15 STATEMENT OF CASH FLOWS

DISCUSSION QUESTIONS

1. Cash equivalents such as money market funds and CDs are highly liquid investments that can be readily converted into cash. They are treated as cash.

2. Operating activities are the ongoing, day-to-day, revenue-generating activities of an organization. Investing activities involve the sale or purchase of long-term assets. Financing activities stem from long-term liabilities and equity sources.

3. The operating activity category is the most useful since it provides the cash effects of ongoing operations.

4. The all-financial-resources approach requires disclosure of all investing and financing activities, even if they do not affect cash.

5. The separation ensures that cash consequences of business transactions are emphasized since the major purpose of the statement is disclosure of cash activities.

6. (1) Compute the change in cash for the period.
(2) Compute the cash flows from operating activities.
(3) Identify the cash flows from investing activities.
(4) Identify the cash flows from financing activities.
(5) Prepare the statement of cash flows.
The first step provides the net cash inflow or outflow that must appear on the statement of cash flows. The next three steps provide the detail for explaining the change in cash flows. The final step summarizes all the detail.

7. Accrual accounting allows a firm to recognize revenues before they are collected or to pay for inputs before they are expensed. This practice creates the possibility of having a negative operating cash flow while still reporting a positive net income.

8. Accrual accounting allows a firm to collect revenues that were recognized in a prior period and to recognize expenses not yet paid for. Additionally, noncash expenses are deducted to arrive at net income. Thus, a loss may not mean negative cash flows.

9. An increase in current liabilities means that payments to creditors were less than purchases made during the period. A decrease in a noncash current asset means that cash is freed up by using up the noncash current asset. (For example, a decrease in receivables means more cash was collected than revenues recognized.)

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10. A decrease in a current liability means that cash payments to creditors were greater than the expenses recognized during the period. An increase in a noncash current asset means that more cash was paid than the expenses recognized. (As assets expire, they become expenses.)

11. Noncash expenses are added back to net income because they involve no cash outflow and have already been deducted in computing net income.

12. Since dividends are payments to owners and an equity transaction, they are reflected in the Financing Activities section of the Cash Flow Statement.

13. Worksheets are an efficient, logical way of organizing the data needed to prepare a statement of cash flows.

14. The worksheet approach is based on a transaction analysis. Using the beginning and ending balances on the balance sheet, transactions are analyzed that impact cash flows. Debit and credit columns are set up for the upper and lower halves of the worksheet. The upper half corresponds to the balance sheet, and the lower half corresponds to the classifications on the statement of cash flows. A debit or credit in the balance sheet section produces a corresponding credit or debit in the cash flow columns of the lower section. Once the transactions are all analyzed, the lower section can be used to prepare the statement.

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MULTIPLE-CHOICE EXERCISES

15-1. **c**

15-2. **b**

15-3. **a**

15-4. **e**

15-5. **e**

15-6. **b**

15-7. **a**

15-8. **e**

15-9. **d**

15-10. **b**

15-11. **e**

15-12. **c**

15-13. **d**

15-14. **a**

15-15. **e**

15-16. **a**

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CORNERSTONE EXERCISES

CE 15-17

a. Investing—use of cash
b. Financing—source of cash
c. Operating—source of cash
d. Investing—source of cash
e. Financing—use of cash
f. Investing—source of cash
g. Financing—use of cash
h. Operating—use of cash
i. Financing—source of cash

CE 15-18

1. Change in cash: $565,000 – $350,000 = $215,000

2. The sum of the operating, investing, and financing cash flows must equal the change in cash from 2011 to 2012 ($215,000)

CE 15-19

Net income	$450,000
Add (deduct) adjusting items:	
Decrease in accounts receivable……………………….	83,750
Decrease in wages payable…………………………….	(92,500)
Increase in inventories………………………………….	(10,000)
Depreciation expense……………………………………	135,000
Gain on sale of equipment………………………………	(50,000)
Net cash from operating activities………………….	$516,250

CE 15-20

Sale of equipment…………………………………………..	$ 190,000
Purchase of equipment…………………………………….	(215,000) *
Purchase of land…………………………………………….	(218,750) **
Net cash from investing activities…………………….	$(243,750)

*Ending balance plant and equipment + Original cost of equipment sold – Beginning balance = Purchase of equipment ($1,075,000 + $240,000 – $1,100,000 = $215,000)

**Ending balance (land) – Beginning balance (land)

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CE 15-21

Issuance of bonds payable………………………	$ 192,500
Payment of mortgage…………………………	(50,000)
Payment of dividends…………………………	(200,000) *
Net cash from financing activities ………………	$ (57,500)

* Retained earnings (2011) + Net income – Retained earnings (2012) = Dividends ($912,500 + $450,000 – $1,162,500 = $200,000)

CE 15-22

1.

Blaylock Company Statement of Cash Flows For the Year Ended December 31, 2012		
Cash flows from operating activities:		
Net income………………………………	$ 450,000	
Add (deduct) adjusting items:		
Decrease in accounts receivable………………	83,750	
Decrease in wages payable……………………	(92,500)	
Increase in inventories…………………………	(10,000)	
Depreciation expense…………………………	135,000	
Gain on sale of equipment……………………	(50,000)	
Net cash from operating activities…………		$ 516,250
Cash flows from investing activities:		
Sale of equipment………………………………	$ 190,000	
Purchase of equipment…………………………	(215,000)	
Purchase of land………………………………	(218,750)	
Net cash from investing activities…………		(243,750)
Cash flows from financing activities:		
Issuance of bonds payable……………………	$ 192,500	
Payment of mortgage…………………………	(50,000)	
Payment of dividends…………………………	(200,000)	
Net cash from financing activities …………		(57,500)
Net increase in cash…………………………		$ 215,000

2. The sum of the operating, investing, and financing cash flows must equal the change in cash flow.

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CE 15-23

	Income Statement	Adjustments		Cash Flows
Revenues	$1,200,000	$ 68,500	*	$1,268,500
Gain on sale of equipment	50,000	(50,000)		
Less: Cost of goods sold	(650,000)	(62,500)	**	
		(25,000)	***	(737,500)
Less: Depreciation expense	(125,000)	125,000		
Less: Interest expense	(25,000)			(25,000)
Net income	$ 450,000			$ 506,000
Net cash from operating activities				

* Decrease in Accounts Receivable.
** Decrease in Accounts Payable.
*** Increase in Inventories.

CE 15-24

Worksheet: Young Company
At December 31, 2012

	2011		Transactions Debit		Transactions Credit	2012
Assets:						
Cash	$ 54,000	(1)	$57,000			$111,000
Accounts receivable	33,000	(2)	3,800			36,800
Inventory	48,000			(3)	$15,000	33,000
Plant and equipment	78,000			(4)	18,000	60,000
Accumulated depr.	(39,000)	(4)	9,000	(5)	6,000	(36,000)
Land	15,000	(6)	25,000			40,000
Total assets	$189,000					$244,800
Liabilities and stockholders' equity:						
Accounts payable	$ 24,000			(7)	12,000	$ 36,000
Wages payable	3,000	(8)	1,200			1,800
Bonds payable	18,000	(9)	7,000			11,000
Preferred stock (no par)	3,000			(10)	7,000	10,000
Common stock	30,000			(11)	6,000	36,000
Paid-in capital in excess of par	30,000			(11)	19,000	49,000
Retained earnings	81,000	(13)	10,000	(12)	30,000	101,000
Total liabilities and stockholders’ equity	$189,000					$244,800

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CE 15-24 (Continued)

	Transactions			
		Debit		Credit
Cash flows from operating activities:				
Net income	(12)	$30,000		
Depreciation expense	(5)	6,000		
Loss on sale of equipment	(4)	4,200		
Decrease in inventory	(3)	15,000		
Increase in accounts payable	(7)	12,000		
Increase in accounts receivable			(2)	$ 3,800
Decrease in wages payable			(8)	1,200
Cash flows from investing activities:				
Sale of equipment	(4)	4,800		
Cash flows from financing activities:				
Reduction in bonds payable			(9)	7,000
Payment of dividends			(13)	10,000
Issuance of preferred stock	(10)	7,000		
Net increase in cash			(1)	57,000
Noncash investing and financing activities:				
Land acquired with common stock	(11)	25,000	(6)	25,000

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EXERCISES

E 15-25

a. Investing—source of cash
b. Operating—source of cash
c. Financing—use of cash
d. Financing—use of cash
e. Financing—source of cash
f. Investing—use of cash
g. Financing—source of cash
h. Investing—use of cash
i. Operating—use of cash
j. Financing—source of cash

E 15-26

a. Added to
b. Added to
c. Deducted from
d. Added to
e. Deducted from
f. Added to
g. Added to
h. Added to
i. Added to

E 15-27

1. *Note:* Balances refer to prepaid rent account

Cash paid for rent = Rent expense + Ending balance – Beginning balance
= $157,500 + $75,600 – $63,000
= $170,100

2. Under the indirect method, any increase in a noncash current asset is deducted from net income. Thus, since prepaid rent increased by $12,600, this would be deducted from net income.

E 15-28

1. Cash flows from operating activities:

Net income	$ 41,150
Add (deduct) adjusting items:	
Increase in accounts receivable	(21,500)
Increase in inventory	(11,000)
Increase in prepaid expenses	(2,000)
Increase in accounts payable	6,750
Decrease in wages payable	(8,000)
Depreciation expense	7,000
Net cash from operating activities	$ 12,400

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E 15-28 (Continued)

2. From Requirement 1, the net operating cash without the change in accounts payable is $5,650. ($12,400 – $6,750). Thus, the change in accounts payable must be $13,650 – $5,650 = $8,000, which means accounts payable must have increased by this amount. The ending balance is therefore $38,000 = Beginning accounts payable + Increase = $30,000 + $8,000.

3. The operating cash flows are only $12,400, about half of what would be needed. However, Makenzie has a large cash balance ($84,400, including this year's increase from operating cash flows. Accordingly, it would be easy to use the excess cash to make the investment. Alternatively, other forms of financing could be used such as loans, issuing bonds, or new stock to raise the difference.

E 15-29

1. Cash flows from investing activities:

Purchase of bonds	$(100,000)
Sale of equipment	165,000
Purchase of new machinery	(120,000)
Purchase of common stock	(55,000)
Net cash from investing activities	$(110,000)

Noncash investing activity:

Land in exchange for machinery	$35,000

2. The negative cash flow from investing can be covered using cash from operating and financing activities. Sources of cash for investment include operating cash flows and financing activities such as issuing bonds, issuing common stock, and taking out mortgages. Thus, it is important to know operating cash flows so that a decision can be made concerning the use of other forms of financing.

E 15-30

Cash flows from financing activities:

Sold preferred stock	$ 480,000
Borrowed from bank	575,000
Purchased treasury stock	(80,000)
Retired bonds	(400,000)
Net cash from financing activities	$ 575,000

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E 15-31

	2011	2012	Change
1. Cash	$24,600	$64,600	$40,000 (increase)

2.

Oliver Company
Operating Cash Flows
Indirect Method

Cash flows from operating activities:	
Net income	$40,000
Add (deduct) adjusting items:	
Increase in accounts receivable	(3,800)
Decrease in inventory	2,000
Depreciation expense	2,000
Increase in accounts payable	1,400
Net cash from operating activities	$41,600

3. Change in accounts receivable = Total operating cash flows – Operating cash flows without accounts receivable
= $41,000 − $45,400
= $(4,400)

Thus, accounts receivable increased by $4,400 and
Ending AR = Beg AR + Change in AR
= $5,400 + $4,400
= $9,800

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E 15-32

Oliver Company
Operating Cash Flows
Direct Method

Cash flows from operating activities:

	Income Statement	Adjustments	Cash Flows
Revenues	$ 75,000	$(3,800) *	$ 71,200
Cost of goods sold	(20,000)	2,000 **	
		1,400 ***	(16,600)
Depreciation expense	(2,000)	2,000	0
Other expenses	(13,000)		(13,000)
Net operating cash			$ 41,600

* Increase in Accounts Receivable.
** Increase in Inventory.
*** Increase in Accounts Payable.

E 15-33

a. Financing activities
b. Operating activities—added to net income
c. Operating activities—deducted from net income
d. Noncash financing/Investing activities
e. Operating activities—added to net income
f. Financing activities
g. Investing activities
h. Operating activities—added to net income
i. Operating activities—deducted from net income
j. Operating activities—deducted from net income
k. Investing activities
l. Operating activities—deducted from net income
m. Financing activities
n. Investing activities

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E 15-34

Cash flows from operating activities:	
Net income	$156,000
Add (deduct) adjusting items:	
Decrease in accounts payable	(20,000)
Increase in accounts receivable	(20,000)
Increase in wages payable	12,000
Increase in prepaid insurance	(24,000)
Decrease in inventory	200,000
Depreciation expense	100,000
Amortization of patent	20,000
Net cash from operating activities	$424,000

E 15-35

Piura Merchandising Corporation
Cash Flows from Operating Activities
For the Year Ended December 31, 2010
Direct Method

Cash flows from operating activities:

	Income Statement	Adjustments	Cash Flows
Revenues	$ 1,500,000	$ (20,000) *	$1,480,000
Cost of goods sold	(1,000,000)	200,000 **	
		(20,000) ***	(820,000)
Depreciation expense	(100,000)	100,000	-
Amortization of patent	(20,000)	20,000	-
Wages expense	(80,000)	12,000	(68,000)
Insurance expense	(40,000)	(24,000)	(64,000)
Income taxes	(104,000)		(104,000)
Net income	$ 156,000		
Net cash from operating activities			$ 424,000

* Increase in Accounts Receivable.
** Decrease in Inventory.
*** Decrease in Accounts Payable.

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PROBLEMS

P 15-36

Lunarica Corporation Statement of Cash Flows For the Year Ended December 31, 2012		
Cash flows from operating activities:		
Net income……………………………………………	$ 21,000	
Add (deduct) adjusting items:		
Decrease in accounts receivable…………………………	9,000	
Increase in inventory………………………………………	(9,000)	
Decrease in accounts payable……………………………	(13,200)	
Depreciation expense………………………………………	3,000	
Net cash from operating activities……………………		$10,800
Cash flows from financing activities:		
Sale of common stock………………………………………	$ 5,400	
Payment of dividends………………………………………	(5,700)	
Net cash from financing activities……………………		(300)
Net increase in cash…………………………………………		$10,500

P 15-37

Direct Method Lunarica Corporation Statement of Cash Flows For the Year Ended December 31, 2012			
Cash flows from operating activities:			
	Income Statement	Adjustments	Cash Flows
Revenues	$ 99,000	$ 9,000 *	$108,000
Cost of goods sold	(58,500)	(9,000) **	
		(13,200) ***	(80,700)
Operating expenses	(19,500)	3,000	(16,500)
Net cash from operating activities			$ 10,800
Cash flows from financing activities:			
Sale of common stock		5,400	
Payment of dividends		(5,700)	
Net cash from financing activities			(300)
Net increase in cash			$ 10,500

* Decrease in Accounts Receivable.
** Increase in Inventory.
*** Decrease in Accounts Payable.

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P 15-38

Roberts Company Statement of Cash Flows For the Year Ended September 30, 2012		
Cash flows from operating activities:		
Net loss…………………………………………………….	$ (800)	
Add (deduct) adjusting items:		
Increase in accounts receivable…………………………	(2,000)	
Decrease in inventories…………………………………..	2,800	
Decrease in accounts payable……………………………	(1,600)	
Decrease in wages payable………………………………	(400)	
Depreciation expense……………………………………	6,000	
Net cash from operating activities……………………		$ 4,000
Cash flows from investing activities:		
Purchase of equipment…………………………………		(20,000)
Net decrease in cash………………………………………….		$(16,000)

P 15-39

Roberts Company Operating Cash Flows For the Year Ended September 30, 2012				
Cash flows from operating activities:				
	Income Statement	Adjustments		Cash Flows
Revenues	$ 40,000	$(2,000)	*	$ 38,000
Cost of goods sold	(28,800)	2,800	**	-
		(1,600)	***	(27,600)
Wages expense	(4,000)	(400)		(4,400)
Advertising	(2,000)			(2,000)
Depreciation expense	(6,000)	6,000		-
Net cash from operating activities				$ 4,000

* Increase in Accounts receivable.
** Decrease in Inventory.
*** Decrease in Accounts payable.

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P 15-40

1. and 2.

Booth Manufacturing Statement of Cash Flows For the Year Ended December 31, 2012		
Cash flows from operating activities:		
Net income	$ 450,000	
Add (deduct) adjusting items:		
Decrease in accounts receivable	68,750	
Decrease in accounts payable	(62,500)	
Increase in inventories	(25,000)	
Depreciation expense	125,000	
Gain on sale of equipment	(50,000)	
Net cash from operating activities		$ 506,250
Cash flows from investing activities:		
Sale of equipment	$ 175,000	
Purchase of equipment*	(250,000)	
Purchase of land	(218,750)	
Net cash from investing activities		(293,750)
Cash flows from financing activities:		
Mortgage received	$ 250,000	
Dividends	(225,000)	
Net cash from financing activities		25,000
Net increase in cash		$ 237,500

*Beginning equipment	$1,000,000
Purchases	250,000
Less sales	(225,000)
Ending equipment	$1,025,000

3. Answers will vary.

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P 15-41

1. and 2.

Booth Manufacturing
Operating Cash Flows
For the Year Ended September 30, 2012

Cash flows from operating activities:

	Income Statement	Adjustments	Cash Flows
Revenues	$1,200,000	$ 68,750 [a]	$1,268,750
Gain on sale of equipment	50,000	(50,000)	-
Cost of goods sold	(640,000)	(25,000) [b]	
		(62,500) [c]	(727,500)
Depreciation expense[d]	(125,000)	125,000	-
Interest expense	(35,000)	-	(35,000)
Net cash from operating activities			$ 506,250

[a]Decrease in Accounts receivable.
[b]Increase in Inventory.
[c]Decrease in Accounts payable.

[d]Beginning equipment	$1,000,000
Purchases	250,000
Less sales	$ (225,000)
Ending equipment	$1,025,000

P 15-42

1. a. Indirect Method:

Cash flows from operating activities:		
Net income………………………………………	$122,400	
Add (deduct) adjusting items:		
Increase in accounts receivable………………	(18,000)	
Increase in accounts payable…………………	18,000	
Depreciation expense*…………………………	19,800	
Loss on sale of equipment……………………	1,800	
Net cash from operating activities…………		$144,000

*Beginning accumulated depreciation	$54,000
Depreciation expense	19,800
Less accumulated depreciation for asset sold	(16,200)
Ending accumulated depreciation	$ 57,600

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P 15-42 (Continued)

b. Direct Method:

	Income Statement	Adjustments	Cash Flows
Revenues	$ 920,000	$(18,000)	$ 902,000
Cost of goods sold	(620,000)	18,000	(602,000)
Operating expenses	(177,600)	19,800	
		1,800	(156,000)
Net cash from operating activities			$ 144,000

2.

Rosie-Lee Company
Statement of Cash Flows
For the Year Ended June 30, 2012

Cash flows from operating activities:		
Net income…………………………………………	$ 122,400	
Add (deduct) adjusting items:		
Increase in accounts receivable………………	(18,000)	
Increase in accounts payable…………………	18,000	
Depreciation expense*…………………………	19,800	
Loss on sale of equipment……………………	1,800	
Net cash from operating activities…………		$144,000
Cash flows from investing activities:		
Sale of equipment……………………………..	$ 3,600	
Purchase of investments………………………	(54,000)	
Purchase of equipment**………………………	(30,600)	
Purchase of land………………………………	(18,000)	
Net cash from investing activities…………		(99,000)
Cash flows from financing activities:		
Retirement of mortgage………………………	$(108,000)	
Issuance of bonds………………………………	90,000	
Retirement of preferred stock…………………	(36,000)	
Payment of dividends…………………………	(36,000)	
Issuance of common stock……………………	108,000	
Net cash from financing activities…………		18,000
Net increase in cash……………………………….		$ 63,000

* Beginning accumulated depreciation	$ 54,000
Depreciation expense	19,800
Less accumulated depreciation for asset sold	(16,200)
Ending accumulated depreciation	$ 57,600

** Beginning equipment	$180,000
Purchases	30,600
Less sales	(21,600)
Ending equipment	$189,000

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P 15-43

Worksheet: Rosie-Lee Company						
	Beginning Balance		Transaction Debit		Transaction Credit	Ending Balance
Assets:						
Cash	$270,000	(1)	$ 63,000			$333,000
Accounts receivable	126,000	(2)	18,000			144,000
Investments	-	(3)	54,000			54,000
Plant and equipment	180,000	(4)	30,600	(5)	$ 21,600	189,000
Accumulated depreciation	(54,000)	(5)	16,200	(6)	19,800	(57,600)
Land	36,000	(7)	18,000			54,000
Total assets	$558,000					$716,400
Liabilities and equity:						
Accounts payable	$ 72,000			(8)	18,000	$ 90,000
Mortgage payable	108,000	(9)	108,000			-
Bonds payable	-			(10)	90,000	90,000
Preferred stock	36,000	(11)	36,000			-
Common stock	180,000			(12)	108,000	288,000
Retained earnings	162,000	(13)	36,000	(14)	122,400	248,400
Total liabilities and equity	$558,000					$716,400
Cash flows from operating activities:						
Net income (loss)		(14)	122,400			
Increase in accounts receivable				(2)	18,000	
Increase in account payable		(8)	18,000			
Depreciation expense		(6)	19,800			
Loss on sale of equipment		(5)	1,800			
Cash flows from investing activities:						
Sale of equipment		(5)	3,600			
Purchase of equipment				(4)	30,600	
Purchase of land				(7)	18,000	
Purchase of investments				(3)	54,000	
Cash flows from financing activities:						
Retirement of mortgage				(9)	108,000	
Retirement of preferred stock				(11)	36,000	
Issuance of bonds		(10)	90,000			
Issuance of common stock		(12)	108,000			
Payment of dividends				(13)	36,000	
Net increase in cash				(1)	63,000	

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P 15-43 (Continued)

Rosie-Lee Company Statement of Cash Flows For the Year Ended June 30, 2012		
Cash flows from operating activities:		
Net income	$ 122,400	
Add (deduct) adjusting items:		
Increase in accounts receivable	(18,000)	
Increase in accounts payable	18,000	
Depreciation expense	19,800	
Loss on sale of equipment	1,800	
Net cash from operating activities		$144,000
Cash flows from investing activities:		
Sale of equipment	$ 3,600	
Purchase of investments	(54,000)	
Purchase of equipment	(30,600)	
Purchase of land	(18,000)	
Net cash from investing activities		(99,000)
Cash flows from financing activities:		
Retirement of mortgage	$(108,000)	
Issuance of bonds	90,000	
Retirement of preferred stock	(36,000)	
Payment of dividends	(36,000)	
Issuance of common stock	108,000	
Net cash from financing activities		18,000
Net increase in cash		$ 63,000

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P 15-44

Brierwold Corporation
Statement of Cash Flows

Cash flows from operating activities:		
Net loss…………………………………………………	$ (15,000)	
Add (deduct) adjusting items:		
Decrease in accounts receivable………………………	20,000	
Increase in inventory…………………………………	(10,000)	
Decrease in accounts payable…………………………	(50,000)	
Depreciation expense…………………………………	80,000 *	
Gain on sale of equipment……………………………	(15,000)	
Net cash from operating activities…………………		$ 10,000
Cash flows from investing activities:		
Sale of equipment………………………………………	$ 40,000	
Purchase of equipment…………………………………	(50,000)	
Purchase of land………………………………………	(50,000)	
Net cash from investing activities		(60,000)
Cash flows from financing activities:		
Retirement of preferred stock…………………………	$(110,000)	
Issuance of common stock……………………………	100,000	
Receipt of mortgage……………………………………	110,000	
Net cash from financing activities…………………		100,000
Net increase in cash………………………………………		$ 50,000 **

* Beginning accumulated depreciation	$200,000
Depreciation expense	80,000
Accumulated depreciation for asset sold	(35,000)
Ending accumulated depreciation	$245,000

** Change in cash flow:	
Cash ending balance	$150,000
Cash beginning balance	100,000
Increase	$ 50,000

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P 15-45

Worksheet: Brierwold Corporation						
	Beginning Balance		Transaction Debit		Transaction Credit	Ending Balance
Assets:						
Cash	$ 100,000	(1)	$ 50,000			$ 150,000
Accounts receivable	200,000			(2)	$ 20,000	180,000
Inventory	400,000	(3)	10,000			410,000
Plant and equipment	700,000	(4)	50,000	(5)	60,000	690,000
Accumulated depreciation	(200,000)	(5)	35,000	(6)	80,000	(245,000)
Land	100,000	(7)	50,000			150,000
Total assets	$1,300,000					$1,335,000
Liabilities and equity:						
Accounts payable	$ 300,000	(8)	50,000			$ 250,000
Mortgage	-			(9)	110,000	110,000
Preferred stock	100,000	(10)	100,000			-
Common stock	240,000			(11)	40,000	280,000
Paid-in capital in excess of par:	360,000				60,000	
Retained earnings	300,000	(10)	10,000			
		(12)	15,000			275,000
Total liabilities and equity	$1,300,000					$915,000
Cash flows from operating activities:						
Net loss				(12)	15,000	
Decrease in accounts receivable		(2)	20,000			
Increase in inventory				(3)	10,000	
Decrease in account payable				(8)	50,000	
Depreciation expense		(6)	80,000			
Gain on sale of equipment				(5)	15,000	
Cash flows from investing activities:						
Sale of equipment		(5)	40,000			
Purchase of equipment				(4)	50,000	
Purchase of land				(7)	50,000	
Cash flows from financing activities:						
Retirement of preferred stock				(10)	110,000	
Issuance of mortgage		(9)	110,000			
Issuance of common stock		(11)	100,000			
Net increase in cash				(1)	50,000	

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P 15-45 (Continued)

Brierwold Corporation
Statement of Cash Flows
At the Year Ended

Cash flows from operating activities:		
Net loss…………………………………………	$ (15,000)	
Add (deduct) adjusting items:		
Decrease in accounts receivable……………………	20,000	
Increase in inventory………………………………	(10,000)	
Decrease in accounts payable………………………	(50,000)	
Depreciation expense………………………………	80,000	
Gain on sale of equipment…………………………	(15,000)	
Net cash from operating activities………………		$ 10,000
Cash flows from investing activities:		
Sale of equipment…………………………………	$ 40,000	
Purchase of equipment……………………………	(50,000)	
Purchase of land……………………………………	(50,000)	
Net cash from investing activities………………		(60,000)
Cash flows from financing activities:		
Retirement of preferred stock………………………	$(110,000)	
Issuance of common stock…………………………	100,000	
Receipt of mortgage………………………………	110,000	
Net cash from financing activities………………		100,000
Net increase in cash……………………………………		$ 50,000 *

*Change in cash flow:	
Cash ending balance	$150,000
Cash beginning balance	100,000
Increase	$ 50,000

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P 15-46

Cash flows from operating activities:	
Net income…………………………………...……….	$ 17,500
Add (deduct) adjusting items:	
Increase in accounts receivable………………………	(10,000)
Increase in accounts payable…………………………	7,500
Decrease in wages payable……………………………	(3,000)
Decrease in prepaid insurance………………………	2,000
Discount amortization…………………………………	1,800
Depreciation expense…………………………………	60,000
Patent amortization……………………………………	20,000
Net cash from operating activities…………………	$ 95,800

P 15-47

1.

Golding Company
Statement of Cash Flows
For the Year Ended 2012

Cash flows from operating activities:		
Net income…………………………...……….	$ 25,000,000	
Add (deduct) adjusting items:		
Decrease in accounts receivable………………	5,000,000	
Decrease in accounts payable…………………	(5,000,000)	
Depreciation expense…………………………...	5,000,000	
Net cash from operating activities…………		$ 30,000,000
Cash flows from investing activities:		
Purchase of equipment…………………………		(10,000,000)
Cash flows from financing activities:		
Payment of dividends……………………………	$(10,000,000)	
Issuance of bonds………………………………	10,000,000	
Net cash from financing activities…………		-
Net increase in cash…………………………………		$ 20,000,000

2. First, some assessment of Lemmons's value is needed. The net worth of Lemmons as of 2012 is $640,000. What is the market value of these assets? The operating cash produced in 2012 was $202,500. Assuming that the operating cash flow will continue at that level, then the question becomes: How much is a perpetuity of $202,500 worth? At a discount rate of 10 percent, the value would be a little more than $2 million. Given that Golding has free (uncommitted) cash flows from operations of $20 million, it seems that Golding could easily finance the purchase of Lemmons.

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P 15-48

Blalock Company Statement of Cash Flows For the Year Ended December 31, 2012		
Cash flows from operating activities:		
Net income	$ 68,000	
Add (deduct) adjusting items:		
Increase in accounts receivable	(10,000)	
Increase in accounts payable	10,000	
Depreciation expense*	11,000	
Loss on sale of equipment	1,000	
Net cash from operating activities		$ 80,000
Cash flows from investing activities:		
Sale of equipment	$ 2,000	
Purchase of investments	(30,000)	
Purchase of equipment**	(17,000)	
Purchase of land	(10,000)	
Net cash from investing activities		(55,000)
Cash flows from financing activities:		
Retirement of bonds	$ (60,000)	
Receipt of mortgage	50,000	
Retirement of preferred stock	(20,000)	
Issuance of common stock	60,000	
Payment of dividends	(20,000)	
Net cash from financing activities		10,000
Net increase in cash		$ 35,000

* Beginning accumulated deprecation	$ 30,000
Depreciation expense	11,000
Less accumulated depreciation for asset sold	(9,000)
Ending accumulated depreciation	$ 32,000
** Beginning equipment	$100,000
Purchases	17,000
Less sales	(12,000)
Ending equipment	$105,000

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P 15-49

Worksheet: Blalock Company
For the Year Ended, December 31, 2012

	Beginning Balance		Transaction Debit		Transaction Credit	Ending Balance
Assets:						
Cash	$150,000	(1)	$35,000			$185,000
Accounts receivable	70,000	(2)	10,000			80,000
Investments	-	(3)	30,000			30,000
Plant and equipment	100,000	(4)	17,000	(5)	$12,000	105,000
Accumulated depreciation	(30,000)	(5)	9,000	(6)	11,000	(32,000)
Land	20,000	(7)	10,000			30,000
Total assets	$310,000					$398,000
Liabilities and equity:						
Accounts payable	$ 40,000			(8)	10,000	$ 50,000
Bonds payable	60,000	(9)	60,000			-
Mortgage Payable	-			(10)	50,000	50,000
Preferred stock	20,000	(11)	20,000			-
Common stock	100,000			(12)	60,000	160,000
Retained earnings	90,000	(13)	20,000	(14)	68,000	138,000
Total liabilities and equity	$310,000					$398,000
Cash flows from operating activities:						
Net income (loss)		(14)	68,000			
Depreciation expense		(6)	11,000			
Loss on sale of equipment		(5)	1,000			
Increase in accounts receivable				(2)	10,000	
Increase in account payable		(8)	10,000			
Cash flows from investing activities:						
Sale of equipment		(5)	2,000			
Purchase of equipment				(4)	17,000	
Purchase of land				(7)	10,000	
Purchase of investments				(3)	30,000	
Cash flows from financing activities:						
Retirement of bonds				(9)	60,000	
Retirement of preferred stock				(11)	20,000	
Receipt of mortgage		(10)	50,000			
Issuance of common stock		(12)	60,000			
Payment of dividends				(13)	20,000	
Net increase in cash				(1)	35,000	

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P 15-49 (Continued)

Blalock Company
Statement of Cash Flows
For the Year Ended December 31, 2012

Cash flows from operating activities:		
Net income…………………………………………	$ 68,000	
Add (deduct) adjusting items:		
Increase in accounts receivable………………….	(10,000)	
Increase in accounts payable……………………..	10,000	
Depreciation expense……………………………….	11,000	
Loss on sale of equipment…………………………	1,000	
Net cash from operating activities		$ 80,000
Cash flows from investing activities:		
Sale of equipment…………………………………..	$ 2,000	
Purchase of investments…………………………….	(30,000)	
Purchase of equipment……………………………..	(17,000)	
Purchase of land……………………………………..	(10,000)	
Net cash from investing activities……………..		(55,000)
Cash flows from financing activities:		
Retirement of bonds…………………………………	$(60,000)	
Receipt of mortgage……………………………………	50,000	
Retirement of preferred stock……………………..	(20,000)	
Issuance of common stock………………………..	60,000	
Payment of dividends……………………………….	(20,000)	
Net cash from financing activities……………..		10,000
Net increase in cash……………………………………		$ 35,000

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CASES

Case 15-50

1. a. Indirect method:

Net income	$32,000
Add (deduct) adjusting items:	
Increase in accounts receivable	(4,000)
Decrease in inventory	20,000
Increase in accounts payable	16,000
Decrease in wages payable	(1,600)
Loss on sale of equipment	6,000
Depreciation expense*	8,000
Net cash from operating activities	$76,400

*$48,000 – ($52,000 – $12,000) [The accumulated depreciation ($12,000) on the equipment sold must be removed.]

b. Direct method:

	Income Statement	Adjustments	Cash flows
Revenues	$ 320,000	$ (4,000) [a]	$ 316,000
Cost of goods sold	(200,000)	20,000 [b]	
		16,000 [c]	(164,000)
Operating expenses	(88,000)	(1,600) [d]	
		6,000 [e]	
		8,000 [f]	(75,600)
Net operating cash			$ 76,400

[a] Increase in Accounts receivable
[b] Decrease in Inventory
[c] Increase in Accounts payable
[d] Decrease in Wages payable
[e] Loss on sale of equipment
[f] Depreciation expense

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Case 15-50 (Continued)

2.

Piura Manufacturing
Statement of Cash Flows
For Year Ended June 30, 2012

Cash flows from operating activities:		
Net income…………………………………………	$32,000	
Add (deduct) adjusting items:		
Increase in accounts receivable……………………	(4,000)	
Decrease in inventory………………………………	20,000	
Increase in accounts payable………………………	16,000	
Decrease in wages payable…………………………	(1,600)	
Loss on sale of equipment…………………………	6,000	
Depreciation expense………………………………	8,000	
Net cash from operating activities………………		$76,400
Cash flows from investing activities:		
Sale of equipment…………………………………		6,000
Cash flows from financing activities:		
Reduction in bonds payable………………………	$ (8,000)	
Payment of dividends………………………………	(8,000)	
Issuance of preferred stock…………………………	8,000	
Net cash from financing activities………………		(8,000)
Net increase in cash………………………………		$74,400 *
Noncash investing and financing activities:		
Acquisition of equipment by issuing common stock………………………………		$32,000

*Computation of cash flow change:

	2011	2012	Net Change
Cash	$72,000	$146,400	$74,400

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Case 15-50 (Continued)

3. **Worksheet: Piura Manufacturing**
For the Year Ended, June 30, 2012

	Beginning Balance		Transaction Debit		Transaction Credit	Ending Balance
Assets:						
Cash	$ 72,000	(1)	$74,400			$146,400
Accounts receivable	44,000	(2)	4,000			48,000
Inventory	64,000			(3)	$20,000	44,000
Plant and equipment	104,000	(4)	32,000	(5)	24,000	112,000
Accumulated depreciation	(52,000)	(5)	12,000	(6)	8,000	(48,000)
Land	20,000					20,000
Total assets	$252,000					$322,400
Liabilities and equity:						
Accounts payable	$ 32,000			(7)	16,000	$ 48,000
Wages payable	4,000	(8)	1,600			2,400
Bonds payable	24,000	(9)	8,000			16,000
Preferred stock (no par)	4,000			(10)	8,000	12,000
Common stock	30,000			(11)	6,000	36,000
Paid-in capital in excess of par	50,000			(11)	26,000	76,000
Retained earnings	108,000	(12)	8,000	(13)	32,000	132,000
Total liabilities and equity	$252,000					$322,400
Cash flows from operating activities:						
Net income		(13)	32,000			
Increase in accounts receivable				(2)	4,000	
Decrease in inventory		(3)	20,000			
Increase in account payable		(7)	16,000			
Decrease in wages payable				(8)	1,600	
Depreciation expense		(6)	8,000			
Loss on sale of equipment		(5)	6,000			
Cash flows from investing accounts:						
Sale of equipment		(5)	6,000			
Cash flows from financing accounts:						
Reduction in bonds payable				(9)	8,000	
Payment of dividends				(12)	8,000	
Issuance of preferred stock		(10)	8,000			
Net increase in cash				(1)	74,400	
Noncash investing and financing activities:						
Equipment acquired with common stock		(11)	32,000	(4)	32,000	

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Case 15-50 (Continued)

Piura Manufacturing
Statement of Cash Flows
For the Year Ended June 30, 2012

Cash flows from operating activities:		
Net income…………………………………….…………	$32,000	
Add (deduct) adjusting items:		
Increase in accounts receivable………………………	(4,000)	
Decrease in inventory…………………………………	20,000	
Increase in accounts payable………………………..	16,000	
Decrease in wages payable…………………………..	(1,600)	
Loss on sale of equipment……………………………	6,000	
Depreciation expense…………………………………	8,000	
Net cash from operating activities…………………		$76,400
Cash flows from investing activities:		
Sale of equipment…………………………………..….		6,000
Cash flows from financing activities:		
Reduction in bonds payable…………………………	$ (8,000)	
Payment of dividends…………………………………..	(8,000)	
Issuance of preferred stock…………………………	8,000	
Net cash from financing activities…………………		(8,000)
Net increase in cash………………………………………		$74,400
Noncash investing and financing activities:		
Acquisition of equipment by issuing common stock…………………………………..…….		$32,000

4. Although answers may vary, the group should mention that the direct method provides much more information for investors (a detailed, line-by-line conversion of the income statement plus the indirect method), allowing them to better assess firm value. However, presenting the direct method requires more effort on the part of the firm, and thus costs more to prepare. Further, while disclosing more information may help investors, it also may help competitors.

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Case 15-51

1. **The intent of the owner is to acquire extra operating cash through an arrangement that essentially provides a side payment by the contractor in order to acquire the business. Since the cost of construction is fuzzy to begin with, the bank will not likely know that the cost is out of line. Furthermore, it is very likely that the contractor is not returning any of its profit but is simply increasing the cost of the business by the 5 percent that Fred is seeking. In effect, Fred is borrowing the 5 percent for short-term operating needs (without the bank's knowledge). Thus, the arrangement is a deception and is not consistent with ethical behavior.**

2. **Delivering the large order early and reporting it as a cash sale and at the same time writing off other receivables as collected and borrowing money on the side from Bill (which would not appear on the balance sheet either) in order to improve the reported cash position of the firm is fraudulent behavior. It is a misrepresentation of the firm's economic strength to obtain a loan that might otherwise not be given. The degree of risk is concerned with the likelihood of getting caught—not with what is right or wrong. It should have no bearing on the decision.**

3. **The standards that would be violated should Karla agree to Fred's scheme: Management accountants have a responsibility to: "Provide decision support information and recommendations that are accurate, clear, concise, and timely" (I-3); "Refrain from engaging in or supporting any activity that would discredit the profession" (III-3); "Communicate information fairly and objectively" (IV-1); "Disclose fully all relevant information that could reasonably be expected to influence an intended user's understanding of the reports" (IV-2).**

4. **Should Fred insist on implementing the plan, then consultation with the Board of Directors (if one exists) or owners is mandated. If this brings no resolution of the ethical conflict, then resignation is in order. If resignation is the outcome, then consultation with a lawyer may be needed since fraud may be present. If Fred is willing to consider other, ethical solutions, then no action is needed.**

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