Week Four

Like we do at the start of every new week, what's the first step? **Roll up the earnings from last week**. Note, we're going to stick with LIFO for the rest of this mini-course because we want to save taxes.

Talking Points

NOTE: *In real life, LIFO records are difficult and expensive to maintain. Only companies with large amounts of inventory would adopt this method. Consult a good accountant when making this decision. Enough of the legal warnings - let's get rolling. Roll up the earnings from week three.*

The journal to roll up the earnings is the following (See page 63):

Account	Debit(Dr)	Credit(Cr)
Earnings Week to Date	$ 8.00	
Retained Earnings		$ 8.00
Total	$ 8.00	$ 8 .00

Description: To roll up the earnings from week three.

BALANCE SHEET

ASSETS			LIABILITIES		
Cash		$59.00	Accounts Payable		$ 24.00
Accounts Receivable		11.00	Notes Payable		25.00
			TOTAL LIABILITIES		49.00
Inventory:			***Owner's Equity:***		
Raw Material	$10.00		Original Investment	$5.00	
Finished Goods	0.00		Retained Earnings		
		10.00	Earning Week to date		
Prepaid Expenses		2.00	*Total Owner's Equity*		
			TOTAL LIABILITIES &		
TOTAL ASSETS		$82.00	OWNERS'S EQUITY		$

What's our Retained Earnings? **Twenty-eight dollars.** And, given the new week (week four), what's our Earnings Week to Date? **None, so far.**

First thing - you receive a phone call from one of your friends who bought some orange juice on account several weeks ago. He finally got his allowance and is ready to pay you five dollars. This is great! You collected on an account without having to call in the collection agency.

Did we receive Cash? **Yes.**

So what do we have to do to demonstrate this?

Add $5 in cash and take away $5 in Accounts Receivable. Use the next Balance Sheet to demonstrate this transaction.

The journal entry is as follows.

Account	Debit(Dr)	Credit(Cr)
Cash	$5.00	
Account Receivable		$5.00
Total	$5.00	$5.00

Description: To record the pay-off from accounts receivable.

BALANCE SHEET

ASSETS			LIABILITIES		
Cash		$	Accounts Payable		$24.00
Accounts Receivable			Notes Payable		25.00
			TOTAL LIABILITIES		49.00
Inventory:			***Owner's Equity:***		
Raw Material	$10.00		Original Investment	$5.00	
Finished Goods	0.00		Retained Earnings	28.00	
		$10.00	Earning Week to date	0.00	
Prepaid Expenses		2.00	*Total Owner's Equity*		33.00
			TOTAL LIABILITIES &		
TOTAL ASSETS		$	OWNERS'S EQUITY		$82.00

Did we account for that Accounts Receivable as a sale a few weeks back? **Yes**.

Did it show up on our Income Statement as a sale back then? **Yes**.

Are we going to account for it as a sale now? **No.**

No, because we already accounted for it as a sale on our Income Statement when? **A few weeks ago.**

That's because we are using the Accrual Method of accounting. Is any part of this transaction going to show up on your Income Statement? **No**. But, we did get in some cash, didn't we? Would it be helpful to keep track of our cash as it flows in and out of the business? **Yes.** We're going to bring out our third financial statement.

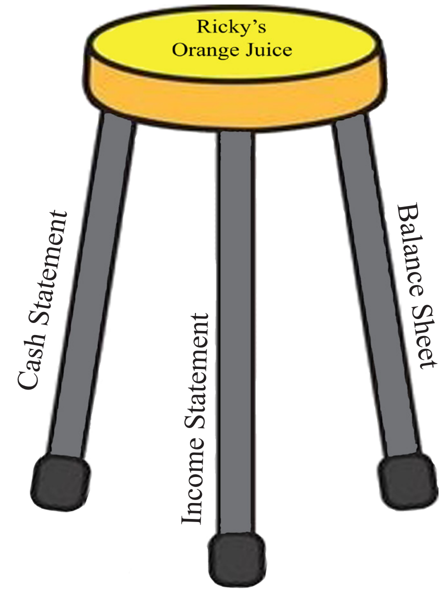
Why three? Think it of this way. At least, how many legs does a stool need to be stable?

If we think of our financial record-keeping as a stool, the Balance Sheet is one leg. The Income Statement is another leg. So, we need another leg for our financial stool to become stable.

And we've been managing our business with an income statement and a balance sheet. Both of which are on what method? **The Accrual Method.**

The third financial statement is the Cash Flow Statement.

Here's a Cash Flow Statement. We're going to build it line by line.



CASH FLOW STATEMENT FOR WEEK_______	
Cash At The Begining of The Week	
Cash From Operating Activities (Inflows and Outflows):	
Accounts Receivable, Sales, ___________ =	
Inventory Paid ___________ =	
Expenses Paid___________ =	
Cash From Investing Activities (Inflows and Outflows):	
Fixed Assets ___________ =	
From Other Operations___________ =	
Net Increase (Decrease) in Cash	
Cash At Week's End	

We're going to go through it line by line and, at the end of the week, we'll put the whole Cash Flow Statement together.

Basically, the Cash Statement records only the cash that comes in and the cash that goes out in a given time period - in our case each week. This bears repeating: **The Cash Flow Statement records only the cash that comes in and the cash that goes out.** (Inflows and Outflows).

Did we start this week with some cash? **Yes.**

How much was the beginning cash? **$59.00**. Record that on the Beginning Cash line.

Now, did we collect five dollars on our account? **Yes.**

Record the cash that comes in and the cash that goes out. We'll put in a plus if cash comes in and a minus if cash goes out. On what line of our Cash Statement would this $5 go? Well, it was a collection of Account Receivable, right? So add plus $5 to it.

The Net Increase (Decrease) in Cash line is where you will total all the pluses and minuses at the end of the week (based on all the detailed line items above).

Buying Assets

Given that you're such an entrepreneur - and once an entrepreneur, always an entrepreneur, you decide to spruce up your place of business. A friend's older brother has a great stand that he built a couple of years ago when he had his own orange juice business. You decide to buy it. You negotiate a hard deal and get the stand for eight dollars.

Another friend's family has a tiny patch of land they're willing to sell you for your new location. It's part of an enormous vacant lot, that while located near the corner of a busy street, it's years away from serious development.

You buy the lot and the new orange juice stand for $10 cash.

You expect the stand will last about 10 years without major repairs. In the initial sales contract, you specify that $8 of the purchase is for the stand and $2 is for the land.

(There is a reason for separating these which we'll discuss later). How do we demonstrate that on our Balance Sheet? We're going to put our brand new stand in a corner lot for $10.

What are we going to buy it with? **Cash.**

Okay. Ten dollars goes out. What comes in? **The new stand and lot.**

Is the stand and lot something we have? **Yes.**

So, where are we going to show it? Is it an Asset? **Yes.**

What are we going to call it? What does a business call something it has acquired which is property, plant, or equipment? **A Fixed Asset**. Why "fixed"? Because they are things not normally intended for sale, which are used over and over again in the course of doing business.

Go ahead and do another Balance Sheet reflecting this transaction. Here is the journal entry.

Account		Debit(Dr)	Credit(Cr)
Fixed Assets:			
Land	$2.00		
Stand	8.00	$10.00	
Cash			$10.00
Total		$10.00	$10.00

Description: To record the purchased land and stand for the business.

Talking Points

At the end of the year you will have to provide your accountant or tax preparer with a list of all assets for which depreciation is allowed. Many different kinds of property can be depreciated, such as machinery, buildings, vehicles, furniture, equipment, and proprietary rights such as copyrights and patents. These are items purchased for use in your business usually at a cost in excess of $500.

What Can Be Depreciated? *In general, property is depreciable if is meets these requirements: 1) It must be used in the business, 2) It must have a determinable life longer than one year and 3) It must be something that wears out, decays, gets used up, becomes obsolete, or loses value from natural causes. You never depreciate land or the cost of repairs which do not increase the value of the property.*

BALANCE SHEET

ASSETS			LIABILITIES		
Cash		$	Accounts Payable		$24.00
Accounts Receivable		6.00	Notes Payable		25.00
			TOTAL LIABILITIES		49.00
Inventory:			***Owner's Equity:***		
Raw Material	$10.00		Original Investment	$5.00	
Finished Goods	0.00		Retained Earnings	28.00	
		10.00	Earning Week to date	0.00	
Prepaid Expenses		2.00	*Total Owner's Equity*		33.00
Fixed Assests			TOTAL LIABILITIES &		
TOTAL ASSETS		$	OWNERS'S EQUITY		$82.00

Besides a building or land, what other Fixed Assets can you think of? ______________________________

Maybe you wrote down things like office furniture, business vehicles, computers, tools, fax machines, telephones, book shelves, refrigerators - things like that.

We just bought a Fixed Asset. Is it ours? **Yes.** How much? **$10.00.**

Do you know what it's called when you buy an asset and add it to the Balance Sheet? **Capitalizing the asset.**

Now, does the purchase of the land or the stand show up on your Income Statement? **No.**

Can we take the stand and the land as an expense? **No**.

How come we can't expense them? **Because it is a major purchase of significant value with a long life.**

What's the rule here? Generally, the purchase of major items of significant value increase your assets and are added to the Balance Sheet; they are capitalized. One more time:

Generally, the purchase of major items of significant value increase your assets and are added to the Balance Sheet (capitalized).

Deciding whether to capitalize or expense an item is a pretty important decision that has some general guide lines. We will look at a few examples, then clarify the guidelines. We've just transferred cash into another kind of asset, and capitalized the asset. Do you see it?

Did cash go out? **Yes.**

We made a what? **An investment.**

Go back to your Cash Statement and put minus $10 on the Cash Statement, on which line? **Fixed Asset.**