Thammasat University
Faculty of Economics
Bachelor of Economics (International Program)

AC201
Fundamental Accounting

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Course Materials

Topic:

Chapter 06 Reporting and Interpreting Sales Revenue, Receivables, and Cash

Session:

Sessions #5 & #6

Instructor:

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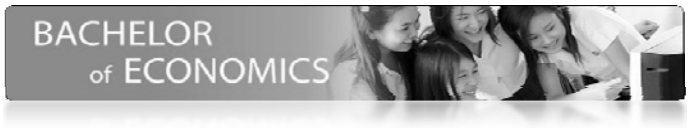

CHAPTER 6: REPORTING AND INTERPRETING SALES REVENUE, RECEIVABLES, AND CASH

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Accounting for Sales Revenue

Accounting for Sales Revenue

The revenue principle requires that revenues be recorded when earned.

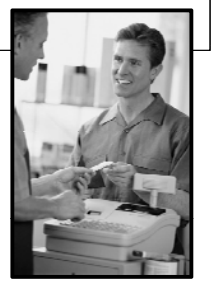
1. Goods or services have been delivered.
2. There is persuasive evidence of a customer payment arrangement
3. Price is fixed or determinable.
4. Collection is reasonably assured.

Credit Card Sales to Consumers

Companies accept credit cards for several reasons:

1. To increase sales.
2. To avoid providing credit directly to customers.
3. To avoid losses due to bad checks.
4. To avoid losses due to fraudulent credit card sales.
5. To receive payment quicker.

When credit card sales are made, the company must pay the credit card company a fee for the service it provides.



Sales Discounts to Businesses

When customers purchase on open account, they may be offered a **sales discount** to encourage early payment.

2/10, n/30

- **Discount Percentage**
- **# of Days in Discount Period**
- **Net (Total sales less returns)**
- **Maximum Days in Credit Period**

Read as: "Two ten, net thirty"

To Take or Not Take the Discount, That is the Question

With discount terms of 2/10, n/30,
a customer saves $2 on a $100 purchase
by paying on the 10th day instead of the 30th day.

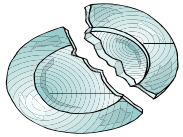
$$\text{Interest Rate for 20 Days} = \frac{\text{Amount Saved}}{\text{Amount Paid}}$$

$$\text{Interest Rate for 20 Days} = \frac{\$2}{\$98} = 2.04\%$$

$$\text{Annual Interest Rate} = \frac{365 \text{ Days}}{20 \text{ Days}} \times 2.04\% = 37.23\%$$

Sales Returns and Allowances

These situations are recorded in a separate account called **Sales Returns and Allowances**.



Damaged merchandise.

Returned merchandise.

Reporting Net Sales

Companies record credit card discounts, sales discounts, and sales returns and allowances separately to allow management to monitor these transactions.

Sales revenue
Less: Credit card discounts
Sales discounts
Sales returns and allowances
Net sales

Gross Profit Percentage

$$\text{Gross Profit Percentage} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

In 2009, adidas AG reported gross profit of $4,712,000 on sales of $10,381,000.

Gross profit percentage for adidas AG for 2009 is:

$$\frac{\$4,712,000}{\$10,381,000} = 45.4\%$$

COMPARISONS OVER TIME		
adidas		
2007	2008	2009
47.4%	48.7%	45.4%

COMPARISONS WITH COMPETITORS
Nike
2009
46.3%

Other things equal, higher gross profit results in higher net income.

Measuring and Reporting Receivables

Classifying Receivables

Accounts receivable are created when companies have sales to customers on open accounts.

Notes receivable are written promises from another party to pay with specified terms.

Trade receivables are amounts owed to the business for credit sales of goods, or services.

Nontrade receivables are amounts owed to the business for other than business transactions.

Balance Sheet Classifications
Current (short term)
Noncurrent (long term)

Accounting for Bad Debts

Bad debts result from credit customers who will not pay the amount they owe, regardless of collection efforts.

Matching Principle ⇒ **Bad Debt Expense** — **Record in same accounting period.** — **Sales Revenue**

Most businesses record an **estimate** of the **bad debt expense** with an adjusting entry at the end of the accounting period.

Recording Bad Debt Expense Estimates

adidas estimated bad debt expense for 2009 to be €68,000,000. Prepare the adjusting entry.

Bad debt expense (+E, −SE)	68	
Allowance for doubtful accounts (+XA, −A)		68

Assets		= Liabilities +	Stockholders' Equity	
Allowance for doubtful accounts	−68		Bad debt expense (+E)	−68

Bad Debt Expense is normally classified as a selling expense and is closed at year-end.

Allowance for Doubtful Accounts

Balance Sheet Disclosure

Accounts receivable
Less: Allowance for doubtful accounts
Net realizable value of accounts receivable

Amount the business expects to collect.

Writing Off Specific Uncollectible Accounts

When it is clear that a **specific** customer's account receivable will be uncollectible, the amount should be removed from the Accounts Receivable account and charged to the Allowance for Doubtful Accounts.

adidas' total write-offs for 2009 were €34,000,000. Prepare a summary journal entry for these write-offs.

Allowance for doubtful accounts (−XA, +A)	63	
Accounts receivable (−A)		63

Assets		= Liabilities +	Stockholders' Equity	
Allowance for doubtful accounts	+63			
Accounts receivable	−63			

Writing Off Specific Uncollectible Accounts

Step	Timing	Accounts Affected		Financial Statement Effects		
1. Record estimated bad debts adjustment	End of period in which sales are made	Bad Debt Expense (E)	↑	Net Income	↓	
		Allowance for Doubtful Accounts (XA)	↑	Assets (Accounts Receivable, Net)	↓	
2. Identify and write off actual bad debts	Throughout period as bad debts become known	Accounts Receivable (A)	↓	Net Income		No effect
		Allowance for Doubtful Accounts (XA)	↓	Assets (Accounts Receivable, Net)		

Estimating Bad Debts – Percentage of Credit Sales Method

Bad debt percentage is based on actual uncollectible accounts from prior years' credit sales.

Focus is on determining the amount to record on the income statement as Bad Debt Expense.

Net credit sales
x % Bad debt loss rate
Bad debt expense

Estimating Bad Debts – Percentage of Credit Sales Method

In 2010, Kid's Clothes had credit sales of €600,000.
Past experience indicates that bad debts are **one percent of sales**.
What is the estimate of bad debts expense for 2010?

€600,000 × 0.01 = €6,000

Prepare the adjusting entry.

GENERAL JOURNAL				
Date		Description	Debit	Credit
Dec.	31	Bad Debt Expense (+E,-SE)	6,000	
		Allowance for Doubtful Accounts (+XA,-A)		6,000
		To record bad debt expense.		

Estimating Bad Debts – Aging of Accounts Receivable Method

Focus is on determining the desired balance in the Allowance for Doubtful Accounts on the balance sheet.

Each customer's account is aged
by breaking down the balance
by showing the age (in number of days)
of each part of the balance.

An aging of accounts receivable for Kid's Clothes in 2010 might look like this . . .

Aging Schedule

Customer	Not Yet Due	Days Past Due 1-30	31-60	61-90	Over 90	Total A/R Balance
Aaron, R.		€ 235				€ 235
Baxter, T.	€ 1,200	300				1,500
Clark, J.			€ 50	€ 200	€ 500	750
Zak, R.			325			325
Total	€ 3,500	€ 2,550	€ 1,830	€ 1,540	€ 1,240	€ 10,660
% Uncollectible	0.01	0.04	0.10	0.25	0.40	

Based on past experience, the business estimates the percentage of uncollectible accounts in each time category. These percentages are then multiplied by the appropriate column totals.

Aging Schedule

Customer	Not Yet Due	Days Past Due 1-30	31-60	61-90	Over 90	Total A/R Balance
Aaron, R.		€ 235				€ 235
Baxter, T.	€ 1,200	300				1,500
Clark, J.			€ 50	€ 200	€ 500	750
Zak, R.			325			325
Total	€ 3,500	€ 2,550	€ 1,830	€ 1,540	€ 1,240	€ 10,660
% Uncollectible	0.01	0.04	0.10	0.25	0.40	
Estimated Uncoll. Amount	€ 35	€ 102	€ 183	€ 385	€ 496	€ 1,201

The column totals are then added to arrive at the total estimate of uncollectible accounts of €1,201.

Record the Dec. 31, 2010 adjusting entry assuming that the Allowance for Doubtful Accounts currently has a €50 credit balance.

Estimating Bad Debts – Aging of Accounts Receivable Method

GENERAL JOURNAL				
Date		Description	Debit	Credit
Dec.	31	Bad Debt Expense (+E,-SE)	1,151	
		Allowance for Doubtful Accounts (+XA,-A)		1,151
		To record bad debt expense.		

1,201 Desired balance
- 50 Credit balance
€ **1,151 Adjusting entry**

After posting, the Allowance account would look like this . . .

Estimating Bad Debts – Aging of Accounts Receivable Method

Allowance for Doubtful Accounts (XA)		
	50	Balance at 12/31/2010 before adjustment
	1,151	2010 adjustment
	1,201	Balance at 12/31/2010 after adjustment

Notice that the balance after adjustment is equal to the estimate of €1,201 based on the aging analysis performed earlier.

Estimating Bad Debts – Aging of Accounts Receivable Method

Accounts Receivable
X % Estimated Uncollectible
Desired Balance in Allowance Account
- Allowance Account **Credit** Balance
Amount of Journal Entry

Accounts Receivable
X % Estimated Uncollectible
Desired Balance in Allowance Account
+ Allowance Account **Dedit** Balance
Amount of Journal Entry

Receivables Turnover Ratio

$$\text{Receivables Turnover} = \frac{\text{Net Sales}}{\text{Average Net Trade Receivables}}$$

This ratio measures how many times average receivables are recorded and collected for the year.

adidas reported 2009 net sales of €10,381,000. December 31, 2008, receivables were €1,624,000 and December 31, 2009, receivables were €1,429,000.

$$\text{Receivables Turnover} = \frac{€10,381,000}{(€1,429,000 + €1,429,000) \div 2} = 6.8$$

Average Collection Period

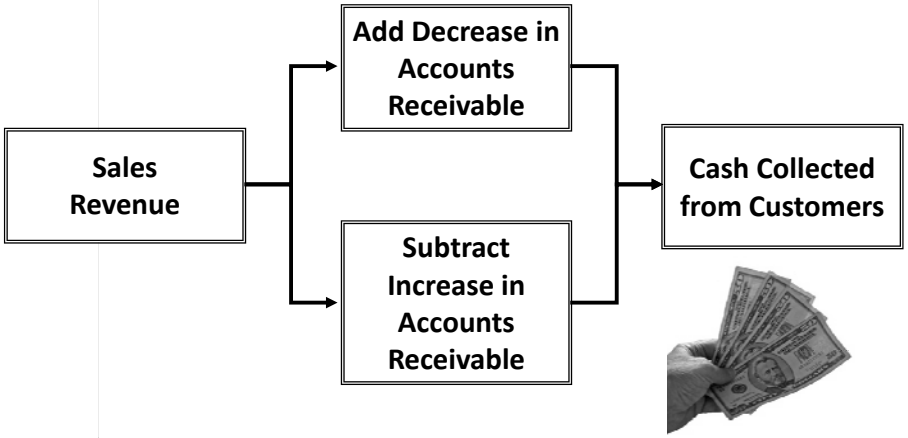
$$\text{Average Collection Period} = \frac{365}{\text{Receivables Turnover}}$$

This ratio indicates the average time it takes a customer to pay its accounts.

adidas' Receivables Turnover was 6.8.

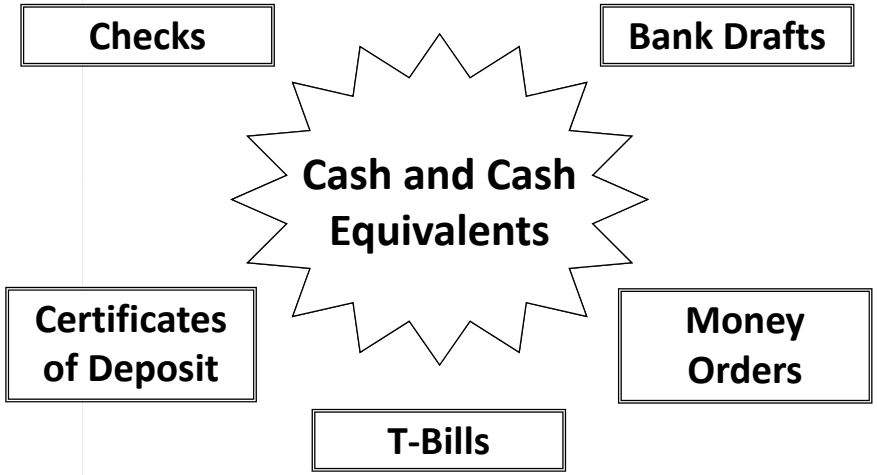
$$\text{Average Collection Period} = \frac{365}{6.8} = 53.7 \text{ days}$$

Focus on Cash Flows



Reporting and Safeguarding Cash

Cash and Cash Equivalents

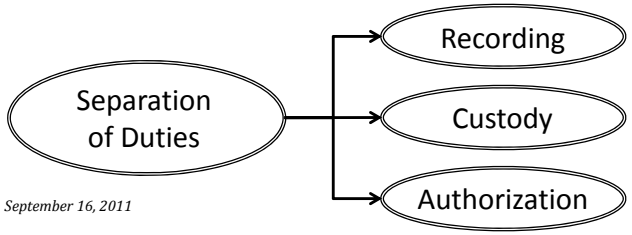


Internal Control of Cash

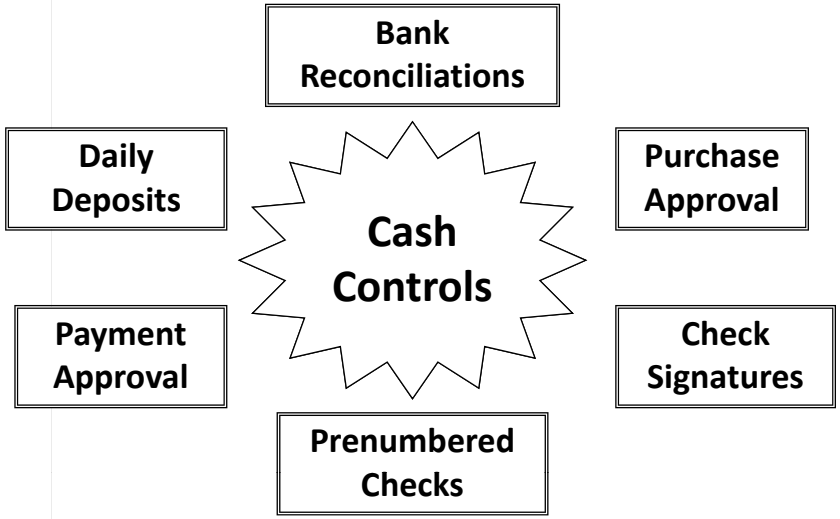
Internal control refers to policies and procedures designed to:

- Properly account for assets.
- Safeguard assets.
- Ensure the accuracy of financial records.

Cash is the asset most susceptible to theft and fraud.



Internal Control of Cash



Bank Reconciliation

Explains the difference between cash reported on bank statement and cash balance on company's books and provides information for reconciling journal entries.

Balance per Bank	Balance per Book
+ Deposits in Transit	+ Deposits by Bank (credit memos)
- Outstanding Checks	- Service Charge - NSF Checks
± Bank Errors	± Book Errors
= Correct Balance	= Correct Balance

Bank Reconciliation

Explains the difference between cash reported on bank statement and cash balance on company's books and provides information for reconciling journal entries.

All reconciling items on the book side require an adjusting entry to the cash account.

- **Balance per Book**
- **+ Deposits by Bank (credit memos)**
- **- Service Charge**
- **- NSF Checks**
- **± Book Errors**
- **= Correct Balance**

Bank Reconciliation

Prepare a July 31 bank reconciliation statement and the resulting journal entries for the Simmons Company. The July 31 bank statement indicated a cash balance of €9,610, while the cash ledger account on that date shows a balance of €7,430.

Additional information necessary for the reconciliation is shown on the next page.

Bank Reconciliation

- Outstanding checks totaled €2,417.
- A €500 check mailed to the bank for deposit had not reached the bank at the statement date.
- The bank returned a customer's NSF check for €225 received as payment of an account receivable.
- The bank statement showed €30 interest earned on the bank balance for the month of July.
- Check 781 for supplies cleared the bank for €268 but was erroneously recorded in our books as €240.
- A €486 deposit by Acme Company was erroneously credited to our account by the bank.

Bank Reconciliation

Ending **BANK** balance, July 31		€ 9,610
Additions:		
Deposit in transit		500
Deductions:		
Bank error	€ 486	
Outstanding checks	2,417	2,903
Correct cash balance		**€ 7,207**
Ending **BOOK** balance, July 31		€ 7,430
Additions:		
Interest		30
Deductions:		
Recording error	€ 28	
NSF check	225	253
Correct cash balance		**€ 7,207**

Bank Reconciliation

Based on the bank reconciliation,
these are the entries needed **to adjust the Cash account**.

GENERAL JOURNAL				
Date		Description	Debit	Credit
Jul	31	Cash (+A)	30	
		Interest Revenue (+R, +SE)		30
		To record interest earned on checking account		
	31	Supplies Inventory (+A)	28	
		Accounts Receivable (+A)	225	
		Cash (-A)		253
		To correct bookeeping error and adjust for NSF check		

Supplement A: Recording Discounts and Returns

Supplement A: Recording Discounts and Returns

On January 2, an adidas factory store's credit card sales were $3,000. The credit card company charges a 3% service fee.

GENERAL JOURNAL				
Date		Description	Debit	Credit
Jan.	2	Cash (+A)	2,910	
		Credit Card Discounts (+XR,-R,-SE)	90	
		Sales Revenue (+R,+SE)		3,000
		To record credit card sales and credit card		
		service fee of $3,000 × 3% = $90		

contra-revenue account

Supplement A: Recording Discounts and Returns

On January 6, adidas sold $1,000 of merchandise on credit with terms of 2/10, n/30.
Prepare the adidas journal entry.

GENERAL JOURNAL				
Date		Description	Debit	Credit
Jan.	6	Accounts Receivable (+A)	1,000	
		Sales Revenue (+R,+SE)		1,000
		To record sales of merchandise on credit		

Supplement A: Recording Discounts and Returns

On January 14, adidas receives the appropriate payment from the customer for the January 6 sale. Prepare the adidas journal entry.

$1,000 × 2% = $20 sales discount
$1,000 - $20 = $980 cash receipt

GENERAL JOURNAL				
Date		Description	Debit	Credit
Jan.	14	Cash (+A)	980	
		Sales Discounts (+XR,-R,-SE)	20	
		Accounts Receivable (-A)		1,000
		To record payment from customer		

contra-revenue account

Supplement A: Recording Discounts and Returns

If the customer remits the appropriate amount on January 20 instead of January 14, what entry would adidas make?

Since the customer paid outside of the discount period, a sales discount is not granted.

GENERAL JOURNAL				
Date		Description	Debit	Credit
Jan.	20	Cash (+A)	1,000	
		Accounts Receivable (-A)		1,000
		To record payment from customer		

Supplement A: Recording Discounts and Returns

On July 8, before paying, a customer returns $500 of sandals originally purchased on account from adidas. Prepare the adidas journal entry.

GENERAL JOURNAL				
Date		Description	Debit	Credit
Jan.	8	Sales Returns and Allowances (+XR,-R,-SE)	500	
		Accounts Receivable (-A)		500
		To record return of merchandise		

End of Chapter 6

EXERCISE 6 – 1

ACCOUNTS RECEIVABLE JOURNAL ENTRIES

Prepare journal entries to record the following transactions:

(1) On December 15, 2010, the company recorded $150,000 sales on credit.

Dec. 15			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

(2) On December 31, 2010, the company estimated bad debt expenses of $15,000.

Dec. 31			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

(3) On January 12, 2011, collect $100,000 worth of accounts receivable.

Jan. 12			
2011			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

EXERCISE 6 – 1, CONTINUED

(4) After many collection attempts, the Company determined on June 15, 2011 that it would not collect $10,000 in accounts receivables from Pendant Publishing. It decided to write-off this account.

Jun. 15			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

(5) On July 16, Pendant Publishing called to say that they have had financial problems but can afford to pay $7,000 to settle their $10,000 debt in full. Vandolay Industries agreed to these terms, and reversed $7,000 of the prior write-off. It received a $7,000 check from Pendant the next day.

Jul. 16			
Jul. 16			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

Post the above entries to the following T-accounts:

+ Accounts Receivable (A) –			

- Allowance for Doubtful Accounts (xA) +			

EXERCISE 6 – 2

ESTIMATION AND RECORDING OF UNCOLLECTIBLE ACCOUNTS – PERCENTAGE OF CREDIT SALES RECEIVABLE METHOD

Part 1 – During 2011, Vandolay reported $300,000 in sales. The company's allowance for doubtful accounts has an unadjusted credit balance of $12,000 at December 31, 2011. Based on prior experience, management estimates that 2.5% of sales will result in bad debts. Prepare the required adjusting journal entry.

Dec. 31			

Ensure the equation still balances and debits = credits

Assets		=	**Liabilities**		+	**Stockholders' Equity**	

+ Bad Debt Expense (E) –				- Allowance for Doubtful Accounts (xA) +			

Part 2 – Assume instead that the company's allowance for doubtful accounts has an unadjusted debit balance of $400. Prepare the required adjusting journal entry.

Dec. 31			

Ensure the equation still balances and debits = credits

Assets		=	**Liabilities**		+	**Stockholders' Equity**	

+ Bad Debt Expense (E) –				- Allowance for Doubtful Accounts (xA) +			

EXERCISE 6 – 3

ESTIMATION AND RECORDING OF UNCOLLECTIBLE ACCOUNTS – AGING OF ACCOUNTS RECEIVABLE METHOD

Part 1 – During 2011, Vandolay reported $300,000 in sales. The company's allowance for doubtful accounts has an unadjusted credit balance of $12,000 at December 31, 2011. Vandolay Industries accountants prepared the following Aging of Accounts Receivable:

Customer	Total	Number of days unpaid			
		0-30	30-60	60-90	Over 90
Alpha Sales	$ 700		$ 700		
Gamma Manufacturing Co.	1,900	$ 1,900			
Delta Shipping Corp.	2,200			$ 2,200	
Epsilon Industries	6,000				$ 6,000
Theta Manufacturing	1,800		1,800		
Zeta Industries	600		600		
Other customers	136,800	88,100	26,900	9,800	12,000
Totals	$150,000	$90,000	$30,000	$12,000	$18,000

Vandolay accountants believe that receivables 0-30 days old have a 2% chance of noncollection. Receivables 30-60 days old have a 4% chance of noncollection. Receivables 60-90 days old have an 8% chance of noncollection. Receivables over 90 days old have a 20% chance of noncollection. The company's allowance for doubtful accounts has an unadjusted credit balance of $12,000. Prepare the required adjusting journal entry.

Dec. 31			

Ensure the equation still balances and debits = credits

Assets		=	**Liabilities**		+	**Stockholders' Equity**	

+ Bad Debt Expense (E) –			

– Allowance for Doubtful Accounts (xA) +			

EXERCISE 6 – 3, CONTINUED

Part 2 – Assume instead that the company's allowance for doubtful accounts has an unadjusted debit balance of $400. Prepare the required adjusting journal entry.

Dec. 31			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

+ Bad Debt Expense (E) –				– Allowance for Doubtful Accounts (xA) +			

EXERCISE 6 – 4

BANK RECONCILIATION

Information from the records and bank statement and of Matrix, Inc. as of July 31, 2010 is set forth below

Cash balance per bank, July 31, 2010	$9,610
Cash balance per general ledger, July 31, 2010	7,430
Outstanding checks at July 31, 2010	2,417
Check mailed to the bank for deposit that had not reached the bank by July 31, 2010	500
NSF check (from a customer for a payment on account) returned by bank	281
July interest earned per bank statement	30
Check no. 781 for supplies expense cleared the bank for $240, but was erroneously recorded in the books at $268.	
Deposit by Acme Company erroneously credited by the bank to our account	486

Part A

Prepare the bank reconciliation for Matrix, Inc.

EXERCISE 6 – 4, continued

Part B

Prepare any journal entries that should be made as a result of the bank reconciliation.

Date	Accounts	Debit	Credit

EXERCISE 6 – 5

BANK RECONCILIATION

Prepare the bank reconciliation for Donna's Day Care using the following information:

Cash balance per bank, June 30, 2010	$5,586
Cash balance per general ledger, June 30, 2010	5,055
Outstanding checks, June 30, 2010	1,816
Deposit in transit, June30, 2010	750
NSF check (from a customer for a payment on account) returned by bank	450
June interest earned per bank statement	15
Check no. 800 in payment of accounts payable cleared the bank for $1,100, but was erroneously recorded in the books at $$800.	
Deposit in amount of $6,000, recorded properly on books, erroneously credited on bank statement as $5,800	

Part A

Prepare the bank reconciliation for Donna's Day Care.

EXERCISE 6 – 5, continued

Part B

Prepare any journal entries that should be made as a result of the bank reconciliation.

Date	Accounts	Debit	Credit

EXERCISE 6 – 6

SALES JOURNAL ENTRIES

On March 3, Gooddeal.com sold merchandise for $2,500, terms 2/10 n/30. Prepare the journal entry.

Debit and credit the accounts affected

Mar. 3			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

The customer paid for the merchandise on March 6, taking advantage of the permitted discount. Prepare the journal entry.

Debit and credit the accounts affected

Mar. 6			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	

On March 8, the customer returned $1,250 (or one-half) of the merchandise that was purchased back on March 3. Prepare the journal entry.

Debit and credit the accounts affected

Mar. 8			

Ensure the equation still balances and debits = credits

Assets		=	Liabilities		+	Stockholders' Equity	