Exercise 1 –Understanding Retained earnings & WCR

- Assume an opening balance sheet as follows……

Assets	E	Liabilities+SE	E
Cash	1000	Paid in Capital	1000

- Purchase inventories for 800 E cash. Prepare a B/S.

- Sell the entire inventory for 950 E cash. Prepare a B/S.

- Buy an equipment for 800 E cash.

  - What does RE represent ?

Exercise –RE & WCR

- Assume an opening balance sheet as follows……
- Purchase inventory for 800 E cash. Prepare a B/S.
  - With cash provided by shareholders in equity, one can pay cash inventories
- Sell the entire inventory for 950 E cash. Prepare a B/S.
  - Sales are paid cash so earnings are cashed in.
  - RE are **internal equity,** self financing of the company
- Buy an equipment for 800 E cash.
  - As long as earnings are retained in the company (in equity) **investments and growth can be partly self financed. If not the company has to raise external funds (equity or debt)**

Assets	E	Liabilities+SE	E
Cash	1000	Paid in Capital	1000

Assets	E	Liabilities+SE	E
Inventory	800	Paid in Capital	1000
Cash	200		

Assets	E	Liabilities+SE	E
Inventory	0	Paid in Capital	1000
Cash	1150	RE	150
Total Assets	**1150**	**Total L+SE**	**1150**

Assets	E	Liabilities+SE	E
Inventory	0	Paid in Capital	1000
Equipment	800	RE	150
Cash	350		
Total Assets	**1150**	**Total L+SE**	**1150**

Exercise 2 – Understanding RE & WCR

- Assume an opening balance sheet as follows……

Assets	E	Liabilities+SE	E
Cash	1000	Paid in Capital	1000

- Purchase inventory for 800 E paid in 30 days. Prepare a B/S.

- Sell the entire inventory for 950 E paid in 45 days. Prepare a B/S.

- Pay inventory for 800 E and buy an equipment for 800 E cash. Prepare a B/S

  - What does WCR represent ?

Exercise –RE & WCR

- Assume an opening balance sheet as follows……
- Purchase inventory for 800 E paid in 30 days. Prepare a B/S.
  - Inventories purchased are on account (resources are provided by suppliers, no impact on the cash balance)
- Sell the entire inventory for 950 E paid in 45 days. Prepare a B/S.
  - Receivables outstanding as the firm must wait 45 days to collect the cash from the sales. **WCR freezes capital**
  - RE is **internal equity**, self financing of the company
  - Still as long as sales are not paid RE is not cashed
- Pay inventory for 800 E cash & buy equipment for 800 E cash.
  - **Even if profitable a company can be short in cash because of a positive WCR (say more uses of resources than resources available)**

Assets	E	Liabilities+SE	E
Cash	1000	Paid in Capital	1000
Assets	**E**	**Liabilities+SE**	**E**
Inventory	**800**	Paid in Capital	1000
Cash	1000	Payables	**800**
Total Assets	**1800**	**Total L+SE**	**1800**
Assets	**E**	**Liabilities+SE**	**E**
Inventory	0	Paid in Capital	1000
Receivables	950	RE	**150**
Cash	**1000**	Payables	800
Total Assets	**1950**	**Total L+SE**	**1950**
Assets	**E**	**Liabilities+SE**	**E**
Inventory	0	Payables	0
Receivables	950	**ST debt**	**600**
Cash	0	RE	150
Equipment	800	Paid in Capital	1000
Total Assets	**1750**	**Total L+SE**	**1750**