

Example: Dave's Car Transport Service

- Dave starts a business to transport expensive cars
- On December 1, 2015
 - Receives \$50,000 cash from issuing common stock
 - Borrows \$80,000 from bank and buys \$100,000 truck
 - Will be used for 48 mos., with a \$4,000 salvage value
 - Pays \$12,000 cash upfront to rent office space for 1 year
- During December
 - Moves two cars, will get paid \$40,000 within 30 days
 - Pays employees \$10,000 of wages
- December 31: Bank wants to see financial statements

Did the company “make money” during December?

Cash Flows

Stock 50,000

Bank 80,000

Truck (100,000)

Rent (12,000)

Wages (10,000)

Customers 0

Cash 8,000

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Did the company “make money” during December?

Cash Flows

Operating

Rent (12,000)

Wages (10,000)

Customers 0

CFO (22,000)

Investing

Truck (100,000)

CFI (100,000)

Financing

Stock 50,000

Bank 80,000

CFF 130,000

Cash 8,000

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Statement of Cash Flows

Dec 2015 Cash Flows

Operating

Rent (12,000)

Wages (10,000)

Customers 0

CFO (22,000)

Investing

Truck (100,000)

CFI (100,000)

Financing

Stock 50,000

Bank 80,000

CFF 130,000

Cash 8,000

- Reports cash transactions *over a period of time*
- Operating Activities
 - Transactions related to the provision of goods or services and other normal business activities
- Investing Activities
 - Transactions related to the acquisition or disposal of long-lived productive assets
- Financing Activities
 - Transactions related to owners or creditors

Did the company “make money” during December?

Accounting Income

Revenue	40,000
Truck Expense	(2,000)
Rent Expense	(1,000)
Wages Expense	<u>(10,000)</u>
Net Income	27,000

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- Pays employees \$10,000 of wages

Notes: Truck expense

(“depreciation”) =
 $(100,000 - 4,000) / 48$

Rent expense is one month at
\$1000/mo.

Income Statement

Dec 2015 Accounting Income

Revenue	40,000
Truck Expense	(2,000)
Rent Expense	(1,000)
Wages Expense	<u>(10,000)</u>
Net Income	27,000

Notes: Truck expense

("depreciation") =
 $(100,000 - 4,000) / 48$

Rent expense is one month at
\$1000/mo.

- Reports results of operations over a period of time using accrual accounting
 - Recognition tied to business activities
 - Revenues
 - Increases in "owners' equity" from providing goods or services
 - Expenses
 - Decreases in "owners' equity" incurred in the process of generating revenues
 - Net Income (or Earnings or Net Profit)
 - = Revenues – Expenses
- => DOES NOT EQUAL CHANGE IN CASH!!!

Did the company “make money” during December?

Dec 2015 Cash Flows

Operating

Rent (12,000)

Wages (10,000)

Customers 0

CFO (22,000)

Investing

Truck (100,000)

CFI (100,000)

Financing

Stock 50,000

Bank 80,000

CFF 130,000

Cash 8,000

Dec 2015 Accounting Income

Revenue 40,000

Truck Expense (2,000)

Rent Expense (1,000)

Wages Expense (10,000)

Net Income 27,000

Notes: Truck expense

(“depreciation”) =

$(100,000 - 4,000) / 48$

Rent expense is one month at
\$1000/mo.

What is financial position at end of the month?

Balance Sheet

Assets

Cash	8,000	(Cash in the bank on 12/31/2015)
Accounts Receivable	40,000	(Cash owed by customers on 12/31/2015)
Prepaid Rent	11,000	(Prepaid for 11 months of future space on 12/31/2015)
Truck	<u>98,000</u>	(100,000 original cost – 2,000 “depreciation”)
Total	157,000	

Liabilities & Stockholder's Equity

Bank Debt	80,000	(Cash owed to the bank on 12/31/2015)
Common Stock	50,000	(Stockholder investment as of 12/31/2015)
Retained Earnings	<u>27,000</u>	(Accounting Net income – Dividends as of 12/31/2015)
Total	157,000	

Balance Sheet

Dec 31, 2015 Balance Sheet

Assets

Cash	8,000
Accounts Receivable	40,000
Prepaid Rent	11,000
Truck	<u>98,000</u>
Total	157,000

Liabilities & Stockholder's Equity

Bank Debt	80,000
Common Stock	50,000
Retained Earnings	<u>27,000</u>
Total	157,000

- Reports financial position (resources and obligations) on a specific date
- Assets
 - Resources owned by a business that are expected to provide future economic benefits
- Liabilities
 - Claims on assets by “creditors” (non-owners) that represent an obligation to make future payment of cash, goods, or services
- Stockholders' Equity (Owners' Equity)
 - Claims on assets by owners of business
 - Contributed Capital (arises from sale of shares)
 - Retained Earnings (arises from operations)

Statement of Stockholders' Equity

- We'll get to this later...