

# CHAPTER 12

## Statement of Cash Flows

### ANSWERS TO QUESTIONS

1. (a) The statement of cash flows reports the cash receipts and cash payments from operating, investing, and financing activities 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) The sources of cash (inflows) in the statement of cash flows come from:
  - (1) Operating activities
    - i. Sale of goods or services
    - ii. Interest and dividends received
  - (2) Investing activities
    - i. Sale of property, plant, and equipment
    - ii. Sale of investments in other entities' securities
    - iii. Collection of principal on loans to other entities
  - (3) Financing activities
    - i. Sale of common stock
    - ii. Issuance of debt (bonds and notes)
- (b) The uses of cash (outflows) in the statement of cash flows come from:
  - (1) Operating activities
    - i. Payments to suppliers for inventory
    - ii. Payments to employees for services
    - iii. Payments to government for taxes
    - iv. Payments to lenders for interest
    - v. Payments to others for expenses
  - (2) Investing activities

- i. Purchase of property, plant, and equipment
- ii. Purchase of investments in other entities' securities
- iii. Making loans to other entities

## Questions Chapter 12 (Continued)

- (3) Financing activities
  - i. Payment of cash dividends to stockholders
  - ii. Redeeming principal of long-term debt
  - iii. Payment to reacquire capital stock (treasury stock)
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. (a) The phases of the corporate life cycle are the introductory phase, growth phase, maturity phase, and decline phase.  
(b) During the introductory phase, net cash provided by operating and investing activities would be expected to be negative, and cash from financing would be positive.

During the growth phase, a company would be expected to show some small amounts of cash from operations while continuing to show negative cash from investing and positive cash from financing.

During the maturity phase, net cash provided by operating, investing, and financing activities would all be expected to be positive while in the decline phase, net cash provided by operating and investing activities would continue to be positive while cash from financing would be negative.

9. Tootsie Roll has positive net cash provided by operating activities that exceeds its net income. Net cash provided by operating exceeded its investing needs and it retired shares of stock and paid dividends. Tootsie Roll appears to be in the middle to late maturity phase.
10. 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. However, the indirect method is the overwhelming favorite of companies.