

Chapter 6



Reporting and Interpreting Sales Revenue, Receivables, and Cash

Accounting for Sales Revenue

The **revenue principle** requires that revenues be recorded when earned:

An exchange has taken place.

The earnings process is nearly complete.

Collection is probable.

Reporting Net Sales

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



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

Credit Card Sales to Consumers

Companies accept credit cards for several reasons:

To increase sales.

To avoid providing credit directly to customers.

To avoid losses due to bad checks.

To receive payment quicker.



Credit Card Sales to Consumers

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



Credit Card Sales to Consumers

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

Prepare the Timberland journal entry.

GENERAL JOURNAL				Page 34	
Date		Description	Debit	Credit	
Jan.	2				

Credit Card Sales to Consumers

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

Pro **Credit Card Discounts are reported as a **contra revenue** account.** ry.

GENERAL JOURNAL

Page 34

Date		Description	Debit	Credit
Jan.	2	Accounts Receivable	2,910	
		Credit Card Discounts	90	
		Sales Revenue		3,000
		\$3,000 × 3% = \$90 Credit Card Fee		

Sales to Businesses on Account

When companies allow customers to purchase merchandise on an **open account**, the customer promises to pay the company in the future for the purchase.



Sales to Businesses on Account

2/10, n/30

Read as: “Two ten, net thirty”

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

Sales to Businesses on Account

2/10, n/30

Percentage
of Discount

of Days
Discount Is
Available

Otherwise,
the Full
Amount Is
Due

of Days
when Full
Amount Is
Due

Sales to Businesses on Account

On January 6, Timberland sold \$1,000 of merchandise on credit with terms of 2/10, n/30.

Prepare the Timberland journal entry.

GENERAL JOURNAL				Page 34
Date		Description	Debit	Credit
Jan.	6			

Sales to Businesses on Account

On January 6, Timberland sold \$1,000 of merchandise on credit with terms of 2/10, n/30.

Prepare the Timberland journal entry.

GENERAL JOURNAL				Page 34	
Date		Description	Debit	Credit	
Jan.	6	Accounts Receivable	1,000		
		Sales Revenue		1,000	

Sales to Businesses on Account

On January 14, Timberland receives the appropriate payment from the customer for the January 6 sale.

Prepare the Timberland journal entry.

GENERAL JOURNAL				Page 34
Date		Description	Debit	Credit
Jan.	14			

Sales to Businesses on Account

On January 14, Timberland receives the appropriate payment from the customer for the January 6 sale.

Prepare the Timberland journal entry.

Date				Page 34
				Credit
Jan.	14	Cash	980	
		Sales Discounts	20	
		Accounts Receivable		1,000

$\$1,000 \times 2\% = \20 sales discount

$\$1,000 - \$20 = \$980$ cash receipt

Contra-revenue account

Sales to Businesses on Account

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

GENERAL JOURNAL				Page 34
Date		Description	Debit	Credit
Jan.	20			

Sales to Businesses on Account

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

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

Date		Description	Debit	Credit
Jan.	20	Cash	1,000	
		Accounts Receivable		1,000

Sales Returns and Allowances

Debited for damaged merchandise.



Debited for returned merchandise.



Contra revenue account.

Sales Returns and Allowances

On July 8, Fontana Shoes returns \$500 of hiking boots originally purchased on account from Timberland.

Prepare the Timberland journal entry.

GENERAL JOURNAL				Page 40	
Date		Description	Debit	Credit	
July	8				

Sales Returns and Allowances

On July 8, Fontana Shoes returns \$500 of hiking boots originally purchased on account from Timberland.

Prepare the Timberland journal entry.

GENERAL JOURNAL				Page 40	
Date		Description	Debit	Credit	
July	8	Sales Returns and Allowances	500		
		Accounts Receivable		500	

Gross Profit Percentage

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

In 1998, Timberland reported gross profit of \$342,839,000 on sales of \$862,168,000.

All other things equal, a higher gross profit results in higher net income.

Gross Profit Percentage

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

$$\text{Gross Profit Percentage} = \frac{\$342,839,000}{\$862,168,000} = 39.8\%$$

All other things equal, a higher gross profit results in higher net income.

1998 Gross Profit Comparisons

Timberland
39.8%

Skechers U.S.A.
41.5%

Wolverine
31.8%

Measuring and Reporting Receivables

Accounts Receivable

```
graph TD; A[Accounts Receivable] --> B[Amounts owed by other companies or persons for cash, goods, or services.]; A --> C[Open accounts owed to the business by trade customers.];
```

**Amounts owed by
other companies
or persons for
cash, goods, or
services.**

**Open accounts
owed to the
business by trade
customers.**

Measuring and Reporting Receivables

\$1,200 **Wheaton, Ohio** **January 5, 2000**

Sixty days **after date I promise to pay to**

the **Wheaton Mountain Bank**

One thousand two hundred ----- Dollars

Payable at **in Bank**

Value received with interest at **12%** **per annum**

No. 10242 **Due** **March 6, 2000**

Pat Rogers
Timberland Company

Term **Payee** **Principal** **Interest Rate** **Maker** **Due Date**

Accounting for Bad Debts

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



Accounting for Bad Debts



**Matching
Principle**



**Bad Debt
Expense**

**Record in same
accounting
period.**

**Sales
Revenue**

Accounting for Bad Debts

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



Recording Bad Debt Expense Estimates

**Timberland estimated bad debt
expense for 1998 to be \$2,383,000.**

Prepare the adjusting entry.

GENERAL JOURNAL				Page 78
Date		Description	Debit	Credit
Dec.	31			

Recording Bad Debt Expense Estimates

Timberland estimated bad debt expense for 1998 to be \$2,383,000.

Prepare the adjusting entry.

Date				Page 78
				Credit
Dec.	31	Bad Debt Expense	2,383,000	
		Allowance for Doubtful Accounts		2,383,000

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

Contra asset account

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 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.



Writing Off Uncollectible Accounts

On May 6, Timberland wrote off a specific account receivable with a balance of \$2,500.

Prepare the Timberland journal entry.

GENERAL JOURNAL			Page 37
Date	Description	Debit	Credit
May 6			

Writing Off Uncollectible Accounts

On May 6, Timberland wrote off a specific account receivable with a balance of \$2,500.

Prepare the Timberland journal entry.

Date		Description	Debit	Credit
May	6	Allowance for Doubtful Accounts	2,500	
		Accounts Receivable		2,500

Writing Off Uncollectible Accounts

Assume that before the write-off entry, Timberland's Accounts Receivable balance was \$81,000,000 and the Allowance for Doubtful Accounts balance was \$2,000,000.

Let's see what effect the write-off had on these accounts.

Writing Off Uncollectible Accounts

	Before Write-Off	After Write-Off
Accounts receivable	\$ 81,000,000	\$ 80,997,500
Less: Allow. for doubtful accts.	2,000,000	1,997,500
Net realizable value	\$ 79,000,000	\$ 79,000,000

Notice that the write-off did not change the net realizable value nor did it affect any income statement accounts.

Methods for Estimating Bad Debts

**Percentage of credit sales
or
Aging of accounts receivable**



Percentage of Credit Sales

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.**

Percentage of Credit Sales

$$\begin{array}{l} \text{Net Credit Sales} \\ \times \text{ \% Estimated Uncollectible} \\ \hline \text{Amount of Journal Entry} \end{array}$$



Percentage of Credit Sales

In 2000, Kid's Clothes had credit sales of \$60,000. Past experience indicates that bad debts are **one percent of sales.**

What is the estimate of bad debts expense for 2000?

Percentage of Credit Sales

In 2000, Kid's Clothes had credit sales of \$60,000. Past experience indicates that bad debts are **one percent** of sales.

What is the estimate of bad debts expense for 2000?

$$\$60,000 \times .01 = \$600$$

Now, prepare the adjusting entry.

Percentage of Credit Sales

Date		Description	Debit	Credit
Dec.	31	Bad Debt Expense	600	
		Allowance for Doubtful Accounts		600



**Now let's discuss
another method that is
used to account for
uncollectible accounts.**



Aging of Accounts Receivable

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



Aging of Accounts Receivable

$$\begin{array}{l} \text{Accounts Receivable} \\ \times \text{ \% Estimated Uncollectible} \\ \hline \text{Desired Balance in Allowance Account} \\ - \text{ Allowance Account Credit Balance} \\ \hline \text{Amount of Journal Entry} \end{array}$$

$$\begin{array}{l} \text{Accounts Receivable} \\ \times \text{ \% Estimated Uncollectible} \\ \hline \text{Desired Balance in Allowance Account} \\ + \text{ Allowance Account Debit Balance} \\ \hline \text{Amount of Journal Entry} \end{array}$$

Aging Schedule

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 2000 might look like this . . .

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

Based on past experience, the business estimates the percentage of uncollectible accounts in each time category.

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	

These percentages are then multiplied by the appropriate column totals.

Aging Schedule

Customer	Days Past Due					Total A/R Balance
Aaron,						\$ 235
Baxter, T.	\$ 1,200	500				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.

Aging of Accounts Receivable

Customer	Days Past Due					Total A/R balance
Aaron, R.						235
Baxter, T.						1,500
Clark, J.						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

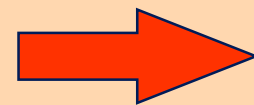
Record the Dec. 31, 2000 adjusting entry assuming that the Allowance for Doubtful Accounts currently has a \$50 credit balance.

Aging of Accounts Receivable

GENERAL JOURNAL					Page 76
Date		Description	Post. Ref.	Debit	Credit
Dec.	31	Bad Debt Expense		1,151	
		Allowance for Doubtful Accounts			1,151

	1,201	Desired Balance
-	50	Credit Balance
	<hr/>	
	\$ 1,151	Adjusting Entry
	<hr/> <hr/>	

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



Aging of Accounts Receivable

Allowance for Doubtful Accounts

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

50	Balance at 12/31/2000 before adj.
1,151	2000 adjustment
1,201	Balance at 12/31/2000 after adj.



Now let's
start our
discussion
of cash.

Cash and Cash Equivalents

Checks

**Money
Orders**

**Cash and
Cash
Equivalents**

**Certificates
of Deposit**

**Bank
Drafts**

T-Bills

Internal Control of Cash

Internal control refers to policies and procedures that are designed to:

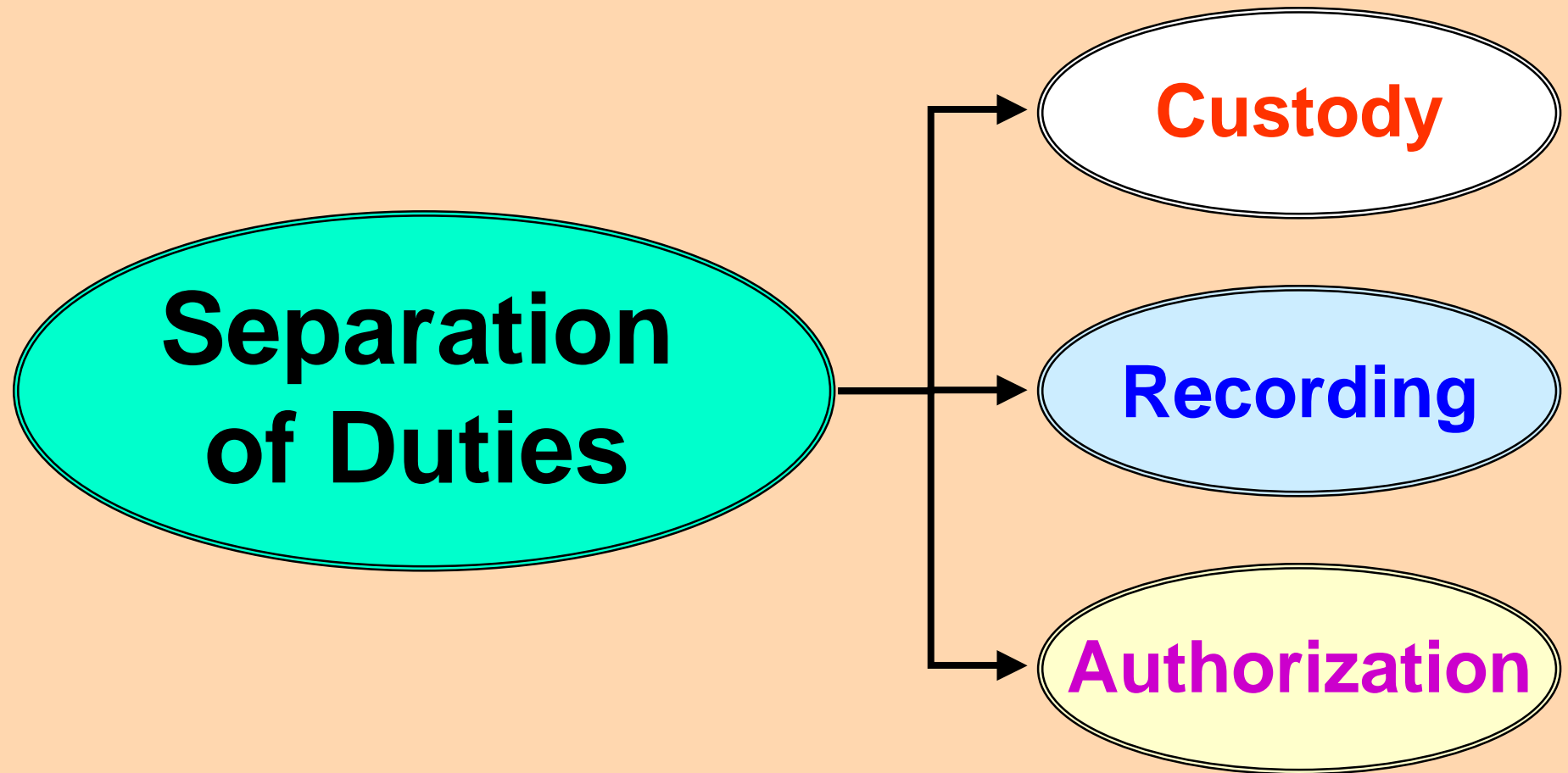
**Properly
account for
assets.**

**Safeguard
assets.**

**Ensure the
accuracy of
financial
records.**

Cash is the asset most susceptible to theft and fraud.

Internal Control of Cash



Internal Control of Cash

**Bank
Reconciliations**

**Daily
Deposits**

**Prenumbered
Checks**

**Cash
Controls**

**Payment
Approval**

**Check
Signatures**

**Purchase
Approval**

Bank Reconciliation

Explains the difference between cash reported on bank statement and cash balance on company's books.

Provides information for reconciling journal entries.

Bank Reconciliation

Balance per Bank

+ Deposits in Transit

- Outstanding Checks

± Bank Errors

= Adjusted Balance

Balance per Book

**+ Deposits by Bank
(credit memos)**

**- Service Charge
- NSF Checks**

± Book Errors

= Adjusted Balance

Bank Reconciliation

**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

= Adjusted 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		<u>\$ 7,207</u>

Bank Reconciliation

Ending bank balance, July 31		\$ 9,610
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Additions:

Deposit in transit		500
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Deductions:

Bank error	\$ 486	
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Outstanding checks	2,417	2,903
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Correct cash balance		<u>\$ 7,207</u>
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Ending book balance, July 31		\$ 7,430
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Additions:

Interest		30
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Deductions:

Recording error	\$ 28	
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NSF check	225	253
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Correct cash balance		<u>\$ 7,207</u>
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Bank Reconciliation

GENERAL JOURNAL

Page 56

Date		Description	Post. Ref.	Debit	Credit
Jul	31	Cash		30	
		Interest Revenue			30
	31	Supplies Inventory		28	
		Accounts Receivable		225	
		Cash			253

End of Chapter 6

