

Accounting for Managers

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MGM341

Lecture (3)
Cash Flow Statement



Learning outcomes

- 1. Explain the difference between net income & net cash flow**
- 2. Indicate the usefulness of the statement of cash flows.**
- 3. Distinguish among operating, investing, and financing activities.**
- 4. Prepare a statement of cash flows using the indirect method.**
- 5. Analyze the statement of cash flows.**

STATEMENT OF CASH FLOWS

**Income
statement**



Net income



Accrual Basis

**Cash flow
statement**



Net cash flow



Cash Basis

Usefulness of the Statement of Cash Flows

Provides information about:

1. Entity's ability to generate future cash flows.
2. Entity's ability to pay dividends and obligations.
3. Reasons for difference between net income and net cash provided (used) by operating activities.

Classification of Cash Flows

Operating Activities

Income Statement
Items

Investing Activities

Generally Long-
Term Asset
Items
And investments

Financing Activities

Generally Long-Term
Liability and
Equity Items

Format of the Statement of Cash Flows

Order of Presentation:

1. Operating activities.
2. Investing activities.
3. Financing activities.

Direct Method

Indirect Method

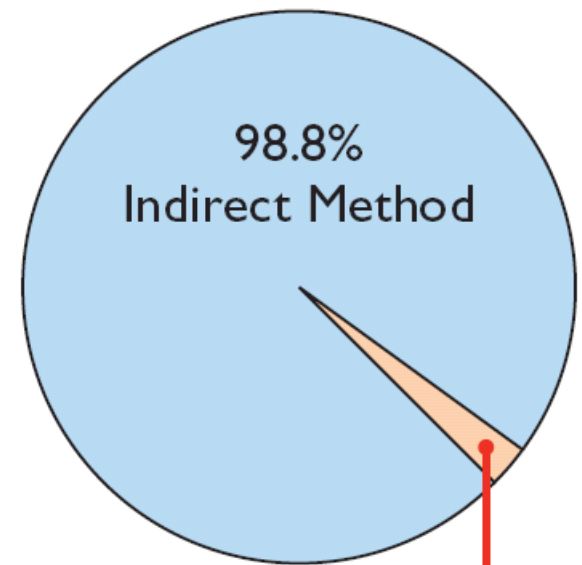
Preparing the Statement of Cash Flows

Indirect and Direct Methods

Companies favor the indirect method for two reasons:

1. It is easier and less costly to prepare, and
2. It focuses on the differences between net income and net cash flow from operating activities.

Usage of Methods



1.2% Direct Method

Operating Activities (Indirect method)

Net income

xx

Adjustments to reconcile net income to net cash flow

Depreciation & Amortization expense

x

Add

Loss on sale of fixed assets

x

Add

Gain on sale of fixed assets

(x)

Deduct

Changes in current assets and current liabilities

increase in current assets

(x)

Deduct

Decrease in current assets.

x

Add

Increase in current liabilities

x

Add

Decrease in current liabilities

(x)

Deduct

Net cash flow provided by operating activity

xx

Current Assets	Current liabilities
↓	↓
Accounts Receivable	Accounts Payable
Note Receivable	Note Payable
Inventory	Expense payable
Prepaid Expense	Unearned Revenue

Operating Activities

Summary of Conversion to Net Cash Provided by Operating Activities—Indirect Method

Adjustment Required to Convert Net Income to Net Cash Provided by Operating Activities

Noncash Charges	{ Depreciation expense	Add
	{ Patent amortization expense	Add
	{ Depletion expense	Add
Gains and Losses	{ Loss on sale of plant asset	Add
	{ Gain on sale of plant asset	Deduct
Changes in Current Assets and Current Liabilities	{ Increase in current asset account	Deduct
	{ Decrease in current asset account	Add
	{ Increase in current liability account	Add
	{ Decrease in current liability account	Deduct

Mayer company reported net income of \$ 50000 for the year. During the year accounts receivable increased by 7000, accounts payable decreases by 3000 and Depreciation Expense of 5000 was recorded, **Net cash provided by operating Activities for the year is...**

A- \$45000

B- 65000

C- \$49000

D- \$50000

Cash flow From operating Activities:	
Net income	50000
Adjustment to reconcile Net income to Net Cash	
Increase in accounts receivable	(7000)
Decrease in Accounts Payable	(3000)
Depreciation Expense	5000
Net Cash flow provided by operating Activities.	45000

The correct Answer is (A)

A company had Net income of \$ 180000. depreciation exp. is \$26000. During The year Accounts receivable and inventory increases \$ 15000 and 40000 Respectively. Prepaid expense . and Accounts payable decreased \$2000 \$ 4000 respectively. There was also a loss on the sale of equipment of \$3000 . **How much cash was provided by operating Activities .**

- A) \$146000 B) 152000 C) \$22600 D) \$23800

Cash flow From operating Activities:	
Net income	180000
Adjustment to reconcile Net income to Net Cash	
Depreciation Expense	26000
Increase in accounts receivable	(15000)
Increase in inventory	(40000)
Decrease in Prepaid expenses	2000
Decrease in accounts payable	(4000)
Loss on sale of equipment	3000
Net Cash flow provided by operating Activities.	152000

The correct Answer is (B)

Classification of Cash Flows

Investing activities

Cash inflows:

From **sale** of property, plant, and equipment.

From **sale** of investments in debt.

From collection of principal on loans to other entities.

Cash outflows:

To **purchase** property, plant, and equipment.

To **purchase** investments in debt or equity securities.

To **make loans** to other entities.

- Depreciation expense of \$15.000
- Gain on sale of PPE (Property, Plant and Equipment) \$7.000
- Purchases of PPE (Property, plant and Equipment)during the year totaled \$120.000
- Proceeds from sale of PPE (receipts from sale) \$92.000
- Collection of loans during the year \$5.000
- Purchase Cost of Investments, of \$45.000
- New Loans Made to other \$35.000

Requirement: Compute cash flow from investing activities

Cash flow From investing Activities:	
Purchases of PPE	(120000)
Proceeds from sale of PPE	92000
Purchase Cost of Investments	(45000)
Collection of loans during the year	5000
New Loans Made to other	(35000)
⇒ Net cash flow from investing Activities	(103000)

Classification of Cash Flows

Financing activities

Cash inflows:

From **sale** of common stock.

From **issuance** of long-term debt (bonds and notes).

Cash outflows:

To pay dividends to stockholders.

To redeem long-term debt .

To reacquire capital stock (treasury stock).

The following information concerning Maldives Company :

- Issuing share capital :\$20.000 إصدار الأسهم
- Net income :\$40.000 صافي الدخل
- Increase in account payable : \$13.000 الزيادة في الدائنون
- Depreciation expense:18.000 مصروف الإهلاك
- Payment of dividends : 1.000 سداد توزيعات الأرباح
- Increase in account receivable :7.000 الزيادة في المدينين
- Collection of long term notes receivable : 5.000 تحصيل أوراق قبض
- Loss on sale of land : 10.000 خسارة بيع أراضي
- Acquisition of equipment:40.000 شراء معدات
- Payment of long - term debt:13.000 سداد الديون طويلة الأجل
- Proceeds from sale of land : 32.000 متحصلات من بيع أراضي
- Decrease in inventories :5.000 النقص في المخزون

1) Using the indirect method Net cash provided by **operating** activities is equal to :

- a. \$85.000 \$66.000 c. **\$79.000** d.\$52.000

2)Net cash provided by (used for) **investing** activities is equal to :

- a. \$(2.000) **b. \$(3.000)** c.\$2.000 d.\$3.000

3) Net cash provided by (used for) **financing** activities is equal to :

- a. \$(7.000) b. \$(18.000) c. \$7.000 **d.\$6.000**

Cash flow From <u>operating</u> Activities:	
Net income	40,000
Depreciation expense	18,000
Loss on sale of land	10,000
Increase in accounts payable	13000
Increase in Accounts receivable	(7000)
Decrease in Inventories	5000
⇒ Net cash flow from operating Activities	79000

Cash flow From investing Activities:	
Collection of long term notes receivable	5000
Acquisition of Equipment	(40,000)
Proceeds from sale of land	32000
⇒ Net cash flow from investing Activities	(3000)

Cash flow From Financing Activities:	
Issuance of shares capital	20,000
Payment of dividends	(1000)
Payment of long term debt	(13000)
⇒ Net cash flow from Financing Activities	6000

Significant Noncash Activities

1. Issuance of common stock to purchase assets.
2. Conversion of bonds into common stock.
3. Issuance of debt to purchase assets.
4. Exchanges of plant assets.

ABC Company issued common stock for of \$ 19000 during 2008. The company paid dividends of \$ 2000 and issued along term note payable for \$ 30000 in exchange for equipment during the year. The company also sold treasury stock that had a cost of \$ 7000 for L.E 4000. **Compute net cash flow from financing activity**

Cash flow From Financing Activities:	
Issuance of common Stock	19000
Payment of dividends	(2000)
Sale of Treasury Stock	4000
⇒ Net cash flow from Financing Activities	21000

Use the following information to calculate the net cash provided or used by **financing activities for the Electro light Corporation:**

- a. Net income , L.E. 10,000
- b. Paid cash dividend of L.E. 3,000
- c. Paid bond payable, L.E. 8,000
- d. Purchased equipment for L.E. 12,000 cash

Cash flow From Financing Activities:	
Paid cash dividends	(3000)
Paid bonds payable	(8000)
⇒ Net cash flow from financing Activities	(11000)

ABC Company reported net income of \$200000 for the current year. Depreciation expense amounted to \$80000 for the year. Balances of the current asset and current Liability accounts at the beginning and end of the year are as follows:

	2011	2010
Accounts receivable	24000	32000
Inventories	50000	65000
Prepaid expenses	7500	5000
Accounts payable	12000	18000
Income taxes payable	1600	1200

Instructions : Prepare the cash flows from the operating activities section of the statement of cash flows using the indirect method

Net Income	\$200000
Adjustments to reconcile net income to net cash provided By operating activities:	
Depreciation expense	80000
Decrease in accounts receivable	8000
Decrease in inventories	15000
Increase in prepaid expenses	(2500)
Decrease in accounts payable	(6000)
Increase in income taxes payable	400
Net cash provided by operating activities	\$294900

1. All of the following activities are presented on the statement of cash flows except:

- a. financing activities.
- b. Operating activities.
- c. investing activities.
- d. Advertising activities.

2. Activities that create long term liabilities are usually:

a. Investing activities.

b. Financing activities.

c. Advertising activities.

d. Operating activities.

3. Activities impacting long term assets:

a. Investing activities.
b. Financing activities.

c. Marketing activities.
d. Operating activities.

4. Issuing bonds payable is reported on the statement of cash flows under:

- a. investing activities.
- b. operating activities.
- c. financing activities.
- d. noncash activity

5. Selling equipment is reported on the statement of cash flows under:

- a. operating activities.
- b. investing activities.
- c. financing activities.
- d. noncash investing and financing activities.

6. To compute the cash flow provided by operating activities using the indirect method, **an increase in a prepaid insurance should be:**

- a. added to increases in current assets.
- b. added to net income.
- c. included in payments to suppliers.
- d. subtracted from net income.

7. Paying cash dividends is:

- a. operating activities.
- b. investing activities.
- c. financing activities.
- d. noncash investing and financing activities.

8. To compute the cash flow provided/used by operating activities using the indirect method, **a gain on the sale of PPE would be:**

- a. Reported in the investing activities section.
- b. ignored, as the gain did not generate any cash.
- c. deducted from net income in the operating activities section.
- d. added to net income in the operating activities section.

9. To compute the cash flow provided/used by operating activities using the indirect method, **an increase in a accounts payable should be:**

- a. added to net income in the operating activities section.
- b. deducted from net income in the operating activities section.
- c. reported in the investing activities section.
- d. reported in the financing activities section.

Question

Which is an example of a cash flow from an investing activity?

- a. Receipt of cash from the issuance of bonds payable.
- b. Payment of cash to repurchase outstanding capital stock.
- ☒ c. Receipt of cash from the sale of equipment.
- d. Payment of cash to suppliers for inventory.

Using Cash Flows to Evaluate a Company

Free Cash Flow

$$= \text{Cash Provided by Operating Activities} - \text{Capital Expenditures} - \text{Cash Dividends}$$

Free cash flow describes the cash remaining from operations after adjustment for capital expenditures and dividends.

Thank You

