

BACHELOR of ECONOMICS



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

AC201 Fundamental Accounting

Semester 1/2013

Course Materials

Topic:

Chapter 6 Reporting and Interpreting
Sales Revenue, Receivables, and Cash

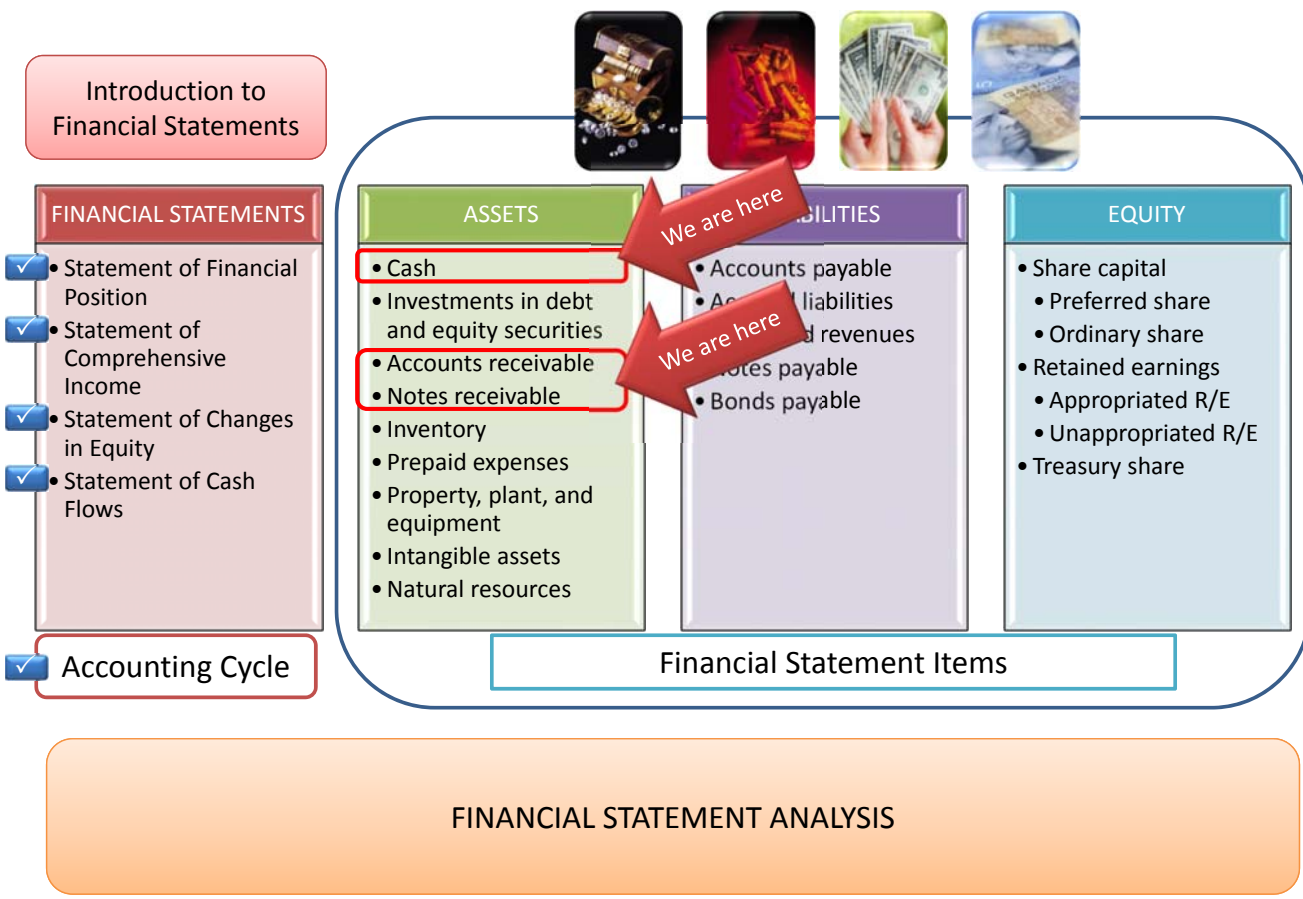
Session:

Sessions #6

Instructor:

Ajarn Santana Singhasaneh





AC201 Fundamental Accounting

BACHELOR of ECONOMICS

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

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Accounting for Sales Revenue

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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.

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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

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I. 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.



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Recording Credit Card Discounts

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 \times 3\% = \90		

contra-revenue account

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II. 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"**

The above credit term means the customer can deduct 2% from the invoice price if cash payment is made within 10 days from the date of sales.

If cash payment is not made with in 10 day discount period, the full sales price (less any returns) is due within a maximum of 30 days.

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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.

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

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

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



Recording Sales Discounts

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		



Recording Sales Discounts

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, -R, -SE)	20	
	Accounts Receivable (-A)		1,000
	To record payment from customer		

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Recording Sales Discounts

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		

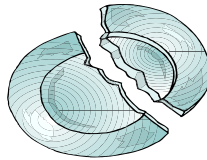
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III. Sales Returns and Allowances

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



Damaged merchandise.



Returned merchandise.



Recording Sales Returns and Allowances

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		

contra-revenue account



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

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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.

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Measuring and Reporting Receivables

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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.

Statement of Financial Position Classifications

- **Current (short-term)**
- **Noncurrent (long-term)**

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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

Statement of Financial Position Disclosure:

Accounts receivable
<u>Less: Allowance for doubtful accounts</u>
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 } Assets (Accounts Receivable, Net) } No effect
		Allowance for Doubtful Accounts (XA) ↓	

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Estimation and Recording of Uncollectible Receivables

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Estimation of Uncollectible Receivables

An estimate of uncollectible accounts at the end of period is required at the end of period. This estimate is normally based on past experience, industry averages, and forecasts of the future.

The two methods used to estimate uncollectible accounts are as follows:

1. Percentage of Sales Method
2. Aging of Accounts Receivable Method



Estimating Bad Debts – Percentage of 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**.



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



Estimating Bad Debts – Percentage of 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 statement of financial position.

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
<u>€ 1,151</u>	<u>Adjusting entry</u>

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

Allowance for Doubtful Accounts (XA)

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

50	Balance at 12/31/2010 before adjustment
1,151	2010 adjustment
<u>1,201</u>	<u>Balance at 12/31/2010 after adjustment</u>



Estimating Bad Debts - Aging of Accounts Receivable Method



X Accounts Receivable
% Estimated Uncollectible

Desired Balance in Allowance Account
- Allowance Account **Credit** Balance

Amount of Journal Entry



X Accounts Receivable
% 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.

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



Average Collection Period

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

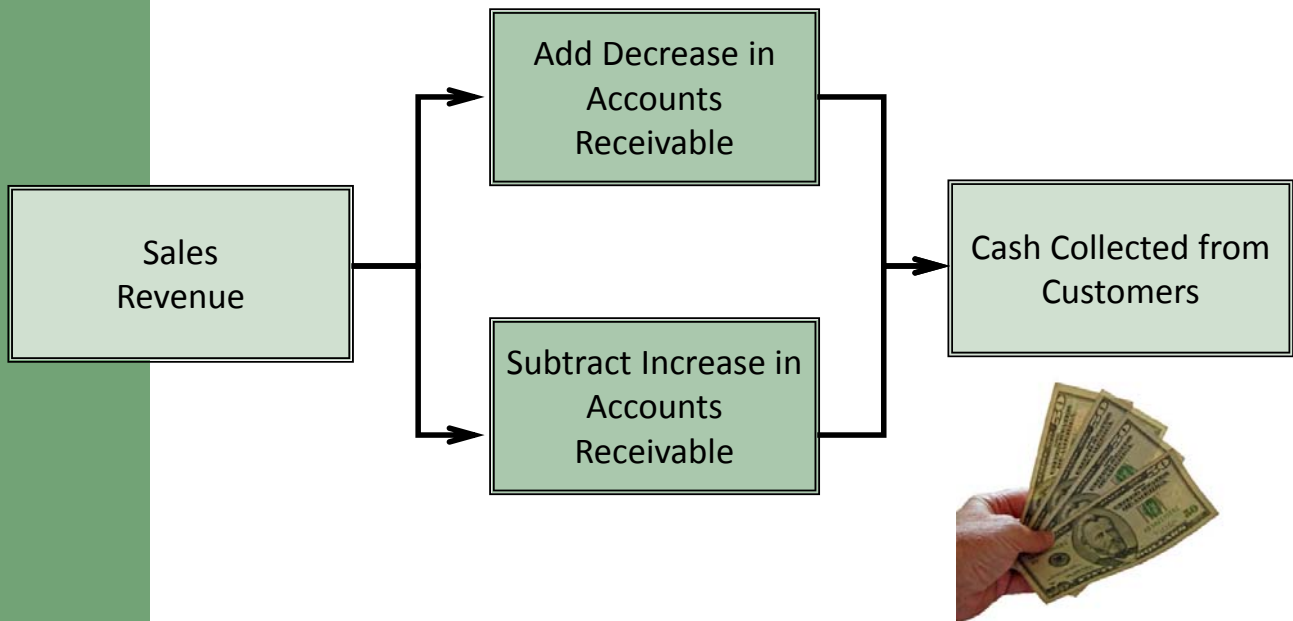
This ratio indicates the average time it takes a customer to pay its accounts.

adidas' Receivables Turnover was 6.8.

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



Focus on Cash Flows



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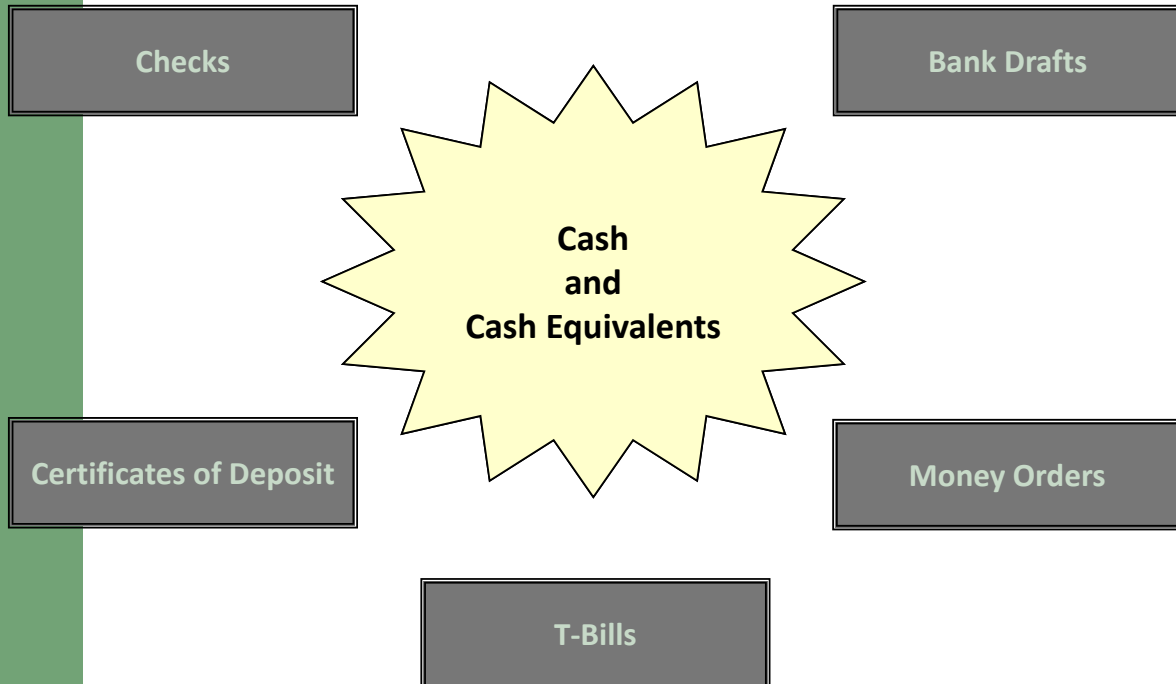
Reporting and Safeguarding Cash

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Cash and Cash Equivalents

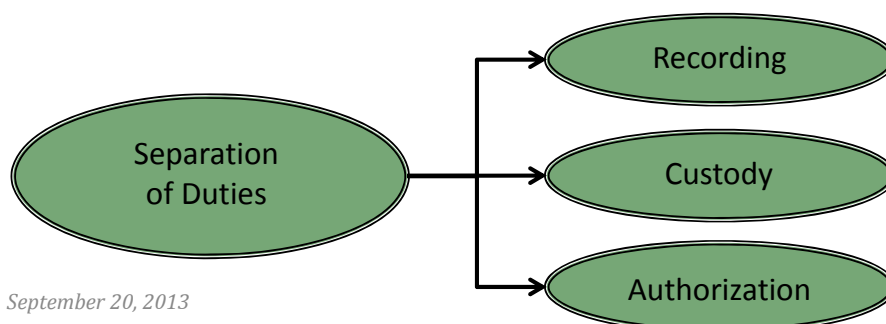
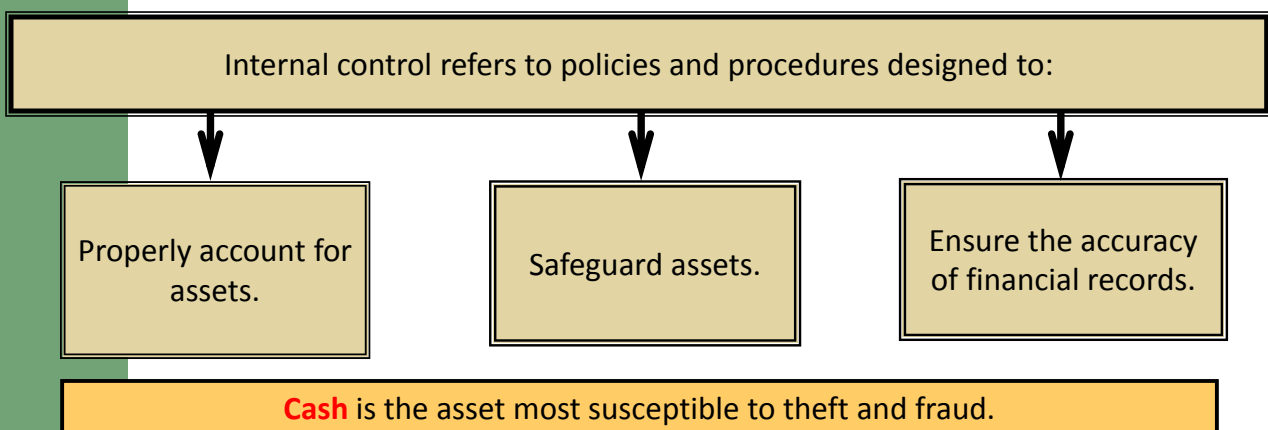


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Internal Control of Cash

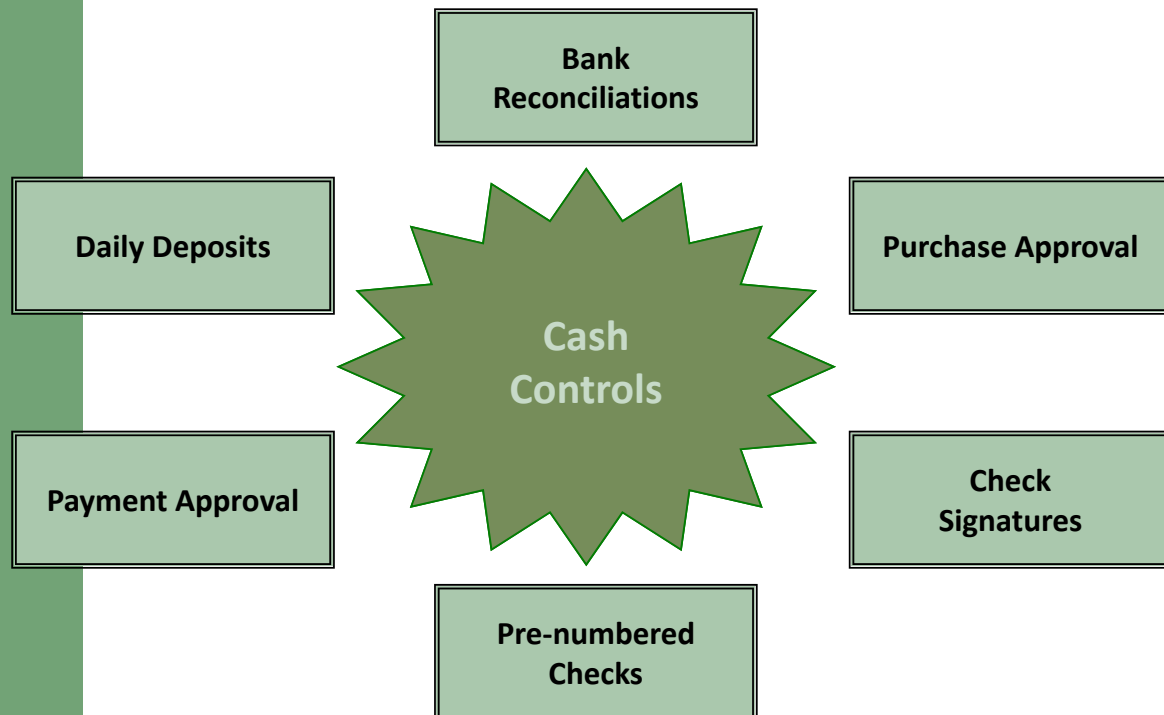


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Internal Control of Cash



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Bank Reconciliation (1)

A bank reconciliation is the process of comparing (reconciling) the ending cash balance in the company's records and the ending balance reported by the bank on the monthly bank statement.

- It is an important part of internal control.
 - Need for calculating a true cash balance
- Two "sections" to be reconciled
 - balance per bank
 - balance per books
- If there are any mistakes or transactions that have not been recorded in the company's books, adjusting journal entries will be needed.
 - **Book errors:** These are numerical errors made by either the company or the bank. The most common is transposition of numbers.

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Bank Reconciliation (2)

Possible Difference between What You and Your Bank Know

Your bank may not know about . . .

1. Errors made by the bank
2. Time lags
 - a. Deposits that you made recently
 - b. Checks that you wrote recently

You may not know about . . .

3. Interest the bank has put into your account
4. Service charges taken out of your account
5. Customer checks you deposited but that bounced
6. Errors made by you

Adjustments to BANK balance

- **Deposit in transit:** The deposit that has not been processed by the bank as of the bank statement date, usually because it was made at or near the end of the month.
- **Outstanding check:** A check that has been written and deducted from a company's cash account but have not cleared by the bank as of the bank statement date.

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Bank Reconciliation (3)

Adjustments to BOOK balance

- **Bank credits:** These are additions made by the bank to a company's account before they are recorded by the company. The most common source is **interest paid by the bank** on the account balance.
- **Bank debits:** These are deductions made by the bank that have not yet been recorded by the company. The most common are monthly service charges, NSF checks, and bank transfers out of the account.
 - **NSF (Non-sufficient-fund) check:** A check that is not honored by a bank because of insufficient cash in the check writer's account.
 - **Bank Service Charge:** The bank automatically reduces the depositor's account balance for monthly fee for servicing an account.

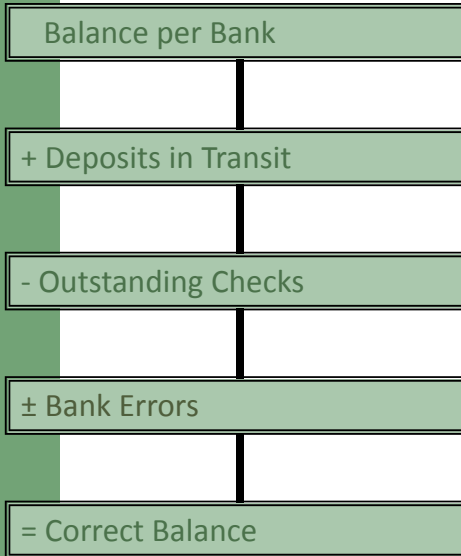
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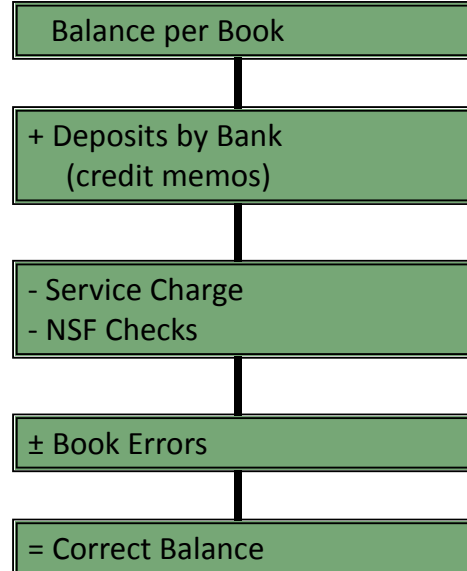


Bank Reconciliation (4)

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



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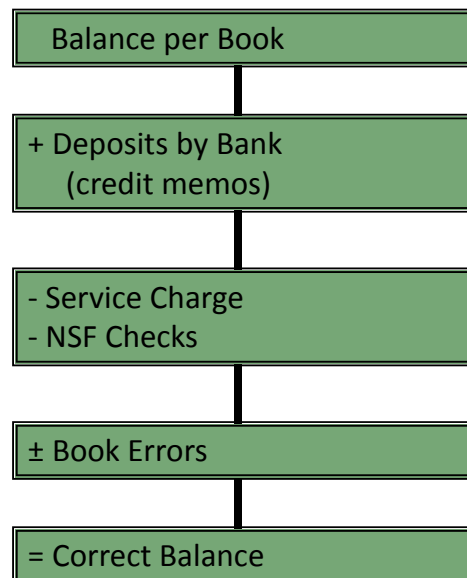
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Bank Reconciliation (5)

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 (6)

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 as follows.

- 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 (7)

Ending BANK balance, July 31		€	9,610
Additions:			
Deposit in transit			500
Deductions:			
Bank error	€	486	
Outstanding checks		2,417	2,903
			<u>2,903</u>
Correct cash balance		€	<u><u>7,207</u></u>

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

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Bank Reconciliation (8)

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		

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End of Chapter 6



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