

# FINANCIAL STATEMENT ANALYSIS

## Lecture 10

### THE STATEMENT OF CASH FLOWS /CASH FLOW STATEMENT

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NB

This is a continuation of lecture 9.

#### Example one

Spencer Company has the following financial statements for the years ended December 31, 2020.

**Spencer Company**  
**Income Statement**  
**For The Year Ended December 31, 2020**

Sales	1,520,700
Cost of merchandise sold	<u>1,110,200</u>
Gross profit	410,500
<b>Operating expenses</b>	
Depreciation expense	(39,990)
Other operating expenses	<u>(227,110)</u>
	<u>143,400</u>
<b>Other income</b>	
Gain on sale of land	20,500
Gain on sale of investments	<u>11,000</u>
	<u>31,500</u>
<b>Other expenses</b>	
Interest expense	25,000
	<u>6,500</u>
Income before income tax	149,900
Income tax	<u>38,500</u>
Net income	<u><u>111,400</u></u>

**Spencer Company**  
**Comparative Balance Sheets**  
**As at December 31**  
**2020                      2019**

**Fixed Assets**

Investments	44,500	93,500
Land	77,250	75,000
Buildings	412,500	225,000
Accumulated depreciation	(91,260)	(81,220)
Equipment	493,700	437,500
Accumulated depreciation	<u>(179,700)</u>	<u>(149,750)</u>
Total fixed assets	<u>756,990</u>	<u>600,030</u>

**Current assets**

Cash	57,870	66,200
Trade receivables (net)	137,180	117,800
Inventories	211,500	190,150
Prepaid expenses	5,160	6,120
Total current assets	<u>411,710</u>	<u>380,270</u>
Total assets	<u>1,168,700</u>	<u>980,300</u>

**Liabilities and Stockholders' Equity****Short term liabilities**

Accounts payable	58,715	51,875
Accrued expenses	11,000	10,500
Interest payable	1,875	1,875
Income tax payable	5,000	8,500
Dividends payable	<u>15,660</u>	<u>12,500</u>
	<u>92,250</u>	<u>85,250</u>

**Long term liabilities**

Mortgage note payable	175,000	-
Bonds payable	<u>100,000</u>	<u>250,000</u>
	<u>275,000</u>	<u>250,000</u>

**Stockholders' Equity**

Common stock,	450,000	375,000
Share premium	47,250	41,250
Retained earnings	<u>304,200</u>	<u>228,800</u>
Total liabilities and stockholders' equity	<u>1,168,700</u>	<u>980,300</u>

The following additional information was obtained from an examination of the general ledger and subsidiary ledgers.

- i. Investments (long-term) were purchased for sh 40,500
- ii. Investments (long-term) costing 89,500 were sold for sh 100,500

- iii. Equipment was purchased for sh 56,200. There were no disposals.
- iv. A building valued at sh 187,500 and land valued at sh 62,500, were acquired by a cash payment of 250,000.
- v. Land which cost sh 60,250 was sold for sh 80,750 cash
- vi. A mortgage note payable for sh 175,000 was issued for cash
- vii. Bonds payable of sh 150,000 were retired by the payment of their face amount
- viii. 3,000 shares of common stock were issued for cash at sh 27
- ix. Cash dividends of sh 36,000 were declared

Required

Prepare a statement of cash flow for the year ended 31<sup>st</sup> December 2020 using the indirect method.

## SOLUTION

**NB**

Use the format in the lecture 9 as a guide on how to prepare the statement of cash flows

**Spencer Company**  
**Statement of cash flows**  
**For The Year Ended December 31, 2020**

**Operating activities**

Net income	111,400
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**Adjustments**

Depreciation expense	39,990
Increase in accounts receivable	(19,380)
Increase in inventories	(21,350)
Decrease in prepaid expenses	960
Increase in accounts payable	6,840
Increase in accrued expenses	500
Decrease in income tax payable	(3,500)
Gain on sale of investment	(11,000)

Gain on sale of land	<u>(20,500)</u>	<u>(27,440)</u>
Net cash provided by operating activities		83,960
<b>Cash flows from investing activities</b>		
Cash received from sale of investments	100,500	
Cash received from sale of land	80,750	
Cash payments for purchase of investments	(40,500)	
Cash payments for purchase of equipment	(56,200)	
Cash payments for purchase of land	(62,500)	
Cash payments for purchase of building	<u>(187,500)</u>	
Net cash used in investing activities		(165,450)
<b>Cash flows from financing activities</b>		
Cash received from issuance of mortgage note	175,000	
Cash received from issuance of stock	81,000	
Cash paid for retirement of bonds payable	(150,000)	
Cash paid for dividends (36,000 + 12500 – 15660)	<u>(32,840)</u>	
Net cash provided by financing activities		<u>73,160</u>
Net decrease in cash		(8,330)
Cash, January 1		<u>66,200</u>
Cash, December 31		57,870

### Example two

Tax Consultants Inc. has been in operation for the past one year. The company started on January 1, 2017, when it issued 60,000 shares of sh1 par value common stock for \$60,000 cash. The company rented its office space and furniture and equipment, and it performed tax consulting services throughout the first year. The comparative balance sheets at the beginning and at the end of the year 2017 appear as follows.

**Tax Consultants Inc.**  
**balance sheet**  
**as at December 31, 2020**

<b>Assets</b>	<b>Dec. 31, 2020</b>	<b>Jan. 1, 2020</b>
Cash	49,000	-0-
Accounts receivables	36,000	-0-
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<b>Total</b>	<b>85,000</b>	<b>-0-</b>
<b>Liabilities and Stockholder's Equity</b>	<b>=====</b>	<b>=====</b>
Accounts payables	5,000	-0-
Common stock	60,000	-0-
Retained earnings	20,000	-0-
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<b>Total</b>	<b>85,000</b>	<b>-0-</b>
	<b>=====</b>	<b>=====</b>

The income statement and additional information for Tax Consultation Inc. are as follows.

**Tax Consultants Inc.**  
**Income Statement**  
**For the year ended December 31, 2020**

Revenue	125,000
Operating expenses	<u>85,000</u>
Income before income taxes	40,000
Income tax expenses	<u>6,000</u>
Net income	<u>34,000</u>

Required

Prepare a cash flow statement for the year ending 31<sup>st</sup> December 2020 using the indirect method.

**Question three**

Fancy, a sole trader balance sheets for two successive years are shown below;

**2017**

**2018**

**Fixed assets**

Land and premises (cost sh 52,000)		44,000		40,000
Plant and machinery				
		58,250		59,600
<b>Current assets</b>				
Inventory	6,600		6,300	
Accounts receivables	17,800		12,600	
Bank	=	<u>24,400</u>	<u>7,100</u>	<u>26,000</u>
Total assets		82,650		85,600
<b>Current liabilities</b>				
Accounts payables	22,000		11,600	
Bank overdraft	13,650		=	
	35,650		11,600	
<b>Non-current liabilities</b>				
Loan	=	<u>(35,650)</u>	<u>20,000</u>	<u>(31,600)</u>
		<u>47,000</u>		<u>54,000</u>
<b>Financed by</b>				
Capital		42,000		47,000
Net profit		<u>18,000</u>		<u>22,000</u>
		60,000		69,000
Drawings		<u>(13,000)</u>		<u>(15,000)</u>
		<u>47,000</u>		<u>54,000</u>

Assume depreciation for new plant and machinery is not provided for in the first year.

Required

Prepare a cash flow statement for the year ending 31<sup>st</sup> July 2018 using the indirect method.

### References

ACCA Study text Paper F3 Financial Accounting (International).

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Thomas R., Hennie G., Elaine H., Michael A., & David T. (2008). International Financial Statement Analysis, Wiley.