CHAPTER 16
STATEMENT OF CASH FLOWS

DISCUSSION QUESTIONS

1. The primary advantage of the direct method is that it directly reports cash receipts and cash payments in the statement of cash flows. Its primary disadvantage is that these data may not be readily available in the accounting records. Thus, the direct method is normally more costly to prepare and, as a result, is used infrequently in practice.

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. It would be reported in a separate schedule of noncash investing and financing activities accompanying the statement of cash flows. This section usually appears at the bottom of 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 merchandise 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 (used for) financing activities—issuance of bonds, $1,960,000 ($2,000,000 × 98%)

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 total amount reported as the net cash flow from operating activities is not affected by the use of the direct or indirect method.

10. Cash received from customers, cash payments for merchandise, cash payments for operating expenses, cash payments for interest, and cash payments for income taxes.

PRACTICE EXERCISES

PE 16-1A

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

PE 16-1B

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

PE 16-2A

Net income	$224,500
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation	11,575
Amortization of patents	2,500
Loss from sale of land	3,400
Net cash flow from operating activities	$241,975

PE 16-2B

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	(18,750)
Net cash flow from operating activities	$168,250

PE 16-3A

Net income	$320,000
Adjustments to reconcile net income to net cash flow from operating activities:	
Changes in current operating assets and liabilities:	
Decrease in accounts receivable	4,500
Increase in inventory	(4,050)
Increase in accounts payable	2,200
Net cash flow from operating activities	$322,650

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

PE 16-3B

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

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

PE 16-4A

Cash flows from operating activities:		
Net income	$490,000	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	52,000	
Gain on disposal of equipment	(26,500)	
Changes in current operating assets and liabilities:		
Decrease in accounts receivable	32,400	
Decrease in accounts payable	(12,350)	
Net cash flow from operating activities		$535,550

PE 16-4B

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	**8,960**	
Net cash flow from operating activities		**$339,200**

PE 16-5A

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

Loss on sale of land	**$ 45,000**

The purchase and sale of land are reported as part of cash flows from (used for) investing activities as shown below.

Cash received from sale of land	**110,000**
Cash paid for purchase of land	**(420,000)**

PE 16-5B

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

Gain on sale of land	**$ (40,000)**

The purchase and sale of land are reported as part of cash flows from (used for) investing activities as shown below.

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

PE 16-6A

Sales	**$480,000**
Increase in accounts receivable	**(54,000)**
Cash received from customers	**$426,000**

PE 16-6B

Sales	**$112,000**
Decrease in accounts receivable	**10,500**
Cash received from customers	**$122,500**

PE 16-7A

Cost of merchandise sold	$770,000
Decrease in inventories	(66,000)
Decrease in accounts payable	44,000
Cash paid for merchandise	$748,000

PE 16-7B

Cost of merchandise sold	$240,000
Increase in inventories	19,200
Increase in accounts payable	(12,000)
Cash paid for merchandise	$247,200

PE 16-8A

		Year 2	Year 1
a.	Net cash flow from operating activities	$ 294,000	$ 280,000
	Investments in fixed assets to replace existing capacity	(156,800)*	(176,400)**
	Free cash flow	$ 137,200	$ 103,600

* 70% × $224,000
** 70% × $252,000

b. The change in free cash flow from $103,600 to $137,200 represents an improvement.

PE 16-8B

		Year 2	Year 1
a.	Net cash flow from operating activities	$ 476,000	$ 455,000
	Investments in fixed assets to replace existing capacity	(341,600)*	(302,400)**
	Free cash flow	$ 134,400	$ 152,600

* 80% × $427,000
** 80% × $378,000

b. The change in free cash flow from $152,600 to $134,400 represents a decline.

EXERCISES

Ex. 16-1

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 reorganization items. This represents accrual basis expenses associated with the company's bankruptcy reorganization. These costs include severance packages and other costs that will be paid in cash at some point in the future.

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

AMERICAN AIRLINES GROUP, INC.
Cash Flows from Operating Activities
(Selected from Statement of Cash Flows)
(in millions)

Cash flows from operating activities:	
Net income (loss)	$(1,834)
Adjustments to reconcile net income (loss) to net cash flow	
provided by operating activities:	
Depreciation and amortization	1,020
Special items, noncash	95
Pension and postretirement	(154)
Deferred income taxes	(324)
Share based compensation	39
Reorganization items, noncash	2,112
Interest expense, noncash	181
Other, net	(76)
Changes in certain assets and liabilities:	
Decrease (increase) in accounts receivable	(93)
Decrease (increase) in other assets	(28)
Increase (decrease) in accounts payable	71
Increase (decrease) in air traffic liability	150
Increase (decrease) in loyalty program liability	38
Contributions to pension plans	(494)
Increase (decrease) in other liabilities	(28)
Net cash flows from operating activities	$ 675

Ex. 16-2

a. **Cash payment, $411,000**
b. **Cash receipt, $440,000**
c. **Cash receipt, $60,000**
d. **Cash payment, $650,000**
e. **Cash payment, $50,000**
f. **Cash receipt, $490,000**
g. **Cash payment, $500,000**
h. **Cash payment, $1,320,000***

* 880,000 shares outstanding × $1.50
880,000 shares outstanding = 1,000,000 shares issued – 120,000 treasury stock shares

Ex. 16-3

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

Ex. 16-4

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

Ex. 16-5

a. Cash flows from operating activities:

Net income	**$73,600**	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	**27,400**	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	**(8,000)**	
Decrease in merchandise inventory	**4,500**	
Decrease in prepaid expenses	**2,250**	
Increase in accounts payable	**5,000**	
Decrease in wages payable	**(900)**	
Net cash flow from operating activities		**$103,850**

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. 16-6

a. Cash flows from operating activities:

Net income	**$185,000**	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	**96,000**	
Changes in current operating assets and liabilities:		
Decrease in accounts receivable	**5,450**	
Increase in inventories	**(11,200)**	
Decrease in prepaid expenses	**900**	
Decrease in accounts payable	**(18,500)**	
Increase in salaries payable	**3,200**	
Net cash flow from operating activities		**$260,850**

b. Yes. The amount of net cash flow from operating activities reported on the statement of cash flows is not affected by the method of reporting such flows. The net amount of all three sections: operating, investing, and financing will be the same regardless of which method is used.

Ex. 16-7

a. Cash flows from operating activities:

Net income	**$620,000**	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	**65,000**	
Gain on disposal of equipment	**(27,500)**	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	**(11,200)**	
Decrease in inventory	**6,350**	
Decrease in prepaid insurance	**1,200**	
Decrease in accounts payable	**(4,200)**	
Increase in income taxes payable	**1,650**	
Net cash flow from operating activities		**$651,300**

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. 16-8

Dividends declared	**$585,000**
Decrease in dividends payable	**21,375***
Dividends paid to stockholders during the year	**$606,375**

*** $167,625 – $146,250**

Ex. 16-9

Cash flows from (used for) investing activities:

Cash received from sale of equipment……	**$101,250**

The loss on the sale, $16,875 ($101,250 proceeds from sale less $118,125* 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 was used.

* **$202,500 – $84,375**

Ex. 16-10

Cash flows from (used for) investing activities:

Cash received from sale of equipment……	**$132,500**

The loss on the sale, $7,500 ($132,500 proceeds from sale less $140,000* 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 was used.

* **$200,000 – $60,000**

Ex. 16-11

Cash flows from (used for) investing activities:

Cash from sale of land……	**$ 95,550**
Cash used for purchase of land……	**(104,300)**

The gain on the sale of land, $31,710*, would be deducted from net income in determining the cash flows from operating activities if the indirect method of reporting cash flows from operations was used.

* **$63,840 Cost of land – $95,550**

Ex. 16-12

Cash flows from (used for) financing activities:

Cash from sale of common stock……	**$1,920,000***
Cash used for dividends……	**(463,200)**

* **$1,200,000 + $720,000**

A stock dividend does not involve the receipt or payment of cash.

Note: **It could be disclosed in a note since it involves the issuance of additional stock.**

Ex. 16-13

Cash flows from (used for) investing activities:	
Cash used for purchase of land	**$(246,000)**

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**

Ex. 16-14

Cash flows from (used for) financing activities:	
Cash from issuing bonds payable	**$420,000***
Cash used to redeem bonds payable	**138,000**

Note: **The noncash discount amortization of $2,625 would be shown as an adjusting item (increase) in the Cash flows from operating activities section under the indirect method.**

* **$450,000 – $30,000**

Ex. 16-15

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	**13,200**	**38,170**
			$395,670
Deduct:	**Depreciation**	**$(29,480)**	
	Decrease in inventories	**(19,140)**	
	Increase in accounts payable	**(5,280)**	**(53,900)**
Net income, per income statement			**$341,770**

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. 16-15 (Concluded)

b. **Curwen's net income differed from cash flows from operations because of the following:**

- **$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. 16-16

a.

Cash flows from operating activities:		
Net income	$49,311	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	11,580	
Gain on disposal of property	(1,188)	
Other items involving noncash expense	1,383	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	(1,746)	
Decrease in inventory	990	
Increase in prepaid expenses	(605)	
Decrease in accounts payable and other current liabilities	(1,705)	
Net cash flow from operating activities		$58,020

b. **National Beverage is doing well financially. The company has positive earnings and positive net cash flow from operating activities. The slight increase in accounts receivable is reasonable variation and not concerning. The slight decrease in inventory is not significant. In addition, the company is using its cash to decrease its accounts payable balance, which indicates that the company is generating enough cash from operations to pay for its inventory in cash. This is a healthy trend.**

Ex. 16-17

a.

OLSON-JONES INDUSTRIES INC. Statement of Cash Flows For the Year Ended December 31, 20Y2		
Cash flows from operating activities:		
Net income	$ 62	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	26	
Gain on sale of land	(40)	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	(6)	
Increase in inventories	(18)	
Increase in accounts payable	14	
Net cash flow from operating activities		$ 38
Cash flows from (used for) investing activities:		
Cash from sale of land	$120	
Cash used for purchase of equipment	(30)	
Net cash flow from investing activities		90
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 60	
Cash used for dividends*	(19)	
Net cash flow from financing activities		41
Increase (decrease) in cash		$169
Cash at the beginning of the year		14
Cash at the end of the year		$183

* $24 – $5 = $19

b. Olson-Jones Industries Inc.'s net income was more than the cash flows from operations because of the following:

- $26 of depreciation expense, which has no effect on cash.
- A $40 gain on the sale of land. The proceeds from this sale of $120, 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, $6 deducted
  Increase in inventories, $18 deducted
  Increase in accounts payable, $14 added

Ex. 16-18

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.**

Ex. 16-18 (Concluded)

A corrected statement of cash flows would be as follows:

SHASTA INC. Statement of Cash Flows For the Year Ended December 31, 20Y9		
Cash flows from operating activities:		
Net income	$ 360,000	
Adjustments to reconcile net income to		
net cash flow from operating activities:		
Depreciation	100,800	
Gain on sale of investments	(17,280)	
Changes in current operating assets		
and liabilities:		
Increase in accounts receivable	(27,360)	
Increase in inventories	(36,000)	
Increase in accounts payable	3,600	
Decrease in accrued expenses		
payable	(2,400)	
Net cash flow from operating activities		$ 381,360
Cash flows from (used for) investing activities:		
Cash from sale of investments	$ 240,000	
Cash used for purchase of land	(259,200)	
Cash used for purchase of equipment	(432,000)	
Net cash flow used for investing activities		(451,200)
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 312,000	
Cash used for dividends	(132,000)	
Net cash flow from financing activities		180,000
Increase (decrease) in cash		$ 110,160
Cash at the beginning of the year		240,000
Cash at the end of the year		$ 350,160

Ex. 16-19

a.	Sales	$753,500
	Decrease in accounts receivable balance	48,400
	Cash received from customers	$801,900
b.	Income tax expense	$50,600
	Decrease in income tax payable	5,500
	Cash payments for income taxes	$56,100

c. Because the customers 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. 16-20

Cost of merchandise sold*	$12,265
Increase in merchandise inventories	224
Decrease in accounts payable	260
Cash paid for merchandise	$12,749

* In millions

Ex. 16-21

a.	Cost of merchandise sold	$1,031,550
	Decrease in accounts payable	9,660
	Decrease in inventories	(15,410)
	Cash payments for merchandise	$1,025,800
b.	Operating expenses other than depreciation	$179,400
	Decrease in accrued expenses payable	1,380
	Cash payments for operating expenses	$180,780

Ex. 16-22

a. Cash flows from (used for) operating activities:

Cash received from customers	$ 522,760[1]	
Cash payments for merchandise	(302,400)[2]	
Cash payments for operating expenses	(99,960)[3]	
Cash payments for income taxes	(24,360)[4]	
Net cash flow from operating activities		$ 96,040

Computations:

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

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. 16-23

Cash flows from operating activities:

Cash received from customers	**$ 440,440[1]**	
Cash payments for merchandise	**(161,260)[2]**	
Cash payments for operating expenses	**(115,720)[3]**	
Cash payments for income taxes	**(39,600)**	
Net cash flow from operating activities		**$123,860**

Computations:

1.	**Sales**	**$445,500**
	Increase in accounts receivable	**(5,060)**
	Cash received from customers	**$440,440**
2.	**Cost of merchandise sold**	**$154,000**
	Increase in inventories	**12,100**
	Increase in accounts payable	**(4,840)**
	Cash payments for merchandise	**$161,260**
3.	**Operating expenses other than depreciation**	**$115,280**
	Decrease in accrued expenses payable	**1,760**
	Decrease in prepaid expenses	**(1,320)**
	Cash payments for operating expenses	**$115,720**

Ex. 16-24

a.	**Cash flows from investment in PPE**	**$ 210,000**
	Replacement percentage	**75%**
	Cash paid for maintaining property, plant, and equipment	**$ 157,500**
	Cash flows from operating activities	**$ 539,000**
	Cash paid for maintaining property, plant, and equipment	**(157,500)**
	Free cash flow	**$ 381,500**

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. 16-25

a.

	Recent Fiscal Year End (all numbers in thousands)*
Cash flows from investment in PPE	$ 1,143
Replacement percentage	90%
Cash paid for maintaining PPE	$ 1,029
Cash flows from operating activities	$ 3,096
Cash paid for maintaining PPE	(1,029)
	$ 2,067

* Rounded

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 well in excess of the capital expenditures necessary to maintain capacity.**

Ex. 16-26

Cash flows from investment in PPE	$ 440,000
Replacement percentage	85%
Cash paid for maintaining PPE	$ 374,000
Net cash flow from operating activities	$ 720,000
Investments in fixed assets to maintain current production	(374,000)
Free cash flow	$ 346,000

PROBLEMS

Prob. 16-1A

NAVARIA INC. Statement of Cash Flows For the Year Ended December 31, 20Y3		
Cash flows from operating activities:		
Net income	$ 500,000	
Adjustments to reconcile net income to		
net cash flow from operating activities:		
Depreciation*	100,000	
Gain on sale of investments	(75,000)	
Changes in current operating assets		
and liabilities:		
Increase in accounts receivable	(50,000)	
Increase in inventories	(20,000)	
Increase in accounts payable	40,000	
Decrease in accrued expenses		
payable	(5,000)	
Net cash flow from operating activities		$ 490,000
Cash flows from (used for) investing activities:		
Cash from sale of investments	$ 175,000	
Cash used for purchase of land	(500,000)	
Cash used for purchase of equipment	(200,000)	
Net cash flow used for investing activities		(525,000)
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 125,000	
Cash used for dividends**	(85,000)	
Net cash flow from financing activities		40,000
Increase (decrease) in cash		$ 5,000
Cash at the beginning of the year		150,000
Cash at the end of the year		$ 155,000

* Accumulated Depreciation: $600,000 – $500,000

** $90,000 + $25,000 – $30,000 = $85,000

Prob. 16-1A (Concluded)

(Optional)

NAVARIA INC. Spreadsheet (Work Sheet) for Statement of Cash Flows For the Year Ended December 31, 20Y3						
	Balance,	**Transactions**				**Balance,**
Account Title	**Dec. 31, 20Y2**	**Debit**		**Credit**		**Dec. 31, 20Y3**
Cash	150,000	(m)	5,000			155,000
Accounts receivable (net)	400,000	(l)	50,000			450,000
Inventories	750,000	(k)	20,000			770,000
Investments	100,000			(j)	100,000	—
Land	0	(i)	500,000			500,000
Equipment	1,200,000	(h)	200,000			1,400,000
Accum. depr.—equipment	(500,000)			(g)	100,000	(600,000)
Accounts payable	(300,000)			(f)	40,000	(340,000)
Accrued expenses payable	(50,000)	(e)	5,000			(45,000)
Dividends payable	(25,000)			(d)	5,000	(30,000)
Common stock, $4 par	(600,000)			(c)	100,000	(700,000)
Paid-in capital in excess						
of par—common stock	(175,000)			(c)	25,000	(200,000)
Retained earnings	(950,000)	(b)	90,000	(a)	500,000	(1,360,000)
Totals	0		870,000		870,000	0
Operating activities:						
Net income		(a)	500,000			
Depreciation		(g)	100,000			
Gain on sale of investments				(j)	75,000	
Increase in accounts						
receivable				(l)	50,000	
Increase in inventories				(k)	20,000	
Increase in accounts payable		(f)	40,000			
Decrease in accrued						
expenses payable				(e)	5,000	
Investing activities:						
Purchase of equipment				(h)	200,000	
Purchase of land				(i)	500,000	
Sale of investments		(j)	175,000			
Financing activities:						
Declaration of cash dividends				(b)	90,000	
Sale of common stock		(c)	125,000			
Increase in dividends payable		(d)	5,000			
Net increase in cash				(m)	5,000	
Totals			945,000		945,000	

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. 16-2A

YELLOW DOG ENTERPRISES INC. Statement of Cash Flows For the Year Ended December 31, 20Y8		
Cash flows from operating activities:		
Net income	$ 190,000	
Adjustments to reconcile net income to		
net cash flow from operating activities:		
Depreciation	115,000	
Changes in current operating assets		
and liabilities:		
Decrease in accounts receivable	25,000	
Increase in merchandise inventory	(110,000)	
Increase in prepaid expenses	(5,000)	
Increase in accounts payable	10,000	
Net cash flow from operating activities		$ 225,000
Cash flows from (used for) investing activities:		
Cash used for equipment	$(395,000)	
Net cash flow used for investing activities		(395,000)
Cash flows from (used for) financing activities:		
Cash from sale of common stock*	$ 600,000	
Cash used for dividends	(50,000)	
Cash used to retire mortgage note payable	(400,000)	
Net cash flow from financing activities		150,000
Increase (decrease) in cash		$ (20,000)
Cash at the beginning of the year		100,000
Cash at the end of the year		$ 80,000

* 40,000 shares × $15 = $600,000

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 $75,000 from the equipment and accumulated depreciation—equipment accounts.**

Prob. 16-2A (Concluded)

(Optional)

YELLOW DOG ENTERPRISES INC.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 20Y8

Account Title	Balance, Dec. 31, 20Y7	Transactions Debit		Transactions Credit		Balance, Dec. 31, 20Y8
Cash	100,000			(l)	20,000	80,000
Accounts receivable (net)	300,000			(k)	25,000	275,000
Merchandise inventory	400,000	(j)	110,000			510,000
Prepaid expenses	10,000	(i)	5,000			15,000
Equipment	750,000	(h)	395,000	(g)	75,000	1,070,000
Accum. depr.—equipment	(160,000)	(g)	75,000	(f)	115,000	(200,000)
Accounts payable	(90,000)			(e)	10,000	(100,000)
Mortgage note payable	(400,000)	(d)	400,000			—
Common stock, $10 par	(200,000)			(c)	400,000	(600,000)
Paid-in capital in excess						
of par—common stock	(100,000)			(c)	200,000	(300,000)
Retained earnings	(610,000)	(b)	50,000	(a)	190,000	(750,000)
Totals	0		1,035,000		1,035,000	0
Operating activities:						
Net income		(a)	190,000			
Depreciation		(f)	115,000			
Decrease in accts. receivable		(k)	25,000			
Increase in merchandise						
inventory				(j)	110,000	
Increase in prepaid expenses				(i)	5,000	
Increase in accounts payable		(e)	10,000			
Investing activities:						
Purchase of equipment				(h)	395,000	
Financing activities:						
Payment of cash dividends				(b)	50,000	
Sale of common stock		(c)	600,000			
Payment of mortgage note						
payable				(d)	400,000	
Net decrease in cash		(l)	20,000			
Totals			960,000		960,000	

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. 16-3A

WHITMAN CO. Statement of Cash Flows For the Year Ended December 31, 20Y2		
Cash flows from operating activities:		
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)
Cash flows from (used for) investing activities:		
Cash from land sold	$ 151,200	
Cash used for acquisition of building	(561,600)	
Cash used for purchase of equipment	(104,400)	
Net cash flow used for investing activities		(514,800)
Cash flows from (used for) financing activities:		
Cash from issuance of bonds payable	$ 270,000	
Cash from issuance of comon stock	400,000	
Cash used for dividends	(32,400)	
Net cash flow from financing activities		637,600
Increase (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

*** When a company has negative cash flow from operations, the total is described as net cash used for operating activities.

Prob. 16-3A (Concluded)

(Optional)

WHITMAN CO.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 20Y2

Account Title	Balance, Dec. 31, 20Y1	Transactions Debit		Transactions Credit		Balance, Dec. 31, 20Y2
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. 16-4A

CANACE PRODUCTS INC. Statement of Cash Flows For the Year Ended December 31, 20Y6		
Cash flows from operating activities:		
Cash received from customers[1]	$ 5,960,600	
Cash payments for merchandise[2]	(2,456,800)	
Cash payments for operating expenses[3]	(3,107,400)	
Cash payments for income taxes	(102,800)	
Net cash flow from operating activities		$ 293,600
Cash flows from (used for) investing activities:		
Cash from sale of investments	$ 176,000	
Cash used for purchase of land	(520,000)	
Cash used for purchase of equipment	(200,000)	
Net cash flow used for investing activities		(544,000)
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 240,000	
Cash used for dividends*	(25,600)	
Net cash flow from financing activities		214,400
Increase (decrease) in cash		$ (36,000)
Cash at the beginning of the year		679,400
Cash at the end of the year		$ 643,400

Schedule Reconciling Net Income with Cash Flows from Operating Activities:

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	$293,600

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

Prob. 16-4A (Concluded)

Computations:

1.	**Sales**	**$5,980,000**
	Increase in accounts receivable	**(19,400)**
	Cash received from customers	**$5,960,600**
2.	**Cost of merchandise sold**	**$2,452,000**
	Increase in inventories	**28,200**
	Increase in accounts payable	**(23,400)**
	Cash payments for merchandise	**$2,456,800**
3.	**Operating expenses other than depreciation**	**$3,100,000**
	Decrease in accrued expenses payable	**7,400**
	Cash payments for operating expenses	**$3,107,400**

Prob. 16-5A

NAVARIA INC. Statement of Cash Flows For the Year Ended December 31, 20Y3		
Cash flows from operating activities:		
Cash received from customers[1]	$ 2,950,000	
Cash payments for merchandise[2]	(1,380,000)	
Cash payments for operating expenses[3]	(955,000)	
Cash payments for income taxes	(125,000)	
Net cash flow from operating activities		$ 490,000
Cash flows from (used for) investing activities:		
Cash from sale of investments	$ 175,000	
Cash used for purchase of land	(500,000)	
Cash used for purchase of equipment	(200,000)	
Net cash flow used for investing activities		(525,000)
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 125,000	
Cash used for dividends[4]	(85,000)*	
Net cash flow from financing activities		40,000
Increase (decrease) in cash		$ 5,000
Cash at the beginning of the year		150,000
Cash at the end of the year		$ 155,000

Schedule Reconciling Net Income with Cash Flows from Operating Activities:

Cash flows from operating activities:	
Net income……	$500,000
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation……	100,000
Gain on sale of investments……	(75,000)
Changes in current operating assets and liabilities:	
Increase in accounts receivable……	(50,000)
Increase in inventories……	(20,000)
Increase in accounts payable……	40,000
Decrease in accrued expenses payable……	(5,000)
Net cash flow from operating activities……	$490,000

* Dividends paid = $25,000 + $90,000 – $30,000 = $85,000

Prob. 16-5A (Concluded)

Computations:

1.	**Sales**	**$3,000,000**
	Increase in accounts receivable	**(50,000)**
	Cash received from customers	**$2,950,000**
2.	**Cost of merchandise sold**	**$1,400,000**
	Increase in inventories	**20,000**
	Increase in accounts payable	**(40,000)**
	Cash payments for merchandise	**$1,380,000**
3.	**Operating expenses other than depreciation**	**$950,000**
	Decrease in accrued expenses payable	**5,000**
	Cash payments for operating expenses	**$955,000**
4.	**Cash dividends declared**	**$90,000**
	Deduct increase in dividends payable	**(5,000)**
	Cash payments for dividends	**$85,000**

Prob. 16-1B

MERRICK EQUIPMENT CO. Statement of Cash Flows For the Year Ended December 31, 20Y9		
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		$ 154,260
Cash flows from (used for) investing activities:		
Cash from sale of investments	$ 91,800	
Cash used for purchase of land	(295,800)	
Cash used for purchase of equipment	(80,580)	
Net cash flow used for investing activities		(284,580)
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 250,000	
Cash used for dividends**	(96,900)	
Net cash flow from financing activities		153,100
Increase (decrease) in cash		$ 22,780
Cash at the beginning of the year		47,940
Cash at the end of the year		$ 70,720

* $91,800 – $102,000 = $10,200 loss on sale of investment

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

Prob. 16-1B (Concluded)

(Optional)

MERRICK EQUIPMENT CO.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 20Y9

Account Title	Balance, Dec. 31, 20Y8	Transactions Debit		Transactions Credit		Balance, Dec. 31, 20Y9
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	—
Land	—	(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)
Totals	0		528,870		528,870	0
Operating activities:						
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			
Investing activities:						
Purchase of equipment				(h)	80,580	
Purchase of land				(i)	295,800	
Sale of investments		(j)	91,800			
Financing activities:						
Declaration of cash dividends				(b)	102,000	
Sale of common stock		(c)	250,000			
Increase in dividends payable		(d)	5,100			
Net increase in cash				(m)	22,780	
Totals			528,870		528,870	

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. 16-2B

HARRIS INDUSTRIES INC. Statement of Cash Flows For the Year Ended December 31, 20Y4		
Cash flows from operating activities:		
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
Cash flows from (used for) investing activities:		
Cash paid for construction of building	$(579,600)	
Net cash flow used for investing activities		(579,600)
Cash flows from (used for) financing activities:		
Cash from issuance of mortgage note	$ 224,000	
Cash used for dividends*	(123,480)	
Net cash flow from financing activities		100,520
Increase (decrease) in cash		$ 82,320
Cash at the beginning of the year		360,920
Cash at the end of the year		$ 443,240
Schedule of Noncash Financing and Investing Activities:		
Issuance of common stock to retire bonds		$ 390,000

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

Prob. 16-2B (Continued)

(Optional)

HARRIS INDUSTRIES INC.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 20Y4

Account Title	Balance, Dec. 31, 20Y3	Transactions Debit		Transactions Credit		Balance, Dec. 31, 20Y4
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	—			(e)	224,000	(224,000)
Bonds payable	(390,000)	(d)	390,000			—
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. 16-2B (Concluded)

HARRIS INDUSTRIES INC.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 20Y4

Account Title	Balance, Dec. 31, 20Y3	Transactions Debit	Transactions Credit	Balance, Dec. 31, 20Y4
Operating activities:				
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	
Investing activities:				
Construction of building			(l) 579,600	
Financial activities:				
Declaration of cash dividends			(b) 131,040	
Issuance of mortgage note				
payable		(e) 224,000		
Increase in dividends payable		(g) 7,560		
Schedule of noncash investing				
and financing activities:				
Issuance of common stock				
to retire bonds		(c) 390,000	(d) 390,000	
Net increase in cash			(p) 82,320	
Totals		1,360,200	1,360,200	

Prob. 16-3B

COULSON, INC. Statement of Cash Flows For the Year Ended December 31, 20Y2		
Cash flows from operating activities:		
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
Cash flows from (used for) investing activities:		
Cash from sale of land	$ 456,000	
Cash used for acquisition of building	(990,000)	
Cash used for purchase of equipment	(196,800)	
Net cash flow used for investing activities		(730,800)
Cash flows from (used for) financing activities:		
Cash from issuance of bonds payable	$ 330,000	
Cash from issuance of common stock	280,000	
Cash used for dividends	(79,200)	
Net cash flow from financing activities		530,800
Increase (decrease) in cash		$ (37,200)
Cash at the beginning of the year		337,800
Cash at the end of the year		$ 300,600

Prob. 16-3B (Concluded)

(Optional)

COULSON, INC.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 20Y2

Account Title	Balance, Dec. 31, 20Y1	Transactions Debit		Transactions Credit		Balance, Dec. 31, 20Y2
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	—			(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. 16-4B

MARTINEZ INC. Statement of Cash Flows For the Year Ended December 31, 20Y4		
Cash flows from operating activities:		
Cash received from customers[1]	$ 4,433,760	
Cash payments for merchandise[2]	(2,269,200)	
Cash payments for operating expenses[3]	(1,356,240)	
Cash payments for taxes	(299,100)	
Net cash flow from operating activities		$ 509,220
Cash flows from (used for) investing activities:		
Cash from sale of investments	$ 588,000	
Cash used for land	(960,000)	
Cash used for equipment	(240,000)	
Net cash flow used for investing activities		(612,000)
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 600,000	
Cash used for dividends*	(518,400)	
Net cash flow from financing activities		81,600
Increase (decrease) in cash		$ (21,180)
Cash at the beginning of the year		683,100
Cash at the end of the year		$ 661,920

Schedule Reconciling Net Income with Cash Flows from Operating Activities:

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……	$ 509,220

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

Prob. 16-4B (Concluded)

Computations:

1.	**Sales**	**$4,512,000**
	Increase in accounts receivable	**(78,240)**
	Cash received from customers	**$4,433,760**
2.	**Cost of merchandise sold**	**$2,352,000**
	Increase in inventories	**30,600**
	Increase in accounts payable	**(113,400)**
	Cash payments for merchandise	**$2,269,200**
3.	**Operating expenses other than depreciation**	**$1,344,840**
	Decrease in accrued expenses payable	**11,400**
	Cash payments for operating expenses	**$1,356,240**

Prob. 16-5B

MERRICK EQUIPMENT CO. Statement of Cash Flows For the Year Ended December 31, 20Y9		
Cash flows from operating activities:		
Cash received from customers[1]	$ 2,004,858	
Cash payments for merchandise[2]	(1,242,586)	
Cash payments for operating expenses[3]	(513,559)	
Cash payments for taxes	(94,453)	
Net cash flow from operating activities		$ 154,260
Cash flows from (used for) investing activities:		
Cash from sale of investments	$ 91,800	
Cash used for purchase of land	(295,800)	
Cash used for purchase of equipment	(80,580)	
Net cash flow used for investing activities		(284,580)
Cash flows from (used for) financing activities:		
Cash from sale of common stock	$ 250,000	
Cash used for dividends*	(96,900)	
Net cash flow from financing activities		153,100
Increase (decrease) in cash		$ 22,780
Cash at the beginning of the year		47,940
Cash at the end of the year		$ 70,720

Schedule Reconciling Net Income with Cash Flows from Operating Activities:

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	$154,260

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

Prob. 16-5B (Concluded)

Computations:

1.	**Sales**	**$2,023,898**
	Increase in accounts receivable	**(19,040)**
	Cash received from customers	**$2,004,858**
2.	**Cost of merchandise sold**	**$1,245,476**
	Increase in inventories	**8,670**
	Increase in accounts payable	**(11,560)**
	Cash payments for merchandise	**$1,242,586**
3.	**Operating expenses other than depreciation**	**$517,299**
	Increase in accrued expenses payable	**(3,740)**
	Cash payments for operating expenses	**$513,559**

CASES & PROJECTS

CP 16-1

Although this situation might seem harmless at first, it is, in fact, 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, and operating cash flow “undoes” the accounting accruals. Thus, unlike Lucas’s assertion that this information would be useful, more likely the information would 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 whether Lucas would 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 16-2

A sample solution based on Nike Inc.'s Form 10-K for the fiscal year ended May 31, 2016, follows:

1. **a. $3,096 million**
   b. $(1,034) million
   c. $(2,671) million
   d. $(714) million

2. **The company has a very strong cash position, generating considerably more cash flows from operations than it requires for investing or financing activities.**

CP 16-3

Memo

To: My Instructor
From: A+ Student
Re: Tidewater Inc. Financial Condition

Tidewater Inc. is a retailer that has been unprofitable in recent years. While the company has returned to profitability, there are several "red flags" indicating that the company's future prospects are highly uncertain. These red flags are discussed below.

- **The company has initiated a new marketing campaign that significantly increased the number of customers who are purchasing merchandise on credit using the company's branded credit card. This campaign significantly increased revenue and has helped the company return to profitability. However, it appears that the company has done a poor job of screening the creditworthiness of its new credit card customers. Increases in credit card purchases have resulted in a large accounts receivable balance. It is unlikely that the company will be able to collect a large portion of these accounts receivable, which will likely lead to a cash crisis.**
- **The purchases of deeply discounted merchandise appear to be backfiring. The company has received some "good deals" on price. However, the merchandise is only a "good deal" if the company can resell the merchandise at a profit. The large increase in inventory indicates that this is not the case. It appears that the merchandise has little customer appeal, and it is questionable whether the company will be able to sell the merchandise.**
- **The company has not been able to pay off its accounts payable in a timely manner, resulting in significant overdue accounts payable balances. While the company reports that most of the past-due payables have been paid, it is concerning that the company became overdue on its accounts payable. A retailer cannot afford a poor payment history, or it will be denied future merchandise shipments. This is a signal of a severe cash flow problem.**

These red flags suggest that the company is having severe operating cash flow difficulties, and the company's future prospects are highly uncertain.

CP 16-4

Start-up companies are unique in that they frequently 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 in a straightforward manner. Only actual sales will reveal whether the service is a hit. Until such a 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 16-5

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 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 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. Because 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.**

CP 16-5 (Concluded)

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 impacting 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 decision is made on a final loan.**

CP 16-6

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 $19.3 billion in cash flow from operations. This is enough to support more than $7.7 billion in investing activities, with cash left over to pay a sizable dividend and repurchase shares of common stock. Overall, the statement of cash flows indicates very favorable cash flows for J&J. J&J's free cash flow is approximately $15.9 billion for the year ($19.3 – $3.4).

JetBlue Airways Corp.

JetBlue is weaker than J&J. JetBlue had cash flows from operating activities of around $1.6 billion. In addition, JetBlue had net negative cash flows from investing activities of $1.1 billion. The net cash outflows from financing activities was $487 million and was used primarily to repay short- and long-term debt. JetBlue generated slightly more cash flow from operations than it needed to maintain the necessary investment in its fixed assets. Free cash flow is approximately $600 million ($1.6 – $1.0). JetBlue is in a much weaker cash flow position than Johnson & Johnson.

CP 16-6 (Continued)

JOHNSON & JOHNSON Consolidated Statements of Cash Flows For Period Ended December 31, 2015 (in millions)	
Cash flows from operating activities:	
Net earnings	**$ 15,409**
Adjustments to reconcile net earnings to cash flows:	
Depreciation and amortization of property and intangibles	**3,746**
Stock-based compensation	**874**
Venezuela adjustments	**122**
Asset write-downs and impairments	**624**
Net gain on sale of assets/businesses	**(2,583)**
Deferred tax provision	**(270)**
Accounts receivable allowances	**18**
Changes in assets and liabilities, net of effects from acquisitions:	
Increase in accounts receivable	**(433)**
Increase in inventories	**(449)**
(Decrease)/increase in accounts payable and accrued liabilities	**(3)**
(Decrease)/increase in other current and noncurrent assets	**65**
(Decrease)/increase in other current and noncurrent liabilities	**2,159**
Net cash flow from operating activities	**$ 19,279**
Cash flows from (used for) investing activities:	
Additions to property, plant, and equipment	**$ (3,463)**
Proceeds from the disposal of assets	**3,464**
Acquisitions, net of cash acquired	**(954)**
Purchases of investments	**(40,828)**
Sales of investments	**34,149**
Other (primarily intangibles)	**(103)**
Net cash used by investing activities	**$ (7,735)**
Cash flows from (used for) financing activities:	
Dividends to shareholders	**$ (8,173)**
Repurchase of common stock	**(5,290)**
Proceeds from short-term debt	**2,416**
Retirement of short-term debt	**(1,044)**
Proceeds from long-term debt	**75**
Retirement of long-term debt	**(68)**
Proceeds from the exercise of stock options	**1,295**
Other	**(57)**
Net cash used by financing activities	**$(10,846)**
Effect of exchange rate changes on cash and cash equivalents	**$ (1,489)**
Increase (decrease) in cash and cash equivalents	**$ (791)**
Cash and cash equivalents, beginning of year	**14,523**
Cash and cash equivalents, end of year	**$ 13,732**
Supplemental Schedule of Noncash Investing and Financing Activities:	
Treasury stock issued for employee compensation and	
stock option plans, net of cash proceeds	**$ 1,196**
Conversion of debt	**16**

CP 16-6 (Concluded)

JETBLUE AIRWAYS CORP. Consolidated Statements of Cash Flows For Period Ended December 31, 2015 (in millions)	
Cash flow from operating activities:	
Net income	$ 677
Adjustments to reconcile net income to net cash provided (used)	
by operating activities:	
Depreciation	288
Amortization	57
Stock-based compensation	20
Gains on sale of assets, debt extinguishment and customer	
contract termination	(11)
Deferred income taxes	377
Collateral returned (deposits) for derivative instruments	52
Changes in certain operating assets and liabilities:	
Decrease (increase) in receivables	11
Increase (decrease) in inventories, prepaid and other	(5)
Increase (decrease) in air traffic liability	80
Increase (decrease) accounts payable and other accrued liabilities	64
Other, net	(12)
Net cash from operating activities	$ 1,598
Cash flow from (used for) investing activities:	
Capital expenditures	$ (837)
Predelivery deposits for flight equipment	(104)
Purchase of held-to-maturity investments	(370)
Proceeds from maturity of held-to-maturity investments	313
Purchase of available-for-sale securities	(372)
Proceeds from sale of available-for-sale securities	242
Other, net	(6)
Net cash used for investing activities	$(1,134)
Cash flow from (used for) financing activities:	
Proceeds from:	
Issuance of common stock	$ 84
Issuance of long-term debt	—
Repayment of:	
Long-term debt and capital lease obligations	(328)
Short-term borrowings	—
Acquisition of treasury stock	(241)
Other, net	(2)
Net cash used for financing activities	$ (487)
Net increase (decrease) in cash	(23)
Cash at beginning of year	341
Cash at end of year	$ 318