CHAPTER 5

Statement of Financial Position and Statement of Cash Flows

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. **Explain the uses and limitations of a statement of financial position.**
2. Identify the major classifications of the statement of financial position.
3. Prepare a classified statement of financial position using the report and account formats.
4. Indicate the purpose of the statement of cash flows.
5. Identify the content of the statement of cash flows.
6. Prepare a basic statement of cash flows.
7. Understand the usefulness of the statement of cash flows.
8. Determine additional information requiring note disclosure.
9. Describe the major disclosure techniques for financial statements.

STATEMENT OF FINANCIAL POSITION

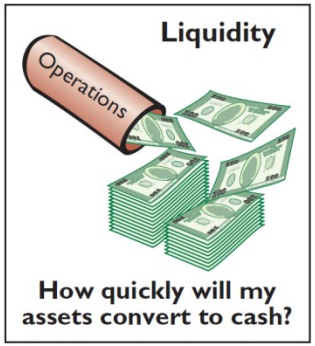
Statement of financial position, also referred to as the **balance sheet**:

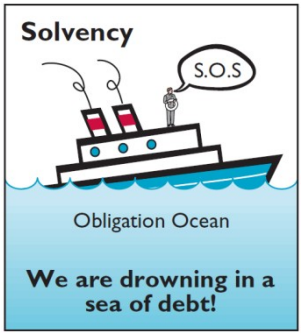
1. Reports assets, liabilities, and equity at a specific date.
2. Provides information about resources, obligations to creditors, and equity in net resources.
3. Helps in predicting amounts, timing, and uncertainty of future cash flows.

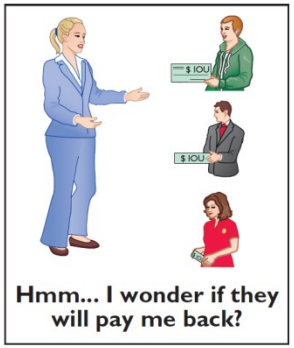
STATEMENT OF FINANCIAL POSITION

Usefulness

- Computing rates of return.
- Evaluating the capital structure.
- Assess risk and future cash flows.
- Assess the company's:
  - Liquidity,
  - Solvency, and
  - Financial flexibility.



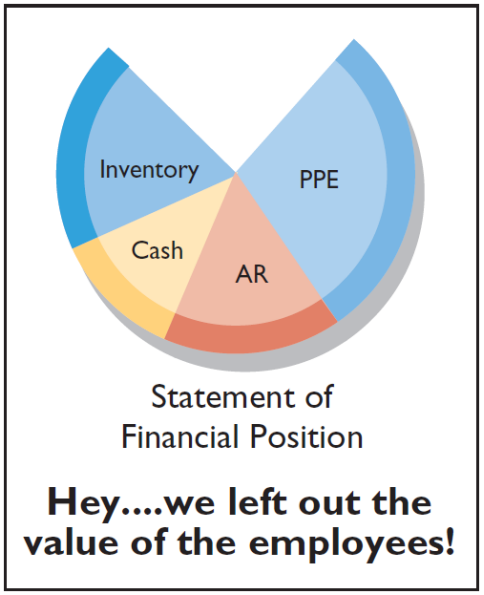




STATEMENT OF FINANCIAL POSITION

Limitations

- Most assets and liabilities are reported at **historical cost**.
- Use of **judgments** and **estimates**.
- Many items of **financial value** are **omitted**.



CLASSIFICATION IN THE STATEMENT

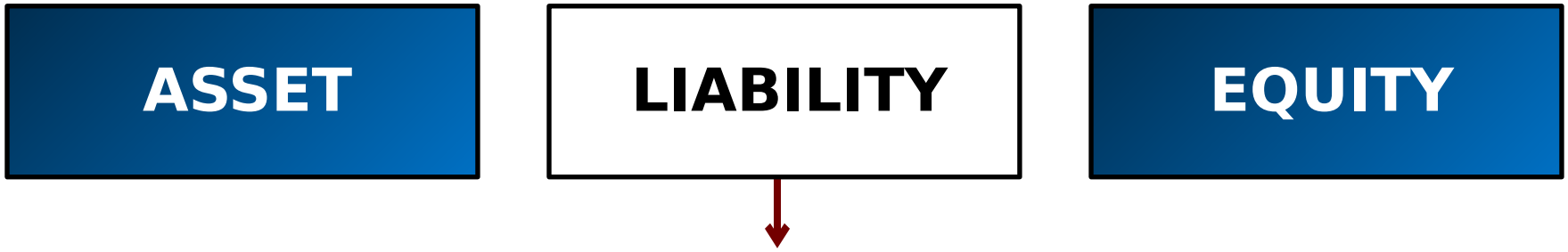
Elements of the Statement of Financial Position



- Resource controlled by the entity.
- Result of past events.
- Future economic benefits are expected to flow to the entity.

CLASSIFICATION IN THE STATEMENT

Elements of the Statement of Financial Position



- Present obligation of the entity.
- Arising from past events.
- Settlement is expected to result in an outflow of resources embodying economic benefits.

CLASSIFICATION IN THE STATEMENT

Elements of the Statement of Financial Position



- Residual interest in the assets of the entity after deducting all its liabilities.

CLASSIFICATION IN THE STATEMENT

Subclassifications

ILLUSTRATION 5-1 Statement of Financial

Assets	Equity and Liabilities
Non-current assets	Equity
Investments	*Share capital*
Property, plant, and equipment	*Share premium*
Intangible assets	*Retained earnings*
Other assets	*Accumulated other comprehensive income*
Current assets	*Non-controlling interest (Minority interest)*
	Non-current liabilities
	Current liabilities

A recent survey shows that companies are moving toward reporting current assets first on the statement of financial position, which is a change from a few years ago.

CLASSIFICATION IN THE STATEMENT

Non-Current Assets

Generally consists of:

- Long-term Investments
- Property, Plant, and Equipment
- Intangibles Assets
- Other Assets

CLASSIFICATION IN THE STATEMENT

Long-term Investments

1. **Securities** (bonds, ordinary shares, or long-term notes).
2. **Tangible assets** not currently used in operations (land held for speculation).
3. **Special funds** (sinking fund, pension fund, or plant expansion fund).
4. **Non-consolidated subsidiaries** or associated companies.

CLASSIFICATION IN THE STATEMENT

Investments in Debt and Equity Securities

Portfolio	Type	Valuation	Classification
Held-for-Collection	Debt	Amortized Cost	Current or Non-current
Trading	Debt or Equity	Fair Value	Current
Non-Trading Equity	Equity	Fair Value	Current or Non-current

CLASSIFICATION IN THE STATEMENT

Long-Term Investments

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets

Non-Current Assets			
Long-term investments			
Investments in held-for-collection securities		$ 82,000	
Land held for future development		5,500	$ 87,500
Property, plant, and equipment			
Land		125,000	
Buildings	$975,800		
Less: Accumulated depreciation	341,200	634,600	
Total property, plant, and equipment			759,600

CLASSIFICATION IN THE STATEMENT

Property, Plant, and Equipment

Tangible long-lived assets used in the regular operations of the business.

- **Physical property** such as land, buildings, machinery, furniture, tools, and wasting resources (minerals).
- With the exception of land, a company either depreciates (e.g., buildings) or depletes (e.g., oil reserves) these assets.

CLASSIFICATION IN THE STATEMENT

Property, Plant, and Equipment

ILLUSTRATION 5-17 Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets

Non-Current Assets			
Long-term investments			
Investments in held-for-collection securities		$ 82,000	
Land held for future development		5,500	$ 87,500
Property, plant, and equipment			
Land		125,000	
Buildings	$975,800		
Less: Accumulated depreciation	341,200	634,600	
Total property, plant, and equipment			759,600

CLASSIFICATION IN THE STATEMENT

Intangible Assets

Lack physical substance and are not financial instruments.

- Patents, copyrights, franchises, goodwill, trademarks, trade names, and customer lists.
- Amortize limited-life intangible assets over their useful lives.
- Periodically assess indefinite-life intangibles for impairment.

Intangible Assets

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets

Non-Current Assets			
Long-term investments			
Investments in held-for-collection securities		$ 82,000	
Land held for future development		5,500	$ 87,500
Property, plant, and equipment			
Land		125,000	
Buildings	$975,800		
Less: Accumulated depreciation	341,200	634,600	
Total property, plant, and equipment			759,600
Intangible assets			
Capitalized development costs		6,000	
Goodwill		66,000	
Other identifiable intangible assets		28,000	100,000
Total non-current assets			947,100

CLASSIFICATION IN THE STATEMENT

Other Assets

Items vary in practice. Can include:

- Long-term prepaid expenses
- Non-current receivables
- Assets in special funds
- Property held for sale
- Restricted cash or securities

CLASSIFICATION IN THE STATEMENT

Current Assets

Cash and other assets a company expects to **convert into cash**, **sell**, or **consume** either in one year or in the operating cycle, whichever is longer.

ILLUSTRATION 5-5
Current Assets and Basis of Valuation

Item	Basis of Valuation
Inventories	Lower-of-cost-or-net realizable value
Prepaid expenses	Cost
Receivables	Estimated amount collectible
Short-term investments	Generally, fair value
Cash and cash equivalents	Fair value

CLASSIFICATION IN THE STATEMENT

Inventories

Disclose:

- Basis of valuation (e.g., lower-of-cost-or-net realizable value).
- Cost flow assumption (e.g., FIFO or average cost).

Inventories

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets

Intangible assets			
Capitalized development costs		6,000	
Goodwill		66,000	
Other identifiable intangible assets		28,000	100,000
Total non-current assets			947,100
Current Assets			
Inventory		489,713	
Prepaid expenses		16,252	
Accounts receivable	165,824		
Less: Allowance for doubtful accounts	1,850	163,974	
Short-term investments		51,030	
Cash and cash equivalents		52,485	
Total current assets			773,454
Total assets			$1,720,554

CLASSIFICATION IN THE STATEMENT

Receivables

Major categories of receivables should be shown in the balance sheet or the related notes.

A company should clearly identify

- Anticipated loss due to uncollectibles.
- Amount and nature of any non-trade receivables.
- Receivables used as collateral.

Receivables

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets

Intangible assets			
Capitalized development costs		6,000	
Goodwill		66,000	
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Current Assets			
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Accounts receivable	165,824		
Less: Allowance for doubtful accounts	1,850	163,974	
Short-term investments		51,030	
Cash and cash equivalents		52,485	
Total current assets			773,454
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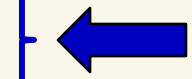

CLASSIFICATION IN THE STATEMENT

Prepaid Expenses

Payment of cash, that is recorded as an asset because service or benefit will be received in the future.

Cash Payment **BEFORE** Expense Recorded

Prepayments often occur in regard to:

- Insurance
- Supplies
- Advertising
- Rent
- Taxes

Prepaid Expenses

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets

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Short-term investments		51,030	
Cash and cash equivalents		52,485	
Total current assets			773,454
Total assets			$1,720,554

CLASSIFICATION IN THE STATEMENT

Short-Term Investments

Portfolio	Type	Valuation	Classification
Held-for-Collection	Debt	Amortized Cost	Current or Non-current
Trading	Debt or Equity	Fair Value	Current
Non-Trading Equity	Equity	Fair Value	Current or Non-current

Short-Term Investments

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets			
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Goodwill		66,000	
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Prepaid expenses		16,252	
Accounts receivable	165,824		
Less: Allowance for doubtful accounts	1,850	163,974	
Short-term investments		51,030	
Cash and cash equivalents		52,485	
Total current assets			773,454
Total assets			$1,720,554

CLASSIFICATION IN THE STATEMENT

Cash

- Generally any monies available “on demand.”
- **Cash equivalents** - short-term highly liquid investments that mature within three months or less.
- Restrictions or commitments must be disclosed.

Cash

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets

Intangible assets			
Capitalized development costs		6,000	
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Current Assets			
Inventory		489,713	
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Accounts receivable	165,824		
Less: Allowance for doubtful accounts	1,850	163,974	
Short-term investments		51,030	
Cash and cash equivalents		52,485	
Total current assets			773,454
Total assets			$1,720,554

CLASSIFICATION IN THE STATEMENT

Equity

EQUITY SECTION

1. **SHARE CAPITAL.** The par or stated value of shares issued. It includes ordinary shares (sometimes referred to as *common shares*) and preference shares (sometimes referred to as *preferred shares*).
2. **SHARE PREMIUM.** The excess of amounts paid-in over the par or stated value.
3. **RETAINED EARNINGS.** The corporation's undistributed earnings.
4. **ACCUMULATED OTHER COMPREHENSIVE INCOME.** The aggregate amount of the other comprehensive income items.
5. **TREASURY SHARES.** Generally, the amount of ordinary shares repurchased.
6. **NON-CONTROLLING INTEREST (MINORITY INTEREST).** A portion of the equity of subsidiaries not owned by the reporting company.

Equity

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Equity and Liabilities			
Equity			
Share capital—preference	$300,000		
Share capital—ordinary	400,000		
Share premium—preference	10,000		
Share premium—ordinary	27,500		
Retained earnings	170,482		
Accumulated other comprehensive income (loss)	(8,650)		
Less: Treasury shares	12,750		
Equity attributable to owners		$886,582	
Non-controlling interest		13,500	
Total equity			$ 900,082
Non-current liabilities			
Bond liabilities due January 31, 2024	425,000		
Provisions related to pensions	75,000		
Total non-current liabilities		500,000	

CLASSIFICATION IN THE STATEMENT

Non-Current Liabilities

Obligations that a company does not reasonably expect to liquidate within the longer of one year or the normal operating cycle. Three types:

1. Obligations arising from specific financing situations.
2. Obligations arising from the ordinary operations of the company.
3. Obligations that depend on the occurrence or non-occurrence of one or more future events to confirm the amount payable, or the payee, or the date payable.

LO 2

Non-Current Liabilities

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Equity and Liabilities

Equity			
Share capital—preference	$300,000		
Share capital—ordinary	400,000		
Share premium—preference	10,000		
Share premium—ordinary	27,500		
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Accumulated other comprehensive income (loss)	(8,650)		
Less: Treasury shares	12,750		
Equity attributable to owners		$886,582	
Non-controlling interest		13,500	
Total equity			$ 900,082
Non-current liabilities			
Bond liabilities due January 31, 2024	425,000		
Provisions related to pensions	75,000		
Total non-current liabilities		500,000	

CLASSIFICATION IN THE STATEMENT

Current Liabilities

Obligations that a company generally expects to settle in its normal operating cycle or one year, whichever is longer.

Includes:

1. Payables resulting from the acquisition of goods and services.
2. Collections received in advance for the delivery of goods or performance of services.
3. Other liabilities whose liquidation will take place within the operating cycle or one year.

LO 2

Current Liabilities

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Equity and Liabilities			
Non-current liabilities			
Bond liabilities due January 31, 2024	425,000		
Provisions related to pensions	75,000		
Total non-current liabilities		500,000	
Current liabilities			
Notes payable	80,000		
Accounts payable	197,532		
Interest payable	20,500		
Salaries and wages payable	5,560		
Provisions related to warranties	12,500		
Deposits received from customers	4,380		
Total current liabilities		320,472	
Total liabilities			820,472
Total equity and liabilities			$1,720,554

CLASSIFICATION IN THE STATEMENT

Statement of Financial Position Format

- IFRS **does not specify** the order or format of the items in the statement.
- **Two general forms**:
  - Account form
    - Assets on left side
    - Equity and liabilities on right side
  - Report form

Statement of Financial Position Format

Report Form

lists the sections one above the other.

ILLUSTRATION 5-17
Classified Report-Form Statement of Financial Position

SCIENTIFIC PRODUCTS, INC.
STATEMENT OF FINANCIAL POSITION
DECEMBER 31, 2015

Assets			
Non-Current Assets			
Long-term investments			
Investments in held-for-collection securities		$ 82,000	
Land held for future development		5,500	$ 87,500
Property, plant, and equipment			
Land		125,000	
Buildings	$975,800		
Less: Accumulated depreciation	341,200	634,600	
Total property, plant, and equipment			759,600
Intangible assets			
Capitalized development costs		6,000	
Goodwill		66,000	
Other identifiable intangible assets		28,000	100,000
Total non-current assets			947,100
Current Assets			
Inventory		489,713	
Prepaid expenses		16,252	
Accounts receivable	165,824		
Less: Allowance for doubtful accounts	1,850	163,974	
Short-term investments		51,030	
Cash and cash equivalents		52,485	
Total current assets			773,454
Total assets			$1,720,554
Equity and Liabilities			
Equity			
Share capital—preference	$300,000		
Share capital—ordinary	400,000		
Share premium—preference	10,000		
Share premium—ordinary	27,500		
Retained earnings	170,482		
Accumulated other comprehensive income (loss)	(8,650)		
Less: Treasury shares	12,750		
Equity attributable to owners		$886,582	
Non-controlling interest		13,500	
Total equity			$ 900,082
Non-current liabilities			
Bond liabilities due January 31, 2024	425,000		
Provisions related to pensions	75,000		
Total non-current liabilities		500,000	
Current liabilities			
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Deposits received from customers	4,380		
Total current liabilities		320,472	
Total liabilities			820,472
Total equity and liabilities			$1,720,554

STATEMENT OF CASH FLOWS

An important element of the objective of financial reporting is

“assessing the amounts, timing, and uncertainty of cash flows.”

IASB requires the **statement of cash flows** (also called the cash flow statement).

STATEMENT OF CASH FLOWS

Primary Purpose: To provide relevant information about the ***cash receipts*** and ***cash payments*** of an enterprise during a period.

Statement provides answers to the following questions:

1. Where did the cash come from?
2. What was the cash used for?
3. What was the change in the cash balance?

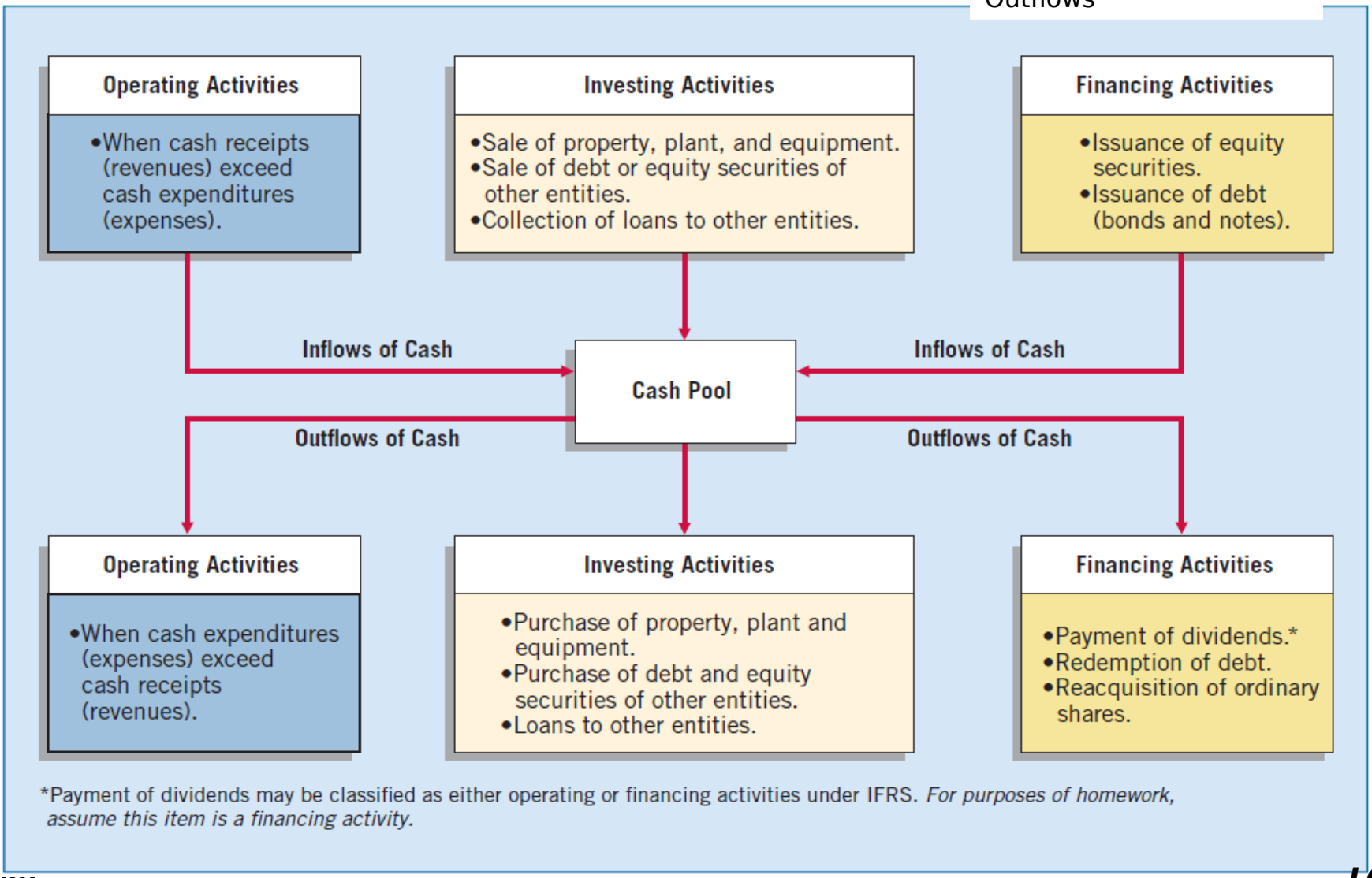
STATEMENT OF CASH FLOWS

Content and Format

Operating Activities	Investing Activities	Financing Activities
Transactions that enter into the determination of net income	Making and collecting loans and acquiring and disposing of investments and property, plant, and equipment	Transactions involving liability and equity items

CONTENT AND FORMAT

ILLUSTRATION 5-19
Cash Inflows and Outflows



*Payment of dividends may be classified as either operating or financing activities under IFRS. *For purposes of homework, assume this item is a financing activity.*

Format of the Statement of Cash Flows

COMPANY NAME
STATEMENT OF CASH FLOWS
PERIOD COVERED

Cash flows from operating activities		
Net income		XXX
Adjustments to reconcile net income to net cash provided (used) by operating activities:		
(List of individual items)	XX	XX
Net cash provided (used) by operating activities		XXX
Cash flows from investing activities		
(List of individual inflows and outflows)	XX	
Net cash provided (used) by investing activities		XXX
Cash flows from financing activities		
(List of individual inflows and outflows)	XX	
Net cash provided (used) by financing activities		XXX
Net increase (decrease) in cash		XXX
Cash at beginning of period		XXX
Cash at end of period		XXX

ILLUSTRATION 23-2

LO 2

STATEMENT OF CASH FLOWS

Preparation of the Statement of Cash Flows

Sources of Information

Information obtained from several sources:

1. comparative statements of financial position,
2. current income statement, and
3. selected transaction data.

Classification of Cash Flows

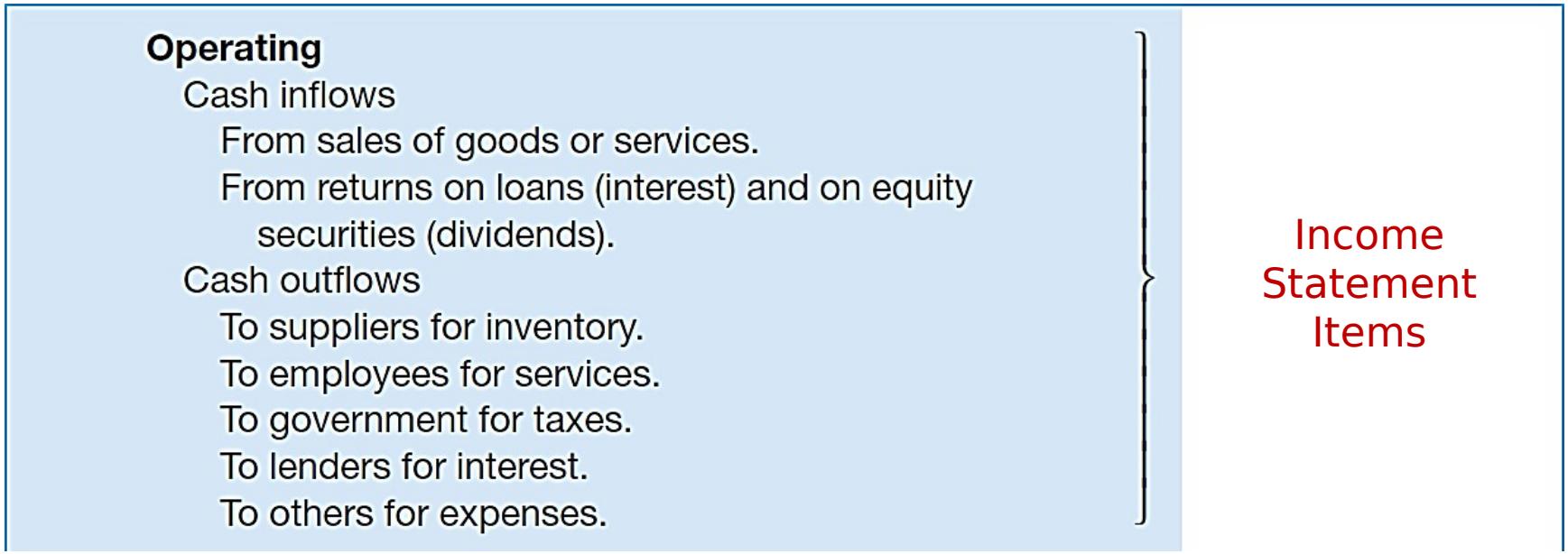


ILLUSTRATION 23-1 Classification of Typical Cash Inflows and Outflows

LO 2

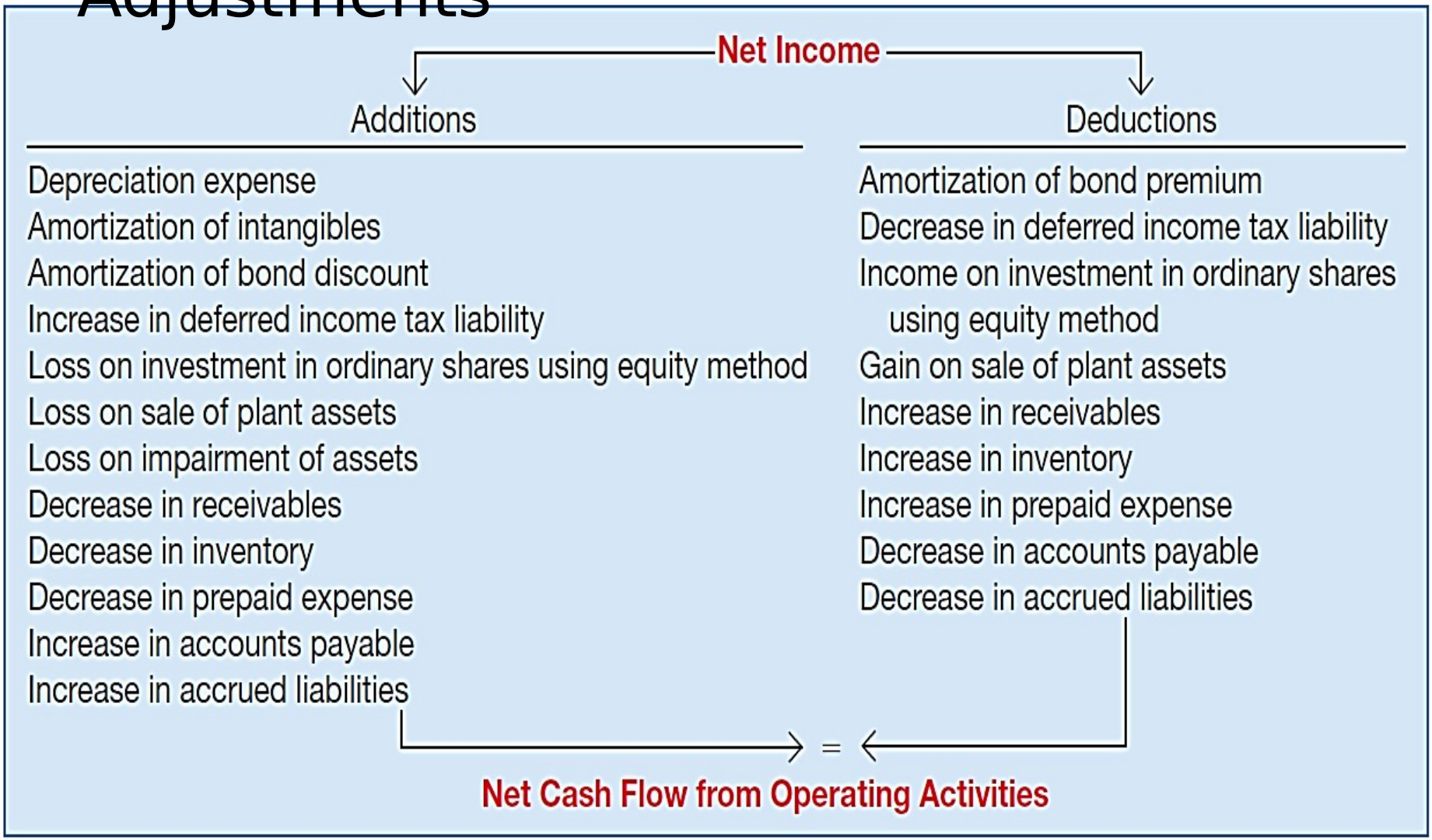
Classification of Cash Flows

Investing	Generally Investments and Non-Current Asset Items
Cash inflows	
From sale of property, plant, and equipment.	
From sale of debt or equity securities of other entities.	
From collection of principal on loans to other entities.	
Cash outflows	
To purchase property, plant, and equipment.	
To purchase debt or equity securities of other entities.	
To make loans to other entities.	
Financing	Generally Equity and Non-Current Liability Items
Cash inflows	
From sale of equity securities.	
From issuance of debt (bonds and notes).	
Cash outflows	
To shareholders as dividends.	
To redeem long-term debt or reacquire share capital.	

ILLUSTRATION 23-1
Classification of Typical Cash Inflows and Outflows

LO 2

Indirect Method—Additional Adjustments



Preparation of Statement of Cash Flows

Illustration: On January 1, 2015, in its first year of operations, Telemarketing Inc. issued 50,000 ordinary shares of $1 par value for $50,000 cash. The company rented its office space, furniture, and telecommunications equipment and performed marketing services throughout the first year. In June 2015, the company purchased land for $15,000.

Illustration 5-20 shows the company's comparative statements of financial position at the beginning and end of 2015.

TELEMARKETING INC.
STATEMENTS OF FINANCIAL POSITION

ILLUSTRATION 5-20

Assets	Dec. 31, 2015	Jan. 1, 2015	Increase/Decrease
Land	$15,000	$–0–	$15,000 Increase
Accounts receivable	41,000	–0–	41,000 Increase
Cash	31,000	–0–	31,000 Increase
Total	$87,000	$–0–	
Equity and Liabilities			
Share capital	$50,000	$–0–	50,000 Increase
Retained earnings	25,000	–0–	25,000 Increase
Accounts payable	12,000	–0–	12,000 Increase
Total	$87,000	$–0–	

TELEMARKETING INC.
INCOME STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2015

ILLUSTRATION 5-21

Revenues	$172,000
Operating expenses	120,000
Income before income tax	52,000
Income tax	13,000
Net income	$ 39,000

Additional information:
Dividends of $14,000 were paid during the year.

Preparation of Statement of Cash Flows

Preparing the Statement of Cash Flows

Determine:

1. Net cash provided by (or used in) operating activities.
2. Net cash provided by (or used in) investing and financing activities.
3. Determine the change (increase or decrease) in cash during the period.
4. Reconcile the change in cash with the beginning and the ending cash balances.

Preparing the Statement of Cash Flows

Net cash provided by operating activities

- Excess of cash receipts over cash payments from operating activities.
- Determined by converting net income on an accrual basis to a cash basis.
- Add to or deduct from net income those items in the income statement that do not affect cash.
- Requires an analysis of the current year's income statement, comparative statements of financial position and selected transaction data.

ILLUSTRATION 5-20

TELEMARKETING INC.
STATEMENTS OF FINANCIAL POSITION

Assets	Dec. 31, 2015	Jan. 1, 2015	Increase/Decrease
Land	$15,000	$–0–	$15,000 Increase
Accounts receivable	41,000	–0–	41,000 Increase
Cash	31,000	–0–	31,000 Increase
Total	$87,000	$–0–	

Increase in **accounts receivable** reflects a non-cash increase of $41,000 in revenues.

50,000 Increase
25,000 Increase
12,000 Increase

Cash provided by operating activities

ILLUSTRATION 5-22

Net income		$39,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	$(41,000)	
Increase in accounts payable	12,000	(29,000)
Net cash provided by operating activities		$10,000

LO 6

ILLUSTRATION 5-20

TELEMARKETING INC.
STATEMENTS OF FINANCIAL POSITION

Assets	Dec. 31, 2015	Jan. 1, 2015	Increase/Decrease
			$15,000 Increase
			41,000 Increase
			31,000 Increase
Share capital	$50,000	$–0–	50,000 Increase
Retained earnings	25,000	–0–	25,000 Increase
Accounts payable	12,000	–0–	12,000 Increase
Total	$87,000	$–0–	

Increase in **accounts payable** reflects a non-cash increase of $12,000 in expenses.

Cash provided by operating activities

ILLUSTRATION 5-22

Net income		$39,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	$(41,000)	
Increase in accounts payable	12,000	(29,000)
Net cash provided by operating activities		$10,000

Preparing the Statement of Cash Flows

Telemarketing Inc.'s investing and financing activities.

- Purchased land for $15,000.
- Issued ordinary shares for $50,000.
- Paid $14,000 in dividends.

Investing and Financing Activities

Purchased land for $15,000 (Investing)

ILLUSTRATION 5-23

TELEMARKETING INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015

Cash flows from operating activities		
Net income		$39,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	$(41,000)	
Increase in accounts payable	12,000	(29,000)
Net cash provided by operating activities		10,000
Cash flows from investing activities		
Purchase of land	(15,000)	
Net cash used by investing activities		(15,000)
Cash flows from financing activities		
Issuance of ordinary shares	50,000	
Payment of cash dividends	(14,000)	
Net cash provided by financing activities		36,000
Net increase in cash		31,000
Cash at beginning of year		–0–
Cash at end of year		$31,000

Investing and Financing Activities

Issued ordinary shares for $50,000 (Financing)

ILLUSTRATION 5-23

TELEMARKETING INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015

Cash flows from operating activities		
Net income		$39,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	$(41,000)	
Increase in accounts payable	12,000	(29,000)
Net cash provided by operating activities		10,000
Cash flows from investing activities		
Purchase of land	(15,000)	
Net cash used by investing activities		(15,000)
Cash flows from financing activities		
Issuance of ordinary shares	50,000	
Payment of cash dividends	(14,000)	
Net cash provided by financing activities		36,000
Net increase in cash		31,000
Cash at beginning of year		–0–
Cash at end of year		$31,000

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Investing and Financing Activities

Paid $14,000 in dividends → (Financing)

ILLUSTRATION 5-23

TELEMARKETING INC.
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015

Cash flows from operating activities		
Net income		$39,000
Adjustments to reconcile net income to net cash provided by operating activities:		
Increase in accounts receivable	$(41,000)	
Increase in accounts payable	12,000	(29,000)
Net cash provided by operating activities		10,000
Cash flows from investing activities		
Purchase of land	(15,000)	
Net cash used by investing activities		(15,000)
Cash flows from financing activities		
Issuance of ordinary shares	50,000	
Payment of cash dividends	(14,000)	
Net cash provided by financing activities		36,000
Net increase in cash		31,000
Cash at beginning of year		–0–
Cash at end of year		$31,000

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Preparation of Statement of Cash Flows

BE 5-12: Keyser Beverage Company reported the following items in the most recent year.

		Activity
Net income	$40,000	Operating
Dividends paid	5,000	Financing
Increase in accounts receivable	10,000	Operating
Increase in accounts payable	7,000	Operating
Purchase of equipment	8,000	Investing
Depreciation expense	4,000	Operating
Issue of notes payable	20,000	Financing

Required: Determine if each item should be classified as an operating, investing, or financing activity.

BE 5-12

Statement of Cash Flow (in thousands)	
Operating activities	
Net income	$ 40,000
Increase in accounts receivable	(10,000)
Increase in accounts payable	7,000
Depreciation expense	4,000
Net cash provided by operating activities	41,000
Investing activities	
Purchase of equipment	(8,000)
Financing activities	
Dividends paid	(5,000)
Proceeds from notes payable	20,000
Net cash provided by financing activities	15,000
Increase in cash	$ 48,000

Preparation of Statement of Cash Flows

Question

In preparing a statement of cash flows, which of the following transactions would be considered an investing activity?

a. Sale of equipment at book value
b. Sale of merchandise on credit
c. Declaration of a cash dividend
d. Issuance of bonds payable.

Preparation of Statement of Cash Flows

Significant Non-Cash Activities

Reported in a **separate note** to the financial statements.

Examples include:

- Issuance of ordinary shares to purchase assets.
- Conversion of bonds into ordinary shares.
- Issuance of debt to purchase assets.
- Exchanges on long-lived assets.

ILLUSTRATION 5-24
Comprehensive Statement of Cash Flows

NESTOR COMPANY
STATEMENT OF CASH FLOWS
FOR THE YEAR ENDED DECEMBER 31, 2015

Cash flows from operating activities		
Net income		€320,750
Adjustments to reconcile net income to net cash provided by operating activities:		
Depreciation expense	€88,400	
Amortization of intangibles	16,300	
Gain on sale of plant assets	(8,700)	
Increase in accounts receivable (net)	(11,000)	
Decrease in inventory	15,500	
Decrease in accounts payable	(9,500)	91,000
Net cash provided by operating activities		411,750
Cash flows from investing activities		
Sale of plant assets	90,500	
Purchase of equipment	(182,500)	
Purchase of land	(70,000)	
Net cash used by investing activities		(162,000)
Cash flows from financing activities		
Payment of cash dividend	(19,800)	
Issuance of ordinary shares	100,000	
Redemption of bonds	(50,000)	
Net cash provided by financing activities		30,200
Net increase in cash		279,950
Cash at beginning of year		135,000
Cash at end of year		€414,950[1]

[1]Cash Flow Note
A non-cash investing and financing activity was the purchase of equipment through issuance of €50,000 of bonds.

Usefulness of Statement of Cash Flows

Without cash, a company will not survive.

Cash flow from Operations:

- High amount - able to generate sufficient cash from operations to pay its bills without further borrowing.
- Low or negative amount - may have to
  - borrow or
  - issue equity securities.

PREPARATION OF STATEMENT OF CASH FLOWS

Usefulness of the Statement of Cash Flows

Provides information to help assess:

1. Entity's ability to generate future cash flows.
2. Entity's ability to pay dividends and meet obligations.
3. Reasons for the difference between net income and net cash flow from operating activities.
4. Cash and noncash investing and financing transactions during the period.

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ADDITIONAL INFORMATION

IFRS requires that a complete set of financial statements be presented annually. Comprised of the following:

1. **Statement of financial position** at the end of the period;
2. **Statement of comprehensive income** for the period to be presented either as:
   a) One single statement of comprehensive income.
   b) A separate income statement and statement of comprehensive income.
3. **Statement of changes in equity**;
4. **Statement of cash flows**; and
5. **Notes**, comprising a summary of significant accounting

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ADDITIONAL INFORMATION

Notes to the Financial Statements

Accounting Policies

- Specific principles, bases, conventions, rules, and practices applied in preparing and presenting financial information.
- First note generally titled, “Summary of Significant Accounting Policies.”

Notes to the Financial Statements

Additional Notes to the Financial Statements

IFRS requires specific disclosures. Examples include:

1. Items of property, plant, and equipment are disaggregated into classes such as
   - land,
   - buildings, etc.,
   - in the notes, with related accumulated depreciation reported where applicable.

Notes to the Financial Statements

Additional Notes to the Financial Statements

IFRS requires specific disclosures. Examples include:

2. Receivables are disaggregated into amounts
   - receivable from trade customers,
   - receivables from related parties,
   - prepayments, and
   - other amounts.

Additional Notes



ILLUSTRATION 5-34
Maturity Analysis for Receivables

Cadbury plc
(in millions)

	Current	Non-current
Trade receivables	£835	—
Less: provision for impairment of trade receivables	(46)	—
	£789	—

20. Trade and other receivables

The aged analysis of past due but not impaired receivables is as follows:

Total trade receivables	£835
Less: Provision for impairment of trade receivables	(46)
	£789
Of which:	
Not overdue	£657
Past due less than three months	123
Past due more than three months	9
	£789

Additional Notes

Additional Notes to the Financial Statements

IFRS requires specific disclosures. Examples include:

3. Inventories are disaggregated into classifications such as merchandise, production supplies, work in process, and finished goods.

4. Provisions are disaggregated into provisions for employee benefits and other items.

Techniques of Disclosure

Parenthetical Explanations



ILLUSTRATION 5-37
Parenthetical Disclosure of Shares Issued

Cadbury plc

Equity	
Ordinary shares (1,361 million of 10p each)	£136,100,000

Parenthetical explanation is an advantage over a note because it brings the additional information into the body of the statement where readers will less likely overlook it.

Techniques of Disclosure

Cross-Reference and Contra Items

Companies "cross-reference" a direct relationship between an asset and a liability on the statement of financial position.

Current Assets (in part)	
Cash on deposit with sinking fund trustee for redemption of bonds payable—see Current liabilities	$800,000

Current Liabilities (in part)	
Bonds payable to be redeemed in 2015—see Current assets	$2,300,000

ILLUSTRATION 5-38
Cross-Referencing and Contra Items

ADDITIONAL INFORMATION

Other Guidelines

Offsetting

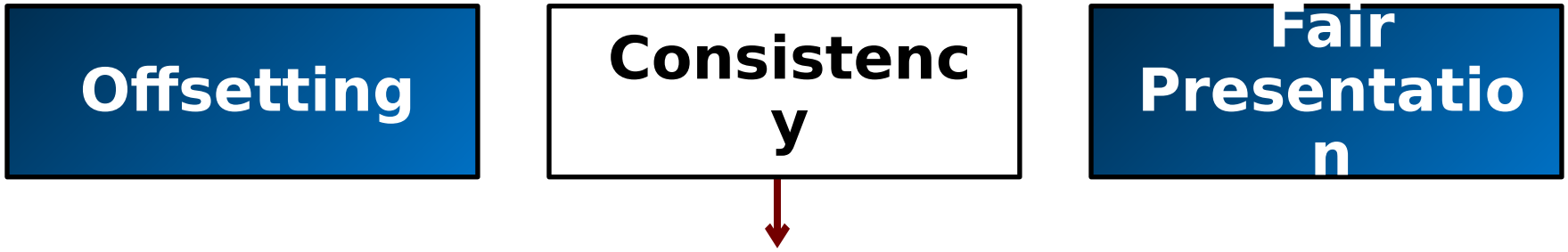
Consistency

Fair Presentation

- IAS No. 1 indicates that it is important that assets and liabilities, and income and expense, be reported separately.
- It is proper to measure assets net of valuation allowances, such as allowance for doubtful accounts or inventory net of impairment.

ADDITIONAL INFORMATION

Other Guidelines



- The Conceptual Framework indicates that companies should follow consistent principles and methods from one period to the next.
- Accounting policies must be consistently applied for similar transactions and events unless an IFRS requires a different policy.

ADDITIONAL INFORMATION

Other Guidelines

Offsetting

Consistency

Fair Presentation



- Faithful representation of transactions and events using the definitions and recognition criteria in the Conceptual Framework.
- Presumed that the use of IFRS with appropriate disclosure results in financial statements that are fairly presented.

GLOBAL ACCOUNTING INSIGHTS

STATEMENT OF FINANCIAL POSITION AND STATEMENT OF CASH FLOWS

As in IFRS, the statement of financial position and the statement of cash flows are required statements for U.S. GAAP. In addition, the content and presentation of a U.S. GAAP statement of financial position and cash flow statement are similar to those used for IFRS.

Relevant Facts

Following are the key similarities and differences between U.S. GAAP and IFRS related to the statement of financial position.

Similarities

- Both U.S. GAAP and IFRS allow the use of the title "balance sheet" or "statement of financial position." IFRS recommends but does not require the use of the title "statement of financial position" rather than balance sheet.
- Both U.S. GAAP and IFRS require disclosures about (1) accounting policies followed, (2) judgments that management has made in the process of applying the entity's accounting policies, and (3) the key assumptions and estimation uncertainty that could result in a material adjustment. Comparative prior period information must be presented and financial statements must be prepared

GLOBAL ACCOUNTING INSIGHTS

Relevant Facts

Similarities

- U.S. GAAP and IFRS require presentation of non-controlling interests in the equity section of the statement of financial position.

Differences

- U.S. GAAP follows the same guidelines as presented in the chapter for distinguishing between current and noncurrent assets and liabilities. However, under U.S. GAAP, public companies must follow U.S. SEC regulations, which require specific line items. In addition, specific U.S. GAAP mandates certain forms of reporting for this information. IFRS requires a classified statement of financial position except in very limited situations.



GLOBAL ACCOUNTING INSIGHTS

Relevant Facts

Differences

- Under U.S. GAAP cash is listed first, but under IFRS it is many times listed last. That is, under IFRS, current assets are usually listed in the reverse order of liquidity than under U.S. GAAP.
- U.S. GAAP has many differences in terminology that you will notice in this textbook. One example is the use of common stock under U.S. GAAP, which is referred to as share capital—ordinary under IFRS.
- Use of the term “reserve” is discouraged in U.S. GAAP, but there is no such prohibition in IFRS.

GLOBAL ACCOUNTING INSIGHTS

About The Numbers

The order of presentation in the statement of financial position differs between U.S. GAAP and IFRS. As indicated in the following table, U.S. companies generally present current assets, non-current assets, current and non-current liabilities, and shareholders' equity. In addition, within the current asset and liability classifications, items are presented in order of liquidity.

Assets	Liabilities and Owners' Equity
Current assets	Current liabilities
Long-term investments	Long-term debt
Property, plant, and equipment	Shareholders' equity
Intangible assets	Common stock
Other assets	Additional paid-in capital
	Retained earnings

GLOBAL ACCOUNTING INSIGHTS

On the Horizon

The IASB and the FASB are working on a project to converge their standards related to financial statement presentation. A key feature of the proposed framework is that each of the statements will be organized, in the same format, to separate an entity's financing activities from its operating and investing activities and, further, to separate financing activities into transactions with owners and creditors. Thus, the same classifications used in the statement of financial position would also be used in the statement of comprehensive income and the statement of cash flows.