

**HAYSTACK BOOKSTORE**

<b>Balance Sheet as of:</b>	<b>March 31, 200x</b>	<b>Dec. 31, 200x</b>
<b>ASSETS:</b>		
Current assets:		
Cash	\$ 8,100	\$ 14,600
Accounts receivable	0	4,000
Inventories	19,300	19,600
Prepaid Insurance	600	150
<i>Total current assets</i>	<u>\$ 28,000</u>	<u>\$ 38,350</u>
Non-current assets:		
Land	21,000	21,000
Building, net	84,000	80,850
Furniture & fixtures, net	9,800	8,330
<i>Total non-current assets</i>	<u>\$ 114,800</u>	<u>\$ 110,180</u>
<b>TOTAL ASSETS</b>	<u>\$ 142,800</u>	<u>\$ 148,530</u>
<b>LIABILITIES:</b>		
Current liabilities:		
Accounts payable	\$ 2,800	\$ 4,600
Interest payable		6,000
Current portion of long-term debt	10,000	10,000
<i>Total current liabilities</i>	<u>\$ 12,800</u>	<u>\$ 20,600</u>
Non-current liabilities:		
Long-term loan	70,000	70,000
<i>Total non-current liabilities</i>	<u>\$ 70,000</u>	<u>\$ 70,000</u>
<b>TOTAL LIABILITIES</b>	<u>\$ 82,800</u>	<u>\$ 90,600</u>
<b>OWNER'S EQUITY</b>		
Capital, A. King	<u>\$ 60,000</u>	<u>\$ 57,930</u>
<i>Total owners' equity</i>	<u>60,000</u>	<u>57,930</u>
<b>TOTAL EQUITIES</b>	<u>\$ 142,800</u>	<u>\$ 148,530</u>

## HAYSTACK BOOKSTORE

### Income Statement for 9 months ended:

	<i>owner's salary treated as a withdrawal (a dividend)</i>	<i>owner's salary treated as an expense</i>
	<u>December 31, 200x</u>	<u>December 31, 200x</u>
Sales revenue:	\$ 66,300	\$ 66,300
Cost of goods sold	<u>43,600</u>	<u>43,600</u>
Gross Profit	\$ 22,700	\$ 22,700
Other expenses:		
Wages	\$ 2,800	\$ 2,800
Utilities	1,900	1,900
Insurance	450	450
Interest	6,000	6,000
Depreciation	4,620	4,620
Owner's "salary"	<u>-</u>	<u>9,000</u>
Total other expenses	\$ 15,770	\$ 24,770
NET INCOME (LOSS)	<u>\$ 6,930</u>	<u>\$ (2,070)</u>

### Reconciliation to Ending Owners' Equity

Beginning Owners' Equity	60,000	60,000
Net Income (Loss)	6,930	(2,070)
Withdrawals by owner	<u>(9,000)</u>	<u>-</u>
Ending Owners' Equity	57,930	57,930

**HAYSTACK BOOKSTORE***With Salary\**

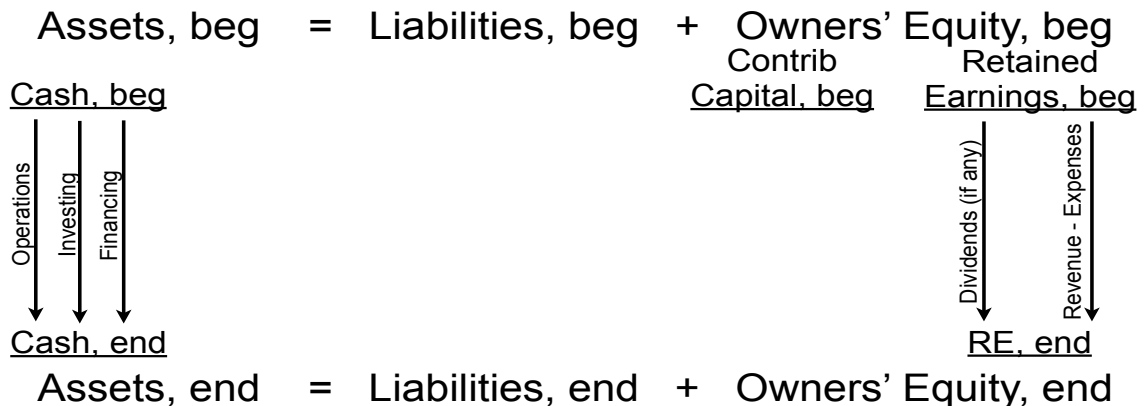
<b>Cash Flow Statement for the period ended</b>	<b>December 31, 200x</b>	<b>December 31, 200x</b>
<b>OPERATING ACTIVITIES</b>		
Cash collected from customers:	\$ 62,300	\$ 62,300
Cash outflows for operations:		
Acquire inventory**	\$ (16,500)	\$ (16,500)
Payments to suppliers	(42,100)	(42,100)
Wages	(2,800)	(2,800)
Utilities	(1,900)	(1,900)
Insurance	(600)	(600)
King's "salary"	0	(9,000)
Total operating cash outflows	\$ (63,900)	\$ (72,900)
Cash from operating activities	\$ (1,600)	\$ (10,600)
<b>INVESTING ACTIVITIES</b>		
Acquire fixtures, land & building**	\$ (108,500)	\$ (108,500)
Legal fees	(5,000)	(5,000)
Purchase fixtures	(1,300)	(1,300)
Cash from investing activities	\$ (114,800)	\$ (114,800)
<b>FINANCING ACTIVITIES</b>		
Original contribution	\$ 60,000	\$ 60,000
Loan**	80,000	80,000
Owner withdrawals	(9,000)	0
Cash from financing activities	\$ 131,000	\$ 140,000
Change in Cash	\$ 14,600	\$ 14,600

\* Treats the \$9,000 as salary, an operating cash outflow, rather than an owner withdrawal.

\*\* Treats the loan *as if* it was an inflow of cash, which was then disbursed to pay for the fixtures, land & bldg.

## Take-Aways from the Haystack Bookstore Case

- Financial statements are produced by management. They are required for all listed companies and may be demanded by other users, including (potential) employees, creditors, suppliers, regulators, and investors.
- Accountants generally record events at their historical cost – and only those they can measure. (Does this include all important events?)
- The Balance Sheet is the *snapshot* of the Assets, Liabilities and Owners' Equity at a point in time, i.e.,  $A = L + OE$
- Personal and business transactions should not be comingled
- Our two *videos* are about Cash Flow and Profits. These are different concepts. (Very important.)
- The 3 major financial statements articulate (fit together) to provide data about the economics of the firm.



- Product costs are matched (expensed) with sales; period costs with time.
- Judgment is required to prepare financial statements as well as to use them. Sometimes pressures on management affect this judgment.

# Cash Flow versus Earnings

## How are they different?

- Cash flows are literally about cash inflows and cash outflows. Under the direct method, they are observable and intuitive; the only real issue is categorizing into Operations, Investing and Financing activities. While cash flows do give us information about liquidity and perhaps the survival of a business, comparisons of cash-in versus cash-out make no attempt to capture the effort and accomplishment of a time period. Thus, cash flow is not an especially good measure of performance.
- Net income is an important but abstract concept that attempts to measure business performance from the owners' perspective. Calculation of earnings requires:
  1. Recognizing revenue (accomplishment) of the period.
  2. Matching expenses (effort) to this revenue (accomplishment). For example, what CGS should be matched to the period's revenue?<sup>1</sup>
  3. Recognizing period expenses (more effort), e.g., interest, insurance or salary expenses that accrue with the passage of time.

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<sup>1</sup> A key here is deciding what is an asset (still has measurable future benefit) and what is an expense (benefit has expired this period). For example, what should be the amount of ending inventory versus the amount expensed as cost of goods sold?