



BACHELOR of ECONOMICS



**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:

Ajarn Santana Singhasaneh





BACHELOR
of ECONOMICS



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

Ajarn Santana Singhasaneh
Department of Accounting
Thammasat Business School
Thammasat University



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.

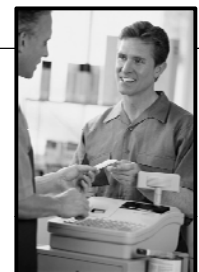


Credit Card Sales to Consumers

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.

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

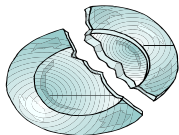
$$\text{Interest Rate for 20 Days} = \frac{\$2}{\$98} = 2.04\%$$

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



Sales Returns and Allowances

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



Damaged merchandise.

RETURNS



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
<u>Less:</u> Credit card discounts
Sales discounts
Sales returns and allowances
<hr/>
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			COMPARISONS WITH COMPETITORS
adidas			Nike
2007	2008	2009	2009
47.4%	48.7%	45.4%	46.3%

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



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)



Measuring and Reporting Receivables



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.

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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.

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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		

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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
		Allowance for Doubtful Accounts (XA)	↓ Assets (Accounts Receivable, Net) } No effect

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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.



$$\begin{array}{l} \text{Net credit sales} \\ \times \text{ \% Bad debt loss rate} \\ \hline \text{Bad debt expense} \end{array}$$

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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?



$$€600,000 \times 0.01 = €6,000$$

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.		

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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 . . .

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Aging Schedule

Customer	Not Yet Due	Days Past Due				Total A/R Balance
		1-30	31-60	61-90	Over 90	
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.

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Aging Schedule

Customer	Not Yet Due	Days Past Due				Total A/R Balance
		1-30	31-60	61-90	Over 90	
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.

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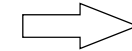


Estimating Bad Debts - Aging of Accounts Receivable Method

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 . . .



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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.

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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

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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.

$$\text{Receivables Turnover} = \frac{€10,381,000}{(€1,624,000 + €1,429,000) \div 2} = 6.8$$



Average Collection Period

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

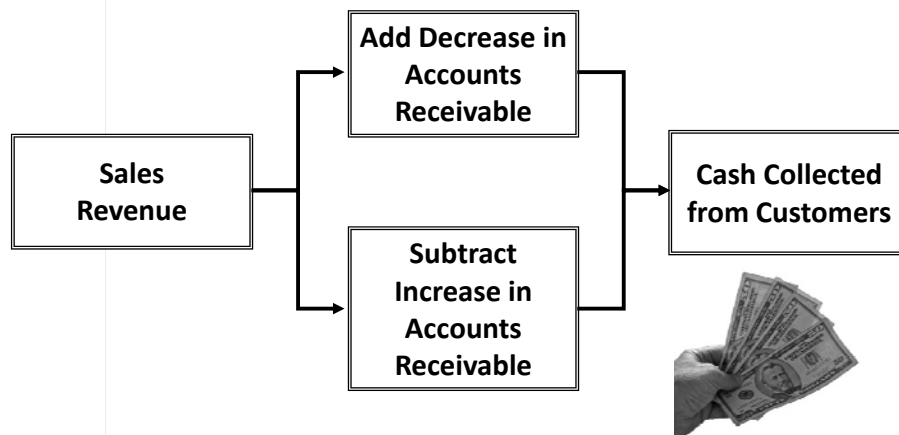
This ratio indicates the average time it takes a customer to pay its accounts.

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

Checks

Bank Drafts

Cash and Cash Equivalents

Certificates of Deposit

Money Orders

T-Bills



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.

Separation of Duties

Recording

Custody

Authorization



Internal Control of Cash

Bank Reconciliations

Daily Deposits

Purchase Approval

Cash Controls

Payment Approval

Check Signatures

Prenumbered Checks



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

+ Deposits in Transit

- Outstanding Checks

± Bank Errors

= Correct Balance

Balance per Book

+ Deposits by Bank (credit memos)

- Service Charge
- NSF Checks

± Book Errors

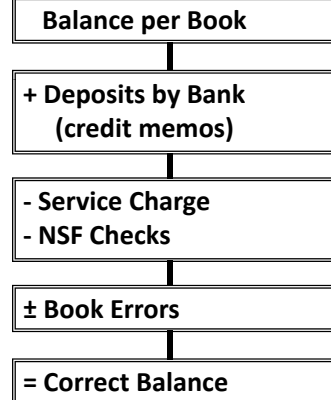
= Correct Balance



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.



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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.

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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.

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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	€	<u>7,207</u>	
Ending BOOK balance, July 31	€	7,430	
Additions:			
Interest		30	
Deductions:			
Recording error	€	28	
NSF check		225	253
Correct cash balance	€	<u>7,207</u>	

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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 bookkeeping 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, -SE)	90	
	Sales Revenue (+R, +SE)		3,000
	To record credit card sales and credit card service fee of $\$3,000 \times 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.

$$\begin{aligned} \$1,000 \times 2\% &= \$20 \text{ sales discount} \\ \$1,000 - \$20 &= \$980 \text{ cash receipt} \end{aligned}$$

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

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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		

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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, -SE)	500	
	Accounts Receivable (-A)		500
	To record return of merchandise		

contra-revenue account



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, 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, 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	