BUS312A/612A
Financial Reporting I

Balance Sheet & Statement of Cash Flows
Chapter 5
Start of Cash Flow

Operating
Net income
+ Non Cash IS expenses & losses
- Non Cash IS gains

\( \Delta CA \downarrow \)
- \( \Delta CA \uparrow \)
- \( \Delta CL \downarrow \)
+ \( \Delta CL \uparrow \)

\[ \text{Cash from/for operating} \quad \boxed{619,800} \]

Investing
\( \Delta NCA \) - Analyze Taccounts

\[ \text{Cash from/for Investing} \quad \boxed{-(14,400)} \]

Financing
\( \Delta TL \& SHE \) - Analyze Taccounts

\[ \text{Cash from/for Financing} \quad \boxed{82,000} \]

\[ \frac{619,800 - 14,400 + 82,000}{134,400} \]

Change in Cash
+ Beg CL

\[ \text{End Cash} \quad \text{Non Cash activities} \]
E5-13 (Statement of Cash Flows – Classifications)  The major classifications of activities reported in the statement of cash flows are operating, investing, and financing. Classify each of the transactions listed below as:

1. Operating activity – add to net income.
2. Operating activity – deduct from net income.
3. Investing activity.
5. Reported as a “significant noncash activity”.

(a) Issuance of capital stock.
(b) Purchase of land and building.
(c) Redemption of bonds.
(d) Sale of equipment.
(e) Depreciation of machinery.
(f) Amortization of patent.
(g) Issuance of bonds for plant assets.

(h) Payment of cash dividends.
(i) Exchange of furniture for office equipment.
(j) Purchase of treasury stock.
(k) Loss on sale equipment.
(l) Increase in accounts receivable during the year.
(m) Decrease in accounts payable during the year.

**Operating:** NonCashRev-Exp, ΔCA
**Investing:** ΔNCA
**Financing:** ΔLiab, ΔSHC
**NonCash Activities**
Ortega Corporation's income statement for the year ended June 30, 2010 and its comparative balance sheets as of June 30, 2010 and 2009 appear on the next page. During 2010, the corporation sold at a loss of $4,000 equipment that cost $24,000, on which it had accumulated depreciation of $17,000. It also purchased land and a building for $100,000 through an increase of $100,000 in Mortgage Payable; made a $20,000 payment on the mortgage; repaid notes but borrowed an additional $30,000 through the issuance of a new note payable of $80,000; and declared and paid a $60,000 cash dividend.

P7.  

Ortega Corporation  
Income Statement  
For the Year Ended June 30, 2010  

Sales $4,040,900  
Cost of goods sold 3,656,300  
Gross margin $384,600  
Operating expenses (including depreciation expense of $60,000) 189,200  
Income from operations $195,400  
Other income (expenses)  
Loss on sale of equipment ($4,000)  
Interest expense (37,600) (41,600)  
Income before income taxes $153,800  
Income taxes expense 34,200  
Net income $119,600  

Ortega Corporation  
Comparative Balance Sheets  
June 30, 2010 and 2009  

<table>
<thead>
<tr>
<th>Assets</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$167,000</td>
<td>$20,000</td>
</tr>
<tr>
<td>Accounts receivable (net)</td>
<td>100,000</td>
<td>120,000</td>
</tr>
<tr>
<td>Inventory</td>
<td>180,000</td>
<td>220,000</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>600</td>
<td>1,000</td>
</tr>
<tr>
<td>Property, plant, and equipment</td>
<td>628,000</td>
<td>552,000</td>
</tr>
<tr>
<td>Accumulated depreciation, property, plant, and equipment</td>
<td>(183,000)</td>
<td>(140,000)</td>
</tr>
<tr>
<td>Total assets</td>
<td>$892,600</td>
<td>$773,000</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and Stockholders' Equity</th>
<th>2010</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>$64,000</td>
<td>$42,000</td>
</tr>
<tr>
<td>Notes payable (due in 90 days)</td>
<td>30,000</td>
<td>80,000</td>
</tr>
<tr>
<td>Income taxes payable</td>
<td>26,000</td>
<td>18,000</td>
</tr>
<tr>
<td>Mortgage payable</td>
<td>360,000</td>
<td>280,000</td>
</tr>
<tr>
<td>Common stock, $5 par value</td>
<td>200,000</td>
<td>200,000</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>212,600</td>
<td>153,000</td>
</tr>
<tr>
<td>Total liabilities and stockholders' equity</td>
<td>$892,600</td>
<td>$773,000</td>
</tr>
</tbody>
</table>

Required

1. Using the indirect method, prepare a statement of cash flows. Include a supporting schedule of noncash investing and financing transactions.

2. What are the primary reasons for Ortega Corporation's large increase in cash from 2009 to 2010?
Significant N/A

100,000

3000

(80,000)

3,000

(29,000)

14,700

10,000

1,700

1,400

222,400

30,000

20,000

3,000

20,000

22,400

119,600

A
E8

<table>
<thead>
<tr>
<th>Inv+</th>
<th>Loss 216,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Beg 152,000</td>
<td>Cash 130,000</td>
</tr>
<tr>
<td>Buy 232,000</td>
<td>Inv+ 156,000</td>
</tr>
<tr>
<td>228,000</td>
<td></td>
</tr>
</tbody>
</table>

Investing

Buy Inv+ Sold Inv+

PA

\[
\begin{array}{c|c|c}
\text{PA} & \text{AD} & \text{AD} \\
\hline
260,000 & 58,800 & 58,800 \\
134,400 & 138,000 & 50,800 \\
302,400 & 40,800 & 92,000 \\
\hline
\end{array}
\]

Investing

Cash Purchase of PA (134,400)

Cash Sale of PA (50,800)

<table>
<thead>
<tr>
<th>Sharma Fabrics, Inc.</th>
<th>2011</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Assets</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td>$189,120</td>
<td>$54,720</td>
</tr>
<tr>
<td>Accounts receivable (net)</td>
<td>204,860</td>
<td>150,860</td>
</tr>
<tr>
<td>Inventory</td>
<td>225,780</td>
<td>275,780</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>—</td>
<td>40,000</td>
</tr>
<tr>
<td>Land</td>
<td>50,000</td>
<td>—</td>
</tr>
<tr>
<td>Building</td>
<td>274,000</td>
<td>—</td>
</tr>
<tr>
<td>Accumulated depreciation—building</td>
<td>(30,000)</td>
<td>—</td>
</tr>
<tr>
<td>Equipment</td>
<td>66,000</td>
<td>—</td>
</tr>
<tr>
<td>Accumulated depreciation—equipment</td>
<td>(29,000)</td>
<td>(48,000)</td>
</tr>
<tr>
<td>Patents</td>
<td>8,000</td>
<td>—</td>
</tr>
<tr>
<td>Total assets</td>
<td>$958,760</td>
<td>$553,360</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Liabilities and Stockholders’ Equity</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts payable</td>
<td>$21,500</td>
</tr>
<tr>
<td>Notes payable (current)</td>
<td>20,000</td>
</tr>
<tr>
<td>Accrued liabilities</td>
<td>—</td>
</tr>
<tr>
<td>Mortgage payable</td>
<td>324,000</td>
</tr>
<tr>
<td>Common stock, $10 par value</td>
<td>360,000</td>
</tr>
<tr>
<td>Additional paid-in capital</td>
<td>114,400</td>
</tr>
<tr>
<td>Retained earnings</td>
<td>118,860</td>
</tr>
<tr>
<td>Total liabilities and stockholders’ equity</td>
<td>$958,760</td>
</tr>
</tbody>
</table>

Additional information about Sharma Fabrics’s operations during 2011 is as follows: (a) net income, $56,000; (b) building and equipment depreciation expense amounts, $30,000 and $6,000, respectively; (c) equipment that cost $27,000 with accumulated depreciation of $25,000 sold at a gain of $10,600; (d) equipment purchases, $25,000; (e) patent amortization, $6,000; purchase of patent, $2,000; (f) funds borrowed by issuing notes payable, $50,000; notes payable repaid, $30,000; (g) land and building purchased for $324,000 by signing a mortgage for the total cost; (h) 3,000 shares of $20 par value common stock issued for a total of $100,000; and (i) paid cash dividend, $18,000.

Required

1. Using the indirect method, prepare a statement of cash flows for Sharma Fabrics, Inc.
2. Why did Sharma Fabrics have an increase in cash of $134,400 when it recorded net income of only $56,000? Discuss and interpret.
Operating

Net Income
+ DE - E
+ DE - B
+ Amort
- Gain
- Δ AR
+ Δ Inv
+ Δ Prepds
- Δ AP
+ Δ NPT
- Δ Acc

Investing

Buy Equity
Sell Equity
Buy Patent

Financing

Issue Common Stock
Paid Dividend
Change in Cash

Non Cash Activity

\[ \begin{align*}
\text{Net Income} & : 56,000 \\
\text{Depreciation} & : 6,000 \\
\text{Gain} & : 30,000 \\
\text{Amortization} & : 6,000 \\
\text{Change in Accounts Receivable} & : (10,600) \\
\text{Change in Inventory} & : 54,000 \\
\text{Prepaid Expenses} & : 50,000 \\
\text{Change in Accounts Payable} & : 40,000 \\
\text{Net Property, Plant, and Equipment} & : (52,000) \\
\text{Change in Accruals} & : 20,000 \\
\text{Total} & : 106,800
\end{align*} \]

\[ \begin{align*}
\text{Buy Equity} & : (25,000) \\
\text{Sell Equity} & : 12,600 \\
\text{Buy Patent} & : (2,000)
\end{align*} \]

\[ \begin{align*}
\text{Issue Common Stock} & : 10,000 \\
\text{Paid Dividend} & : (18,000) \\
\text{Change in Cash} & : 82,000 \\
\text{Non Cash Activity} & : 324,000
\end{align*} \]

\[ \begin{align*}
\text{Total} & : 134,400
\end{align*} \]
Extra Arif Fabrics Inc
Cash Flow Statement

Operating
Net Income 28,000
+ DE - A/P 15,000
+ DE - Eqmt 3,000
- Cash (5,300)
+ Amort 3,000
- A/R (27,000)
+ A Inv (25,000)
+ A Prepaid (20,000)
+ A AP (26,000)
+ A NP (10,000)
- A Accruals (12,300)

33,400

Investing
Buy Eqmt - Patent (12,500)
Sell Eqmt 10,000

-700

Financing
Sell Stock 50,000
Pay Dividend (9,000)

41,000

Change in Cash 67,200
Beginning Cash 27,360
Ending Cash $94,560

Non Cash Activities $162,000
Statement of Cashflows: US GAAP vs. IFRS

US GAAP specifically identifies classifications of ambiguous accounts, such as:

- Interest paid (operating)
- Interest received (operating)
- Dividends paid (financing)
- Dividends received (operating)

Depending on their inclusion in net income.

IFRS allows judgment in classifications of ambiguous accounts, such as:

- Interest paid (operating or financing)
- Interest received (operating or investing)
- Dividends paid (operating or financing)
- Dividends received (operating or investing)
E 5-3. (Classification of Balance Sheet Accounts) Assume that Masters Enterprises uses the following headings on its balance sheet:

| A. | Current Assets          | F. | Current Liabilities         |
| B. | Investments            | G. | Long-term Liabilities       |
| C. | Property, Plant, and Equipment | H. | Capital Stock               |
| D. | Intangible Assets       | I. | Paid-in Capital in Excess of Par |
| E. | Other Assets            | J. | Retained Earnings           |

N = Note to the Financial Statements; X = Does not appear on the Financial Statements.

1. Prepaid insurance.
2. Stock owned in affiliated companies.
3. Unearned subscription revenue.
4. Advances to suppliers.
5. Unearned rent revenue.
6. Preferred Stock
7. Additional paid in capital on preferred stock.
8. Copyrights.
10. Sales tax payable.
11. Accrued interest on notes receivable.
12. Twenty-year issue of bonds payable which will mature within the next year. (No sinking fund exists and refunding is not planned.)
13. Machinery retired from use and held for sale.
14. Fully depreciated machine still in use.
15. Accrued interest on bonds payable.
16. Salaries that company budget shows will be paid to employees within the next year.
17. Discounts on bonds payable. (Assume related to bonds payable in No. 12.)
18. Accumulated depreciation.
19. Noncontrolling interest.
1. SL depreciation, 35 year service life on factory building for 15 years, change in 2012 to SL depreciation, 25 MORE years in service life. Effects on financial statements?


3. Accrual for 2011 salaries found in 2012 to have been overstated. Effects on financial statements?

4. Cash dividend declared on 12/15/12, payable 2/1/13, to holders of record on 12/31/12. Effects on financial statements?
E5-6 (Corrections of a Balance Sheet)  The bookkeeper for Geronimo Company has prepared the following balance sheet as of July 31.

<table>
<thead>
<tr>
<th>GERONIMO COMPANY</th>
<th>BALANCE SHEET AS OF JULY 31</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$ 69,000</td>
</tr>
<tr>
<td>Accounts receivable (net)</td>
<td>40,500</td>
</tr>
<tr>
<td>Inventories</td>
<td>60,000</td>
</tr>
<tr>
<td>Equipment (net)</td>
<td>84,000</td>
</tr>
<tr>
<td>Patents</td>
<td>21,000</td>
</tr>
<tr>
<td>Notes and accounts payable</td>
<td>$ 44,000</td>
</tr>
<tr>
<td>Long-term liabilities</td>
<td>75,000</td>
</tr>
<tr>
<td>Stockholders Equity</td>
<td>$155,500</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>$274,500</strong></td>
</tr>
</tbody>
</table>

The following additional information is provided:

1. Cash includes $1,200 in a petty cash fund and $15,000 in a bond sinking fund.

2. The net accounts receivable balance is comprised of the following three items: (a) accounts receivable-debit balances $52,000; (b) accounts receivable – credit balance $8,000; (c) allowance for doubtful accounts $3,500.

3. Merchandise inventory costing $5,300 was shipped out on consignment on July 31. The ending inventory balance does not include the consigned goods. Receivable in the amount of $5,300 were recognized on these consigned goods.

4. Equipment had a cost of $112,000 and an accumulated depreciation balance of $28,000.

5. Taxes payable of $6,000 were accrued on July 31. Geronimo Company, however, had set up a cash fund to meet this obligation. This cash fund was not included in the cash balance, but was offset against the taxes payable amount.

Prepare a corrected classified balance sheet as of July 31.
E5-9 (Current Assts and Current Liabilities) The current assets and liabilities sections of the balance sheet of Scarlatti Company appear as follows:

<table>
<thead>
<tr>
<th>SCARLATTI COMPANY</th>
</tr>
</thead>
<tbody>
<tr>
<td>BALANCE SHEET (PARTIAL)</td>
</tr>
<tr>
<td>DECEMBER 31</td>
</tr>
</tbody>
</table>

<p>| | |</p>
<table>
<thead>
<tr>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>$40,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$89,000</td>
</tr>
<tr>
<td>Less: Allowance for doubtful accounts</td>
<td>$7,000</td>
</tr>
<tr>
<td>Inventories</td>
<td>$171,000</td>
</tr>
<tr>
<td>Prepaid expenses</td>
<td>$9,000</td>
</tr>
<tr>
<td></td>
<td>$302,000</td>
</tr>
<tr>
<td>Accounts payable</td>
<td>$61,000</td>
</tr>
<tr>
<td>Notes payable</td>
<td>$67,000</td>
</tr>
<tr>
<td></td>
<td>$128,000</td>
</tr>
</tbody>
</table>

The following errors in the corporation’s accounting have been discovered:

1. January 2015 cash disbursements entered as of December 2014 included payments of accounts payable in the amount of $39,000, on which a cash discount of 2% was taken.

2. The inventory included $27,000 of merchandise that had been received at December 31 but for which no purchase invoices had been received or entered. Of this amount, $12,000 had been received on consignment; the remainder was purchased f.o.b. destination, terms 2/10, n/30.

3. Sales for the first four days in January 2015 in the amount of $30,000 were entered in the sales book as of December 31, 2014. Of these, $21,500 were sales on account and the remainder were cash sales.

4. Cash, not including cash sales, collected in January 2015 and entered as of December 31, 2014, totaled $35,324. Of this amount, $23,324 was received on account after cash discounts of 2% had been deducted; the remainder represented the proceeds of a bank loan.
EX 5-9

Current Assets

Current Liabilities