

14.4: Prepare the Completed Statement of Cash Flows Using the Indirect Method

In this section, we use the example of Virtual Co. to work through the entire process of preparing the company's statement of cash flows using the indirect method. Virtual's comparative balance sheet and income statement are provided as a base for the preparation of the statement of cash flows.

Review Problem: Preparing the Virtual Co. Statement of Cash Flows

VIRTUAL CO. Comparative Balance Sheet December 31			
	2018	2017	Change increase/ (decrease)
Assets			
Cash	\$ 66,700	\$ 83,250	\$(16,550)
Accounts Receivable	55,400	54,220	1,180
Prepaid Insurance	2,400	3,600	(1,200)
Investments	95,000	75,000	20,000
Plant Assets	356,000	290,000	66,000
Accumulated Depreciation	<u>(65,700)</u>	<u>(36,700)</u>	<u>(29,000)</u>
Total Assets	\$509,800	\$469,370	\$ 40,430
Liabilities and Equity			
Liabilities:			
Accounts Payable	\$ 48,100	\$ 47,300	\$ 800
Notes Payable	<u>160,000</u>	<u>185,000</u>	<u>(25,000)</u>
Total Liabilities	208,100	232,300	(24,200)
Equity:			
Common Stock	130,000	100,000	30,000
Retained Earnings	<u>171,700</u>	<u>137,070</u>	<u>34,630</u>
Total Equity	<u>301,700</u>	<u>237,070</u>	<u>64,630</u>
Total Liabilities and Equity	\$509,800	\$469,370	\$ 40,430

Figure 16.6 Comparative Balance Sheet. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

VIRTUAL CO. Income Statement For the Year Ended December 31, 2018	
Sales Revenue	\$433,000
Cost of Goods Sold	<u>289,000</u>
Gross Profit	144,000
Operating Expenses:	
Depreciation Expense	\$29,000
Insurance Expense	14,400
Other Operating Expenses	<u>57,200</u>
Total Operating Expenses	<u>100,600</u>
Operating Income	43,400
Other Revenue and (Expenses):	
Gain on Sale of Land	<u>17,500</u>
Total Other Revenue and Expenses	<u>17,500</u>
Income Before Income Tax	60,900
Income Tax Expense	<u>18,270</u>
Net Income	\$ 42,630

Figure 16.7 Income Statement. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

Additional Information

The following additional information is provided:

1. Investments that originally cost \$30,000 were sold for \$47,500 cash.
2. Investments were purchased for \$50,000 cash.
3. Plant assets were purchased for \$66,000 cash.
4. Cash dividends were declared and paid to shareholders in the amount of \$8,000.

Directions:

Prepare the statement of cash flows (indirect method), for the year ended December 31, 2018.

VIRTUAL CO. Statement of Cash Flows: Indirect Method For the Year Ended December 31, 2018		
Cash Flow from Operating Activities:		
Net Income		\$ 42,630
Adjustments to Reconcile Net Income to		
Net Cash Flow from Operating Activities:		
Depreciation	\$ 29,000	
Gain on Sale of Plant Assets	(17,500)	
Accounts Receivable decrease	(1,180)	
Prepaid Insurance decrease	1,200	
Accounts Payable increase	800	12,320
Net Cash Flow: Operating Activities		54,950
Cash Flow from Investing Activities:		
Proceeds from Sale of Investments	47,500	
Cost of Investments Purchased	(50,000)	
Cost of New Plant Assets	(66,000)	
Net Cash Flow: Investing Activities		(68,500)
Cash Flow from Financing Activities:		
Payment of Notes Payable (principal)	(25,000)	
Issuance of Common Stock	30,000	
Payment of Dividends	(8,000)	
Net Cash Flow: Financing Activities		(3,000)
Total Cash Flow increase/(decrease)		(16,550)
Cash Balance, December 31, 2017		83,250
Cash Balance, December 31, 2018		\$ 66,700

Figure 16.8 Statement of Cash Flows. (attribution: Copyright Rice University, OpenStax, under CC BY-NC-SA 4.0 license)

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