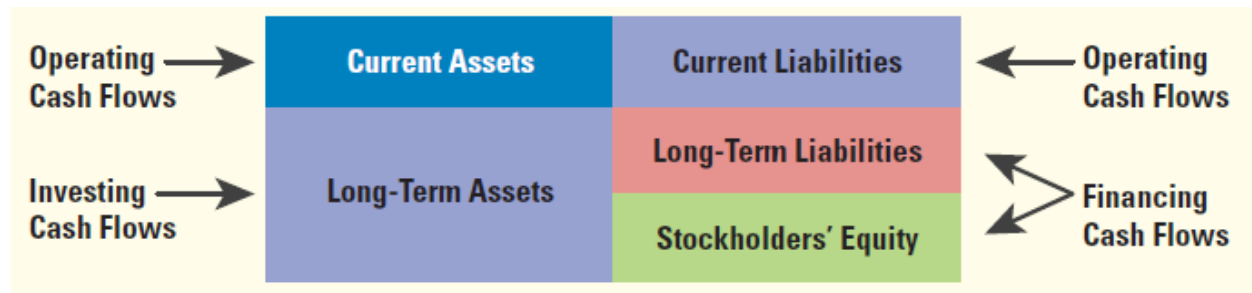


CLUTCH

www.clutchprep.com

CONCEPT: INTRODUCTION TO STATEMENT OF CASH FLOWS

- The **Statement of Cash Flows** shows what affected the Cash account balance throughout the period
 - *Predictive Value* – Helps predict future cash flows based on past cash flows
 - *Evaluate Management* – Window into management’s decision making surrounding cash flows
 - *Ability to Pay* – Determine the company’s ability to pay interest and dividends
 - *Net Income and Cash Flow* – Investors have a clear picture of the relationship between net income and cash flow
- The **Statement of Cash Flows** organizes the cash flows into _____ main sections:
 - **Operating Activities** create revenues, expenses, gains, and losses resulting in net income.
 - Represents the core business of the organization
 - Successful businesses must generate positive cash flows from operating activities
 - Operating activities are focused on changes in operating _____
 - **Investing Activities** relate to the purchase and sale of _____
 - **Financing Activities** describe cash activities with investors and creditors
 - Financing Activities are focused on _____ and _____



PRACTICE: The purchase of equipment and the sale of equipment would be shown on the Statement of Cash Flows as:

- a) Purchase: Investing Sale: Financing
- b) Purchase: Operating Sale: Financing
- c) Purchase: Investing Sale: Investing
- d) Purchase: Operating Sale: Investing

- The **Statement of Cash Flows** also includes supplemental disclosures at the _____ of the statement:
 - Cash paid for interest**
 - Cash paid for taxes**
 - Significant Noncash Investing and Financing Activities** shows important noncash transactions

E-GAMES, INC.		
Statement of Cash Flows—Indirect Method		
For the year ended December 31, 2012		
Cash Flows from Operating Activities		
Net income	\$42,000	
<i>Adjustments for noncash effects:</i>		
Depreciation expense	9,000	
Loss on sale of land	4,000	
<i>Changes in current assets and current liabilities:</i>		
Increase in accounts receivable	(7,000)	
Decrease in inventory	10,000	
Increase in prepaid rent	(2,000)	
Decrease in accounts payable	(5,000)	
Increase in interest payable	1,000	
Decrease in income tax payable	<u>(2,000)</u>	
Net cash flows from operating activities		\$50,000
Cash Flows from Investing Activities		
Purchase of investment	(35,000)	
Sale of land	<u>6,000</u>	
Net cash flows from investing activities		(29,000)
Cash Flows from Financing Activities		
Issuance of common stock	5,000	
Payment of cash dividends	<u>(12,000)</u>	
Net cash flows from financing activities		<u>(7,000)</u>
Net increase (decrease) in cash		14,000
Cash at the beginning of the period		<u>48,000</u>
Cash at the end of the period		<u><u>\$62,000</u></u>
Note: Noncash Activities		
Purchased equipment by issuing a note payable		<u><u>\$20,000</u></u>

CONCEPT: OPERATING ACTIVITIES – INDIRECT METHOD

- The **indirect method** finds the cash flows from operating activities by starting with net income from the income statement
 - Note: the **indirect** or **direct** method only deal with operating activities

Indirect Method	
1. Start with Net Income	Net Income is found on the _____
2. Addback Noncash Expenses	Noncash expenses reduce income, but did not reduce cash Most common → _____
3. Remove Effects of Gains/Losses	Gains _____ net income, but are not a cash amount To remove the effect of a gain, we must _____ net income Losses _____ net income, but are not a cash amount To remove the effect of a loss, we must _____ net income
4. Changes in Current Assets (except Cash)	Increase to a current asset → _____ cash Decrease to a current asset → _____ cash
5. Changes in Current Liabilities	Increase to a current liability → _____ cash Decrease to a current liability → _____ cash

ABC COMPANY Comparative Balance Sheets As of December 31			
	2018	2017	Change in Account Balance
Assets			
Current Assets			
Cash	\$ 55,000	\$ 33,000	
Accounts Receivable	20,000	30,000	
Inventory	30,000	21,000	
Property, Plant, and Equipment			
Land	130,000	20,000	
Equipment	187,000	50,000	
Accumulated Depreciation – Equipment	(14,000)	(6,000)	
Total Assets	\$ 408,000	\$ 148,000	
Liabilities			
Current Liabilities			
Accounts Payable	\$ 28,000	\$ 12,000	
Income Taxes Payable	6,000	8,000	
Long-term Liabilities			
Bonds Payable	130,000	20,000	
Stockholders' Equity			
Common Stock	80,000	60,000	
Retained Earnings	164,000	48,000	
Total Liabilities and Stockholders' Equity	\$ 408,000	\$ 148,000	

ABC COMPANY Income Statement For the Year Ended December 31, 2018		
Sales revenue		\$ 517,000
Cost of goods sold	\$ 160,000	
Operating expenses (excluding depreciation)	111,000	
Depreciation expense	9,000	
Loss on disposal of plant assets	3,000	
Interest expense	<u>42,000</u>	<u>325,000</u>
Income before income taxes		192,000
Income tax expense		<u>47,000</u>
Net income		\$ 145,000

EXAMPLE: Use the indirect method to find cash flows from operating activities for ABC Company

Cash Flows from Operating Activities

Net Income

Adjustments to reconcile net income to cash flows from
operating activities

Net cash provided (used) by operating activities

1. Start with Net Income
2. Addback Noncash Expenses
3. Remove effects of Gains/Losses

Assume we sold equipment that cost \$8,000 with Accumulated Depreciation of \$1,000. We received \$4,000 in cash on sale.

4. Changes in Current Assets (except Cash)

5. Changes in Current Liabilities

PRACTICE: A company reported net income of \$250,000. Depreciation and amortization totaled \$120,000. In total, Current assets excluding cash increased by \$25,000 and current liabilities increased by 16,000. The company also had a gain on the sale of equipment of \$4,000. Using the indirect method, what are cash flows from operating activities?

- a) \$357,000
- b) \$365,000
- c) \$375,000
- d) \$383,000

PRACTICE: A company had net income of \$240,000. Depreciation expense was \$36,000. During the year, the accounts receivable and Inventory increased \$12,000 and \$25,000, respectively. Accrued expenses and prepaid expenses decreased by \$3,000 and \$14,000, respectively. There was also a gain on the sale of equipment of \$4,000. How much cash was provided by operating activities?

- a) \$246,000
- b) \$260,000
- c) \$263,000
- d) \$292,000

CONCEPT: OPERATING ACTIVITIES – DIRECT METHOD

- The **direct method** finds the cash flows from operating activities by summing all relevant cash flows
 - Note: the **indirect** or **direct** method only deal with operating activities
 - We use T-accounts to find the cash effect of transactions

Direct Method	
1. Cash Received from Customers	Relevant T-account → _____
2. Cash Paid to Suppliers	Relevant T-account → _____ and _____
3. Cash Paid for Operating Expenses	Relevant T-account → _____ and _____

EXAMPLE: ABC Company is preparing its Statement of Cash Flows using the direct method. The accountant gathered the following information: purchases totaled was \$200,000; Accounts Payable increased by \$6,000 during the year; cash received from customers was \$440,000; depreciation expense was \$25,000; cash paid for operating expenses (excluding interest) totaled \$140,000; interest expense was \$35,000; Interest Payable increased by \$5,000; and a loss on the disposal of plant assets equaled \$6,000. What is the cash flow provided by operating activities?

- a) \$76,000
- b) \$91,000
- c) \$106,000
- d) \$146,000

PRACTICE: ABC Company is preparing its Statement of Cash Flows using the direct method. The accountant gathered the following information: cash paid to suppliers was \$140,000; sales revenue was \$350,000; Accounts Receivable increased by \$10,000 during the year; depreciation expense was \$15,000; operating expenses totaled \$80,000; Prepaid Expenses decreased by \$8,000 during the year; and a loss on the disposal of plant assets equaled \$6,000. What is the cash flow provided by operating activities?

- a) \$128,000
- b) \$138,000
- c) \$144,000
- d) \$149,000

PRACTICE: During the year, cash paid to suppliers was \$340,000. Cash received from customers was \$580,000. Cash paid for operating expenses totaled \$64,000. Depreciation expense totaled \$16,000. The company also purchased equipment for \$35,000. Using the direct method, what is the cash provided by operating activities?

- a) \$125,000
- b) \$141,000
- c) \$160,000
- d) \$176,000

CONCEPT: INVESTING ACTIVITIES

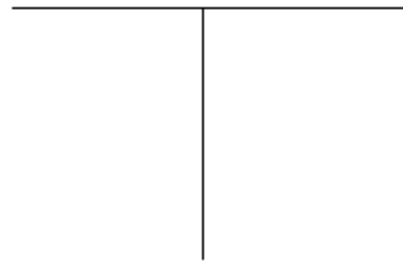
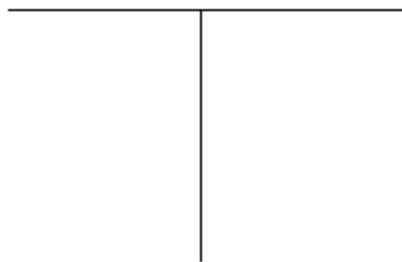
- The **cash flows from investing activities** are focused on changes in _____
 - Note: the **indirect** or **direct** method only deal with operating activities

Cash Flows from Investing Activities	
Cash Inflows	Cash Outflows

- The journal entry used in the sale of a plant asset is crucial to completing the investing activities section:

Cost = \$20,000 Accum. Dep = \$14,000 Sell Price = \$8,000	Cost = \$20,000 Accum. Dep = \$14,000 Sell Price = \$4,000
--	--

- It is also important to be familiar with the flow of transactions through a PPE account and Accumulated Depreciation



EXAMPLE: Calculate ABC Company's net cash provided (used) by investing activities using the financial information on the previous page. Additional information includes:

1. The company sold equipment with a book value of \$7,000 (cost \$8,000, less accumulated depreciation of \$1,000) for \$4,000 cash.
2. The company issued \$110,000 of long-term bonds and used the proceeds to purchase land.
3. The company purchased new equipment totaling \$145,000.
4. The company issued common stock for \$20,000 cash.
5. The company declared and paid a \$29,000 cash dividend.

PRACTICE: Which of the following is a cash flow from investing activities?

- a) The purchase of merchandise for resale
- b) Sale of a piece of land no longer used in retail
- c) Payment of a note payable
- d) Issuance of common stock

PRACTICE: The cash received from the sale of factory equipment no longer in use would be reported in the cash flow statement as an:

- a) Operating Activity
- b) Investing Activity
- c) Financing Activity
- d) None of the Above

PRACTICE: Spooky Company is preparing its Statement of Cash Flows and gathered the following information:

1. Since the previous year: the cash account increased by \$35,000, land increased by \$40,000, Equipment decreased by \$15,000, Accumulated Depreciation – Equipment increased by \$6,000, and Bonds Payable increased by \$100,000
2. Depreciation expense for Equipment totaled \$16,000.
3. Equipment with a purchase price of \$15,000 was sold for a \$2,000 gain.
4. Spooky loaned \$24,000 to Witch Company signing a long-term note receivable.
5. Spooky declared and paid dividends of \$32,000. Net income was \$420,000.

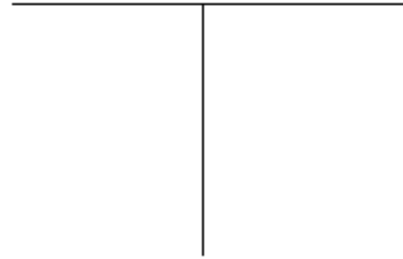
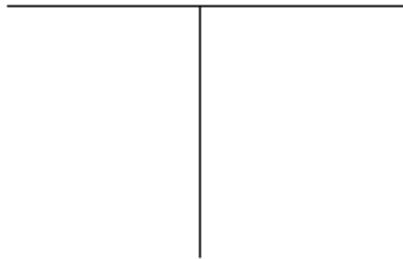
What is Spooky Company's net cash flow from investing activities?

CONCEPT: FINANCING ACTIVITIES

- The **cash flows from financing activities** are focused on changes in _____
 - Note: the **indirect** or **direct** method only deal with operating activities

<u>Cash Flows from Financing Activities</u>	
Cash Inflows	Cash Outflows

- It is also important to be familiar with the flow of transactions through a Retained Earnings and Dividends Payable



EXAMPLE: Calculate ABC Company's net cash provided (used) by financing activities using the financial information on the previous page. Additional information includes:

1. The company sold equipment with a book value of \$7,000 (cost \$8,000, less accumulated depreciation of \$1,000) for \$4,000 cash.
2. The company issued \$110,000 of long-term bonds and used the proceeds to purchase land.
3. The company purchased new equipment totaling \$145,000.
4. The company issued common stock for \$20,000 cash.
5. The company declared and paid a \$29,000 cash dividend.

PRACTICE: Which of the following is a cash flow from financing activities?

- a) The prepayment of a year's worth of rent
- b) Sale of a piece of land no longer used in retail
- c) Payment of dividends
- d) Payment of interest

PRACTICE: The exchange of land worth \$110,000 for 50,000 shares of common stock in the company would be an:

- a) Operating Activity
- b) Investing Activity
- c) Financing Activity
- d) None of the Above

PRACTICE: Turkey Company is preparing its Statement of Cash Flows and gathered the following information:

1. Since the previous year: the cash account increased by \$35,000, land increased by \$40,000, Equipment decreased by \$15,000, Accumulated Depreciation – Equipment increased by \$6,000, Retained Earnings increased by \$340,000, and Bonds Payable increased by \$100,000,
2. Depreciation expense for Equipment totaled \$16,000.
3. Equipment with a purchase price of \$15,000 was sold for a \$2,000 gain.
4. Turkey loaned \$24,000 to Potatoes Company signing a long-term note receivable.
5. Net income was \$420,000.
6. Turkey issued 100,000 shares of \$5 par value common stock. The additional paid-in capital from this transaction was \$300,000.

What is Turkey Company's net cash flow from financing activities?

CONCEPT: SIGNIFICANT NON-CASH ACTIVITIES

- The **significant non-cash activities** include _____ and _____ activities that do not affect cash
 - Note: the **indirect** or **direct** method only deal with operating activities
 - These activities have no cash receipt or disbursement, but are important to the users of the financial statements
 - These activities show up at the bottom of the Statement of Cash Flows as a disclosure
 - They are not included in the calculation of the change in the Cash account

The Exchanger Company signed an \$110,000 notes payable in exchange for land.

Journal Entry:

The Exchanger Company retired \$100,000 of bonds payable by issuing 50,000 shares of \$0.01 par value common stock.

Journal Entry: