CHAPTER 16
STATEMENT OF CASH FLOWS

DISCUSSION QUESTIONS

1. It is costly to accumulate the data needed and to prepare the statement of cash flows.

2. It focuses on the differences between net income and cash flows from operating activities, and the data needed are generally more readily available and less costly to obtain than is the case for the direct method.

3. In a separate schedule of noncash investing and financing activities accompanying 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 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, cash payments for income taxes.

PRACTICE EXERCISES

PE 16–1A

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

PE 16–1B

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

PE 16–2A

Net income	$120,400
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation	8,400
Amortization of patents	3,080
Loss from sale of land	4,480
Net cash flow from operating activities	$136,360

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	$207,000
Adjustments to reconcile net income to net cash flow from operating activities:	
Changes in current operating assets and liabilities:	
Decrease in accounts receivable	5,400
Increase in inventory	(2,520)
Increase in accounts payable	1,980
Net cash flow from operating activities	$211,860

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	$405,000	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	45,000	
Gain on disposal of equipment	(36,900)	
Changes in current operating assets and liabilities:		
Decrease in accounts receivable	25,200	
Decrease in accounts payable	(6,480)	
Net cash flow from operating activities		$431,820

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	$ 90,000

The purchase and sale of land is reported as part of cash flows from investing activities as shown below.

Cash received from sale of land	180,000
Cash paid for purchase of land	(540,000)

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 is reported as part of cash flows from investing activities as shown below.

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

PE 16–6A

Sales	$480,000
Deduct increase in accounts receivable	54,000
Cash received from customers	$426,000

PE 16–6B

Sales	$112,000
Add decrease in accounts receivable	10,500
Cash received from customers	$122,500

PE 16–7A

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

PE 16–7B

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

PE 16–8A

a.

Net cash flow from operating activities	$ 294,000	$ 280,000
Less: 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 from $103,600 to $137,200 indicates a positive trend.

PE 16–8B

a.

Net cash flow from operating activities	$ 476,000	$ 455,000
Less: 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 from $152,600 to $134,400 indicates a negative trend.

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 advanced ticket sales of $246 million. This represents an increase in unused, but paid, tickets (unearned revenue) between the two balance sheet dates. This is a significant item that is largely unique to the airline industry.

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

UNITED CONTINENTAL HOLDINGS, INC.
Cash Flows from Operating Activities
(Selected from Statement of Cash Flows)
(in millions)

CASH FLOWS FROM OPERATING ACTIVITIES	
Net income (loss)	$ (723)
Adjustments to reconcile net income (loss) to net cash flow	
provided by operating activities:	
Depreciation and amortization	1,522
Special charges	389
Debt and lease discount amortization	(247)
Share based compensation	14
Other, net	251
Changes in certain assets and liabilities:	
Decrease (increase) in accounts receivable	(21)
Decrease (increase) in other assets	(484)
Increase (decrease) in accounts payable	285
Increase (decrease) in advanced ticket sales	246
Increase (decrease) in frequent flyer deferred revenue	(712)
Increase (decrease) in other liabilities	415
Net cash flows from (used for) operating activities	$ 935

Ex. 16–2

- a. Cash payment, $525,000
- b. Cash receipt, $180,000
- c. Cash receipt, $117,500
- d. Cash payment, $322,000
- e. Cash payment, $75,000
- f. Cash receipt, $303,000
- g. Cash payment, $125,000
- h. Cash payment, $80,000

Ex. 16–3

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

Ex. 16–4

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

Ex. 16–5

a.

Net income	$400,000	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	16,000	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	(2,400)	
Decrease in merchandise inventory	4,000	
Increase in prepaid expenses	(1,200)	
Increase in accounts payable	4,000	
Decrease in wages payable	(2,800)	
Net cash flow from operating activities		$417,600

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	$320,000	
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	6,400	
Increase in inventories	(24,000)	
Decrease in prepaid expenses	1,600	
Decrease in accounts payable	(8,000)	
Increase in salaries payable	2,400	
Net cash flow from operating activities		$394,400

b. Yes. The amount of cash flows from operating activities reported on the statement of cash flows is not affected by the method of reporting such flows.

Ex. 16–7

a. **Cash flows from operating activities:**

Net income	$508,000	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	57,600	
Gain on disposal of equipment	(33,600)	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	(8,960)	
Decrease in inventory	5,120	
Decrease in prepaid insurance	1,920	
Decrease in accounts payable	(6,080)	
Increase in income taxes payable	1,410	
Net cash flow from operating activities		$525,410

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
Add decrease in dividends payable	21,375
Dividends paid to stockholders during the year	$606,375

Ex. 16–9

Cash flows from 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 is used.

Ex. 16–10

Cash flows from investing activities:	
Cash received from sale of equipment	**$37,200**

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

Ex. 16–11

Cash flows from investing activities:	
Cash received from sale of land	**$ 95,550**
Less: Cash paid 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 is used.

Ex. 16–12

Cash flows from financing activities:	
Cash received from sale of common stock	**$1,920,000**
Less: Cash paid for dividends	**463,200**

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

Ex. 16–13

Cash flows from investing activities:	
Cash paid 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 financing activities:	
Cash received from issuing bonds payable	$420,000
Less: Cash paid to redeem bonds payable	138,000

Note: The 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.

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:**

- **$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.

NATIONAL BEVERAGE CO. Cash Flows from Operating Activities (in thousands)		
Cash flows from operating activities:		
Net loss	$(43,993)	
Adjustments to reconcile net loss to net		
cash flow from operating activities:		
Depreciation	10,174	
Stock-based compensation expense (noncash)	290	
Losses on inventory write-down and fixed assets	7	
Changes in current operating assets and		
liabilities:		
Increase in accounts receivable	(5,679)	
Increase in inventory	(7,509)	
Decrease in prepaid expenses	2,239	
Decrease in accounts payable		
and other current liabilities	(1,341)	
Net cash flow from operating activities		$(45,812)

b. **National Beverage is doing well financially. The company has positive earnings and positive net cash flow from operating activities. The company continues to grow, and the trend in recent years has been positive. The increase in accounts receivable is a positive sign, indicating an increase in sales. The increase in inventory supports this trend. 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.

PELICAN JOE INDUSTRIES INC.
Statement of Cash Flows
For the Year Ended December 31, 2016

Cash flows from operating activities:		
Net income	$325	
Adjustments to reconcile net income to net cash flow from operating activities:		
Depreciation	30	
Gain on sale of land	(75)	
Changes in current operating assets and liabilities:		
Increase in accounts receivable	(80)	
Increase in inventories	(65)	
Increase in accounts payable	15	
Net cash flow from operating activities		$150
Cash flows from investing activities:		
Cash received from sale of land	$125	
Less cash paid for purchase of equipment	50	
Net cash flow from investing activities		75
Cash flows from financing activities:		
Cash received from sale of common stock	$175	
Less cash paid for dividends*	70	
Net cash flow from financing activities		105
Increase in cash		$330
Cash at the beginning of the year		160
Cash at the end of the year		$490

* $100 – $30 = $70

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

- $30 of depreciation expense, which has no effect on cash.
- A $75 gain on the sale of land. The proceeds from this sale of $125, 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, $80 deducted
  Increase in inventories, $65 deducted
  Increase in accounts payable, $15 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.**

7. **The "cash paid for dividends" should be preceded by "Less:".**

Ex. 16–18 (Concluded)

A correct statement of cash flows would be as follows:

SHASTA INC. Statement of Cash Flows For the Year Ended December 31, 2016			
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 investing activities:			
Cash received from sale of investments		$240,000	
Less: Cash paid for purchase of land	$259,200		
Cash paid for purchase of equip.	432,000	691,200	
Net cash flow used for investing activities			(451,200)
Cash flows from financing activities:			
Cash received from sale of common stock		$312,000	
Less: Cash paid for dividends		132,000	
Net cash flow from financing activities			180,000
Increase 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
Plus decrease in accounts receivable balance	48,400
Cash received from customers	$801,900

b.

Income tax expense	$ 50,600
Plus 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*	$11,625
Add increase in merchandise inventories	163
Deduct increase in accounts payable	(95)
Cash paid for merchandise	$11,693

*In millions

Ex. 16–21

a.

Cost of merchandise sold	$1,031,550
Add decrease in accounts payable	9,660
	$1,041,210
Deduct decrease in inventories	(15,410)
Cash payments for merchandise	$1,025,800

b.

Operating expenses other than depreciation	$ 179,400
Add decrease in accrued expenses payable	1,380
	$ 180,780
Deduct decrease in prepaid expenses	(1,610)
Cash payments for operating expenses	$ 179,170

Ex. 16–22

a. **Cash flows from operating activities:**

Cash received from customers		$522,760[1]	
Deduct: Cash payments for merchandise	$302,400[2]		
Cash payments for operating expenses	99,960[3]		
Cash payments for income taxes	24,360[4]	426,720	
Net cash flow from operating activities			$ 96,040

Computations:

1.	Sales		$511,000
	Add decrease in accounts receivable		11,760
	Cash received from customers		$522,760
2.	Cost of merchandise sold		$290,500
	Add: Increase in inventories	$3,920	
	Decrease in accounts payable	7,980	11,900
	Cash payments for merchandise		$302,400
3.	Operating expenses other than depreciation		$105,000
	Deduct: Decrease in prepaid expenses	$3,780	
	Increase in accrued expenses payable	1,260	5,040
	Cash payments for operating expenses		$ 99,960
4.	Income tax expense		$ 21,700
	Add 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]	
Deduct: Cash payments for merchandise	$161,260[2]		
Cash payments for operating expenses	115,720[3]		
Cash payments for income taxes	39,600	316,580	
Net cash flow from operating activities			$123,860

Computations:

1.	Sales	$445,500
	Deduct increase in accounts receivable	5,060
	Cash received from customers	$440,440
2.	Cost of merchandise sold	$154,000
	Add increase in inventories	12,100
		$166,100
	Deduct increase in accounts payable	4,840
	Cash payments for merchandise	$161,260
3.	Operating expenses other than depreciation	$115,280
	Add decrease in accrued expenses payable	1,760
		$117,040
	Deduct 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
	Less 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	$ 636
Replacement percentage	90%
Cash paid for maintaining PPE	$ 572
Cash flows from operating activities	$3,027
Less cash paid for maintaining PPE	(572)
	$2,455

*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 3.7 times greater than 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
Less investments in fixed assets to maintain current production	374,000
Free cash flow	$346,000

PROBLEMS

Prob. 16–1A

CROMME INC. Statement of Cash Flows For the Year Ended December 31, 2016			
Cash flows from operating activities:			
Net income		$ 199,540	
Adjustments to reconcile net income to			
net cash flow from operating activities:			
Depreciation		18,400	
Gain on sale of investments		(40,000)	
Changes in current operating assets			
and liabilities:			
Increase in accounts receivable		(18,880)	
Increase in inventories		(24,640)	
Increase in accounts payable		19,520	
Decrease in accrued expenses			
payable		(10,400)	
Net cash flow from operating activities			$ 143,540
Cash flows from investing activities:			
Cash received from sale of investments		$ 280,000	
Less: Cash paid for purchase of land	$328,000		
Cash paid for purchase of			
equipment	152,000	480,000	
Net cash flow used for investing activities			(200,000)
Cash flows from financing activities:			
Cash received from sale of common stock		$ 187,500	
Less cash paid for dividends*		91,200	
Net cash flow from financing activities			96,300
Increase in cash			$ 39,840
Cash at the beginning of the year			585,920
Cash at the end of the year			$ 625,760

* $96,000 + $19,200 – $24,000 = $91,200

Prob. 16–1A (Concluded)

(Optional)

CROMME INC.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 2016

Account Title	Balance, Dec. 31, 2015	Transactions Debit	Transactions Credit	Balance, Dec. 31, 2016
Cash	585,920	(m) 39,840		625,760
Accounts receivable (net)	208,960	(l) 18,880		227,840
Inventories	617,120	(k) 24,640		641,760
Investments	240,000		(j) 240,000	0
Land	0	(i) 328,000		328,000
Equipment	553,120	(h) 152,000		705,120
Accum. depr.—equipment	(148,000)		(g) 18,400	(166,400)
Accounts payable	(404,960)		(f) 19,520	(424,480)
Accrued expenses payable	(52,640)	(e) 10,400		(42,240)
Dividends payable	(19,200)		(d) 4,800	(24,000)
Common stock, $2 par	(100,000)		(c) 50,000	(150,000)
Paid-in capital in excess				
of par—common stock	(280,000)		(c) 137,500	(417,500)
Retained earnings	(1,200,320)	(b) 96,000	(a) 199,540	(1,303,860)
Totals	0	669,760	669,760	0
Operating activities:				
Net income		(a) 199,540		
Depreciation		(g) 18,400		
Gain on sale of investments			(j) 40,000	
Increase in accounts				
receivable			(l) 18,880	
Increase in inventories			(k) 24,640	
Increase in accounts payable		(f) 19,520		
Decrease in accrued				
expenses payable			(e) 10,400	
Investing activities:				
Purchase of equipment			(h) 152,000	
Purchase of land			(i) 328,000	
Sale of investments		(j) 280,000		
Financing activities:				
Declaration of cash dividends			(b) 96,000	
Sale of common stock		(c) 187,500		
Increase in dividends payable		(d) 4,800		
Net increase in cash			(m) 39,840	
Totals		709,760	709,760	

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

DEL RAY ENTERPRISES INC.
Statement of Cash Flows
For the Year Ended December 31, 2016

Cash flows from operating activities:			
Net income		$ 332,000	
Adjustments to reconcile net income to			
net cash flow from operating activities:			
Depreciation		83,400	
Changes in current operating assets			
and liabilities:			
Decrease in accounts receivable		17,400	
Increase in inventory		(22,400)	
Increase in prepaid expenses		(3,800)	
Increase in accounts payable		12,600	
Net cash flow from operating activities			$ 419,200
Cash flows from investing activities:			
Cash paid for equipment		$(162,800)	
Net cash flow used for investing			
activities			(162,800)
Cash flows from financing activities:			
Cash received from sale of common stock		$ 200,000	
Less: Cash paid for dividends	$153,600		
Cash paid to retire mortgage			
note payable	336,000	489,600	
Net cash flow used for financing			
activities			(289,600)
Decrease in cash			$ (33,200)
Cash at the beginning of the year			179,800
Cash at the end of the year			$ 146,600

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 $44,800 from the equipment and accumulated depreciation—equipment accounts.**

Prob. 16–2A (Concluded)

(Optional)

DEL RAY ENTERPRISES INC.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 2016

Account Title	Balance, Dec. 31, 2015	Transactions Debit		Transactions Credit		Balance, Dec. 31, 2016
Cash	179,800			(l)	33,200	146,600
Accounts receivable (net)	242,000			(k)	17,400	224,600
Merchandise inventory	299,200	(j)	22,400			321,600
Prepaid expenses	9,600	(i)	3,800			13,400
Equipment	537,000	(h)	162,800	(g)	44,800	655,000
Accum. depr.—equipment	(132,200)	(g)	44,800	(f)	83,400	(170,800)
Accounts payable	(237,600)			(e)	12,600	(250,200)
Mortgage note payable	(336,000)	(d)	336,000			0
Common stock, $25 par	(24,000)			(c)	50,000	(74,000)
Paid-in capital in excess						
of par—common stock	(320,000)			(c)	150,000	(470,000)
Retained earnings	(217,800)	(b)	153,600	(a)	332,000	(396,200)
Totals	0		723,400		723,400	0
Operating activities:						
Net income		(a)	332,000			
Depreciation		(f)	83,400			
Decrease in accts. receivable		(k)	17,400			
Increase in merchandise						
inventory				(j)	22,400	
Increase in prepaid expenses				(i)	3,800	
Increase in accounts payable		(e)	12,600			
Investing activities:						
Purchase of equipment				(h)	162,800	
Financing activities:						
Payment of cash dividends				(b)	153,600	
Sale of common stock		(c)	200,000			
Payment of mortgage note						
payable				(d)	336,000	
Net decrease in cash		(l)	33,200			
Totals			678,600		678,600	

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, 2016			
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 investing activities:			
Cash received from land sold		$151,200	
Less: Cash paid for acquisition			
of building	$561,600		
Cash paid for purchase			
of equipment	104,400	666,000	
Net cash flow used for investing activities			(514,800)
activities			
Cash flows from financing activities:			
Cash received from issuance of			
bonds payable	$270,000		
Cash received from issuance of			
common stock	400,000	$670,000	
Less cash paid for dividends		32,400	
Net cash flow from financing activities			637,600
Decrease in cash			$ (46,800)
Cash at the beginning of the year			964,800
Cash at the end of the year			$ 918,000

* $26,280 + $29,340

** $151,200 – $163,800

Prob. 16–3A (Concluded)

(Optional)

WHITMAN CO.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 2016

Account Title	Balance, Dec. 31, 2015	Transactions Debit		Transactions Credit		Balance, Dec. 31, 2016
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, 2016			
Cash flows from operating activities:			
Cash received from customers[1]		$5,960,600	
Deduct: Cash payments for merchandise[2]	$2,456,800		
Cash payments for operating expenses[3]	3,107,400		
Cash payments for income taxes	102,800	5,667,000	
Net cash flow from operating activities			$ 293,600
Cash flows from investing activities:			
Cash received from sale of investments		$ 176,000	
Less: Cash paid for purchase of land	$ 520,000		
Cash paid for purchase of equipment	200,000	720,000	
Net cash flow used for investing activities			(544,000)
Cash flows from financing activities:			
Cash received from sale of common stock		$ 240,000	
Less cash paid for dividends*		25,600	
Net cash flow from financing activities			214,400
Decrease in cash			$ (36,000)
Cash at the beginning of the year			679,400
Cash at the end of the year			$ 643,400

Reconciliation of Net Income with Cash Flows from Operating Activities:

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

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

Prob. 16–4A (Concluded)

Computations:

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

Prob. 16–5A

CROMME INC.
Statement of Cash Flows
For the Year Ended December 31, 2016

Cash flows from operating activities:			
Cash received from customers[1]		$5,353,679	
Deduct: Cash payments for merchandise[2]	$3,311,310		
Cash payments for operating			
expenses[3]	1,765,802		
Cash payments for income taxes	133,027	5,210,139	
Net cash flow from operating activities			$ 143,540
Cash flows from investing activities:			
Cash received from sale of investments		$ 280,000	
Less: Cash paid for purchase of land	$ 328,000		
Cash paid for purchase of equipment	152,000	480,000	
Net cash flow used for investing activities			(200,000)
Cash flows from financing activities:			
Cash received from sale of common stock		$ 187,500	
Less: Cash paid for dividends[4]		91,200	
Net cash flow from financing activities			96,300
Increase in cash			$ 39,840
Cash at the beginning of the year			585,920
Cash at the end of the year			$ 625,760

Reconciliation of Net Income with Cash Flows from Operating Activities:

Net income	$199,540
Adjustments to reconcile net income to net cash flow from operating activities:	
Depreciation	18,400
Gain on sale of investments	(40,000)
Changes in current operating assets and liabilities:	
Increase in accounts receivable	(18,880)
Increase in inventories	(24,640)
Increase in accounts payable	19,520
Decrease in accrued expenses payable	(10,400)
Net cash flow from operating activities	$143,540

Prob. 16–5A (Concluded)

Computations:

1.	Sales	$5,372,559
	Deduct increase in accounts receivable	18,880
	Cash received from customers	$5,353,679
2.	Cost of merchandise sold	$3,306,190
	Add increase in inventories	24,640
		$3,330,830
	Deduct increase in accounts payable	19,520
	Cash payments for merchandise	$3,311,310
3.	Operating expenses other than depreciation	$1,755,402
	Add decrease in accrued expenses payable	10,400
	Cash payments for operating expenses	$1,765,802
4.	Cash dividends declared	$ 96,000
	Deduct increase in dividends payable	4,800
	Cash payments for dividends	$ 91,200

Prob. 16–1B

MERRICK EQUIPMENT CO.
Statement of Cash Flows
For the Year Ended December 31, 2016

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 investing activities:			
Cash received from sale of investments		$ 91,800	
Less: Cash paid for purchase of land	$295,800		
Cash paid for purchase of			
equipment	80,580	376,380	
Net cash flow used for investing activities			(284,580)
Cash flows from financing activities:			
Cash received from sale of common stock		$250,000	
Less: Cash paid for dividends*		96,900	
Net cash flow from financing activities			153,100
Increase in cash			$ 22,780
Cash at the beginning of the year			47,940
Cash at the end of the year			$ 70,720

* $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, 2016

Account Title	Balance, Dec. 31, 2015	Transactions Debit		Transactions Credit		Balance, Dec. 31, 2016
Cash	47,940	(m)	22,780			70,720
Accounts receivable (net)	188,190	(l)	19,040			207,230
Inventories	289,850	(k)	8,670			298,520
Investments	102,000			(j)	102,000	0
Land	0	(i)	295,800			295,800
Equipment	358,020	(h)	80,580			438,600
Accum. depr.—equipment	(84,320)			(g)	14,790	(99,110)
Accounts payable	(194,140)			(f)	11,560	(205,700)
Accrued expenses payable	(26,860)			(e)	3,740	(30,600)
Dividends payable	(20,400)			(d)	5,100	(25,500)
Common stock, $1 par	(102,000)			(c)	100,000	(202,000)
Paid-in capital in excess of par—common stock	(204,000)			(c)	150,000	(354,000)
Retained earnings	(354,280)	(b)	102,000	(a)	141,680	(393,960)
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, 2016

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 investing activities:		
Cash paid for construction of building	$(579,600)	
Net cash flow used for investing activities		(579,600)
Cash flows from financing activities:		
Cash received from issuance of mortgage note	$ 224,000	
Less: Cash paid for dividends*	123,480	
Net cash flow from financing activities		100,520
Increase in cash		$ 82,320
Cash at the beginning of the year		360,920
Cash at the end of the year		$ 443,240
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, 2016

Account Title	Balance, Dec. 31, 2015	Transactions Debit		Transactions Credit		Balance, Dec. 31, 2016
Cash	360,920	(p)	82,320			443,240
Accounts receivable (net)	592,200	(o)	73,080			665,280
Inventories	1,022,560			(n)	134,680	887,880
Prepaid expenses	25,200	(m)	6,440			31,640
Land	302,400					302,400
Buildings	1,134,000	(l)	579,600			1,713,600
Accum. depr.—buildings	(414,540)			(k)	51,660	(466,200)
Machinery and equipment	781,200					781,200
Accum. depr.—machinery and equipment	(191,520)			(j)	22,680	(214,200)
Patents	112,000			(i)	5,040	106,960
Accounts payable	(927,080)	(h)	89,600			(837,480)
Dividends payable	(25,200)			(g)	7,560	(32,760)
Salaries payable	(87,080)	(f)	8,120			(78,960)
Mortgage note payable	0			(e)	224,000	(224,000)
Bonds payable	(390,000)	(d)	390,000			0
Common stock, $5 par	(50,400)			(c)	150,000	(200,400)
Paid-in capital in excess of par—common stock	(126,000)			(c)	240,000	(366,000)
Retained earnings	(2,118,660)	(b)	131,040	(a)	524,580	(2,512,200)
Totals	0		1,360,200		1,360,200	0

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

Prob. 16–2B (Concluded)

HARRIS INDUSTRIES INC. Spreadsheet (Work Sheet) for Statement of Cash Flows For the Year Ended December 31, 2016						
Account Title	Balance, Dec. 31, 2015	Transactions Debit		Transactions Credit		Balance, Dec. 31, 2016
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, 2016

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 investing activities:			
Cash received from sale of land		$ 456,000	
Less: Cash paid for acquisition			
of building	$990,000		
Cash paid for purchase			
of equipment	196,800	1,186,800	
Net cash flow used for investing activities			(730,800)
Cash flows from financing activities:			
Cash received from issuance of			
bonds payable	$330,000		
Cash received from issuance of			
common stock	280,000	$ 610,000	
Less cash paid for dividends		79,200	
Net cash flow from financing activities			530,800
Decrease in cash			$ (37,200)
Cash at the beginning of the year			337,800
Cash at the end of the year			$ 300,600

Prob. 16–3B (Concluded)

(Optional)

COULSON INC.
Spreadsheet (Work Sheet) for Statement of Cash Flows
For the Year Ended December 31, 2015

Account Title	Balance, Dec. 31, 2015	Transactions Debit		Transactions Credit		Balance, Dec. 31, 2016
Cash	337,800			(p)	37,200	300,600
Accounts receivable (net)	609,600	(i)	94,800			704,400
Inventories	865,800	(h)	52,800			918,600
Prepaid expenses	26,400			(g)	7,800	18,600
Land	1,386,000			(m)	396,000	990,000
Buildings	990,000	(l)	990,000			1,980,000
Accum. depr.—buildings	(366,000)			(f)	31,200	(397,200)
Equipment	529,800	(j)	196,800	(k)	66,000	660,600
Accum. depr.—equipment	(162,000)	(k)	66,000	(e)	37,200	(133,200)
Accounts payable	(631,200)	(d)	37,200			(594,000)
Income taxes payable	(21,600)			(c)	4,800	(26,400)
Bonds payable	0			(n)	330,000	(330,000)
Common stock, $20 par	(180,000)			(o)	140,000	(320,000)
Paid-in capital in excess of						
par—common stock	(810,000)			(o)	140,000	(950,000)
Retained earnings	(2,574,600)	(b)	79,200	(a)	326,600	(2,822,000)
Totals	0		1,516,800		1,516,800	0
Operating activities:						
Net income		(a)	326,600			
Depreciation—equipment		(e)	37,200			
Depreciation—buildings		(f)	31,200			
Gain on sale of land				(m)	60,000	
Increase in accts. receivable				(i)	94,800	
Increase in inventories				(h)	52,800	
Decrease in prepaid expenses		(g)	7,800			
Decrease in accounts payable				(d)	37,200	
Increase in income taxes						
payable		(c)	4,800			
Investing activities:						
Purchase of equipment				(j)	196,800	
Acquisition of building				(l)	990,000	
Sale of land		(m)	456,000			
Financing activities:						
Payment of cash dividends				(b)	79,200	
Issuance of bonds payable		(n)	330,000			
Issuance of common stock		(o)	280,000			
Net decrease in cash		(p)	37,200			
Totals			1,510,800		1,510,800	

Prob. 16–4B

MARTINEZ INC. Statement of Cash Flows For the Year Ended December 31, 2016			
Cash flows from operating activities:			
Cash received from customers[1]		$4,433,760	
Deduct: Cash payments for			
merchandise[2]	$2,269,200		
Cash payments for operating			
expenses[3]	1,356,240		
Cash payments for income tax	299,100	3,924,540	
Net cash flow from operating activities			$ 509,220
Cash flows from investing activities:			
Cash received from sale of investments		$ 588,000	
Less: Cash paid for land	$ 960,000		
Cash paid for equipment	240,000	1,200,000	
Net cash flow used for investing			
activities			(612,000)
Cash flows from financing activities:			
Cash received from sale of			
common stock		$ 600,000	
Less: Cash paid for dividends*		518,400	
Net cash flow from financing activities			81,600
Decrease in cash			$ (21,180)
Cash at the beginning of the year			683,100
Cash at the end of the year			$ 661,920

Reconciliation of Net Income with Cash Flows from Operating Activities:

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

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

Prob. 16–4B (Concluded)

Computations:

1.	Sales	$4,512,000
	Deduct increase in accounts receivable	78,240
	Cash received from customers	$4,433,760
2.	Cost of merchandise sold	$2,352,000
	Add increase in inventories	30,600
		$2,382,600
	Deduct increase in accounts payable	113,400
	Cash payments for merchandise	$2,269,200
3.	Operating expenses other than depreciation	$1,344,840
	Add 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, 2016			
Cash flows from operating activities:			
Cash received from customers[1]		$2,004,858	
Deduct: Cash payments for merchandise[2]	$1,242,586		
Cash payments for operating			
expenses[3]	513,559		
Cash payments for income taxes	94,453	1,850,598	
Net cash flow from operating activities			$ 154,260
Cash flows from investing activities:			
Cash received from sale of investments		$ 91,800	
Less: Cash paid for purchase of land	$ 295,800		
Cash paid for purchase of			
equipment	80,580	376,380	
Net cash flow used for investing			
activities			(284,580)
Cash flows from financing activities:			
Cash received from sale of			
common stock		$ 250,000	
Less: Cash paid for dividends*		96,900	
Net cash flow from financing activities			153,100
Increase in cash			$ 22,780
Cash at the beginning of the year			47,940
Cash at the end of the year			$ 70,720

Reconciliation of Net Income with Cash Flows from Operating Activities:

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

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

Prob. 16–5B (Concluded)

Computations:

1.	Sales	$2,023,898
	Deduct increase in accounts receivable	19,040
	Cash received from customers	$2,004,858
2.	Cost of merchandise sold	$1,245,476
	Add increase in inventories	8,670
		$1,254,146
	Deduct increase in accounts payable	11,560
	Cash payments for merchandise	$1,242,586
3.	Operating expenses other than depreciation	$ 517,299
	Deduct 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, while operating cash flow "undoes" the accounting accruals. Thus, unlike Lucas's assertion that this information would be useful, more likely the information could be confusing to users. Some users might not be able to distinguish between earnings and operating cash flow per share—or how to interpret the difference. By agreeing with Lucas, John has breached his professional ethics because the disclosure would violate generally accepted accounting principles. On a more subtle note, Lucas is being somewhat disingenuous. Apparently, Lucas is not pleased with this year's operating performance and would like to cover the earnings "bad news" with some cash flow "good news" disclosures. An interesting question is: Would Lucas be as interested in the dual per share disclosures in the opposite scenario—with earnings per share improving and cash flow per share deteriorating? Probably not.

CP 16–2

Start-up companies are unique in that they frequently will have negative retained earnings and operating cash flows. The negative retained earnings are often due to losses from high start-up expenses. The negative operating cash flows are typical because growth requires cash. Growth must be financed with cash before the cash returns. For example, a company must expend cash to provide the service in Period 1 before selling it and receiving cash in Period 2. The start-up company constantly faces the problem of spending cash today for the next period's growth. For Giraffe Inc., the money spent on salaries to develop the business is a cash outflow that must occur before the service provides revenues. In addition, the company must use cash to market its service to potential customers. In this situation, the only way the company stays in business is from the capital provided by the owners. This owner-supplied capital is the lifeblood of a start-up company. Banks will not likely lend money on this type of venture (except with assets as security). Giraffe Inc. could be a good investment. It all depends on whether the new service has promise. The financial figures will not reveal this easily. Only actual sales will reveal if the service is a hit. Until 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 16–3

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 should be reported in a separate schedule to the statement, even though they do not affect cash. Accordingly, even though the issuance of the common stock for land does not affect cash, the transaction affects future cash flows and must be reported.**

3. **The $180,000 cash received from the sale of the investments is reported in the Cash Flows from Investing Activities section. 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.**

4. **The balance sheets for the last two years will indicate the increase in cash but will not indicate the firm's activities in meeting its financial obligations, paying dividends, and maintaining and expanding operating capacity. Such information, as provided by the statement of cash flows, assists creditors in assessing the firm's solvency and profitability—two very important factors bearing on the evaluation of a potential loan.**

b. **The statement of cash flows indicates a strong liquidity position for Argon Inc. The increase in cash of $291,000 for the past year is more than adequate to cover the $150,000 of new building and store equipment costs that will not be provided by the loan. Thus, the statement of cash flows most likely will enhance the company's chances of receiving a loan. However, other information, such as a projection of future earnings, a description of collateral pledged to support the loan, and an independent credit report, would normally be considered before a final loan decision is made.**

CP 16–4

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

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

CP 16–5

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 $15.4 billion in cash flow from operations. This is enough to support more than $4.5 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 $12.5 billion for the year ($15.4 – $2.9).

JetBlue Airways Corp.

JetBlue is weaker than J&J. JetBlue had cash flows from operating activities of around $698 million. In addition, JetBlue had net negative cash flows from investing activities of $867 million. The net cash outflows from financing activities was $322 million, which primarily came from the issuance of short-term and long-term debt. JetBlue did not generate enough cash flow from operations to maintain the necessary investment in its fixed assets. Free cash flow is approximately ($127) million ($698 – $825). JetBlue is in a much weaker cash flow position than Johnson & Johnson.

CP 16–5 (Continued)

JOHNSON & JOHNSON Consolidated Statements of Cash Flows	
In Millions For Period Ended December 31, 2012	12/31/12
CASH FLOWS FROM OPERATING ACTIVITIES:	
Net earnings	$ 10,514
Adjustments to reconcile net earnings to cash flows:	
Depreciation and amortization of property and intangibles	3,666
Non-controlling interest	339
Asset write-downs and impairments	2,131
Stock based compensation	662
Deferred tax provision	(39)
Accounts receivable allowances	92
Changes in assets and liabilities, net of effects from acquisitions:	
Increase in accounts receivable	(9)
(Increase)/decrease in inventories	(1)
(Decrease)/increase in accounts payable and accrued liabilities	2,768
(Decrease)/increase in other current and noncurrent assets	(2,171)
(Decrease)/increase in other current and noncurrent liabilities	(2,555)
NET CASH FLOWS FROM OPERATING ACTIVITIES	$ 15,397
CASH FLOWS FROM INVESTING ACTIVITIES:	
Additions to property, plant and equipment	$ (2,934)
Proceeds from the disposal of assets	1,509
Acquisitions, net of cash acquired	(4,486)
Purchases of investments	(13,434)
Sales of investments	14,797
Other (primarily intangibles)	37
NET CASH USED BY INVESTING ACTIVITIES	$ (4,511)
CASH FLOWS FROM FINANCING ACTIVITIES:	
Dividends to shareholders	$ (6,614)
Repurchase of common stock	(12,919)
Proceeds from short-term debt	3,268
Retirement of short-term debt	(6,175)
Proceeds from long-term debt	45
Retirement of long-term debt	(804)
Proceeds from the exercise of stock options	2,720
Other	(83)
NET CASH USED BY FINANCING ACTIVITIES	$(20,562)
Effect of exchange rate changes on cash and cash equivalents	45
Increase in cash and cash equivalents	(9,631)
Cash and cash equivalents, beginning of year	24,542
CASH AND CASH EQUIVALENTS, END OF YEAR	$ 14,911
SUPPLEMENTAL SCHEDULE OF NONCASH INVESTING AND	
FINANCING ACTIVITIES	
Treasury stock issued for employee compensation and	
stock option plans, net of cash proceeds	433
Conversion of debt	1

CP 16–5 (Concluded)

JETBLUE AIRWAYS CORP. Consolidated Statements of Cash Flows 31-Dec-12	
In Millions For Period Ended December 31, 2012	12/31/12
Cash Flow from Operating Activities:	
Net income	$ 128
Adjustments to reconcile net income to net cash provided (used)	
by operating activities:	
Depreciation	230
Amortization	39
Stock-based compensation	13
Losses (Gains) on sale of flight equipment and extinguishment of debt	(17)
Deferred income taxes	76
Collateral returned (deposits) for derivative instruments	8
Changes in certain operating assets and liabilities:	
Decrease (increase) in receivables	1
Increase (decrease) in inventories, prepaid and other	38
Increase (decrease) in air traffic liability	66
Increase (decrease) accounts payable and other accrued liabilities	92
Other, net	24
Net cash (used) provided by operating activities	$ 698
Cash Flow from Investing Activities:	
Capital expenditures, including purchase deposits on flight equipment	$(541)
Predelivery deposits for flight equipment	(284)
Purchase of held-to-maturity investments	(444)
Proceeds from maturity of held-to-maturity investments	434
Purchase of available-for-sale securities	(532)
Sale of available-for-sale securities	438
Other	62
Net cash used for investing activities	$(867)
Cash Flow from Financing Activities:	
Proceeds from:	
Issuance of common stock	$ 9
Issuance of long-term debt	215
Short-term borrowings	375
Repayment of:	
Long-term debt and capital lease obligations	(418)
Short-term borrowings	(463)
Other	(40)
Net cash provided by financing activities	$(322)
Net increase in cash	(491)
Cash at beginning of year	673
Cash at end of year	$ 182