**Chapter 4**

**True-False**

1. The analyst of financial statements should consider cash flows over a period of time, looking at patterns of performance and exploring underlying causes of strength and weakness.

2. The statement of cash flows shows the changes in the balance sheet accounts between periods.

3. Cash flow from operations represents the “cash” income from the company’s business operations.

4. Cash from sales of property, plant and equipment is considered an operating activity on the cash flow statement.

5. Proceeds from borrowing are a financing cash outflow.

6. Repurchase of a firm’s own shares is an investing cash outflow.

7. Cash outflows result from increases in asset accounts and decreases in liability and equity accounts.

8. Analyzing the statement of cash flows helps determine the future external financing needs of a business firm.

9. An analysis of the statement of cash flows should, at a minimum, cover the following areas: analysis of cash inflows, analysis of cash outflows, and an analysis of the structure of asset and liabilities.

10. The amounts on a cash flow statement cannot be manipulated.

**Fill in the Blank**

1. Cash flows are segregated on a statement of cash flows by activities, activities, and activities.

2. A change in the retained earnings account is the result of the

for the period and the payment of .

3. Per FASB rules, firms may use the method or the method to calculate and present cash flow from operating activities.

4. The is one way to common size the cash flow statement.

For questions 5 through 10, insert the word “added” or “subtracted” in the blank.

5. An increase in inventory should be to convert net income to cash flow from operating activities.

6. An increase in accounts payable should be to convert net income to cash flow from operating activities.

7. A decrease in accrued liabilities should be to convert net income to cash flow from operating activities.

8. A decrease in accounts receivable should be to convert net income to cash flow from operating activities.

9. Depreciation and amortization should be to convert net income to cash flow from operating activities.

10. A gain on sale of asset should be to convert net income to cash flow from operating activities.

**Multiple Choice**

1. All of the following are reasons that the statement of cash flows is useful to the analyst except:

a. The statement of cash flows shows how cash is generated during an accounting period and how it has been used.

b. A positive net income figure on the income statement is ultimately insignificant unless a company can translate its earnings into cash, and the only source in financial statements for learning about cash generation is the statement of cash flows.

c. The statement of cash flows shows the adjustments made to net income in order to calculate cash flow from operations; those should be examined to determine why cash flow from operations is negative or positive.

d. The statement of cash flows is the only financial statement that cannot be manipulated.

2. How is the statement of cash flows connected to the balance sheet?

a. The statement of cash flows shows changes in the asset and liability accounts to explain cash from operating activities.

b. The changes in all revenue and expense accounts are calculated and then listed as cash inflows or outflows.

c. The changes in all of the balance sheet accounts are calculated and then listed as inflows or outflows, except for cash.

d. Changes in asset accounts are recorded as operating activities, changes in liability accounts are recorded as financing activities and changes in equity accounts are recorded as investing activities.

3. The following item would be classified as an operating activity on the statement of cash flows:

a. Payments for inventory.

b.Acquisitions of equipment.

c. Proceeds from borrowing.

d. Payments on loans.

4. The following item would be classified as an investing activity on the statement of cash flows:

a. Proceeds from borrowing.

b. Sale of goods.

c.Sale of property.

d. Payment to lenders.

5. The following item would be classified as a financing activity on the statement of cash flows:

a. Payments for inventory.

b. Payment of dividends.

c. Acquisition of land.

d. Sales of goods.

6. Which item is a noncash item that would be added to net income to convert it to cash flow from operating activities?

a. Accounts receivable.

b. Depreciation.

c. Accounts payable.

d. Inventory.

Use the indirect method to answer questions 7-10. The following information is available for Armstrong Company:

Net income $450 Increase in plant and equip. $170

Depreciation expense 80 Payment of dividends 10

Decrease in accts. receiv. 20 Increase in long-term debt 100

Increase in inventories 15 Decrease in accounts payable 30

7. What is cash flow from operating activities for Armstrong Company?

a. $505

b. $495

c. $335

d. $55

8. What is cash from investing activities for Armstrong Company?

a. ($160)

b. $160

c. $170

d. ($170)

9. What is cash from financing activities for Armstrong Company?

a. $70

b. $60

c. $90

d. ($110)

10. What is the change in cash for Armstrong Company?

a. $315

b. $565

c. $425

d. $215

Use the indirect method to answer questions 11-14. The following information is available for Felix Company:

Net income $300 Decrease in plant and equip. $40

Depreciation expense 20 Increase in deferred tax asset 5

Gain on sale of assets 35 Decrease in long-term debt 50

Increase in inventories 25 Decrease in accounts payable 15

11. What is cash flow from operating activities for Felix Company?

a. $240

b. $70

c. $320

d. $250

12. What is cash from investing activities for Felix Company?

a. $5

b. $40

c. $75

d. $10

13. What is cash from financing activities for Felix Company?

a. $50

b. $65

c. ($50)

d. $60

14. What is the change in cash for Felix Company?

a. $310

b. $205

c. $330

d. $230

15. What is implied if the inventory account has increased?

a. Cash flow from financing activities has decreased relative to net income.

b. Cash flow from operating activities has increased relative to net income.

c. Cash flow from operating activities has decreased relative to net income.

d. Cash flow from financing activities has increased relative to net income.

16. Why are gains and losses from asset sales removed from net income when calculating the cash flows from operating activities?

a. Selling assets is a noncash item.

b. Gains and losses from asset sales are a financing activity.

c. Gains and losses are not removed from net income when calculating the cash flows from operating activities

d. The entire proceeds from sales of long-lived assets are included in investing activities.

17. What is the preferred method to generate cash in a firm?

a. Operating activities.

b. Investing activities.

c. Financing activities.

d. Investing and financing activities.

18. Which item may be of concern when analyzing cash flow from financing activities?

a. Increasing inventories.

b. Borrowing each year to repay debt from prior years.

c. Repayment of debt.

d. Payments of dividends.

19. Which of the following would increase cash from operating activities?

a. Increasing accounts receivable.

b. Increasing inventories.

c. Decreasing accounts payable.

d. Decreasing accounts receivable.

20. Which of the following items would be a way to manipulate the cash flow from operating activities amount on the statement of cash flows?

a. Adding depreciation back to net income to determinecash flow from operating activities.

b. Including interest expense and tax expense in the calculation of cash flow from operating activities.

c. Recording an item that should be recorded as an operating activity as an investing activity.

d. The cash flow statement cannot be manipulated.

**Short Answer/Problem**

1. What can be learned from a statement of cash flows?

2. Discuss the format of a statement of cash flows prepared using the indirect method.

3. What are the three areas of a cash flow statement that an analyst should cover at a minimum? Discuss each area by explaining items an analyst should be concerned with when reviewing the cash flow statement.

4. Identify the following as operating (O), financing (F), or investing (I) activities:

a. Proceeds from borrowing

b. Purchases of property, plant and equipment

c. Cash from sale of a business segment

d. Interest payments to lenders

e. Cash from sales of goods and services

f. Payment of dividends

g. Payments for purchase of inventory

h. Payments for taxes

i. Repurchase of a firm’s own shares

j. Cash collections from loans to others

5. Indicate which of the following current asset and current liability accounts are operating (O), investing (I), or financing (F) accounts.

a. Current portion of long-term debt

b. Accounts receivable

c. Prepaid expenses

d. Marketable securities

e. Accrued expenses

f. Notes payable to bank

6. Indicate whether each of the following items would result in net cash flow from operating activities being higher (H) or lower (L) than net income.

a. Increase in inventory

b. Increase in accounts payable

c. Amortization expense

d. Decrease in accrued liabilities

e. Loss on sale of assets

f. Decrease in accounts receivable

g. Decrease in deferred tax assets

h. Increase in deferred revenue

i. Decrease in income taxes payable

j. Decrease in prepaid expenses

7. Jesse Corporation reported the following information for the current year:

(1) Net income is $205 million.

(2) Acquisitions were $32 million.

(3) Customer accounts receivable increased by $12 million.

(4) Dividends paid to common shareholders were $8 million.

(5) Depreciation expense was $41 million.

(6) Income tax payable decreased by $11 million.

(7) Long-term debt increased by $28 million.

(8) Accounts payable decreased by $6 million.

(9) Inventories increased by $17 million.

Required: Based on the above information, calculate the following items:

a. Cash flow from operating activities.

b. Cash flow from investing activities.

c. Cash flow from financing activities.

d. The increase or decrease in the cash balance.

8. N&M Corporation reported the following information for the current year:

(1) Net income is $560million.

(2) Sales of assets $26 million.

(3) Customer accounts receivable decreased by $14 million.

(4) Repurchases of common stock were $20 million.

(5) Depreciation expense was $38 million.

(6) Income tax payable increased by $4 million.

(7) Long-term debt decreased by $13 million.

(8) Accounts payable increased by $9 million.

(9) Inventories increased by $24 million.

Required: Based on the above information, calculate the following items:

a. Cash flow from operating activities.

b. Cash flow from investing activities.

c. Cash flow from financing activities.

d. The increase or decrease in the cash balance.

9.Prepare the statement of cash flows for Franklin Company using the indirect method.

Franklin Company

Income Statement

For the Year Ended December 31, 2015

Revenues $9,000

Depreciation expense $ 650

Other operating expenses 7,100 7,750

Income before income taxes $1,250

Interest expense 440

Income tax expense 270

Net income $ 540

Franklin Company

Balance Sheet

December 31, 2015 and 2014

**2015 2014 2015 2014**

Assets: Liab. & SE:

Cash $ 230 $ 480 A/P $ 370$ 550

A/R 510 590 Inc.Taxes/Pay. 120 280

Inventories 980 960 LT debt 910 830

Plant & Equip. 3,140 2,150 Common Stock 1,100 1,350

Less: Acc. Depr.(1,520) (870) Retained Earnings 840 300

Total Assets $3,340 $3,310 Total Liab. & SE $3,340$3,310

10. Prepare the statement of cash flows for Benji Company using the indirect method.

Benji Company

Income Statement

For the Year Ended December 31, 2015

Revenues $8,200

Depreciation expense $ 400

Other operating expenses 6,800 7,200

Income before income taxes $1,000

Income tax expense 340

Net income $ 660

Benji Company

Balance Sheet

December 31, 2015 and 2014

**2015 2014 2015 2014**

Assets: Liab. & SE:

Cash $ 380 $ 120 A/P $ 770 $ 600

A/R 640 580 Inc.Taxes/Pay. 90 160

Inventories 950 840 LT debt 1,080 1,630

Plant & Equip. 2,870 2,990 Common Stock 1,000 1,000

Less: Acc. Depr.(1,120) (720) Retained Earnings 780 420

Total Assets $3,720 $3,810 Total Liab. & SE $3,720$3,810

11. Using the excerpt from the Ralston Company statement of cash flows analyze thoroughly the cash flow from operating activities. Be sure to offer possible reasons for the changes identified.

|  |  |  |
| --- | --- | --- |
| Operating Activities | **2015** | **2014** |
| Net income | $175,000 | $137,000 |
| Depreciation and amortization | 28,500 | 23,200 |
| Deferred income taxes | 7,600 | 4,100 |
| Equity in gains of investees | 3,300 | 1,100 |
| Increase (decrease) in cash resulting from changes in: |  |  |
| Accounts receivable | (6,500) | (66,700) |
| Inventories | 35,600 | (53,900) |
| Accounts payable and accrued expenses | 43,400 | (5,000) |
| Net cash provided (used) by operating activities | $286,900 | $(39,800) |

12. Using the excerpt from the Animal World Company statement of cash flows analyze thoroughly the cash flow from operating activities. Be sure to offer possible reasons for the changes identified.

|  |  |  |
| --- | --- | --- |
| Operating Activities | **2015** | **2014** |
| Net income | $(2,800) | $(9,800) |
| Depreciation and amortization | 21,800 | 21,700 |
| Loss on disposal of property and equipment | 11,000 | 3,100 |
| Increase (decrease) in cash resulting from changes in: |  |  |
| Accounts receivable | (10,100) | (9,200) |
| Inventories | (35,500) | (56,500) |
| Accounts payable and accrued expenses | 54,700 | 24,200 |
| Net cash provided (used) by operating activities | $39,100 | $(26,500) |

13. Using the summary analysis for eApparel, Inc. analyze the cash inflows and cash outflows for 2015 and 2014.

|  |  |  |  |
| --- | --- | --- | --- |
| **Inflows (in percent of total)** | | 2015 | 2014 |
| Sales and maturities of marketable securities | | 20.1 | 22.9 |
| Proceeds from issuance of common stock | | 54.5 | 23.5 |
| Proceeds from long-term debt | | 25.4 | 53.6 |
|  | Total Inflows | 100.0 | 100.0 |
| **Outflows (in percent of total)** | |  |  |
| Operations | | 18.4 | 22.4 |
| Purchases of marketable securities | | 19.8 | 21.7 |
| Purchases of fixed assets | | 26.5 | 23.1 |
| Repayment of long-term debt | | 35.3 | 32.8 |
|  | Total Outflows | 100.0 | 100.0 |

14. Use the following statement of cash flowsfor Star Pharmaceuticals to:

a. prepare a summary analysis of the statement of cash flows,

b. analyze cash flow from operating activities, and

c. analyze the cash inflows and cash outflows.

Star Pharmaceuticals

Statement of Cash Flows

For the Years Ended December 31, 2015 and 2014

|  |  |  |
| --- | --- | --- |
| (in millions) | 2015 | 2014 |
| Cash flows from operating activities (CFO): |  |  |
| Net income | $5,800 | $3,300 |
| Adjustments to reconcile net income to CFO: |  |  |
| Depreciation and amortization | 550 | 360 |
| Deferred income taxes | 10 | (580) |
| Stock-based compensation | 590 | 170 |
| (Increase) decrease in operating assets and liabilities: |  |  |
| Accounts receivable | (490) | (380) |
| Inventories | (6,900) | (1,960) |
| Other current assets | 410 | (480) |
| Accounts payable | 700 | 690 |
| Income taxes payable | 250 | 140 |
| Accrued liabilities | 170 | (290) |
| Net CFO | 1,090 | 970 |
| Cash flows from investing activities: |  |  |
| Purchases of property and equipment | (740) | (750) |
| Acquisitions | 0 | (350) |
| Net cash used by investing activities | (740) | (1,100) |
| Cash flows from financing activities: |  |  |
| Proceeds from common stock sales | 2,000 | 580 |
| Repayment of short-term line of credit | 0 | (140) |
| Repayment of long-term debt | (70) | (70) |
| Net cash provided by financing activities | 1,930 | 370 |
| Net increase in cash | 2,280 | 240 |
| Beginning cash balance | 980 | 740 |
| Ending cash balance | $3,260 | $980 |

15. Using the statements of cash flows for JAJ Enterprises:

a. prepare a summary analysis of the statement of cash flows,

b. analyze cash flow from operating activities, and

c. analyze the cash inflows and cash outflows.

JAJ Enterprises

Statement of Cash Flows

For the Years Ended December 31, 2015 and 2014

|  |  |  |
| --- | --- | --- |
| (in thousands) | 2015 | 2014 |
| Cash flows from operating activities (CFO): |  |  |
| Net income | $8,100 | $6,800 |
| Adjustments to reconcile net income to CFO: |  |  |
| Depreciation and amortization | 3,100 | 1,600 |
| Deferred income taxes | 900 | 700 |
| Other non-cash items | (600) | (700) |
| (Increase) decrease in operating assets and liabilities: |  |  |
| Accounts receivable | (7,800) | (2,300) |
| Inventories | (2,100) | 1,700 |
| Other current assets | (900) | 2,000 |
| Accounts payable | (1,300) | 4,100 |
| Income taxes payable | 400 | (800) |
| Accrued liabilities | 1,700 | 700 |
| Net CFO | 1,500 | 13,800 |
| Cash flows from investing activities: |  |  |
| Purchases of property and equipment | (800) | (1,200) |
| Net cash used by investing activities | (800) | (1,200) |
| Cash flows from financing activities: |  |  |
| Proceeds from common stock sales | 4,700 | 4,600 |
| Proceeds (repayments) of short-term debt | 100 | (1,100) |
| Repayment of long-term debt | (200) | (3,300) |
| Net cash provided by financing activities | 4,600 | 200 |
| Net increase in cash | 5,300 | 12,800 |
| Beginning cash balance | 30,600 | 17,800 |
| Ending cash balance | $35,900 | $30,600 |