CHAPTER 19

UNDERSTANDING CASH FLOW STATEMENTS

1. (A) **No effect.**

Explanation

The seller financing is a noncash transaction. Accordingly, Wichita's 20X8 cash flows are unaffected. The noncash transaction should be disclosed in the footnotes to the 20X8 cash flow statement.

For Further Reference:

(Study Session 6, Module 19.1, LOS 19.a)

CFA® Program Curriculum, Volume 3, page 121

Related Material

SchweserNotes - Book 2

2. (B) **Increase in cash of $8,125.**

Explanation

Silverstone Company's cash flow from operations would be calculated as +Net Income $8,000 + Inventory $250 - Prepaid exp. $500 + Depreciation $175 + A/P $200 = $8,125.

Bonds payable is a financing activity and would not be included in the cash flow from operations. The indirect method takes the change in the non-cash accounts and decreases or increases net income to get to the change in cash flow.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

3. (A) **Net income.**

Explanation

Property, Plant, & Equipment and payment of dividends are components of the statement of cash flows under both the direct and indirect methods. Net income is the first figure under the indirect method, but it is not a part of the statement of cash flows under the direct method. The correct response is net income.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

4. (B) **Purchase of plant and equipment used in the manufacturing process with financing provided by the seller.**

Explanation

The purchase of plant and equipment with financing provided by the seller is a non-cash transaction. Non-cash transactions are disclosed separately in a note or supplementary schedule to the cash flow statement.

(Study Session 6, Module 19.1, LOS 19.b)
Related Material
SchweserNotes - Book 2

5. (A) **$35.**

Explanation

Using the indirect method, CFO = Net income 25 + increase in accounts payable 20 + increase in deferred taxes 5 - profit on sale of equipment 15 = $35.

Increases in accounts payable and deferred taxes are sources of operating cash that are not included in net income and must be added. Profit on sale of equipment is a CFI item that must be removed from net income.

No adjustment needs to be made for cash payment of dividends (CFF), sale of preferred stock (CFF), or purchase of land (CFI) because they are not included in net income. Only the profit on sale of equipment, not the full proceeds from sale, is included in net income.

(Study Session 6, Module 19.2, LOS 19.f)
Related Material
SchweserNotes - Book 2

6. (A) **Dividends paid.**

Explanation

According to SFAS 95, dividends paid are treated as cash flow from financing.
(Study Session 6, Module 19.1, LOS 19.a)
Related Material
SchweserNotes - Book 2

7. (A) **Reinvestment ratio. Cash-to-income ratio**

Explanation

The reinvestment ratio measures a firm's ability to acquire long-term assets with cash flows from operations. In contrast, the investing and financing ratio, which is more comprehensive, measures the firm's ability to purchase assets, satisfy debts, and pay dividends.

The cash-to-income ratio measures the ability to generate cash from a firm's operations and is a performance ratio for cash flow analysis purposes. The debt payment ratio measures the firm's ability to satisfy long-term debt with cash flow from operations but it is more of a coverage ratio than a performance ratio.

(Study Session 6, Module 19.4, LOS 19.i)
Related Material
SchweserNotes - Book 2

8. (C) **Gain on sale of stock of a subsidiary.**

Explanation

Gains or losses will be found in cash flow from investments.
(Study Session 6, Module 19.1, LOS 19.a)
Related Material
SchweserNotes - Book 2

9. (C) $1,300.

Explanation

Indirect Method	
EAT	+1,000
Depreciation	+500
Change in Inv.	+ 100 a source
Change in Accts. Rec.	(300) a use
CFO	**1,300**

Direct Method.	
Net Sales	+3,500
Change in Accts. Rec.	(300) a use
COGS	(1,500)
Cash Taxes	(500)
Change in Inv.	+100 a source
CFO	**1,300**

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

10. (A) $4,600,000.

Explanation

$3,000,000 + $1,500,000 - $200,000 + $300,000 = $4,600,000.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

11. (C) reduce cost of goods sold by any decreases in inventory.

Explanation

Decreases in inventory represent a source of cash so these would be subtracted from cost of goods sold. Any depreciation and/or amortization included in the cost of goods sold does not represent an actual use of cash, so this amount should be subtracted from cost of goods sold. Decreases in accounts payable represent a use of cash so these should be added to cost of goods sold.

(Study Session 6, Module 19.3, LOS 19.g)

Related Material

SchweserNotes - Book 2

12. (B) $23.

Explanation

Using the indirect method, cash flow from operations is net income less increase in accounts receivable, plus increase in accounts payable, less increase in inventory, plus loss on sale of equipment, less gain on sale of real estate.

27 - 4 + 1 - 5 + 8 - 4 = $23 million.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

13. (A) add decreases in accounts receivables to net sales.

Explanation

A decrease in accounts receivable represents an increase in cash so this should be added to sales. Increases in accounts payable represent an increase in cash so these should be subtracted from cost of goods sold. Increases in inventory represent a use of cash so these would be added to cost of goods sold.

(Study Session 6, Module 19.3, LOS 19.g)

Related Material

SchweserNotes - Book 2

14. (B) No impact No

Explanation

Decreasing accounts payable turnover saves cash by delaying payments to suppliers. The result is an operating source of cash, not a financing source. Decreasing accounts payable turnover is not a sustainable source of cash flow because suppliers will refuse to extend credit, at some point, if payment is slower and slower.

(Study Session 6, Module 19.3, LOS 19.h)

Related Material

SchweserNotes - Book 2

15. (A) Increase in cash of $248.

Explanation

Cash-to-income ratio

CFO for Moose Printing Corporation is calculated as follows:

+Net Income $225 - A/R $55 + Inventory $33 + Depreciation $65 - A/P $25 + Wages Payable $15 - Deferred taxes $10 = $248.

The purchase of new equipment is an investing activity and therefore is not included in CFO. Dividends paid is a financing activity and is not included in CFO.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

16. (B) **The direct method starts with sales and follows cash as it flows through the income statement, while the indirect method starts with net income and adjusts for non-cash charges and other items.**

Explanation

The main difference between the direct and indirect methods of calculating cash flows is the way that cash flow from operations is calculated. The direct method starts with sales and follows cash as it flows through the income statement, while the indirect method starts with income after taxes and adjusts backwards for non-cash and other items. Both methods will have the same result for operating cash flows. The direct and indirect method calculates the financing and investing cash flows the same way and both methods will result in the same cash flow figure.

(Study Session 6, Module 19.1, LOS 19.c)

Related Material

SchweserNotes - Book 2

17. (C) **CFF CFF or CFO**

Explanation

U.S. GAAP treats dividends paid as CFF whereas IAS GAAP treats dividends paid as either CFO or CFF.

(Study Session 6, Module 19.1, LOS 19.c)

Related Material

SchweserNotes - Book 2

18. (A) **Financing.**

Explanation

Dividends paid to stockholders are considered cash outlays from financing according to U.S. GAAP.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

19. (A) **having no cash flow impact.**

Explanation

Depreciation expense has no cash flow impact.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

20. (A) **Selling stock of the company.**

Explanation

Selling stock of the company would be a financing cash flow.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

21. (A) **dividends paid to shareholders.**

Explanation

Dividends paid are a financing cash flow. Dividends received and interest paid are both operating cash flows.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

22. (C) **Neither argument.**

Explanation

It is the direct method, not the indirect method, that presents operating cash receipts and payments and is thus more consistent with the objectives of the cash flow statement. The direct method provides more information than the indirect method and is preferred by analysts who are estimating future cash flows.

(Study Session 6, Module 19.1, LOS 19.d)

Related Material

SchweserNotes - Book 2

23. (C) **subtract the change in accounts receivable from net sales.**

Explanation

Cash received from customers is most appropriately calculated by subtracting the change in accounts receivable from net sales.

(Study Session 6, Module 19.1, LOS 19.e)

Related Material

SchweserNotes - Book 2

24. (B) **$7,800 million $8,500 million**

Explanation

Cost of goods sold is equal to $7,800 million ($2,000 million beginning inventory + $8,100 million purchases - $2,300 million ending inventory). Cash paid to suppliers is equal to $8,500 million (-$7,800 COGS - $300 million increase in inventory - $400 million decrease in accounts payable). Alternate solution: Cash paid to suppliers is equal to $8,500 million (-$8,100 million purchases - $400 decrease in accounts payable).

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

25. (A) **Increase in cash of $10,500.**

Explanation

Cash flow from operations would be calculated as +Net Income $12,000 + Depreciation $1,000 + Loss on sale of machinery $500 - A/R $2,000 - A/P $1,500 + Income taxes payable $500 = $10,500.

Repayment of Bonds is a financing activity and would not be included with operating activities. Depreciation is not a cash flow activity and is therefore always added back to net income to calculate CFO.

The loss on the sale of machinery is not a cash outflow so it is also added back to calculate CFO. Accounts receivable is subtracted when there is an increase as this increases net income but does not affect cash.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

26. (B) Does not Considers Consider

Explanation

The indirect method must add back depreciation expense because the starting point is net income. Since the direct method does not begin with net income it does not need to consider non-cash expenses such as depreciation.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

27. (B) $202,400 $119,900

Explanation

Cash collections are $202,400 ($200,000 sales + $2,400 increase in unearned revenue). Cash expenses are $119,900 (-$89,000 wages expense - $1,200 decrease in wages payable -$17,000 insurance expense - $1,200 increase in prepaid insurance - $10,400 interest expense - $1,100 decrease in interest payable). Depreciation expense is a non-cash expense.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

28. (A) an operating cash outflow.

Explanation

The coupon payment is recorded on the statement of cash flows as an operating cash outflow under U.S. GAAP.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

29. (B) Investing cash flows.

Explanation

Investing cash flows are most closely linked with a firm's noncurrent assets. For example, purchases and sales of property, plant, and equipment are classified as investing cash flows.

(Study Session 6, Module 19.1, LOS 19.e)

Related Material

Schweser Notes - Book 2

30. (A) 0.50.

Explanation

The reinvestment ratio is CFO divided by cash paid for long-term assets: €1,300 / €2,600 = 0.5. (Note that on this cash flow statement, CFI includes interest and dividends received and CFF includes interest paid, which is acceptable under IFRS.)

(Study Session 6, Module 19.4, LOS 19.i)

Related Material

SchweserNotes - Book 2

31. (C) $170,000 $37,000

Explanation

Investing Activities:

$10,000 - $180,000 = -$170,000 cash flow from investing or $170,000 used

Financing Activities:

$38,000 - $75,000 = -$37,000 cash flow from financing or $37,000 used

Note that the question asked for net cash used therefore this is a positive cash outflow.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

32. (C) Only one should be reported as such.

Explanation

Retiring bonds by issuing common stock to the bondholders is a non-cash transaction and is disclosed separately in a note or supplementary schedule to the cash flow statement, rather than as a financing cash flow. The cash borrowed for the equipment purchase is a financing inflow and the cash cost of the equipment is reported as an investing cash flow in the cash flow statement. Had a bond been issued to the seller of the equipment, it would be treated as a non-cash transaction and reported only in the notes to the cash flow statement.

(Study Session 6, Module 19.1, LOS 19.b)

Related Material

SchweserNotes - Book 2

33. (A) $4,300,000.

Explanation

Cash provided or used by operating activities under the direct method is computed by adding cash inflows and subtracting cash inputs and cash outflows. Operating Cash inflows for Rockway Inc. for 2005 came from sales ($21,000,000) and decrease in accounts receivable ($3,000,000 - $2,500,000 = $500,000) for net cash inflows of ($21,000,000 + $500,000 =) $21,500,000. Operating cash inputs were cost of goods sold ($15,000,000), plus the increase in inventory

($3,000,000 - $2,400,000 = $600,000) less the increase in accounts payable, (which is a source of funds) ($1,000,000 - $1,400,000 = -$400,000) for net cash inputs of ($15,000,000 + $600,000 - $400,000 =) $15,200,000. Other operating cash outflows were interest paid ($1,000,000) and current income taxes paid ($1,000,000) totaling ($2,000,000). Cash provided by operations was ($21,500,000 - $15,200,000 - $2,000,000 =) $4,300,000. Changes in property, plant and equipment, long-term debt and common stock do not affect cash from operations.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

34. (C) CFO CFO or CFF

Explanation

U.S. GAAP treats interest paid as CFO whereas IAS GAAP treats interest paid as either CFO or CFF.

(Study Session 6, Module 19.1, LOS 19.c)

Related Material

SchweserNotes - Book 2

35. (B) Elegant's payment to purchase equipment to be used in its business.

Explanation

Purchases of equipment are considered to be cash flows from investing. Interest paid or received and dividends received are considered to be cash flows from operations under U.S. GAAP.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

36. (B) Change in retained earnings.

Explanation

Changes in retained earnings are not included in the calculation of financing cash flows.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

37. (B) $900,000.

Explanation

CFO = sales $3,000,000 - change in accounts receivable ($200,000 - $300,000) - purchases $1,800,000 - other cash operating expenses $400,000 = $900,000.

Note that no adjustment for inventories is necessary because purchases are given. From the inventory equation, P = COGS + EI - BI.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

38. (B) sales, subtracts any increase in accounts receivable, and adds any increase in unearned revenue.

Explanation

To compute cash collections from customers, begin with net sales from the income statement, subtract (add) any increase (decrease) in accounts receivable, and add (subtract) any increase (decrease) in unearned revenue.

For Further Reference:

(Study Session 6, Module 19.3, LOS 19.g)

CFA® Program Curriculum, Volume 3, page 149

Related Material

SchweserNotes - Book 2

39. (B) $3,000 -$10,000

Explanation

Cash flow relating to financing activities includes dividends paid, cash received from preferred stock, and repayment of loan. -2,000 + 10,000 + -5,000 = 3,000.

Cash flow relating to investing activities includes cash paid for equipment and cash from sale of land. -22,000 + 12,000 = -10,000.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

40. (C) The current portion of long-term debt.

Explanation

The current portion of long-term debt arises from a financing activity. The other items listed arise from operating activities.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

41. (A) Working capital.

Explanation

Typically, operating activities on the cash flow statement are most closely related to the working capital accounts (current assets and current liabilities) on the balance sheet. Investing activities are typically related to non-current assets. Financing activities are typically related to non-current liabilities for transactions with creditors, or equity for transactions with shareholders.

(Study Session 6, Module 19.1, LOS 19.e)

Related Material

SchweserNotes - Book 2

42. (C) -$400,000.

Explanation

Dividends declared are net income less the increase in retained earnings ($800,000 -$300,000 = $500,000). Dividends declared less the increase in dividends payable is dividends paid ($500,000 - ($300,000 - $200,000) = $400,000). This is a cash outflow so it is a negative number. Dividends paid are always cash flow from financing under U.S. GAAP. Note that accounts payable changes are included in cash flow from operations (CFO).

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

43. (A) as operating cash flow.

Explanation

Taxes paid are classified as operating cash outflows under U.S. GAAP.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

44. (B) Dividends paid to stockholders.

Explanation

U.S. GAAP requires dividends paid to stockholders to be classified as cash flow relating to financing activity, and interest paid to bondholders to be classified an operating activity.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

45. (C) Subtract decrease in unearned Revenue Subtract an inventory writedown

Explanation

Beginning with net sales, calculating cash collected from customers requires the addition (subtraction) of any increase (decrease) in unearned revenue. Cash advances from customers represent unearned revenue and are not included in net sales, so any advances must be added to net sales in order to calculate cash collected.

An inventory writedown, as a result of applying the lower of cost or market rule, will reduce ending inventory and increase COGS for the period. However, no cash flow is associated with the writedown, so COGS is reduced by the amount of the writedown in calculating cash paid to suppliers.

(Study Session 6, Module 19.3, LOS 19.g)

Related Material

SchweserNotes - Book 2

46. (A) **cash flow from financing would increase and cash flow from investing would decrease.**

Explanation

Cash flow from financing increases when stock is issued, while cash flow from investing decreases when spending for purchases of fixed assets.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

47. (C) **Both statements are correct.**

Explanation

A cash flow statement can be presented in common-size format by expressing each line item as a percentage of total revenue or by expressing each inflow of cash as a percentage of total cash inflows and each outflow as a percentage of total cash outflows. Expressing each line item of the cash flow statement as a percentage of revenue is useful in forecasting future cash flows since revenue usually drives the forecast.

(Study Session 6, Module 19.3, LOS 19.h)

Related Material

SchweserNotes - Book 2

48. (A) **decrease CFO and increase CFI.**

Explanation

The analyst believes an expenditure the firm classified as an investing cash outflow should have been classified as an operating cash outflow. Thus, the analyst should adjust CFO downward and CFI upward.

For Further Reference:

(Study Session 6, Module 19.1, LOS 19.a)

CFA® Program Curriculum, Volume 3, page 121

Related Material

SchweserNotes - Book 2

49. (A) **$925,000 $950,000**

Explanation

Cash paid for insurance = insurance expense + change in prepaid insurance, so insurance expense = cash paid for insurance - change in prepaid insurance. Insurance expense for 2007 is equal to $925,000 [($750,000 cash paid for insurance - (4175,000)]. Interest expense for 2007 is equal to $950,000 ($900,000 cash interest paid + $50,000 increase in interest payable).

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

50. (C) operating cash flow.

Explanation

Interest paid is classified as operating cash flow under U.S. GAAP.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

51. (C) Investing activity Financing activity

Explanation

Under IFRS, interest received may be classified as CFO or CFI, while dividends paid may be classified as CFO or CFF.

For Further Reference:

(Study Session 6, Module 19.1, LOS 19.c)

CFA® Program Curriculum, Volume 3, page 123

Related Material

SchweserNotes - Book 2

52. (B) -$45,000.

Explanation

Only the preferred stock dividends paid would be considered CFF. Issuing bonds in exchange for equipment and exchanging bonds for stock are both noncash transactions that should be disclosed in a footnote to the Statement of Cash Flows. Interest paid is an operating cash flow under U.S. GAAP.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

53. (B) A nonprofitable company that uses LIFO to account for inventory will have higher total cash flow than a nonprofitable company that uses FIFO during a period of rising prices.

Explanation

Because of the impact of income taxes, a profitable company that accounts for inventory using LIFO will have higher total cash flow than a profitable company that uses FIFO. The company that uses LIFO will have higher cost of goods sold, resulting in lower net income and thus lower taxes.

The other statements are accurate:

- A company that issues common stock is not required to pay dividends (which would reduce cash flow from financing). Thus, it may have the same CFF as a firm that issues debt since interest paid on debt is a component of CFO.
- When a company issues bonds at a premium, the proceeds raised at issuance (CFF inflow) are greater than the par value repaid at maturity (CFF outflow). For bonds issued at par, the CFF inflow at issuance is equal to the CFF outflow at maturity.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

54. (B) investing cash flow.

Explanation

The sale of equipment is classified as investing cash flow.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

55. (A) $24 million.

Explanation

Free cash flow to the firm = net income + noncash charges + after-tax interest - fixed capital investment - working capital investment.

Net income is $43.7 million.

Noncash charges are $4.2 million (depreciation expense).

No interest expense is shown.

Fixed capital investment is $35 million purchased - $15 million sold = $20 million.

Working capital investment is $1.5 million increase in accounts receivable + $2.3 million decrease in accounts payable = $3.8 million. (Both are uses of cash)

FCFF = $43.7 million + $4.2 million - $20 million - $3.8 million = $24.1 million.

(Study Session 6, Module 19.4, LOS 19.i)

Related Material

SchweserNotes - Book 2

56. (B) $18 million.

Explanation

Free cash flow to equity (FCFE) is generally defined as cash flow from operations (CFO) less net fixed capital expenditures plus net borrowing. No information on borrowing is given here, so FCFE = 20 - (5 - 3) = $18 million.

(Study Session 6, Module 19.4, LOS 19.i)

Related Material

SchweserNotes - Book 2

57. (A) cash flow from either investing or operations.

Explanation:

Under IFRS, interest and dividends received may be shown as either cash flow from operations or cash flow from investing.

(Study Session 6, Module 19.1, LOS 19.c)

Related Material

Schweser Notes - Book 2

58. (B) A positive (negative) adjustment to net income when accounts payable increases (decreases).

Explanation

A decrease in accounts payable represents an outflow. Hence, a negative adjustment will be required. Conversely, an increase represents an inflow and a positive adjustment.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

59. (B) Disclosed in the footnotes.

Explanation

No cash changes hands in a stock split. If a stock split is mentioned in the statement of cash flows, it will be disclosed in the footnotes as a noncash transaction.

(Study Session 6, Module 19.1, LOS 19.b)

Related Material

SchweserNotes - Book 2

60. (C) the indirect method.

Explanation

Depreciation is a non-cash expense. Only in the indirect method is depreciation added back to net income when determining CFO because net income is only used in the indirect method and not the direct method. The direct method instead starts with cash sales and works down the income statement.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

61. (C) $40,000 outflow.

Explanation

Given the gain of $100,000 and book value of the machinery sold of $260,000 ($500,000 original cost - $240,000 accumulated depreciation), the proceeds from the sale of the machinery were $360,000 ($100,000 gain + $260,000 book value). For 20X7, CFI was an outflow of $40,000 ($360,000 sale proceeds - $400,000 machinery purchase). The $600,000 financed by the seller is a non-cash transaction and is reported in the notes to the cash flow statement.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

62. (A) $31,000 $31,000

Explanation

CFO is the same under both methods, the only difference is presentation. Direct method: $92,500 cash collections ($100,000 revenue - $7,500 increase in receivables) - $38,500 cash paid to suppliers (- $40,000 COGS + $2,500 decrease in inventory - $1,000 decrease in payables) - $20,000 cash operating expenses - $3,000 tax expense = $31,000. Indirect method: $32,000 net income + $5,000 depreciation expense - $7,500 increase in receivables + $2,500 decrease in inventory - $1,000 decrease in payables = $31,000. The increase in short-term notes payable is a financing activity.

(Study Session 6, Module 19.1, LOS 19.d)

Related Material

SchweserNotes - Book 2

63. (C) $210.

Explanation

Cash flow from operations (CFO) calculated using the indirect method is: net income (100) + depreciation (50) - increase in accounts receivable (10) + decrease in inventory (20) + increase in accounts payable (50) = $210.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

64. (B) total cash flows.

Explanation

Common-size cash flow statements show each cash flow item as a percentage of revenue or show each cash flow outflow as a percentage of all cash outflows and each cash inflow as a percentage of all cash inflows.

For Further Reference:

(Study Session 6, Module 19.4, LOS 19.i)

CFA® Program Curriculum, Volume 3, page 160

Related Material

SchweserNotes - Book 2

65. (A) -$1,300.

Explanation

The format of the question information suggests the use of the direct cash flow method. In this method, depreciation is not a component of cash flow from operations. Cash flow from operations = (all numbers in thousands of dollars) 45 - 17 - 22 - 6.3 - 1.0 = -1.3, or -$1,300.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

66. (C) Accounts payable Current portion of long-term debt

Explanation

Operating liabilities result from the operations of the firm and consist of operating and trade liabilities such as accounts payable, customer advances, and accrued liabilities. Financing liabilities are a result of prior financing inflows. Financing liabilities (current) include short-term notes payable and the current maturities of long-term debt.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

67. (C) investing includes interest income from investment in debt securities.

Explanation

Interest income is considered an operating cash flow under U.S. GAAP.

For Further Reference:

(Study Session 6, Module 19.1, LOS 19.a)

CFA® Program Curriculum, Volume 3, page 121

Related Material

SchweserNotes - Book 2

68. (C) $6,000.

Explanation

Cash flow relating to operating activities includes cash paid to suppliers, cash received from customers, interest received, and wages paid.

-5,000 + 14,000 + 1,000 + -4,000 = 6,000.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

69. (C) +$105.

Explanation

Using the indirect method, the increase in accounts payable is a source of cash from operations (+25), depreciation expense is a non-cash expense added back in computing cash from operations (+100), and increase in inventory is a use of cash from operations (-20) = 25 + 100 - 20 = 105. The sale of stock and the dividends paid are financing cash flows that are not included in net income, so they do not require adjustment when calculating CFO.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

70. (A) $5,900,000.

Explanation

Using the indirect method, net income is adjusted by adding back depreciation (a non-cash expense) and changes in working capital: the increase in wages payable and the increase in income taxes payable are sources of cash, and the decrease in interest payable is a use of cash. Dividends paid are financing cash flows under U.S. GAAP.

CFO = $3,000,000 + $2,500,000 + $100,000 + $500,000 - $200,000 = $5,900,000.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

71. (B) Operating.

Explanation

Under U.S. GAAP, interest paid is an operating cash flow.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

72. (A) $6.0 million outflow $2.7 million inflow

Explanation

Only the acquisition of common stock of the affiliate for $2.7 million and the purchase of the patent for $3.3 million are included in cash flow from investing activities. Since the acquisition of the stock purchase was financed with a bank loan, $2.7 million will be reported as a financing inflow. Both remaining transactions are non-cash transactions and are disclosed in the notes to or in a supplementary schedule to the cash flow statement.

(Study Session 6, Module 19.1, LOS 19.b)

Related Material

SchweserNotes - Book 2

73. (B) $90.

Explanation

Sale of common stock	$100
Repayment of debt	(10)
Financing cash flows	$ 90

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

74. (C) **a footnote describing the conversion of the bonds into common stock.**

Explanation

Conversion of bonds into common stock is a non-cash transaction, but the conversion should be disclosed in a footnote to the statement of cash flows.

For Further Reference:

(Study Session 6, Module 19.2, LOS 19.f)

CFA® Program Curriculum, Volume 3, page 137

Related Material

SchweserNotes - Book 2

75. (A) **When recognizing a gain on the sale of fixed assets, the amount is a deduction to operating cash flows.**

Explanation

When recognizing a gain on the sale of fixed assets, the amount is a deduction to operating cash flows. This is because the gain would be double counted in the investing section and in net income. Therefore, the gain must be removed from net income. The direct method of cash flow calculation converts the income statement items to their cash equivalents, not the indirect method. Also, depreciation is added to net income in order to calculate CFO using the indirect method.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

76. (A) **-$100,000.**

Explanation

The only item involving cash flow from financing (CFF) was the payment of a cash dividend by Juniper. The sale of equipment affects cash flow from investing (CFI), the purchase of land has no effect on cash, and the preferred dividends received are cash flow from operations under U.S. GAAP.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

77. (B) **$70.**

Explanation

Sale of common stock	45
Issuance of bonds	25
Financing cash flows	**$70**

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

78. (A) -$5.

Explanation

CFF = 25(Sale of Stock) - 30(Div Paid) = -$5

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

79. (A) $10.

Explanation

Purchase of equipment	-$50
Fixed asset sold	$60
CFI	$10

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

80. (A) $8,000,000.

Explanation

Using the indirect method, CFO is net income increased by 20X5 depreciation ($1,000,000) and decreased by the gain recognized on the sale of the plane [$10,000,000 sale price -($15,000,000 original cost - $10,000,000 accumulated depreciation including 20X5) = $5,000,000]. $12,000,000 + $1,000,000 - $5,000,000 = $8,000,000.

Related Material

SchweserNotes - Book 2

81. (C) $156.

Explanation

Net Income	+$96
Depreciation	+30
Gain on sale of asset.	-30
Accts. Rec.	+30
Inventory	+20
Accts. Payable	+20
Wages Payable	-10
CFO	+$156

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

82. (A) operating cash flow for the period.

Explanation

There are two formats for a common-size cash flow statement, expressing each type of outflow as a percentage of total cash outflows or as a percentage of total revenue for the period. Operating cash flow for the period mixes inflows and outflows and is not used to calculate percentage flows for payment made.

(Study Session 6, Module 19.3, LOS 19.h)

Related Material

SchweserNotes - Book 2

83. (B) always equal to zero.

Explanation

The direct and indirect methods are two ways of presenting the same total for cash from operations.

(Study Session 6, Module 19.1, LOS 19.d)

Related Material

SchweserNotes - Book 2

84. (B) Only accounts receivable will increase.

Explanation

If a firm sells more than it collects, accounts receivable will increase. If a firm pays suppliers more than it purchases, accounts payable will decrease.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

85. (B) $1,000,000.

Explanation

Cash flow from operations (CFO) using the indirect method is computed by taking net income plus non-cash expenses (i.e. depreciation) less gains from the equipment sale. Note that cash flow from operations must be adjusted downward for the amount of the gain on the sale of the equipment. Cash flow from operations is ($850,000 + $200,000 - ($100,000 - $50,000))

= $1,000,000. The other information relates to financing cash flows.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

86. (A) $2,900.

Explanation

FCFF = CFO + Int(1 — tax rate) — capital expenditures

$$\text{FCFF} = 3{,}500 + \left[195 \times \left(1 - \left(\frac{1{,}540}{4{,}400}\right)\right)\right] - 727 = 2{,}899.75 \approx 2{,}900$$

For Further Reference:

(Study Session 6, Module 19.4, LOS 19.i)

CFA® Program Curriculum, Volume 3, page 160

Related Material

SchweserNotes - Book 2

87. (C) $10,000,000.

Explanation

Investing cash of $2 million was used to purchase the cargo plane. Proceeds from the sale of the plane were a source of $12 million of investing cash. Net CFI is $12 million - $2 million = $10 million. Under U.S. GAAP, the interest payment is included in cash from operations (CFO) and the dividend payment in cash from financing (CFF). Redemption of the bonds is a use of cash from financing (CFF).

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

88. (B) IFRS but not under U.S. GAAP.

Explanation

IFRS permits interest received to be reported as either cash flow from operations or cash flow from investing, and permits dividends paid to be reported as either cash flow from operations or cash flow from financing. U.S. GAAP requires interest received to be reported as cash flow from operations, but requires dividends paid to be reported as cash flow from financing.

(Study Session 6, Module 19.1, LOS 19.c)

Related Material

SchweserNotes - Book 2

89. (A) $70.

Explanation

Dividends paid	-$30
Stock issued	20
Bonds issued	80
CFF	$70

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

90. (C) **Dividends paid.**

Explanation

Under U.S. GAAP, dividends paid are classified as financing cash flows. Under IFRS, dividends paid may be classified as operating or financing cash flows. Purchases and sales of long-lived assets such as equipment or land are examples of investing cash flows.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

91. (A) **$1,000.**

Explanation

Net income is ($6,000 - 3,200 - 800)(1 - 0.4) = $1,200. Adjustments to reconcile net income to cash flow from operating activities will require that depreciation ($800) be added back, and increase in accounts receivable ($1,000) be subtracted: $1,200 + 800 - 1,000 = $1,000.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

Schweser Notes - Book 2

92. (A) **financing cash flow.**

Explanation

An increase in notes payable is classified as financing cash flow.

(Study Session 6, Module 19.1, LOS 19.a)

Related Material

SchweserNotes - Book 2

93. (B) **Both will increase operating cash flow.**

Explanation

A decrease in the accounts receivable amount on the balance sheet indicates that cash collections exceed revenues (sales). This increases operating cash flow because receivables are being collected. An increase in the accounts payable amount on the balance sheet indicates that purchases from suppliers exceed cash payments. This increases operating cash flow because the cash was not used to pay the suppliers.

For Further Reference:

(Study Session 6, Module 19.2, LOS 19.f)

CFA® Program Curriculum, Volume 3, page 137

Related Material

SchweserNotes - Book 2

94. (A) **$10**

Explanation

Item		Amount
Cash payment of dividends	CFF	-$30
Sale of equipment	CFI	+$25

Net income	CFO	+$25
Purchase of land	CFI	-$15
Increase in accounts payable	CFO	+$20
Sale of preferred stock	CFF	+$25
Increase in deferred taxes	CFO	+$5

CFI = Sale of Equipment (+25) + Purchase of Land (-15) = $10.

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

95. (B) **operating or financing cash flow.**

Explanation

IFRS allows interest paid to be reported in either the operating or financing section of the cash flow statement. U.S. GAAP requires interest paid to be reported in the operating section of the cash flow statement.

(Study Session 6, Module 19.1, LOS 19.c)

Related Material

Schweser Notes - Book 2

96. (A) **$29.**

Explanation

Using the indirect method:

Add: Net Income	$10
Add: Depreciation Expense	22
Less: Gain from Sale of Equip.	(6)
Less: Increase in Accounts Receivable	(4)
Add: Decrease in Inventory	2
Add: Increase in Accounts Payable	5
Cash flow from operations (CFO)	**29**

(Study Session 6, Module 19.2, LOS 19.f)

Related Material

SchweserNotes - Book 2

97. (C) **indirect method, depreciation must be added to net income, because it is a non-cash expense.**

Explanation

The indirect method begins with net income, which has already included all cash and non-cash expenses. Therefore, under the indirect method, depreciation must be added to net income, because it is a non-cash expense.

Related Material

SchweserNotes - Book 2