Chapter 17

The Cash Flow Statement

Questions

1. The cash flow statement reports the reasons for the changes in cash during the period. In the process, it shows a listing of the entity’s operating, investing, and financing activities.

2. Four purposes of the cash flow statement are to (a) predict future cash flows, (b) evaluate management decisions, (c) determine the company’s ability to pay dividends and debts, and (d) show the relationship between net income and changes in cash.

3. a. Operating activities create revenues and expenses in the entity’s major line of business. Operating activities are those that affect the income statement.

b. Investing activities increase and decrease the assets that the business has to work with (its capital assets).

c. Financing activities obtain the funds from investors and creditors that are needed to launch and sustain the business. Financing activities also include payments to these parties.

4. The cash flow statement is dated “For the period ended XXX” because it reports the reasons for the *changes* in cash that occurred *during* the period, such as “For the Year Ended December 31, 2020” or “For the Month Ended June 30, 2020.”

5. The check figure for the cash flow statement is the change in cash and cash equivalents during the period. This amount is obtained by subtracting the beginning cash balance from the ending cash balance (taken from the comparative balance sheet). The change in cash is compared to the net change in cash shown at the bottom of the cash flow statement. The two amounts should be equal. As a final check, the ending cash balance on the cash flow statement should match the cash balance on the balance sheet.

6. The largest source of cash for most successful companies is operations.

7. Cash may decrease during a year when income is high because the entity may be using cash to invest in long-term assets or to increase inventory. Cash may increase in a bad year because the entity may be borrowing heavily or selling off assets such as inventory and equipment. The cash flow statement reports these activities to show where cash came from and how it was spent during the year.

8. Issuance of a note payable to purchase land should be reported as a  
non-cash investing and financing activity. This category of transactions should be disclosed in the notes to the financial statements. Three other transactions in this category are issuance of shares to acquire a building, issuance of shares to pay long-term debt, and issuance of a note payable to retire shares. *Note:* Students may have other examples that are acceptable.

9. Free cash flow is the amount of cash a company can “free up” for new opportunities, calculated as net cash inflows from operating activities less cash payments for planned investments in long-term assets.

10. The *direct method* does a better job of showing the individual cash flows from operating activities. The *indirect method* shows more clearly the relationship between net income and operating cash flow.

11. Amortization expense is reported on a cash flow statement prepared by the indirect method because the first item, net income, includes a deduction for it. Since it does not affect cash, amortization must be added back to net income to cancel the effect of its subtraction in computing income.

12. A net increase in another current asset is a *decrease* in cash.

A net decrease in another current asset is an *increase* in cash.

13. A net increase in a current liability is an *increase* in cash.

A net decrease in a current liability is a *decrease* in cash.

14. Aggasiz Corporation’s net cash inflow from operations = $120,000

($90,000 + $24,000 + $18,000 – $12,000).

15. Cash flows from *operating* activities:

Net income $XXX

Add (subtract) items that affect net income and

cash flow differently:

Gain on sale of investments (10,000)

Cash flows from investing activities:

Sale of investments $160,000

16.

|  |  |  |  |
| --- | --- | --- | --- |
| Property, Plant, and Equipment, Net | | | |
| Beginning balance | 200,000 | Amortization expense | 35,000 |
| Acquisitions | X | Book value of capital assets disposed of | 10,000 |
| Ending balance | 180,000 |  |  |

Acquisitions of capital assets ($X) are $25,000, computed as follows:

$200,000 + $X – $35,000 – $10,000 = $180,000

$X = $180,000 – $200,000 +

$35,000 + $10,000

$X = $25,000

This amount is reported as a cash payment in the Investing Activities section of the cash flow statement.

17. Cash receipts and cash payments reported on the cash flow statement prepared by the direct method:

OPERATING ACTIVITIES

Cash Receipts Cash Payments

Collection from customers Payments to suppliers

Receipts of interest and Payments to employees

dividends on investments Payments of interest and taxes

Other operating receipts Other operating disbursements

INVESTING ACTIVITIES (affect long-term assets):

Cash Receipts Cash Payments

Sale of property, plant, and Acquisition of property, plant, and

equipment, and intangible assets equipment, and intangible

assets

Sale of long-term investments Acquisition of long-term

investments

Cash receipts on long-term loans Making long-term loans

receivable

FINANCING ACTIVITIES (affect long-term liabilities and equity):

Cash Receipts Cash Payments

Issuing shares Repurchase of company shares

Borrowing money (long term) Payment of cash dividends

Paying principal amounts of

debt, including the current

portion of long-term debt

18. a. Financing activities

b. Operating activities

c. Operating activities

d. Amortization expense does not appear on a cash flow statement prepared using the direct method because it does not affect cash.

e. Operating activities

19. The net cash inflow from operating activities of Winford Distributing Corp. was $64,000 ($102,000 + $8,000 – $28,000 – $18,000).

20. Nelson Inc. paid employees $60,000 ($54,000 + $8,000 – $2,000). This would be reported in the Operating Activities section of the cash flow statement.

21. There is no difference between the two methods for reporting investing activities and financing activities. These methods differ only in the reporting of operating activities.

22. Amortization expense is not reported on a cash flow statement prepared by the direct method because it does not affect cash at all.

Starters

(10 min.) **S17-1**

The statement of cash flows helps investors and creditors:

1. *Predict future cash flow* by reporting past cash receipts and payments, which can be good predictors of future cash flows.

2. *Evaluate management decisions* by reporting on managers’ investments (shown in the investing activities section of the cash flow statement). Wise investments help companies prosper. Unwise investments cause businesses to suffer financially. It also helps to evaluate management decisions in its handling of operating cash flows, which are the most important for the business.

3. *Predict the ability* *to make debt payments to lenders and pay dividends to shareholders* by reporting where cash came from and how cash was spent. Cash flow information helps investors and creditors predict whether the business can pay its debts and dividends.

4. *Show the relationship of net income to cash flow* by reporting cash flow from operations in the first section of the cash flow statement. A company’s cash balance can decrease when net income is high, and cash can increase when net income is low due to timing and accrual-based accounting. Poor cash flow from operations is a warning signal that a company may be in financial trouble.

(10 min.) **S17-2**

a. Operating

Investing

Financing

b. The change, or increase or decrease in cash, is the difference between the beginning-of-period and end-of-period balance sheets.

c. Collections from customers

d. Net income

(5 min.) **S17-3**

In this example, Company X would be considered a start-up for the following reasons:

* The cash from operations is in a negative position, indicating that the company is not currently generating positive cash flow from operations.
* Cash flow from investing is negative, indicating that the company is investing in long-term assets.
* Financing cash flow is positive, implying that the company is borrowing or acquiring cash to fund operations or to invest in assets.

(5 min.) **S17-4**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Free cash  flow | = | Net cash inflows from  operating activities | – | Net cash outflows from  investing activities |
|  | = | $120,000 | – | $64,000 |
|  | = | $56,000 |  |  |

(10 min.) **S17-5**

Cash flows from operating activities

Net income $63,000

Add (subtract) items that affect net

income and cash flow differently:

Amortization expense 10,000

Increase in accounts receivable (7,000)

Decrease in accounts payable (5,000)

Net cash inflow from operating activities $61,000

(5 min.) **S17-6**

|  |  |  |
| --- | --- | --- |
| **APPLE DISTILLERY INC.** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended June 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $100,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 40,000 |  |
| Increase in current assets other than cash | (60,000) |  |
| Decrease in current liabilities | (10,000) | (30,000) |
| Net cash inflow from operating activities |  | $ 70,000 |

(15-20 min.) **S17-7**

|  |  |  |
| --- | --- | --- |
| **PRESTON MEDIA CORPORATION** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended March 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $19,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $11,000 |  |
| Increase in accounts receivable | (4,500) |  |
| Increase in accounts payable | 3,500 | 10,000 |
| Net cash inflow from operating activities |  | 29,000 |
|  |  |  |

(5-10 min.) **S17-8**

Investing activities section:

Purchase of equipment $(200,000)

Sale of equipment 50,000

(Note that the August 1 transactions would be reported as a non-cash financing and investing activity.)

(10-15 min.) **S17-9**

a. *Payment* of long-term note payable = $6,000 ($204,000 − $198,000)  
This is clear from the *decrease* in long-term note payable.

b. Issuance of common shares = $9,000 ($120,000 – $111,000)  
This is clear from the *increase* in common shares.

c. Payment of dividends = $42,000, as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Beginning  retained  earnings | + | Net  income | – | Dividends | = | Ending  retained  earnings |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| $738,000 | + | $120,000 | – | X | = | $816,000 |
| X | = | + $738,000 + $120,000 – $816,000 | | | | |
|  | = | $42,000 |  |  |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| Retained Earnings | | | |
|  |  | Beg. bal. | 738,000 |
| Dividends | 42,000 | Net income | 120,000 |
|  |  | End. bal. | 816,000 |

(10-15 min.) **S17-10**

a. Equipment, Net(Let Acquisitions = *x*)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Beginning | + | *Acquisitions* | – | Amortization | = | Ending |
| $105,000 | + | *x* | – | $9,000 | = | $112,500 |
|  |  | *x* = $16,500 |  |  |  |  |

Or solve using a T-account:

|  |  |  |  |
| --- | --- | --- | --- |
| Equipment, Net | | | |
| Beginning | 105,000 | Amortization | 9,000 |
| *Acquisitions* | *16,500* |  |  |
| Ending | 112,500 |  |  |

b. Long-Term Note Payable (Let *x* = Payment)

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Beginning | + | Issuance | – | *Payment* | = | Ending |
| $18,000 | + | $7,500 | – | *x* | = | $15,000 |
|  |  |  |  | *x* = $10,500 |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| Long-Term Note Payable | | | |
|  |  | Beginning | 18,000 |
| Payment | 10,500 | Issuance | 7,500 |
|  |  | Ending | 15,000 |

Or solve using a T-account:

(10 min.) **S17-11**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| O+ | a. | Loss on sale of land | O+ | f. | Increase in accounts payable |
| O+ | b. | Amortization expense | F– | g. | Payment of dividends |
| O– | c. | Increase in inventory | O– | h. | Decrease in accrued liabilities |
| O+ | d. | Decrease in accounts |  |  |  |
|  |  | receivable | F+ | i. | Issuance of common shares |
| I– | e. | Purchase of equipment | O– | j. | Gain on sale of building |

(5 min.) **S17-12**

*(\* Requested a calculation and not a formal statement)*

Net income $98,000

+ Amortization 16,500

– Purchase of building (132,000)

+ Borrowing 66,000

Increase in cash $48,500

(15 min.) **S17-13**

|  |  |  |
| --- | --- | --- |
| **APPLE DISTILLERY INC.** | | |
| Cash Flow Statement | | |
| For the Year Ended June 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $100,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $40,000 |  |
| Increase in current assets other than cash | (60,000) |  |
| Decrease in current liabilities | (10,000) | (30,000) |
| Net cash inflow from operating activities |  | 70,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Purchase of equipment | (80,000) |  |
| Cash received from sale of land | 120,000 |  |
| Net cash inflow from investing activities |  | 40,000 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Cash received from issuance of common shares | 40,000 |  |
| Payment of note payable | (60,000) |  |
| Payment of dividends | (12,000) |  |
| Repurchase of Apple Distillery shares | (10,000) |  |
| Net cash outflow from financing activities |  | (42,000) |
|  |  |  |
| **Net increase in cash** |  | $ 68,000 |

(5 min.) **S17-14**

1. Under IFRS, an entity may choose to report cash inflows from interest and dividends as either operating, investing or financing activities. Once an accounting policy is chosen, it must be applied consistently to all transactions of a similar nature.

IFRS differs from ASPE in that ASPE requires that the receipt of interest and dividends be reported as operating activities on the cash flow statement.

2. Under IFRS, an entity may choose to report cash payments for interest and dividends as either operating activities or financing activities. Once an accounting policy is chosen, it must be applied consistently to all transactions of a similar nature.

IFRS differs from ASPE in that ASPE requires that payments of interest be reported as an operating activity on the cash flow statement and that payments of dividends be reported in the Financing Activities section.

(5 min.) **S17-15**

|  |  |  |
| --- | --- | --- |
| **NAPANEE RESOURCES INC.** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended June 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Collections from customers | $ 400,000 |  |
| Payments to suppliers | (220,000) |  |
| Payments to employees | (140,000) |  |
| Net cash inflow from operating activities |  | $40,000 |

(15-20 min.) **S17-16**

a. Collections from customers = $402,000, as follows:

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Collections  from customer | = | Sales  Revenue | – | Increase in Accounts Receivable |
|  |  |  |  |  |
|  | = | $420,000 | – | $18,000 ($162,000 – $144,000) |
|  | = | $402,000 |  |  |

|  |  |  |  |
| --- | --- | --- | --- |
| Accounts Receivable | | | |
| Beg. Bal. | 144,000 |  |  |
| Sales | 420,000 | Collections | 402,000 |
| End. Bal. | 162,000 |  |  |

b. Payment for inventory = $233,000, as follows:

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Payments for  inventory | = | Cost of goods  sold | – | Increase in inventory | – | Increase in Accounts Payable |
|  |  |  |  |  |  |  |
|  | = | $240,000 | + | $8,000 | – | $15,000 |
|  | ($240,000 – $232,000) | ($141,000 – $126,000) |
|  | = | $233,000 |  |  |  |  |
|  |  |  |  |  |  |  |

|  |  |
| --- | --- |
| Accounts Payable | |
| Amount paid *y* = 233,000 | 126,000 |
| Purchased 248,000 |
|  | 141,000 |

|  |  |
| --- | --- |
| Inventory | |
| 232,000 |  |
| *x* = 248,000 purchased | COGS 240,000 |
| 240,000 |  |

(15-20 min.) **S17-17**

|  |  |  |
| --- | --- | --- |
| **MEMMOT HEALTH LABS INC.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Collections from customers | $ 660,000 |  |
| Payments to suppliers and employees | (460,000) |  |
| Net cash inflow from operating activities |  | $ 200,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Purchase of equipment | (150,000) |  |
| Net cash outflow from investing activities |  | (150,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of dividends | (40,000) |  |
| Net cash outflow from financing activities |  | (40,000) |
|  |  |  |
| **Net increase in cash** |  | 10,000 |
| Cash balance, beginning |  | 65,000 |
| Cash balance, ending |  | $ 75,000 |

(15-20 min.) **S17-18**

|  |  |  |
| --- | --- | --- |
| **NAPANEE RESOURCES INC.** | | |
| Cash Flow Statement | | |
| For the Year Ended June 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Collections from customers | $ 400,000 |  |
| Payments to suppliers | (220,000) |  |
| Payments to employees | (140,000) |  |
| Net cash inflow from operating activities |  | $ 40,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Purchase of equipment | (80,000) |  |
| Cash received from sale of land | 120,000 |  |
| Net cash inflow from investing activities |  | 40,000 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Cash received from issuing shares | 40,000 |  |
| Payment of note payable | (60,000) |  |
| Payment of dividends | (12,000) |  |
| Net cash outflow from financing activities |  | (32,000) |
|  |  |  |
| **Net increase in cash** |  | $ 48,000 |

Exercises

(10-15 min.) **E17-1**

One purpose of the cash flow statement is to help management predict the future cash flows of a business. It measures historical cash flows, which help predict future cash flows. Although accrual-basis net income is an important measure of management performance, it still takes cash to pay the bills. Also, a manager’s performance should be evaluated in part on the basis of how well the manager uses cash. This information is given in the cash flow statement.

Finally, the cash flow statement helps lenders and investors predict whether   
a company can pay debts and dividends.

*Instructional Note:* Student responses may vary considerably.

(10-15 min.) **E17-2**

*Req.1*

1. A cash outflow from operations could occur for several reasons:

a. The company may have taken advantage of a very favourable large inventory purchase late in the year.

b. The company may have a large outflow for operating expenses.

c. Other outflows could be for salaries, interest or taxes.

d. The company may be operating at a loss.

(The students may suggest other possible reasons.)

*Req. 2*

2. The cash flow statement should be compared with the income statement and balance sheet to discover the source of the outflow. The main danger of this situation is that the company could run out of money even if it is profitable.

*Req.3*

3. If this situation continues for two more years, then Whiteshell Inc. is likely to have to seek court protection to protect it from creditors. It may be forced to sell off assets or divisions of the company to enable it to survive.

*(10-15 min.)* **E17-3**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Section | +/– Cash | Transaction |
| a. | O | + | Amortization of equipment |
| b. | O  I | +  + | Sale of long-term investment at a loss |
| c. | F | – | Payment of cash dividend |
| d. | O | – | Increase in inventory |
| e. | F | + | Issuance of preferred shares for cash |
| f. | O | + | Prepaid expenses decreased during the year |
| g. | O | + | Accrual of salaries expense |
| h. | F | + | Issuance of long-term note payable to borrow cash |
| i. | I | + | Cash sale of land |
| j. | F | – | Payment of long-term debt |

(5-10 min.) **E17-4**

Case A— New borrowing and cash from operations generated the cash needed to acquire new property, plant, and equipment.

Case B— New borrowing generated the cash for acquisitions of new property, plant, and equipment.

Case C— The sale of property, plant, and equipment generated the cash to acquire new property, plant, and equipment.

*(10 min.)* **E17-5**

Case A— Indicates a healthy cash flow from operations and investment in new property, plant, and equipment. They financed the acquisition by new borrowing and operating cash flow but may be struggling a bit as they have a total negative cash flow for the year. Caution would be advised here.

Case B— Cash flow from operations is in a negative position, which would cause red flags or caution to be noted. Investment in new property, plant, and equipment was financed by major new borrowing in the amount of $516,000, which could cause debt servicing issue for future operations. Even though this case has positive overall cash flow, I would advise extreme caution in this case.

Case C— A positive cash flow from operations and investment in new property, plant, and equipment is evident in this case. This also indicates that a growth strategy may be at play here. Case C financed the acquisition by selling assets or investments, as opposed to borrowing and generated a positive cash flow for the year. This case appears on the surface to be in the best financial position.

(10-15 min.) **E17-6**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **TAIRONG CORPORATION** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended July 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $288,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 156,000 |  |
| Loss on sale of land | 60,000 |  |
| Increase in current assets other than cash | (252,000) |  |
| Decrease in current liabilities | (276,000) | (312,000) |
| Net cash outflow from operating activities |  | $ (24,000) |

*Req. 2*

The operating cash flows are weak.

*(10-15 min.)* **E17-7**

|  |  |  |
| --- | --- | --- |
| **Cash flows from operating activities** |  |  |
| Net income |  | $ **X\*** |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Loss on the sale of equipment | $ 1,500 |  |
| Amortization expense | 3,350 |  |
| Decrease in inventory | 2,175 |  |
| Increase in prepaid expenses | (400) |  |
| Increase in accounts payable | 600 |  |
| Decrease in legal fees payable | (1,000) |  |
| Increase in trade accounts receivable | (2,000) |  |
| Net cash inflow from operating activities |  | 4,225 |
| Net increase in cash |  | $40,625 |

**X** = $36,400 : 40,625 – 4,225

**Net income is $36,400**

(15-20 min.) **E17-8**

|  |  |  |
| --- | --- | --- |
| **VINTAGE COLOUR ENGRAVING** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended April 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $ 36,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 5,000 |  |
| Loss on sale of land | 4,000 |  |
| Increase in current assets other than cash | (10,000) |  |
| Decrease in current liabilities | (19,000) | (20,000) |
| Net cash inflow from operating activities |  | $ 16,000 |
|  |  |  |

(15-20 min.) **E17-9**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **HIP DANCE ACADEMY LTD.** | | |
| Cash Flow Statement (partial) | | |
| For the Month Ended March 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $ 69,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 9,000 |  |
| Increase in accounts receivable | (102,000) |  |
| Increase in shoe inventory | (3,000) |  |
| Increase in accounts payable | 15,000 |  |
| Decrease in accrued liabilities | (9,000) | (90,000) |
| Net cash outflow from operating activities |  | $(21,000) |

*Req. 2*

Hip Dance Academy Ltd. shows signs of trouble collecting receivables but no signs of trouble selling inventory. There is a large build-up in receivables but not in inventory. The reasons are hard to tell without further information.

(15-20 min.) **E17-10**

a.

|  |  |
| --- | --- |
| Retained Earnings | |
| x = cash dividends | 120,000 |
| 65,000 | 150,000 |
|  | 160,000 |

Cash dividend payments = $45,000

$120,000 + $150,000 – $65,000 – Cash dividends = $160,000

$205,000 – Cash dividends = $160,000

Cash dividends = $45,000

b.

|  |  |  |  |
| --- | --- | --- | --- |
| Property, Plant, and Equipment (net) | | | |
| Beginning balance | 320,000 | Amortization | 36,000 |
| Purchases | 104,000 | Book value sold | X |
| Ending balance | 365,000 |  |  |

$320,000 + $104,000 – $36,000 – Book value sold = $365,000

Book value sold = $388,000 – $365,000

Book value sold = $23,000

Cash proceeds of sale = Book value of asset sold, $23,000

– Loss on sale, $8,000

= $15,000

(20-30 min.) **E17-11**

Added/ Type of (Reasons are given for both required and not required)

Deducted Activity Reason

a. No effect Operating This has already been recorded and is part of the net income figure.

b. No effect — This merely capitalizes part of retained earnings and does not involve cash.

c. Deducted Operating More cash has been paid out than appears in the expenses on the income statement.

d. Added Investing Part of investment in assets has been turned into cash.

e. Added Financing Cash has been received from long-term debt.

f. Deducted Operating The gain has been included in net income. The total cash received would be shown under Investing (see d. above).

g. No effect Investing and Does not affect cash. Would be shown by way of a

Financing note to the financial statements.

h. Added Operating Add to net income figure as amortization expense does not require a payment of cash.

i. Added Operating Add to net income figure as cash was not expended in this period to produce sales.

j. Deducted Operating Cash was expended that did not increase costs for this period.

k. Deducted Financing The payment to bondholders is greater than the interest expense in the financial statements.

l. No effect — This is part of the cash equivalents and therefore part of the change being explained by this statement.

m. No effect Operating This has already been recorded and is part of the net income figure.

n. Deducted Investing Investment in assets uses cash.

o. Added Financing Cash has been received from issue of common shares.

p. Added Operating Add to net income figure as amortization expense does not require cash outflow.

(5-10 min.) **E17-12**

a. Subtract the $40,000 gain from net income in the *operating* activities section. Report cash receipt of $80,000 as an investing activity.

b. Report the $1,300,000 as an *investing* activity. Report the $1,600,000 note payable in non-cash investing and financing activities and note that the cash payment is part of the same transaction.

(20-30 min.) **E17-13**

Req. 1

|  |  |  |
| --- | --- | --- |
| **FLASHPOINT CONSULTING LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended September 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $120,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 58,000 |  |
| Decrease in accounts receivable | 114,000\*\* |  |
| Increase in office supplies | (12,000)\*\* |  |
| Increase in accounts payable | 12,000\*\*\* |  |
| Decrease in accrued liabilities | (4,000)\*\*\* | 168,000 |
| Net cash inflow from operating activities |  | 288,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of computer equipment | (202,000) |  |
| Cash received from sale of land | 20,000 |  |
| Net cash outflow from investing activities |  | (182,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Cash received from issuance of common shares | 84,000 |  |
| Payment of long-term note payable | (40,000) |  |
| Dividends paid | (130,000) |  |
| Net cash outflow from financing activities |  | (86,000) |
|  |  |  |
| **Net increase in cash** |  | 20,000 |
| Cash balance at beginning of 2020 |  | 36,000 |
| Cash balance at end of 2020 |  | $ 56,000 |

*Note to financial statements:*

The company also issued a long-term note for $30,000 in partial payment of computer equipment purchased for $232,000.

\*\*These amounts can be combined into a single total and reported as

“Decrease in current assets other than cash 102,000.”

\*\*\*These amounts can be combined into a single total and reported as

“Increase in current liabilities 8,000.”

(continued) **E17-13**

Req. 2

The cash flow from operating activities is very satisfactory at 53 percent of revenue and it provided the bulk of the funds to acquire the computer equipment. The company is fairly strong and has little problem in acquiring long-term financing by way of notes and common shares.

(25 – 30 min) **E17-14**

|  |  |  |
| --- | --- | --- |
| BURAGINA INC. | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $104,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 40,000 |  |
| Loss on sale of building | 8,000 |  |
| Decrease in accounts receivable | 4,000 |  |
| Increase in inventory | (12,000) |  |
| Decrease in prepaid expenses | 8,000 |  |
| Increase in note payable, short-term | 16,000 |  |
| Increase in accounts payable | 20,000 |  |
| Decrease in accrued liabilities | (8,000) | 76,000 |
| Net cash inflow from operating activities |  | 180,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Purchase of equipment | (392,000) |  |
| Sale of building | 296,000 |  |
| Purchase of long-term investment | (32,000) |  |
| Net cash outflow from investing activities |  | (128,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Issuance of long-term note payable | 28,000 |  |
| Issuance of common shares | 76,000 |  |
| Payment of cash dividends | (72,000) |  |
| Repurchase of Buragina Inc. shares | (20,000) |  |
| Net cash inflow from financing activities |  | 12,000 |
|  |  |  |
| **Net increase in cash and cash equivalents** |  | $ 64,000 |
| Cash and cash equivalents at beginning of 2020 |  | 12,000 |
| Cash and cash equivalents at end of 2020 |  | $ 76,000 |

*(continued)* **E17-14**

In the notes to the financial statements:

1. During the year, the company issued a long-term note payable in the amount of $148,000 in payment for a patent.

2. During the year, the company issued common shares in the amount of $52,000 to retire bonds payable in the same amount.

(10 – 15 min) **E17-15**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| a. | NIF | Acquisition of a building by | g. | O + | Collection of cash interest |
|  |  | issuance of common shares |  |  |  |
|  |  |  |  |  |  |
| b. | F + | Issuance of common shares | h. | N | Distribution of stock dividend |
|  |  | for cash |  |  |  |
|  |  |  |  |  |  |
| c. | O – | Payment of accounts payable |  |  |  |
|  |  |  |  |  |  |
| d. | NIF | Acquisition of equipment by issuance of note payable | i. | F – | Repurchase of common shares |
|  |  |  |  |  |  |
| e. | I – | Purchase of long-term investment | j. | N | Amortization of bond discount |
|  |  |  |  |  |  |
| f. | O – | Payment of wages to | k. | O + | Collection of accounts receivable |
|  |  | employees |  |  |  |

(15-20 min.) **E17-16**

|  |  |  |
| --- | --- | --- |
| **NORTHERN AUTO REPAIR SERVICES** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| i. Collections from customers | $ 85,000 |  |
| l. Collections of interest | $8,000 |  |
| j. Payments to suppliers | (39,000) |  |
| d. Payments to employees | (19,000) |  |
| Net cash inflow from operating activities |  | $ 35,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| f. Sale of long-term investment in bonds | 125,000 |  |
| e. Purchase of equipment | (137,000) |  |
| a. Purchase of land | (185,000) |  |
| Net cash outflow from investing activities |  | (197,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| g. Issue Bond payable | 80,000 |  |
| b. Payment of dividends | (40,000) |  |
| k. Sale of common shares | 140,000 |  |
| Net cash outflow from financing activities |  | 180,000 |
|  |  |  |
| **Net increase in cash** |  | 18,000 |
| Cash balance, beginning of the year |  | 55,000 |
| Cash balance, end of the year |  | $   73,000 |

\*Non-cash item c. — purchase of Furniture and Fixtures using note $43,000

h. — purchase of Building using a long-term note $210,000

(10-15 min.) **E17-17**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  | | A/R | |
| a. | Cash collections | = | $100,000 | + | $4,000 decrease in Accounts Receivable ($25,000 – $21,000) | or | | 25,000  100,000 | x = 104,000 |
| 21,000 |  |
|  |  | = | $104,000 |  |  |  | | | |
|  |  |  |  |  |  |  |  | | |
| b. | Cash payments for inventory | = | $80,000 | – | $4,000 decrease in Inventory ($20,000 – $16,000) | + | $4,000 decrease in  Accounts Payable  ($12,000 – $8,000) | | |
|  |  | = | $80,000 |  |  |  |  | | |

OR

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Inventory | |  | Accounts Payable | |
| 20,000 |  |  |  | 12,000 |
| Purchased x =76,000 | COGS 80,000 |  | Paid for y = 80,000 | Purchases 76,000 |
| 16,000 |  |  |  | 8,000 |

(10-15 min.) **E17-18**

|  |  |  |
| --- | --- | --- |
| **THE OLIVE OIL COMPANY** | | |
| Cash Flow Statement (Partial) | | |
| For the Month Ended August 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collection from customers ($186,000 + $78,000) |  | $ 264,000 |
| Dividends received on investments |  | 4,000 |
| Total cash receipts |  | 268,000 |
| Payments |  |  |
| To suppliers | $(110,000) |  |
| To employees | (76,000) |  |
| For interest | (14,000) |  |
| For income tax | (8,000) |  |
| Total cash payments |  | (208,000) |
| Net cash inflow from operating activities |  | $ 60,000 |

*(10 min.)* **E17-19**

*Accounts Receivable*—Report cash receipts from customers of $354,000 as an operating cash flow.

*Land*—Report acquisitions of land of $81,000 as investing cash flows.

*Long-Term Debt*—Report issuance of debt for cash of $249,000 and payments of long-term debt of $207,000 as financing cash flows.

(10-15 min.) **E17-20**

1. Net income = $640,000 ($2,400,000 – $1,760,000)

2. Ending cash = $212,000 ($112,000 + $2,360,000 – $1,640,000 – $60,000  
 – $480,000 – $80,000)

3.

|  |  |  |
| --- | --- | --- |
| **UNBEWEAVEABLE BEAUTY SUPPLY** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Collections from customers | $ 2,360,000 |  |
| Payments to suppliers and employees | (1,700,000) |  |
| Net cash inflow from operating activities |  | $ 660,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Purchase of equipment | (480,000) |  |
| Net cash outflow from investing activities |  | (480,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of dividends | (80,000) |  |
| Net cash outflow from financing activities |  | (80,000) |
|  |  |  |
| **Net increase in cash** |  | 100,000 |
| Cash balance, beginning of the year |  | 112,000 |
| Cash balance, end of the year |  | $ 212,000 |

(20-30 min.) **E17-21**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **FLASHPOINT CONSULTING LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended September 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from clients |  | $662,000 |
| Payments |  |  |
| To employees | $ 288,000 |  |
| For rent | 14,000 |  |
| For insurance | 4,000 |  |
| For interest | 4,000 |  |
| For office supplies | 28,000 |  |
| For income tax | 36,000 |  |
| Total cash payments |  | 374,000 |
| Net cash inflow from operating activities |  | 288,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of computer equipment | (202,000)\* |  |
| Cash receipts from sale of land | 20,000 |  |
| Net cash outflow from investing activities |  | (182,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Cash receipts from issuance of common shares | 84,000 |  |
| Payment of long-term note payable | (40,000) |  |
| Dividends paid | (130,000) |  |
| Net cash inflow from financing activities |  | (86,000) |
|  |  |  |
| **Net increase in cash** |  | 20,000 |
| Cash balance, beginning of the year |  | 36,000 |
| Cash balance, end of the year |  | $ 56,000 |

\* *Note to financial statements:*

The company purchased computer equipment for $232,000 and issued a note payable in the amount of $30,000 in partial payment.

(continued) **E17-21**

*Req. 2*

The company’s operations appear to be very healthy. On consulting revenue of $548,000, the net cash inflow from operations was $288,000, or about  
53 percent. On collections from customers of $662,000 (calculated as $548,000 + $114,000), the net cash inflow from operations of $288,000 is about 44 percent. This would enable the company to invest or to pay down its debt at a good rate. The company has used cash from issuing common shares to pay down a note, which is good as it will reduce the interest expense.

The cash inflow from operations has financed most of the cost of new capital assets without resorting to much additional debt.

(15-25 min.) **E17–22**

Req. 1

|  |  |  |
| --- | --- | --- |
| **AHN PHOTOGRAPHY LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from clients |  | $140,500 |
| Payments |  |  |
| To employees | ($72,000) |  |
| For rent | (6,000) |  |
| For insurance | (1,000) |  |
| For interest | (1,000) |  |
| For office supplies | (4,500) |  |
| For income tax | (9,000) |  |
| Total cash payments |  | (93,500) |
| Net cash inflow from operating activities |  | 47,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of property, plant, and equipment | (50,500)\* |  |
| Cash receipts from sale of land | 5,000 |  |
| Net cash outflow from investing activities |  | (45,500) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Cash receipts from issuance of common shares | 21,000 |  |
| Payment of dividends | (7,500) |  |
| Payment of long-term note payable | (10,000) |  |
| Net cash inflow from financing activities |  | 3,500 |
|  |  |  |
| **Net increase in cash** |  | 5,000 |
| Cash balance at beginning of 2020 |  | 8,000 |
| Cash balance at end of 2020 |  | $ 13,000 |

*Note to financial statements:*

\*1. The company purchased property, plant, and equipment for $58,000 and issued a note payable in the amount of $7,500 in partial payment.

Req. 2

The payment of dividends could be classified as an operating or financing activity.

Serial Exercise  *(60-70 min.)* E17-23

|  |  |  |
| --- | --- | --- |
| **CANYON CANOE COMPANY** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2024 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $ 417,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 34,330 |  |
| Amortization of bond discount | 254 |  |
| Increase in short-term investments | (23,840) |  |
| Decrease in accounts receivable | 5,178 |  |
| Increase in inventory | (355) |  |
| Decrease in office supplies | 105 |  |
| Decrease in prepaid rent | 2,000 |  |
| Increase in accounts payable | 2,970 |  |
| Increase in salaries payable | 3,000 |  |
| Increase in interest payable | 300 |  |
| Increase in unearned revenue | 150 | 24,092 |
| Net cash inflows from operating activities |  | 441,092 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Cash payment for acquisition of building | (575,000) |  |
| Cash payment for acquisition of office furniture and equipment | (150,000) |  |
| Net cash outflows from investing activities |  | (725,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Cash receipt from issuance of common shares | 200,000 |  |
| Cash receipt from issuance of note payable | 15,000 |  |
| Cash receipt from issuance of mortgage payable | 405,000 |  |
| Cash receipt from issuance of bonds payable | 208,476 |  |
| Cash payment of dividends | (33,000) |  |
| Net cash inflows from financing activities |  | 795,476 |
|  |  |  |
| **Net increase in cash** |  | 511,568 |
| Cash balance at beginning of 2024 |  | 12,125 |
| Cash balance at end of 2024 |  | $ 523,693 |

Note to financial statements:

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Acquisition of land by issuing preferred shares | $ 70,000 |

**Challenge Exercise**

*(15-20 min.)* **E17–24**

Req. 1

Indirect method

Req. 2

The largest source of cash for 2017 was from “financing” of $12,486,784, and for 2016 it was from “issuance of convertible debentures” in the amount of $4,120,289.

Req. 3

In 2017 the greatest use of cash is the note payable $3,000,000.

Req. 4

Nanotech Security reported the largest source of cash in both years from the Financing section, 2017 ($8,339,784) and 2016 ($4,317,689). This is a sign that investors are still confident in the business even though it is not profitable.

Req. 5

It appears as if Nanotech Security has improved significantly since 2016. The losses are about half of the prior year and the cash used in operating activities has decreased significantly. The loss from discontinued operations is hopefully at an end, so next year might be even better.

Req. 6

In 2017, Nanotech Security built up a large pool of cash and equivalents. At the end of the fiscal year it had $10,883,919.

**Beyond the Numbers**

(15-25 min.) **BN17-1**

Sweet Treats Ltd. looks like the better investment for the following reasons:

1. Operations generate far more cash for Sweet Treats Ltd. than for Cupcakes Inc. Operations should be the main source of cash for a healthy company.

2. Sweet Treats Ltd. is investing more in property, plant, and equipment than is Cupcakes Inc. Sweet Treats Ltd. is laying a more solid foundation in revenue-producing assets than is Cupcakes Inc.

3. One of Cupcakes Inc.’s main sources of cash is the sale of property, plant, and equipment. This trend cannot continue for long without hurting the company’s ability to produce revenue.

4. Sweet Treats Ltd. is raising more cash by selling shares than is Cupcakes Inc. This gives Sweet Treats Ltd. more cash to invest in research and development of new products and other innovations to enhance the company’s competitiveness. Cupcakes Inc., on the other hand, appears to have done some refinancing, issuing long-term debt and repaying other long-term debt. That is not bad for Cupcakes Inc., but Sweet Treats Ltd. appears to be a step ahead in terms of financing its operations with owners’ equity and investing the cash in income-producing assets.

Ethical Issue

EI17-1

Req. 1

**Cash flows from operating activities**

**Without With**

**Reclassification Reclassificatio**n

Net income $ 60,000 $60,000

Increase in accounts receivable (40,000)      —

Net cash inflow from operating activities $ 20,000 $60,000

Globex Travel Ltd. looks better with the reclassification because net cash inflow from operations is higher.

Req. 2

**Cash flows from investing activities**

Reclassification of (or long-term

investment in) receivables    —     (40,000)

Increase in cash from all activities $20,000 $ 20,000

Aleksi Belland is correct that reclassifying the receivables will increase the *reported* amount of cash inflow from *operations*. This will make Globex Travel Ltd. look better. But Belland is wrong about the overall effect on cash flow. Reclassifying a receivable has no effect on cash, as shown in the final result above.

Req. 3

The reclassification would be *ethical* if the terms of the receivable are that payment is to be made beyond the current operating cycle or one year, whichever is longer. Reclassification would be *unethical* if Globex Travel Ltd. expects to collect within the current period. In that case, the reclassification would appear to be designed to create a false picture of cash flow from operations.

Problems

Group A

(15-30 min.) **P17-1A**

It appears that 2020 was a good year. Net income increased by 16 percent, which is outstanding. Operations appear to be generating increasing profits and financing the expansions. The increases in property, plant, and equipment are consistent with a growing, prospering company. No unhealthy changes are apparent among the assets or liabilities.

The cash flow data describe a similar picture. Operating activities produced most of the increase in cash, which is healthy. Over the long run, successful companies generate the bulk of their cash through operations. The expansion program is generating net cash outflows from investing activities. Sew It Seams Repairs appears to be making the long-term investments to lay the foundation for strong future operations. Financing activities resulted in a net cash inflow of $280,000. This amount is not as significant as cash flows from operating and investing activities. Overall, the cash flow data reveal a healthy set of relationships.

On balance, there are no obvious danger signals, so the outlook is good.

*Instructional Note:* Student responses will vary considerably. The key conclusion is that 2020 was a good year and the outlook is not clouded by any obvious difficulties.

(30-35 min.) **P17-2A**

Req. 1

|  |  |  |
| --- | --- | --- |
| **BRENTWOOD BAY INC.** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended September 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $ 349,600 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 34,000 |  |
| Gain on sale of land | (43,600) |  |
| Increase in accounts receivable | (3,600) |  |
| Increase in interest receivable | (5,200) |  |
| Increase in inventory | (19,200) |  |
| Decrease in prepaid expenses | 2,800 |  |
| Decrease in accounts payable | (34,000) |  |
| Increase in income tax payable | 800 |  |
| Decrease in accrued liabilities | (44,800) |  |
| Increase in interest payable | 5,200 |  |
| Increase in salaries payable | 1,600 | (106,000) |
| Net cash inflow from operating activities |  | $ 243,600 |

Req. 2

The direct method would result in the same total net cash inflows from operating activities but it would be presented in terms of “cash receipts” and “cash payments.”Req. 1 (30-40 min.) **P17-3A**

|  |  |  |
| --- | --- | --- |
| **SHOCK ELECTRICITY INC.** | | |
| Cash Flow Statement | | |
| For the Year Ended August 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $ 466,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 253,000 |  |
| Decrease in accounts receivable | 16,000\* |  |
| Decrease in interest receivable | 3,000\* |  |
| Increase in inventory | (94,000)\* |  |
| Decrease in prepaid expenses | 5,000\* |  |
| Decrease in accounts payable | (65,000)\*\* |  |
| Decrease in interest payable | (4,000)\*\* |  |
| Increase in salaries payable | 57,000\*\* |  |
| Decrease in lease liabilities | (6,000)\*\* |  |
| Increase in income tax payable | 35,000\*\* | 200,000 |
| Net cash inflow from operating activities |  | 666,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Purchase of land | (201,000) |  |
| Purchase of equipment\* | (325,000) |  |
| Net cash outflow from investing activities |  | (526,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Issuance of common shares | 188,000 |  |
| Payment of dividends\*\* | (237,000) |  |
| Payment of notes payable | (200,000) |  |
| Net cash outflows from financing activities |  | (249,000) |
|  |  |  |
| **Net decrease in cash** |  | (109,000) |
| Cash and cash equivalents, September 1, 2019 |  | 156,000 |
| Cash and cash equivalents, August 31, 2020 |  | $   47,000 |

\*These amounts can be combined into a single total and reported as

“Increase in current assets other than cash (70,000).”

\*\*These amounts can be combined into a single total and reported as

“Increase in current liabilities 17,000.”

\* Purchase of equipment = ($1,009,000 + $253,000 − $937,000) = ($325,000)

\*\* Payment of dividends = ($296,000 + $466,000 – $525,000) = ($237,000)

*(continued)* **P17-3A**

*Req. 2*

A positive net cash flow from operating activities in the amount of $666,000 conveys a positive signal to investors as does the investment in land and electrical equipment of $526,000. However, outflows related to financing activities caused yearly cash flow to result in a negative balance of $109,000. Either the payment of dividends or the payment of the note should have been delayed until cash was adequate to cover these outflows. As long as this is not a trend, the business will endure; however, it will need to be monitored closely in the years to come.

(35-45 min.) **P17-4A**

|  |  |  |
| --- | --- | --- |
| **NATURE’S DESIGN LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $12,625 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 5,075 |  |
| Gain on sale of investment | (875) |  |
| Decrease in accounts receivable | 1,400\* |  |
| Increase in inventory | (5,500)\* |  |
| Increase in prepaid expenses | (275)\* |  |
| Decrease in note payable, short-term | (1,625)\*\* |  |
| Increase in accounts payable | 1,150\*\* |  |
| Decrease in income tax payable | (475)\*\* |  |
| Increase in accrued liabilities | 6,275\*\* | 5,150 |
| Net cash inflow from operating activities |  | 17,775 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of farm equipment | (18,500) |  |
| Acquisition of long-term investment | (11,200) |  |
| Sale of long-term investment | 5,550 |  |
| Collection of loan | 2,575 |  |
| Net cash outflow from investing activities |  | (21,575) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of cash dividends | (10,700) |  |
| Issuance of common shares | 14,050 |  |
| Issuance of long-term debt | 17,750 |  |
| Payment of long-term debt | (16,950) |  |
| Net cash inflow from financing activities |  | 4,150 |
|  |  |  |
| **Net increase in cash and cash equivalents** |  | 350 |
| Cash and cash equivalents balance, January 1, 2020 |  | 8,700 |
| Cash and cash equivalents balance, December 31, 2020 |  | $ 9,050 |

\* These amounts can be combined into a single total and reported as

“Increase in current assets other than cash (4,375).”

\*\* These amounts can be combined into a single total and reported as

“Increase in current liabilities 5,325.”

*Note:* Non-cash Investing and Financing Activities—

(1) The company issued a long-term note for $33,000 in payment for a building.

(2) The company issued $22,350 of preferred shares in order to pay long-term debt.

(3) The company distributed a share dividend in the amount of $10,150.

(continued) **P17-4A**

Req. 2

The company has a good cash flow from operations. However, its current cash position is very tight and could lead to problems.

The investment in building and farm equipment is good for the long term. The purchase of the building is either for expansion or, alternatively, should reduce operating costs. Similarly, the equipment should either improve production or replace older equipment; either way, this is good for the future of the company.

The financing section shows that investment in the company is attractive to investors since they are prepared to acquire the company’s shares and lend on a long-term basis. The payment of dividends is also an attraction to investors.

Req. 1 (40-60 min.) **P17-5A**

|  |  |  |
| --- | --- | --- |
| **ZAIBAK CORP.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $ 101,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense—equipment | $  100,000 |  |
| Write-down (loss) of goodwill | 10,000 |  |
| Increase in accounts receivable | (14,000) |  |
| Decrease in inventory | 330,000 |  |
| Increase in prepaid expenses | (7,000) |  |
| Increase in accounts payable | 56,000 |  |
| Increase in salaries payable | 10,000 | 485,000 |
| Net cash inflow from operating activities |  | 586,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Sale of equipment | 370,000 |  |
| Purchase of equipment | (574,000) |  |
| Net cash outflow from investing activities |  | (204,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of dividends | (480,000) |  |
| Sale of preferred shares\* | 100,000 |  |
| Payment of loan payable\*\* | (50,000) |  |
| Net cash outflow from financing activities |  | (430,000) |
|  |  |  |
| **Net decrease in cash** |  | (48,000) |
| Cash and cash equivalents, January 1, 2020\*\*\* |  | 58,000 |
| Cash and cash equivalents, December 31, 2020 |  | $    10,000 |

\* The company issued preferred shares for an investment, $200,000 (non-cash item).

\*\* Payment of loan payable = ($90,000 – $40,000) = ($50,000)

\*\*\* The cash equivalents amounts include both cash and money market fund.

Req. 2 (continued) **P17-5A**

The payment of dividends is excessive in view of the company’s cash position. The payment of nearly 30 percent on the preferred shares and 50 percent on the common shares was a heavy burden. It was made by paying out nearly as much as the company received in cash flow from operations, and this was only made possible by a drastic reduction in inventory, which may affect the ability of this company to compete.

The company increased its total assets, but this was possible only by the issue of additional share capital, which may have meant that the owners are more encumbered to pay dividends as the share issue was for preferred. The cash and cash equivalents declined during the year, leaving only $10,000 in cash at year-end.

(30-40 min.) **P17-6A**

Req. 1

|  |  |  |
| --- | --- | --- |
| **SHOCK ELECTRICITY INC.** | | |
| Cash Flow Statement | | |
| For the Year Ended August 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from customers 1 | $ 4,396,000 |  |
| Interest received 2 | 20,000 | $ 4,416,000 |
| Payments |  |  |
| To suppliers 3 | (2,111,000) |  |
| To employees 4 | (757,000) |  |
| \*Other operating expenses 5 | (498,000) |  |
| Interest 6 | (250,000) |  |
| Income tax 7 | (134,000) |  |
| Total cash payments |  | (3,750,000) |
| Net cash inflow from operating activities |  | 666,000 |
|  |  |  |

\*Includes Lease

1 Collections from customers = $4,380,000 + $16,000 = $4,396,000

2 Interest received = $17,000 + $3,000 = $20,000

3 To suppliers = $1,952,000 + $94,000 + $65,000 = $2,111,000

4 To employees = $814,000 – $57,000 = $757,000

5 Other operating expenses = $497,000 – $5,000 + $6,000 = $498,000

6 Interest = $246,000 + $4,000 = $250,000

7 Income tax = $169,000 – $35,000= $134,000

Req. 2

The indirect method would report the above information differently but end up with the same net inflow total. The indirect method starts with net income and then reconciles it to net cash.

*(35-45 min.)* **P17-7A**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **SAWYER PRODUCTS LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended July 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from customers\* | $5,172,600 |  |
| Interest received | 30,200 |  |
| Dividends received | 56,200 |  |
| Total cash receipts |  | $ 5,259,000 |
| Payments |  |  |
| To suppliers | (4,129,800) |  |
| To employees | (804,000) |  |
| For income tax | (338,400) |  |
| For interest | (226,800) |  |
| Total cash payments |  | (5,499,000) |
| Net cash outflow from operating activities |  | (240,000) |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of property, plant, and equipment | (1,035,000) |  |
| Collection of notes receivable | 486,400 |  |
| Proceeds from sale of property, plant, and equipment | 318,200 |  |
| Proceeds from sale of investments | 538,200 |  |
| Net cash inflow from investing activities |  | 307,800 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Proceeds from issuance of common shares | 589,400 |  |
| Payments of long-term debt | (142,800) |  |
| Payment of dividends | (310,000) |  |
| Proceeds from issuance of long-term debt | 264,600 |  |
| Net cash inflow from financing activities |  | 401,200 |
|  |  |  |
| **Net increase in cash** |  | 469,000 |
| Cash balance, August 1, 2019 |  | 654,800 |
| Cash balance, July 31, 2020 |  | $ 1,123,800 |

\*Collections from customers = ($4,038,600 + $1,134,000) (continued) **P17-7A**

Note to financial statements:

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Payment of long-term debt by issuing common shares | $ 900,000 |
| Acquisition of equipment by issuing short-term note payable | 213,000 |
| Total non-cash investing and financing activities | $1,113,000 |

Req. 2

Evaluation:

2020 was a somewhat disappointing year from a cash flow standpoint. Operations generated a net cash *outflow*. On the positive side, Sawyer Products Ltd. was able to issue $589,400 of new shares, which means the shareholders have faith in the company. The business invested heavily in property, plant, and equipment, and cash increased by $469,000. But ultimately, operations must generate a net cash inflow for the company to remain in business.

*Req. 1* *(45-60 min.)* **P17-8A**

|  |  |  |
| --- | --- | --- |
| **BRENTWOOD BAY INC**. | | |
| Cash Flow Statement | | |
| For the Year Ended September 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| From customers 1 | $1,464,800 |  |
| From interest 2 | 34,000 |  |
| Total cash receipts |  | $1,498,800 |
| Payments |  |  |
| To suppliers 3 | 699,200 |  |
| To employees 4 | 252,000 |  |
| For operating expenses 5 | 160,400 |  |
| For interest 6 | 58,800 |  |
| For income tax 7 | 84,800 |  |
| Total cash payments |  | (1,255,200) |
| Net cash inflow from operating activities |  | 243,600 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of equipment (see note in req. 2) | (16,000) |  |
| Sale of land 8 | 152,400 |  |
| Acquisition of long-term investments | (149,200) |  |
| Net cash outflow from investing activities |  | (12,800) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of cash dividends | (217,200) |  |
| Issuance of common shares | 207,600 |  |
| Payment of long-term note payable | (122,800) |  |
| Net cash outflow from financing activities |  | (132,400) |
|  |  |  |
| **Net increase in cash** |  | 98,400 |
| Cash balance, October 1, 2019 |  | 96,400 |
| Cash balance, September 30, 2020 |  | $ 194,800 |

1. Receipts from customers: $1,468,400 – $3,600
2. Receipts of interest: $39,200 – $5,200
3. Payments to suppliers: $646,000 + $34,000 + $19,200
4. Payments to employees: $253,600 – $1,600
5. Payments for operating expenses: $118,400 + $44,800 – $2,800
6. Payments for interest: $64,000 – $5,200
7. Payments for income tax: $85,600 – $800
8. Receipt from sale of land: $297,200 − $188,400 + $43,600

(continued) **P17-8A**

Req. 2

*Note to financial statements:*

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Acquisition of equipment by issuing short-term note payable | $ 40,000 |
| Acquisition of equipment by issuing long-term note payable | 89,200 |
| Total non-cash investing and financing activities | $129,200 |

*Req. 1* *(45-60 min.)* **P17-9A**

|  |  |  |
| --- | --- | --- |
| **WEST BOATS LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended October 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| From customers | $307,000 |  |
| From interest | 22,200 |  |
| From dividends | 17,900 |  |
| Total cash receipts |  | $ 347,100 |
| Payments |  |  |
| To suppliers | (101,600) |  |
| To employees | (67,500) |  |
| For interest | (41,800) |  |
| For income tax | (6,000) |  |
| For operating expenses | (46,100) |  |
| Total cash payments |  | (263,000) |
| Net cash inflow from operating activities |  | 84,100 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Sale of investments | 28,400 |  |
| Purchase of equipment | (79,900) |  |
| Net cash outflow from investing activities |  | (51,500) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Sale of common shares | 80,800 |  |
| Repurchase of common shares | (30,400) |  |
| Payments of long-term debt | (78,900) |  |
| Payment of dividends | (16,000) |  |
| Net cash outflow from financing activities |  | (44,500) |
|  |  |  |
| **Net decrease in cash** |  | (11,900) |
| Cash and cash equivalents, November 1, 2019 |  | 87,100 |
| Cash and cash equivalents, October 31, 2020 |  | $    75,200 |

(continued) **P17-9A**

*Note to financial statements:*

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Acquisition of land by issuing common shares | $64,500 |
| Repayment of long-term debt by issuing common shares | 31,600 |
| Total non-cash investing and financing activities | $96,100 |

Req. 2

|  |  |  |
| --- | --- | --- |
| **WEST BOATS LTD.** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended October 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $78,500 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $  10,900 |  |
| Gain on sale of investments | (700) |  |
| Increase in accounts receivable | (10,000)\* |  |
| Increase in inventory | (5,700)\* |  |
| Decrease in prepaid expenses | 1,900\* |  |
| Increase in accounts payable | 7,700\*\* |  |
| Increase in interest payable | 2,300\*\* |  |
| Decrease in salaries payable | (700)\*\* |  |
| Decrease in other accrued liabilities | (3,300)\*\* |  |
| Increase in income tax payable | 3,200\*\* | 5,600 |
| Net cash inflow from operating activities |  | $84,100 |

\*These amounts can be combined into a single total and reported as

“Increase in current assets other than cash (13,800).”

\*\*These amounts can be combined into a single total and reported as

“Increase in current liabilities 9,200.”

**(**30-40 min.) **P17-10A**

Req. 1

|  |  |  |
| --- | --- | --- |
| **ASJID ANALYTICS LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from customers\* | $1,924,200 |  |
| Interest revenue | 33,400 |  |
| Dividends revenue | 5,400 | $1,963,000 |
| Payments |  |  |
| To suppliers | (1,376,600) |  |
| To employees | (468,000) |  |
| For income tax | (112,800) |  |
| Interest expense | (75,600) |  |
| Payment of dividends | (100,000) | (2,133,000) |
| Net cash outflow from operating activities |  | (170,000) |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of property, plant, and equipment | (345,000) |  |
| Collection of notes receivable | 138,800 |  |
| Proceeds from sale of property, plant, and equipment | 119,400 |  |
| Proceeds from sale of investments | 179,400 |  |
| Net cash inflow from investing activities |  | 92,600 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Proceeds from issuance of common shares | 209,800 |  |
| Payments of long-term debt | (37,600) |  |
| Proceeds from issuance of long-term debt | 88,200 |  |
| Net cash inflow from financing activities |  | 260,400 |
|  |  |  |
| **Net increase in cash** |  | 183,000 |
| Cash balance, January 1, 2020 |  | 151,600 |
| Cash balance, December 31, 2020 |  | $   334,600 |

\* Collections from customers = $1,346,200 + $578,000 = $1,924,200

(continued) **P17-10A**

Note to financial statements:

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Payment of long-term debt by issuing preferred shares | $400,000 |
| Acquisition of equipment by issuing short-term note payable | 91,000 |
| Total non-cash investing and financing activities | $491,000 |

Req. 2

Electing to restate the cash flow statement, the net cash from operating would be $(33,200); from investing, $131,400; and from financing, $84,800. These numbers contrast with the other method, in which operating is $(170,000); investing, $92,600; and financing, $260,400.

Note: Asjid Analytics would not be able to change this from year to year. If it elects to present information one way, then it must continue to do so in later years.

**Problems**

Group B

(15-30 min.) **P17-1B**

2020 was *not* a very good year. Most of the increase in net income results from the unusual gain on the sale of equipment, which means that normal operations were not very profitable. This is confirmed by the increases in receivables, which hints that collections are lagging.

The cash flow data paint a similar picture. Operating activities resulted in a net cash *outflow,* which is bad news. Over the long run, operations should generate the bulk of the net cash inflow if the business expects to succeed. Financing activities produced a net cash inflow, which is normal. During 2020, the sale of equipment helped investing activities produce a net cash inflow. Ordinarily, investing activities should produce net cash outflows as the business invests in new assets. Growth is usually indicated by investments in new assets, but during 2020 net investments caused a net cash inflow. Although the net cash inflow resulting from investing activities may be temporary, it does not reflect especially well on the company. It means that—in part, at least—the company is maintaining its cash position by liquidating fixed assets. This is a bad sign. Coupled with the net cash outflow from operations and the net cash inflow from investing activities, the (assumed) additional debt created in 2020 through financing activities may be difficult to pay back.

Overall, the outlook for the future is not bright.

*Instructional Note:* Student responses will vary considerably. The key conclusion is that 2020 was not a good year and the outlook is not bright.

(45-60 min.) **P17-2B**

Req. 1

|  |  |  |
| --- | --- | --- |
| **GARIEPY WHOLESALE LTD.** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $433,500 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $  27,000 |  |
| Loss on sale of land | 33,500 |  |
| Increase in accounts receivable | (128,500) |  |
| Decrease in interest receivable | 3,500 |  |
| Increase in inventory | (42,000) |  |
| Increase in prepaid expenses | (4,500) |  |
| Increase in accounts payable | 33,000 |  |
| Decrease in income tax payable | (3,500) |  |
| Decrease in accrued liabilities | (7,500) |  |
| Increase in interest payable | 4,000 |  |
| Decrease in salaries payable | (8,500) | (93,500) |
| Net cash inflow from operating activities |  | $340,000 |

Req. 2

When the operating section of a cash flow statement is prepared using the direct method, the total cash flow remains the same. The presentation differs and shows cash receipts and cash payments instead of reconciling net income to cash from operations.

(30-40 min.) **P17-3B**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **MANDARIN DESIGN LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended June 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $107,300 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $      4,000 |  |
| Increase in accounts receivable | (4,700)\* |  |
| Increase in interest receivable | (1,200)\* |  |
| Decrease in inventory | 23,600\* |  |
| Increase in prepaid expenses | (600)\* |  |
| Increase in accounts payable | 2,600\*\* |  |
| Decrease in interest payable | (500)\*\* |  |
| Decrease in salaries payable | (3,500)\*\* |  |
| Decrease in other accrued liabilities | (2,300)\*\* |  |
| Increase in income tax payable | 1,200\*\* | 18,600 |
| Net cash inflow from operating activities |  | 125,900 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of land | (49,000) |  |
| Acquisition of equipment | (21,100)\*\*\* |  |
| Net cash outflow from investing activities |  | (70,100) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of dividends | (68,500)\*\*\*\* |  |
| Payment of notes payable | (20,000) |  |
| Issuance of common shares | 33,600 |  |
| Net cash outflow from financing activities |  | (54,900) |
|  |  |  |
| **Net increase in cash** |  | 900 |
| Cash and cash equivalents, July 1, 2020 |  | 6,300 |
| Cash and cash equivalents, June 30, 2020 |  | $   7,200 |

\*These amounts can be combined into a single total and reported as

“Increase in current assets other than cash (17,100).”

\*\*These amounts can be combined into a single total and reported as

“Decrease in current liabilities (2,500).”

\*\*\* Acquisition of equipment = ($66,500 - $49,400 + $4,000) = ($21,100)

\*\*\*\* Payment of dividends = ($2,700 + $107,300 – $41,500) = ($68,500)

(continued) **P17-3B**

*Req. 2*

Mandarin Design Ltd.’s 2020 cash flows are positive overall. Operations provide positive cash flows, which is the most important source of cash for a healthy company. Mandarin Design Ltd. is investing in equipment, which is a positive sign, and is paying dividends while paying off a note payable.

(35-45 min.) **P17-4B**

Req. 1

|  |  |  |
| --- | --- | --- |
| **GG’S COFFEE LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $199,000 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $ 60,250 |  |
| Loss on sale of equipment | 16,750 |  |
| Increase in accounts receivable | (18,750)\* |  |
| Increase in inventory | (59,000)\* |  |
| Increase in prepaid expenses | (3,000)\* |  |
| Increase in note payable, short-term | 10,750\*\* |  |
| Decrease in accounts payable | (7,250)\*\* |  |
| Increase in income tax payable | 54,750\*\* |  |
| Decrease in accrued liabilities | (29,250)\*\* | 25,250 |
| Net cash inflow from operating activities |  | 224,250 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of building | (325,750) |  |
| Acquisition of long-term investment | (79,000) |  |
| Sale of equipment | 145,000 |  |
| Collection of loan | 71,750 |  |
| Net cash outflow from investing activities |  | (188,000) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Issuance of common shares | 123,000 |  |
| Issuance of long-term note payable | 36,000 |  |
| Payment of cash dividends | (90,750) |  |
| Repurchase of common shares | (85,750) |  |
| Net cash outflow from financing activities |  | (17,500) |
|  |  |  |
| **Net increase in cash** |  | $  18,750 |
| Cash balance, January 1, 2020 |  | 56,750 |
| Cash balance, December 31, 2020 |  | $’ 75,500 |

\*These amounts can be combined into a single total and reported as

“Increase in current assets other than cash (80,750).”

\*\*These amounts can be combined into a single total and reported as

“Increase in current liabilities (29,000).”

*(continued)* **P17-4B**

*Note:* Non-cash Investing and Financing Activities—

* The company issued common shares for $157,500 to retire bonds payable.
* The company issued a long-term note payable for $237,500 to buy land.
* The company distributed stock dividends in the amount of $79,500.

Req. 2

The cash flow from operating activities amounted to $224,250. This is a satisfactory amount and shows that the company is reasonably profitable, although we do not have figures for sales and cost of sales to evaluate. Accounts receivables have increased considerably, which is a concern. The increase in inventory is also a concern.

The investment in building and equipment is a good sign for the future of the company. Presumably, these purchases will provide the facilities to reduce costs or, alternatively, to expand the company’s lines of business. In either case, it bodes well for the future when the company invests in new capital assets.

The financing activities indicate that the company is considered sufficiently creditworthy to be able to issue long-term notes. The investment in building and equipment shows that the company is growing. The company partially borrowed to repurchase common shares—a risky procedure if interest rates rise. The fact that the company bought back shares and retired them and also issued new shares during the year could be confusing to the financial markets.

*(40-60 min.)* **P 17-5B**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **VAUGHAN SALES CORP.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $   12,600 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense—equipment | $   24,000 |  |
| Write-down (loss) of goodwill | 4,500 |  |
| Decrease in accounts receivable | 21,500 |  |
| Decrease in inventory | 61,915 |  |
| Increase in prepaid expenses | (750) |  |
| Decrease in accounts payable | (1,200) |  |
| Increase in salaries payable | 13,000 | 122,965 |
| Net cash inflow from operating activities |  | 135,565 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Sale of equipment | 29,685 |  |
| Purchase of equipment | (94,750) |  |
| Net cash outflow from investing activities |  | (65,065) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of dividends | (5,100) |  |
| Repurchase of common shares | (75,000) |  |
| Payment of loan payable | (15,000) |  |
| Net cash outflow from financing activities |  | (95,100) |
|  |  |  |
| **Net decrease in cash** |  | (24,600) |
| Cash and cash equivalents, January 1, 2020 |  | 32,100 |
| Cash and cash equivalents, December 31, 2020 |  | $   7,500 |

*Note:* Land was acquired in exchange for common shares valued at $90,000.

Req. 2

The cash inflow of $135,565 from operating activities appears to be very good on sales of $267,000. But in fact it may have harmed the company’s future by reducing the inventory so drastically. By repurchasing shares and purchasing equipment, the company looks as though it may have severe cash shortages in the future. The company may not be able to repeat this large operating cash inflow again, which is a cause for concern.

(30-40 min.) **P17-6B**

Req. 1

|  |  |  |
| --- | --- | --- |
| **MANDARIN DESIGN LTD.** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended June 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from customers 1 | $252,300 |  |
| Interest received 2 | 12,400 | $264,700 |
| Payments |  |  |
| To suppliers 3 | (50,400) |  |
| To employees 4 | (31,300) |  |
| Interest 5 | (17,100) |  |
| Other operating expenses 6 | (13,400) |  |
| Income tax 7 | (26,600) | (138,800) |
| Net cash inflow from operating activities |  | 125,900 |
|  |  |  |

1. Collections from customers = $257,000 – $4,700 = $252,300
2. Interest received = $13,600 – $1,200 = $12,400
3. To suppliers = $76,600 – $23,600 – $2,600\* = ($50,400)
4. To employees = $27,800 + $3,500 = ($31,300)
5. Interest = $16,600 + $500 = ($17,100)
6. Other operating expenses = $10,500 + $600 + $2,300 = ($13,400)
7. Income tax = $27,800 – $1,200 = ($26,600)

\*These amounts are the cost of goods sold + the change in inventory value + the change in accounts payable.

Req. 2

The indirect method provides more detailed information to answer this sort of question. A business that wants this sort of information should not use the direct method for its cash flow statement. The most that can be said is that Mandarin Design Ltd. earned a net income of $107,300 and ended up with a cash inflow from operating activities of $125,900, so its operations decisions added to the total cash of this business.

Req. 1 (35-45 min.) **P17-7B**

|  |  |  |
| --- | --- | --- |
| **DIRECT BUILDERS’ SUPPLY LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended April 30, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from customers\* | $793,125 |  |
| Interest received | 34,250 |  |
| Dividends received | 25,125 |  |
| Total cash receipts |  | $ 852,500 |
| Payments |  |  |
| To suppliers | (460,625) |  |
| To employees | (129,500) |  |
| For interest | (16,625) |  |
| For income tax | (47,375) |  |
| Total cash payments |  | (654,125) |
| Net cash inflow from operating activities |  | 198,375 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of property, plant, and equipment | (49,250) |  |
| Proceeds from sale of property, plant, and equipment | 28,000 |  |
| Collection of notes receivable | 35,000 |  |
| Proceeds from sale of investments | 11,375 |  |
| Net cash inflow from investing activities |  | 25,125 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payments of long-term debt | (62,500) |  |
| Payment of dividends | (80,500) |  |
| Proceeds from issuance of short-term debt | 69,500 |  |
| Proceeds from issuance of long-term debt | 85,000 |  |
| Net cash inflow from financing activities |  | 11,500 |
|  |  |  |
| **Net increase in cash** |  | 235,000 |
| Cash balance, May 1, 2019 |  | 99,125 |
| Cash balance, April 30, 2020 |  | $334,125 |

\*($578,250 + $214,875) (continued) **P17-7B**

Note to financial statements:

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Payment of short-term note payable by issuing long-term note payable | $ 78,750 |
| Acquisition of equipment by issuing short-term note payable | 40,500 |
| Total non-cash investing and financing transactions | $119,250 |

Req. 2

Evaluation: 2020 was a strong year from a cash flow standpoint. Operations generated the bulk of the company’s cash. The business slightly reduced its property, plant, and equipment and collected a note to end up positive for the investing section. This could warrant investigation to ensure assets will be eventually replaced and/or increased. The corporation increased its debt position.

Req. 1 (35-45 min.) **P17-8B**

|  |  |  |
| --- | --- | --- |
| **GARIEPY WHOLESALE LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from customers 1 | $1,198,500 |  |
| From interest 2 | 56,500 | $1,255,000 |
| Payments |  |  |
| To suppliers 3 | (411,000) |  |
| To employees 4 | (202,500) |  |
| Interest 5 | (26,500) |  |
| Other expenses 6 | (222,000) |  |
| Income tax 7 | ( 53,000) | (915,000) |
| Net cash inflow from operating activities |  | $340,000 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Sale of land 8 | 234,500 |  |
| Acquisition of equipment | (5,000) |  |
| Acquisition of long-term investments | (24,500) |  |
| Net cash inflow from investing activities |  | 205,000 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payment of long-term note payable 9 | (310,000) |  |
| Issuance of common shares | 40,000 |  |
| Payment of cash dividends | (130,000) |  |
| Net cash outflow from financing activities |  | (400,000) |
|  |  |  |
| **Net increase in cash** |  | 145,000 |
| Cash balance, January 1, 2020 |  | 43,000 |
| Cash balance, December 31, 2020 |  | $  188,000 |

1. Collections from customers: $1,327,000 – $128,500
2. Receipts of interest: $53,000 + $3,500
3. Payments to suppliers: $402,000 – $33,000 + $42,000
4. Payments to employees: $194,000 + $8,500
5. Payments for interest: $30,500 – $4,000
6. Payments for other expenses: $210,000 + $7,500 + $4,500
7. Payments for income tax: $49,500 + $3,500
8. Receipt from sale of land: $480,000 − $212,000 − $33,500
9. Payment of long-term note payable: $237,000 − $470,500 − $76,500

*Req. 2*

*Note to financial statements*:

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Payment of a short-term note by issuing common shares | $ 23,500 |
| Purchased equipment costing $81,500 by issuing a long-term note in partial payment | 76,500 |
|  | $100,000 |

(60-75 min.) **P17-9B**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **CRAFTIQUE INC.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collection from customers | $ 814,440 |  |
| Interest received | 39,120 |  |
| Dividends received | 25,400 | $ 878,960 |
| Payments |  |  |
| To suppliers | (447,720) |  |
| To employees | (172,560) |  |
| Interest | (56,280) |  |
| Operating expenses | (41,160) |  |
| Income tax | (22,680) | (740,400) |
| Net cash inflow from operating activities |  | 138,560 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of equipment | (37,680) |  |
| Sale of investment | 31,440 |  |
| Collection of loan | 39,600 |  |
| Net cash inflow from investing activities |  | 33,360 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Issuance of common shares | 33,360 |  |
| Payment of long-term debt | (73,560) |  |
| Payment of dividends | (52,640) |  |
| Repurchase of common shares | (20,280) |  |
| Net cash outflow from financing activities |  | (113,120) |
|  |  |  |
| **Net increase in cash** |  | 58,800 |
| Cash balance, January 1, 2020 |  | 64,320 |
| Cash balance, December 31, 2020 |  | $  123,120 |

*Notes:*

1. The company issued common shares to acquire land costing $77,320.

2. The company issued common shares to retire long-term debt in the amount of $42,800.

Req. 2 (continued) **P17-9B**

|  |  |  |
| --- | --- | --- |
| **CRAFTIQUE INC.** | | |
| Cash Flow Statement (partial) | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $146,600 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $29,160 |  |
| Loss on sale of investments | 3,720 |  |
| Increase in accounts receivable | (33,120) |  |
| Decrease in inventory | 14,160 |  |
| Increase in prepaid expenses | (720) |  |
| Decrease in accounts payable | (41,160) |  |
| Increase in interest payable | 2,280 |  |
| Increase in salaries payable | 8,400 |  |
| Increase in other accrued liabilities | 12,480 |  |
| Decrease in income tax payable | (3,240) | (8,040) |
| Net cash inflow from operating activities |  | $138,560 |

(30-40 min.) **P17-10B**

*Req. 1*

|  |  |  |
| --- | --- | --- |
| **GRECH RESTAURANT SUPPLY LTD.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| **Cash flows from operating activities** |  |  |
| Receipts |  |  |
| Collections from customers\* | $ 317,250 |  |
| Interest received | 13,700 |  |
| Dividends received | 2,050 | $333,000 |
| Payments |  |  |
| To suppliers | (184,250) |  |
| To employees | (43,800) |  |
| For income tax | (18,950) |  |
| Payment of interest | (16,650) |  |
| Payment of dividends | (24,200) | (287,850) |
| Net cash inflow from operating activities |  | 45,150 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of property, plant, and equipment | (29,700) |  |
| Proceeds from sale of property, plant, and equipment | 11,200 |  |
| Collection of notes receivable | 24,000 |  |
| Proceeds from sale of investments | 4,550 |  |
| Net cash inflow from investing activities |  | 10,050 |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Payments of long-term debt | (25,000) |  |
| Proceeds from issuance of short-term debt | 29,800 |  |
| Proceeds from issuance of long-term debt | 34,000 |  |
| Net cash inflow from financing activities |  | 38,800 |
|  |  |  |
| **Net increase in cash** |  | 94,000 |
| Cash balance, January 1, 2020 |  | 39,650 |
| Cash balance, December 31, 2020 |  | $133,650 |

\* Collections from customers = ($231,300 + $85,950) (continued) **P17-10B**

*Note to financial statements*:

|  |  |
| --- | --- |
| Summary of Non-cash Investing and Financing Activities | |
| Payment of short-term note payable by issuing long-term note payable | $31,500 |
| Acquisition of equipment by issuing short-term note payable | 18,200 |
| Total non-cash investing and financing transactions | $49,700 |

*Req. 2*

Reclassifying items would give the operating cash flow amount of $70,250. By removing the interest and dividends received ($13,700 + $2,050) from operating and adding this amount to investing, we would change that total to $25,800. Also, by removing interest and dividends paid ($16,650 + $24,200= –$40,850) from operating and adding this amount to financing (–$40,850 + 38,800), we would end up with $(2,050).

Comparing these amounts to the previous format, the numbers would be operating, $45,150; investing, $10,050; and financing, $38,800. The effect of this format change could influence how investors see the company.

**Challenge Problems**

**P17-1C**

The indirect method may be prepared directly from the income statement and the balance sheet; hence it is easier to prepare. In addition, most companies’ accounting systems are not set up to provide easily the data needed for the direct method, such as cash payments. On the other hand, some believe the direct method, with its disclosure of the sources and uses of cash, is more informative for users. Because both CPA Canada’s AcSB and the US’s FASB offer a choice, preparers use the method that is easier for them.

*Note:* Students may state other reasons.

**P17-2C**

Few companies provided information about non-cash investing and financing activities when such disclosure was not required. This exclusion deprived users of significant information about the companies’ transactions—in effect, they were “off-financial-statement” transactions.

A user would not be able to tell how a company financed additions to long-term assets or if a company had refinanced through a swap of debt for equity. The current required disclosure gives full disclosure of the reason for the changes in all the long-term accounts on the balance sheet, regardless of the net cash effects.

*Note:* The question gives the student the option of saying that the required disclosure is not more informative. They should provide support for their answer.

Decision Problems

Req. 1 (45-60 min.) **DP17-1**

|  |  |  |
| --- | --- | --- |
| **ECLIPSE GOLF INC.** | | |
| Cash Flow Statement | | |
| For the Year Ended December 31, 2020 | | |
| (Amounts in thousands) | | |
| **Cash flows from operating activities** |  |  |
| Net income |  | $52.5 |
| Add (subtract) items that affect net income and cash flow differently: |  |  |
| Amortization expense | $28.5 |  |
| Increase in accounts receivable | (15.5)\* |  |
| Increase in inventory | (6.5)\* |  |
| Increase in accounts payable | 3.5\*\* |  |
| Decrease in accrued liabilities | (2.5)\*\* | 7.5 |
| Net cash inflow from operating activities |  | 60.0 |
|  |  |  |
| **Cash flows from investing activities** |  |  |
| Acquisition of capital assets | (66.5)\*\*\* |  |
| Net cash outflow from investing activities |  | (66.5) |
|  |  |  |
| **Cash flows from financing activities** |  |  |
| Issuance of common shares | 44.0 |  |
| Payment of short-term note payable | (34.5) |  |
| Payment of cash dividends | (20.0)\*\*\*\* |  |
| Payment of long-term note payable | (8.0) |  |
| Net cash outflow from financing activities |  | (18.5) |
|  |  |  |
| **Net decrease in cash** |  | (25.0) |
| Cash balance, January 1, 2020 |  | 31.5 |
| Cash balance, December 31, 2020 |  | $  6.5 |

\*These amounts can be combined into a single total and reported as

“Increase in current assets other than cash ($22.0).”

\*\*These amounts can be combined into a single total and reported as

“Increase in current liabilities $1.0.”

\*\*\* $30.5 – amort. of $23 = $7.5; $74 – $7.5 = $66.5

\*\*\*\* $78 + $52.5 – $110.5 = $20.0

(continued) **DP17-1**

*Req. 2*

During the previous year, the company sold equipment for $17,520 and land for $30,500. (This information is provided on the 2019 Income Statement.) But during the year 2020, no similar sales took place; therefore, the cash available during the year was more limited.

It must also be remembered that during 2020 the company purchased property, plant, and equipment for $66,500 and paid down the short-term note by $34,500. In addition, accounts receivable increased by $15,500. The payment of $20,000 in dividends (calculated as beginning retained earnings + income – ending retained earnings)—a return to shareholders of 27 percent on the book value of the shares—seems high. Since the common shares more than doubled, the dividend had to do the same. These are the main reasons for the reduction in cash this year.

Req. 3

Overall, 2020 was a good year. Net income was up from $25,000 to $52,500— more than double—and operations were the main source of cash. On this basis, business appears to have been successful. Also, the company increased its property, plant, and equipment by $66,500. Eclipse Golf Inc. should be able to use these assets to earn profits in future years. The business eliminated debt by $42,500 ($34,500 short term and $8,000 long term), mainly by increasing the number of common shares outstanding. Reducing debt decreases future interest expense. Tell the board members that the future looks bright for Eclipse Golf Inc. Generally, the cash has been spent wisely.

Financial Statement Cases

**FSC17-1**

1. Indigo Books and Music Inc. uses the indirect method to report cash flows because it starts with net income and adjusts for non-cash items along with changes in non-cash working capital balances related to operations. Neither of these figures appear in the direct method.

2. No, the cash and cash equivalents decreased from $216,488,000 in fiscal 2016 to $130,438,000 in fiscal 2017. They therefore decreased by $86,050,000.

3. Indigo’s cash from operations decreased from $38,553,000 to $35,613,000 in fiscal 2017, or a net decrease of $2,940,000. The importance of a strong cash position from operating activities is to prove that the company is successful from its normal operations and does not need financing or investing to show positive cash flow.

4. The major investing activity during the year was an increase in short-term investments. The major financing activity for 2017 was the issuance of shares in the amount of $4,966,000.

5. Indigo was cautiously expanding in fiscal 2017 as it once again invested in more property, plant, equipment, and intangibles. Indigo was profitable and used the cash flow from operations (and its cash balances) to increase its short-term investments. This is a prudent move to store excess cash in short-term investments that are likely to earn more returns than if the monies were in a bank account.

**FSC17-2**

1. TELUS uses the indirect method to report cash flows from operations. You can tell this because the statement begins with earnings and adjusts for items not involving cash, changes in non-cash working capital, and other items.

2. Yes, significantly. Cash went from $223 million in 2015 to $432 million in 2016, an increase of $209 million.

3. TELUS summarizes the working capital items into one total, instead of listing the increases and decreases separately. Detailed information is found in Note 31(a). Companies may vary the details within sections of the cash flow statement; however, the main structure must be maintained, i.e., Operating, Investing, and Financing Activities sections.

4. Normally, an expanding company would show an outflow of cash in the investing activities section, and TELUS shows this information. The largest outflow in 2016 was due to the purchase of capital assets.

5. TELUS appears to be in a healthy position and is expanding to take advantage of opportunities that would improve its strategic position. Cash was used primarily for investing activities. Not only did TELUS add capital assets and licences, it acquired businesses and participated in joint ventures. This shows a commitment to future growth.