Revenue and receivables

In most businesses, what drives the balance sheet are sales and expenses. In other words, they cause the assets and liabilities in a business. One of the more complicated accounting items are the accounts receivable. As a hypothetical situation, imagine a business that offers all its customers a 30-day credit period, which is fairly common in transactions between businesses, (not transactions between a business and individual consumers).

An accounts receivable asset shows how much money customers who bought products on credit still owe the business. It's a promise of case that the business will receive. Basically, accounts receivable is the amount of uncollected sales revenue at the end of the accounting period. Cash does not increase until the business actually collects this money from its business customers. However, the amount of money in accounts receivable is included in the total sales revenue for that same period. The business did make the sales, even if it hasn't acquired all the money from the sales yet. Sales revenue, then isn't equal to the amount of cash that the business accumulated.

To get actual cash flow, the accountant must subtract the amount of credit sales not collected from the sales revenue in cash. Then add in the amount of cash that was collected for the credit sales that were made in the preceding reporting period. If the amount of credit sales a business made during the reporting period is greater than what was collected from customers, then the accounts receivable account increased over the period and the business has to subtract from net income that difference.

If the amount they collected during the reporting period is greater than the credit sales made, then the accounts receivable decreased over the reporting period, and the accountant needs to add to net income that difference between the receivables at the beginning of the reporting period and the receivables at the end of the same period.