

Cash paid for dividends

Cash paid for interests

Cash paid for treasury shares

Cash paid to retire bonds

OPERATING CASH FLOWS: DIRECT AND INDIRECT METHOD

Cash flows from operating activities -- Direct method:

List major cash flow items under the operating activities

Cash received from sales	XXX
--------------------------	-----

Cash paid for merchandises purchased	(xx)
--------------------------------------	------

Cash paid for operating expenses	(xx)
----------------------------------	------

...

NET cash flows from operating activities	<u>OCF</u>
--	------------

Cash flows from operating activities -- Indirect method:

Adjust the net income number to be OCF

Net income	NI
------------	----

Adjustments:

(1) Noncash items	xx (xx)
-------------------	-----------

(2) Nonoperating items	xx (xx)
------------------------	-----------

(3) Changes in current assets and liabilities	xx (xx)
---	-----------

NET cash flows from operating activities	<u>OCF</u>
--	------------

CALCULATION OF OPERATING CASH FLOWS UNDER INDIRECT METHOD

Company A
Statement of Income
For the Years Ended December 31, 20X1
(In Baht)

Sales revenue	1,500
- Cost of goods sold	(600)
- Other operating expenses eg. Wages, rent, etc.	(400)
- Depreciation expense	(100)
+ Gain on sales of land	300
- Loss on sale of machine	(200)
Net income	500

Company A
Statement of Cash Flows
For the Years Ended December 31, 20X1
(In Baht)

Cash flows from operating activities -- Indirect method

Net income	500
Adjustments:	
(1) Noncash items	
+ Depreciation expense	100
(2) Nonoperating activities	
- Gain on sales of land	(300)
+ Loss on sale of machine	200
(3) Changes in current assets and liabilities	
- Increases in current assets	
>> accounts receivable, inventory, prepaid expenses	(100)
+ Decreases in current assets	
>> accounts receivable, inventory, prepaid expenses	50
+ Increases in current liabilities	
>> accounts payable, accrued expenses, unearned revenues	250
- Decreases in current liabilities	
>> accounts payable, accrued expenses, unearned revenues	(120)
NET cash flows from operating activities	580

Example: Prepare the statement of cash flows from the information given below:

Company A
Statement of Income
For the Years Ended December 31, 20X2
(In Baht)

Sales		2,540,000
Cost of goods sold	1,257,500	
Wages and other operating expenses	860,000	
Interest expense	27,000	
Depreciation expense	50,000	(2,194,500)
		345,500
Other gains (losses)		
Gain on sale of plant assets	10,000	
Loss on retirement of bonds	(8,000)	2,000
Income before taxes		347,500
Income taxes expense		(69,500)
Net income		278,000

Company A
Statement of Financial Position
As of December 31, 20X2 and 20X1
(In Baht)

	20X2	20X1	Changes
Assets			
Current assets			
Cash	594,000	664,000	(70,000)
Accounts receivable	120,000	250,000	(130,000)
Merchandise inventory	84,000	70,000	14,000
Prepaid expenses	12,000	4,000	8,000
Total current assets	810,000	988,000	(178,000)
Noncurrent assets			
Plant assets	850,000	560,000	290,000
Less: Accumulated depreciation	(60,000)	(48,000)	(12,000)
Plant assets, net	790,000	512,000	278,000
Total assets	1,600,000	1,500,000	100,000
Liabilities			
Current liabilities			
Accounts payable	10,000	12,000	(2,000)
Interest payable	18,000	4,000	14,000
Income taxes payable	22,000	34,000	(12,000)
Total current liabilities	50,000	50,000	0
Long-term bonds payable	500,000	700,000	(200,000)
Total liabilities	550,000	750,000	(200,000)
Equity			
Ordinary shares	800,000	600,000	200,000
Retained earnings	250,000	150,000	100,000
Total equity	1,050,000	750,000	300,000
Total liabilities and equity	1,600,000	1,500,000	100,000

Additional Information:

- Company acquired property, plant, and equipment for ₪400,000 cash.
- Company sold property, plant, and equipment for ₪82,000 cash and realized a gain on sale of ₪10,000.
- Company early retired the bonds payable by paying ₪208,000 cash and realized a loss on retirement of ₪8,000.
- Company issued ordinary shares for ₪200,000 cash.
- Company declared and paid dividends for ₪178,000.

Company A
Statement of Cash Flows
For the Year Ended December 31, 20X2
(in Baht)

Cash flows from operating activities

Net income

--

Adjustments:

Noncash items

Nonoperating items

Changes in current assets and liabilities

Net cash flows from operating activities

Cash flows from investing activities

Net cash flows from investing activities

--

Cash flows from financing activities

Net cash flows from financing activities

--

Net change in cash

--

Beginning cash balance

--

Ending cash balance

--

EXERCISES



Available with McGraw-Hill's Homework Manager

E13-1 Matching Items Reported to Cash Flow Statement Categories (Indirect Method)

L01

Reebok

Reebok International Ltd. is a global company that designs and markets sports and fitness products, including footwear, apparel, and accessories. Some of the items included in its recent annual consolidated statement of cash flows presented using the **indirect method** are listed here.

Indicate whether each item is disclosed in the Operating Activities (O), Investing Activities (I), or Financing Activities (F) section of the statement or (NA) if the item does not appear on the statement. (**Note:** This is the exact wording used on the actual statement.)

- _____ 1. Dividends paid
- _____ 2. Repayments of long-term debt
- _____ 3. Depreciation and amortization
- _____ 4. Proceeds from issuance of common stock to employees
- _____ 5. [Change in] Accounts payable and accrued expenses
- _____ 6. Cash collections from customers
- _____ 7. Net repayments of notes payable to banks
- _____ 8. Net income
- _____ 9. Payments to acquire property and equipment
- _____ 10. [Change in] Inventory

Matching Items Reported to Cash Flow Statement Categories (Direct Method)

The Australian company BHP Billiton is the world's biggest mining company. Some of the items included in its recent annual consolidated statement of cash flows presented using the **direct method** are listed here.

Indicate whether each item is disclosed in the Operating Activities (O), Investing Activities (I), or Financing Activities (F) section of the statement or (NA) if the item does not appear on the statement. (Note: This is the exact wording used on the actual statement.)

- _____ 1. Proceeds from sale of property, plant, and equipment
- _____ 2. Interest received
- _____ 3. Repayments of loans
- _____ 4. Income taxes paid
- _____ 5. Proceeds from ordinary share [stock] issues
- _____ 6. Dividends paid
- _____ 7. Payments in the course of operations
- _____ 8. Receipts from customers
- _____ 9. Payments for property, plant, and equipment
- _____ 10. Net income

Determining Cash Flow Statement Effects of Transactions

Stanley Furniture Company is a Virginia-based furniture manufacturer. For each of the following first-quarter transactions, indicate whether **net cash inflows (outflows)** from operating activities (NCFO), investing activities (NCFI), or financing activities (NCFI) are affected and whether the effect is an inflow (+) or outflow (−), or (NE) if the transaction has no effect on cash. (Hint: Determine the journal entry recorded for the transaction. The transaction affects net cash flows *if and only if* the account Cash is affected.)

- _____ 1. Recorded an adjusting entry to record accrued salaries expense.
- _____ 2. Paid cash to purchase new equipment.
- _____ 3. Collected payments on account from customers.
- _____ 4. Recorded and paid interest on debt to creditors.
- _____ 5. Declared and paid cash dividends to shareholders.
- _____ 6. Sold used equipment for cash at book value.
- _____ 7. Prepaid rent for the following period.
- _____ 8. Repaid principal on revolving credit loan from bank.
- _____ 9. Purchased raw materials inventory on account.
- _____ 10. Made payment to suppliers on account.

Determining Cash Flow Statement Effects of Transactions

Hewlett-Packard is a leading manufacturer of computer equipment for the business and home markets. For each of the following recent transactions, indicate whether **net cash inflows (outflows)** from operating activities (NCFO), investing activities (NCFI), or financing activities (NCFI) are affected and whether the effect is an inflow (+) or outflow (−), or (NE) if the transaction has no effect on cash. (Hint: Determine the journal entry recorded for the transaction. The transaction affects net cash flows *if and only if* the account Cash is affected.)

- _____ 1. Purchased raw materials inventory on account.
- _____ 2. Prepaid rent for the following period.
- _____ 3. Purchased new equipment by signing a three-year note.

E13-2
L01
BHP Billiton



E13-3
L01
Stanley Furniture

E13-4
L01
Hewlett-Packard

- _____ 4. Recorded an adjusting entry for expiration of a prepaid expense.
- _____ 5. Recorded and paid income taxes to the federal government.
- _____ 6. Purchased investment securities for cash.
- _____ 7. Issued common stock for cash.
- _____ 8. Collected payments on account from customers.
- _____ 9. Sold equipment for cash equal to its net book value.
- _____ 10. Issued long-term debt for cash.

E13-5
L01 **Comparing the Direct and Indirect Methods**

To compare statement of cash flows reporting under the direct and indirect methods, enter check marks to indicate which items are used with each method.

STATEMENT OF CASH FLOWS METHOD		
Cash Flows (and Related Changes)	Direct	Indirect
1. Accounts payable increase or decrease		
2. Payments to employees		
3. Cash collections from customers		
4. Accounts receivable increase or decrease		
5. Payments to suppliers		
6. Inventory increase or decrease		
7. Wages payable, increase or decrease		
8. Depreciation expense		
9. Net income		
10. Cash flows from operating activities		
11. Cash flows from investing activities		
12. Cash flows from financing activities		
13. Net increase or decrease in cash during the period		

E13-6
L02 **Reporting Cash Flows from Operating Activities (Indirect Method)**

The following information pertains to Night Company:

Income Statement		
Sales		\$75,000
Expenses		
Cost of goods sold	\$46,875	
Depreciation expense	8,500	
Salaries expense	12,000	67,375
Net income		\$ 7,625
Partial Balance Sheet		
	2010	2009
Accounts receivable	\$12,500	\$10,000
Inventory	8,000	15,000
Salaries payable	1,750	800

Required:

Present the operating activities section of the statement of cash flows for Night Company using the indirect method.

E13-7
L02 **Reporting and Interpreting Cash Flows from Operating Activities from an Analyst's Perspective (Indirect Method)**

Able Company completed its income statement and balance sheet for 2010 and provided the following information:

Income Statement		
Service revenue		\$51,000
Expenses		
Salaries	\$41,000	
Depreciation	5,000	
Amortization of copyrights	200	
Other expenses	8,700	54,900
Net loss		(\$ 3,900)
Partial Balance Sheet		
	2010	2009
Accounts receivable	\$ 8,000	\$25,000
Salaries payable	14,000	1,000
Other accrued liabilities	1,000	5,100

In addition, Able bought a small service machine for \$5,000.

Required:

1. Present the operating activities section of the statement of cash flows for Able Company using the indirect method.
2. What were the major reasons that Able was able to report a net loss but positive cash flow from operations? Why are the reasons for the difference between cash flow from operations and net income important to financial analysts?

Reporting and Interpreting Cash Flows from Operating Activities from an Analyst's Perspective (Indirect Method)

Time Warner Telecom, Inc., offers network, local, and long-distance voice services, data transmission services, high-speed dedicated Internet access, and intercarrier services to business customers and organizations throughout the United States. The company's recent annual report contained the following information (dollars in thousands):

Net loss	\$ (98,819)
Depreciation and amortization	259,380
Increase in receivables	18,161
Decrease in accrued interest	18,207
Increase in accounts payable	571
Decrease in accrued payroll and benefits	3,236
Increase in other liabilities (current)	53,030
Increase in long-term debt	94,248
Additions to equipment	192,269

Required:

1. Based on this information, compute cash flow from operating activities using the indirect method.
2. What were the major reasons that Time Warner was able to report a net loss but positive cash flow from operations? Why are the reasons for the difference between cash flow from operations and net income important to financial analysts?

Inferring Balance Sheet Changes from the Cash Flow Statement (Indirect Method)

A recent statement of cash flows for Colgate-Palmolive reported the following information (dollars in millions):

E13-8
L02
Time Warner Telecom

E13-9
L02
Colgate-Palmolive

Operating Activities	
Net income	\$1,353.4
Depreciation	328.7
Cash effect of changes in	
Receivables	(116.0)
Inventories	(118.5)
Other current assets	8.2
Payables	149.9
Other	215.8
Net cash provided by operations	<u>\$1,821.5</u>

Required:

Based on the information reported on the statement of cash flows for Colgate-Palmolive, determine whether the following accounts increased or decreased during the period: Receivables, Inventories, Other Current Assets, and Payables.

E13-10
L02
Apple, Inc.

Inferring Balance Sheet Changes from the Cash Flow Statement (Indirect Method)

A recent statement of cash flows for Apple contained the following information (dollars in thousands):

Operations	
Net income	\$ 310,178
Depreciation	167,958
Changes in assets and liabilities	
Accounts receivable	(199,401)
Inventories	418,204
Other current assets	33,616
Accounts payable	139,095
Income taxes payable	50,045
Other current liabilities	39,991
Other adjustments	(222,691)
Cash generated by operations	<u>\$ 736,995</u>

Required:

For each of the asset and liability accounts listed on the statement of cash flows, determine whether the account balances increased or decreased during the period.

E13-11
L04

Reporting Cash Flows from the Sale of Plant and Equipment

During two recent years A. Klein, Inc. disposed of the following plant and equipment:

	Year 1	Year 2
Plant and equipment (at cost)	\$55,000	\$ 8,500
Accumulated depreciation on equipment disposed of	29,677	3,616
Cash received	14,692	11,616
Gain (loss) on sale	(10,631)	6,732

Required:

1. Determine the cash flow from the sale of property for each year that would be reported in the investing activities section of the cash flow statement.
2. Klein uses the indirect method for the operating activities section of the cash flow statement. What amounts related to the sales would be added or subtracted in the computation of Net Cash Flows from Operating Activities for each year?

Reporting Cash Flows from the Sale of Equipment

During the period, English Company sold some excess equipment at a loss. The following information was collected from the company's accounting records:

From the income statement

Depreciation expense	\$ 630
Loss on sale of equipment	2,700

From the balance sheet

Beginning equipment	13,000
Ending equipment	7,700
Beginning accumulated depreciation	1,800
Ending accumulated depreciation	1,900

No new equipment was bought during the period.

Required:

1. For the equipment that was sold, determine its original cost, its accumulated depreciation, and the cash received from the sale. (Use the equipment and accumulated depreciation T-accounts to infer the book value of the equipment sold.)
2. English Company uses the indirect method for the Operating Activities section of the cash flow statement. What amount related to the sales would be added or subtracted in the computation of Net Cash Flows from Operating Activities?
3. What amount related to the sales would be added or subtracted in the computation of Net Cash Flows from Investing Activities?

Analyzing Cash Flows from Operating Activities; Interpreting the Quality of Income Ratio

A recent annual report for PepsiCo contained the following information for the period (dollars in millions):

Net income	\$5,642
Depreciation and amortization	1,406
Increase in accounts receivable	330
Increase in inventory	186
Increase in prepaid expense	37
Increase in accounts payable	223
Decrease in taxes payable	295
Decrease in other current liabilities	339
Cash dividends paid	1,854
Treasury stock purchased	3,000

Required:

1. Compute cash flows from operating activities for PepsiCo using the indirect method.
2. Compute the quality of income ratio.
3. What were the major reasons that Pepsi's quality of income ratio did not equal 1.0?

Reporting Cash Flows from Investing and Financing Activities

Randall's Furniture Corporation is a Virginia-based manufacturer of furniture. In a recent quarter, it reported the following activities:

Net income	\$ 4,135
Purchase of property, plant, and equipment	871
Borrowings under line of credit (bank)	1,417
Proceeds from issuance of stock	11
Cash received from customers	29,164
Payments to reduce long-term debt	46
Sale of marketable securities	134
Proceeds from sale of property and equipment	6,594
Dividends paid	277
Interest paid	90
Purchase of treasury stock (stock repurchase)	1,583

E13-12
L04

E13-13
L02, 3
PepsiCo



E13-14
L04, 6

Required:

Based on this information, present the cash flow from investing and financing activities sections of the cash flow statement.

E13-15 Preparing a Statement of Cash Flows (Indirect Method)
L02, 4, 6

Dive In Company was started several years ago by two diving instructors. The company's comparative balance sheets and income statement are presented below, along with additional information.

	2008	2007
Balance sheet at December 31		
Cash	\$ 3,200	\$ 4,000
Accounts receivable	700	500
Prepaid expenses	100	50
Equipment	300	0
	<u>\$ 4,300</u>	<u>\$ 4,550</u>
Wages payable	\$ 350	\$ 1,100
Contributed capital	1,200	1,000
Retained earnings	2,750	2,450
	<u>\$ 4,300</u>	<u>\$ 4,550</u>
Income statement for 2008		
Lessons revenue	\$33,950	
Wages expense	30,000	
Other expenses	3,650	
Net income	<u>\$ 300</u>	

Additional Data:

- Prepaid expenses relate to rent paid in advance.
- Other operating expenses were paid in cash.
- Purchased equipment for \$300 cash at the end of 2008 to be used starting in 2009.
- An owner contributed capital by paying \$200 cash in exchange for the company's stock.

Required:

Prepare the statement of cash flows for the year ended December 31, 2008, using the indirect method.

E13-16 Reporting and Interpreting Cash Flows from Investing and Financing Activities with Discussion of Management Strategy
L04, 5, 6



Gibraltar Industries is a Buffalo, New York-based manufacturer of high-value-added steel products. In a recent year, it reported the following activities:

Acquisitions (investments in other companies)	\$ (84,243)
Decrease in inventories	11,056
Depreciation and amortization	22,448
Long-term debt reduction	(118,100)
Net cash provided by operating activities	64,663
Net income	26,953
Net proceeds from issuance of common stock	73,558
Net proceeds from sale of property and equipment	436
Payment of dividends	(2,733)
Proceeds from long-term debt	122,144
Purchases of other equity investments	(7,797)
Purchases of property, plant, and equipment	(22,571)

Required:

1. Based on this information, present the cash flow from investing and financing activities sections of the cash flow statement.
2. Compute the capital acquisitions ratio. What does the ratio tell you about Gibraltar's ability to finance purchases of property, plant, and equipment with cash provided by operating activities?
3. What do you think was Gibraltar management's plan for the use of the cash generated by the issuance of common stock?

Reporting Noncash Transactions on the Statement of Cash Flows; Interpreting the Effect on the Capital Acquisitions Ratio

E13-17
L05, 7



An analysis of Martin Corporation's operational asset accounts provided the following information:

- a. Acquired a large machine that cost \$26,000, paying for it by giving a \$15,000, 12 percent interest-bearing note due at the end of two years and 500 shares of its common stock, with a par value of \$10 per share and a market value of \$22 per share.
- b. Acquired a small machine that cost \$8,700. Full payment was made by transferring a tract of land that had a book value of \$8,700.

Required:

1. Show how this information should be reported on the statement of cash flows.
2. What would be the effect of these transactions on the capital acquisitions ratio? How might these transactions distort interpretation of the ratio?

Reporting Cash Flows from Operating Activities from an Analyst's Perspective (Direct Method) (Supplement A)

E13-18

Refer to the information for Night Company in Exercise 13.6.

Required:

Present the operating activities section of the statement of cash flows for Night Company using the direct method.

Reporting and Interpreting Cash Flows from Operating Activities from an Analyst's Perspective (Direct Method) (Supplement A)

E13-19

Refer to the information for Able Company in Exercise 13.7.

Required:

1. Present the operating activities section of the statement of cash flows for Able Company using the direct method. Assume that other accrued liabilities relate to other expenses on the income statement.
2. What were the major reasons that Able was able to report a net loss but positive cash flow from operations? Why are the reasons for the difference between cash flow from operations and net income important to financial analysts?

Reporting and Interpreting Cash Flows from Operating Activities from an Analyst's Perspective (Direct Method) (Supplement A)

E13-20

Refer to the following summarized income statement and additional selected information for Sizzler, Inc.:

Income statement		Other information:	
Revenues	\$136,500	Increase in receivables	\$ 170
Cost of sales	45,500	Decrease in inventories	643
Gross margin	91,000	Increase in prepaid expenses	664
Salary expense	56,835	Decrease in accounts payable	2,282
Depreciation and amortization	33,305	Decrease in accrued liabilities	719
Other expense	7,781	Increase in income taxes payable	1,861
Net loss before tax	(6,921)		
Income tax expense	2,561		
Net loss	\$ (9,482)		

Required:

1. Based on this information, compute cash flow from operating activities using the direct method. Assume that prepaid expenses and accrued liabilities relate to other expense.
2. What were the major reasons that Sizzler was able to report a net loss but positive cash flow from operations? Why are the reasons for the difference between cash flow from operations and net income important to financial analysts?

E13-21 Preparing a Statement of Cash Flows, Indirect Method: Complete Spreadsheet (Supplement B)

An analysis of accounts follows:

- a. Purchased equipment, \$16,000, and issued capital stock in full payment.
- b. Purchased a long-term investment for cash, \$10,000.
- c. Paid cash dividend, \$15,000.
- d. Sold operational asset for \$6,000 cash (cost, \$21,000, accumulated depreciation, \$15,000).
- e. Sold capital stock, 300 shares at \$12 per share cash.

Items from Financial Statements	Beginning Balances, 12/31/2010	ANALYSIS OF CHANGES		Ending Balances, 12/31/2011
		Debit	Credit	
Income statement items				
Sales			\$140,000	
Cost of goods sold		\$59,000		
Depreciation		3,000		
Wage expense		28,000		
Income tax expense		9,000		
Interest expense		5,000		
Remaining expenses		15,800		
Net income		20,200		
Balance sheet items				
Cash	\$ 20,500			\$ 18,800
Accounts receivable	22,000			22,000
Merchandise inventory	68,000			75,000
Investments, long-term				10,000
Equipment	114,500			109,500
Total debits	<u>\$225,000</u>			<u>\$235,300</u>
Accumulated depreciation	\$ 32,000			\$ 20,000
Accounts payable	17,000			14,000
Wages payable	2,500			1,500
Income taxes payable	3,000			4,500
Bonds payable	54,000			54,000
Common stock, no par	100,000			119,600
Retained earnings	16,500			21,700
Total credits	<u>\$225,000</u>			<u>\$235,300</u>
		Inflows	Outflows	
Statement of cash flows				
Cash flows from operating activities:				
Cash flows from investing activities:				
Cash flows from financing activities:				
Net increase (decrease) in cash				
Totals				

Required:

Complete the spreadsheet for the statement of cash flows, indirect method.

EXERCISES

E13-1.

- | | |
|-----------|--|
| <u>F</u> | 1. Dividends paid |
| <u>F</u> | 2. Repayments of long-term debt |
| <u>O</u> | 3. Depreciation and amortization |
| <u>F</u> | 4. Proceeds from issuance of common stock to employees |
| <u>O</u> | 5. [Change in] Accounts payable and accrued expenses |
| <u>NA</u> | 6. Cash collections from customers |
| <u>F</u> | 7. Net repayments of notes payable to banks |
| <u>O</u> | 8. Net income |
| <u>I</u> | 9. Payments to acquire property and equipment |
| <u>O</u> | 10. [Change in] Inventory |

E13-2.

- | | |
|-----------|--|
| <u>I</u> | 1. Proceeds from sale of property, plant and equipment |
| <u>O</u> | 2. Interest received |
| <u>F</u> | 3. Repayments of loans |
| <u>O</u> | 4. Income taxes paid |
| <u>F</u> | 5. Proceeds from ordinary share [stock] issues |
| <u>F</u> | 6. Dividends paid |
| <u>O</u> | 7. Payments in the course of operations |
| <u>O</u> | 8. Receipts from customers |
| <u>I</u> | 9. Payments for property, plant and equipment |
| <u>NA</u> | 10. Net income |

E13-3.

- | | | |
|-----|--------|---|
| 1. | NE | Salaries expense
Accrued salaries payable |
| 2. | – NCFI | Plant and equipment
Cash |
| 3. | + NCFO | Cash
Accounts receivable |
| 4. | – NCFO | Interest expense
Cash |
| 5. | – NCFF | Retained earnings
Cash |
| 6. | + NCFI | Cash
Accumulated depreciation
Plant and equipment |
| 7. | – NCFO | Prepaid expenses (rent)
Cash |
| 8. | – NCFF | Short-term debt
Cash |
| 9. | NE | Inventory
Accounts payable |
| 10. | – NCFO | Accounts payable
Cash |

E13-4.

- | | | |
|-----|--------|--|
| 1. | NE | Inventory
Accounts payable |
| 2. | – NCFO | Prepaid expenses (rent)
Cash |
| 3. | NE | Plant and equipment
Note payable |
| 4. | NE | Expense
Prepaid expense |
| 5. | – NCFO | Income tax expense
Cash |
| 6. | – NCFI | Investment securities
Cash |
| 7. | + NCFF | Cash
Common stock
Additional paid-in capital |
| 8. | + NCFO | Cash
Accounts receivable |
| 9. | + NCFI | Cash
Plant and equipment (net) |
| 10. | + NCFF | Cash
Long-term Debt |

E13-5.

Comparison of Statement of Cash Flows direct and indirect reporting

Cash flows (and related changes)	Statement of Cash Flows Method	
	Direct	Indirect
1. Accounts payable increase or decrease		X
2. Payments to employees	X	
3. Cash collections from customers	X	
4. Accounts receivable increase or decrease		X
5. Payments to suppliers	X	
6. Inventory increase or decrease		X
7. Wages payable, increase or decrease		X
8. Depreciation expense		X
9. Net income		X
10. Cash flows from operating activities	X	X
11. Cash flows from investing activities	X	X
12. Cash flows from financing activities	X	X
13. Net increase or decrease in cash during the period	X	X

The direct method reports cash flows from operating activities individually for each major revenue and expense. In contrast, the indirect method reports a reconciliation of net income to cash flow from operating activities. The two methods report the investing and financing activities in exactly the same way.

E13-6.

Cash flows from operating activities—indirect method

Net income	\$7,625
Depreciation expense	8,500
Accounts receivable increase (\$12,500 – \$10,000)	(2,500)
Inventory decrease (\$8,000 – \$15,000)	7,000
Salaries payable increase (\$1,750 – \$800)	950
Net cash provided by operating activities	<u>\$21,575</u>

E13-7.

Req. 1

Cash flows from operating activities—indirect method

Net loss	(\$3,900)
Depreciation expense	5,000
Amortization of copyrights	200
Accounts receivable decrease (\$8,000 – \$25,000)	17,000
Salaries payable increase (\$14,000 – \$1,000)	13,000
Other accrued liabilities decrease (\$1,000 – \$5,100)	(4,100)
Net cash provided by operating activities	<u>\$27,200</u>

Req. 2

The first reason for the net loss was the depreciation expense. This is a non-cash expense. Depreciation expense, along with decreased working capital requirements (current assets - current liabilities), turned the net loss into positive operating cash flow from operations. The reasons for the difference between net income and cash flow are important because they help the financial analyst to determine if the trends are sustainable or whether they represent one-time events.

E13-8.

Req. 1

Cash flows from operating activities—indirect method

Net loss.....	(\$98,819)
Depreciation and amortization.....	259,380
Increase in receivables.....	(18,161)
Decrease in accrued interest.....	(18,207)
Increase in accounts payable.....	571
Decrease in accrued payroll and benefits	(3,236)
Increase in other liabilities	53,030
Cash flows from operating activities	<u>\$174,558</u>

Note: The increase in long-term debt and additions to equipment do not affect cash flows from operating activities.

Req. 2

The primary reason for the net loss was the depreciation and amortization expense. These represent non-cash expenses. Large depreciation and amortization expense, offset partially by increased working capital requirements, turned Time Warner's net loss into positive operating cash flow. The reasons for the difference between net income and cash flow from operations are important because they help the financial analyst to determine if the trends are sustainable or whether they represent one-time events.

E13-9.

<i>Account</i>	<i>Change</i>
Receivables	Increase
Inventories	Increase
Other current assets	Decrease
Payables	Increase

E13-10.

<i>Account</i>	<i>Change</i>
Accounts receivable	Increase
Inventories	Decrease
Other current assets	Decrease
Accounts payable	Increase
Income taxes payable	Increase
Other current liabilities	Increase

E13-11.

Req. 1

Cash flows from investing activities	<u>Year 1</u>	<u>Year 2</u>
Proceeds from sale of equipment	\$14,692	\$11,616

The amount reported in the cash flow from investing activities section of the statement of cash flows is the total cash proceeds from the sale of the equipment, regardless of the amount of any gain or loss.

Req. 2

Any gain on the sale of the equipment is subtracted from net income to avoid double counting of the gain. Any loss on the sale of the equipment is added to avoid double counting of the loss.

Cash flows from operating activities	<u>Year 3</u>	<u>Year 2</u>	<u>Year 1</u>
Loss (Gain) on sale of equipment.....	\$10,631	\$(6,732)	--

Computations:

	<u>Year 1</u>	<u>Year 2</u>
Plant and equipment (at cost)	\$55,000	\$8,500
Accumulated depreciation	<u>29,677</u>	<u>3,616</u>
Net book value	<u>25,323</u>	<u>4,884</u>
Cash Proceeds – Net book value = Gain (Loss)	(10,631)	6,732

on sale

E13-12.

Req. 1

Equipment		Accumulated Depreciation	
Beg. Bal.	13,000		
	5,300*Sold	Sold	530*
End. Bal.	7,700		

	1,800	Beg. Bal.
	630	Dep. Exp.
	1,900	End. Bal.

*plug figures

Cost of equipment sold = \$5,300

Accumulated depreciation on sold equipment = \$530

Book value of sold equipment..... \$4,770

Less: Loss on sale (given) (2,700)

Cash received from sale \$2,070

Req. 2

Any gain on the sale of the equipment is subtracted from net income to avoid double counting of the gain. Any loss on the sale of the equipment is added to avoid double counting of the loss. The loss of \$2,700 would be added.

Req. 3

The amount of cash received is added in the computation of Net Cash Flow from investing activities, regardless of whether the sale results in a gain or loss. The cash inflow of \$2,070 would be added.

E13-13.

Req. 1

Cash flows from operating activities—indirect method

Net income	\$5,642
Depreciation and amortization.....	1,406
Increase in accounts receivable	(330)
Increase in inventory	(186)
Increase in prepaid expense	(37)
Increase in accounts payable	223
Decrease in taxes payable	(295)
Decrease in other current liabilities	(339)
Cash flows from operating activities	<u>\$6,084</u>

Note: The cash dividends paid and treasury stock purchased are not related to operating activities and do not affect cash flows from operating activities.

Req. 2

$$\text{Quality of income ratio} = \frac{\text{Cash flow from operations}}{\text{Net income}} = \frac{\$6,084}{\$5,642} = 1.08$$

Req. 3

The reason the quality of income ratio was greater than one was primarily because of large non-cash depreciation charges.

E13-14.

The investing and financing sections of the statement of cash flows for Randall's Furniture:

Cash flows from investing activities:

Purchase of property, plant & equipment	\$(871)	
Sale of marketable securities	134	
Proceeds from sale of property & equipment	6,594	
Net cash flows from investing activities		\$5,857

Cash flows from financing activities:

Borrowings under line of credit	1,417	
Proceeds from issuance of stock.....	11	
Payments on long term debt.....	(46)	
Payment of dividends	(277)	
Purchase of treasury stock	(1,583)	
Net cash flows from financing activities		(478)

E13-15.

DIVE IN COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities:

Net income	\$ 300	
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	(200)	
Increase in prepaids	(50)	
Decrease in wages payable	(750)	
Net cash provided by (used for) operating activities.....	(700)	

Cash flows from Investing activities:

Cash paid for equipment	(300)	
Net cash provided by (used for) investing activities	(300)	

Cash flows from financing activities:

Cash proceeds from issuing stock	200	
Net cash provided by financing activities	200	
Net increase (decrease) in cash during the year	(800)	
Cash balance, January 1, 2008	4,000	
Cash balance, December 31, 2008	<u>\$3,200</u>	

E13-16.

Req. 1

The investing and financing sections of the statement of cash flows for Gibraltar Industries:

Cash flows from investing activities:

Acquisitions (investments in other companies)	(84,243)	
Purchases of other equity investments	(7,797)	
Purchases of property, plant and equipment	(22,571)	
Net proceeds from sale of property and equipment	436	
Net cash used in investing activities		(114,175)

Cash flows from financing activities:

Long-term debt reduction	(118,100)	
Proceeds from long-term debt	122,144	
Net proceeds from issuance of common stock	73,558	
Payment of dividends	(2,733)	
Net cash provided by (used in) financing activities		74,869

Req. 2

$$\text{Capital acquisitions ratio} = \frac{\text{Cash flow from operations}}{\text{Cash Paid for Plant \& Equipment}} = \frac{\$64,663}{\$22,571} = 2.86$$

The capital acquisitions ratio measures the company's ability to finance plant and equipment purchases from operations. Since this amount was more than 1 (2.86), the company has generated more than enough to finance plant and equipment purchases from operations.

Req. 3

Gibraltar's management is using the cash proceeds from the stock offering, along with the excess cash generated by operations (see Req. 2) mainly to invest in other companies. Note that most of the new long-term debt issuances are being used to pay off existing long-term debt.

E13-17.

Req. 1

Both of these transactions are considered noncash investing and financing activities, and are not reported on the statement of cash flows. The transactions must be disclosed in a separate schedule or in the footnotes. The information disclosed in the separate schedule would state:

- Equipment valued at \$26,000 was acquired by giving a \$15,000, 12%, two-year note, and common stock with a market value of \$11,000.
- A machine valued at \$8,700 was acquired by exchanging land with a book value of \$8,700.

Req. 2

The capital acquisitions ratio measures the company's ability to finance plant and equipment purchases from operations. Since neither of these transactions enters the numerator or denominator of the ratio, they would have no effect. Many analysts believe that these transactions represent important capital acquisitions, and thus should be included in the denominator of the ratio to indicate what portion of all (not just cash) acquisitions are being financed from operations.

E13-18.

Cash flows from operating activities—direct method

Cash collected from customers ¹	\$72,500
Cash payments to suppliers of inventory ²	(39,875)
Cash payments to employees ³	(11,050)
Net cash provided by operating activities	<u>\$21,575</u>

1. Cash collected from customers = Sales revenue – Increase in Accounts receivable
 $\$75,000 - \$2,500 = \$72,500$
2. Cash payments to suppliers of inventory = Cost of goods sold – Decrease in Inventory
 $\$46,875 - \$7,000 = \$39,875$
3. Cash payments to employees = Salaries expense – Increase in Salaries payable
 $\$12,000 - \$950 = \$11,050$

E13-19.

Req. 1

Cash flows from operating activities—direct method

Cash collected from customers ¹	\$68,000
Cash payments to employees ²	(28,000)
Cash paid for other expenses ³	(12,800)
Net cash provided by operating activities	<u>\$27,200</u>

1. Cash collected from customers = Sales revenue + Decrease in Accounts receivable
 $\$51,000 + \$17,000 = \$68,000$
2. Cash payments to employees = Salaries expense – Increase in Salaries payable
 $\$41,000 - \$13,000 = \$28,000$
3. Cash paid for other expenses = Other expenses + Decrease in Other accrued liabilities
 $\$8,700 + \$4,100 = \$12,800$

Req. 2

The first reason for the net loss was the depreciation expense. This is a non-cash expense. Depreciation expense, along with decreased working capital requirements (current assets - current liabilities), turned the net loss into positive operating cash flow. The reasons for the difference between net income and cash flow are important because they help the financial analyst to determine if the trends are sustainable or whether they represent one-time events.

E13-20.

Req. 1

Cash flows from operating activities—direct method

Cash collected from customers ¹	\$136,330
Cash payments to employees	(56,835)
Cash payments to suppliers ²	(47,139)
Cash payments for other expenses ³	(9,164)
Cash payments for income tax ⁴	(700)
Net cash provided by operating activities	<u>\$22,492</u>

1. Cash collected from customers:
Revenues – Increase in Accounts receivable
 $\$136,500 - 170 = 136,330$
2. Cash payments to suppliers:
Cost of sales – Decrease in Inventories + Decrease in Accounts payable
 $\$45,500 - 643 + 2,282 = 47,139$
3. Cash payments for other expenses:
Other expense + Increase in Prepaid expenses + Decrease in Accrued liabilities
 $\$7,781 + 664 + 719 = 9,164$
4. Cash payments for income tax:
Income tax expense – Increase in income taxes payable
 $\$2,561 - 1,861 = 700$

Req. 2

The primary reason for the net loss was the depreciation and amortization expense. These represent non-cash expenses. Large depreciation and amortization expense, offset partially by increased working capital requirements, turned Sizzler's net loss into positive operating cash flow. The reasons for the difference between net income and cash flow from operations are important because they help the financial analyst to determine if the trends are sustainable or whether they represent one-time events.

E13-21.

Item	Balances 12/31/2010	Analysis		Balances 12/31/2011
		Debit	Credit	
Cash	20,500		l 1,700	18,800
Noncash accounts:				
Accounts receivable (net)	22,000			22,000
Merchandise inventory	68,000	h 7,000		75,000
Investments, long-term		d 10,000		10,000
Equipment	114,500	b 16,000	i 21,000	109,500
Total	<u>225,000</u>			<u>235,300</u>
Accumulated depreciation	32,000	i 15,000	c 3,000	20,000
Accounts payable	17,000	e 3,000		14,000
Wages payable	2,500	f 1,000		1,500
Income taxes payable	3,000		g 1,500	4,500
Bonds payable	54,000		j 3,600	54,000
Common stock, no par	100,000		b 16,000	119,600
Retained earnings	16,500	k 15,000	a 20,200	21,700
Total	<u>225,000</u>			<u>235,300</u>
Statement of Cash Flows		Inflows	Outflows	
Conversion of net income to cash flow from operating activities:				
Net income		a 20,200		
Depreciation expense		c 3,000		
Accounts payable decrease			e 3,000	
Wages payable decrease			f 1,000	
Income taxes payable increase		g 1,500		
Inventory increase			h 7,000	13,700
Cash flows from investing activities:				
Long-term investment purchased			d 10,000	
Sale of equipment		i 6,000		(4,000)
Cash flows from financing activities:				
Sale of capital stock		j 3,600		
Dividends paid			k 15,000	(11,400)
Net increase (decrease) in cash		l 1,700		
Totals		<u>103,000</u>	<u>103,000</u>	<u>(1,700)</u>