

## Quick Question On Cash Flows Part II

Prepare a statement of cash flows using the direct method for the IOU Company, which had income in 1995 of \$50,000. Depreciation expense for 1995 was \$30,000. Analyze the results.

### IOU Company Partial Balance Sheet December 31, 1995

	12/95	12/94
<b>Assets</b>		
Cash	\$ 23,000	\$ 20,000
Accounts Receivable	122,000	82,000
Inventory	100,000	53,000
Depreciable Assets (NET)	<u>230,000</u>	<u>250,000</u>
Total Assets	<u>\$475,000</u>	<u>\$405,000</u>
<b>Liabilities</b>		
Accounts Payable	\$ 90,000	\$ 70,000
Notes Payable	<u>155,000</u>	<u>135,000</u>
Total Liabilities	\$245,000	\$205,000
<b>Owner's Equity</b>		
Common Stock	200,000	190,000
Retained Earnings	<u>30,000</u>	<u>10,000</u>
Total Owner's Equity	\$230,000	\$200,000
Total Liabilities and Owner's Equity	<u>\$475,000</u>	<u>\$405,000</u>

Note: Net depreciable assets decreased by only \$20,000 even though depreciation expense for the period was \$30,000. This means depreciable assets were purchased worth \$10,000.

Note: Retained Earnings increased by only \$20,000 even though Net Income was \$50,000. This means the company paid a dividend of \$30,000.

### IOU Company Partial Balance Sheet December 31, 1995

IOU Company Partial Balance Sheet December 31, 1995		
<b>CASH FLOWS FROM OPERATING ACTIVITIES</b>		
Net Income		\$50,000
Accounts Receivable Increased	(\$40,000)	
Inventory Increased	(47,000)	
Depreciation, a Noncash Expense	30,000	
Accounts Payable Increased	20,000	(37,000)
Cash Flows From Operating Activities		\$13,000
<b>CASH FLOWS FROM INVESTING ACTIVITIES</b>		
Fixed Assets Purchased		(\$10,000)
<b>CASH FLOWS FROM FINANCING ACTIVITIES</b>		
Sold Bonds	20,000	
Sold Stock	10,000	
Paid Dividend	(30,000)	-0-
Net Increase (Decrease)		\$ 3,000
Cash Beginning of Period		<u>20,000</u>
Cash End of Period		<u>\$23,000</u>

#### ANALYSIS:

Substantial increases in Accounts Receivable and Inventory were not offset by increases in Accumulated Depreciation and Accounts Payable and as a result, cash flows from operating activity were substantially smaller than income. As a result, it was necessary to sell stocks and bonds to pay dividends.