

ILLUSTRATION 24-1 OPERATING, INVESTING, AND FINANCING ACTIVITIES

COMPONENTS OF THE STATEMENT OF CASH FLOWS

CASH FLOWS FROM OPERATING ACTIVITIES

- + Sales and Service Revenue Received
- Cost of Sales Paid
- Selling Expenses
- Administrative Expenses Paid
- Income and Other Taxes Paid
- + Interest Revenue Received (from OTHER companies)
- + Dividend Revenue Received (from OTHER companies)
- + Other Revenues Received
- Interest Expense Paid (on OWN company notes and bonds)
- Other Expenses Paid

CASH FLOWS FROM INVESTING ACTIVITIES

- +/- Plant and Equipment Sale and Acquisition
 - +/- Notes Receivable Collection from and Issuance to Customers
 - +/- Stock and Bond Sale and Acquisition
(Investments in OTHER companies)
- (gain or loss affects operating activities; cash flows appear here)*

CASH FLOWS FROM FINANCING ACTIVITIES

- +/- Stock and Bond Issuance and Retirement (for OWN company securities)
- +/- Notes Payable to Vendors and Banks Issuance and Retirement
- Dividends Paid (of OWN company to its owners)

NOTE: Only difficult pair to remember—Key is the originating statement:

Interest Expense is an Income Statement item ® Operating Flow
Dividends Declared is a Retained Earnings item ® Financing Flow

ILLUSTRATION 24-2
FORMAT OF STATEMENT OF CASH FLOWS (Indirect Method)

Company Name
STATEMENT OF CASH FLOWS (Indirect Method)
 Period Covered

Cash Flows from operating activities		
Net income		xxx
Adjustments to reconcile net income to net cash provided by operating activities:		
(List of individual items)	<u>xx</u>	<u>xx</u>
Net cash flow from operating activities		xxx
Cash flows from investing activities		
(List of individual inflows and outflows)	<u>xx</u>	
Net cash provided (used) by investing activities		xxx
Cash flows from financing activities		
(List of individual inflows and outflows)	<u>xx</u>	
Net cash provided (used) by financing activities		<u>xxx</u>
Net increase (decrease) in cash		xxx
Cash at beginning of period		<u>xxx</u>
Cash at end of period		<u><u>xxx</u></u>

ILLUSTRATION 24-3
INDIRECT METHOD: ADDITIONS AND DEDUCTIONS
TO AND FROM NET INCOME

INDIRECT METHOD: ADDITIONS AND DEDUCTIONS

Net Income

Additions

Depreciation expense
 Amortization of intangibles and deferred charges
 Amortization of bond discount
 Increase in deferred income tax liability
 Loss on investment in common stock using equity method
 Loss on sale of plant assets
 Decrease in receivables
 Decrease in inventories
 Decrease in prepaid expense
 Increase in accounts payable
 Increase in accrued liabilities

Deductions

Amortization of bond premium
 Decrease in deferred income tax liability
 Income on investment in common stock using equity method
 Gain on sale of plant assets
 Increase in receivables
 Increase in inventories
 Increase in prepaid expense
 Decrease in accounts payable
 Decrease in accrued liabilities

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Net Cash Flow from Operating Activities

ILLUSTRATION 24-4
SCHEDULE OF CHANGES FROM THE ACCRUAL
TO THE CASH BASIS INCOME STATEMENT

Farmer Company
SCHEDULE OF CHANGES FROM THE ACCRUAL
TO THE CASH BASIS INCOME STATEMENT
(Direct Method)

Accrual Basis	Adjustment	Add (Subtract)	Cash Basis
Sales	<u>\$232,000</u>	+ Decrease in receivables	\$8,000
			<u>\$240,000</u>
Cost of goods sold	94,000	– Decrease in inventories	(2,000)
		+ Decrease in accounts payable	12,000
			104,000
Selling and administrative expenses	70,000	– Depreciation expense	(4,000)
		+ Increase in prepaid expenses	1,000
			67,000
Income tax expense	<u>12,000</u>	– Increase in taxes payable	(5,000)
			<u>7,000</u>
Total expenses	<u>176,000</u>		<u>178,000</u>
Net income	<u>\$ 56,000</u>	Net cash provided by operating activities	<u>\$ 62,000</u>

ILLUSTRATION 24-5
CASH FLOWS FROM OPERATING ACTIVITIES—
DIRECT APPROACH

Farmer Company
STATEMENT OF CASH FLOWS (PARTIAL)
(Direct Method)

Cash flows from operating activities		
Cash received from customers		\$240,000
Cash paid to suppliers	\$104,000	
Selling and administrative expenses paid	67,000	
Taxes paid	<u>7,000</u>	
Cash disbursed for operating activities		<u>178,000</u>
Net cash provided by operating activities		<u>\$ 62,000</u>

ILLUSTRATION 24-6

DIRECT VS INDIRECT CONTROVERSY

DIRECT AND INDIRECT PRESENTATION OF OPERATING CASH FLOWS

CASH FLOWS FROM OPERATING ACTIVITIES

Sales and Service Revenue Received
 Cost of Sales Paid
 Selling Expenses
 Administrative Expenses Paid
 Income and Other Taxes Paid
 Interest Revenue Received (from OTHER companies)
 Dividend Revenue Received (from OTHER companies)
 Other Revenues Received
 Interest Expense Paid (on OWN company notes and bonds)
 Other Expenses Paid

INDIRECT PRESENTATION OF OPERATING FLOWS

Net Income
 Adjustments to Reconcile Income to Net Cash
 Provided by (Used in) Operating Activities
 Changes in Current Assets
 Changes in Current Liabilities
 Other NonCash Expenses
 Other NonCash Revenues
 NonCash Gains
 NonCash Losses

DIRECT PRESENTATION OF OPERATING FLOWS

Payments Received from Customers and Others
 Payments Made to Suppliers
 Selling and Administrative Expenses Paid
 Interest Paid
 Taxes Paid

ILLUSTRATION 24-7 CALCULATION OF CASH FLOWS FROM OPERATING ACTIVITIES

DATA—The financial statements of the Company are as follows:

THE ROBINSON COMPANY COMPARATIVE BALANCE SHEETS DECEMBER 31,

ASSETS	1999	1998	Increase (Decrease)
Cash	\$130,000	\$ 40,000	\$90,000
Accounts receivable	69,000	60,000	9,000
Inventory	80,000	100,000	(20,000)
Prepaid Insurance	6,000	4,000	2,000
Land	120,000	200,000	(80,000)
Building	500,000	400,000	100,000
Accumulated depreciation	(105,000)	(100,000)	(5,000)
Total Assets	<u>\$800,000</u>	<u>\$704,000</u>	<u>\$96,000</u>
LIABILITIES & OWNERS' EQUITY			
Accounts payable	\$ 20,000	\$ 25,000	\$ (5,000)
Income	22,600	20,000	2,600
Notes payable, long-term	40,000	50,000	(10,000)
Bonds payable	120,000	100,000	20,000
Common stock	450,000	400,000	50,000
Paid-in capital	60,000	50,000	10,000
Retained earnings	87,400	59,000	28,400
Total Liabilities & Owners' Equity	<u>\$800,000</u>	<u>\$704,000</u>	<u>\$96,000</u>

THE ROBINSON COMPANY INCOME STATEMENT For the Year Ended December 31, 1999

Sales Revenue		\$200,000
Expenses		
Cost of goods sold	\$ 80,000	
Salary expense	39,000	
Depreciation expense	5,000	
Interest expense	3,000	
Insurance expense	1,000	
Loss on sale of land	10,000	
Income tax expense	18,600	
Total expenses		<u>156,600</u>
Net income		<u>\$ 43,400</u>

ILLUSTRATION 24-7 (continued)

Other information:

1. Land which originally cost \$100,000 was sold for \$90,000.
2. Building was purchased for cash.
3. Bonds were issued at par value in exchange for land.
4. Common stock with a par value of \$50,000 was issued for \$60,000.
5. Dividends of \$15,000 were declared and paid during the year.

Calculation of cash flow from operating activities (indirect method)

Operating—Net Income	43,400	
Retained Earnings		43,400
Accounts Receivable	9,000	
Operating—Increase in Accounts Receivable		9,000
Operating—Decrease in Inventory	20,000	
Inventory		20,000
Prepaid Insurance	2,000	
Operating—Increase in Prepaid Insurance		2,000
Accounts Payable	5,000	
Operating—Decrease in Accounts Payable		5,000
Operating—Increase in Income Taxes Payable	2,600	
Income Taxes Payable		2,600
Operating—Depreciation Expense	5,000	
Accumulated Depreciation		5,000
Investing—proceeds from sale of land	90,000	
Operating—Loss on Sale of Land	10,000	
Land		100,000

ILLUSTRATION 24-7 (continued)

THE ROBINSON COMPANY STATEMENT OF CASH FLOWS (PARTIAL) (Indirect Method)

Cash flows from operating activities		
Net income		\$43,400
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	\$(9,000)	
Decrease in inventory	20,000	
Increase in prepaid expenses	(2,000)	
Decrease in accounts payable	(5,000)	
Increase in income taxes payable	2,600	
Depreciation expense	5,000	
Loss on sale of land	10,000	21,600
		\$65,000
Net cash from from operating activities		\$65,000

Calculation of cash flows from operating activities (direct method)

THE ROBINSON COMPANY SCHEDULE OF CHANGES FROM THE ACCRUAL TO THE CASH BASIS INCOME STATEMENT

	Accrual Basis	Adjustment	Add (subtract)	Cash Basis
Sales revenue	\$200,000	– Increase in accts. rec.	\$(9,000)	\$191,000
Cost of goods sold	80,000	– Decrease in inventory + Decrease in accts. pay.	(20,000) 5,000	65,000
Salary expense	39,000	—		
Depreciation expense	5,000	– Depreciation expense	(5,000)	
Interest expense	3,000	—		
Insurance expense	1,000	+ Increase in prepaid ins.	2,000	3,000
Loss on sale of land	10,000	– Loss on sale of land	(10,000)	
Income tax expense	18,600	– Increase in taxes pay.	(2,600)	16,000
Total expenses	156,600			126,000
Net income	\$43,400			\$65,000

ILLUSTRATION 24-7 (concluded)

As an aid in understanding the adjustments from the accrual to the cash basis, students may be more familiar with mock journal entries.

Accounts Receivable	9,000	
<u>Cash Received from Customers</u>	<u>191,000</u>	
Sales		200,000
Cost of goods sold	80,000	
Accounts Payable	5,000	
Inventory		20,000
<u>Cash Paid to Suppliers</u>		<u>65,000</u>
Salary Expense	39,000	
<u>Cash Paid to Employees</u>		<u>39,000</u>
Depreciation Expense	5,000	
Accumulated Depreciation		5,000
Interest Expense	3,000	
<u>Cash Paid for Interest</u>		<u>3,000</u>
Insurance Expense	1,000	
Prepaid Insurance	2,000	
<u>Cash Paid for Insurance</u>		<u>3,000</u>
Investing—proceeds for sale of land	90,000	
Loss on sale of land	10,000	
Land		100,000
Income Tax Expense	18,600	
Income Taxes Payable		2,600
<u>Cash Paid for Taxes</u>		<u>16,000</u>

THE ROBINSON COMPANY
STATEMENT OF CASH FLOWS (PARTIAL)(Indirect Method)

Cash flows from operating activities		
Cash received from customers		\$191,000
Cash paid to suppliers	\$65,000	
Cash paid to employees	39,000	
Cash paid for interest	3,000	
Cash paid for insurance	3,000	
Cash paid taxes	<u>16,000</u>	
Cash disbursed for operating activities		<u>126,000</u>
Net cash from from operating activities		<u>\$65,000</u>

ILLUSTRATION 24-8
FORMAT OF WORK SHEET FOR PREPARATION OF THE
STATEMENT OF CASH FLOWS—INDIRECT METHOD

Company Name				
WORK SHEET FOR PREPARATION OF STATEMENT OF CASH FLOWS				
Period Covered				
<u>Balance Sheet Accounts</u>	<u>Balances</u> End of Last year	<u>Reconciling Items</u>		<u>Balances</u> End of Current year
		<u>Debits</u>	<u>Credits</u>	
Debit balance accounts	_____			_____
Total debits	=====			=====
Credit balance accounts	_____			_____
Total credits	=====			=====
<u>Statement of Cash Flow Effects</u>				
Operating activities				
Net income				
Adjustments				
Investing activities				
Receipts and payments				
Financing activities				
Receipts and payments				
Totals		_____	_____	
Increase (decrease) in cash		_____	_____	
Totals		=====	=====	