

Week Two

It's Monday and Ricky is starting his second week in the orange juice business. It's a sunny morning, with the promise of getting really hot by noon. It's a great day to be selling orange juice! Last week wasn't bad, for a beginner. But from now on - look out world! First, let's take a look at our last Balance Sheet (See page 17).

BALANCE SHEET

ASSETS		LIABILITIES	
Cash	\$13.00	Notes Payable	\$0.00
Inventory	\$2.00	<i>Owner's Equity:</i>	
		Original Investment	\$5.00
		Earning Week to date	\$10.00
TOTAL ASSETS	<u>\$15.00</u>	TOTAL LIABILITIES & OWNERS'S EQUITY	<u>\$15.00</u>

Now, this Balance Sheet is for which week? **Last week.**

Therefore, it's what kind of Balance Sheet? **Ending Balance Sheet**

So, this is last week's Ending Balance Sheet, and where is our ending Inventory? **In the refrigerator.**

Let's say, for the sake of household peace, that, sure enough, your orange juice is still in the fridge. This Ending Inventory from last week becomes what kind of Inventory for this week? **Beginning Inventory, right!**

One last time: the ending Inventory automatically becomes what kind of Inventory? **Right! The Beginning Inventory for the next week.**

The Ending Balance Sheet is for last week, so we need to make what kind of Balance Sheet for the beginning of the second week? **Beginning Balance Sheet.**

There's one more thing we need to do to convert last week's Ending Balance Sheet to this week's Beginning Balance Sheet. Do you know what that is? **The earnings.**

The earnings we have were good for which week? **Last week. the first week of our business.**

As a result, these earnings are now what? **History.**

What are earnings that are history, or earnings from past accounting periods called? **Retained Earnings.**

Yes, Retained Earnings, and we need to make room for our earnings for when? **This week.**

We're going to take these earnings from last week and roll them up into a new category called Retained Earnings, making room for this week's earnings.

Roll up the earnings, our oranges are turning to gold.

You've got your earnings rolled up. Now, you should have \$10 in Retained Earnings and zero in Earnings Week to Date. Complete the Balance Sheet below to reflect this. Let's do the journal entry:

<u>Account</u>	<u>Debit(Dr)</u>	<u>Credit(Cr)</u>
Earning Weeks To Date	\$10.00	
Retained Earnings		\$10.00
Total	<u>\$10.00</u>	<u>\$10.00</u>
Description: To close the week one by transferring the profits to the Retained Earnings.		

BALANCE SHEET

ASSETS		LIABILITIES	
Cash	\$ <input type="text"/>	Notes Payable	\$ <input type="text"/>
Inventory	<input type="text"/>	Total Liabilities	<input type="text"/>
		<i>Owner's Equity:</i>	
		Original Investment	\$ <input type="text"/>
		Retained Earnings	<input type="text"/>
		Earning Week to date	<input type="text"/>
		Total Owner's Equity	<input type="text"/>
		TOTAL LIABILITIES &	<input type="text"/>
		OWNERS'S EQUITY	\$ <input type="text"/>
TOTAL ASSETS	\$ <input type="text"/>		

Retained Earning, will show us the business earnings from when? **From prior accounting periods.** For this week, our earnings will be recorded in Earnings Week to Date - because we always work in the current period.

Talking Points

What exactly are Retained Earnings? *We said they are earnings from past accounting periods. Only two things happen to earnings - you either retain them in the business or distribute them to the owners of the company. In a corporation, a distribution of earnings means the company pays a dividend to the stockholders. Earnings that have not been distributed are retained in the company.*

Charts of Accounts. *As you will notice, we are creating more accounts to control the orange juice business, this is called a Chart of Accounts and there's really no secret to making your own charts - just make a list of the accounts that apply to your business. The major divisions of Accounts are separated into the following sections:*

- Assets
- Liabilities
- Capital (Net Worth/ Equity)
- Revenues (Income)
- Cost of Goods Sold
- Expenses

Each sector contains its own individual accounts. Each of these accounts may also be further divided down into subaccounts.

As a tax preparer, you should be familiar with your client's business and it's Charts of Accounts in order to properly allocate the business operations before the IRS.

Let's review. At the beginning of each new week what must we do in order to update our Ending Balance Sheet and make it a Beginning Balance Sheet? **Roll up the earnings and retain them in the company and convert Ending Inventory to Beginning Inventory.**

Great! says Ricky. Now we're ready to start the new week. As you wake Monday morning, you think, why stay small? There's no time like the present to start growing my orange juice business. Real business people don't go on borrowing money from Mom and Dad. Real businesspeople borrow money from a real bank.

You get Mom or Dad to drive you to your neighborhood bank. You show the banker your financial statements.

"I'll be a good customer, I promise," Ricky says, and tells the banker in a squeaky voice. "You won't have to worry about getting your money back. I borrowed ten dollars from my parents and already paid it back."

The banker looks up and nods.

"Look at my balance sheet," you say proudly. "I have \$13.00 in cash. I have some inventory, no debt, and I started my business with five bucks and I had earnings last week of ten dollars."

The banker glances over your scorecard, and nods. "Impressive," the banker says. "There are a lot of grownup businesspeople who don't keep this good a record."

"We don't discriminate because of a potential customer's age, gender, religious, or ethnic identity," the banker says.

"Look at my income statement," you go on. "Last week I had sales of \$25. My gross profit was \$15, these are my expenses, with a net profit of \$10. Would you loan me \$50.00?" Ricky says.

Impressed, the bank loans you \$50.00 cash.

"Hey, thanks," you tell the banker. "I appreciate your interest in my business. You won't be sorry! Come by my stand on your way home." You start to leave, but you can't help but turn back and say, "You know, with an original investment of \$5 and a net profit of \$10, that's a 200 percent return on my investment. Hey, how's the bank doing?"

Smiling, the banker wishes you well.

Now, please demonstrate what just happened on the next scorecard. First, what comes in? **Cash**. So bring in \$50. Let's do the journal entry.

<u>Account</u>	<u>Debit(Dr)</u>	<u>Credit(Cr)</u>
Cash	\$50.00	
Notes Payable (The Bank)		\$50.00
	<u> </u>	<u> </u>
Total	<u>\$50.00</u>	<u>\$50.00</u>
Description: To record the loan made by the bank.		

BALANCE SHEET

ASSETS		LIABILITIES	
Cash	\$ <input type="text"/>	Notes Payable	<u>\$0.00</u>
		Total Liabilities	<u>0.00</u>
Inventory	<input type="text"/>	<i>Owner's Equity:</i>	
		Original Investment	\$15
		Retained Earnings	10
		Earning Week to date	<u>0</u>
		Total Owner's Equity	15.00
	<u> </u>		
TOTAL ASSETS	\$ <u> </u>	TOTAL LIABILITIES & OWNERS'S EQUITY	<u>\$15.00</u>

Are we in balance? **No.**

Who do we owe now? **The banker for \$50.00**

Where do we show it? **Notes payable.**

Demonstrate this on the next scorecard.