

SOLUTIONS TO END-OF-CHAPTER QUESTIONS

CHAPTER 6

► RECALL AND REVIEW

► Question 6.1

- (a) Cash received from the sale of a property: investing activities
- (b) Cash received from customers: operating activities
- (c) Cash received from the sale of inventory: operating activities
- (d) Income tax paid to HMRC: operating activities
- (e) Dividend received from an investment in another company: investing activities
- (f) Interest paid on a bank loan: financing activities
- (g) Interest received: investing activities
- (h) Cash paid to suppliers for goods purchased: operating activities
- (i) Depreciation of equipment: operating activities
- (j) Proceeds from the issue of preference shares: financing activities

► Question 6.2

Cash flow from operating activities + cash flow from investing activities + cash flow from financing activities = net increase or decrease in cash and cash equivalents.

Net cash inflow for the year: £115,800 (cash and cash equivalents at 30 June 2021) – £105,300 (cash and cash equivalents at 1 July 2020) = £10,500.

Therefore, the cash inflow or outflow from operating activities + (£2,400) + £1,300 = £10,500.

Cash inflow from operating activities = £11,600 (£10,500 + £2,400 – £1,300 = £11,600).

» DEVELOP YOUR UNDERSTANDING

» Question 6.3

Abi: statement of cash flows for the year ended 31 August 2021 using the direct method

Cash flows from operating activities	£
Cash received from sales (Note 1)	154,550
Cash payments to suppliers £3,445 + £116,328 + £6,000 (Note 2)	(125,773)
Cash payments for wages (Note 3)	(5,000)
Cash flows from operating activities	<u>23,777</u>
Cash flows from investing activities	
Cash paid to acquire display stands (Note 4)	(600)
Cash flows from financing activities	
Cash repaid to Abi (Note 5)	(18,000)
Net cash inflow for the year	<u>5,177</u>
Cash and cash equivalents at 1 September 2020	<u>7,342</u>
Cash and cash equivalents at 31 August 2021 (Note 6)	<u>12,519</u>

Notes

- As Abi makes all her revenue (sales) for cash, this is the sales figure in the statement of profit or loss. Abi paid £157,689 from cash sales into her bank, but she gave refunds of £3,789 for goods returned. She also had £650 in cash representing unbanked sales at the year end, so her total cash received from sales was $£157,689 - £3,789 + £650 = £154,550$.
- Abi paid the £3,445 owing to suppliers at 31 August 2020 in the current accounting year, so this counts as a cash payment to suppliers during the financial year 1 September 2020 to 31 August 2021. She also paid £116,328 of the total purchases during the year of £120,645, so this is also a cash payment to suppliers during the financial year 1 September 2020 to 31 August 2021. During this same financial year, she paid all her rent of £6,000. Therefore, cash payments to suppliers during the financial year to 31 August 2021 were $£3,445 + £116,328 + £6,000 = £125,773$.
- Cash paid for wages during the financial year was £5,000 with an accrual (cash not paid, but the expense recognised for services received by the end of the financial year together with a liability for the same amount) of £200 making up the statement of profit or loss figure of £5,200.
- The actual cash paid to acquire non-current assets (the display stands) was £600. Remember that depreciation is not a cash flow.
- Abi withdrew £18,000 from the bank for her own personal expenses during the accounting year, so this amounts to a repayment of capital to the owner of the business.
- Cash at 31 August 2021 is made up of the bank balance of £11,869 + cash from sales unbanked of £650 = £12,519.

Abi: statement of cash flows for the year ended 31 August 2021 using the indirect method

Cash flows from operating activities	£
Profit for the year from Abi's statement of profit or loss	24,951
Add: depreciation charged for the year	190
Deduct: increase in inventory £2,382 – £4,638	(2,256)
Add: increase in trade payables £4,137 – £3,445	692
Add: increase in accruals £200 – £Nil	200
Cash flows from operating activities	<u>23,777</u>
Cash flows from investing activities	
Cash paid to acquire display stands	(600)
Cash flows from financing activities	
Cash repaid to Abi	(18,000)
Net cash inflow for the year	<u>5,177</u>
Cash and cash equivalents at 1 September 2020	<u>7,342</u>
Cash and cash equivalents at 31 August 2021	<u><u>12,519</u></u>

» Question 6.4**Alison: statement of cash flows for the year ended 31 December 2021 using the direct method**

	£	£
Cash flows from operating activities		
Cash received from sales (working 1)		420,108
Cash paid to suppliers (working 2)		(222,672)
Cash paid for expenses (working 3)		<u>(91,203)</u>
Cash flows from operating activities		106,233
Cash flows from investing activities		
Cash paid to acquire new computer equipment	(8,000)	
Cash paid to acquire new racks, shelving and office furniture	<u>(9,600)</u>	
Cash flows from investing activities		(17,600)
Cash flows from financing activities		
Cash repaid to Alison		(40,000)
Net cash inflow for the year		<u>48,633</u>
Cash and cash equivalents at 1 January 2021		<u>3,682</u>
Cash and cash equivalents at 31 December 2021		<u><u>52,315</u></u>

Working 1 Cash received from sales

Trade receivables control account			
	£		£
Trade receivables at 1 January 2021 b/f	27,200	Sales returns	17,682
Sales	437,990	Cash received (balancing figure)	420,108
		Trade receivables at 31 December 2021 c/f	27,400
	<u>465,190</u>		<u>465,190</u>

Working 2 Cash paid to suppliers

Trade payables control account			
	£		£
Purchase returns	5,724	Trade payables at 1 January 2021 b/f	30,314
Discounts received	2,324	Purchases (given in question 3.4)	225,368
Cash paid (balancing figure)	222,672		
Trade payables at 31 December 2021 c/f	24,962		
	<u>255,682</u>		<u>255,682</u>

Working 3 Cash paid for expenses

Expenses T account			
	£		£
Rent prepayment at 1 January 2021 b/f	2,500	Accruals at 1 January 2021 b/f	1,500
Rates prepayment at 1 January 2021 b/f	1,965	Statement of profit or loss expenses total	106,548
Depreciation	13,255	Rent prepayment at 31 December 2021 c/f	3,000
Increase in allowance for receivables	2,740	Rates prepayment at 31 December 2021 c/f	1,865
Cash paid (balancing figure)	91,203		
Accruals at 31 December 2021 c/f	1,250		
	<u>112,913</u>		<u>112,913</u>

Alison: statement of cash flows for the year ended 31 December 2021 using the indirect method

	£	£
Cash flows from operating activities		
Profit for the year from Alison's statement of profit or loss		91,393
Add: depreciation charged for the year		13,255
Add: decrease in inventory £27,647 – £22,600		5,047
Add: decrease in trade payables £27,200 – £24,660		2,540
Deduct: increase in rent prepayment £2,500 – £3,000		(500)
Add: reduction in rates prepayment £1,965 – £1,865		100
Deduct: decrease in trade payables £24,962 – £30,314		(5,352)
Deduct: decrease in telephone, electricity and gas accruals £1,500 – £Nil		(1,500)
Add: increase in accountancy accrual		<u>1,250</u>
Cash flows from operating activities		106,233
Cash flows from investing activities		
Cash paid to acquire new computer equipment	(8,000)	
Cash paid to acquire new racks, shelving and office furniture	<u>(9,600)</u>	
Cash flows from investing activities		(17,600)
Cash flows from financing activities		
Cash repaid to Alison		<u>(40,000)</u>
Net cash inflow for the year		48,633
Cash and cash equivalents at 1 January 2021		<u>3,682</u>
Cash and cash equivalents at 31 December 2021		<u><u>52,315</u></u>

Note

Check back to Table 6.1 to remind yourself which figures to add and which figures to deduct from operating profit to determine the cash flow from operating activities when preparing statements of cash flows using the indirect method.

» Question 6.5**Laura: statement of cash flows for the year ended 31 August 2021 (indirect method)**

	£	£
Cash flows from operating activities		
Profit for the year (Note 1)		98,040
Add van depreciation (Note 2)		1,800
Add construction equipment depreciation (Note 2)		1,235
Deduct increase in inventory (£0 – £4,500) (Note 3)		(4,500)
Deduct: increase in trade receivables (£0 – £8,550) (Note 3)		(8,550)
Deduct increase in prepayments (£0 – £600) (Note 3)		(600)
Add increase in trade payables (£6,000 – £0) (Note 3)		6,000
Add increase in accruals (£875 – £0) (Note 3)		875
Deduct interest received (Note 4)		(300)
Add interest paid (Note 5)		200
Net cash inflows from operating activities		<u>94,200</u>
Cash flows from investing activities		
Payment to acquire van (Note 6)	(6,000)	
Payment to acquire construction equipment (Note 6)	(5,000)	
Interest received (Note 7)	250	
Net cash outflow from investing activities		<u>(10,750)</u>
Cash flows from financing activities		
Cash introduced by Laura (Note 8)	50,000	
Cash withdrawn by Laura (Note 8)	(120,000)	
Payment of interest (Note 9)	(200)	
Net cash outflow from financing activities		<u>(70,200)</u>
Net cash inflow for the year		<u>13,250</u>
Cash and cash equivalents at 1 September 2020 (Note 10)		–
Cash and cash equivalents at 31 August 2021		<u><u>13,250</u></u>

Notes

Information from the statement of profit or loss and statement of financial position in the answer to Question 3.10:

- Profit for the year.
- Depreciation for the year on these two non-current assets.
- The inventory, trade receivables, prepayments, trade payables and accruals at the start of the year were all £Nil as this is Laura's first year of trading. All movements in working capital figures are thus the end of year figures – £Nil at the start of the year.
- Cash inflows from interest received are dealt with under investing activities.
- Cash outflows from interest paid are dealt with under financing activities.
- The cash payments actually made to acquire these assets.
- The cash flow from interest received is the actual cash received: ignore interest due for August as this is cash that has not yet been received so no cash inflow relating to this interest receivable has yet taken place.
- Laura's cash introduced and cash withdrawn as shown in the bank account.
- The actual interest paid to the bank during the year.
- As this is the first year of trading, the cash balance at the start of the business' life was £Nil.

Laura: statement of cash flows for the year ended 31 August 2021 (direct method)

	£	£
Cash flows from operating activities		
Cash received from sales (note 11)		148,000
Cash paid to suppliers (note 12)		(38,000)
Cash paid for expenses (note 13)		<u>(15,800)</u>
Net cash inflows from operating activities		94,200
Cash flows from investing activities		
Payment to acquire van (Note 6)	(6,000)	
Payment to acquire construction equipment (Note 6)	(5,000)	
Interest received (Note 7)	<u>250</u>	
Net cash outflow from investing activities		(10,750)
Cash flows from financing activities		
Cash introduced by Laura (Note 8)	50,000	
Cash withdrawn by Laura (Note 8)	(120,000)	
Payment of interest (Note 9)	<u>(200)</u>	
Net cash outflow from financing activities		<u>(70,200)</u>
Net cash inflow for the year		13,250
Cash and cash equivalents at 1 September 2020 (Note 10)		<u>—</u>
Cash and cash equivalents at 31 August 2021		<u>13,250</u>

Notes

11. As the bank account presents the relevant information relating to cash inflows and outflows there is no need to prepare T accounts to calculate the cash received from sales, the cash payments to suppliers and the cash payments for expenses. Cash received from customers and paid into the bank account is £112,000 from cash customers + £36,000 received from credit customers = £148,000. The £50,000 paid in by Laura is treated under cash flows from financing activities while the £250 bank interest received is treated under cash flows from investing activities.
12. Cash paid to suppliers in the bank account amounts to £38,000.
13. Cash paid for expenses is a slightly more difficult figure to calculate as various cash payments in the bank account relate to cash flows from both financing and investing activities as well as to payments for expenses. Cash flows for expenses are £4,000 for van running expenses + £9,600 wages + £1,800 insurance + £400 bank charges = £15,800. Cash paid for the van and the construction equipment is allocated to cash flows from investing activities as these are payments to acquire long term assets rather than being payments of expenses. Bank interest paid of £200 and the two drawings figures of £30,000 and £90,000 are both cash flows from financing activities and not expenses payments.

» Question 6.6

- (a) Profit does not equal cash. A business can make a profit by selling goods on credit but there is no corresponding inflow of cash from these credit sales until the customer actually pays what is due. Therefore, although the business has made a profit of £20,000, this profit has not yet been fully realised in cash.
- (b) There are a number of reasons why cash and profit are not equal. Sales and purchases may be made on either cash terms or credit terms. When sale and purchase transactions are made on cash terms, the effect of such transactions is instantly reflected in both the statement of profit or loss and in the cash balance of the organisation. However, when sale and purchase transactions are made on credit terms, the values of these sales and purchases are recorded in the statement of profit or loss as soon as the goods are transferred or services are delivered even though cash has not been received or paid. The corresponding entry for credit transactions is made to the statement of financial position, recording a trade receivable for credit sales (cash due at a later date) and a trade payable for credit purchases (cash payable at a later date). Similarly, businesses incur expenses that will be paid at a future date, but those expenses are recorded at the time they are incurred, not at the point at which cash is paid. Again, the effect is reflected in the statement of profit or loss immediately, while the cash effect will only be recorded at a later date. On the acquisition of a non-current asset, there is an immediate cash outflow for the entire cost of the asset in the period the asset is acquired, while the cost of each asset is gradually spread over the useful life of those assets: the depreciation charged in the statement of profit or loss is much lower than the cash actually paid to acquire the non-current assets, so profits will be higher than cash. Inventory at the end of the financial year is a deduction from cost of sales in the statement of profit or loss and an asset in the statement of financial position. However, closing inventory, while increasing profit for the year, is not cash: cash has been spent to acquire this inventory and this cash will only be realised in the future when the closing inventory is sold in the next accounting period.
- (c) The accruals basis of accounting applies to all income earned and all expenditure incurred during an accounting period. The statement of profit or loss (and the statement of financial position) is drawn up on the basis of the time at which a transaction occurred not on the basis of when cash is received or paid. On the other hand, the statement of cash flows only reports cash receipts and payments to show the sources and uses of cash for an accounting period. The statement of cash flows is drawn up on the basis of when cash was paid or received and does not use the accruals basis of accounting in its preparation.

» Question 6.7**The Palace Company: Statement of cash flows for the year ended 31 December 2021**

	£000	£000
Cash flows from operating activities		
Operating profit		45,500
Add: Depreciation		3,800
Add: Decrease in inventory		2,900
Deduct: Increase in trade and other receivables		(7,800)
Deduct: Decrease in trade and other payables		(8,200)
Deduct: Income tax paid		(24,950)
Net cash inflow from operating activities		<u>11,250</u>
Cash flows from investing activities		
Dividends received	1,020	
Proceeds from the sale of property, plant and equipment	<u>2,130</u>	
Net cash inflow from investing activities		3,150
Cash flows from financing activities		
Receipts from the issue of bonds	13,200	
Dividends paid	<u>(19,500)</u>	
Net cash outflow from financing activities		(6,300)
Net increase in cash and cash equivalents		<u>8,100</u>
Cash and cash equivalents at 1 January 2021		<u>3,300</u>
Cash and cash equivalents at 31 December 2021		<u>11,400</u>

»» TAKE IT FURTHER**»» Question 6.8****Potters Limited: statement of cash flows for the year ended 30 June 2021**

	£000	£000
Cash flows from operating activities		
Operating profit		845
Add: depreciation		800
Deduct: profit on disposal of plant and equipment: £150,000 cash received – £100,000 carrying amount		(50)
Add: amortisation of trademarks		20
Add: decrease in inventory: £1,000 – £1,100		100
Deduct: increase in trade and other receivables: £1,800 – £1,550		(250)
Add: increase in trade and other payables: £1,200 – £1,000		200
Cash generated from operations		<u>1,665</u>
Taxation paid		<u>(275)</u>
Net cash inflow from operating activities		1,390
Cash flows from investing activities		
Acquisition of property, plant and equipment	(2,500)	
Proceeds from sale of property, plant and equipment	<u>150</u>	
Net cash outflow from investing activities		(2,350)
Cash flows from financing activities		
Proceeds from the issue of ordinary share capital £2.75 × 200,000	550	
Increase in long-term borrowings: £3,200,000 – £2,600,000	600	
Dividends paid	(100)	
Interest paid	<u>(200)</u>	
Net cash inflow from financing activities		<u>850</u>
Net cash outflow for the year		<u>(110)</u>
Cash and cash equivalents at 1 July 2020		<u>310</u>
Cash and cash equivalents at 30 June 2021		<u><u>200</u></u>

»» Question 6.9**1. Metal Bashers Limited: statement of cash flows for the year ended 30 September 2021 direct method**

	£000	£000
Cash flows from operating activities		
Cash receipts from sales (working 1)		12,171
Cash payments to suppliers (workings 2 and 3)		(7,797)
Cash payments for expenses (working 4)		<u>(1,204)</u>
Cash generated from operations		3,170
Taxation paid		<u>(375)</u>
Net cash inflow from operating activities		2,795
Cash flows from investing activities		
Acquisition of property, plant and equipment	(5,000)	
Acquisition of intangible assets	(70)	
Proceeds from sale of property, plant and equipment	175	
Interest received	<u>100</u>	
Net cash outflow from investing activities		(4,795)
Cash flows from financing activities		
Proceeds from the issue of ordinary share capital £3 × 1,600,000	4,800	
Repayment of borrowings (£500 + £6,500) – (£500 + £7,000)	(500)	
Dividends paid	(1,080)	
Interest paid	<u>(870)</u>	
Net cash inflow from financing activities		2,350
Net cash inflow for the year		<u>350</u>
Cash and cash equivalents at 1 October 2020		<u>400</u>
Cash and cash equivalents at 30 September 2021		<u>750</u>

Working 1 Cash received from sales

Trade receivables control account			
	£000		£000
Trade receivables at 1 October 2020 b/f	2,100	Irrecoverable debt	125
Sales	12,196	Cash received (balancing figure)	12,171
		Trade receivables at 30 September 2021 c/f	2,000
	<u>14,296</u>		<u>14,296</u>

Working 2 Calculation of purchases

Opening inventory + purchases + depreciation of property, plant and equipment – closing inventory = cost of sales

Therefore, purchases = cost of sales + closing inventory – depreciation of property, plant and equipment – opening inventory

Purchases = £9,147 (cost of sales) + £1,400 (closing inventory) – £1,800 (depreciation of property, plant and equipment) – £1,200 (opening inventory)

Purchases = £7,547

Working 3 Cash paid to suppliers

Trade payables control account			
	£000		£000
Cash paid (balancing figure)	7,797	Trade payables at 1 October 2020 b/f	2,050
Trade payables at 30 September 2021 c/f	1,800	Purchases (calculated in working 2)	7,547
	<u>9,597</u>		<u>9,597</u>

Working 4 Cash paid for expenses

Expenses T account			
	£000		£000
Prepayments at 1 October 2020 b/f	300	Accruals at 1 October 2020 b/f	250
Amortisation of patents	20	Distribution and selling costs	425
Loss on disposal	75	Administration costs	899
Irrecoverable debt	125	Prepayments at 30 September 2021 c/f	350
Cash paid (balancing figure)	1,204		
Accruals at 30 September 2021 c/f	200		
	<u>1,924</u>		<u>1,924</u>

2. Metal Bashers Limited: statement of cash flows for the year ended 30 September 2021 indirect method

	£000	£000
Cash flows from operating activities		
Operating profit		1,725
Add: depreciation		1,800
Add: loss on disposal of plant and equipment: £250,000 carrying amount – £175,000 cash received		75
Add: amortisation of patents		20
Deduct increase in inventory: £1,400 – £1,200		(200)
Add: decrease in trade and other receivables: £2,350 – £2,400		50
Deduct: decrease in trade and other payables: £2,000 – £2,300		(300)
Cash generated from operations		<u>3,170</u>
Taxation paid		(375)
Net cash inflow from operating activities		<u>2,795</u>
Cash flows from investing activities		
Acquisition of property, plant and equipment	(5,000)	
Acquisition of intangible assets	(70)	
Proceeds from sale of property, plant and equipment	175	
Interest received	<u>100</u>	
Net cash outflow from investing activities		(4,795)
Cash flows from financing activities		
Proceeds from the issue of ordinary share capital £3 × 1,600,000	4,800	
Repayment of borrowings (£500 + £6,500) – (£500 + £7,000)	(500)	
Dividends paid	(1,080)	
Interest paid	<u>(870)</u>	
Net cash inflow from financing activities		<u>2,350</u>
Net cash inflow for the year		350
Cash and cash equivalents at 1 October 2020		<u>400</u>
Cash and cash equivalents at 30 September 2021		<u><u>750</u></u>

»» Question 6.10

Watson Limited: Statement of cash flows for the year ended 31 December 2021

	£	£
Cash flows from operating activities		
Profit for the year		7,770
Income tax		2,310
Interest expense		1,260
Dividends received		(1,540)
Add: Depreciation		4,900
Deduct: Increase in inventory (£16,170 – £14,840)		(1,330)
Add: Decrease in trade and other receivables (£10,990 – £9,800)		1,190
Add: Increase in trade and other payables (£12,740 – £12,320)		420
Deduct: Income tax paid (working 1)		<u>(3,850)</u>
Net cash inflow from operating activities		11,130
Cash flows from investing activities		
Dividends received	1,540	
Cash paid to acquire property, plant and equipment (working 2)	<u>(6,160)</u>	
Net cash outflow from investing activities		(4,620)
Cash flows from financing activities		
Receipts from share issue (£20,300 – £18,200)	2,100	
Repayment of loan (£1,840 – £6,300)	(4,460)	
Interest paid (working 3)	(1,050)	
Dividends paid	<u>(2,100)</u>	
Net cash outflow from financing activities		(5,510)
Net increase in cash and cash equivalents		1,000
Cash and cash equivalents at 1 January 2021		50
Cash and cash equivalents at 31 December 2021		<u><u>1,050</u></u>

Workings:

(1)

Taxation account			
	£		£
Cash paid (balancing figure)	3,850	Balance b/f	3,850
Balance c/f	<u>2,310</u>	Statement of profit or loss tax charge	<u>2,310</u>
	<u><u>6,160</u></u>		<u><u>6,160</u></u>

(2)

Property, plant and equipment			
	£		£
Carrying amount b/f	32,900	Depreciation	4,900
Cash paid (balancing figure)	<u>6,160</u>	Carrying amount c/f	<u>34,160</u>
	<u>39,060</u>		<u>39,060</u>

(3)

Interest payable			
	£		£
Cash paid (balancing figure)	1,050	Balance b/f	0
Balance c/f	<u>210</u>	Interest expense in the statement of profit or loss	<u>1,260</u>
	<u>1,260</u>		<u>1,260</u>