

Problem 8

Thai Company was formed on January 1, 20X1. The company’s accountant prepared the following income statement, statement of retained earnings, and balance sheet at the conclusion of the first full year of operations. Mr. Thai desires for the company to declare and pay a dividend equivalent to the company’s net income for the year.

THAI COMPANY Income Statement For the Year Ending December 31, 20X1			
Revenues			
Services to customers		\$	105,000
Expenses			
Wages	\$	45,000	
Rent		18,000	3,000
Net income		\$	<u>42,000</u>

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Thai company Statement of Retained Earnings For the Year Ending December 31, 20X1	
Beginning retained earnings	\$ -
Plus: Net income	42,000
	\$ 42,000
Less: Dividends	-
Ending retained earnings	\$ 42,000

THAI company Balance Sheet December 31, 20X1	
Assets	
Cash	\$ 6,000
Accounts receivable	22,500
Equipment	75,000
Total assets	\$ 103,500
Liabilities	
Rent payable	\$ 1,500
Notes payable	45,000
Total liabilities	\$ 46,500
Stockholders' equity	
Capital stock	\$ 15,000
Retained earnings	42,000
Total stockholders' equity	57,000
Total liabilities and equity	\$ 103,500

- a) Is the company currently able to declare and pay the dividend? Why or why not?
- b) Explain why net income can differ from cash provided by operations.
- c) In addition to operating activities, what other "categories" of business activity can generate or expend cash? Provide examples for each category.
- d) Prepare a statement of cash flows for Thai Company for the year ending December 31, 20X1.

Worksheet 8

- a)
- b)
- c)
- d) At this point in your study, you will be challenged to prepare the following statement of cash flows! If you avoid changing the formulas in column “F” of the electronic spreadsheet, you should simplify your search for the correct answer.

THAI company		
Statement of Cash Flows		
For the Year Ending December 31, 20X1		
Operating activities		
Cash received from customers	\$	-
Cash paid for Wages		-
Cash paid for rent		-
Cash provided by operations	<u> </u>	\$ -
Investing activities		
Purchase of equipment		-
Financing activities		
Issue stock	\$	-
Proceeds of loan		-
Increase in cash	<u> </u>	<u>\$ -</u>
Cash, January 1		<u>-</u>
Cash, December 31		<u><u>\$ -</u></u>

Solution 8

- a) Thai is unable to pay a \$42,000 dividend. The company only has \$6,000 in available cash.
- b) In the short run, many things will cause net income to differ from cash provided by operations. For example, various revenues and expenses may have occurred but not yet be funded. In Thai’s case, notice that \$22,500 of the revenues have not yet been collected, as evidenced by the increase in accounts receivable. Conversely, \$1,500 of the rent cost has not yet been paid, as evidenced by the rent payable liability.
- c) A business will generate or expend cash from investing activities (like buying and selling property, investment securities, and so forth). A business will also have financing activities that can be a source or use of cash (examples include issuing stock, paying dividends, and borrowing/repaying loans).
- d) At this point in their studies, most students will be challenged to prepare the following statement of cash flows! The student worksheet includes substantial preformatting to aid the process. Be sure to tell your students to not be discouraged by this complex problem - focus on the central theme that this is an important financial statement. The preparation and use is the subject of a complete chapter much later in the book.

THAI COMPANY Statement of Cash Flows For the Year Ending December 31, 20X1			
Operating activities			
Cash received from customers	\$	82,500	
Cash paid for Wages		(45,000)	
Cash paid for rent		(16,500)	
Cash provided by operations			\$ 21,000
Investing activities			
Purchase of equipment		-	(75,000)
Financing activities			
Issue stock	\$	15,000	
Proceeds of loan		45,000	60,000
Increase in cash			\$ 6,000
Cash, January 1			-
Cash, December 31			\$ 6,000