cHAPTER 12

statement of cash flows

# Student Learning Objectives and Related Assignment Materials

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| **Student Learning Objectives** | **Mini-Exercises** | **Exercises** | **Coached Problems** | **Problems (Groups  A & B)** | **Skills Development Cases** | **Continuing Case** |
| LO 12-1 Identify cash flows arising from operating, investing, and financing activities. | 1, 2, 8, 11 | 1, 7, 13 | 1 | A1, B1 | 1, 2, 4, 5 |  |
| LO 12-2 Report cash flows from operating activities, using the indirect method. | 2, 3, 4, 5 | 1, 2\*, 3\*, 4\*, 5\*, 6\*, 7\*, 8, 9, 10, 11, 12, 13, 14^, 17, 18 | 2, 3, 4 | A2, A3, A4, B2, B3, B4 | 6, 7 | 1†, 2^£ |
| LO 12-3 Report cash flows from investing activities. | 6, 9 | 13, 15, 16 | 3, 4, 6 | A3, A4, A6, B3, B4, B6 |  | 1† |
| LO 12-4 Report cash flows from financing activities. | 7, 9 | 13, 15, 16 | 3, 4, 6 | A3, A4, A6, B3, B4, B6 |  | 1† |
| LO 12-5 Interpret cash flows from operating, investing, and financing activities. | 1, 10 | 6\*, 7\*, 9, 10, 13, 17, 19, 20 | 3, 4, 6 | A3, A4, A6, B3, B4, B6 | 1, 2, 3, 4, 5, 9 | 1† |
| LO 12-6 Report and interpret cash flows from operating activities, using the direct method. | 11, 12, 13 | 18, 19, 20 | 5, 6 | A5, A6, B5, B6 | 8 |  |
| LO 12-S1 Report cash flows from PPE disposals using the indirect method. |  | 21, 22 | 7 | A7 |  |  |
| LO 12-S2 Use the T-account approach for preparing an indirect method statement of cash flows. |  | 23 |  |  |  |  |

*(Table footnotes on next page.)*

# Student Learning Objectives and Related Assignment Materials, continued

\* Animated solution included in the PowerPoint Slides.

^ Particularly challenging; requires students to combine multiple concepts in order to advance to the next level of accounting knowledge.

† Continuing Case 12-1 builds on the story of Nicole’s Getaway Spa, introduced in earlier chapters. This case focuses on preparing a statement of cash flows using the indirect method. This case will be extended in future chapters.

£ Continuing Case 12-2 builds on the story of Wiki Art Gallery (WAG), an instructional case in Connect. This case focuses on the calculation of the amount of cash collected from its customers.

# Overview

The difference between operating cash flows and net income has never been so apparent as when Lehman Brothers reported $11.5 billion in net income and $94.2 billion in net operating cash outflows during 2006-08, perhaps making it the initial tipping point into a worldwide financial crisis.

Students learn how to classify cash flows, interpret both direct and indirect method statements of cash flows, and prepare both formats of statements.

Chapter supplements illustrate two additional topics for the indirect method: the cash flow effects of fixed asset disposals (A) and using a spreadsheet to prepare the statement (B).

# Synopsis of Chapter Revisions

* Updated focus company illustrations
* Final section of chapter illustrates user analyses that are possible with direct method but not indirect method presentation
* Deleted spreadsheet approach, previously in chapter supplement
* Revised demonstration cases to be more consistent with approaches illustrated in chapter
* Reviewed and updated all end-of-chapter material

# PowerPoint Slides

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| --- | --- |
| **Student Learning Objective** | **PowerPoint® Slides** |
| LO 12-1 Identify cash flows arising from operating, investing, and financing activities. | 12-2 through 12-12 |
| LO 12-2 Report cash flows from operating activities, using the indirect method. | 12-13 through 12-23 |
| LO 12-3 Report cash flows from investing activities. | 12-24 through 12-26 |
| LO 12-4 Report cash flows from financing activities. | 12-27 through 12-33 |
| LO 12-5 Interpret cash flows from operating, investing, and financing activities. | 12-34 through 12-38 |
| LO 12-6 Report and interpret cash flows from operating activities, using the direct method. | 12-39 through 12-42 |
| LO 12-S1 Report cash flows from PPE disposals using the indirect method. | 12-43 through 12-45 |
| LO 12-S2 Use the T-account approach for preparing an indirect method statement of cash flows. | 12-46 through 12-49 |

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| **Animated Builds and Animated Solutions** | **PowerPoint® Slides** |
| Exercise 12-2 | 12-51 through 12-52 |
| Exercise 12-3 | 12-53 through 12-55 |
| Exercise 12-4 | 12-56 through 12-58 |
| Exercise 12-5 | 12-59 through 12-61 |
| Exercise 12-6 | 12-62 through 12-65 |
| Exercise 12-7 | 12-66 through 12-70 |

# Chapter Summary

**LO 12-1 Identify cash flows arising 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 period is the same amount as the increase or decrease in cash and cash equivalents for the period on the balance sheet. Cash equivalents are highly liquid investments purchased within three months of maturity.

**LO 12-2 Report cash flows from operating activities, using the 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) noncash expenses (such as depreciation expense) and revenues that do not affect current assets or current liabilities, and (2) changes in each of the individual current assets (other than cash) and current liabilities (other than debt to financial institutions, which relates to financing).

**LO 12-3 Report cash flows from investing activities.**

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

**LO 12-4 Report cash flows from financing activities.**

* Cash inflows from financing activities include cash proceeds from issuance of debt and common stock. Cash outflows include cash principal payments on 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.

**LO 12-5 Interpret cash flows from operating, investing, and financing activities.**

* A healthy company will generate positive cash flows from operations, some of which will be used to pay for purchases of property, plant, and equipment. Any additional cash (called free cash flow) can be used to further expand the business, pay down some of the company’s debt, or simply build up the cash balance. A company is in trouble if it is unable to generate positive cash flows from operations in the long-run because eventually creditors will stop lending to the company and stockholders will stop investing in it.

**LO 12-6 Report and interpret cash flows from operating activities, using the direct method.**

* The direct method for reporting cash flows from operating activities accumulates all of the operating transactions that result in either a debit or a credit to cash into categories. The most common inflows are cash received from customers and dividends and interest on investments. The most common outflows are cash paid for purchase of services and goods for resale, salaries and wages, income taxes, and interest on liabilities. It is prepared by adjusting each item on the income statement from an accrual basis to a cash basis.

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| Chapter Outline | Teaching Notes |
| ***LO 12-1 Identify cash flows arising from operating, investing, and financing activities.*** | |
| I. Understand the Business |  |
| A. Business Activities and Cash Flows |  |
| 1. Business activities have financial effects even when they don’t involve cash. That’s why accrual accounting exists. |  |
| a. Accrual-based net income is the best measure of profitability during the period. |  |
| b. Financial statement users need information about cash and changes in its cash; the balance sheet and income statement do not provide this information. |  |
| i. The balance sheet shows a company’s cash balance at a point in time, but it doesn’t explain the activities that caused changes in its cash. |  |
| ii. The income statement doesn’t explain changes in cash because it focuses on just the operating results of the business; also, the timing of cash receipts and payments may differ from the accrual-based income statement, which reports revenues when they are earned and expenses when they are incurred. |  |
| c. The purpose of the statement of cash flows is to show how each major type of business activity caused a company’s cash to increase or decrease during the accounting period. | The “Spotlight on Ethics” |
| 2. On statement of cash flows, cash is defined to include cash and cash equivalents –short-term, highly liquid investments purchased within three months of maturity; considered equivalent to cash because they are both: | feature addresses the usefulness of the statement of cash flows in predicting business failures. |
| a. Readily convertible to known amounts of cash, and |  |
| b. So near to maturity that there is little risk their value will change. | * Supplemental Enrichment |
| B. Classifying Cash Flows | Activity (Activity) #1 |
| 1. **Cash Flows from Operating Activities** **(Cash Flows from Operations)**—Cash inflows and outflows related to components of net income. | Condensed statement illustrated in Exhibit 12.1 |
| a. Inflows––Cash provided by: |  |
| i. Collecting from customers  ii. Receiving dividends  iii. Receiving interest |  |
| b. Outflows––Cash used for: |  |
| i. Purchase of services (electricity, etc.) and goods for resale  ii. Paying salaries and wages  iii. Paying income taxes  iv. Paying interest |  |

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| Chapter Outline | Teaching Notes |
| c. Difference between these cash inflows and outflows is reported as a subtotal, Net Cash Provided by (Used for) Operating Activities. |  |
| 2. **Cash flows from Investing Activities**—Cash inflows and outflows related to the sale or purchase of investments and long-lived assets. |  |
| a. Inflows––Cash provided by: |  |
| i. Sale or disposal of property, plant, and equipment  ii. Sale or maturity of investments in securities |  |
| b. Outflows––Cash used for: |  |
| i. Purchase of property, plant, and equipment  ii. Purchase of investments in securities |  |
| c Difference between these cash inflows and outflows is reported as a subtotal, Net Cash Provided by (Used for) Investing Activities. |  |
| 3. **Cash flows from Financing Activities** – Cash inflows and outflows related to financing sources external to the company (owners and lenders). |  |
| a. Inflows––Cash provided by: |  |
| i. Borrowing from lenders (formal debt contracts)  ii. Issuing stock to owners |  |
| b. Outflows––Cash used for: |  |
| i. Repaying principal to lenders  ii. Repurchasing stock from owners  iii. Paying cash dividends to owners |  |
| c. The difference between these cash inflows and outflows is reported as a subtotal, Net Cash Provided by (Used for) Financing Activities. |  |
| 4. Although exceptions exist, a general rule is that | The “Spotlight on the World” |
| a. Operating cash flows cause changes in current assets and current liabilities. | feature addresses the classification of interest and |
| b. Investing cash flows affect noncurrent assets. | dividends under GAAP and |
| c. Financing cash flows affect noncurrent liabilities or stockholders’ equity accounts. | IFRS |
| II. Study the Accounting Methods |  |
| A. Relationship to Other Financial Statements |  |
| 1. To prepare a statement of cash flows, you need: |  |
| a. Comparative balance sheets showing beginning and ending balances––used in calculating the cash flows from all activities. |  |
| b. A complete income statement––used primarily in calculating cash flows from operating activities. |  |
| c. Additional data concerning selected accounts that increase and decrease as a result of investing and/or financing activities. |  |

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| Chapter Outline | Teaching Notes |
| 2. The balance sheet equation can be rearranged. |  |
| a. Changes in Cash = Changes in (Liabilities + Stockholders’ Equity – Noncash Assets). |  |
| b. That is, changes in cash must be accompanied by and can be accounted for by changes in liabilities, stockholders’ equity, and noncash assets. |  |
| B. Preparing the Statement of Cash Flows |  |
| 1. Use the following 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). | Relationships between classified balance sheet and statement of cash flow |
| b. Identify the cash flow category or categories to which each account relates. Exhibit 12.2 as a guide, but be aware that some accounts may include two categories of cash flows. | categories are illustrated in Exhibit 12.2 – included as an animated build in PPT slides |
| i. Retained Earnings can include both financing cash flows (paying dividends) and operating cash flows (generating net income). |  |
| ii. Accumulated Depreciation can be affected by operating activities (depreciation for using equipment in daily operations) as well as investing activities (disposing of equipment). | Background information for |
| c. Create schedules that summarize operating, investing, and financing cash flows. | Under Amour provided in Exhibit 12.3 |
| C. Direct and Indirect Reporting Operating Cash Flows |  |
| 1. Two alternative methods may be used when presenting the operating activities section of the statement. |  |
| a. **Direct Method**—Reports the components of cash flows from operating activities as gross receipts and gross payments. |  |
| b. I**ndirect Method**—Adjusts net income to compute cash flows from operating activities. |  |
| 2. The amount of net cash flows provided by (used in) operating activities is always the same under the direct and indirect methods. |  |
| 3. The choice between the two methods affects only the operating activities section of the statement of cash flows, not the investing and financing sections. |  |
| 4. The indirect method in the following section is currently the most commonly used method in the United States. |  |

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| Chapter Outline | Teaching Notes |
| ***LO 12-2 Report cash flows from operating activities, using the indirect method.*** | |
| D. Determining Operating Cash Flows Using the Indirect Method | * Activity #2 |
| 1. When using the indirect method, the schedule of operating activities has the following format: |  |
| Net income  Items included in net income that do not involve cash:  + Depreciation  Changes in current assets and current liabilities:  + Decreases in current assets  – Increases in current assets  – Decreases in current liabilities  + Increases in current liabilities  Net cash flow provided by (used in) operating activities | Illustrated in Exhibit 12.4 |
| 2. Net income—When preparing a schedule to determine operating cash flows using the indirect method, start with net income as reported on the last line of the company’s income statement. |  |
| 3. + Depreciation—When initially recording depreciation in the accounting system, we increase Depreciation Expense (with a debit) and increase Accumulated Depreciation (with a credit). |  |
| a. Depreciation does not involve cash |  |
| b. To eliminate the effect of having deducted Depreciation Expense in the income statement, we add it back in the statement of cash flows. |  |
| 4. + Decreases in current assets – Adding decreases in current assets serves two purposes. |  |
| a. First, it eliminates the effects of some transactions that decreased net income but did not affect cash in the current period. |  |
| b. Second, adding decreases in current assets allows us to include the cash effects of other transactions that did not affect net income in the current period but did increase cash. |  |
| 5. – Increases in current assets—Subtracting increases in current assets similarly serves two purposes. |  |
| a. First, it eliminates the effects of transactions that increased net income but did not affect cash in the current period. |  |
| b. Second, subtracting increases in current assets allows us to include the cash effects of other transactions that did not affect net income in the current period but did decrease cash. |  |

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| Chapter Outline | Teaching Notes |
| 6. – Decreases in current liabilities—Subtracting decreases in current liabilities serves two purposes. |  |
| a. First, it eliminates the effects of transactions that increased net income but did not affect cash. |  |
| b. Second, subtracting decreases in current liabilities allows us to include the cash effects of other transactions that did not affect net income in the current period but did decrease cash. |  |
| 7. + Increases in current liabilities—Adding increases in current liabilities serves two purposes. |  |
| a. First, it eliminates the effects of transactions that decreased net income but did not affect cash. |  |
| b. Second, adding increases in current liabilities allows us to include the cash effects of other transactions that did not affect net income in the current period but did increase cash. |  |
| ***LO 12-3 Report cash flows from investing activities.*** | |
| E. Under Amour’s Investing Cash Flow Calculations | Illustrated in Exhibit 12.5 |
| 1. To prepare this section of the statement of cash flows, you must analyze accounts related to long-lived tangible and intangible assets. |  |
| 2. Unlike the analysis of operating activities, where you were concerned only with the net change in selected balance sheet accounts, an analysis of investing (and financing) activities requires that you identify and separately report the causes of both increases and decreases in account balances. |  |
| 3. The following relationships are encountered most frequently: |  |
| a. Purchase of property, plant, and equipment for cash––Outflow |  |
| b. Sale of property, plant, and equipment for––Inflow |  |
| c. Purchase of intangible assets––Outflow |  |
| d. Sale of intangible assets––Inflow |  |
| 4. Equipment—To determine the cause of the change in the Equipment account, accountants would examine the detailed accounting records for equipment. |  |
| a. Purchases of equipment increase the account. |  |
| b. Disposals of equipment decrease it. | Covered in Supplement 12A |
| 5. Intangible and Other Assets—A similar approach is used to determine cash flows associated with intangible asset. |  |

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| Chapter Outline | Teaching Notes |
| ***LO 12-4 Report cash flows from financing activities.*** | |
| F. Under Amour’s Financing Cash Flow Calculations | Illustrated in Exhibit 12.6 |
| 1. This section includes changes in liabilities owed to owners (dividends payable) and financial institutions notes payable and other types of debt) as well as changes in stockholders’ equity accounts. |  |
| 2. The following relationships are encountered most frequently: |  |
| a. Borrowing cash from bank or other financial institutions––Inflow |  |
| b. Repayment of loan principal––Outflow |  |
| c. Issuance of bonds for cash––Inflow |  |
| d. Repayment of bond face value––Outflow |  |
| e. Issuance of stock for cash––Inflow |  |
| f. Repurchase of stock with cash––Outflow |  |
| g. Payment of cash dividends––Outflow |  |
| 3. To compute cash flows from financing activities, you should review changes in all debt and stockholders’ equity accounts. Increases and decreases must be identified and reported separately. |  |
| 4. Long-term Debt—Analysis of the related account(s) will indicated if it is affected by both cash inflows (borrowings) and outflows (repayments). |  |
| 5. Contributed Capital—Analysis of the related account(s) will indicated if it is affected by both cash inflows (stock issuance) and outflows (purchase of treasury stock). |  |
| 6. Retained Earnings—Net income increases Retained Earnings and any dividends decrease Retained Earnings. |  |
| a. Net income has already been accounted for as an operating cash flow. |  |
| b. Dividends, if any, would have decreased Retained Earnings, had they been declared; their payment would have been reported as a cash outflow in the financing section of the statement of cash flows. |  |
| G. Under Amour’s Statement of Cash Flows | Illustrated in Exhibit 12.7 |
| 1. Under either method, the statement of cash flows combines cash flows from operating, investing, and financing activities to produce an overall net increase (or decrease) in cash. |  |
| 2. The net increase (decrease) subtotal combines cash flows from operating, investing, and financing activities to produce an overall net change in cash. |  |
| 3. This net change is added to the beginning cash balance to arrive at the ending cash balance, which is the same cash balance as reported on the balance sheet. |  |

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| Chapter Outline | Teaching Notes |
| H. Supplemental Disclosures |  |
| 1. In addition to their cash flows, all companies are required to report material investing and financing transactions that did not have cash flow effects (called noncash investing and financing activities). |  |
| 2. These activities are not listed in the three main sections of the statement of cash flows. |  |
| 3. This important information is normally presented for users in a supplementary schedule to the statement of cash flows or in the financial statement notes. |  |
| 4. Supplementary information must also report (for companies using the indirect method) the amount of cash paid for interest and for income taxes. |  |
| ***LO 12-5 Interpret cash flows from operating, investing, and financing activities using ratios.*** | |
| III. Evaluate the Results |  |
| A. Free Cash Flow |  |
| 1. An established, healthy company will show positive cash flows from operations, which are sufficiently large to pay for replacing existing property, plant, and equipment and to pay dividends to stockholders. |  |
| 2. Any additional cash (called free cash flow) can (a) be used to expand the business through additional investing activities, (b) be used for other financing activities, or (c) simply build up the company’s cash balance. |  |
| B. Evaluating Cash Flows |  |
| 2. Cash Flows from Operating Activities |  |
| a. When evaluating the operating activities section of the statement of cash flows, consider the absolute amount of cash, keeping in mind that operating cash flows have to be positive over the long run for a company to be successful. | The “Spotlight on Business Decision” feature addresses Lehman Brothers’ operating cash flows and the financial crisis |
| b. All other things being equal, when net income and operating cash flows are similar, there is a high likelihood that revenues are realized in cash and that expenses are associated with cash outflows; any major deviations should be investigated. |  |
| c. Four potential causes of deviations to consider include: |  |
| i. Seasonality |  |
| ii. The corporate life cycle (growth in sales) |  |
| iii. Changes in revenue and expense recognition |  |
| iv. Changes in working capital management |  |

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| Chapter Outline | Teaching Notes |
| 3. Cash Flows from Investing Activities |  |
| a. Healthy companies tend to show negative cash flows in the investing section of the statement of cash flows. |  |
| b. A negative total for this section means the company is spending more to acquire new long-term assets than it is taking in from selling its existing long-term assets. |  |
| c. Positive total cash flow in the investing activities section can raise concerns because it could mean the company is selling off its long-term assets just to generate cash inflows. |  |
| 4. Cash Flows from Financing Activities |  |
| a. The financing activities section does not have an obvious expected direction for cash flows. |  |
| b. Detailed line items within this section need to be considered to assess the company’s overall financing strategy. (Is the company moving toward greater reliance on risky debt financing?) |  |
| 5. Overall Patterns of Cash Flows |  |
| a. Corporate lifecycle phases include: | Illustrated in Exhibit 12.8 |
| i. An introductory phase when the company is being established. |  |
| ii. A growth phase when the company’s presence expands. |  |
| iii. A maturity phase when the company stabilizes. |  |
| iv. A decline phase when the company loses its way. |  |
| b. During each of these phases, a company is likely to show different patterns of net cash flows from operating, investing, and financing activities. |  |
| i. Introductory (start-up) phase—Most companies experience negative net operating cash flows. |  |
| ii. Growth phase—Operating cash flows turn positive because the company has improved its cash inflows from customers. |  |
| iii. Maturity phase—The company generates positive operating cash flows, but no longer has opportunities for expanding the business, so it stops spending cash on investing activities and instead uses its cash for financing activities. |  |
| iv. Decline phase—A company’s operating cash flows again become negative. |  |

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| Chapter Outline | Teaching Notes |
| ***LO 12-6 Report and interpret cash flows from operating activities, using the direct method.*** | |
| C. Reporting Operating Cash Flows with the Direct Method | * Activity #3 |
| 1. Direct method presents a summary of all operating transactions that result in either a debit or a credit to cash. | Illustrated in Exhibit 12.9 |
| 2. Prepared by adjusting each revenue and expense on the income statement from the accrual basis to the cash basis. |  |
| 3. The following adjustments must commonly be made to convert income statement items to the related operating cash flow amounts: |  |
| a. Converting Sales Revenues to Cash Inflows: Sales Revenue + Decrease in Accounts Receivable (A) (or – Increase in Accounts Receivable (A)) = Collections from customers. |  |
| b. Converting Cost of Goods Sold to Cash Paid to Suppliers: Cost of Goods Sold + Increase in Inventory (A) (or – Decrease in Inventory (A)) – Increase in Accounts Payable (L) (or + Decrease in Accounts Payable (L)) = Payments to suppliers of inventory. |  |
| c. Converting Operating Expense to Cash Outflow: Other Expenses + Increase in Prepaid Expenses (A) (or – Decrease in Prepaid Expenses (A)) – Increase in Accrued Expenses (L) (or + Decrease in Accrued Expenses (L)) = Payments to suppliers of services (e.g., rent, utilities, wages, interest). |  |
| IV. Supplement 12A: Report cash flows from Property, Plant, and Equipment (Indirect Method) |  |
| ***LO 12-S1 Report cash flows from PPE disposals using the 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. |  |

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| V. Supplement 12B: T-Account Approach (Indirect Method) |  |
| ***LO 12-S2 Use the T-account approach for preparing an indirect method statement of cash flows.*** | |
| A. Cash T-account |  |
| 1. 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. | Illustrated in Panel A of Exhibit 12B.1 |
| 2. The cash account in Panel A shows increases in cash as debits and decreases in cash as credits; each section matches the three schedules that we prepared for Under Armour’s cash flows presented in Exhibits 12.4, 12.5, and 12.6. |  |
| 3. Panel B includes the same T-accounts for the noncash balance sheet accounts we used in our discussion of each cash flow statement section in the body of the chapter; each change in the noncash balance sheet accounts has a number referencing the change in the cash account that it accompanies. |  |

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# Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout 12–1

Use Handout 12–1 for an in-class activity designed to review the reporting of various items in the three cash flow statement categories. The solution follows the handout master.

1. Handout 12–2

Use Handout 12–2 for an in-class activity designed to review the preparation of the statement of cash flows using the indirect method. The solution follows the handout master.

1. Handout 12–3

Use Handout 12–3 for an in-class activity designed to review the preparation of the statement of cash flows using the direct method. The solution follows the handout master.

# HANDOUT 12–1

# CASH FLOW CATEGORIES

Maya Corporation reports the following items in its statement of cash flows prepared using the direct method. Indicate whether each item is disclosed in the operating, investing, or financing activities section of the statement.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Operating | Investing | Financing |
| Cash paid for salaries and wages |  |  |  |
| Cash paid to purchase property, plant, and equipment |  |  |  |
| Cash received from issuing common stock to owners |  |  |  |
| Cash paid for income taxes |  |  |  |
| Cash paid to purchase investments in securities |  |  |  |
| Dividends paid to owners |  |  |  |
| Interest paid on liabilities |  |  |  |
| Cash received from sale of property, plant, and equipment |  |  |  |
| Cash used for repaying principal to lenders |  |  |  |
| Cash used to repurchase stock from owners |  |  |  |
| Cash provided by dividends and interest on investments |  |  |  |
| Cash received from customers |  |  |  |
| Cash from sale or maturity of investments in securities |  |  |  |
| Cash provided by borrowing from a bank |  |  |  |

# HANDOUT 12–1 SOLUTION

# CASH FLOW CATEGORIES

Maya Corporation reports the following items in its statement of cash flows prepared using the direct method. Indicate whether each item is disclosed in the operating, investing, or financing activities section of the statement.

|  |  |  |  |
| --- | --- | --- | --- |
|  | Operating | Investing | Financing |
| Cash paid for salaries and wages | X |  |  |
| Cash paid to purchase property, plant, and equipment |  | X |  |
| Cash received from issuing common stock to owners |  |  | X |
| Cash paid for income taxes | X |  |  |
| Cash paid to purchase investments in securities |  | X |  |
| Dividends paid to owners |  |  | X |
| Interest paid on liabilities | X |  |  |
| Cash received from sale of property, plant, and equipment |  | X |  |
| Cash used for repaying principal to lenders |  |  | X |
| Cash used to repurchase stock from owners |  |  | X |
| Cash provided by dividends and interest on investments | X |  |  |
| Cash received from customers | X |  |  |
| Cash from sale or maturity of investments in securities |  | X |  |
| Cash provided by borrowing from a bank |  |  | X |

# HANDOUT 12–2

# STATEMENT OF CASH FLOWS (INDIRECT METHOD)

The Group, Inc.

Consolidated Balance Sheet

December 31

(in thousands)

|  |  |  |
| --- | --- | --- |
|  | Current Year | Prior Year |
| **ASSETS** |  |  |
| Cash and Cash Equivalents | $92,069 | $72,634 |
| Accounts Receivables, Net | 55,947 | 75,492 |
| Inventories | 50,784 | 53,129 |
| Prepaid Expenses | 12,112 | 13,057 |
| Equipment | 145,444 | 134,312 |
| Accumulated Depreciation | (50,515) | (36,689) |
| Total Assets | $305,841 | $311,935 |
|  |  |  |
| **LIABILITIES AND STOCKHOLDERS’ EQUITY** |  |  |
| Accounts Payable | $25,466 | $34,879 |
| Accrued Liabilities | 40,574 | 40,722 |
| Long-Term Debt | 10,422 | 10,206 |
| Common Stock | 1,662 | 1,284 |
| Retained Earnings | 227,717 | 224,844 |
| Total Liabilities And Stockholders’ Equity | $305,841 | $311,935 |

Consolidated Statement of Income

Year Ended December 31

(in thousands)

|  |  |
| --- | --- |
|  | Current Year |
| Net Sales | $130,896 |
| Cost of Sales | 74,040 |
| Gross Profit | 56,856 |
| Operating Expenses: |  |
| Selling, General & Administrative Expenses | 33,211 |
| Depreciation Expense | 13,826 |
| Total Operating Expenses | 47,037 |
| Operating Income | 9,819 |
| Interest Income | 239 |
| Income Before Income Taxes | 10,058 |
| Income Tax Expense | 3,621 |
| Net Income | $6,437 |

# HANDOUT 12–2, continued

The Group, Inc. did not sell any equipment or repay any borrowings during the current year. The company declared and paid dividends in the amount of $3,564 during the current year.

Using the information provided above, compute the net cash flows from operating activities using the indirect method.

Then, compute the cash flows during the current year for each category and complete the following table:

|  |  |
| --- | --- |
| Net Cash Flows from Operating Activities | $ |
| Net Cash Flows from Investing Activities |  |
| Net Cash Flows from Financing Activities |  |
| Net Increase (Decrease) in Cash and Cash Equivalents | 19,435 |
| Cash and Cash Equivalents at beginning of year | 72,634 |
| Cash and Cash Equivalents at end of year | $ 92,069 |

# HANDOUT 12–2 SOLUTION

# STATEMENT OF CASH FLOWS (INDIRECT METHOD)

The Group, Inc.

Consolidated Balance Sheets

December 31

(in thousands)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| *Section* |  | Current Year | Prior Year | *Change* |
|  | **ASSETS** |  |  |  |
|  | Cash and Cash Equivalents | $92,069 | $72,634 | *+ 19,435* |
| *O* | Accounts Receivables, Net | 55,947 | 75,492 | – *19,545* |
| *O* | Inventories | 50,784 | 53,129 | – *2,345* |
| *O* | Prepaid Expenses | 12,112 | 13,057 | – *945* |
| *I* | Equipment | 145,444 | 134,312 | *+ 11,132* |
| *O* | Accumulated Depreciation | (50,515) | (36,689) | *­*– *13,826* |
|  | Total Assets | $305,841 | $311,935 |  |
|  |  |  |  |  |
|  | **LIABILITIES AND STOCKHOLDERS’ EQUITY** |  |  |  |
| *O* | Accounts Payable | $25,466 | $34,879 | – *9,413* |
| *O* | Accrued Liabilities | 40,574 | 40,722 | – *148* |
| *F* | Long-Term Debt | 10,422 | 10,206 | *216* |
| *F* | Common Stock | 1,662 | 1,284 | *+ 378* |
| *O,F* | Retained Earnings | 227,717 | 224,844 | *+ 2,873* |
|  | Total Stockholders’ Equity | 229,379 | 226,128 |  |
|  | Total Liabilities And Stockholders’ Equity | $305,841 | $311,935 |  |

Consolidated Statement of Income

Year Ended December 31

(in thousands)

|  |  |
| --- | --- |
|  | Current Year |
| Net Sales | $130,896 |
| Cost of Sales | 74,040 |
| Gross Profit | 56,856 |
| Operating Expenses: |  |
| Selling, General & Administrative Expenses | 33,211 |
| Depreciation Expense | 13,826 |
| Total Operating Expenses | 47,037 |
| Operating Income | 9,819 |
| Interest Income | 239 |
| Income Before Income Taxes | 10,058 |
| Income Tax Expense | 3,621 |
| Net Income | $6,437 |

# HANDOUT 12–2 SOLUTION, continued

The Group, Inc. did not sell any equipment or repay any borrowings during the current year. The company declared and paid dividends in the amount of $3,564 during the current year.

Using the information provided above, compute the net cash flow provided by (used for) operating activities using the indirect method.

|  |  |
| --- | --- |
| Net Income | $6,437 |
| Adjustments: |  |
| Depreciation | 13,826 |
| Change in Accounts Receivable | 19,545 |
| Change in Inventories | 2,345 |
| Change in Prepaid Expenses | 945 |
| Change in Accounts Payable | (9,413) |
| Change in Accrued Liabilities | (148) |
| Net Cash Flows Provided by Operating Activities | $33,537 |

Then, compute the cash flows during the current year for each category and complete the following table:

|  |  |
| --- | --- |
| Cash Flows from Operating Activities (see above) | $33,537 |
| Cash Flows from Investing Activities (1) | (11,132) |
| Cash Flows from Financing Activities (2) | (2,970) |
| Net Increase in Cash and Cash Equivalents | 19,435 |
| Cash and Cash Equivalents at beginning of year | 72,634 |
| Cash and Cash Equivalents at end of year | $92,069 |

1. Attributable to purchases of equipment (that is, the increase in the equipment account). There were no other investing activities.
2. Cash flows from financing activities were determined as follows:

|  |  |
| --- | --- |
| Proceeds from issuance of long-term debt | $ 216 |
| Proceeds from issuance of stock | 378 |
| Payment of dividends | (3,564) |
| Net Cash Flows from Financing Activities | $(2,970) |

# HANDOUT 12–3

# STATEMENT OF CASH FLOWS (DIRECT METHOD)

The Group, Inc.

Consolidated Balance Sheet

December 31

(in thousands)

|  |  |  |
| --- | --- | --- |
|  | Current Year | Prior Year |
| **ASSETS** |  |  |
| Cash and Cash Equivalents | $92,069 | $72,634 |
| Accounts Receivables, Net | 55,947 | 75,492 |
| Inventories | 50,784 | 53,129 |
| Prepaid Expenses | 12,112 | 13,057 |
| Equipment | 145,444 | 134,312 |
| Accumulated Depreciation | (50,515) | (36,689) |
| Total Assets | $305,841 | $311,935 |
|  |  |  |
| **LIABILITIES AND STOCKHOLDERS’ EQUITY** |  |  |
| Accounts Payable | $25,466 | $34,879 |
| Accrued Liabilities | 40,574 | 40,722 |
| Long-Term Debt | 10,422 | 10,206 |
| Common Stock | 1,662 | 1,284 |
| Retained Earnings | 227,717 | 224,844 |
| Total Liabilities And Stockholders’ Equity | $305,841 | $311,935 |

Consolidated Statement of Income

Year Ended December 31

(in thousands)

|  |  |
| --- | --- |
|  | Current Year |
| Net Sales | $130,896 |
| Cost of Sales | 74,040 |
| Gross Profit | 56,856 |
| Operating Expenses: |  |
| Selling, General & Administrative Expenses | 33,211 |
| Depreciation Expense | 13,826 |
| Total Operating Expenses | 47,037 |
| Operating Income | 9,819 |
| Interest Income | 239 |
| Income Before Income Taxes | 10,058 |
| Income Tax Expense | 3,621 |
| Net Income | $6,437 |

# HANDOUT 12–3, continued

The Group, Inc. did not sell any equipment or repay any borrowings during the current year. The company declared and paid dividends in the amount of $3,564 during the current year.

Using the information provided above, compute the net cash flows from operating activities using the direct method.

Then, compute the cash flows during the current year for each category and complete the following table:

|  |  |
| --- | --- |
| Net Cash Flows from Operating Activities | $ |
| Net Cash Flows from Investing Activities |  |
| Net Cash Flows from Financing Activities |  |
| Net Increase (Decrease) in Cash and Cash Equivalents | 19,435 |
| Cash and Cash Equivalents at beginning of year | 72,634 |
| Cash and Cash Equivalents at end of year | $ 92,069 |

# HANDOUT 12–3 SOLUTION

# STATEMENT OF CASH FLOWS (DIRECT METHOD)

The Group, Inc.

Consolidated Balance Sheets

December 31

(in thousands)

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| *Section* |  | Current Year | Prior Year | *Change* |
|  | **ASSETS** |  |  |  |
|  | Cash and Cash Equivalents | $92,069 | $72,634 | *+ 19,435* |
| *O* | Accounts Receivables, Net | 55,947 | 75,492 | *­*– *19,545* |
| *O* | Inventories | 50,784 | 53,129 | – *2,345* |
| *O* | Prepaid Expenses | 12,112 | 13,057 | – *945* |
| *I* | Equipment | 145,444 | 134,312 | *+ 11,132* |
| *O* | Accumulated Depreciation | (50,515) | (36,689) | – *13,826* |
|  | Total Assets | $305,841 | $311,935 |  |
|  |  |  |  |  |
|  | **LIABILITIES AND STOCKHOLDERS’ EQUITY** |  |  |  |
| *O* | Accounts Payable | $25,466 | $34,879 | – *9,413* |
| *O* | Accrued Liabilities | 40,574 | 40,722 | – *148* |
| *F* | Long-Term Debt | 10,422 | 10,206 | *216* |
| *F* | Common Stock | 1,662 | 1,284 | *+ 378* |
| *O,F* | Retained Earnings | 227,717 | 224,844 | *+ 2,873* |
|  | Total Stockholders’ Equity | 229,379 | 226,128 |  |
|  | Total Liabilities And Stockholders’ Equity | $305,841 | $311,935 |  |

Consolidated Statement of Income

Year Ended December 31

(in thousands)

|  |  |
| --- | --- |
|  | Current Year |
| Net Sales | $130,896 |
| Cost of Sales | 74,040 |
| Gross Profit | 56,856 |
| Operating Expenses: |  |
| Selling, General & Administrative Expenses | 33,211 |
| Depreciation Expense | 13,826 |
| Total Operating Expenses | 47,037 |
| Operating Income | 9,819 |
| Interest Income | 239 |
| Income Before Income Taxes | 10,058 |
| Income Tax Expense | 3,621 |
| Net Income | $6,437 |

# HANDOUT 12–3 SOLUTION, continued

The Group, Inc. did not sell any equipment or repay any borrowings during the current year. The company declared and paid dividends in the amount of $3,564 during the current year.

Using the information provided above, compute the net cash flow provided by (used for) operating activities using the direct method.

|  |  |
| --- | --- |
| Cash collected from customers (1) | $150,441 |
| Cash payments to suppliers (2) | (81,108) |
| Cash payments for operating expenses (3) | (32,414) |
| Cash received for interest (4) | 239 |
| Cash payments for income tax expense (5) | (3,621) |
|  | $33,537 |

1. Sales of $130,896 + decrease in Accounts Receivable of $19,435.
2. Cost of Sales of $74,040 + decrease in Accounts Payable of $9,413 – decrease in Inventories of $2,345.
3. Operating Expenses (not including depreciation) of $33,211 + decrease in Accrued Liabilities of $148 – decrease in Prepaid Expenses of $945.
4. Equals Interest Expense; no change in Interest Payable.
5. Equals Income Tax Expense; no change in Taxes Payable.

Compute total net cash flows and their effect on cash at the end of the period.

|  |  |
| --- | --- |
| Net Cash Flows from Operating Activities (see above) | $33,537 |
| Net Cash Flows from Investing Activities (6) | (11,132) |
| Net Cash Flows from Financing Activities (7) | (2,970) |
| Net Increase (Decrease) in Cash and Cash Equivalents | 19,435 |
| Cash and Cash Equivalents at beginning of year | 72,634 |
| Cash and Cash Equivalents at end of year | $92,069 |

1. Attributable to purchases of equipment (that is, the increase in the equipment account). There were no other investing activities.
2. Cash flows from financing activities were determined as follows:

|  |  |
| --- | --- |
| Proceeds from issuance of long-term debt | $ 216 |
| Proceeds from issuance of stock | 378 |
| Payment of dividends | (3,564) |
| Net Cash Flows from Financing Activities | $(2,970) |