

CONCEPT: OPERATING ACTIVITIES – DIRECT METHOD

- The **direct method** finds the cash flows from operating activities by summing all relevant cash flows
 - Note: the **indirect** or **direct** method only deal with operating activities
 - We use T-accounts to find the cash effect of transactions

<u>Direct Method</u>	
1. Cash Received from Customers	Relevant T-account → _____
2. Cash Paid to Suppliers	Relevant T-account → _____ and _____
3. Cash Paid for Operating Expenses	Relevant T-account → _____ and _____

EXAMPLE: ABC Company is preparing its Statement of Cash Flows using the direct method. The accountant gathered the following information: purchases totaled was \$200,000; Accounts Payable increased by \$6,000 during the year; cash received from customers was \$440,000; depreciation expense was \$25,000; cash paid for operating expenses (excluding interest) totaled \$140,000; interest expense was \$35,000; Interest Payable increased by \$5,000; and a loss on the disposal of plant assets equaled \$6,000. What is the cash flow provided by operating activities?

- a) \$76,000
- b) \$91,000
- c) \$106,000
- d) \$146,000

PRACTICE: ABC Company is preparing its Statement of Cash Flows using the direct method. The accountant gathered the following information: cash paid to suppliers was \$140,000; sales revenue was \$350,000; Accounts Receivable increased by \$10,000 during the year; depreciation expense was \$15,000; operating expenses totaled \$80,000; Prepaid Expenses decreased by \$8,000 during the year; and a loss on the disposal of plant assets equaled \$6,000. What is the cash flow provided by operating activities?

- a) \$128,000
- b) \$138,000
- c) \$144,000
- d) \$149,000

PRACTICE: During the year, cash paid to suppliers was \$340,000. Cash received from customers was \$580,000. Cash paid for operating expenses totaled \$64,000. Depreciation expense totaled \$16,000. The company also purchased equipment for \$35,000. Using the direct method, what is the cash provided by operating activities?

- a) \$125,000
- b) \$141,000
- c) \$160,000
- d) \$176,000