Liabilities

Payroll and payroll deductions payable

- Employers deduct amounts from employees' wages and salaries and are responsible to remit these withheld funds to the appropriate parties
  - Tax (pay-as-you-go or PAYG)
  - Superannuation
  - Trade union fees
  - Health insurance

Entry for payroll accrual and payment

Mar 7	Salaries and Wages Expense (E)	100 000	
	Pay-as-you-go Withheld Tax Payable (L)		32 036
	Salaries and Wages Payable (L)		67 964
	(To record payroll and withheld taxes for the week ending 7 March)		
Mar 10	Salaries and Wages Payable (L)	67 964	
	Cash (A)		67 964
	(To record payment of 7 March payroll)		

Journal entry when payment made to Tax Office

Apr 6	Pay-as-you-go Withheld Tax Payable (L)	32 036	
	Cash (A)		32 036
	(To record payment of withheld taxes for March)		

Revenues Received in Advance

- Occur when customers pay ahead of time for goods or services
- Revenue recognized when the obligation ceases – e.g. transfer of risks and rewards, no further control

Aug 6	Cash (A)	500 000	
	Ticket Revenue Received in Advance (L)		500 000
	(To record sale of 10 000 season tickets)		
Sep 5	Ticket Revenue Received in Advance (L)	100 000	
	Football Ticket Revenue (R)		100 000
	(To record football ticket revenue earned to date)		

Notes Payable

- Notes payable or bank bills record obligations in the form of written agreement (securities)
- Borrower is required to pay interest or borrowing costs
- Frequently issued to meet short-term financing needs
- Issued for varying periods of time

Journal entry when note issued

Mar 1	Cash (A)	100 000	
	Notes Payable (L)		100 000
	(To record issue of 12%, 4-month note to West State Bank)		

Journal entry to record interest

Jun 30	Interest Expense (E)	4 000	
	Interest Payable (L)		4 000
	(To accrue interest for 4 months on West State Bank note)		

Equities, Dividends, Share Capital and Changes to Equity Accounts

Preparing the Statement of Cash Flows

1. Determine the net increase (decrease) in cash
   - The difference between the beginning and ending cash balances can be easily calculated from comparative data from the statement of financial position
2. Determine net cash provided (used) by operating activities
   - Involves analysing the current year's statement of profit or loss and comparative data from the statement of financial position and selected additional data
3. Determine net cash provided (used) by investing activities
   - Involves analysis of comparative data from the statement of financial position, statement of profit or loss data and selected additional information for the effects on cash
4. Determine net cash provided (used) by financing activities
   - Involves analysing comparative data from the statement of financial position and selected additional information for the effects on cash

Step 1: Determining the Net Increase (Decrease) in Cash

- The difference between beginning and ending cash balances can be easily calculated from comparative statement of financial position data.
- Reports opening cash balance compared to closing balance.
- Calculate movement in balances over the year.

Step 2: Determining Net Cash Provided (Used) by Operating Activities

Cash receipts from customers

- Use sales and comparative Accounts Receivable account balances.
- Assume all sales made on credit.
- Reconstruct T accounts for Accounts Receivable
- Note: include Discount Expense and Bad Debts as credits if included in Income Statement.

Reconstruct the Accounts Receivable Account

Accounts receivable

2015				
July 1	Balance	15 000	Receipts from customers	978 000
	Revenue from sales	975 000	June 30 Closing balance	12 000
		990 000		990 000
2016				
July 1	Balance	12 000		

Cash Paid to Suppliers

- Use Cost of Sales and comparative accounts for Accounts Payable and Inventory
- Assume all purchases made on credit
- Assume Perpetual method used
- Note: Include Discount Revenue as a debit to Accounts Payable

Two steps:

1. Calculate amount of purchases made during period
2. Then the amount of cash paid to suppliers for purchases

Step 3: Determining Net Cash Provided (Used) by Investing Activities

- This step involves analysing statement of financial position data and statement of profit or loss data and selected additional information for the effects of cash on.
- Transactions relating to non-current assets:
    - Property, plant and equipment
    - Investments
    - Loans to other entities
- New equipment may be completely or partly funded through debt (portion funded by debt will not represent cash outflow, so does not appear in the statement)
- Cash outflow for purchase of equipment or investments is listed separately from cash inflow from sale of equipment or investments.
- Calculate inflows and outflows by reconstructing T accounts.
- Increase and decrease in equipment:
    - Use depreciation expense, loss or gain on sale, and comparative equipment and accumulated depreciation accounts, plus additional information.
    - Check comparative balances from statement of financial position for amounts not accounted for.

Step 4: Determining Net Cash Provided (Used) by Financing Activities

- This step involves analysing comparative statement of financial position data and selected additional information for the effects of cash.
- Relates to debt and equity of company.
- Use net profit and notes payable, issued shares and retained earnings accounts:
    - Cash inflows: issue shares, issue notes.
    - Cash outflows: dividends, repay notes.

Notes Payable

- Cash inflow = cash received from issue of notes.
- Cash outflow = cash paid upon redemption of notes.
- Check additional information for details

Increase in Ordinary Shares

- Check additional information for details.
- If none, assume increase/decrease represents cash received/paid.
- If non-cash transaction, check that details account for changes to issued share balances.

Significant Non-Cash Items

- If non-cash transaction in relation to shares, check the additional information to account for changes to issued share balances (e.g. issue shares for land)
- Report significant non cash transactions in a note at the end of the Statement of Cash Flows. (e.g. Non-cash investing and financing activities)
- Conversion of Notes Payable to Ordinary Shares.

Assessing Liquidity, Solvency and Profitability using Cash Flows

Liquidity

- The ability of an entity to meet its immediate obligations.

$$Current\ cash\ debt\ coverage = \frac{Net\ cash\ provided\ by\ operating\ activities}{Average\ current\ liabilities}$$

Solvency

- The ability of an entity to survive over the long term.

$$Current\ cash\ debt\ coverage = \frac{Net\ cash\ provided\ by\ operating\ activities}{Average\ total\ liabilities}$$

Profitability

- The ability of an entity to generate a reasonable return.

$$Cash\ return\ on\ sales\ ratio = \frac{Net\ cash\ provided\ by\ operating\ activities}{Net\ Sales}$$

Analysis Implications of Cash Flows

Interpreting Cash Flows and Net Income

- An income statement records revenues when earned and expenses when incurred.
    - It does not show the timing of cash inflows and outflows, nor the effect of operations on liquidity and solvency.
    - This information is available in the Cash Flow Statement.
- Cash flows from operations (CFO) is a broader view of operating activities than is net income.
    - It is not a measure of profitability.
- Note: A net measure, be it net income or cash flows from operations, is of limited usefulness. The key is information about <u>components</u> of these net measures.