

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	
Assets			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.
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>	
Liabilities			
Accounts Payable	\$ 90,000	\$ 70,000	
Notes Payable	<u>155,000</u>	<u>135,000</u>	
Total Liabilities	\$245,000	\$205,000	
Owner's Equity			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.
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>	

IOU Company Partial Balance Sheet December 31, 1995

IOU Company Partial Balance Sheet December 31, 1995		
CASH FLOWS FROM OPERATING ACTIVITIES		
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
CASH FLOWS FROM INVESTING ACTIVITIES		
Fixed Assets Purchased		(\$10,000)
CASH FLOWS FROM FINANCING ACTIVITIES		
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		\$23,000

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.