



BACHELOR  
of ECONOMICS



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

**AC 201**  
Fundamental Accounting

**Semester 2/2015**

**Course Materials**

**Topics:**

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

**Session:**

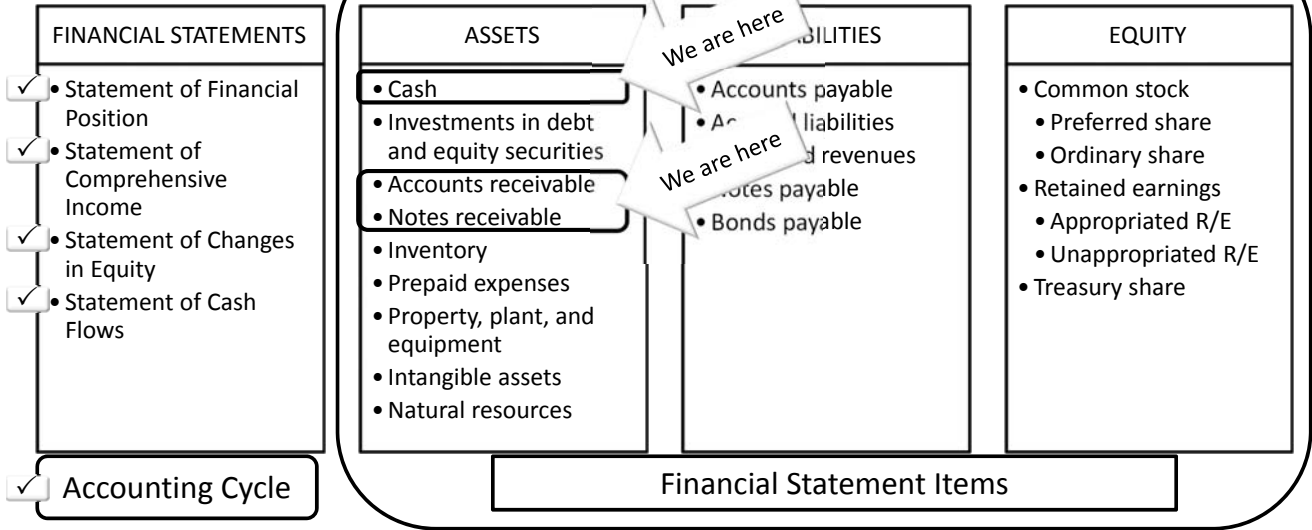
Session #6

**Instructor:**

Ajarn Santana Singhasaneh



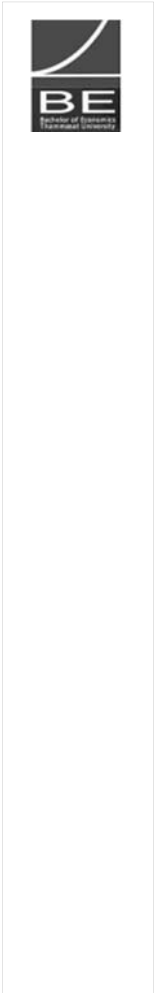
Introduction to Financial Statements



We are here

We are here

FINANCIAL STATEMENT ANALYSIS



AC201 Fundamental Accounting



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



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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 (1)

Companies **record credit card discounts, sales discounts, and sales returns and allowances separately** in contra-revenue accounts **to allow management to monitor these transactions.**

Sales			\$ 9,120,000
<b>Less:</b> Credit card discounts		\$ 15,000	
Sales discounts		65,000	
Sales returns and allowances		<u>40,000</u>	<u>120,000</u>
<b>Net sales</b>			<b><u>\$ 9,000,000</u></b>

Included on the first line of statement of income

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## Reporting Net Sales (2)

Computer City  
Statement of Income  
For the Year Ended December 31, 2014

Revenues:	
Net sales	\$ 9,000,000
Interest income	<u>43,000</u>
Total revenues	<u>9,043,000</u>
Expenses:	
Cost of sales	7,160,000
Selling, general, and administration expenses	<u>590,000</u>
Total expenses	<u>7,750,000</u>
Profit before finance cost and income tax	1,293,000
Finance cost	<u>(12,000)</u>
Profit before income tax	1,281,000
Income tax expense	<u>(384,300)</u>
Net income	\$ <u>896,700</u>

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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.

Date	Account Title & Explanation	Debit	Credit
Jan 2	Cash (A+)	2,910	
	Credit card discounts (XREV+, REV-, SE-)	90	
	Sales revenue (REV+, 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 within 10 day discount period, the full sales price (less any returns) is due within a maximum of 30 days.



## 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 10<sup>th</sup> day instead of the 30<sup>th</sup> 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 (1)

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

Date	Account Title & Explanation	Debit	Credit
Jan 6	Accounts receivable (A+)	1,000	
	Sales revenue (REV+, SE+)		1,000
	To record sales of merchandise on credit		



## Recording Sales Discounts (2)

**Case 1:** On January 14, adidas receives the appropriate payment from the customer for the January 6 sale. Prepare the adidas journal entry.

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

Date	Account Title & Explanation	Debit	Credit
Jan 14	Cash (A+)	980	
	Sales discounts (XREV+, REV-, SE-)	20	
	Accounts receivable (A-)		1,000
	To record sales of merchandise on credit		

contra-revenue account



## Recording Sales Discounts (3)

**Case 2:** 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.

Date	Account Title & Explanation	Debit	Credit
Jan 20	Cash (A+)	1,000	
	Accounts receivable (A-)		1,000
	To record payment from customer		



## 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 making payment, a customer returns \$500 of unsatisfactory sandals originally purchased on account from adidas. Prepare the adidas journal entry.

Date	Account Title & Explanation	Debit	Credit
Jan 8	Sales returns and allowance (XREV+, REV-)	500	
	Accounts receivable (A-)		500
	To record return of merchandise		

contra-revenue account



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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			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.

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## 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.

### Statement of Financial Position Classifications

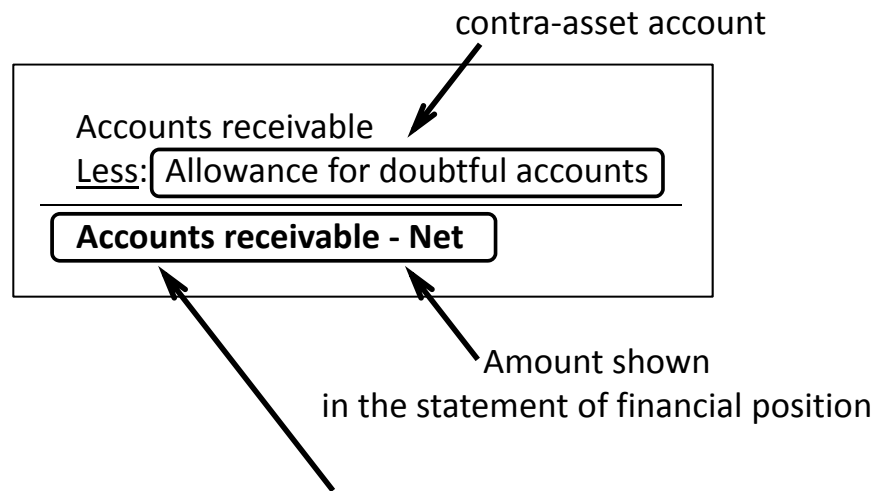
- **Current (short-term)**
- **Noncurrent (long-term)**

The period used to define current assets is typically 1 year  
or the company's operating cycle, whichever is longer.



## Accounts Receivable

Accounts receivable are shown in the statement of financial position at the estimated collectible amount.



## Presentation on the Statement of Financial Position

### STATEMENTS OF FINANCIAL POSITION

President Bakery Public Company Limited

As at 31 December 2014

(Unit: Baht)

	Note	FINANCIAL STATEMENTS IN WHICH THE EQUITY METHOD IS APPLIED		SEPARATE FINANCIAL STATEMENTS	
		As at 31 December 2014	As at 31 December 2013	As at 31 December 2014	As at 31 December 2013
<b>ASSETS</b>					
<b>Current assets</b>					
Cash and cash equivalents	6	124,637,314	1,113,242,389	124,637,314	1,113,242,389
Short-term investments	7	1,674,345,443	156,541,393	1,674,345,443	156,541,393
Trade and other receivables	8, 10	791,151,793	759,600,209	791,151,793	759,600,209
Inventories	9	189,817,939	174,218,295	189,817,939	174,218,295
Other current assets		37,638,316	23,745,015	37,638,316	23,745,015
<b>Total current assets</b>		<b>2,817,590,805</b>	<b>2,227,347,301</b>	<b>2,817,590,805</b>	<b>2,227,347,301</b>

Shown at net realizable value (NRV)





## Disclosure in Notes to Financial Statements

### 8. TRADE AND OTHER RECEIVABLES

(Unit: Thousand Baht)

	2014	2013
<b>TRADE RECEIVABLES - RELATED PARTIES</b>		
Aged on the basis of due dates		
Not yet due	458	491
Trade receivables - related parties	458	491
<b>TRADE RECEIVABLES - UNRELATED PARTIES</b>		
Not yet due	456,887	440,360
Past due		
Up to 3 months	332,204	318,199
3 - 6 months	276	394
6 - 12 months	83	7
Over 12 months	54	-
Total trade receivables - unrelated parties	789,504	758,960
Less: Allowance for doubtful accounts	(107)	(97)
Total trade receivables - unrelated parties - net	789,397	758,863
Total trade receivables - net	789,855	759,354

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## Accounting for Bad Debts

An accounts receivable that has been determined to be uncollectible is no longer an asset. The loss of this asset represents an expense, termed **Bad debts expense**. **Bad debt expense** is caused by selling goods on credit to customers who fail to pay the amount they owe.

Matching Principle



Sales Revenue

Record in  
same accounting period.

Bad Debt Expense

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

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## Recording Bad Debt Expense

contra-asset account

adidas estimated bad debt expense for 2009 to be €68,000,000.  
The following adjusting entry should be made **end of period**:

Bad debt expense (+E, -SE) .....	68	
Allowance for doubtful accounts (+XA, -A) .....		68
<u>Assets</u>	=	<u>Liabilities</u> + <u>Stockholders' Equity</u>
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 in the same manner as any other expense account.

**Allowance for doubtful accounts** appears in the statement of financial position as a deduction from the face amount of accounts receivable. It reduces the accounts receivable to their estimated collectible amount.



## Writing Off Specific Uncollectible Accounts

When it is clear that a **SPECIFIC** customer will be **uncollectible**, the amount should be **removed** or **written off** from the Accounts Receivable account and debited to the Allowance for Doubtful Accounts.

adidas' total write-offs for 2009 were €34,000,000.  
The following adjusting entry should be made **when the bad debts become known**:

Allowance for doubtful accounts (-XA, +A) .....	63	
Accounts receivable (-A) .....		63
<u>Assets</u>	=	<u>Liabilities</u> + <u>Stockholders' Equity</u>
Allowance for doubtful accounts      +63		
Accounts receivable                      -63		



# Summary

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) ↓	



## Estimation and Recording of Bad Debt Expense (Uncollectible Receivables)





## Estimation and Recording of Bad Debt Expense

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

**At the end of period**, the company needs the following adjusting journal entry to record the estimated uncollectible accounts (bad debt expense) :

Dr. Bad debt expense (EXP+, SE-)

Cr. Allowance for doubtful accounts (XA+, A-)

There are 2 general approaches to estimating bad debt expense:

- I. A statement of income approach or **Percentage of sales method**
- II. A statement of financial position approach or **Aging of accounts receivable method**

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## I. Percentage of Sales Method (1)

### Statement of Income Approach

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.



$$\frac{\text{X Net credit sales} \times \text{\% Bad debt loss rate}}{\text{Bad debt expense}}$$

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## I. Percentage of Sales Method (2)

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?

$$€600,000 \times 0.01 = €6,000$$

The following adjusting entry is made **at the end of period**:

Date	Account Title & Explanation	Debit	Credit
Dec 31	Bad debt expense (EXP+, SE-)	6,000	
	Allowance for doubtful accounts (XA+, A-)		6,000
	To record bad debt expense		



## II. Aging of Accounts Receivable Method (1)

### Statement of Financial Position Approach

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 . .



## II. Aging of Accounts Receivable Method (2)

### Analysis of Accounts Receivable by Age

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
<b>Total</b>	<b>€ 3,500</b>	<b>€ 2,550</b>	<b>€ 1,830</b>	<b>€ 1,540</b>	<b>€ 1,240</b>	<b>€ 10,660</b>
<b>% Uncollectible</b>	<b>0.01</b>	<b>0.04</b>	<b>0.10</b>	<b>0.25</b>	<b>0.40</b>	

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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## II. Aging of Accounts Receivable Method (3)

Desired balance

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
<b>Total</b>	<b>€ 3,500</b>	<b>€ 2,550</b>	<b>€ 1,830</b>	<b>€ 1,540</b>	<b>€ 1,240</b>	<b>€ 10,660</b>
<b>% Uncollectible</b>	<b>0.01</b>	<b>0.04</b>	<b>0.10</b>	<b>0.25</b>	<b>0.40</b>	
<b>Estimated Uncoll. Amount</b>	<b>€ 35</b>	<b>€ 102</b>	<b>€ 183</b>	<b>€ 385</b>	<b>€ 496</b>	<b>€ 1,201</b>

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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## II. Aging of Accounts Receivable Method (4)

Desired balance

Date	Account Title & Explanation	Debit	Credit
Jan 31	Bad debt expense (EXP+, SE-)	1,151	
	Allowance for doubtful accounts (XA+, A-)		1,151
	To record bad debt expense		

1,201	Desired balance
- 50	Credit balance
<b>€ 1,151</b>	<b>Adjusting entry</b>

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

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

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



## II. Aging of Accounts Receivable Method (5)

➔

X	Accounts Receivable	
	% Estimated Uncollectible	
	<hr/>	
	<b>DESIRED</b> Balance in Allowance Account	
-	Allowance Account <b>Credit</b> Balance	
	<hr/>	
	Amount of Journal Entry	

➔

X	Accounts Receivable	
	% Estimated Uncollectible	
	<hr/>	
	<b>Desired</b> Balance in Allowance Account	
+	Allowance Account <b>Dedit</b> Balance	
	<hr/>	
	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.

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



## 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.

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



**Exercise 2: Accounts Receivable Journal Entries**

Part A: Prepare journal entries to record the following transactions.

- a. On December 15, 2014, Vandolay Industries recorded \$150,000 sales on credit.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- b. On December 31, 2014, the company estimated bad debt expenses of \$15,000.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

Part B: Post the above entries to the following T-accounts.

+ Accounts Receivable (A) -				- Allowance for Doubtful Accounts (XA) +			

Part C: Show all revenue-related accounts in the following statement of financial position (partial) and statement of income (partial) as of December 31, 2014.

VANDOLAY INDUSTRIES INC. <b>Statement of Financial Position (partial)</b> <b>As of December 31, 2014</b>	
Accounts receivable	_____
<u>Less:</u> Allowance for doubtful accounts	_____
Accounts receivable - net	_____
VANDOLAY INDUSTRIES INC. <b>Statement of Income (partial)</b> <b>For the year ended December 31, 2014</b>	
Bad debt expenses	_____

Part A: Prepare journal entries to record the following transactions.

- c. On January 12, 2015, the company collected \$100,000 worth of accounts receivable.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- d. After many collection attempts, the company determined on May 15, 2015 that it would not collect \$10,000 in accounts receivables from Pendant Publishing. It decided to write-off this account.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

- e. On August 16, 2015, 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. The company agreed to these terms, and reversed \$7,000 of the prior write-off. It received a \$7,000 check from Pendant the next day.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

Part B: Post the above entries to the following T-accounts.

+ Accounts Receivable (A) -				- Allowance for Doubtful Accounts (XA) +			
Dec 31, 14	150,000					Dec 31, 14	15,000
Jan 1, 15	150,000					Jan 1, 15	15,000

Part C: Show all revenue-related accounts in the following statement of financial position (partial) and statement of income (partial) as of December 31, 2015.

VANDOLAY INDUSTRIES INC. <b>Statement of Financial Position (partial)</b> <b>As of December 31, 2015</b>	
Accounts receivable	_____
<u>Less: Allowance for doubtful accounts</u>	_____
Accounts receivable - net	_____
VANDOLAY INDUSTRIES INC. <b>Statement of Income (partial)</b> <b>For the year ended December 31, 2015</b>	
Bad debt expenses	_____

**Exercise 3: Estimation and Recording of Bad Debt Expense – Percentage of Sales Method**

Part A: Prepare the required adjusting journal entry.

During 2015, Vandolay Industries reported \$100,000 in sales. The company’s allowance for doubtful accounts has an **unadjusted CREDIT balance of \$12,000 at December 31, 2015**. Based on prior experience, management estimates that 2.5% of sales will result in bad debts.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

+ Bad Debt Expense (E) -		- Allowance for Doubtful Accounts (XA) +	
		Beg. Bal.	12,000
End Bal.		End Bal.	

VANDOLAY INDUSTRIES INC. Statement of Financial Position (partial) As of December 31, 2015	
Accounts receivable	\$ 40,000
<u>Less: Allowance for doubtful accounts</u>	<u>                    </u>
Accounts receivable - net	<u>                    </u>
VANDOLAY INDUSTRIES INC. Statement of Income (partial) For the year ended December 31, 2015	
Bad debt expenses	<u>                    </u>

Part B: Prepare the required adjusting journal entry.

Assume instead that the company's allowance for doubtful accounts has an **unadjusted DEBIT balance of \$400 at December 31, 2015.**

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

+ Bad Debt Expense (E) -				- Allowance for Doubtful Accounts (XA) +			
				Beg. Bal.	400		
End Bal.						End Bal.	

VANDOLAY INDUSTRIES INC.	
Statement of Financial Position (partial)	
As of December 31, 2015	
Accounts receivable	\$ 40,000
<u>Less: Allowance for doubtful accounts</u>	_____
Accounts receivable - net	_____
VANDOLAY INDUSTRIES INC.	
Statement of Income (partial)	
For the year ended December 31, 2015	
Bad debt expenses	_____

**Exercise 4: Estimation and Recording of Bad Debt Expense – Aging of Accounts Receivable Method**

Part A: Prepare the required adjusting journal entry.

During 2015, Vandolay Industries reported \$100,000 in sales. The company's allowance for doubtful accounts has an **unadjusted CREDIT balance of \$12,000 at December 31, 2015**. 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
<b>Totals</b>	<b>\$150,000</b>	<b>\$90,000</b>	<b>\$30,000</b>	<b>\$12,000</b>	<b>\$18,000</b>
% Uncollectible					
Totals					

Vandolay accountants believe that receivables 0-30 days old have a 5% chance of non-collection. Receivables 30-60 days old have a 10% chance of non-collection. Receivables 60-90 days old have a 20% chance of non-collection. Receivables over 90 days old have a 40% chance of non-collection.

GENERAL JOURNAL			
Date	Account Titles and Explanation	Debit	Credit

+ Bad Debt Expense (E) -				- Allowance for Doubtful Accounts (XA) +			
						Beg. Bal.	12,000
End Bal.						End Bal.	

VANDOLAY INDUSTRIES INC.	
Statement of Financial Position (partial)	
As of December 31, 2015	
Accounts receivable	\$ 40,000
<u>Less: Allowance for doubtful accounts</u>	<u>                    </u>
Accounts receivable - net	<u>                    </u>
VANDOLAY INDUSTRIES INC.	
Statement of Income (partial)	
For the year ended December 31, 2015	
Bad debt expenses	<u>                    </u>

