

## **CHAPTER 13 (MAN) STATEMENT OF CASH FLOWS**

### **DISCUSSION QUESTIONS**

1. It is costly to accumulate the data needed and to prepare the statement of cash flows.
2. It focuses on the differences between net income and cash flows from operating activities, and the data needed are generally more readily available and less costly to obtain than is the case for the direct method.
3. A separate schedule of noncash investing and financing activities accompanies the statement of cash flows.
4. The \$30,000 increase must be added to income from operations because the amount of cash paid to merchandise creditors was \$30,000 less than the amount of purchases included in the cost of goods sold.
5. The \$25,000 decrease in salaries payable should be deducted from income to determine the amount of cash flows from operating activities. The effect of the decrease in the amount of salaries owed was to pay \$25,000 more cash during the year than had been recorded as an expense.
6.
  - a. \$100,000 gain
  - b. Cash inflow of \$600,000
  - c. The gain of \$100,000 would be deducted from net income in determining net cash flow from operating activities; \$600,000 would be reported as cash flows from investing activities.
7. Cash flows from financing activities—issuance of bonds, \$1,960,000
8.
  - a. Cash flows from investing activities—Cash received from the disposal of fixed assets, \$15,000  
The \$15,000 gain on asset disposal should be deducted from net income in determining net cash flow from operating activities under the indirect method.
  - b. No effect
9. The same. The amount reported as the net cash flow from operating activities is not affected by the use of the direct or indirect method.
10. Five common classes of operating cash receipts and cash payments under the direct method are cash received from customers, cash payments for merchandise, cash payments for operating expenses, cash payments for interest, cash payments for income taxes.

**PRACTICE EXERCISES****PE 13–1A (Man)**

- |              |              |
|--------------|--------------|
| a. Operating | d. Financing |
| b. Operating | e. Financing |
| c. Investing | f. Operating |

**PE 13–1B (Man)**

- |              |              |
|--------------|--------------|
| a. Investing | d. Operating |
| b. Investing | e. Operating |
| c. Operating | f. Financing |

**PE 13–2A (Man)**

Net income.....	\$107,500
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation.....	7,500
Amortization of patents.....	2,750
Loss from sale of land.....	<u>4,000</u>
Net cash flow from operating activities.....	\$121,750

**PE 13–2B (Man)**

Net income.....	\$175,000
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation.....	8,750
Amortization of patents.....	3,250
Gain from sale of investments.....	<u>(18,750)</u>
Net cash flow from operating activities.....	\$168,250

**PE 13–3A (Man)**

<b>Net income</b> .....	<b>\$253,000</b>
<b>Adjustments to reconcile net income to net cash flow from operating activities:</b>	
<b>Changes in current operating assets and liabilities:</b>	
Decrease in accounts receivable.....	6,600
Increase in inventory.....	(3,080)
Increase in accounts payable.....	<u>2,420</u>
<b>Net cash flow from operating activities</b> .....	<b>\$258,940</b>

**Note:** The change in dividends payable impacts the cash paid for dividends, which is disclosed under financing activities.

**PE 13–3B (Man)**

<b>Net income</b> .....	<b>\$160,000</b>
<b>Adjustments to reconcile net income to net cash flow from operating activities:</b>	
<b>Changes in current operating assets and liabilities:</b>	
Increase in accounts receivable.....	(3,600)
Increase in inventory.....	(5,100)
Increase in accounts payable.....	<u>6,900</u>
<b>Net cash flow from operating activities</b> .....	<b>\$158,200</b>

**Note:** The change in dividends payable impacts the cash paid for dividends, which is disclosed under financing activities.

**PE 13–4A (Man)**

<b>Cash flows from operating activities:</b>	
<b>Net income</b> .....	<b>\$270,000</b>
<b>Adjustments to reconcile net income to net cash flow from operating activities:</b>	
Depreciation.....	30,000
Gain on disposal of equipment.....	(24,600)
<b>Changes in current operating assets and liabilities:</b>	
Decrease in accounts receivable.....	16,800
Decrease in accounts payable.....	<u>(4,320)</u>
<b>Net cash flow from operating activities</b> .....	<b>\$287,880</b>

**PE 13–4B (Man)****Cash flows from operating activities:**

Net income.....	\$280,000	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation.....	48,000	
Loss on disposal of equipment.....	19,520	
Changes in current operating assets and liabilities:		
Increase in accounts receivable.....	(17,280)	
Increase in accounts payable.....	<u>8,960</u>	
Net cash flow from operating activities.....		\$339,200

**PE 13–5A (Man)**

The loss on the sale of land is added to net income in the Operating Activities section.

Loss on sale of land.....	\$ 60,000
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The purchase and sale of land is reported as part of cash flows from investing activities as shown below.

Cash received from sale of land.....	120,000
Cash paid for purchase of land.....	(360,000)

**PE 13–5B (Man)**

The gain on the sale of land is subtracted from net income in the Operating Activities section.

Gain on sale of land.....	\$ (40,000)
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The purchase and sale of land is reported as part of cash flows from investing activities as shown below.

Cash received from sale of land.....	240,000
Cash paid for purchase of land.....	(400,000)

**PE 13–6A (Man)**

Sales.....	\$480,000
Deduct increase in accounts receivable.....	<u>54,000</u>
Cash received from customers.....	<u>\$426,000</u>

**PE 13–6B (Man)**

Sales.....	\$112,000
Add decrease in accounts receivable.....	<u>10,500</u>
Cash received from customers.....	<u>\$122,500</u>

**PE 13–7A (Man)**

Cost of merchandise sold.....	\$770,000
Deduct decrease in inventories.....	(66,000)
Add decrease in accounts payable.....	<u>44,000</u>
Cash paid for merchandise.....	<u>\$748,000</u>

**PE 13–7B (Man)**

Cost of merchandise sold.....	\$240,000
Add increase in inventories.....	19,200
Deduct increase in accounts payable.....	<u>(12,000)</u>
Cash paid for merchandise.....	<u>\$247,200</u>

**PE 13–8A (Man)**

a. Net cash flow from operating activities.....	\$ 294,000	\$ 280,000
Less: Investments in fixed assets		
to replace existing capacity.....	<u>(156,800)*</u>	<u>(176,400)**</u>
Free cash flow.....	<u>\$ 137,200</u>	<u>\$ 103,600</u>

\* 70% × \$224,000

\*\* 70% × \$252,000

- b. The change from \$103,600 to \$137,200 indicates a positive trend.

**PE 13–8B (Man)**

a. Net cash flow from operating activities.....	\$ 476,000	\$ 455,000
Less: Investments in fixed assets		
to replace existing capacity.....	<u>(341,600)*</u>	<u>(302,400)**</u>
Free cash flow.....	<u>\$ 134,400</u>	<u>\$ 152,600</u>

\* 80% × \$427,000

\*\* 80% × \$378,000

- b. The change from \$152,600 to \$134,400 indicates a negative trend.

**EXERCISES****Ex. 13–1 (Man)**

There were net additions to the net loss reported on the income statement to convert the net loss from the accrual basis to the cash basis. For example, depreciation is an expense in determining net income, but it does not result in a cash outflow. Thus, depreciation is added back to the net loss in order to determine net cash flow from operations. A second large item that is added to the net loss is the increase in air traffic liability of \$225 million. This represents an increase in unused, but paid, tickets (unearned revenue) between the two balance sheet dates. This is a significant item that is largely unique to the airline industry.

The cash flows from operating activities detail is provided as follows for class discussion:

<b>CONTINENTAL AIRLINES, INC.</b> <b>Cash Flows from Operating Activities</b> <b>(Selected from Statement of Cash Flows)</b> <b>(in millions)</b>	
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>	
Net income (loss)	<b>\$ (471)</b>
Adjustments to reconcile net income (loss) to net cash flow provided by operating activities:	
Depreciation and amortization	<b>1,093</b>
Special charges	<b>279</b>
Gain on disposition of investments	<b>—</b>
Undistributed equity in the income of other companies	<b>—</b>
Other, net	<b>(45)</b>
Changes in certain assets and liabilities:	
Decrease (increase) in accounts receivable	<b>29</b>
Decrease (increase) in spare parts and supplies	<b>(81)</b>
Decrease (increase) in prepaid expenses	<b>87</b>
Increase (decrease) in accounts payable	<b>(19)</b>
Increase (decrease) in air traffic liability	<b>225</b>
Increase (decrease) in other liabilities	<b>144</b>
<b>Net cash flows from (used for) operating activities</b>	<b>\$1,241</b>

**Ex. 13–2 (Man)**

- |                            |                            |
|----------------------------|----------------------------|
| a. Cash receipt, \$94,000  | e. Cash receipt, \$200,000 |
| b. Cash receipt, \$255,000 | f. Cash payment, \$52,500  |
| c. Cash payment, \$475,000 | g. Cash payment, \$287,000 |
| d. Cash payment, \$120,000 | h. Cash payment, \$60,000  |

**Ex. 13–3 (Man)**

- |              |              |
|--------------|--------------|
| a. financing | g. financing |
| b. investing | h. financing |
| c. investing | i. operating |
| d. financing | j. financing |
| e. investing | k. investing |
| f. financing |              |

**Ex. 13–4 (Man)**

- |             |             |
|-------------|-------------|
| a. added    | g. deducted |
| b. added    | h. deducted |
| c. deducted | i. added    |
| d. added    | j. added    |
| e. added    | k. deducted |
| f. deducted |             |

**Ex. 13–5 (Man)**

- a. **Net income..... \$600,000**
- Adjustments to reconcile net income to net cash flow from operating activities:**
- |   |                |                  |
|---|----------------|------------------|
| Depreciation.....   | 24,000         |                  |
| <b>Changes in current operating assets and liabilities:</b> |                |                  |
| Increase in accounts receivable.....                        | (3,600)        |                  |
| Decrease in merchandise inventory.....                      | 6,000          |                  |
| Increase in prepaid expenses.....                           | (1,800)        |                  |
| Increase in accounts payable.....                           | 6,000          |                  |
| Decrease in wages payable.....                              | <u>(4,200)</u> |                  |
| <b>Net cash flow from operating activities.....</b>         |                | <b>\$626,400</b> |
- b. Cash flows from operating activities shows the cash inflow or outflow from a company's day-to-day operations. Net income reports the excess of revenues over expenses for a company using the accrual basis of accounting. Revenues are recorded when they are earned, not necessarily when cash is received. Expenses are recorded when they are incurred and matched against revenue, not necessarily when cash is paid. As a result, the cash flows from operating activities differs from net income because it does not use the accrual basis of accounting.

**Ex. 13–6 (Man)**

- a. **Cash flows from operating activities:**
- |  |                  |                  |
|--|------------------|------------------|
| <b>Net income.....</b>   | <b>\$240,000</b> |                  |
| <b>Adjustments to reconcile net income to net cash flow from operating activities:</b> |                  |                  |
| Depreciation.....  | 72,000           |                  |
| <b>Changes in current operating assets and liabilities:</b>                            |                  |                  |
| Decrease in accounts receivable.....   | 4,800            |                  |
| Increase in inventories.....   | (18,000)         |                  |
| Decrease in prepaid expenses.....  | 1,200            |                  |
| Decrease in accounts payable.....  | (6,000)          |                  |
| Increase in salaries payable.....  | <u>1,800</u>     |                  |
| <b>Net cash flow from operating activities.....</b>                                    |                  | <b>\$295,800</b> |
- b. Yes. The amount of cash flows from operating activities reported on the statement of cash flows is not affected by the method of reporting such flows.



**Ex. 13–7 (Man)****a. Cash flows from operating activities:**

Net income.....	\$635,000	
<b>Adjustments to reconcile net income to net cash flow from operating activities:</b>		
Depreciation.....	72,000	
Gain on disposal of equipment.....	(42,000)	
<b>Changes in current operating assets and liabilities:</b>		
Increase in accounts receivable.....	(11,200)	
Decrease in inventory.....	6,400	
Decrease in prepaid insurance.....	2,400	
Decrease in accounts payable.....	(7,600)	
Increase in income taxes payable.....	<u>2,400</u>	
Net cash flow from operating activities.....		<b>\$657,400</b>

**Note:** The change in dividends payable would be used to adjust the dividends declared in obtaining the cash paid for dividends in the Financing Activities section of the statement of cash flows.

- b. Cash flows from operating activities reports the cash inflow or outflow from a company's day-to-day operations. Net income reports the excess of revenues over expenses for a company using the accrual basis of accounting. Revenues are recorded when they are earned, not necessarily when cash is received. Expenses are recorded when they are incurred and matched against revenue, not necessarily when cash is paid. As a result, the cash flows from operating activities differs from net income because it does not use the accrual basis of accounting.**

**Ex. 13–8 (Man)**

Dividends declared.....	\$364,000
Add decrease in dividends payable.....	<u>13,300</u>
Dividends paid to stockholders during the year.....	<u><b>\$377,300</b></u>

**Ex. 13–9 (Man)****Cash flows from investing activities:**

Cash received from sale of equipment.....	\$72,000
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The loss on the sale, \$12,000 (\$72,000 proceeds from sale less \$84,000 book value), would be added to net income in determining the cash flows from operating activities if the indirect method of reporting cash flows from operations is used.

**Ex. 13–10 (Man)****Cash flows from investing activities:**

Cash received from sale of equipment.....	\$37,200
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The loss on the sale, \$6,800 (\$37,200 proceeds from sale less \$44,000 book value), would be added to net income in determining the cash flows from operating activities if the indirect method of reporting cash flows from operations is used.

**Ex. 13–11 (Man)****Cash flows from investing activities:**

Cash received from sale of land.....	\$54,600
Less: Cash paid for purchase of land.....	60,200

The gain on the sale of land, \$18,120, would be deducted from net income in determining the cash flows from operating activities if the indirect method of reporting cash flows from operations is used.

**Ex. 13–12 (Man)****Cash flows from financing activities:**

Cash received from sale of common stock.....	\$4,875,000
Less: Cash paid for dividends.....	723,750

**Note:** The stock dividend is not disclosed on the statement of cash flows.

**Ex. 13–13 (Man)****Cash flows from investing activities:**

Cash paid for purchase of land.....	\$246,000
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A separate schedule of noncash investing and financing activities would report the purchase of \$324,000 land with a long-term mortgage note, as follows:

Purchase of land by issuing long-term mortgage note.....	\$324,000
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**Ex. 13–14 (Man)****Cash flows from financing activities:**

Cash received from issuing bonds payable.....	\$224,000
Less: Cash paid to redeem bonds payable.....	73,600

**Note:** The discount amortization of \$1,400 would be shown as an adjusting item (increase) in the Cash Flows from Operating Activities section under the indirect method.

**Ex. 13–15 (Man)**

a. Net cash flow from operating activities.....		\$357,500
Add:		
Increase in accounts receivable.....	\$14,300	
Increase in prepaid expenses.....	2,970	
Decrease in income taxes payable.....	7,700	
Gain on sale of investments	<u>13,200</u>	<u>38,170</u>
		\$395,670
Deduct:		
Depreciation.....	\$29,480	
Decrease in inventories.....	19,140	
Increase in accounts payable.....	<u>5,280</u>	<u>53,900</u>
Net income, per income statement.....		<u>\$341,770</u>

**Note to Instructors:** The net income must be determined by working backward through the Cash Flows from Operating Activities section of the statement of cash flows. Hence, those items that were added (deducted) to determine net cash flow from operating activities must be deducted (added) to determine net income.

**Ex. 13–15 (Man) (Concluded)**

- b. Curwen's net income differed from cash flows from operations because of:
- \$29,480 of depreciation expense which has no effect on cash flows from operating activities,
  - a \$13,200 gain on the sale of investments. The proceeds from this sale, which include the gain, are reported in the Investing Activities section of the statement of cash flows.
  - Changes in current operating assets and liabilities that are added or deducted, depending on their effect on cash flows:
    - Increase in accounts receivable, \$14,300
    - Increase in prepaid expenses, \$2,970
    - Decrease in income taxes payable, \$7,700
    - Decrease in inventories, \$19,140
    - Increase in accounts payable, \$5,280

**Ex. 13–16 (Man)**

a.

JONES SODA CO. Cash Flows from Operating Activities (in thousands)		
<b>Cash flows from operating activities:</b>		
Net loss	\$(6,106)	
Adjustments to reconcile net loss to net cash flow from operating activities:		
Depreciation	799	
Loss on inventory write-down and fixed assets	379	
Stock-based compensation expense (noncash)	830	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	(278)	
Decrease in inventory	1,252	
Decrease in prepaid expenses	131	
Decrease in accounts payable	(472)	
Net cash flow from operating activities		\$(3,465)

- b. Jones Soda is struggling financially. The company has negative earnings and negative net cash flow from operating activities. The company had grown quickly in prior years, but the company has struggled in recent years. The increase in accounts receivable is a positive sign, indicating an increase in sales. However, the dramatic decrease in inventory and accounts payable suggests that the company is reducing the units sold and reducing its size (i.e., going into a period of negative growth). This is not a healthy trend.

**Ex. 13–17 (Man)****a.**

<b>WEDGE INDUSTRIES INC.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>		
<b>Cash flows from operating activities:</b>		
Net income	\$260	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	24	
Gain on sale of land	(60)	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	(64)	
Increase in inventories	(52)	
Increase in accounts payable	12	
Net cash flow from operating activities		\$120
<b>Cash flows from investing activities:</b>		
Cash received from sale of land	\$100	
Less cash paid for purchase of equipment	40	
Net cash flow from investing activities		60
<b>Cash flows from financing activities:</b>		
Cash received from sale of common stock	\$140	
Less cash paid for dividends*	56	
Net cash flow from financing activities		84
Increase in cash		\$264
Cash at the beginning of the year		128
Cash at the end of the year		\$392

\* \$80 – \$24 = \$56

**b. Wedge Industries Inc.'s net income was more than the cash flows from operations because of:**

- \$24 of depreciation expense which has no effect on cash.
- A \$60 gain on the sale of land. The proceeds from this sale of \$100, which include the gain, are reported in the Investing Activities section of the statement of cash flows.
- Changes in current operating assets and liabilities that are added or deducted, depending on their effect on cash flows:
  - Increase in accounts receivable, \$64 deducted
  - Increase in inventories, \$52 deducted
  - Increase in accounts payable, \$12 added

**Ex. 13–18 (Man)**

- 1. The increase in accounts receivable should be deducted from net income in the Cash Flows from Operating Activities section.**
- 2. The gain on the sale of investments should be deducted from net income in the Cash Flows from Operating Activities section.**
- 3. The increase in accounts payable should be added to net income in the Cash Flows from Operating Activities section.**
- 4. The correct amount of cash at the beginning of the year, \$240,000, should be added to the increase in cash.**
- 5. The final amount should be the amount of cash at the end of the year, \$350,160.**
- 6. The final amount of net cash flow from operating activities is \$381,360.**
- 7. The “cash paid for dividends” should be preceded by “Less:”.**

**Ex. 13–18 (Man) (Concluded)**

A correct statement of cash flows would be as follows:

<b>SHASTA INC.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
<b>Net income</b>		<b>\$360,000</b>	
<b>Adjustments to reconcile net income to</b>			
<b>net cash flow from operating activities:</b>			
<b>Depreciation</b>		<b>100,800</b>	
<b>Gain on sale of investments</b>		<b>(17,280)</b>	
<b>Changes in current operating assets</b>			
<b>and liabilities:</b>			
<b>Increase in accounts receivable</b>		<b>(27,360)</b>	
<b>Increase in inventories</b>		<b>(36,000)</b>	
<b>Increase in accounts payable</b>		<b>3,600</b>	
<b>Decrease in accrued expenses</b>			
<b>payable</b>		<b>(2,400)</b>	
<b>Net cash flow from operating activities</b>			<b>\$ 381,360</b>
<b>Cash flows from investing activities:</b>			
<b>Cash received from sale of investments</b>		<b>\$240,000</b>	
<b>Less: Cash paid for purchase of land</b>	<b>\$259,200</b>		
<b>Cash paid for purchase of equip.</b>	<b>432,000</b>	<b>691,200</b>	
<b>Net cash flow used for investing activities</b>			<b>(451,200)</b>
<b>Cash flows from financing activities:</b>			
<b>Cash received from sale of common stock</b>		<b>\$312,000</b>	
<b>Less: Cash paid for dividends</b>		<b>132,000</b>	
<b>Net cash flow from financing activities</b>			<b>180,000</b>
<b>Increase in cash</b>			<b>\$ 110,160</b>
<b>Cash at the beginning of the year</b>			<b>240,000</b>
<b>Cash at the end of the year</b>			<b>\$ 350,160</b>

**Ex. 13–19 (Man)**

a.	Sales.....	\$753,500
	Plus decrease in accounts receivable balance.....	<u>48,400</u>
	Cash received from customers.....	<u>\$801,900</u>
b.	Income tax expense.....	\$ 50,600
	Plus decrease in income tax payable.....	<u>5,500</u>
	Cash payments for income taxes.....	<u>\$ 56,100</u>
c.	Because the customer paid more than the amount of sales for the period, cash received from customers exceeded sales made on account by \$48,400 during the current year.	

**Ex. 13–20 (Man)**

Cost of merchandise sold*.....	\$15,480
Add increase in merchandise inventories.....	630
Deduct increase in accounts payable.....	<u>(234)</u>
Cash paid for merchandise.....	<u>\$15,876</u>

\*In millions

**Ex. 13–21 (Man)**

a.	Cost of merchandise sold.....	\$1,031,550
	Add decrease in accounts payable.....	<u>9,660</u>
		\$1,041,210
	Deduct decrease in inventories.....	<u>(15,410)</u>
	Cash payments for merchandise.....	<u>\$1,025,800</u>
b.	Operating expenses other than depreciation.....	\$179,400
	Add decrease in accrued expenses payable.....	<u>1,380</u>
		\$180,780
	Deduct decrease in prepaid expenses.....	<u>(1,610)</u>
	Cash payments for operating expenses.....	<u>\$179,170</u>



**Ex. 13–22 (Man)****a. Cash flows from operating activities:**

Cash received from customers.....		\$522,760 <sup>1</sup>	
Deduct: Cash payments for merchandise....	\$302,400 <sup>2</sup>		
Cash payments for operating expenses.....	99,960 <sup>3</sup>		
Cash payments for income taxes....	<u>24,360<sup>4</sup></u>	<u>426,720</u>	
Net cash flow from operating activities.....			\$ 96,040

**Computations:**

1. Sales.....		\$511,000	
Add decrease in accounts receivable.....		<u>11,760</u>	
Cash received from customers.....		<u>\$522,760</u>	
2. Cost of merchandise sold.....		\$290,500	
Add: Increase in inventories.....	\$3,920		
Decrease in accounts payable.....	<u>7,980</u>	<u>11,900</u>	
Cash payments for merchandise.....		<u>\$302,400</u>	
3. Operating expenses other than depreciation.....		\$105,000	
Deduct: Decrease in prepaid expenses.....	\$3,780		
Increase in accrued expenses payable.....	<u>1,260</u>	<u>5,040</u>	
Cash payments for operating expenses.....		<u>\$ 99,960</u>	
4. Income tax expense.....		\$ 21,700	
Add decrease in income tax payable.....		<u>2,660</u>	
Cash payments for income taxes.....		<u>\$ 24,360</u>	

- b. The *direct method* directly reports cash receipts and payments. The cash received less the cash payments is the net cash flow from operating activities. Individual cash receipts and payments are reported in the Cash Flows from Operating Activities section.**

**The *indirect method* adjusts accrual-basis net income for revenues and expenses that do not involve the receipt or payment of cash to arrive at cash flows from operating activities.**

**Ex. 13–23 (Man)****Cash flows from operating activities:**

Cash received from customers.....		<b>\$440,440<sup>1</sup></b>	
Deduct: Cash payments for merchandise.....	<b>\$161,260<sup>2</sup></b>		
Cash payments for operating expenses.....	<b>115,720<sup>3</sup></b>		
Cash payments for income taxes.....	<b><u>39,600</u></b>	<b><u>316,580</u></b>	
Net cash flow from operating activities.....			<b>\$123,860</b>

**Computations:**

1. Sales.....	<b>\$445,500</b>
Deduct increase in accounts receivable.....	<b><u>5,060</u></b>
Cash received from customers.....	<b><u>\$440,440</u></b>
2. Cost of merchandise sold.....	<b>\$154,000</b>
Add increase in inventories.....	<b><u>12,100</u></b>
	<b>\$166,100</b>
Deduct increase in accounts payable.....	<b><u>4,840</u></b>
Cash payments for merchandise.....	<b><u>\$161,260</u></b>
3. Operating expenses other than depreciation.....	<b>\$115,280</b>
Add decrease in accrued expenses payable.....	<b><u>1,760</u></b>
	<b>\$117,040</b>
Deduct decrease in prepaid expenses.....	<b><u>1,320</u></b>
Cash payments for operating expenses.....	<b><u>\$115,720</u></b>

**Ex. 13–24 (Man)**

a. Cash flows from investment in PPE.....	<b>\$210,000</b>
Replacement percentage.....	<b><u>75%</u></b>
Cash paid for maintaining property, plant, and equipment.....	<b><u>\$157,500</u></b>
Cash flows from operating activities.....	<b>\$539,000</b>
Less cash paid for maintaining property, plant, and equipment.....	<b><u>157,500</u></b>
Free cash flow.....	<b><u>\$381,500</u></b>
b. Free cash flow is often used to measure the financial strength of a business. The more free cash flow that a business has, the easier it will be for the company to pay the interest on the loan and repay the loan principal. Sweeter's free cash flow is \$381,500, which is very strong.	

**Ex. 13–25 (Man)****a.**

	<b>Recent Fiscal Year End (all numbers in thousands)</b>
Cash flows from investment in PPE.....	<b>\$432</b>
Replacement percentage.....	<b>90%</b>
Cash paid for maintaining PPE.....	<b><u>\$389</u></b>
 Cash flows from operating activities.....	 <b>\$1,812</b>
Less cash paid for maintaining PPE.....	<b><u>(389)</u></b>
	<b><u>\$1,423</u></b>

- b.** Free cash flow is often used to measure the financial strength of a business. The more free cash flow that a business has, the easier it will be for the company to pay the interest on the loan and repay the loan principal.
- c.** Yes. Nike's free cash flow is extremely strong, and is 3.7 times greater than the capital expenditures necessary to maintain capacity.

**Ex. 13–26 (Man)**

Cash flows from investment in PPE.....	<b>\$440,000</b>
Replacement percentage.....	<b>85%</b>
Cash paid for maintaining PPE.....	<b><u>\$374,000</u></b>
 Net cash flow from operating activities.....	 <b>\$720,000</b>
Less investments in fixed assets to maintain current production.....	 <b><u>374,000</u></b>
Free cash flow.....	<b><u>\$346,000</u></b>

**PROBLEMS****Prob. 13–1A (Man)**

<b>CHARLES INC.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
Net income		\$ 190,280	
Adjustments to reconcile net income to			
net cash flow from operating activities:			
Depreciation		13,800	
Gain on sale of investments		(30,000)	
Changes in current operating assets			
and liabilities:			
Increase in accounts receivable		(14,160)	
Increase in inventories		(18,480)	
Increase in accounts payable		14,640	
Decrease in accrued expenses			
payable		(7,800)	
Net cash flow from operating activities			\$ 148,280
<b>Cash flows from investing activities:</b>			
Cash received from sale of investments		\$ 210,000	
Less: Cash paid for purchase of land	\$(246,000)		
Cash paid for purchase of			
equipment	(114,000)	(360,000)	
Net cash flow used for investing activities			(150,000)
<b>Cash flows from financing activities:</b>			
Cash received from sale of common stock		\$ 100,000	
Less cash paid for dividends*		(68,400)	
Net cash flow from financing activities			31,600
Increase in cash			\$ 29,880
Cash at the beginning of the year			439,440
Cash at the end of the year			\$ 469,320

\* \$72,000 + \$14,400 – \$18,000 = \$68,400

**Prob. 13–1A (Man) (Concluded)**  
**(Optional)**

<b>CHARLES INC.</b> <b>Spreadsheet (Work Sheet) for Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>				
Account Title	Balance Dec. 31, 2013	Transactions		Balance Dec. 31, 2014
		Debit	Credit	
Cash	439,440	(m) 29,880		469,320
Accounts receivable (net)	156,720	(l) 14,160		170,880
Inventories	462,840	(k) 18,480		481,320
Investments	180,000		(j) 180,000	0
Land	0	(i) 246,000		246,000
Equipment	414,840	(h) 114,000		528,840
Accum. depr.—equipment	(111,000)		(g) 13,800	(124,800)
Accounts payable	(303,720)		(f) 14,640	(318,360)
Accrued expenses payable	(39,480)	(e) 7,800		(31,680)
Dividends payable	(14,400)		(d) 3,600	(18,000)
Common stock, \$2 par	(75,000)		(c) 20,000	(95,000)
Paid-in capital in excess of par—common stock	(210,000)		(c) 80,000	(290,000)
Retained earnings	(900,240)	(b) 72,000	(a) 190,280	(1,018,520)
Totals	0	502,320	502,320	0
Operating activities:				
Net income		(a) 190,280		
Depreciation		(g) 13,800		
Gain on sale of investments			(j) 30,000	
Increase in accounts receivable			(l) 14,160	
Increase in inventories			(k) 18,480	
Increase in accounts payable		(f) 14,640		
Decrease in accrued expenses payable			(e) 7,800	
Investing activities:				
Purchase of equipment			(h) 114,000	
Purchase of land			(i) 246,000	
Sale of investments		(j) 210,000		
Financing activities:				
Declaration of cash dividends			(b) 72,000	
Sale of common stock		(c) 100,000		
Increase in dividends payable		(d) 3,600		
Net increase in cash			(m) 29,880	
Totals		532,320	532,320	

The letters in the debit and credit columns are included for reference purposes. They do not correspond to the letters in the additional data section of this problem.

## Prob. 13–2A (Man)

<b>LANKAU ENTERPRISES INC.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
Net income		\$ 198,000	
Adjustments to reconcile net income to net cash flow from operating activities:			
Depreciation		125,100	
Changes in current operating assets and liabilities:			
Decrease in accounts receivable		26,100	
Increase in inventory		(33,600)	
Increase in prepaid expenses		(5,700)	
Increase in accounts payable		18,900	
Net cash flow from operating activities			\$ 328,800
<b>Cash flows from investing activities:</b>			
Cash paid for equipment		\$(244,200)	
Net cash flow used for investing activities			(244,200)
<b>Cash flows from financing activities:</b>			
Cash received from sale of common stock		\$ 600,000	
Less: Cash paid for dividends	\$(230,400)		
Cash paid to retire mortgage note payable	(504,000)	(734,400)	
Net cash flow used for financing activities			(134,400)
Decrease in cash			\$ (49,800)
Cash at the beginning of the year			269,700
Cash at the end of the year			\$ 219,900

**Note to Instructors:** The disposal of fully depreciated equipment is not included in the cash flow statement because there is no associated cash flow. This transaction strictly involves the removal of \$67,200 from the equipment and accumulated depreciation—equipment accounts.

**Prob. 13–2A (Man) (Concluded)**  
**(Optional)**

<b>LANKAU ENTERPRISES INC.</b> <b>Spreadsheet (Work Sheet) for Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>				
Account Title	Balance Dec. 31, 2013	Transactions		Balance Dec. 31, 2014
		Debit	Credit	
Cash	269,700		(l) 49,800	219,900
Accounts receivable (net)	363,000		(k) 26,100	336,900
Merchandise inventory	448,800	(j) 33,600		482,400
Prepaid expenses	14,400	(i) 5,700		20,100
Equipment	805,500	(h) 244,200	(g) 67,200	982,500
Accum. depr.—equipment	(198,300)	(g) 67,200	(f) 125,100	(256,200)
Accounts payable	(356,400)		(e) 18,900	(375,300)
Mortgage note payable	(504,000)	(d) 504,000		0
Common stock, \$25 par	(36,000)		(c) 375,000	(411,000)
Paid-in capital in excess of par—common stock	(480,000)		(c) 225,000	(705,000)
Retained earnings	(326,700)	(b) 230,400	(a) 198,000	(294,300)
Totals	0	1,085,100	1,085,100	0
Operating activities:				
Net income		(a) 198,000		
Depreciation		(f) 125,100		
Decrease in accts. receivable		(k) 26,100		
Increase in merchandise inventory			(j) 33,600	
Increase in prepaid expenses			(i) 5,700	
Increase in accounts payable		(e) 18,900		
Investing activities:				
Purchase of equipment			(h) 244,200	
Financing activities:				
Payment of cash dividends			(b) 230,400	
Sale of common stock		(c) 600,000		
Payment of mortgage note payable			(d) 504,000	
Net decrease in cash		(l) 49,800		
Totals		1,017,900	1,017,900	

The letters in the debit and credit columns are included for reference purposes. They do not correspond to the letters in the additional data section of this problem.

## Prob. 13–3A (Man)

<b>WHITMAN CO.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
Net loss		\$ (35,320)	
Adjustments to reconcile net loss to			
net cash flow from operating activities:			
Depreciation*		55,620	
Loss on sale of land**		12,600	
Changes in current operating assets			
and liabilities:			
Increase in accounts receivable		(66,960)	
Increase in inventories		(105,480)	
Decrease in prepaid expenses		5,760	
Decrease in accounts payable		(35,820)	
Net cash flow used for operating activities			\$(169,600)
<b>Cash flows from investing activities:</b>			
Cash received from land sold		\$151,200	
Less: Cash paid for acquisition			
of building	\$561,600		
Cash paid for purchase			
of equipment	104,400	666,000	
Net cash flow used for investing activities			(514,800)
<b>Cash flows from financing activities:</b>			
Cash received from issuance of			
bonds payable	\$270,000		
Cash received from issuance of			
common stock	400,000	\$670,000	
Less cash paid for dividends		32,400	
Net cash flow from financing activities			637,600
Decrease in cash			\$ (46,800)
Cash at the beginning of the year			964,800
Cash at the end of the year			\$ 918,000

\* \$26,280 + \$29,340

\*\* \$151,200 – \$163,800



**Prob. 13–3A (Man) (Concluded)**  
**(Optional)**

<b>WHITMAN CO.</b> <b>Spreadsheet (Work Sheet) for Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>				
Account Title	Balance Dec. 31, 2013	Transactions		Balance Dec. 31, 2014
		Debit	Credit	
Cash	964,800		(o) 46,800	918,000
Accounts receivable	761,940	(g) 66,960		828,900
Inventories	1,162,980	(h) 105,480		1,268,460
Prepaid expenses	35,100		(f) 5,760	29,340
Land	479,700		(l) 163,800	315,900
Buildings	900,900	(k) 561,600		1,462,500
Accum. depr.—buildings	(382,320)		(e) 26,280	(408,600)
Equipment	454,680	(i) 104,400	(j) 46,800	512,280
Accum. depr.—equipment	(158,760)	(j) 46,800	(d) 29,340	(141,300)
Accounts payable	(958,320)	(c) 35,820		(922,500)
Bonds payable	0		(m) 270,000	(270,000)
Common stock, \$25 par	(117,000)		(n) 200,000	(317,000)
Paid-in capital in excess of par—common stock	(558,000)		(n) 200,000	(758,000)
Retained earnings	(2,585,700)	(a) 35,320		(2,517,980)
		(b) 32,400		
Totals	0	988,780	988,780	0
Operating activities:				
Net loss			(a) 35,320	
Depreciation—equipment		(d) 29,340		
Depreciation—buildings		(e) 26,280		
Loss on sale of land		(l) 12,600		
Increase in accts. receivable			(g) 66,960	
Increase in inventories			(h) 105,480	
Decrease in prepaid expenses		(f) 5,760		
Decrease in accounts payable			(c) 35,820	
Investing activities:				
Purchase of equipment			(i) 104,400	
Acquisition of building			(k) 561,600	
Sale of land		(l) 151,200		
Financing activities:				
Payment of cash dividends			(b) 32,400	
Issuance of bonds payable		(m) 270,000		
Issuance of common stock		(n) 400,000		
Net decrease in cash		(o) 46,800		
Totals		941,980	941,980	

## Prob. 13-4A (Man)

CANACE PRODUCTS INC. Statement of Cash Flows For the Year Ended December 31, 2014			
<b>Cash flows from operating activities:</b>			
Cash received from customers <sup>1</sup>		\$5,960,600	
Deduct: Cash payments for merchandise <sup>2</sup>	\$2,456,800		
Cash payments for operating expenses <sup>3</sup>	3,107,400		
Cash payments for income taxes	102,800	5,667,000	
Net cash flow from operating activities			\$ 293,600
<b>Cash flows from investing activities:</b>			
Cash received from sale of investments		\$ 176,000	
Less: Cash paid for purchase of land	\$ (520,000)		
Cash paid for purchase of equipment	(200,000)	(720,000)	
Net cash flow used for investing activities			(544,000)
<b>Cash flows from financing activities:</b>			
Cash received from sale of common stock		\$ 240,000	
Less cash paid for dividends*		25,600	
Net cash flow from financing activities			214,400
Decrease in cash			\$ (36,000)
Cash at the beginning of the year			679,400
Cash at the end of the year			\$ 643,400

## Reconciliation of Net Income with Cash Flows from Operating Activities:

Net income.....	\$217,200
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation.....	44,000
Loss on sale of investments.....	64,000
Changes in current operating assets and liabilities:	
Increase in accounts receivable.....	(19,400)
Increase in inventories.....	(28,200)
Increase in accounts payable.....	23,400
Decrease in accrued expenses payable.....	(7,400)
Net cash flow from operating activities.....	<u>\$293,600</u>

\* Dividends paid: \$28,000 + \$6,400 – \$8,800 = \$25,600

**Prob. 13–4A (Man) (Concluded)****Computations:**

<b>1. Sales.....</b>	<b>\$5,980,000</b>
<b>Deduct increase in accounts receivable.....</b>	<b><u>19,400</u></b>
<b>Cash received from customers.....</b>	<b><u>\$5,960,600</u></b>
<b>2. Cost of merchandise sold.....</b>	<b>\$2,452,000</b>
<b>Add increase in inventories.....</b>	<b><u>28,200</u></b>
	<b>\$2,480,200</b>
<b>Deduct increase in accounts payable.....</b>	<b><u>23,400</u></b>
<b>Cash payments for merchandise.....</b>	<b><u>\$2,456,800</u></b>
<b>3. Operating expenses other than depreciation.....</b>	<b>\$3,100,000</b>
<b>Add decrease in accrued expenses payable.....</b>	<b><u>7,400</u></b>
<b>Cash payments for operating expenses.....</b>	<b><u>\$3,107,400</u></b>

## Prob. 13-5A (Man)

CHARLES INC. Statement of Cash Flows For the Year Ended December 31, 2014			
<b>Cash flows from operating activities:</b>			
Cash received from customers <sup>1</sup>		\$5,247,541	
Deduct: Cash payments for merchandise <sup>2</sup>	\$3,241,810		
Cash payments for operating expenses <sup>3</sup>	1,730,598		
Cash payments for income taxes	126,853	5,099,261	
Net cash flow from operating activities			\$ 148,280
<b>Cash flows from investing activities:</b>			
Cash received from sale of investments		\$ 210,000	
Less: Cash paid for purchase of land	\$ 246,000		
Cash paid for purchase of equipment	114,000	360,000	
Net cash flow used for investing activities			(150,000)
<b>Cash flows from financing activities:</b>			
Cash received from sale of common stock		\$ 100,000	
Less: Cash paid for dividends <sup>4</sup>		68,400	
Net cash flow from financing activities			31,600
Increase in cash			\$ 29,880
Cash at the beginning of the year			439,440
Cash at the end of the year			\$ 469,320

## Reconciliation of Net Income with Cash Flows from Operating Activities:

Net income.....	\$190,280
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation.....	13,800
Gain on sale of investments.....	(30,000)
Changes in current operating assets and liabilities:	
Increase in accounts receivable.....	(14,160)
Increase in inventories.....	(18,480)
Increase in accounts payable.....	14,640
Decrease in accrued expenses payable.....	(7,800)
Net cash flow from operating activities.....	<u>\$148,280</u>

**Prob. 13–5A (Man) (Concluded)****Computations:**

<b>1. Sales.....</b>	<b>\$5,261,701</b>
<b>Deduct increase in accounts receivable.....</b>	<b><u>14,160</u></b>
<b>Cash received from customers.....</b>	<b><u>\$5,247,541</u></b>
<b>2. Cost of merchandise sold.....</b>	<b>\$3,237,970</b>
<b>Add increase in inventories.....</b>	<b><u>18,480</u></b>
	<b>\$3,256,450</b>
<b>Deduct increase in accounts payable.....</b>	<b><u>14,640</u></b>
<b>Cash payments for merchandise.....</b>	<b><u>\$3,241,810</u></b>
<b>3. Operating expenses other than depreciation.....</b>	<b>\$1,722,798</b>
<b>Add decrease in accrued expenses payable.....</b>	<b><u>7,800</u></b>
<b>Cash payments for operating expenses.....</b>	<b><u>\$1,730,598</u></b>
<b>4. Cash dividends declared.....</b>	<b>\$ 72,000</b>
<b>Deduct increase in dividends payable.....</b>	<b><u>3,600</u></b>
<b>Cash payments for dividends.....</b>	<b><u>\$ 68,400</u></b>

## Prob. 13–1B (Man)

<b>MERRICK EQUIPMENT CO.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
Net income		<b>\$141,680</b>	
Adjustments to reconcile net income to			
net cash flow from operating activities:			
Depreciation		<b>14,790</b>	
Loss on sale of investments		<b>10,200</b>	
Changes in current operating assets			
and liabilities:			
Increase in accounts receivable		<b>(19,040)</b>	
Increase in inventories		<b>(8,670)</b>	
Increase in accounts payable		<b>11,560</b>	
Increase in accrued expenses			
payable		<b>3,740</b>	
Net cash flow from operating activities			<b>\$ 154,260</b>
<b>Cash flows from investing activities:</b>			
Cash received from sale of investments		<b>\$ 91,800</b>	
Less: Cash paid for purchase of land	<b>\$295,800</b>		
Cash paid for purchase of			
equipment	<b>80,580</b>	<b>376,380</b>	
Net cash flow used for investing activities			<b>(284,580)</b>
<b>Cash flows from financing activities:</b>			
Cash received from sale of common stock		<b>\$250,000</b>	
Less: Cash paid for dividends*		<b>(96,900)</b>	
Net cash flow from financing activities			<b>153,100</b>
Increase in cash			<b>\$ 22,780</b>
Cash at the beginning of the year			<b>47,940</b>
Cash at the end of the year			<b>\$ 70,720</b>

\* \$102,000 + \$20,400 – \$25,500 = \$96,900

**Prob. 13–1B (Man) (Concluded)**  
**(Optional)**

<b>MERRICK EQUIPMENT CO.</b> <b>Spreadsheet (Work Sheet) for Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>				
Account Title	Balance Dec. 31, 2013	Transactions		Balance Dec. 31, 2014
		Debit	Credit	
Cash	47,940	(m) 22,780		70,720
Accounts receivable (net)	188,190	(l) 19,040		207,230
Inventories	289,850	(k) 8,670		298,520
Investments	102,000		(j) 102,000	0
Land	0	(i) 295,800		295,800
Equipment	358,020	(h) 80,580		438,600
Accum. depr.—equipment	(84,320)		(g) 14,790	(99,110)
Accounts payable	(194,140)		(f) 11,560	(205,700)
Accrued expenses payable	(26,860)		(e) 3,740	(30,600)
Dividends payable	(20,400)		(d) 5,100	(25,500)
Common stock, \$1 par	(102,000)		(c) 100,000	(202,000)
Paid-in capital in excess of par—common stock	(204,000)		(c) 150,000	(354,000)
Retained earnings	(354,280)	(b) 102,000	(a) 141,680	(393,960)
<b>Totals</b>	<b>0</b>	<b>528,870</b>	<b>528,870</b>	<b>0</b>
<b>Operating activities:</b>				
Net income		(a) 141,680		
Depreciation		(g) 14,790		
Loss on sale of investments		(j) 10,200		
Increase in accounts receivable			(l) 19,040	
Increase in inventories			(k) 8,670	
Increase in accounts payable		(f) 11,560		
Increase in accrued expenses payable		(e) 3,740		
<b>Investing activities:</b>				
Purchase of equipment			(h) 80,580	
Purchase of land			(i) 295,800	
Sale of investments		(j) 91,800		
<b>Financing activities:</b>				
Declaration of cash dividends			(b) 102,000	
Sale of common stock		(c) 250,000		
Increase in dividends payable		(d) 5,100		
<b>Net increase in cash</b>			(m) 22,780	
<b>Totals</b>		<b>528,870</b>	<b>528,870</b>	

The letters in the debit and credit columns are included for reference purposes. They do not correspond to the letters in the additional data section of this problem.

## Prob. 13-2B (Man)

<b>HARRIS INDUSTRIES INC.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>		
<b>Cash flows from operating activities:</b>		
Net income	\$ 524,580	
Adjustments to reconcile net income to		
net cash flow from operating activities:		
Depreciation	74,340	
Patent amortization	5,040	
Changes in current operating assets		
and liabilities:		
Increase in accounts receivable	(73,080)	
Decrease in inventories	134,680	
Increase in prepaid expenses	(6,440)	
Decrease in accounts payable	(89,600)	
Decrease in salaries payable	(8,120)	
Net cash flow from operating activities		\$ 561,400
<b>Cash flows from investing activities:</b>		
Cash paid for construction of building	\$(579,600)	
Net cash flow used for investing activities		(579,600)
<b>Cash flows from financing activities:</b>		
Cash received from issuance of mortgage note	\$ 224,000	
Less: Cash paid for dividends*	(123,480)	
Net cash flow from financing activities		100,520
Increase in cash		\$ 82,320
Cash at the beginning of the year		360,920
Cash at the end of the year		\$ 443,240
<b>Schedule of Noncash Financing and Investing Activities:</b>		
Issuance of common stock to retire bonds		\$ 390,000

\*\$131,040 + \$25,200 – \$32,760 = \$123,480



**Prob. 13–2B (Man) (Continued)**  
**(Optional)**

<b>HARRIS INDUSTRIES INC.</b> <b>Spreadsheet (Work Sheet) for Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>				
Account Title	Balance Dec. 31, 2013	Transactions		Balance Dec. 31, 2014
		Debit	Credit	
Cash	360,920	(p) 82,320		443,240
Accounts receivable (net)	592,200	(o) 73,080		665,280
Inventories	1,022,560		(n) 134,680	887,880
Prepaid expenses	25,200	(m) 6,440		31,640
Land	302,400			302,400
Buildings	1,134,000	(l) 579,600		1,713,600
Accum. depr.—buildings	(414,540)		(k) 51,660	(466,200)
Machinery and equipment	781,200			781,200
Accum. depr.—machinery and equipment	(191,520)		(j) 22,680	(214,200)
Patents	112,000		(i) 5,040	106,960
Accounts payable	(927,080)	(h) 89,600		(837,480)
Dividends payable	(25,200)		(g) 7,560	(32,760)
Salaries payable	(87,080)	(f) 8,120		(78,960)
Mortgage note payable	0		(e) 224,000	(224,000)
Bonds payable	(390,000)	(d) 390,000		0
Common stock, \$5 par	(50,400)		(c) 150,000	(200,400)
Paid-in capital in excess of par—common stock	(126,000)		(c) 240,000	(366,000)
Retained earnings	(2,118,660)	(b) 131,040	(a) 524,580	(2,512,200)
Totals	0	1,360,200	1,360,200	0

The letters in the debit and credit columns are included for reference purposes. They do not correspond to the letters in the additional data section of this problem.

## Prob. 13–2B (Man) (Concluded)

<b>HARRIS INDUSTRIES INC.</b> <b>Spreadsheet (Work Sheet) for Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>				
Account Title	Balance Dec. 31, 2013	Transactions		Balance Dec. 31, 2014
		Debit	Credit	
<b>Operating activities:</b>				
Net income		(a) 524,580		
Depreciation—buildings		(k) 51,660		
Depreciation—machinery and equipment		(j) 22,680		
Amortization of patents		(i) 5,040		
Increase in accounts receivable			(o) 73,080	
Decrease in inventories		(n) 134,680		
Increase in prepaid expenses			(m) 6,440	
Decrease in accounts payable			(h) 89,600	
Decrease in salaries payable			(f) 8,120	
<b>Investing activities:</b>				
Construction of building			(l) 579,600	
<b>Financial activities:</b>				
Declaration of cash dividends			(b) 131,040	
Issuance of mortgage note payable		(e) 224,000		
Increase in dividends payable		(g) 7,560		
<b>Schedule of noncash investing and financing activities:</b>				
Issuance of common stock to retire bonds		(c) 390,000	(d) 390,000	
Net increase in cash			(p) 82,320	
<b>Totals</b>		<b>1,360,200</b>	<b>1,360,200</b>	

## Prob. 13–3B (Man)

<b>COULSON INC.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
Net income		\$ 326,600	
Adjustments to reconcile net income to net cash flow from operating activities:			
Depreciation		68,400	
Gain on sale of land		(60,000)	
Changes in current operating assets and liabilities:			
Increase in accounts receivable		(94,800)	
Increase in inventories		(52,800)	
Decrease in prepaid expenses		7,800	
Decrease in accounts payable		(37,200)	
Increase in income taxes payable		4,800	
Net cash flow from operating activities			\$ 162,800
<b>Cash flows from investing activities:</b>			
Cash received from sale of land		\$ 456,000	
Less: Cash paid for acquisition of building	\$990,000		
Cash paid for purchase of equipment	196,800	1,186,800	
Net cash flow used for investing activities			(730,800)
<b>Cash flows from financing activities:</b>			
Cash received from issuance of bonds payable	\$330,000		
Cash received from issuance of common stock	280,000	\$ 610,000	
Less cash paid for dividends		79,200	
Net cash flow from financing activities			530,800
Decrease in cash			\$ (37,200)
Cash at the beginning of the year			337,800
Cash at the end of the year			\$ 300,600

**Prob. 13–3B (Man) (Concluded)**  
**(Optional)**

<b>COULSON INC.</b> <b>Spreadsheet (Work Sheet) for Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>				
Account Title	Balance Dec. 31, 2013	Transactions		Balance Dec. 31, 2014
		Debit	Credit	
Cash	337,800		(p) 37,200	300,600
Accounts receivable (net)	609,600	(i) 94,800		704,400
Inventories	865,800	(h) 52,800		918,600
Prepaid expenses	26,400		(g) 7,800	18,600
Land	1,386,000		(m) 396,000	990,000
Buildings	990,000	(l) 990,000		1,980,000
Accum. depr.—buildings	(366,000)		(f) 31,200	(397,200)
Equipment	529,800	(j) 196,800	(k) 66,000	660,600
Accum. depr.—equipment	(162,000)	(k) 66,000	(e) 37,200	(133,200)
Accounts payable	(631,200)	(d) 37,200		(594,000)
Income taxes payable	(21,600)		(c) 4,800	(26,400)
Bonds payable	0		(n) 330,000	(330,000)
Common stock, \$20 par	(180,000)		(o) 140,000	(320,000)
Paid-in capital in excess of par—common stock	(810,000)		(o) 140,000	(950,000)
Retained earnings	(2,574,600)	(b) 79,200	(a) 326,600	(2,822,000)
Totals	0	1,516,800	1,516,800	0
Operating activities:				
Net income		(a) 326,600		
Depreciation—equipment		(e) 37,200		
Depreciation—buildings		(f) 31,200		
Gain on sale of land			(m) 60,000	
Increase in accts. receivable			(i) 94,800	
Increase in inventories			(h) 52,800	
Decrease in prepaid expenses		(g) 7,800		
Decrease in accounts payable			(d) 37,200	
Increase in income taxes payable		(c) 4,800		
Investing activities:				
Purchase of equipment			(j) 196,800	
Acquisition of building			(l) 990,000	
Sale of land		(m) 456,000		
Financing activities:				
Payment of cash dividends			(b) 79,200	
Issuance of bonds payable		(n) 330,000		
Issuance of common stock		(o) 280,000		
Net decrease in cash		(p) 37,200		
Totals		1,510,800	1,510,800	

## Prob. 13-4B (Man)

<b>MARTINEZ INC.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
Cash received from customers <sup>1</sup>		\$4,433,760	
Deduct: Cash payments for merchandise <sup>2</sup>	\$2,269,200		
Cash payments for operating expenses <sup>3</sup>	1,356,240		
Cash payments for income tax	299,100	3,924,540	
<b>Net cash flow from operating activities</b>			<b>\$ 509,220</b>
<b>Cash flows from investing activities:</b>			
Cash received from sale of investments		\$ 588,000	
Less: Cash paid for land	\$ 960,000		
Cash paid for equipment	240,000	1,200,000	
<b>Net cash flow used for investing activities</b>			<b>(612,000)</b>
<b>Cash flows from financing activities:</b>			
Cash received from sale of common stock		\$ 600,000	
Less: Cash paid for dividends*		518,400	
<b>Net cash flow from financing activities</b>			<b>81,600</b>
<b>Decrease in cash</b>			<b>\$ (21,180)</b>
<b>Cash at the beginning of the year</b>			<b>683,100</b>
<b>Cash at the end of the year</b>			<b>\$ 661,920</b>

**Reconciliation of Net Income with Cash Flows from Operating Activities:**

Net income.....	\$ 558,960
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation expense.....	113,100
Gain on sale of investments.....	(156,000)
Changes in current operating assets and liabilities:	
Increase in accounts receivable.....	(78,240)
Increase in inventories.....	(30,600)
Increase in accounts payable.....	113,400
Decrease in accrued expenses payable.....	(11,400)
Net cash flow from operating activities.....	<u>\$ 509,220</u>

\* Dividends paid: \$528,000 + \$91,200 – \$100,800 = \$518,400

**Prob. 13–4B (Man) (Concluded)****Computations:**

<b>1. Sales.....</b>	<b>\$4,512,000</b>
<b>Deduct increase in accounts receivable.....</b>	<b><u>78,240</u></b>
<b>Cash received from customers.....</b>	<b><u>\$4,433,760</u></b>
<b>2. Cost of merchandise sold.....</b>	<b>\$2,352,000</b>
<b>Add increase in inventories.....</b>	<b><u>30,600</u></b>
	<b>\$2,382,600</b>
<b>Deduct increase in accounts payable.....</b>	<b><u>113,400</u></b>
<b>Cash payments for merchandise.....</b>	<b><u>\$2,269,200</u></b>
<b>3. Operating expenses other than depreciation.....</b>	<b>\$1,344,840</b>
<b>Add decrease in accrued expenses payable.....</b>	<b><u>11,400</u></b>
<b>Cash payments for operating expenses.....</b>	<b><u>\$1,356,240</u></b>

## Prob. 13–5B (Man)

<b>MERRICK EQUIPMENT CO.</b> <b>Statement of Cash Flows</b> <b>For the Year Ended December 31, 2014</b>			
<b>Cash flows from operating activities:</b>			
Cash received from customers <sup>1</sup>		\$2,004,858	
Deduct: Cash payments for merchandise <sup>2</sup>	\$1,242,586		
Cash payments for operating expenses <sup>3</sup>	513,559		
Cash payments for income taxes	94,453	1,850,598	
<b>Net cash flow from operating activities</b>			<b>\$ 154,260</b>
<b>Cash flows from investing activities:</b>			
Cash received from sale of investments		\$ 91,800	
Less: Cash paid for purchase of land	\$ 295,800		
Cash paid for purchase of equipment	80,580	376,380	
<b>Net cash flow used for investing activities</b>			<b>(284,580)</b>
<b>Cash flows from financing activities:</b>			
Cash received from sale of common stock		\$ 250,000	
Less: Cash paid for dividends*		96,900	
<b>Net cash flow from financing activities</b>			<b>153,100</b>
<b>Increase in cash</b>			<b>\$ 22,780</b>
<b>Cash at the beginning of the year</b>			<b>47,940</b>
<b>Cash at the end of the year</b>			<b>\$ 70,720</b>

**Reconciliation of Net Income with Cash Flows from Operating Activities:**

Net income.....	\$141,680
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation.....	14,790
Loss on sale of investments.....	10,200
Changes in current operating assets and liabilities:	
Increase in accounts receivable.....	(19,040)
Increase in inventories.....	(8,670)
Increase in accounts payable.....	11,560
Increase in accrued expenses payable.....	3,740
Net cash flow from operating activities.....	<u>\$154,260</u>

\* Dividends paid: \$102,000 + \$20,400 – \$25,500 = \$96,900

**Prob. 13–5B (Man) (Concluded)****Computations:**

<b>1. Sales.....</b>	<b>\$2,023,898</b>
<b>Deduct increase in accounts receivable.....</b>	<b><u>19,040</u></b>
<b>Cash received from customers.....</b>	<b><u>\$2,004,858</u></b>
<b>2. Cost of merchandise sold.....</b>	<b>\$1,245,476</b>
<b>Add increase in inventories.....</b>	<b><u>8,670</u></b>
	<b>\$1,254,146</b>
<b>Deduct increase in accounts payable.....</b>	<b><u>11,560</u></b>
<b>Cash payments for merchandise.....</b>	<b><u>\$1,242,586</u></b>
<b>3. Operating expenses other than depreciation.....</b>	<b>\$ 517,299</b>
<b>Deduct increase in accrued expenses payable.....</b>	<b><u>3,740</u></b>
<b>Cash payments for operating expenses.....</b>	<b><u>\$ 513,559</u></b>



**CASES & PROJECTS****CP 13–1 (Man)**

Although this situation might seem harmless at first, it is actually a violation of generally accepted accounting principles. The operating cash flow per share figure should not be shown on the face of the income statement. The income statement is constructed under accrual accounting concepts, while operating cash flow “undoes” the accounting accruals. Thus, unlike Lucas’s assertion that this information would be useful, more likely the information could be confusing to users. Some users might not be able to distinguish between earnings and operating cash flow per share—or how to interpret the difference. By agreeing with Lucas, John has breached his professional ethics because the disclosure would violate generally accepted accounting principles. On a more subtle note, Lucas is being somewhat disingenuous. Apparently, Lucas is not pleased with this year’s operating performance and would like to cover the earnings “bad news” with some cash flow “good news” disclosures. An interesting question is: Would Lucas be as interested in the dual per share disclosures in the opposite scenario—with earnings per share improving and cash flow per share deteriorating? Probably not.

**CP 13–2 (Man)**

Start-up companies are unique in that they frequently will have negative retained earnings and operating cash flows. The negative retained earnings are often due to losses from high start-up expenses. The negative operating cash flows are typical because growth requires cash. Growth must be financed with cash before the cash returns. For example, a company must expend cash to provide the service in Period 1 before selling it and receiving cash in Period 2. The start-up company constantly faces the problem of spending cash today for the next period’s growth. For Giraffe Inc., the money spent on salaries to develop the business is a cash outflow that must occur before the service provides revenues. In addition, the company must use cash to market its service to potential customers. In this situation, the only way the company stays in business is from the capital provided by the owners. This owner-supplied capital is the lifeblood of a start-up company. Banks will not likely lend money on this type of venture (except with assets as security). Giraffe Inc. could be a good investment. It all depends on whether the new service has promise. The financial figures will not reveal this easily. Only actual sales will reveal if the service is a hit. Until this time, the company is at risk. If the service is not popular, the company will have no cash to fall back on—it will likely go bankrupt. If, however, the service is successful, then Giraffe Inc. should become self-sustaining and provide a good return for the shareholders.

**CP 13–3 (Man)**

- a. 1. Normal practice for determining the amount of cash flows from operating activities during the year is to begin with the reported net income. This net income must ordinarily be adjusted upward and/or downward to determine the amount of cash flows. Although many operating expenses decrease cash, depreciation does not. The amount of net income understates the amount of cash flows provided by operations to the extent that depreciation expense is deducted from revenue. The associated cash outflow occurs when the asset is purchased and is reported as a cash outflow from investing activities. Accordingly, the depreciation expense for the year must be added back to the reported net income in arriving at cash flows from operating activities.
2. Generally accepted accounting principles require that significant transactions affecting future cash flows should be reported in a separate schedule to the statement, even though they do not affect cash. Accordingly, even though the issuance of the common stock for land does not affect cash, the transaction affects future cash flows and must be reported.
3. The \$180,000 cash received from the sale of the investments is reported in the Cash Flows from Investing Activities section. Since the net income included a gain of \$30,000, the gain is deducted from net income to avoid double reporting this amount and to remove it from the determination of cash flows from operating activities.
4. The balance sheets for the last two years will indicate the increase in cash but will not indicate the firm's activities in meeting its financial obligations, paying dividends, and maintaining and expanding operating capacity. Such information, as provided by the statement of cash flows, assists creditors in assessing the firm's solvency and profitability—two very important factors bearing on the evaluation of a potential loan.
- b. The statement of cash flows indicates a strong liquidity position for Argon Inc. The increase in cash of \$291,000 for the past year is more than adequate to cover the \$150,000 of new building and store equipment costs that will not be provided by the loan. Thus, the statement of cash flows most likely will enhance the company's chances of receiving a loan. However, other information, such as a projection of future earnings, a description of collateral pledged to support the loan, and an independent credit report, would normally be considered before a final loan decision is made.

**CP 13–4 (Man)**

The senior vice president is very focused on profitability but has been bleeding cash. The increase in accounts receivable and inventory is striking. Apparently, the new credit card campaign has found many new customers, since the accounts receivable is growing. Unfortunately, it appears as though the new campaign has done a poor job of screening creditworthiness in these new customers. In other words, there are many new credit card purchasers—unfortunately, they do not appear to be paying off their balances. The new merchandise purchases appear to be backfiring. The company has received some “good deals,” except that they are only “good deals” if it can resell the merchandise. If the merchandise has no customer appeal, then that would explain the inventory increase. In other words, the division is purchasing merchandise that sits on the shelf, regardless of pricing. The reduction in payables is the result of the division becoming overdue on payments. The memo reports that most of the past due payables have been paid. This situation is critical in the retailing business. A retailer cannot afford a poor payment history, or it will be denied future merchandise shipments. This is a signal of severe cash problems. Overall, the picture is of a retailer having severe operating cash flow difficulties.

*Note to Instructors:* This scenario is essentially similar to Kmart’s path to eventual bankruptcy. It reported earnings, while having significant negative cash flows from operations due to expanding credit too liberally (increases in accounts receivable) and purchasing too much unsaleable inventory (increases in inventory). Eventually, Kmart’s inventory write-down resulted in significant losses about the time it entered bankruptcy.

**CP 13–5 (Man)****a. and b.**

Recent statements of cash flows for Johnson & Johnson and JetBlue Airways Corp. are shown on the following pages. The actual analysis may be different due to updated information. However, this answer shows the structure for a possible response.

**Johnson & Johnson**

Johnson & Johnson (J&J) is a powerful generator of cash flows from operating activities, with almost \$14.3 billion in cash flow from operations. This is enough to support over \$4.6 billion in investing activities, with the remainder available for dividends, repurchases of common stock, and retirement of debt, while still adding \$5.2 billion to the company's cash balance. Overall, the statement of cash flows indicates very favorable cash flows for J&J. J&J's free cash flow is approximately \$11.4 billion for the year (\$14.3 – \$2.9).

**JetBlue Airways Corp.**

JetBlue is weaker than J&J. JetBlue had cash flows from operating activities of around \$614 million. In addition, JetBlue had net negative cash flows from investing activities of \$502 million. The net cash inflows from financing activities was \$96 million, which primarily came from the issuance of short-term debt. JetBlue did not generate enough cash flow from operations to maintain the necessary investment in its fixed assets. Free cash flow is approximately \$89 million (\$614 – \$525). JetBlue is in a much weaker cash flow position than Johnson & Johnson.

## CP 13–5 (Man) (Continued)

JOHNSON & JOHNSON Consolidated Statements of Cash Flows	
In Millions For Period Ended December 31, 2011	12/31/11
<b>CASH FLOWS FROM OPERATING ACTIVITIES:</b>	
Net earnings	\$ 9,672
Adjustments to reconcile net earnings to cash flows:	
Depreciation and amortization of property and intangibles	3,158
Stock based compensation	621
Deferred tax provision	(836)
Accounts receivable allowances	32
Changes in assets and liabilities, net of effects from acquisitions:	
Increase in accounts receivable	(915)
(Increase)/decrease in inventories	(715)
(Decrease)/increase in accounts payable and accrued liabilities	493
(Decrease)/increase in other current and noncurrent assets	(1,625)
(Decrease)/increase in other current and noncurrent liabilities	4,413
<b>NET CASH FLOWS FROM OPERATING ACTIVITIES</b>	<b>\$ 14,298</b>
<b>CASH FLOWS FROM INVESTING ACTIVITIES:</b>	
Additions to property, plant and equipment	\$ (2,893)
Proceeds from the disposal of assets	1,342
Acquisitions, net of cash acquired (Note 17)	(2,797)
Purchases of investments	(29,882)
Sales of investments	30,396
Other (primarily intangibles)	(778)
<b>NET CASH USED BY INVESTING ACTIVITIES</b>	<b>\$ (4,612)</b>
<b>CASH FLOWS FROM FINANCING ACTIVITIES:</b>	
Dividends to shareholders	\$ (6,156)
Repurchase of common stock	(2,525)
Proceeds from short-term debt	9,729
Retirement of short-term debt	(11,200)
Proceeds from long-term debt	4,470
Retirement of long-term debt	(16)
Proceeds from the exercise of stock options	1,246
<b>NET CASH USED BY FINANCING ACTIVITIES</b>	<b>\$ (4,452)</b>
Effect of exchange rate changes on cash and cash equivalents	\$ (47)
Increase in cash and cash equivalents	\$ 5,187
Cash and cash equivalents, beginning of year (Note 1)	19,355
<b>CASH AND CASH EQUIVALENTS, END OF YEAR (NOTE 1)</b>	<b>\$ 24,542</b>
<b>SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND FINANCING ACTIVITIES</b>	
Treasury stock issued for employee compensation and stock option plans, net of cash proceeds	433
Conversion of debt	1

## CP 13–5 (Man) (Concluded)

JETBLUE AIRWAYS CORP. Consolidated Statements of Cash Flows	
In Millions For Period Ended December 31, 2011	12/31/11
<b>Cash Flow from Operating Activities:</b>	
Net income	\$ 86
Adjustments to reconcile net loss to net cash provided (used)	
by operating activities:	
Depreciation	213
Amortization	34
Stock-based compensation	13
Losses (Gains) on sale of flight equipment and extinguishment of debt	6
Deferred income taxes	58
Collateral returned (deposits) for derivative instruments	10
Changes in certain operating assets and liabilities:	
Decrease (increase) in receivables	(10)
Increase (decrease) in inventories, prepaid and other	4
Increase (decrease) in air traffic liability	113
Increase (decrease) accounts payable and other accrued liabilities	26
Other, net	61
Net cash (used) provided by operating activities	\$ 614
<b>Cash Flow from Investing Activities:</b>	
Capital expenditures, including purchase deposits on flight equipment	\$(525)
Net decrease in short-term investments	24
Proceeds from sale of equipment and property and other investments	2
Other	(3)
Net cash used for investing activities	\$(502)
<b>Cash Flow from Financing Activities:</b>	
Proceeds from:	
Issuance of common stock	\$ 10
Issuance of long-term debt	245
Short-term borrowings	128
Other	6
Repayment of:	
Long-term debt and capital lease obligations	(238)
Short-term borrowings	(40)
Other	(15)
Net cash provided by financing activities	\$ 96
Net increase in cash	\$ 208
Cash at beginning of year	465
Cash at end of year	\$ 673