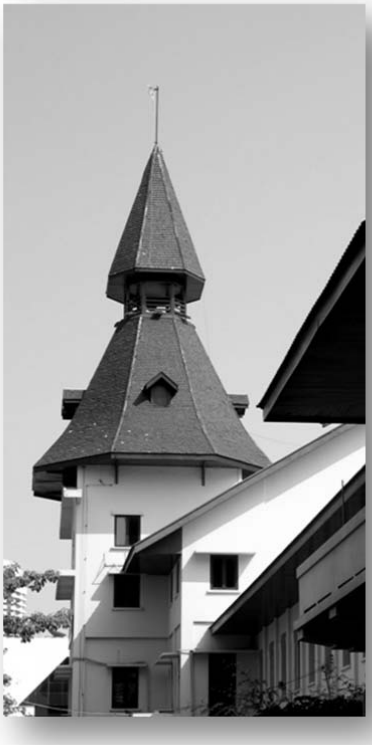
Thammasat University
Faculty of Economics
Bachelor of Economics (International Program)

AC 201

Fundamental Accounting

Semester 1/2015



Course Materials

Topics:

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

Session:

Session #6

Instructor:

Ajarn Santana Singhasaneh

Introduction to Financial Statements

FINANCIAL STATEMENTS	ASSETS	LIABILITIES	EQUITY
✓ • Statement of Financial Position	• Cash	• Accounts payable	• Common stock
✓ • Statement of Comprehensive Income	• Investments in debt and equity securities	• Accrued liabilities	• Preferred share
✓ • Statement of Changes in Equity	• Accounts receivable	• Unearned revenues	• Ordinary share
✓ • Statement of Cash Flows	• Notes receivable	• Notes payable	• Retained earnings
	• Inventory	• Bonds payable	• Appropriated R/E
	• Prepaid expenses		• Unappropriated R/E
	• Property, plant, and equipment		• Treasury share
	• Intangible assets		
	• Natural resources		

We are here

We are here

✓ Accounting Cycle

Financial Statement Items

FINANCIAL STATEMENT ANALYSIS

AC201 Fundamental Accounting

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.

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
Less: Credit card discounts	$ 15,000		
Sales discounts	65,000		
Sales returns and allowances	40,000		120,000
Net sales			$ 9,000,000

Included on the first line of statement of income

Reporting Net Sales (2)

Computer City

Statement of Income

For the Year Ended December 31, 2014

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

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.

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 x 3% = $90		

contra-revenue account

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.

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 (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.

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

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?

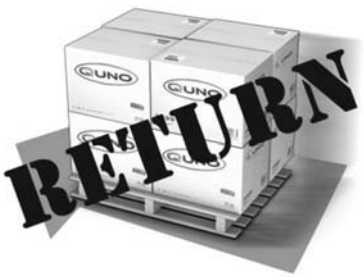
Since the customer paid OUTSIDE of the discount period, a sales discount is NOT granted.

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

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:

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

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.

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.

contra-asset account

Accounts receivable
Less: Allowance for doubtful accounts

Accounts receivable - Net

Amount shown in the statement of financial position

Net realizable value (NRV) of accounts receivable = Amount the business expects to collect.

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
ASSETS					
Current assets					
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
Total current assets		2,817,590,805	2,227,347,301	2,817,590,805	2,227,347,301

Shown at net realizable value (NRV)

Disclosure in Notes to Financial Statements

8. TRADE AND OTHER RECEIVABLES

(Unit: Thousand Baht)

	2014	2013
TRADE RECEIVABLES - RELATED PARTIES		
Aged on the basis of due dates		
Not yet due	458	491
Trade receivables - related parties	458	491
TRADE RECEIVABLES - UNRELATED PARTIES		
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

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.

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

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 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

Assets		= Liabilities +	Stockholders' Equity
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		No effect
		Allowance for Doubtful Accounts (XA)	↓	Assets (Accounts Receivable, Net)		

AC201 Fundamental Accounting

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***

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.

X Net credit sales
% Bad debt loss rate

Bad debt expense

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 × 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
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.

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
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.

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
€ **1,151** **Adjusting entry**

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
1,201	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
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.

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