

CHAPTER 7-Sales revenue, Receivables and Cash

1. Types of Receivables

- **Accounts receivable (A/R) or trade accounts receivable**
 - Amounts owed by customers on account (in GL and sub ledger)
 - No interest
 - Usually the most significant type of claim held by a company.
 - Usually current
- **Notes receivable**
 - Formal instruments of credit issued as evidence of debt.
 - Normally require payment of interest
 - May be current or non-current assets depending on their due dates.
- **Other receivables**
 - Include credit card receivable, interest receivable, loans to company officers, advances to employees, and recoverable sales taxes and income taxes.

2. Sales revenues and A/R accounting

- Per accrual accounting i.e. revenue principle :
 - ◆ Merchandisers record A/R at point of sale (transfer of risks and benefits) of merchandise- according to FOB:
 - shipping point (sale is complete at departure)
 - destination point (sale is complete at arrival)
 - ◆ Service companies record A/R when a service is provided (% of completion method)

- **Sales are reported net of** : (to show **Net sales** on CIS)

- ◆ **Credit card charge** (amounts charged by CC issuers to seller)

<i>A/R from CC</i>	<i>1,000</i>	
<i>Sales</i>		<i>1,000</i>
<i>CC charge</i>	<i>30</i>	
<i>Payable to CC</i>		<i>30</i>

- ◆ **Sales or Cash discounts** (amounts awarded to customers for early payment i.e. 2/10,n/30)

<i>Cash</i>	<i>980</i>	
<i>Sales discount</i>	<i>20</i>	
<i>A/R</i>		<i>1,000</i>

- ◆ **Returns and allowances** (amounts for goods returns or for discount price)

<i>Returns (and allowances)</i>	<i>300</i>	
<i>A/R</i>		<i>300 (Selling price)</i>
<i>Inventory</i>	<i>200</i>	
<i>COGS</i>		<i>200 (cost)</i>

3 – Accounting for Bad /Doubtful Debts/Accounts/Receivables

- ◆ **Allowance method** (Credit losses are recorded at the end of period per matching principle) must be used (**direct write-off method** not accepted)
 - AJE: Bad debt expense (in selling expenses)
 - Allowance for Doubtful Accounts (contra account of A/R)
- ◆ A/R in SFP = Book value (**BV**)= Carrying value (**CV**)= Gross amount – allowance= **NRV** (net realizable value)

◆ One method to estimate bad debt expense or allowance : % or aging of A/R : determines the desired allowance (on SFP)

A Co. has \$200,000 A/R at year end. **Allowance** (per Aging method) is estimated at 5,5% of A/R (= \$11,000) = desired amount in SFP. Assuming an opening balance of **\$1,000 ct** in Allowance for Doubtful Accounts .

AJE is:

Dec. 31	Bad Debts Expense		10,000	
	Allowance for Doubtful Accounts	10,000		(11,000-1,000) so End balance of
	Allowance =	1,000		

◆ **Write-offs** (formal uncollectible accounts) should be formally approved in writing by authorized management personnel (per segregation: not by someone involved in recording A/R!)

Assume the vice-president of finance authorizes a write-off of a \$2,500 balance owed by T. Ebbet.

Allowance for Doubtful Accounts	2,500	
Accounts Receivable (T. Ebbet)		2,500

Note that this entry does not change CV, as A/R and Allowance accounts have been decreased by the same amount.

◆ **Recovery of an Uncollectible Account : IF (rare)** a write-off is recovered, two JE are required:

Assuming Ebbet later pays the \$2,500 balance that has been written off:

Accounts Receivable (T. Ebbet)	2,500	
Allowance for Doubtful Accounts		2,500
 Cash	 2,500	
Accounts Receivable (T. Ebbet)		2,500

5- Ratios:

Receivables turnover ratio= Net credit sales (net sales less cash sales if known) / Average gross A/R
= number of times receivables are collected during the year.

Average collection period = 365/ turnover ratio
= days to collect (should not greatly exceed the credit term period)

Gross profit ratio % / margin = Gross profit (Net sales-COGS)/ Net Sales

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4- Internal Control on A/R and Cash (and cash equivalents)

Examples: separation of duties (i.e. cash deposit and recording of receipt), credit approval, monitor age of A/R (calculate ratio), rotation of duties, internal and external audit, bank reconciliation (i.e. bank/cash balance per GL must equal bank/cash balance per statement)

BOOKS balance (date)	A	STATEMENT balance (same date)	B
+ unrecorded int earned		+ O/S deposits	
+ collections by bank		- O/S cheques	
- NSF			
- service charges			
+/- errors (by co)		+/- errors (by bank)	
Correct balance (JE to be recorded from A to C)	C	Correct balance	C

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