

“Answer on question #58857 - Economics –Accounting”

From the following data of ABC Enterprises, prepare statement of cash flows and balance sheet and income statement through cash basis of accounting and accrual basis of accounting and discuss the result

- Invested \$ 700 Equity
- Purchased plain T-Shirts for \$ 5 each
- Fixed Screen cost \$ 100
- Variable Print cost \$ 0.75 per T-Shirt
- Sold 25 T-Shirts at \$ 10 each on cash
- Sold 25 T-Shirts at \$ 10 each on credit

Solution

I_{nvE}	Invested \$ 700 Equity
C_p	Purchased plain T-Shirts for \$ 5 each
TFC	Fixed Screen cost \$ 100
VC	Variable Print cost \$ 0.75 per T-Shirt
Q_{cash}	Sold 25 T-Shirts on cash
Q_{cred}	Sold 25 T-Shirts on credit
P_s	\$ 10 per T-Shirt

1. Statement of cash flows reports cash generated and used during the special period.

Cash receipts from customer is calculated

$$Cr = Q_{cash} * P_s = 25 * 10 = 250$$

Cash paid for inventory purchases is calculated

$$C_p = (Q_{cash} + Q_{cred}) * C_p = (25 + 25) * 5 = 250$$

Company generated money from investment in equity which compensated zero results in operating activity.

Flows from operating and financing activities summary and cash at the beginning of period have summarized as cash at the end of period.

2. Cash at end of period translated to balance sheet as cash.

Accounts receivable are calculated as sales on credit

$$AR = Q_{cred} * P_s = 25 * 10 = 250$$

Accrued expenses are current liabilities which company has incurred but hasn't paid on balance date.

Accrued expenses for ABC Company are calculated as summary total fixed and total variable costs.

$$AcExp = TFC + (Q_{cash} + Q_{cred}) * VC = 100 + (25 + 25) * 0.75 = 137.50 \text{ rounded to zero}$$

- Income statement shows how company's revenues are transformed to net income during the period time.

Revenues are included all sold T-Shirts and calculated

$$R = (Q_{cred} + Q_{cash}) * P_s = (25 + 25) * 10 = 500$$

Expenses included total variable costs (TVC) and total fixed costs (TFC).

$$TVC = (Q_{cred} + Q_{cash}) * C_p = (25 + 25) * 5 = 250$$

Net income is calculated by subtracting total expenses from total revenues

$$\text{Net income} = \text{Revenue} - \text{Expenses}$$

Net income transferred to balance sheet as retained earnings which increase owner's equity.

Answer

Statement of cash flows, balance sheet and income statement are linked together.

Cash Flows Statement shows that company generated cash only from financing activities.

But at the same time, income statement shows net income which has recorded but hasn't received as cash on account.

The balance sheet shows company's financial position at the end of a specified period and connects with other statements.

The accrual basis of accounting is required because of the matching principle and is used for preparing income statement and balance sheet while statement of cash flows is preparing for cash basis of accounting.

ABC Company	
Statement of Cash Flows	
Cash at Beginning of Period	0
Operations	
Cash receipts from	
Customers	250
Cash paid for	
Inventory purchases	(250)
Net Cash Flow from Operations	0
Financing Activities	
Cash receipts from	
Investing in equity	700
Net Cash Flow from Financing Activities	700
Net Increase in Cash	700
Cash at End of Period	700

ABC Company Balance Sheet

At the End of Year

Assets

Current Assets

Cash	700
Accounts receivable	250
<i>Total current assets</i>	950

Total Assets **950**

Liabilities and Owner's Equity

Current Liabilities

Accrued expenses	138
<i>Total current liabilities</i>	138

Owner's Equity

Owner's investment	700
Retained earnings	113
<i>Total owner's equity</i>	813

Total Liabilities and Owner's Equity **950**

ABC Company Income Statement

For the Years Ending

Revenue

Revenue	500
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Total Revenue **500**

Expenses

Variable costs	(288)
Fixed costs	(100)

Total Expenses **(388)**

Net Income **112**