

Online Course Manual

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Module 13

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Module 13 Summary

I. The Statement of Cash Flows is one of the major statements (along with the Income Statement, Statement of Stockholders' Equity and Balance Sheet) provided to the public in the corporate annual report.

- A. The purpose of the Statement of Cash Flows is to (1) show where the company's cash inflows came from during the period and where the cash outflows went (in other words, it reports on the company's *sources* and *uses* of the company's *funds*, and is sometimes referred to as the "funds statement" or the "sources and uses statement"), and (2) to disclose the events that occurred during the period that caused changes in the balances of the non-current assets (Long-Term Investments; Property, Plant and Equipment; and Intangible Assets), the non-current liabilities, and the Stockholders' Equity accounts.
- B. Information about cash flows is useful to management and to investors and creditors in assessing the company's liquidity position and short-term future solvency (it's ability to raise cash from various sources and it's commitment to make expenditures for various purposes).
- C. The statement also provides additional disclosure to investors and creditors of events occurring during the period that are not reported on the income statement or balance sheet (eg., the purchase or sale of equipment, buildings, land, etc.; the issuance or retirement of long-term debt; the payment of dividends; and so on).

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II. Format of the Statement of Cash Flows.

- A. The statement is divided into three sections, each of which represents one of the three general types of *business activities* that produce cash inflows or cash outflows:
 1. **Operating activities** are those that arise from the normal, on-going operation of the business (i.e., cash inflows from sales and cash outflows to pay operating expenses).
 2. **Investing activities** are those that relate to the sale or purchase of all the noncurrent assets and one of the current assets, short-term investments. Therefore, this section discloses the way the company's managers invested the firm's funds in the assets needed to operate the business or raised cash by selling assets no longer needed.
 3. **Financing activities** are those that pertain to the raising of cash from creditors and investors or to the payment of cash to them (i.e., to the way that the firm *financed* its operations). Therefore, this section reports on long-term debt issuances and retirements, stock issuances and repurchases, and dividend payments to stockholders. Interest payments are *not* included in this section; they are instead listed among the Operating Activities as a component of net income.

- B. **Noncash Investing and Financing Activities.** In some cases events will have occurred that did affect noncurrent assets, noncurrent liabilities, and/or stockholders' equity accounts; but that did not affect cash. For example, the corporation may have issued stock in exchange for a building, or signed a long-term note to acquire equipment. Since these events do not cause changes in cash, they should not be listed among the items in the three major sections of the statement. However, because the statement's secondary purpose is to disclose all the events that caused changes in the balance sheet accounts, these transactions should be reported. They are disclosed in a separate schedule at the bottom of the statement titled Noncash Investing and Financing Activities.
- C. Each event that resulted in cash inflows or outflows during the period is categorized and listed under one of the three classifications, along with the net cash flow it provided (if positive) or used (if negative).
1. The cash inflows and outflows are then netted out against each other to compute the total amount of cash provided by or used in the activity.
 2. The totals for each of the three activities are then added up. Their sum will be equal to the total change in cash that occurred during the period. The form of the statement appears as follows (the \pm symbol indicates that these amounts may be either positive, representing cash inflows, or negative, representing cash outflows):

Statement of Cash Flows		
Cash Flows from Operating Activities		
Item A		
Item B, etc.	\$ \pm X	
Net Cash Flows from Operating Activities	<u>\pmX</u>	
Cash Flows from Investing Activities		
Item A		\$ \pm X
Item B, etc.	\$ \pm X	
Net Cash Flows from Investing Activities	<u>\pmX</u>	
Cash Flows from Financing Activities		
Item A		
Item B, etc.	\$ \pm X	\$ \pm X
Net Cash Flows from Financing Activities	<u>\pmX</u>	
Net Increase (Decrease) in Cash		<u>\$ \pmX</u>
Cash Balance (Beginning of Period)		\$ \pm X
Cash Balance (End of Period)		<u>\$ X</u>
Noncash Investing and Financing Activities:		<u>\$ X</u>

III. Steps in Preparing the Statement of Cash Flows (Indirect Method)

- A. Two methods of presenting the statement of cash flows are allowed under GAAP, the *indirect method* and the *direct method*.
 - 1. The only difference between them lies in the way that the Cash Flows from Operating Activities section of the statement is set up and in how the amount of the net cash flows from operating activities is calculated. Note that under either method the same amount will be determined; it is only the method of calculation that varies.
 - 2. While the FASB has recommended that the direct method be used, the indirect method is the more commonly utilized.

- B. The steps required in preparing the statement under the indirect method are as follows (a worksheet is usually prepared to facilitate the process):
 - 1. Compare the balance sheet account balances from the beginning of the period to those reported at the end of the period. Calculate the *total* change in the following accounts: Cash; all other current assets except for Short-Term Investments; and all the current liabilities except for short-term Notes Payable and Dividends Payable. *These are the accounts whose total changes will be presented on the statement without a description of the individual events that caused them.*
 - 2. For all the remaining accounts, determine the individual events that caused the overall change in the account during the period, and the amount of the increase or decrease caused by the event. *Each individual event that caused the account balance to change must be reported, along with the amount of the change that the event caused in the account.* The accounts, and some of the events that can cause changes in them, are listed below. These events must be described on the statement of cash flows along with the effect they have had on the account in question.

Account	Possible Events Causing Change in Account Balances
Equipment, Buildings, Land, other long-term assets, and Short-Term Investments.	Cash purchase or sale; acquisition by direct issuance of stock, bonds or notes; amortization of intangible assets.
Accumulated Depreciation	Recording of depreciation expense, disposal or sale of partially depreciated asset.
Long- and Short-Term Notes Payable, Dividends Payable, Bonds and Mortgage Payable	Borrowing to raise cash or to finance other assets, retirement by cash payment or conversion into common stock.

<i>Account, Continued</i>	<i>Possible Event, Continued</i>
Common Stock, Preferred Stock, Paid-In Capital in Excess of Par Value	Issuance for cash or other assets; purchase and retirement; distribution of stock dividends.
Retained Earnings	Net income or loss (through closing entries), declaration of stock and cash dividends.

- C. Having determined the total account balance change for the noncurrent assets (excluding Cash and S-T Investments) and for the noncurrent liabilities (excluding S-T Notes Payable and Dividends Payable); and having identified the individual events that explain the changes in these accounts; it is time to list each item and report the change it produced under the appropriate classification on the statement. The steps followed, the rules of classification, and the way that increases or decreases in the account balance are reported on the statement of cash flows are summarized in the table below.

Steps in Preparing the Statement of Cash Flows (Indirect Method)				
Step	Classification	Accounts Affected	Record Increases in Account as	Record Decreases in Account as
1	Operating Activities	Calculate increase (or decrease) in Retained Earnings caused by Net Income (or Net Loss_ during the period.	An Increase (a Positive)	A Decrease (a Negative)
2	Operating Activities	Calculate the increase caused in Accumulated Depreciation due to the recording of Depreciation Expense.	An Increase (a Positive)	Not Applicable
3	Operating Activities	Calculate and report overall change in each Current Asset account except for Cash and Short-Term Investments.	A Decrease (a Negative)	An Increase (a Positive)
4	Operating Activities	Calculate and report overall change in each Current Liability account except for Notes Payable and Dividends Payable.	An Increase (a Positive)	A Decrease (a Negative)
5	Operating Activities	Determine the amount that Net Income increased (decreased) because of gains (losses) from the sale of Short-Term Investments or noncurrent Assets during the year. List here and in Financing Activities (see below).	A Decrease (a Negative)	An Increase (a Positive)

6	Investing Activities	Determine the increases in Short-Term Investments or in the noncurrent Asset accounts due to purchases during the period.	A Decrease (a Negative)	An Increase (a Positive)
7	Investing Activities	Determine the decreases in Short-Term Investments or in the noncurrent Asset accounts due to sales during the period.	An Increase (a Positive)	A Decrease (a Negative)
8	Investing Activities	Determine the amount that Net Income increased (decreased) because of gains (losses) from the sale of Short-Term Investments or noncurrent Assets during the year. List here and in Operating Activities (see above).	An Increase (a Positive) Add to #7 above and report the total.	A Decrease (a Negative) Subtract from #7 above and report the total.
9	Investing Activities	Determine the amount by which Accumulated Depreciation decreased because of the sale of each depreciable Asset during the year.	Not Applicable	A Decrease (a Negative) Subtract from #7 above and report the total.
10	Financing Activities	Determine the increases in Short-Term Notes Payable or in the noncurrent Liabilities accounts due to borrowings.	An Increase (a Positive)	A Decrease (a Negative)
11	Financing Activities	Determine the decreases in Short-Term Notes Payable or in the noncurrent Liabilities accounts due to repayments of principal.	A Decrease (a Negative)	An Increase (a Positive)
12	Financing Activities	Determine the amount of any dividends declared during the period.	A Decrease (a Negative)	Not Applicable
13	Financing Activities	Determine the increase (or decrease) in Dividends Payable in the current period. Subtract (if an increase) or add (if a decrease) to the amount of the dividends declared (listed in # 12 above).	A Decrease (a Negative) Add to #12 above and report the total.	An Increase (a Positive) Subtract from #12 above and report the total

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- D. About Accumulated Depreciation, Gains, and Losses from the Sale of Assets.
1. Determining the amount of the cash inflow to report among the operating activities from the sale of the depreciable noncurrent assets requires us to deal with two complications. You must remember that the sale of a depreciable asset causes the balance in Accumulated Depreciation to fall as well as the balance in the asset account (which is equal to original cost). Therefore, assuming there were no gains or losses arising from the sale, the

decrease in Accumulated Depreciation must be subtracted from the decrease in the asset account to determine the amount of cash actually received from the sale.

- To illustrate, consider Asset X which originally cost \$100, has been depreciated by \$50, and is now sold for \$50. The entry to record the sale would be:

Cash	\$50	
Accumulated Depreciation	50	
Asset X		100

The amount of cash received from the sale is equal to the change in the asset account balance (\$100) less the change in the Accumulated Depreciation account (\$50).

- If a gain or a loss had been recorded on the sale of the asset, the amount of the cash inflow produced by the sale will now be equal to the change in the asset account balance (original cost) less the change in the accumulated depreciation account plus any gain or less any loss.
- To illustrate this, consider two assets, A and B, each of which cost \$100 originally and has been depreciated by \$50. Asset A is sold for \$60, and asset B is sold for \$40. The entries to record the sales would be:

<i>Cash</i>	<i>\$ 60</i>	<i>Cash</i>	<i>\$ 40</i>
<i>Accum. Depreciation</i>	<i>50</i>	<i>Accum. Depreciation</i>	<i>50</i>
<i>Asset A</i>	<i>100</i>	<i>Loss on Sale</i>	<i>10</i>
<i>Gain on Sale</i>	<i>10</i>	<i>Asset B</i>	<i>100</i>

In both cases the amount of cash received is equal to the original cost of the asset (the \$100 balance in the asset account) *less* the decrease in the Accumulated Depreciation account (\$50) *plus* the reported gain (\$10), or *less* the reported loss (\$10).

- One further complication regarding gains and losses now arises: Since the gain was added to revenues and the loss subtracted along with expenses to determine net income, they have already been reported in the Operating Activity section of the statement as part of net income. Adding the gain to the amount reported as an Investing Activity cash inflow means that it must be subtracted from the Operating Activity cash flows (where net income is listed) if the statement is to balance. Likewise, subtracting the loss in the Investing Activity section of the statement means that it must be added back to the net income amount reported in Operating Activities.
- Note that the change in Accumulated Depreciation and the amount of the gain or loss are not reported individually on the statement. Instead, one net amount is reported as the cash inflow from the sale of the asset. To illustrate, our earlier asset A sale would result in a reported cash inflow

from investing activities of \$60; the asset B sale would be shown as \$40. There would be no separate listing of the change in Accumulated Depreciation or the Gain or Loss in the Investing Activities section of the statement. However, the Gain/Loss would be listed in the Operating Activities section and shown as either a negative amount (Gain) or a positive amount (Loss).

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- E. About Dividends and Dividends Payable.
1. Recall that a legal liability is created when the Board of Directors declares a cash dividend. This is recorded as follows:

<i>Retained Earnings</i>	<i>\$ X</i>	
<i>Dividends Payable</i>		<i>\$ X</i>

2. When the dividends declared are listed in the Financing Activities section of the statement of cash flows as a net cash outflow, it is because we assume that the dividend declared was also paid during the period. Recall that payments of dividends are recorded as follows:

<i>Dividends Payable</i>	<i>\$ X</i>	
<i>Cash</i>		<i>\$ X</i>

3. Note that if the Dividends Payable account balance increases during the period, it must mean that more dividends were declared than were paid out. Since we wish to report the amount of cash used to pay dividends during the period, we must subtract the increase in Dividends Payable from the amount declared in order to calculate the amount that was actually paid. Conversely, if the Dividends Payable account balance decreases during the period, it must mean that more dividends were paid out than were declared this period. Previous period's dividends must have been paid along with the current period's dividend. Therefore, since we must now add the decrease in Dividends Payable to the amount of dividends declared this period in order to determine the amount that was actually paid.

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IV. The Direct Method Statement of Cash Flows

- A. As indicated in the previous module, the only difference between the direct method and the indirect method involves the way the Operating Activities section of the statement is prepared.
1. Under the indirect method, the balance reported for net income on the accrual basis income statement is adjusted for depreciation and amortization expense, and for changes in current assets and liabilities (excluding Short-Term Investments, short-term Notes Payable, and Dividends Payable).
 2. ***The effect of these adjustments is to convert (in a very indirect manner)***

the accrual basis net income figure to a cash basis amount. If the way that this occurs is unclear to you at this point, don't be concerned. This is explained in Part V below.

- a. Recall that under the cash basis of accounting, revenues are recorded only when cash is collected and expenses are recorded only when cash is paid.
 - b. Under accrual basis accounting, revenues are recorded when earned and expenses when incurred, irregardless of whether cash has been received or paid.
 - c. Therefore, it is cash basis net income or loss that reflects cash inflows and outflows from operations.
- B. To utilize the direct method, we must use the reported accrual basis information to calculate cash basis revenues (equal to cash collections from customers), cash basis cost of goods sold (equal to the cash payments made to suppliers), and cash basis operating and other expenses (equal to cash payments for expenses). We may then list these items and prepare, in effect, a cash basis income statement, which will then comprise our direct method Operating Activities section of the statement. Its form is as follows:

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Statement of Cash Flows	
<u>Cash Flows from Operating Activities</u>	
Add:	
Cash Receipts from Customers (Cash Basis Sales)	\$ +X
Subtract:	
Cash Payments to Suppliers (Cash Basis COGS)	-X
Cash Payments for Expenses (Cash Basis Operating Expenses)	-X
Cash Payments for Interest	-X
Cash Payments for Taxes	<u>-X</u>
Cash Flows from Operating Activities	\$ ±X

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- C. Steps in Preparing the Direct Method Operating Activities Section:
- 1. Calculate "Cash Receipts from Sales" and report on the statement as a cash inflow.
 - a. This will be equal to the accrual basis Sales balance plus the beginning balance of Accounts Receivable and less the ending balance of Accounts Receivable.
 - b. This is necessary because the beginning Accounts Receivable balance will have been collected during the period, but will have been recorded as revenues of the previous period; and the ending balance of Accounts Receivable represents sales made and recorded

as revenue but not yet collected. Remember that cash basis revenues are those that were realized in cash during the current period.

2. Calculate "Cash Receipts from Interest and Dividends" and cash receipts from any other revenue items listed on the income statement. Report on the statement as a cash inflow. The calculations for these amounts will be done in the same way that the calculations for cash receipts from sales were done.
3. Calculate "Cash Payments for Purchases" and report as a cash outflow.
 - a. Two steps are necessary here. First, subtract the beginning balance of Inventory and add the ending Inventory balance to the Cost of Goods Sold figure from the income statement. This is necessary in order to determine the amount of purchases made during the period, since:

$$\text{COGS} = \text{Beg. Inventory} + \text{Purchases} - \text{End. Inventory}$$

and therefore,

$$\text{Purchases} = \text{COGS} - \text{Beg. Inventory} + \text{End. Inventory}$$

- b. Next, adjust the Purchases balance to determine cash payments for purchases by adding the beginning balance of Accounts Payable to Purchases and then subtracting the ending balance of Accounts Payable. The logic here is identical to that applied above with Accounts Receivable. The beginning balance of Accounts payable will have been paid this period, though the purchase will have been recorded in the previous period, and the ending balance of Accounts payable will not have yet been paid though the purchase will have been recorded.
4. Calculate "Cash Payments for Operating Expenses" and report as a cash outflow.
 - a. Two steps are again necessary. First determine the amount reported on the accrual basis income statement as operating expenses, and then add any accruals (wages payable, utilities payable, etc.) from the beginning of the period and subtract any from the end of the period. The logic behind this step was explained above.
 - b. Next, add the prepaid expenses at the end of the period and subtract any prepaid expenses from the beginning of the period. This is done because the prepaids from the beginning of the period will have expired and been recorded as expenses of the current period, though the payment will have occurred in the previous period; and the prepaids at the end of the period will not have been recorded as expense yet even though they were paid during the current period.
5. Calculate "Cash Payments for Interest," "Cash Payments for Taxes," and cash payments for any other expense not yet dealt with and report as a cash outflow. These flows are computed in the same way as the operating

expenses above.

6. Once these items are all calculated and listed on the statement, they may be added to determine the net cash flows from operating activities. The figure will be the same as that produced on an indirect method statement of cash flows.

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V. Understanding the Direct Method

- A. How does the Operating Activities section of the indirect method statement go about determining cash basis net income?

Note that Accrual Basis net income is equal to:	While Cash Basis net income is equal to:
Accrual Basis Sales - Accrual Basis COGS <u>- Accrual Basis Operating Expenses</u> = Net Income before Depreciation Expense - <u>Depreciation Expense (non-cash expense)</u> = Accrual Basis Net Income	Cash Basis Sales (Cash Collections) - Cash Basis COGS (Cash Payments) <u>- Cash Basis Op. Expenses (Cash Payments)</u> = Net Income before Depreciation Expense - <u>Nothing (since Depreciation is non-cash)</u> = Cash Basis Net Income

- B. When the indirect method statement was prepared, the cash flows from operating activities were calculated as follows:

$$\begin{aligned}
 & \text{Accrual Basis Net Income} \\
 & + \text{Depreciation Expense} \\
 & + \text{Change in Accounts Receivable } (A/R_{beg} - A/R_{end}) \\
 & + \text{Change in Inventory } (Inv_{beg} - Inv_{end}) \\
 & + \text{Change in Accounts Payable } (A/P_{end} - A/P_{beg}) \\
 & + \text{Change in Accrued Expenses Payable } (E/P_{end} - E/P_{beg}) \\
 & + \text{Change in Prepaid Expenses } (P/E_{beg} - P/E_{end}) \\
 & = \text{Cash Flows from Operating Activities, or Cash Basis Income}
 \end{aligned}$$

Or, rearranging this equation, cash flows from operations equal:

$$NI + Depr. Exp + (A/R_{beg} - A/R_{end}) + (Inv_{beg} - Inv_{end}) + (A/P_{end} - A/P_{beg}) + (E/P_{end} - E/P_{beg}) + (P/E_{beg} - P/E_{end})$$

Now, since $NI + Depr. Exp. = NI$ before Depreciation Expense; the cash flows from operating activities are also equal to:

$$NI_{before\ Depr} + (A/R_{beg} - A/R_{end}) + (Inv_{beg} - Inv_{end}) + (A/P_{end} - A/P_{beg}) + (E/P_{end} - E/P_{beg}) + (P/E_{beg} - P/E_{end})$$

But NI before Depreciation Expense equals $Sales - COGS - Expenses.$; so cash flows from operating activities are equal to:

$$\text{Sales} - \text{COGS} - \text{Exp.s} + (\text{A/R}_{\text{beg}} - \text{A/R}_{\text{end}}) + (\text{Inv}_{\text{beg}} - \text{Inv}_{\text{end}}) + (\text{A/P}_{\text{end}} - \text{A/P}_{\text{beg}}) + (\text{E/P}_{\text{end}} - \text{E/P}_{\text{beg}}) + (\text{P/E}_{\text{beg}} - \text{P/E}_{\text{end}})$$

or, rearranging terms in this equation, cash flows from operating activities are equal to:

$$\begin{aligned} & \text{Accrual Basis Sales} + (\text{A/R}_{\text{beg}} - \text{A/R}_{\text{end}}) \\ & - \text{Accrual Basis COGS} + (\text{A/P}_{\text{end}} - \text{A/P}_{\text{beg}}) + (\text{Inv}_{\text{beg}} - \text{Inv}_{\text{end}}) \\ & - \text{Accrual Basis Exp.s} + (\text{E/P}_{\text{end}} - \text{E/P}_{\text{beg}}) + (\text{P/E}_{\text{beg}} - \text{P/E}_{\text{end}}) \\ & = \text{Cash Flows from Operating Activities, or Cash Basis Income} \end{aligned}$$

Note that this is exactly what was done on the direct method statement in order to calculate cash basis net income. Therefore, the indirect method and the direct method produce the same amount for Cash Flows from Operations, because each does exactly the same thing, though in a different manner. Under the indirect method, net income is adjusted and converted into a cash basis income amount. Under the direct method, the accrual basis sales revenue, the cost of goods sold, and the operating expenses are each adjusted to their cash basis equivalents; and the cash basis income is then calculated.

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VI. Interpreting the Statement of Cash Flows

- A. Analysts utilize the statement of cash flows to assess the company's *cash-generating efficiency*, the ability of the company to raise cash from on-going operations.
1. A company that cannot generate sufficient cash inflows from operations is in danger of insolvency. The only way it can continue to operate is by generating cash from investing activities (through the sale of assets) or from financing activities (through the issuance of stock or debt).
 2. **Free cash flow** is a measure of the cash that is "free and clear" of any restrictions and can be used for any purpose the company desires. The more free cash flow the company has, the more liquid it is. It is calculated as follows:

$$\begin{aligned} & \text{Net Cash Flows from Operating Activities} \\ & - \text{Dividends} \\ & - \text{Purchases of plant assets} \\ & = \text{Free Cash Flow} \end{aligned}$$

- a. Free cash flow is a measure of the amount of cash flow from operating activities that remains with the company after all the *cash payments necessary to continue operating at present levels* have been made.
- b. It is assumed that dividends must be paid to stockholders in order to maintain the stock price and allow the corporation to continue in existence, and that the net investment in plant assets made during the year (purchases - sales of plant assets) must be continued to allow the company to produce goods and services at present levels.

-END-

Supplement

Statement of Cash Flows Sample Exercise

Information from Bradley Company's balance sheets for years 20X1 and 20X2 is presented below.

Bradley Company Balance Sheet Data		
	12/31/X1	12/31/X2
Account		
Cash	1,000	400
Accounts Receivable	3,400	3,780
Short-Term Investments	2,000	21,000
Inventory	3,000	3,500
Land	4,500	2,500
Building	<u>20,000</u>	<u>16,000</u>
Total Debits	<u>33,900</u>	<u>47,180</u>
Accumulated Depreciation	1,000	1,400
Accounts Payable	150	750
Salaries Payable	230	30
Short-Term Notes Payable	220	0
Dividends Payable	300	200
Bonds Payable	15,000	21,000
Common Stock, \$1 par value	10,000	12,000
Retained Earnings	<u>7,000</u>	<u>11,800</u>
Total Credits	<u>33,900</u>	<u>47,180</u>

During 20X2, the following events occurred:

- Net income: \$5000.
- Depreciation expense: \$600
- Short-term investments sold during the year: \$1,000 at cost, gain on sale = \$200.
- Short-term investments purchased during the year: \$20,000 at cost.
- Short-term notes retired during the year: \$220.
- Bonds issued during period (at par): \$6,000.
- Stock issued during period (at \$1/share): 2,000 shares.
- Dividends declared during period: \$200
- Land (\$2,000 cost) and a building (\$4,000 cost) were sold at a loss of \$600. The building had been depreciated by \$200.

The company's 20X2 income statement follows:

Income Statement for the year ended December 31, 20X2		
Sales		\$ 26,500
COGS:		
Beg. Inv.	\$ 3,000	
Purchases	12,000	
COG Avail for Sale	15,000	
End. Inv	(3,500)	
COGS		<u>(11,500)</u>
Gross Profit		15,000
Salaries Expense	\$ 7,000	
Other G&A Expenses	2,000	
Depreciation Expense	<u>600</u>	<u>(9,600)</u>
Income before Other Revenues and Expenses		5,400
Gain on Sale of S-T Investments		200
Loss on sale of Land and Building		<u>(600)</u>
Net Income		<u><u>\$ 5,000</u></u>

Required:

1. Prepare a worksheet for the statement of cash flows, complete the worksheet, and then prepare the formal statement of cash flows for 20X2 using the indirect method.
2. Prepare the statement of cash flows for 20X2 using the direct method. Determine the cash flows from investing and financing activities without the use of a worksheet.

Solution



Click the link below to play a presentation that “walks you through” the solution to each part of the sample exercise.

[Solution – Part 1](#)

[Solution – Part 2](#)

Part 1. Worksheet for Statement of Cash Flows				
	12/31/X1	Debit	Credit	12/31/X2
Account				
Cash	1,000		600	400
Accounts Receivable	3,400	380		3,780
Short-Term Investments	2,000	20,000	1,000	21,000
Inventory	3,000	500		3,500
Land	4,500		2,000	2,500
Building	20,000		4,000	16,000
Total Debits	33,900			47,180
Accumulated Depreciation	1,000	200	600	1,400
Accounts Payable	150		600	750
Salaries Payable	230	200		30
Short-Term Notes Payable	220	220		0
Dividends Payable	300	100		200
Bonds Payable	15,000		6,000	21,000
Common Stock, \$1 par value	10,000		2,000	12,000
Retained Earnings	7,000	200	5,000	11,800
Total Credits	33,900			47,180
Operating Activities		<i>Sources</i>	<i>Uses</i>	
Net Income		5000		
Depreciation Expense		600		
Increase in A/R			380	
Increase in Inventory			500	
Increase in A/P		600		
Decrease in Salaries Payable			200	
Gain on Sale of S-T Investments			200	
Loss on Sale of Land & Bldg.		600		
Investing Activities				
Sale of Short-Term Investments		1000		
Purchase of Short-Term Investments			20000	
Sale of Land and Building		6000	200	
Loss on Sale of Land & Bldg.			600	
Gain on Sale of S-T Investments		200		
Financing Activities				
Payment of Notes			220	
Issuance of Bonds		6000		
Issuance of Common Stock		2000		
Payment of Dividends			100	
			200	
Total		22000	22600	
Decrease in Cash		600		
Total		22600	22600	

Part 1, Concluded

Statement of Cash Flows - Indirect Method:

Statement of Cash Flows for the year ended 12/31/X2		
Operating Activities:		
Net Income	5,000	
Adjustments to Convert to Cash Basis Net Income		
Depreciation Expense	600	
Increase in A/R	(380)	
Increase in Inventory	(500)	
Increase in A/P	600	
Decrease in Salaries Payable	(200)	
Gain on Sale of S-T Investments	(200)	
Loss on Sale of Land & Bldg.	600	
	<u>600</u>	
Net Cash Provided by Operating Activities		5,520
Investing Activities		
Sale of Short-Term Investments	1,200	
Purchase of Short-Term Investments	(20,000)	
Sale of Land and Building	5,200	
	<u>5,200</u>	
Net Cash Used by Investing Activities		(13,600)
Financing Activities:		
Payment of Notes	(220)	
Issuance of Bonds	6,000	
Issuance of Common Stock	2,000	
Payment of Dividends	(300)	
	<u>(300)</u>	
Net Cash Provided by Financing Activities		7,480
Net Decrease in Cash		(600)
Cash at Beginning of Year		1,000
Cash at End of Year		400

Part 2, Statement of Cash Flows - Direct Method:

Statement of Cash Flows for the year ended 12/31/X2	
Operating Activities:	
Cash Collections from Customers (26500+3400-3780)	26,120
Cash Payments for Purchases (11500+3500-3000+150-750)	(11,400)
Cash Payments of Operating Expenses (9000+230-30)	<u>(9,200)</u>
Net Cash Provided by Operating Activities	5,520
Investing Activities	
Sale of Short-Term Investments	1,200
Purchase of Short-Term Investments	(20,000)
Sale of Land and Building	<u>5,200</u>
Net Cash Used by Investing Activities	(13,600)
Financing Activities:	
Payment of Notes	(220)
Issuance of Bonds	6,000
Issuance of Common Stock	2,000
Payment of Dividends	<u>(300)</u>
Net Cash Provided by Financing Activities	<u>7,480</u>
Net Decrease in Cash	(600)
Cash at Beginning of Year	<u>1,000</u>
Cash at End of Year	<u><u>400</u></u>

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