CHAPTER 17

The Statement of Cash Flows

ASSIGNMENT CLASSIFICATION TABLE

Study Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1. Indicate the usefulness of the statement of cash flows.	1, 2, 6, 15				
2. Distinguish among operating, investing, and financing activities.	3, 4, 5, 6, 7, 8, 9, 16	1, 2, 3	1, 2, 3	1A	1B
3. Prepare a statement of cash flows using the indirect method.	10, 11, 12, 13, 14	4, 5, 6, 7	4, 5, 6, 7, 8, 9	2A, 3A, 5A, 7A, 9A, 11A	2B, 3B, 5B, 7B, 9B, 11B
4. Analyze the statement of cash flows.		8, 9, 10, 11	7, 8, 9	7A, 8A	7B, 8B
*5. Explain how to use a worksheet to prepare the statement of cash flows using the indirect method.	17	12	10	12A	
*6. Prepare a statement of cash flows using the direct method.	8, 18, 19, 20, 21	13, 14, 15	11, 12, 13, 14	4A, 6A, 8A, 10A	4B, 6B, 8B, 10B

***Note:** All **asterisked** Questions, Exercises, and Problems relate to material contained in the appendix to the chapter.

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Distinguish among operating, investing, and financing activities.	Simple	10–15
2A	Determine cash flow effects of changes in equity accounts.	Simple	10–15
3A	Prepare the operating activities section—indirect method.	Simple	20–30
*4A	Prepare the operating activities section—direct method.	Simple	20–30
5A	Prepare the operating activities section—indirect method.	Simple	20–30
*6A	Prepare the operating activities section—direct method.	Simple	20–30
7A	Prepare a statement of cash flows—indirect method, and compute free cash flow.	Moderate	40–50
*8A	Prepare a statement of cash flows—direct method, and compute free cash flow.	Moderate	40–50
9A	Prepare a statement of cash flows—indirect method.	Moderate	40–50
*10A	Prepare a statement of cash flows—direct method.	Moderate	40–50
11A	Prepare a statement of cash flows—indirect method.	Moderate	40–50
*12A	Prepare a worksheet—indirect method.	Moderate	40–50
1B	Distinguish among operating, investing, and financing activities.	Simple	10–15
2B	Determine cash flow effects of changes in plant asset accounts.	Simple	10–15
3B	Prepare the operating activities section—indirect method.	Simple	20–30
*4B	Prepare the operating activities section—direct method.	Simple	20–30
5B	Prepare the operating activities section—indirect method.	Simple	20–30
*6B	Prepare the operating activities section—direct method.	Simple	20–30
7B	Prepare a statement of cash flows—indirect method, and compute free cash flow.	Moderate	40–50

ASSIGNMENT CHARACTERISTICS TABLE (Continued)

Problem Number	Description	Difficulty Level	Time Allotted (min.)
*8B	Prepare a statement of cash flows—direct method, and compute free cash flow.	Moderate	40–50
9B	Prepare a statement of cash flows—indirect method.	Moderate	40–50
*10B	Prepare a statement of cash flows—direct method.	Moderate	40–50
11B	Prepare a statement of cash flows—indirect method.	Moderate	40–50

BLOOM'S TAXONOMY TABLE

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

Study Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Indicate the usefulness of the statement of cash flows.	Q17-6	Q17-1 Q17-15 Q17-2				
2. Distinguish among operating, investing, and financing activities.	Q17-4 Q17-6 BE17-1	Q17-3 BE17-2 Q17-5 E17-1 Q17-7 E17-2 Q17-8 P17-1A Q17-9 P17-1B Q17-16	BE17-3 E17-2 E17-3			
3. Prepare a statement of cash flows using the indirect method.	Q17-13	Q17-10 Q17-11 Q17-12 Q17-14	BE17-4 E17-8 P17-11A BE17-5 E17-9 P17-3B BE17-6 P17-3A P17-5B E17-4 P17-5A P17-7B E17-5 P17-7A P17-9B E17-7 P17-9A P17-11B	BE17-7 E17-6 P17-2A P17-2B P17-7A P17-7B		
4. Analyze the statement of cash flows.			E17-7 P17-7B E17-9 P17-8B P17-7A P17-8A	BE17-8 P17-7A BE17-9 P17-8A BE17-10 P17-7B BE17-11 P17-8B		
*5 Explain how to use a worksheet to prepare the statement of cash flows using the indirect method.		Q17-17	BE17-12 E17-10 P17-12A			
*6. Prepare a statement of cash flows using the direct method.	Q17-18	Q17-8 Q17-20 Q17-21	Q17-19 E17-13 P17-4B BE17-13 E17-14 P17-6B BE17-14 P17-4A P17-8B BE17-15 P17-6A P17-10B E17-11 P17-8A E17-12 P17-10A	P17-8A P17-8B		
Broadening Your Perspective		Exploring the Web	Comparative Analysis Decision Making Across the Organization Communication			Decision Making Across the Organization Ethics Case Comp. Analysis All About You

ANSWERS TO QUESTIONS

1. (a) The statement of cash flows reports the cash receipts, cash payments, and net change in cash resulting from the operating, investing, and financing activities of a company during a period in a format that reconciles the beginning and ending cash balances.
(b) Disagree. The statement of cash flows is required. It is the fourth basic financial statement.

2. The statement of cash flows answers the following questions about cash: (a) Where did the cash come from during the period? (b) What was the cash used for during the period? and (c) What was the change in the cash balance during the period?

3. The three activities are:
Operating activities include the cash effects of transactions that create revenues and expenses and thus enter into the determination of net income.
Investing activities include: (a) purchasing and disposing of investments and productive long-lived assets and (b) lending money and collecting loans.
Financing activities include: (a) obtaining cash from issuing debt and repaying amounts borrowed and (b) obtaining cash from stockholders, repurchasing shares, and paying them dividends.

4. (a) Major sources of cash in a statement of cash flows include cash from operations; issuance of debt; collection of loans; issuance of capital stock; sale of investments; and the sale of property, plant, and equipment.
(b) Major uses of cash include purchase of inventory, payment of cash dividends; redemption of debt; purchase of investments; making loans; redemption of capital stock; and the purchase of property, plant, and equipment.

5. The statement of cash flows presents investing and financing activities so that even noncash transactions of an investing and financing nature are disclosed in the financial statements. If they affect financial conditions significantly, the FASB requires that they be disclosed in either a separate schedule at the bottom of the statement of cash flows or in a separate note or supplementary schedule to the financial statements.

6. Examples of significant noncash activities are: (1) issuance of stock for assets, (2) conversion of bonds into common stock, (3) issuance of bonds or notes for assets, and (4) noncash exchanges of property, plant, and equipment.

7. Comparative balance sheets, a current income statement, and certain transaction data all provide information necessary for preparation of the statement of cash flows. Comparative balance sheets indicate how assets, liabilities, and equities have changed during the period. A current income statement provides information about the amount of cash provided or used by operations. Certain transactions provide additional detailed information needed to determine how cash was provided or used during the period.

8. The advantage of the **direct method** is that it presents the major categories of cash receipts and cash payments in a format that is similar to the income statement and familiar to statement users. Its principal disadvantage is that the necessary data can be expensive and time-consuming to accumulate.

The advantage of the **indirect method** is it is often considered easier to prepare, and it provides a reconciliation of net income to net cash provided by operating activities. It also tends to reveal less company information to competitors. Its primary disadvantage is the difficulty in understanding the adjustments that comprise the reconciliation.

Both methods are acceptable but the FASB expressed a preference for the direct method. Yet, the indirect method is the overwhelming favorite of companies.

9. When total cash inflows exceed total cash outflows, the excess is identified as a “net increase in cash” near the bottom of the statement of cash flows.

10. The indirect method involves converting accrual net income to net cash provided by operating activities. This is done by starting with accrual net income and adding or subtracting noncash items included in net income. Examples of adjustments include depreciation and other noncash expenses, gains and losses on the sale of noncurrent assets, and changes in the balances of current asset and current liability accounts from one period to the next.

11. It is necessary to convert accrual-based net income to cash-basis income because the unadjusted net income includes items that do not provide or use cash. An example would be an increase in accounts receivable. If accounts receivable increased during the period, revenues reported on the accrual basis would be higher than the actual cash revenues received. Thus, accrual-basis net income must be adjusted to reflect the net cash provided by operating activities.

12. A number of factors could have caused an increase in cash despite the net loss. These are (1) high cash revenues relative to low cash expenses; (2) sales of property, plant, and equipment; (3) sales of investments; (4) issuance of debt or capital stock, and (5) differences between cash and accrual accounting, e.g. depreciation.

13. Depreciation expense.
Gain or loss on sale of a noncurrent asset.
Increase/decrease in accounts receivable.
Increase/decrease in inventory.
Increase/decrease in accounts payable.

14. Under the indirect method, depreciation is added back to net income to reconcile net income to net cash provided by operating activities because depreciation is an expense but not a cash payment.

15. The statement of cash flows is useful because it provides information to the investors, creditors, and other users about: (1) the company’s ability to generate future cash flows, (2) the company’s ability to pay dividends and meet obligations, (3) the reasons for the difference between net income and net cash provided by operating activities, and (4) the cash investing and financing transactions during the period.

16. This transaction is reported in the note or schedule entitled “Noncash investing and financing activities” as follows: “Retirement of bonds payable through issuance of common stock, $1,700,000.”

*17. A worksheet is desirable because it allows the accumulation and classification of data that will appear on the statement of cash flows. It is an optional but efficient device that aids in the preparation of the statement of cash flows.

*18. Net cash provided by operating activities under the direct approach is the difference between cash revenues and cash expenses. The direct approach adjusts the revenues and expenses directly to reflect the cash basis. This results in cash net income, which is equal to “net cash provided by operating activities.”

***19.** (a) Cash receipts from customers = Revenues from sales $\left[\begin{array}{l}\text{+ Decrease in accounts receivable}\\ \text{– Increase in accounts receivable}\end{array}\right.$

(b) Purchases = Cost of goods sold $\left[\begin{array}{l}\text{+ Increase in inventory}\\ \text{– Decrease in inventory}\end{array}\right.$

Cash payments to suppliers = Purchases $\left[\begin{array}{l}\text{+ Decrease in accounts payable}\\ \text{– Increase in accounts payable}\end{array}\right.$

***20.**

Sales	$2,000,000
Add: Decrease in accounts receivables	200,000
Cash receipts from customers	$2,200,000

***21.** Depreciation expense is not listed in the direct method operating activities section because it is not a cash flow item—it does not affect cash.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 17-1

(a) Cash inflow from financing activity, $200,000.
(b) Cash outflow from investing activity, $150,000.
(c) Cash inflow from investing activity, $20,000.
(d) Cash outflow from financing activity, $50,000.

BRIEF EXERCISE 17-2

(a) Investing activity.
(b) Investing activity.
(c) Financing activity.
(d) Operating activity.
(e) Financing activity.
(f) Financing activity.

BRIEF EXERCISE 17-3

Cash flows from financing activities	
Proceeds from issuance of bonds payable	$300,000
Payment of dividends	(50,000)
Net cash provided by financing activities	$250,000

BRIEF EXERCISE 17-4

Net income		$2,500,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$160,000	
Accounts receivable decrease	350,000	
Accounts payable decrease	(280,000)	230,000
Net cash provided by operating activities		$2,730,000

BRIEF EXERCISE 17-5

Cash flows from operating activities		
Net income		$280,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 70,000	
Loss on sale of plant assets	12,000	82,000
Net cash provided by operating activities		$362,000

BRIEF EXERCISE 17-6

Net income		$200,000
Adjustments to reconcile net income to net cash provided by operating activities		
Decrease in accounts receivable	$ 80,000	
Increase in prepaid expenses	(28,000)	
Increase in inventories	(30,000)	22,000
Net cash provided by operating activities		$222,000

BRIEF EXERCISE 17-7

Original cost of equipment sold	$22,000
Less: Accumulated depreciation	5,500
Book value of equipment sold	16,500
Less: Loss on sale of equipment	5,500
Cash received from sale of equipment	$11,000

BRIEF EXERCISE 17-8

Free cash flow = $155,793,000 – $132,280,000 – $0 = $23,513,000

BRIEF EXERCISE 17-9

Free cash flow = $360,000 – $200,000 – $0 = $160,000

BRIEF EXERCISE 17-10

Free cash flow = $45,600,000 – $1,600,000 = $44,000,000

BRIEF EXERCISE 17-11

Free cash flow is cash provided by operations less capital expenditures and cash dividends paid. For Radar Inc. this would be $384,000 ($734,000 – $280,000 – $70,000). Since it has positive free cash flow that far exceeds its dividend, an increase in the dividend might be possible. However, other factors should be considered. For example, it must have adequate retained earnings, and it should be convinced that a larger dividend can be sustained over future years. It should also use the free cash flow to expand its operations or pay down its debt.

*BRIEF EXERCISE 17-12

Balance Sheet Accounts	Balance 1/1/08	Reconciling Items Debit	Reconciling Items Credit	Balance 12/31/08
Prepaid expenses	18,600		(a) 6,600	12,000
Accrued expenses payable	8,200		(b) 2,400	10,600
Statement of Cash Flow Effects				
Operating activities				
Decrease in prepaid expenses		(a) 6,600		
Increase in accrued expenses payable		(b) 2,400		
		9,000	9,000	

*BRIEF EXERCISE 17-13

Receipts from customers = Sales revenues { + Decrease in accounts receivable / – Increase in accounts receivable

$1,033,678,000 = $1,095,307,000 – $61,629,000 (Increase in accounts receivable)

*BRIEF EXERCISE 17-14

Cash payment for income taxes	=	Income Tax Expense	+ Decrease in income taxes payable – Increase in income taxes payable

$95,000,000 = $340,000,000 – $245,000,000*

***$522,000,000 – $277,000,000 = $245,000,000 (Increase in income taxes payable)**

*BRIEF EXERCISE 17-15

Cash payments for operating expenses	=	Operating expenses, excluding depreciation	+ Increase in prepaid expenses – Decrease in prepaid expenses and + Decrease in accrued expenses payable – Increase in accrued expenses payable

$69,000 = $80,000 – $6,600 – $4,400

SOLUTIONS TO EXERCISES

EXERCISE 17-1

(a) Financing activities.
(b) Noncash investing and financing activities.
(c) Noncash investing and financing activities.
(d) Financing activities.
(e) Investing activities.
(f) Operating activities.
(g) Operating activities.

EXERCISE 17-2

(a) Operating activity.
(b) Noncash investing and financing activity.
(c) Investing activity.
(d) Financing activity.
(e) Operating activity.
(f) Operating activity.
(g) Operating activity.
(h) Financing activity.
(i) Operating activity.
(j) Noncash investing and financing activity.
(k) Investing activity.
(l) Noncash investing and financing activity.
(m) Operating activity (loss); investing activity (cash proceeds from sale).
(n) Financing activity.

EXERCISE 17-3

1. (a)

Cash	15,000	
Land		12,000
Gain on Disposal		3,000

(b) The cash receipt ($15,000) is reported in the investing section. The gain ($3,000) is deducted from net income in the operating section.

2. (a)

Cash	20,000	
Common Stock		20,000

(b) The cash receipt ($20,000) is reported in the financing section.

3. (a)

Depreciation Expense	17,000	
Accumulated Depreciation		17,000

(b) Depreciation expense ($17,000) is added to net income in the operating section.

EXERCISE 17-3 (Continued)

4. (a) Salaries Expense 9,000
   Cash 9,000

Salaries Expense	9,000	
Cash		9,000

(b) Salaries expense is not reported separately on the statement of cash flows. It is part of the computation of net income in the income statement, and is included in the net income amount on the statement of cash flows.

5. (a)

Equipment	8,000	
Common Stock		1,000
Paid-in Capital in Excess of Par Value		7,000

(b) The issuance of common stock for equipment ($8,000) is reported as a noncash financing and investing activity at the bottom of the statement of cash flows.

6. (a)

Cash	1,200	
Loss on Disposal	1,800	
Accumulated Depreciation	7,000	
Equipment		10,000

(b) The cash receipt ($1,200) is reported in the investing section. The loss ($1,800) is added to net income in the operating section.

EXERCISE 17-4

VILLA COMPANY
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$195,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$45,000	
Loss on sale of equipment	5,000	
Decrease in accounts receivable	15,000	
Decrease in prepaid expenses	4,000	
Increase in accounts payable	17,000	86,000
Net cash provided by operating activities		$281,000

EXERCISE 17-5

BELLINHAM INC.
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$153,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$24,000	
Increase in accounts receivable	(21,000)	
Decrease in inventory	14,000	
Increase in prepaid expenses	(5,000)	
Increase in accrued expenses payable	10,000	
Decrease in accounts payable	(7,000)	15,000
Net cash provided by operating activities		$168,000

EXERCISE 17-6

CESAR CORP
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$ 67,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 28,000	
Loss on sale of equipment	5,000	33,000
Net cash provided by operating activities		100,000
Cash flows from investing activities		
Sale of equipment	14,000*	
Purchase of equipment	(70,000)	
Construction of equipment	(53,000)	
Net cash used by investing activities		(109,000)
Cash flows from financing activities		
Payment of cash dividends		(14,000)

*Cost of equipment sold	$ 49,000
Accumulated depreciation	(30,000)
Book value	19,000
Loss on sale of equipment	(5,000)
Cash proceeds	$ 14,000

EXERCISE 17-7

(a)

SCULLY CORPORATION
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$ 22,630
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 5,000	
Loss on sale of land	1,100	
Decrease in accounts receivable	2,200	
Decrease in accounts Payable	(18,730)	(10,430)
Net cash provided by operating activities		12,200
Cash flows from investing activities		
Sale of land		4,900
Cash flows from financing activities		
Issuance of common stock	$ 6,000	
Payment of dividends	(19,500)	
Net cash used by financing activities		(13,500)
Net increase in cash		3,600
Cash at beginning of period		10,700
Cash at end of period		$ 14,300

(b) $12,200 – $0 – $19,500 = ($7,300)

EXERCISE 17-8

TAGUCHI COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$103,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$34,000	
Increase in accounts receivable	(9,000)	
Decrease in inventory	19,000	
Decrease in accounts payable	(8,000)	36,000
Net cash provided by operating activities		139,000
Cash flows from investing activities		
Sale of land	25,000	
Purchase of equipment	(60,000)	
Net cash used by investing activities		(35,000)
Cash flows from financing activities		
Issuance of common stock	42,000	
Redemption of bonds	(50,000)	
Payment of cash dividends	(45,000)	
Net cash used by financing activities		(53,000)
Net increase in cash		51,000
Cash at beginning of period		22,000
Cash at end of period		$ 73,000

EXERCISE 17-9

(a)

MULDUR CORPORATION
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$ 18,300
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 5,200*	
Loss on sale of equipment	5,500**	
Increase in accounts payable	3,500	
Increase in accounts receivable	(2,900)	11,300
Net cash provided by operating activities		29,600
Cash flows from investing activities		
Sale of equipment	3,300	
Purchase of investments	(4,000)	
Net cash used by investing activities		(700)
Cash flows from financing activities		
Issuance of common stock	$ 5,000	
Retirement of bonds	(20,000)	
Payment of dividends	(16,400)	
Net cash used by financing activities		(31,400)
Net increase in cash		(2,500)
Cash at beginning of period		17,700
Cash at end of period		$ 15,200

*[$14,000 – ($10,000 – $1,200)]   **[$3,300 – ($10,000 – $1,200)]

(b) $29,600 – $0 – $16,400 = $13,200

*EXERCISE 17-10

EDDIE MURPHY COMPANY
Worksheet
Statement of Cash Flows
For the Year Ended December 31, 2008

Balance Sheet Accounts	Balance 12/31/07	Reconciling Items Debit		Reconciling Items Credit		Balance 12/31/08
Debits						
Cash	22,000	(k)	41,000			63,000
Accounts receivable	76,000	(a)	9,000			85,000
Inventories	189,000			(b)	9,000	180,000
Land	100,000			(e)	25,000	75,000
Equipment	200,000	(f)	60,000			260,000
Total	587,000					663,000
Credits						
Accumulated depreciation—equipment	42,000			(d)	24,000	66,000
Accounts payable	47,000	(c)	13,000			34,000
Bonds payable	200,000	(h)	50,000			150,000
Common stock	164,000			(i)	50,000	214,000
Retained earnings	134,000	(g)	60,000	(j)	125,000	199,000
Total	587,000					663,000
Statement of Cash Flow Effects						
Operating activities						
Net income		(j)	125,000			
Increase in accounts receivable				(a)	9,000	
Decrease in inventories		(b)	9,000			
Decrease in accounts payable				(c)	13,000	
Depreciation expense		(d)	24,000			
Investing activities						
Sale of land		(e)	25,000			
Purchase of equipment				(f)	60,000	
Financing activities						
Payment of dividends				(g)	60,000	
Redemption of bonds				(h)	50,000	
Issuance of common stock		(i)	50,000			
Totals			466,000		425,000	
Increase in cash				(k)	41,000	
Totals			466,000		466,000	

*EXERCISE 17-11

Revenues	$192,000	
Deduct: Increase in accounts receivable	(60,000)	
Cash receipts from customers*		$132,000
Operating expenses	78,000	
Deduct: Increase in accounts payable	(23,000)	
Cash payments for operating expenses**		55,000
Net cash provided by operating activities		$ 77,000

*

Accounts Receivable

Balance, Beginning of year	0		
Revenues for the year	192,000	Cash receipts for year	132,000
Balance, End of year	60,000		

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Accounts Payable

		Balance, Beginning of year	0
Payments for the year	55,000	Operating expenses for year	78,000
		Balance, End of year	23,000

*EXERCISE 17-12

(a) Cash payments to suppliers

Cost of goods sold		$4,852.7 million
Add: Increase in inventory		18.1
Cost of purchases		$4,870.8 million
Deduct: Increase in accounts payable		(136.9)
Cash payments to suppliers		$4,733.9 million

(b) Cash payments for operating expenses

Operating expenses exclusive of depreciation ($10,671.5 – $1,201)		$9,470.5 million
Add: Increase in prepaid expenses	$ 56.3	
Deduct: Increase in accrued expenses payable	(160.9)	(104.6)
Cash payments for operating expenses		$9,365.9 million

*EXERCISE 17-13

Cash flows from operating activities		
Cash receipts from		
Customers	$230,000*	
Dividend revenue	18,000	
		$248,000
Less cash payments:		
To suppliers for merchandise	115,000	
For operating expenses	28,000	
For salaries and wages	53,000	
For interest	10,000	
For income taxes	12,000	218,000
Net cash provided by operating activities		$ 30,000

*$48,000 + $182,000

*EXERCISE 17-14

Cash payments for rentals	
Rent expense	$ 40,000
Add: Increase in prepaid rent	3,100
Cash payments for rent	$ 43,100
Cash payments for salaries	
Salaries expense	$ 54,000
Add: Decrease in salaries payable	2,000
Cash payments for salaries	$ 56,000
Cash receipts from customers	
Revenue from sales	$170,000
Add: Decrease in accounts receivable	9,000
Cash receipts from customers	$179,000

SOLUTIONS TO PROBLEMS

PROBLEM 17-1A

	Transaction	Where Reported	Cash Inflow, Outflow, or No Effect?
(a)	Recorded depreciation expense on the plant assets.	O	No cash flow effect
(b)	Recorded and paid interest expense.	O	Cash outflow
(c)	Recorded cash proceeds from a sale of plant assets.	I	Cash inflow
(d)	Acquired land by issuing common stock.	NC	No cash flow effect
(e)	Paid a cash dividend to preferred stockholders.	F	Cash outflow
(f)	Distributed a stock dividend to common stockholders.	NC	No cash flow effect
(g)	Recorded cash sales.	O	Cash inflow
(h)	Recorded sales on account.	O	No cash flow effect
(i)	Purchased inventory for cash.	O	Cash outflow
(j)	Purchased inventory on account.	O	No cash flow effect

PROBLEM 17-2A

(a) Net income can be determined by analyzing the retained earnings account.

Retained earnings beginning of year	$260,000
Add: Net income (plug)	65,500*
	325,500
Less: Cash dividends	15,000
Stock dividends	10,500
Retained earnings, end of year	$300,000

*($300,000 + $10,500 + $15,000 – $260,000)

(b) Cash inflow from the issue of stock was $9,500 ($160,000 – $140,000 – $10,500).

Common Stock		
	140,000	
	10,500	Stock Dividend
	9,500	Shares Issued for Cash
	160,000	

Cash outflow for dividends was $15,000. The stock dividend does not use cash.

(c) Both of the above activities (issue of common stock and payment of dividends) would be classified as financing activities on the statement of cash flows.

PROBLEM 17-3A

ELBERT COMPANY
Partial Statement of Cash Flows
For the Year Ended November 30, 2008

Cash flows from operating activities		
Net income		$1,650,000
Adjustments to reconcile net income to net cash provided by operating activities activities		
Depreciation expense	$ 90,000	
Increase in accounts receivable	(250,000)	
Decrease in inventory	500,000	
Increase in prepaid expenses	(150,000)	
Decrease in accounts payable	(340,000)	
Decrease in accrued expenses payable	(100,000)	(250,000)
Net cash provided by operating activities		$1,400,000

*PROBLEM 17-4A

ELBERT COMPANY
Partial Statement of Cash Flows
For the Year Ended November 30, 2008

Cash flows from operating activities		
Cash receipts from customers		$7,450,000 (1)
Less cash payments:		
To suppliers	$4,740,000 (2)	
For operating expenses	1,310,000 (3)	6,050,000
Net cash provided by operating activities		$1,400,000

Computations:

(1) Cash receipts from customers

Sales	$7,700,000
Deduct: Increase in accounts receivable	(250,000)
Cash receipts from customers	$7,450,000

(2) Cash payments to suppliers

Cost of goods sold	$4,900,000
Deduct: Decrease in inventories	(500,000)
Cost of purchases	4,400,000
Add: Decrease in accounts payable	340,000
Cash payments to suppliers	$4,740,000

(3) Cash payments for operating expenses

Operating expenses, exclusive of depreciation		$1,060,000*
Add: Increase in prepaid expenses	$150,000	
Decrease in accrued expenses payable	100,000	250,000
Cash payments for operating expenses		$1,310,000

*$450,000 + ($700,000 – $90,000)

PROBLEM 17-5A

GRANIA COMPANY
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$230,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 60,000	
Loss on sale of equipment	16,000	
Increase in accounts receivable	(15,000)	
Increase in accounts payable	13,000	
Increase in income taxes payable	4,000	78,000
Net cash provided by operating activities		$308,000

*PROBLEM 17-6A

GRANIA COMPANY
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Cash receipts from customers............		$955,000 (1)
Less cash payments:		
For operating expenses................	$611,000 (2)	
For income taxes	36,000 (3)	647,000
Net cash provided by operating activities		$308,000

(1) Computation of cash receipts from customers

Revenues..	$970,000
Deduct: Increase in accounts receivable .... ($75,000 – $60,000)	(15,000)
Cash receipts from customers.....................................	$955,000

(2) Computation of cash payments for operating expenses

Operating expenses per income statement..............	$624,000
Deduct: Increase in accounts payable .... ($41,000 – $28,000)	(13,000)
Cash payments for operating expenses	$611,000

(3) Computation of cash payments for income taxes

Income tax expense per income statement..............	$ 40,000
Deduct: Increase in income taxes payable .... ($11,000 – $7,000)	(4,000)
Cash payments for income taxes................................	$ 36,000

PROBLEM 17-7A

(a)

WELLER COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$32,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 14,500*	
Increase in accounts receivable	(19,000)	
Increase in merchandise inventory	(7,000)	
Increase in accounts payable	14,000	
Decrease in income taxes payable	(1,000)	1,500
Net cash provided by operating activities		33,500
Cash flows from investing activities		
Sale of equipment		8,500
Cash flows from financing activities		
Issuance of common stock	4,000	
Payment of dividends	(25,000)	
Redemption of bonds	(6,000)	
Net cash used by financing activities		(27,000)
Net increase in cash		15,000
Cash at beginning of period		20,000
Cash at end of period		$35,000

*$29,000 – ($24,000 – $9,500[A]) = $14,500

[A] $18,000 (cost of equipment) – $8,500 (book value) = $9,500 (accumulated depreciation for equipment sold)

(b) $33,500 – $0 – $25,000 = $8,500

*PROBLEM 17-8A

(a)

WELLER COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Cash receipts from customers		$223,000 (1)
Less cash payments:		
To suppliers	$168,000 (2)	
For operating expenses	9,500 (3)	
For interest	3,000	
For income taxes	9,000 (4)	189,500
Net cash provided by operating activities		33,500
Cash flows from investing activities		
Sale of equipment		8,500
Cash flows from financing activities		
Issuance of common stock	4,000	
Payment of dividends	(25,000)	
Redemption of bonds	(6,000)	
Net cash used by financing activities		(27,000)
Net decrease in cash		15,000
Cash at beginning of period		20,000
Cash at end of period		$ 35,000

Computations:

(1) Cash receipts from customers

Sales	$242,000
Deduct: Increase in accounts receivable	(19,000)
Cash receipts from customers	$223,000

***PROBLEM 17-8A (Continued)**

(2) Cash payments to suppliers

Cost of goods sold	$175,000
Add: Increase in inventory	7,000
Cost of purchases	182,000
Deduct: Increase in accounts payable	14,000
Cash payments to suppliers	$168,000

(3) Cash payments for operating expenses

Operating expenses	$ 24,000
Deduct: Depreciation	14,500
$29,000 – ($24,000 – $9,500*)	
Cash payments for operating expenses	$ 9,500

***$18,000 – $8,500 = $9,500**

(4) Cash payments for income taxes

Income tax expense	$ 8,000
Add: Decrease in income taxes payable	1,000
Cash payments for income taxes	$ 9,000

(b) $33,500 – $0 – $25,000 = $8,500

PROBLEM 17-9A

ARMA INC.
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$158,900
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 46,500	
Loss on sale of plant assets	7,500	
Increase in accounts receivable	(59,800)	
Increase in inventory	(9,650)	
Increase in prepaid expenses	(2,400)	
Increase in accounts payable	44,700	
Decrease in accrued expenses payable	(500)	26,350
Net cash provided by operating activities		185,250
Cash flows from investing activities		
Sale of plant assets	1,500	
Purchase of plant assets	(85,000)	
Purchase of investments	(24,000)	
Net cash used by investing activities		(107,500)
Cash flows from financing activities		
Sale of common stock	45,000	
Payment of cash dividends	(40,350)	
Redemption of bonds	(40,000)	
Net cash used by financing activities		(35,350)
Net increase in cash		42,400
Cash at beginning of period		48,400
Cash at end of period		$ 90,800

***PROBLEM 17-10A**

ARMA INC.
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Cash receipts from customers		$332,980 (1)
Less cash payments:		
To suppliers	$100,410 (2)	
For operating expenses	15,310 (3)	
For income taxes	27,280	
For interest	4,730	147,730
Net cash provided by operating activities		185,250
Cash flows from investing activities		
Sale of plant assets	1,500	
Purchase of plant assets	(85,000)	
Purchase of investments	(24,000)	
Net cash used by investing activities		(107,500)
Cash flows from financing activities		
Sale of common stock	45,000	
Payment of cash dividends	(40,350)	
Redemption of bonds	(40,000)	
Net cash used by financing activities		(35,350)
Net increase in cash		42,400
Cash at beginning of period		48,400
Cash at end of period		$ 90,800

Computations:

(1) Cash receipts from customers

Sales	$392,780
Deduct: Increase in accounts receivable	(59,800)
Cash receipts from customers	$332,980

***PROBLEM 17-10A (Continued)**

(2) Cash payments to suppliers

Cost of goods sold	$135,460
Add: Increase in inventory	9,650
Cost of purchases	145,110
Deduct: Increase in accounts payable	44,700
Cash payments to suppliers	$100,410

(3) Cash payments for operating expenses

Operating expenses exclusive of depreciation		$ 12,410
Add: Increase in prepaid expenses	$2,400	
Decrease in accrued expenses payable	500	2,900
Cash payment for operating expenses		$ 15,310

PROBLEM 17-11A

RAMIREZ COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$ 37,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$42,000	
Loss on sale of equipment	4,000*	
Decrease in accounts receivable	18,000	
Increase in inventory	(9,450)	
Decrease in prepaid expenses	5,720	
Increase in accounts payable	7,730	68,000
Net cash provided by operating activities		105,000
Cash flows from investing activities		
Sale of land	25,000	
Sale of equipment	6,000	
Purchase of equipment	(95,000)	
Net cash used by investing activities		(64,000)
Cash flows from financing activities		
Payment of cash dividends	(15,000)	
Net cash used by financing activities		(15,000)
Net increase in cash		26,000
Cash at beginning of period		45,000
Cash at end of period		$ 71,000
Noncash investing and financing activities		
Conversion of bonds by issuance of common stock		$ 40,000

*($6,000 – $10,000)

*PROBLEM 17-12A

OPRAH COMPANY
Worksheet—Statement of Cash Flows
For the Year Ended December 31, 2008

Balance Sheet Accounts	Balance 12/31/07	Reconciling Items Debit		Reconciling Items Credit		Balance 12/31/08
Debits						
Cash	47,250	(m)	45,450			92,700
Accounts receivable	57,000	(a)	33,800			90,800
Inventories	102,650	(b)	19,250			121,900
Investments	87,000			(e)	2,500	84,500
Plant assets	205,000	(f)	92,000	(h)	47,000	250,000
Totals	498,900					639,900
Credits						
Accumulated depreciation—plant assets	40,000	(h)	40,200	(g)	49,700	49,500
Accounts payable	48,280			(c)	9,420	57,700
Accrued expenses payable	18,830	(d)	6,730			12,100
Bonds payable	70,000			(i)	30,000	100,000
Common stock	200,000			(j)	50,000	250,000
Retained earnings	121,790	(l)	83,400	(k)	132,210	170,600
Totals	498,900					639,900
Statement of Cash Flow Effects						
Operating activities						
Net income		(k)	132,210			
Increase in accounts receivable				(a)	33,800	
Increase in inventories				(b)	19,250	
Increase in accounts payable		(c)	9,420			
Decrease in accrued expenses payable				(d)	6,730	
Depreciation expense		(g)	49,700			
Gain on sale of plant assets				(h)	8,750	
Investing activities						
Sale of investments		(e)	2,500			
Sale of plant assets		(h)	15,550			
Purchase of plant assets				(f)	92,000	
Financing activities						
Sale of common stock		(j)	50,000			
Issuance of bonds		(i)	30,000			
Payment of dividends				(l)	83,400	
Totals			610,210		564,760	
Increase in cash				(m)	45,450	
Totals			610,210		610,210	

PROBLEM 17-1B

	Transaction	Where reported?	Cash inflow, outflow, or no cash flow effect?
(a)	Recorded depreciation expense on the plant assets.	O	No cash flow effect
(b)	Incurred a loss on disposal of plant assets.	O	No cash flow effect
(c)	Acquired a building by paying cash.	I	Cash outflow
(d)	Made principal repayments on a mortgage.	F	Cash outflow
(e)	Issued common stock	F	Cash inflow
(f)	Purchased shares of another company to be held as a long-term equity investment.	I	Cash outflow
(g)	Paid dividends to common stockholders.	F	Cash outflow
(h)	Sold inventory on credit. The company uses a perpetual inventory system.	O	No cash flow effect
(i)	Purchased inventory on credit.	O	No cash flow effect
(j)	Paid wages to employees.	O	Cash outflow

PROBLEM 17-2B

(a) Cash inflows (outflows) related to plant assets 2008:

Equipment purchase	($85,000)
Land purchase	(30,000)
Proceeds from equipment sales	6,000*

*Cost of equipment sold $240,000 + $85,000 – $300,000 = $25,000

Accumulated depreciation removed from accounts for sale of equipment

Accumulated depreciation—Equipment

	96,000	
Plug 16,000	64,000	Depreciation Expense
	144,000	

Cash proceeds = Cost $25,000 – accumulated depreciation $16,000 – loss $3,000 = $6,000

Note to instructor—some students may find journal entries helpful in understanding this exercise.

Equipment	85,000	
Cash		85,000
Land	30,000	
Cash		30,000
Cash (plug)	6,000	
Accumulated depreciation	16,000	
Loss on sale of equipment	3,000	
Equipment		25,000

(b)

Equipment purchase	Investing activities (outflow)
Land purchase	Investing activities (outflow)
Proceeds from equipment sale	Investing activities (inflow)

PROBLEM 17-3B

MARQUETTE COMPANY
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$1,040,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$105,000	
Amortization expense	20,000	
Decrease in accounts receivable	520,000	
Increase in inventory	(140,000)	
Increase in prepaid expenses	(175,000)	
Increase in accounts payable	50,000	
Increase in accrued expenses payable	165,000	545,000
Net cash provided by operating activities		$1,585,000

*PROBLEM 17-4B

MARQUETTE COMPANY
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities				
Cash receipts from customers			$5,920,000	(1)
Less cash payments:				
To suppliers	$3,380,000	(2)		
For operating expenses	955,000	(3)	4,335,000	
Net cash provided by operating activities			$1,585,000	

Computations:

(1) Cash receipts from customers

Sales	$5,400,000
Add: Decrease in accounts receivable	520,000
Cash receipts from customers	$5,920,000

(2) Cash payments to suppliers

Cost of goods sold	$3,290,000
Add: Increase in inventories	140,000
Cost of purchases	3,430,000
Deduct: Increase in accounts payable	(50,000)
Cash payments to suppliers	$3,380,000

(3) Cash payments for operating expenses

Operating expenses ($420,000 + $525,000)		$ 945,000
Add: Increase in prepaid expenses	$ 175,000	
Deduct: Increase in accrued expenses payable	(165,000)	10,000
Cash payments for operating expenses		$ 955,000

PROBLEM 17-5B

SHAPIRO INC.
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$ 98,000
Adjustments to reconcile net income to net cash provided by operating activities		
Decrease in accounts receivable	$ 25,000	
Decrease in accounts payable	(21,000)	
Increase in income taxes payable	6,000	10,000
Net cash provided by operating activities		$108,000

***PROBLEM 17-6B**

SHAPIRO INC.
Partial Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Cash receipts from customers................		$570,000 (1)
Less cash payments:		
For operating expenses....................	$421,000 (2)	
For income taxes	41,000 (3)	462,000
Net cash provided by operating activities		$108,000

(1) Computation of cash receipts from customers

Revenues..	$545,000
Add: Decrease in accounts receivable............................... ($75,000 – $50,000)	25,000
Cash receipts from customers..	$570,000

(2) Computation of cash payments for operating expenses

Operating expenses..	$400,000
Add: Decrease in accounts payable.................................... ($51,000 – $30,000)	21,000
Cash payments for operating expenses............................	$421,000

(3)

Income tax expense..	$ 47,000
Deduct: Increase in income taxes payable .... ($10,000 – $4,000)	(6,000)
Cash payments for income taxes...	$ 41,000

PROBLEM 17-7B

(a)

MOLINA COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$ 38,000
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 6,000	
Increase in accounts receivable	(9,000)	
Increase in inventory	(16,000)	
Decrease in accounts payable	(12,000)	
Increase in income taxes payable	6,000	(25,000)
Net cash provided by operating activities		13,000
Cash flows from investing activities		
Sale of equipment	10,000	
Purchase of equipment	(5,000)	
Net cash provided by investing activities		5,000
Cash flows from financing activities		
Issuance of bonds	10,000	
Payment of cash dividends	(33,000)	
Net cash used by financing activities		(23,000)
Net decrease in cash		(5,000)
Cash at beginning of period		33,000
Cash at end of period		$ 28,000

(b) $13,000 – $5,000 – $33,000 = ($25,000)

*PROBLEM 17-8B

(a)

MOLINA COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Cash receipts from customers..........		$277,000 (1)
Less cash payments:		
To suppliers....................................	$222,000 (2)	
For operating expenses.............. ($37,000 – $6,000)	31,000	
For interest......................................	7,000	
For income taxes	4,000 (3)	264,000
Net cash provided by operating activities..................		13,000
Cash flows from investing activities		
Sale of equipment..................................	10,000	
Purchase of equipment........................	(5,000)	
Net cash provided by investing activities...................		5,000
Cash flows from financing activities		
Issuance of bonds	10,000	
Payment of cash dividends	(33,000)	
Net cash used by financing activities		(23,000)
Net decrease in cash		(5,000)
Cash at beginning of period		33,000
Cash at end of period....................................		$ 28,000

Computations:

(1) Cash receipts from customers

Sales..	$286,000
Deduct: Increase in accounts receivable	(9,000)
Cash receipts from customers....................................	$277,000

***PROBLEM 17-8B (Continued)**

(2) Cash payments to suppliers

Cost of goods sold	$194,000
Add: Increase in inventory	16,000
Cost of purchases	210,000
Add: Decrease in accounts payable	12,000
Cash payments to suppliers	$222,000

(3) Cash payments for income taxes

Income tax expense	$ 10,000
Deduct: Increase in income taxes payable	(6,000)
Cash payments for income taxes	$ 4,000

(b) $13,000 – $5,000 – $33,000 = ($25,000)

PROBLEM 17-9B

YAEGER COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$ 122,660
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 35,500	
Gain on sale of plant assets	(5,000)	
Increase in accounts receivable	(33,800)	
Increase in inventory	(19,250)	
Increase in accounts payable	14,420	
Decrease in accrued expenses payable	(3,730)	(11,860)
Net cash provided by operating activities		110,800
Cash flows from investing activities		
Sale of investments	17,500	
Sale of plant assets	15,000	
Purchase of plant assets	(141,000)	
Net cash used by investing activities		(108,500)
Cash flows from financing activities		
Issuance of bonds	70,000	
Sale of common stock	50,000	
Payment of cash dividends	(58,000)	
Net cash provided by financing activities		62,000
Net increase in cash		64,300
Cash at beginning of period		33,400
Cash at end of period		$ 97,700

*PROBLEM 17-10B

YAEGER COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Cash receipts from customers		$263,700 (1)
Less cash payments:		
To suppliers	$ 104,290 (2)	
For operating expenses	18,400 (3)	
For income taxes	27,270	
For interest	2,940	152,900
Net cash provided by operating activities		110,800
Cash flows from investing activities		
Sale of investments	17,500	
Sale of plant assets	15,000	
Purchase of plant assets	(141,000)	
Net cash used by investing activities		(108,500)
Cash flows from financing activities		
Issuance of bonds	70,000	
Sale of common stock	50,000	
Payment of cash dividends	(58,000)	
Net cash provided by financing activities		62,000
Net increase in cash		64,300
Cash at beginning of period		33,400
Cash at end of period		$ 97,700

***PROBLEM 17-10B (Continued)**

Computations:

(1) Cash receipts from customers

Sales	$297,500
Deduct: Increase in accounts receivable	(33,800)
Cash receipts from customers	$263,700

(2) Cash payments to suppliers

Cost of goods sold	$ 99,460
Add: Increase in inventory	19,250
Cost of purchases	118,710
Deduct: Increase in accounts payable	(14,420)
Cash payments to suppliers	$104,290

(3) Cash payments for operating expenses

Operating expenses	$ 14,670
Add: Decrease in accrued expenses payable	3,730
Cash payments for operating expenses	$ 18,400

PROBLEM 17-11B

LEWIS COMPANY
Statement of Cash Flows
For the Year Ended December 31, 2008

Cash flows from operating activities		
Net income		$32,890
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 65,000	
Gain on sale of equipment	(2,000)*	
Increase in accounts receivable	(13,000)	
Increase in inventory	(52,000)	
Decrease in prepaid expenses	4,400	
Increase in accounts payable	13,000	15,400
Net cash provided by operating activities		48,290
Cash flows from investing activities		
Sale of land	50,000	
Sale of equipment	25,000	
Purchase of equipment	(80,000)	
Net cash used by investing activities		(5,000)
Cash flows from financing activities		
Payment of cash dividends		(69,290)
Net decrease in cash		(26,000)
Cash at beginning of period		57,000
Cash at end of period		$31,000
Noncash investing and financing activities		
Conversion of bonds by issuance of stock		$30,000

*($25,000 – $23,000)

BYP 17-1 FINANCIAL REPORTING PROBLEM

(a) Net cash provided by operating activities:

2005	$5,852 million
2004	$5,054 million

(b) The increase in cash and cash equivalents for the year ended December 31, 2005 was $436 million.

(c) PepsiCo uses the indirect method of computing and presenting the net cash provided by operating activities.

(d) The change in accounts and notes receivable required cash of $272 million in 2005. The change in inventories required cash of $132 million in 2005. The change in accounts payable (and other current liabilities) provided cash of $188 million in 2005.

(e) The net cash used by investing activities in 2005 was $3,517 million.

(f) The supplemental disclosure of cash flow information disclosed interest paid of $213 million and income taxes paid of $1,258 million in 2005.

BYP 17-2 COMPARATIVE ANALYSIS PROBLEM

		PepsiCo	Coca-Cola
(a)	\$5,852 – \$1,736 – \$1,642 =	\$2,474	
	\$6,423 – \$899 – \$2,678 =		\$2,846
	All amounts in millions		

(b) The companies are similar in their ability to generate cash. Both had a significant amount of "free cash" available after covering capital expenditures and cash dividends.

BYP 17-3 EXPLORING THE WEB

(a) Crucial to the SEC's effectiveness is its enforcement authority. Each year the SEC brings between 400–500 civil enforcement actions against individuals and companies that break the securities laws. Typical infractions include insider trading, accounting fraud, and providing false or misleading information about securities and the companies that issue them.

(b) The main purposes of these laws can be reduced to two common-sense notions:

- Companies publicly offering securities for investment dollars must tell the public the truth about their businesses, the securities they are selling, and the risks involved in investing.
- People who sell and trade securities—brokers, dealers, and exchanges—must treat investors fairly and honestly, putting investors' interests first.

(c) President Franklin Delano Roosevelt appointed Joseph P. Kennedy, President John F. Kennedy's father, to serve as the first Chairman of the SEC.

BYP 17-4 EXPLORING THE WEB

Answers will vary depending on the company chosen by the student.

BYP 17-5 DECISION MAKING ACROSS THE ORGANIZATION

(a)

CARPINO COMPANY
Statement of Cash Flows
For the Year Ended January 31, 2008

Cash flows from operating activities		
Net loss		$ (30,000)*
Adjustments to reconcile net income to net cash provided by operating activities		
Depreciation expense	$ 55,000	
Gain from sale of investment	(5,000)	50,000
Net cash provided by operating activities		20,000
Cash flows from investing activities		
Sale of investment	80,000	
Purchase of fixtures and equipment	(330,000)	
Purchase of investment	(75,000)	
Net cash used by investing activities		(325,000)
Cash flows from financing activities		
Sale of capital stock	420,000	
Purchase of treasury stock	(10,000)	
Net cash provided by financing activities		410,000
Net increase in cash		105,000
Cash at beginning of period		140,000
Cash at end of period		$245,000
Noncash investing and financing activities		
Issuance of note for truck		$ 20,000

BYP 17-5 (Continued)

*Computation of net income (loss)

Sales of merchandise		$380,000
Interest revenue		6,000
Gain on sale of investment ($80,000 – $75,000)		5,000
Total revenues and gains		391,000
Merchandise purchased	$258,000	
Operating expenses ($160,000 – $55,000)	105,000	
Depreciation	55,000	
Interest expense	3,000	
Total expenses		421,000
Net loss		$ (30,000)

(b) From the information given, it appears that from an operating standpoint, Carpino Company did not have a superb first year, having suffered a $30,000 net loss. Lisa is correct; the statement of cash flows is not prepared in correct form. The sources and uses format is no longer the acceptable form. The correct format classifies cash flows from three activities—operating, investing, and financing; and it also presents significant noncash investing and financing activities in a separate schedule. Lisa is wrong, however, about the actual increase in cash not being $105,000; $105,000 is the correct increase in cash.

BYP 17-6 COMMUNICATION ACTIVITY

MEMO

To: Kyle Benson

From: Student

Re: Statement of cash flows

The statement of cash flows provides information about the cash receipts and cash payments of a firm, classified as operating, investing, and financing activities. The operating activities section of the company's statement of cash flows shows that cash increased by $172,000 as a result of transactions which affected net income. This amount is computed by adjusting net income for those items which affect net income, but do not affect cash, such as sales on account which remain uncollected at year-end.

The investing activities section of the statement reports cash flows resulting from changes in investments and other long-term assets. The company had a cash outflow from investing activities due to purchases of buildings and equipment.

The financing activities section of the statement reports cash flows resulting from changes in long-term liabilities and stockholders' equity. The company had a cash inflow from financing activities due to the issuance of common stock and an outflow due to the payment of cash dividends.

If you have any further questions, please do not hesitate to contact me.

BYP 17-7 ETHICS CASE

(a) The stakeholders in this situation are:
- Willie Morton, president of Tappit Corporation.
- Robert Jennings, controller.
- The Board of Directors.
- The stockholders of Tappit Corporation.

(b) The president's statement, "We must get that amount above $1 million," puts undue pressure on the controller. This statement along with his statement, "I know you won't let me down, Robert," encourages Robert to do something unethical.

Controller Robert Jennings' reclassification (intentional misclassification) of a cash inflow from a long-term note (financing activity) issuance to an "increase in payables" (operating activity) is inappropriate and unethical.

(c) It is unlikely that any board members (other than board members who are also officers of the company) would discover the misclassification. Board members generally do not have detailed enough knowledge of their company's transactions to detect this misstatement. It is possible that an officer of the bank that made the loan would detect the misclassification upon close reading of Tappit Corporation's statement of cash flows. It is also possible that close scrutiny of the balance sheet showing an increase in notes payable (long-term debt) would reveal that there is no comparable financing activity item (proceeds from note payable) in the statement of cash flows.

BYP 17-8 ALL ABOUT YOU ACTIVITY

(a) The article describes three factors that determine how much money you should set aside. (1) *Your willingness to take risk.* You need to evaluate how willing you are to experience wide swings in your financial position. (2) *Your needs.* Your need to carefully evaluate your situation and evaluate the possibility of various events and what the financial implications would be. This is also impacted by the number of dependents you have. (3) *Your upcoming expenses.* Here you need to look further out into the horizon and consider the implications of larger events such as a big trip, a wedding, or education costs.

(b) They recommend having at least three months of living expenses set aside, and up to six months.

(c) Responses to this question will vary. What is most important is that students begin the process of considering their cash needs and developing a plan to set aside enough money to provide a cushion in the event of a financial "hiccup."