

CASH FLOWS

Key Topics to Know

Accounting for Cash Flows

- Purpose for preparing the Statement of Cash Flows.
- Prepare each of the three sections of cash flow activities and identify types of receipts and disbursements are included in each.
 - Operating
 - Investing
 - Financing
- Cash has its own section to report the change in the cash balance and the beginning and ending balances in cash.
- Two methods used to prepare the cash flows from operating activities section.
- Prepare the operating activities section using the indirect method.
- Reporting of investing and financing activities that do not involve cash.
- Be able to classify dividends paid on the cash flow statement.

Problems

Problem #1 - Identify the type of cash flow activity

Following is a list of common transactions.

- a) payment of cash dividends
- b) sale of land
- c) issuance of bonds
- d) redemption of bonds
- e) purchase of bonds as an investment
- f) sale of treasury stock
- g) issuance of preferred stock
- h) purchase of equipment

Required: Identify the type of cash flow activity (operating, investing, or financing) for each of the transactions.

Problem #2 - State the effect on cash flow

Following is a list of transactions supplied by the J Company.

- a) Issued 10,000 shares of \$10 par common stock for \$15 per share, receiving cash.
- b) Sold investment, which cost \$72,000 for \$62,000.
- c) Issued \$ 1,000,000 of 10 year 8 % bonds at 98.
- d) Purchased 2,000 shares of \$10 par common stock as treasury stock at \$25 per share.
- e) Redeemed bonds with a face value of \$250,000 and a carrying value of \$248,000 for \$252,500.
- f) Sold land which cost \$75,000 for \$ 90,000
- g) Sold 1,000 shares of treasury stock, which cost \$25 per share for \$30 per share.

Required: State the effect on cash flow (increase or decrease and the amount) for each of the transactions, considered individually:

Problem #3 - State the effect on cash flow

S Company discarded a piece of fully depreciated equipment costing \$10,000. The equipment had no salvage value and no cash was received. S Company also disposed of a piece of fully depreciated equipment costing \$10,000 and received \$500 cash.

Required: What was the effect of the transaction on cash flow

Problem #4 - State the effect on cash flow from operating activities

The balances of the current asset and current liability accounts at the beginning and end of the year are listed below. Determine if the balance increased or decreased and indicate whether each of the following would be added to or deducted from net income in determining the net cash flow from operating activities using the indirect method.

	<u>End of</u> <u>Year</u>	<u>Beginning</u> <u>of Year</u>	<u>Increase</u> <u>(Decrease)</u>	<u>Add or</u> <u>Deduct</u>
a) Accounts receivable	74,000	84,100		
b) Prepaid expenses	5,100	6,600		
c) Accounts payable	39,400	33,200		
d) Salaries payable	5,000	7,000		

Practice Problem #5

Arcade Corporation's balance sheet and income statement appear below:

<u>Income Statement</u>	
Sales	\$723
Cost of goods sold	<u>453</u>
Gross margin	270
Selling and administrative expenses	<u>163</u>
Income before income taxes	107
Income tax expense	<u>32</u>
Net income	\$75

Balance Sheet

	<u>Ending</u> <u>Balance</u>	<u>Beginning</u> <u>Balance</u>
Cash	\$42	\$36
Accounts receivable	77	80
Inventories	54	58
Plant and equipment	581	480
less: accumulated depreciation	<u>(318)</u>	<u>(294)</u>
Total Assets	\$436	\$360
Accounts payable	\$23	\$28
Bonds payable	293	270
Common stock	61	60
Retained earnings	<u>59</u>	<u>2</u>
Total liabilities and equity	\$436	\$360

The company did not dispose of any property, plant, and equipment, retire any bonds payable, or repurchase any of its own common stock during the year. The company declared and paid a cash dividend.

Required: Prepare a statement of cash flows using the indirect method.

Multiple Choice Questions

1. The net cash provided by operating activities is affected by
 - a) A change in merchandise inventory.
 - b) A purchase of land for cash.
 - c) The issue of bonds payable for cash.
 - d) Proceeds of cash investments by stockholders.

2. Investing activities include
 - a) Purchases of merchandise for cash.
 - b) Purchases of plant and equipment for cash.
 - c) Purchases of prepaid expense items such as supplies and insurance for cash.
 - d) Increase in accounts receivable.

3. An example of a financing activity is
 - a) The sale of merchandise for cash.
 - b) The issue of stock for cash.
 - c) The sale of used equipment for cash.
 - d) The purchase of a building.

4. A Company received \$50,000 in cash when it sold a building and paid \$90,000 in cash when it purchased some new machinery. As a result, the statement of cash flows would report
 - a) \$40,000 as the net cash used in financing activities.
 - b) \$40,000 as the net cash provided by investing activities.
 - c) \$40,000 as the net cash used in investing activities.
 - d) \$40,000 as the net cash provided by financing activities.

5. On a statement of cash flows, depreciation expense is
 - a) subtracted from net income in the computation of the net cash provided by operating activities
 - b) added to net income in the computation of the net cash provided by operating activities
 - c) treated as a cash outflow in the computation of the net cash used in investing activities
 - d) treated as a cash inflow in the computation of the net cash used in investing activities

6. Generally, if a short-term investment is to be classified as a cash equivalent, it must fall due within
 - a) 12 months from the date it was acquired
 - b) 6 months from the date it was acquired
 - c) 3 months from the date it was acquired
 - d) 1 month from the date it was acquired

7. P Company sold equipment that cost \$45,600 for \$12,450. Depreciation on the equipment from purchase to date of sale amounted to \$35,000. What amount is reported in the Cash Flows from Investing Activities section of the Statement of Cash Flows?
 - a) \$12,450
 - b) \$0
 - c) \$1,850
 - d) \$10,600

8. E Company acquired land valued at \$56,000 for 4,200 shares of its stock. Where on the Statement of Cash flows does this transaction activity appear?
 - a) Operating Activities
 - b) Investing Activities
 - c) Financing Activities
 - d) Disclosures

9. Gains on the retirement of bonds are deducted from net income because
 - a) They represent cash flows which increase net income
 - b) They represent cash flows which decrease net income
 - c) They are not cash flows but increase net income
 - d) They are not cash flows but increase net income

10. The N Company's cash balance at December 31, 2015, was \$150,000. The following information was reported on the company statement of cash flows for 2013:

Net income	\$360,000
Depreciation and amortization	110,000
Increase in accounts receivable	58,000
Increase in inventory	120,000
Decrease in accounts payable	40,000
Dividends paid to shareholders	25,000
Proceeds from sale of common stock	500,000
Repayment of bonds payable	200,000
Proceeds from sale of equipment, book value = \$84,000	50,000
Purchase of land and building	300,000

The N Company's balance sheet would report the balance of Cash on December 31, 2013

- a) \$311,000.
 b) \$410,000
 c) \$426,000
 d) \$461,000.
11. Which of the following would be classified as an investing activity?
 a) Purchasing an investment in bonds
 b) Payment of a dividend
 c) Issuing Common Stock
 d) Payment of interest
12. According to the comparative balance sheet, the balance of the Dividends Payable account at the beginning and end of the year was \$54,000 and \$52,500 respectively. The Retained Earnings Statement indicates that \$80,000 in dividends was declared during the year. What amount of dividends was paid out during the year?
 a) \$80,000
 b) \$54,000
 c) \$78,500
 d) \$81,500

13. Given the following information and using the indirect method, calculate the cash flows from operating activities.

	<u>End of</u> <u>Year</u>	<u>Beginning</u> <u>of Year</u>
Cash	\$ 38,500	\$ 44,200
Accounts receivable (net)	79,200	68,800
Inventories	90,700	81,100
Prepaid expenses	4,500	6,500
Accounts payable	65,000	72,800
Salaries Payable	5,900	5,400

Net Income reported on the Income Statement for the current year was \$115,000, which included a loss on sale of land of \$8,000. Depreciation recorded on office equipment for the year amounted to \$48,000.

- a) \$129,700
 b) \$137,700
 c) \$144,700
 d) \$145,700
14. A corporation issued \$2,000,000 of 20-year bonds for cash at 108. How would this transaction be reported in the statement of cash flows?
- a) \$2,000,000 inflow in cash flows from financing activities
 b) \$2,000,000 inflow in cash flows from investing activities
 c) \$2,160,000 inflow in cash flows from financing activities
 d) \$2,160,000 inflow in cash flows from investing activities
15. During the year, J Company acquired a new building, issuing common stock in payment. The transaction would be reported on the Cash Flow Statement in:
- a) Cash flows from Operating Activities section
 b) Cash flows from Investing Activities section
 c) Cash flows from Financing Activities section
 d) A separate supplementary schedule appended to the Statement

Solutions to Problems

Problem 1 - Identify the type of cash flow activity

- a. Payment of cash dividends - **financing**
- b. Sale of land - **investing**
- c. Issuance of bonds - **financing**
- d. Redemption of bonds - **financing**
- e. Purchase of bonds as an investment - **investing**
- f. Sale of treasury stock - **financing**
- g. Issuance of preferred stock - **financing**
- h. Purchase of equipment – **investing**

Problem 2 - State the effect on cash flow

- a. Issued 10,000 shares of \$10 par common stock for \$15 per share, receiving cash.
Increase in cash of \$150,000
- b. Sold investment which cost \$72,000 for \$62,000.
Increase in cash of \$62,000
- c. Issued \$ 1,000,000 of 10 year 8 % bonds at 98.
Increase in cash of \$980,000
- d. Purchased 2,000 shares of \$ 10 par common stock as treasury stock at \$25 per share.
Decrease in cash of \$50,000
- e. Redeemed bonds with a face value of \$250,000 and a carrying value of \$248,000 for \$252,500.
Decrease in cash of \$252,500
- f. Sold land which cost \$75,000 for \$ 90,000
Increase in cash of \$90,000
- g. Sold 1,000 shares of treasury stock which cost \$25 per share for \$30 per share.
Increase in cash of \$30,000

Problem 3 - State the effect on cash flow

- a. No effect on cash flow
- b. Increase in cash of \$500

Problem 4 - State the effect on cash flow from operating activities

	<u>End of</u> <u>Year</u>	<u>Beginning</u> <u>of Year</u>	<u>(Decrease)</u>	<u>Deduct</u>
a) Accounts receivable	74,000	84,100	Decrease	Add
b) Prepaid expenses	5,100	6,600	Decrease	Add
c) Accounts payable	39,400	33,200	Increase	Add
d) Salaries payable	5,000	7,000	Decrease	Deduct

Practice Problem #5

Operating Activities:

Net income		\$75
Adjustments for non-cash effects:		
Depreciation expense		\$24
Adjustments for changes in current assets and liabilities:		
Decrease in accounts receivable	3	
Decrease in inventories	4	
Decrease in accounts payable	<u>(5)</u>	<u>2</u>
Net cash flows from operating activities		101

Investing Activities:

Purchase of property, plant and equipment	<u>(101)</u>	
Net cash flows from investing activities		(101)

Financing Activities:

Cash dividends paid	(18)	
Issuance of bonds	23	
Issuance of common stock	<u>1</u>	
Net cash flows from financing activities		<u>6</u>

Net Change in Cash		<u>6</u>
Beginning cash balance		<u>36</u>
Ending cash balance		\$42

Solutions to Multiple Choice Questions

- | | |
|-----|---|
| 1. | A |
| 2. | B |
| 3. | B |
| 4. | C |
| 5. | B |
| 6. | C |
| 7. | A |
| 8. | D |
| 9. | C |
| 10. | D |
| 11. | A |
| 12. | D |
| 13. | D |
| 14. | C |
| 15. | D |