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Notes – Topic 4

Sales, Revenue, and Credit

I. Sales Revenue
   a. Most revenues are recognized at the point of sale. Both earned and realized then.
   b. Sometimes not both criteria are met simultaneously.
      i. Cash received but nothing delivered yet.
      ii. DR Cash, CR Unearned Revenues
      iii. DR Unearned Revenues, CR Revenues as services are provided.
   c. Long-term sales contracts
      i. Ex: Four year contract to construct something.
      ii. Recognize revenue based on the percentage of the job estimated as completed.
   d. Returns and Allowances
      i. Refunds for returned items and discounts for various reasons after the sale (defective product, et cetera)
      ii. Use contra account "Sales Returns and Allowances"
      iii. Can still see gross sales, but can then net adjustments.
      iv. Found on the Income Statement
      v. Journalized as DR To "Returns and Allowances" and CR to "Accounts Receivable"
   e. Discounts
      i. Trade
         1. Money deducted from the price through negotiation
         2. Price concessions and purchase incentives
         3. Gross sales recognized as price *after* deducting the discount.
      ii. Cash
         1. Reductions awarded for prompt payments.
         2. Reduces the need for excess cash and reduces risk of bad debts.
         3. When should discounts be taken?
            a. When the "cost" of borrowing the money to pay promptly is less than the amount saved by doing so.
            b. $30,000 due 2 / 10, n / 60 (see below for credit terms)
            c. Borrowing rate = 10% per annum.
            d. $30,000 * 2% = $600
            e. $600 / $29,400 = 2.04%
               i. Return on investment = $600. The amount "earned" by "investing" the $29,400
               ii. Return on investment for the 50 days (60 – 10) is 2.04%
            f. 2.04% * (365 / 50) = 14.9% per annum.
            g. Return on investment is 14.9%, and money "costs" only 10%. Take the discount!
         4. Charge Slips
            a. Charge Slips are deposited in the bank like cash, but a transaction fee is applied.
            b. The complete transaction is: DR Cash, DR Cash Discounts for Bank Cards (contra to sales?), CR Sales

II. Credit Sales
   a. n / 30
      i. "Net 30"
      ii. Full amount due 30 days after the invoice date.
   b. 1 / 5, n / 30
      i. "One percent 5 net 30"
      ii. 1% discount from the invoice if paid in 5 days, otherwise due in 30.
   c. EOM

      i. “End of Month”
      ii. Due at the end of the month following the invoice date.
      iii. Received 9/18, due 9/30
   d. 15 EOM
      i. “15 End of Month”
      ii. Received 9/18, due 10/15.

III. Uncollectable Accounts
   a. Specific Write-Off
      i. Wait until you’re certain the accounts won’t be paid.
      ii. Not GAAP.
      iii. Only viable when very small amounts are in question (then opinions aren’t affected by missing information on the financial statements)
   b. Allowance Method
      i. Make an estimate based on historical records.
      ii. Allowance for Uncollectable Accounts
         1. Contra to Accounts Receivable
         2. Contains the estimate
      iii. DR Bad Debt Expense, CR Allowance for Doubtful accounts
      iv. To actually write-off the specific debt once it’s certain to go unpaid, DR Allowance for Doubtful Accounts, CR Accounts Receivable
   c. Two (and ½) Methods to Estimate
      i. Percentage of Sales
         1. Consider the percentage of total sales that have historically gone unpaid.
         2. To make the adjustment as described, apply the historical percentage to current Accounts Receivable.
         3. The amount calculated is posted to the allowance account directly, regardless of any balance already in the account.
      ii. Percentage of Accounts Receivable
         1. Average Bad Debt / Average Ending Accounts Receivable Balance
         2. Apply that percentage to the current Accounts Receivable
         3. Prepare adjusting entry
         4. The balance in the allowance account should be the amount calculated, so the adjustment must account for any existing balance.
      iii. Aging of Accounts Receivable Method
         1. Same technique as “Percentage of Accounts Receivable” method, except age composition of debt is considered.
         2. Essentially becomes a weighted average.