ACCT 100 - Intro to Acct.
Chapter 7 - Accounting for Sales, A/R, and Cash Receipts
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<u>Where we have been</u>: You have completed the full accounting cycle for a service-oriented firm.

<u>Where we are going</u>: We will now change our focus from a service-oriented firm to a merchandising enterprise. We will discuss some special accounts, journals, and other accounting transactions unique to merchandising operations.

<u>What is a merchandising Enterprise?</u>

A merchandiser is a company who buys goods and turns around and sells them in the same form. (That is, they don't make or manufacture the goods - they only sell them.) A merchandising entity has three basic parts to its operations: the selling side and the buying side relate to the sales process. The rest of it deals with other general and administrative functions. These will all be discussed in detail over the next few chapters. The Selling side involves the sales of merchandise, and the related collection of the cash which may be immediate (at the time of sale) or at a later date (when there are "terms" involved.)

Some new accounts to learn

The Revenue Side of the house

In the past, we have used revenue accounts like Income from Services or Concession Income. A merchandiser has one main source of income: **<u>Sales.</u>**

The **Sales** account is a revenue account. It has a credit balance like all normal revenue accounts. It is used to record the sales of merchandise.

The **Sales Tax Payable** is a liability account. It has a credit balance. It appears on the Balance Sheet. It records the sales tax charged to customers that must be remitted to the taxing authority.

The **Credit Card Expense** is an expense account. It has a debit balance. It appears on the income statement along with all of the other expenses. It records the fees charged by the credit card companies to the sellers.

We will also learn about two new contra accounts. (Remember those are the accounts that have balances contrary to their normal accounts.) There are two contra revenue accounts in this chapter.

- **Sales return and allowances -** Used to record the physical return of merchandise from our customers. This account also handles allowances, which are reductions for defective or damaged goods that the customer does not want to physically return. These returns and allowances are tracked because even a trend showing slight increases in these activities can affect a merchandiser. Because this is a contra-revenue, it has a debit balance. As you will see later, it will eventually wind up the amount of sales on the income statement. (Documents called "credit memos" are usually used to confirm that a seller will reduce the amount of the buyer's debt.)
- **Sales discounts -** To encourage quicker payments to assist us in our cash flow, we may offer discounts for fast payment. We may offer credit terms such as 1/10 net 30, which means that we are offering a 1% discount if the invoice amount is remitted within 10 days. Otherwise, the full amount is due in 30 days. We will discuss these more in the chapter on cash receipts and payments.

Transactions that you should be able to record:

- Sales for Cash and On Account
- Sales with tax for Cash and On Account
- Sales returns and Allowances -
- Different Types of Credit Sales
    - Open Account credit
    - Business Credit cards
    - Bank Credit cards
    - Non-bank credit cards

Because all of these are common transactions, we will discuss each one a bit more in detail. It's important that you understand the proper accounting and recording of each before we discuss how they are recorded in a special journal. For each transaction, let's assume we made a $1 sale and that the sales tax rate is 8%.

Cash Sales at the Counter

The customer would give us $1.08 for the sale. Of this amount, $1 is our revenue and .08 represent the sales tax. This would be recorded as follows:

Dr. Cash 1.08

Cr. Sales 1.00

Cr. Sales Tax Payable .08

Credit card sales at the counter - Bank Credit Cards

Do you know how credit cards work? You may know from having a credit card that there may be an annual fee for the card, and that you must pay interest on any outstanding balances not paid off. Did you also know that every time you use your credit card, the merchant is changed a percentage of every sale, including sales tax? This fee is recorded up front when the sales are made. Although the percentage varies among cards, we will assume a rate of 4% of the total transaction amount. The company gets the cash put into their account the same day. It is then up to the bank issuing the credit card to collect from the customers. The fee covers the cost of doing this. Look at the previous transaction. The credits will be the same. We still have $1 in revenue and we still owe .08 in tax. However, because our bank will deduct a fee up front, we cannot expect to get the 1.08 in our bank account. They take it off the top when credit card receipts are deposited. This journal entry would look:

Dr. Cash 1.04 (1.08 - fee (1.08x.04=. 04)

Dr. Credit Cd Fee Exp .04

Cr. Sales 1.00

Cr. Sales Tax Payable .08

Don't forget that the credit card fee is changed on the entire transaction amount including the tax.

Credit Card Sales using non-bank credit Cards

Since banks do not issue these cards, the company making the sales does not get instant cash placed in their bank accounts on the day of the sale. Instead the credit card company remits payment to the company. Because of this, the debit to cash placed to Accounts Receivable. The fees for these private company charges a fee of

6%. American Express, Discover, and Diner's club are the most commonly use private card. The same transaction above would be recorded as follows:

Dr. AR - Amer. Exp 1.08

Cr. Sales 1.00

Cr. Sales Tax Payable .08

When American Express remits the cash back to the company, you would:

Dr. Cash 1.02 (1.08 X 94% because cc company took 6%)

Dr. Credit Card Expense .06 (1.08 X 6%)

Cr. AR-American Ex 1.08

Payments on Account from Customers

Remember the journal entry form when the original sale on account was made? We

Dr. AR

Cr. Sales

When the cash comes in we:

Dr. Cash

Cr. AR

This is no different from the beginning chapters of the book.

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Other Sources of cash

There are various other reasons why cash may come in to a company. The owner may infuse more money into the firm. The bank may collect on a transaction turned over to them for collection. These types of transactions don�t happen on a daily basis, however the other ones described above happen many times over the course of a day.

More on Credit Terms

We previously discussed the meaning of 1/10 net 30 or 2/10 net 30 or net 30. We stated that some firms offer discounts for prompt payment. We will have to become more familiar with how these credit terms work, since we will focus on the receipt of cash in this chapter. Let's assume that we had made a sale on account to a customer for $200 on Jan 1. We offered then terms of 1/10 net 30. At the time of the sale, we recorded the following:

Dr AR 200

Cr. Sales 200

The customer sends in the check 7 days later. How much will it be for? It will be 200 less a discount of 1% or 2. The check will be for $198. How do you record this?

Dr. Cash 198

Dr. Sales Discount 2

Cr. AR 200

You must get the full amount of 200 off the books because the customer has paid its balance in full. DON'T FORGET THAT ANYTIME YOU TOUCH AR YOU MUST GO UPDATE THE CUSTOMER'S INDIVIDUAL ACCOUNT IN THE AR SUBSIDIARY LEDGER!

The Account Receivable (Subsidiary) Ledger

One more issue - tracking individual customer balances:

Accounts Receivable or AR can be a very large asset for a merchandiser, and it�s important to have a mechanism to track the individual balances at all times. To do this, we introduce the concept of an accounts receivable (subsidiary) ledger. Remember, the AR balance in the general ledger represents the **total amount** of money owed to us by our customer.

The subsidiary ledger tracks the **individual amount** owed by each individual customer. This AR subsidiary ledger can be compared to a notebook - one page for each customer showing all the activity that has happened to the individual account. The sum of all the individual balances in this notebook (the subsidiary ledger) should balance to the AR total amount in the general ledger after all postings are up to date. Because we need to keep track of these individual balances, it is important to update the subsidiary ledger every time a sale is made. This update will be shown by placing a checkmark in the post reference column of the journal.

Also, any time a customer returns something, we need to remember to update that customer′s account._

In other words, from here on out, EVERY TIME WE TOUCH AN A/R ACCOUNT WE NEED TO UPDATE THE INDIVIDUAL′S ACCOUNT IN THE AR SUBSIDIARY LEDGER!!!

The balancing act: The schedule of Accounts Receivable

You have probably figured out by now that almost everything we do in accounting has a balancing feature to it. This is not the exception. At the end of the month, the accountant takes all the ending balances from the individual customer accounts and lists them out by customer. The accountant then checks to make sure this total balances with the amount in the G/L. This insures that all posting have been done correctly.

We will demonstrate how the various transactions are recorded, how the postings are made, and how to reconcile the AR total to the subsidiary ledgers in class. The book shows this process.

Trade Discounts

A trade discount is an adjustment made to regular selling prices based on volume. It's a reduction of the list price. The "net price" is what the buyer pays after all discounts have been taken. The process for calculating the net price or invoice price is shown in your text.

Net Sales on the Income Statement

Net Sales is one of the first components that we will learn how to calculate on a multi-step income statement that will be discussed over the next few weeks. Net sales means sales after the contra accounts have been subtracted. (Just like Net pay means your pay AFTER the deductions have been taken out.) An example would be as follows:

ABC Company
Income Statement (Partial)
For the Month Ended 1-31-XX

Revenue:		
Sales		$10,000
Less Sales Returns & Allow	$500	
Sales Discounts	100	600
Net Sales		$ 9,400

We will also cover various return transactions in class.