

Sales Revenue

Sales Revenues

Financial Statements

Balance Sheet

Assets =
Liabilities +
Owners Equity

Income Statement

(Revenue)
Expenses
Net Income

Revenues

Definition: The amount of inflowing assets (usually cash or accounts receivable) from the sale of goods or services to customers. This amount is the product's sales price or the service fee charged to the customer.

Timing: Revenues are to be recognized by the company and reported on the income statement when a **PERFOMANCE OBLIGATION** has been satisfied.

Performance Obligation: A contract to provide a product or service to a customer.

Journal Entry

When the performance obligation has been satisfied:

Cash or Accounts Receivable or Deferred Revenue	XXX	
Sales Revenue		XXX

Journal Entry

Cash received in advance for a performance obligation not completed:

Cash	XXX	
Deferred Revenue (liability account)		XXX

Once the performance obligation is completed (revenue now recognized):

Deferred Revenue (liability account)	XXX	
Sales Revenues		XXX

Complicating Revenue Transactions

1. The providing of sales or cash discounts to our credit customers to encourage early payment on account.
2. The acceptance of merchandise returns from our customers.
3. The uncollectibility of customer accounts receivable.

Sales Revenue

Example of Sales (Cash) Discount

A company sells merchandise costing \$600 to a customer on account for \$1,000 with terms of 2/10, N/30.

2/10, N/30 means that the customer may take a 2% discount off all or any portion of the sales price paid within 10 days of the sale. Any portion of the price not paid within the 10 day discount period is due within the next 20 days (30 days from date of sale) in full.

Entries if not paid within the discount period:

At date of sale:	Accounts Receivable Sales Revenues	1,000	1,000
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At date of collection:	Cash Accounts Receivable	1,000	1,000
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Problem: Sales Discount

The company sells some inventory with the terms 1/15 N/45. What does this mean?

- A. The customer can take a 15% discount on the sales price if the account is paid within 1 day of the sale. The balance of the account is due within 45 days
- B. The customer can take a 1% discount on the sales price if the account is paid within 45 days. A 15% penalty will be applied to the outstanding balance after 45 days.
- C. The customer can take a 1% discount on the sales price if the account is paid within 15 days. The balance is due in 45 days.
- D. The customer must pay a penalty of 1% if the account is not paid within 15 days

Example of Sales (Cash) Discount

A company sells merchandise costing \$600 to a customer on account for \$1,000 with terms of 2/10, N/30.

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At date of sale:

Accounts Receivable Sales Revenues	1,000	1,000
Cost of Goods Sold Inventory	600	600

At date of collection WITHIN 10 days:

Cash Sales Discounts	980 (1,000 x .98) 20	1,000
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A contra-revenue account is a reduction of a revenue account.

Sales Revenues		Sales Discounts	
Decrease	Increase	Increase	Decrease
—	+	+	—
Assets		DR	CR
Liabilities		+	—
Owners' Equity:		—	+
Capital Stock		—	+
Retained Earnings		—	+
Revenues		—	+
Expenses		+	—
Dividends		+	—
Sales Discounts		+	—

Income Statement Presentation:

Sales Revenues	\$ 1,000
Less: Sales Discounts	(20)
Net Sales Revenues	\$ 980

Net Sales Revenue: Gross sales revenue less any contra revenues, which are reductions in revenues

Is Sales Discount a Real or Nominal Account?

Nominal

Closing Entry:

Retained Earnings	XXX
Sales Discount	XXX

Why are we using a Sales Discount account rather than just reducing sales revenues directly?

To provide better information for management

Sales Revenue

Merchandise or sales returns Example

A company sells a couch to a customer on account for \$800. The cost of the couch to the company is \$450.

Entry at the date of sale:

Accounts Receivable	800	800
Sales Revenues		
Cost of Goods Sold	450	
Inventory		450

Entry at the date of return:

Sales returns and allowances	800	800
Accounts Receivable		
Inventory	450	
Cost of Goods Sold		450

What kind of account is Sales Returns and Allowances?

Contra-Revenue

Is it a Real or Nominal Account?

Nominal

Why are we using Sales Returns and allowances, a contra-revenue account, rather than debiting Sales Revenues directly?

Better information for management

Problem: Sales Discount and Returns

On April 3, 20X7, Smith, Inc. sold merchandise to Taylor Stores for \$100,000 with terms 2/10, n/30. On April 13, Taylor paid one half of the obligation to Smith, paying \$49,000 net of the discount. On May 2, Taylor paid \$34,000 on account and returned \$16,000 of merchandise, claiming that it did not meet contract terms for which Smith agreed to give full credit on account. Assume this returned inventory can be resold. The cost of the inventory sold was 70% of the sales price.

- A. Record the necessary journal entries on Smith's books for the April 3, April 13, and May 2 transactions.
- B. Why is it important to have separate accounts for Sales Returns and Allowances and Sales Discounts? Wouldn't it be much easier to directly reduce (debit) the Sales Revenue account for these adjustments?

Solution: Sales Discount and Returns

4/3/X7	Accounts Receivable	100,000	100,000
	Sales Revenue	70,000	
	Cost of Goods Sold		70,000
	Inventory (70% x 100,000)		
4/13/X7	Cash (98% X \$50,000)	49,000	
	Sales Discount (2% x \$50,000)	1,000	
	Accounts Receivable		50,000
5/2/X7	Cash	34,000	34,000
	Accounts Receivable	16,000	
	Sales Returns and Allowances		16,000
	Accounts Receivable		
	Inventory (70% x 16,000)	11,200	
	Cost of Goods Sold		11,200

B. It would be an easy and accurate representation of the economic effect of these transactions to simply debit sales revenues. However, the use of these contra revenue accounts quickly distinguishes information useful to management.

Damaged Goods Merchandise Returns

A company sells a couch to a customer on account for \$800. The cost of the couch to the company is \$450.

Entry at the date of sale:

Accounts Receivable	800	800	
Sales Revenues			
Cost of Goods Sold	450		250
Inventory		450	

Cost of Goods Sold

450	250
END 200	

Entry at the date of return:

Sales returns and allowances	800	800	
Accounts Receivable			
Inventory	250		250
Cost of Goods Sold		250	

To record a Sale on Account

Accounts Receivable	XXX
Sales Revenue	XXX

Bad Debt

Balance Sheet
Accounts Receivable

Income Statement
Sales Revenue

Accounting for Uncollectible

To record a Sale on Account

Accounts Receivable	XXX	
Sales Revenue		XXX

Bad Debt

Balance Sheet

Accounts Receivable

Income Statement

Sales Revenue

- Should the amount of bad debt be estimated and reported as an expense in the **year of the sale** or recorded **later** when the actual bad debt is identified as uncollectable?

- Accrual accounting requires revenues are recorded in the period they are earned and not when cash is collected. In addition all expenses associated with generating the revenue must be reported in the same income statement.

To record an estimate of bad debt expense

Bad Debt Expense	XXX	
Allowance for Bad Debt		XXX

Balance Sheet

Accounts Receivable

Income Statement

Sales Revenue
(Bad Debt Expense)

(Allowance for Bad Debt)

Net Accounts Receivable

Allowance for Bad Debt: A contra asset account

Is Allowance for Bad Debt a Real or Nominal Account?

Real

This account does not close out each period, it has a cumulative running balance.

Does Allowance for Bad Debt have a debit or credit balance?

Credit

Allowance for Bad Debts
Decrease Increase

—

+

To record a sale on account (in the month of **January**)

Accounts Receivable	XXX	
Sales Revenue		XXX

To record an estimate of bad debt expense (in the month of **January**)

Bad debt expense	XXX	
Allowance for bad debt		XXX

To write-off an uncollectible account (when the debt actually goes bad)

Allowance for bad debt	XXX	
Accounts receivable		XXX

To record a Sale on Account

Accounts Receivable	XXX	
Sales Revenue		XXX

Bad Debt

Balance Sheet

Accounts Receivable

Income Statement

Sales Revenue

Accounting for Uncollectible

Accounts receivable		Allowance for bad debt		Bad Debt Expense	
Beg Bal	Credit Sales		Write-off	Beg Bal	Bad Debt Exp
Beg Bal	Collections Write-off		Write-off	End Bal	End Bal

Balance Sheet
Accounts receivable
(Allowance for bad debt)
Net accounts receivable

Income Statement
Sales revenue
(Bad debt expense)

Problem: Uncollectible Receivables

Ava is a consulting company who makes all sales on account. The following data relates to 20X1:

- Accounts receivable beginning balance \$15,000
- Allowance for doubtful accounts beginning balance \$7,000
- Credit Sales of \$340,000 during the year 20X1
- \$310,000 collected in cash during the year 20X1
- \$6,000 was written off as uncollectible during 20X1
- Bad debt expense was estimated to be \$10,000 for 20X1

Provide the journal entries for 20X1

Walkthrough: Uncollectible Receivables					
Accounts receivable		Allowance for bad debt		Bad Debt Expense	
15,000			7,000		
340,000	310,000		10,000		
6,000			10,000		
39,000		6,000	11,000	10,000	

Balance Sheet
Accounts receivable \$39,000
(Allowance for bad debt) (11,000)
Net accounts receivable \$28,000

Income Statement
Sales revenue \$340,000
(Bad debt expense) (10,000)

Estimate Bad Debt

To record an estimate of bad debts:

Bad debt expense	XXX	
Allowance for bad debt		XXX

2 Approaches to estimate the amount of bad debts

- **Income statement approach**
 - Percentage of credit sales
 - Direct method
- **Balance sheet approach**
 - Percentage or aging of accounts receivable
 - Indirect method (indirectly solve for Bad Debt Expense)

Income Statement Approach

Percentage-of-Sales
(direct method)

Using this method, management will look to an income statement account (**credit sales**) to directly estimate another income statement account (**bad debt expense**). This is referred to as the direct method because bad debt expense is directly calculated as a percentage of credit sales. This percentage is determined by looking at past experiences of the company or other businesses in the same industry to determine what **credit sales** have historically been uncollectible. This information is then used to estimate what percentage of the current credit sales will be uncollectible.

Problem: % of Credit Sales 1

Ava is a consulting company who makes all sales on account. The following data relates to 20X1:

- Accounts receivable beginning balance \$15,000
- Allowance for doubtful accounts beginning balance \$7,000
- Sales of \$340,000 during the year 20X1
- \$310,000 collected in cash during the year 20X1
- \$6,000 was written off as uncollectible during 20X1
- 3% of credit sales are estimated to be uncollectible

Provide the journal entry to record bad debt expense

Accounting for Uncollectible

Accounts receivable	Allowance for bad debt	Bad Debt Expense
15,000	7,000	
340,000	10,200	
6,000	6,000	10,200
39,000	11,200	10,200

Balance Sheet
 Accounts receivable \$39,000
 (Allowance for bad debt) **(11,200)**
 Net accounts receivable \$27,800

Income Statement
 Sales revenue \$340,000
 (Bad debt expense **10,200**)

Balance Sheet Approach

Percentage or Aging of Accounts Receivable
 (indirect method)

Using this method, management will look to a balance sheet account (**accounts receivable**) to estimate another balance sheet account (**allowance for bad debt**) which will indirectly determine bad debt expense. This estimate is determined by looking at past experiences of the company or other businesses in the same industry to calculate what percentage of accounts receivable has been historically uncollectible. This information is then used to estimate what percentage of the current **accounts receivable** will be uncollectible.

Balance Sheet Approach

Percentage or Aging of Accounts Receivable
 (indirect method)

This accounts receivable percentage approach can be applied in one of two ways.

1. The percentage can be applied to the entire accounts receivable balance
2. The total accounts receivable balance can be broken down into smaller balances (or categories) based upon how long the receivable has been outstanding. This is referred to as an aging of accounts receivable. Separate percentages for each category can be applied.

Accounts receivable
15,000
340,000
6,000

$$39,000 \downarrow \\ 39,000 \times 28\% = \$10,920$$

1. Percentage of accounts receivable:
 A single percentage applied to the total balance

Accounts receivable
15,000
340,000
6,000

1. Percentage of accounts receivable:
 A single percentage applied to the total balance
2. Aging of accounts receivable:
 Different percentages applied to the individual categories

Accounts Receivable Aging Schedule

	Overall	Less than 30 days	30 days to 60 days	61 days to 90 days	Over 90 days
Total	39,000	18,000	8,000	75,000	5,500
% Uncollectible		5%	20%	35%	90%

Problem: % of Credit Sales 2

Ava is a consulting company who makes all sales on account. The following data relates to 20X1:

- Accounts receivable beginning balance \$15,000
- Allowance for doubtful accounts beginning balance \$7,000
- Sales of \$340,000 during the year 20X1
- \$310,000 collected in cash during the year 20X1
- \$6,000 was written off as uncollectible during 20X1
- 28% of accounts receivable are estimated to be uncollectible

Provide the journal entry to record bad debt expense

Accounting for Uncollectible

Solution: % of Credit Sales 2

Accounts receivable	Allowance for bad debt	Bad Debt Expense
15,000	7,000	
340,000	9,920	
6,000		9,920
39,000	\$10,920	9,920

Balance Sheet
 Accounts receivable \$39,000
 (Allowance for bad debt) **(10,920)**
 Net accounts receivable \$28,080

Income Statement
 Sales revenue \$340,000
 (Bad debt expense) **(9,920)**

Assume the same information except Ava company has decided to use an aging schedule to determine the amount of accounts receivable that will ultimately be uncollectible.

Accounts Receivable Aging Schedule

	Overall	Less than 30 days	30 days to 60 days	61 days to 90 days	Over 90 days
Total	39,000	18,000	8,000	7,500	5,500
% Uncollectible		5%	20%	35%	90%
	10,075	900	1,600	2,625	4,950

Accounts receivable	Allowance for bad debt	Bad Debt Expense
15,000	7,000	
340,000	9,075	
6,000		9,075
39,000	\$10,075	9,075

Balance Sheet
 Accounts receivable \$39,000
 (Allowance for bad debt) **(10,075)**
 Net accounts receivable \$28,925

Income Statement
 Sales revenue \$340,000
 (Bad debt expense) **(9,075)**

	Income Statement Approach	Balance Sheet Approach	Balance Sheet Approach
	% of credit sales	% of accounts receivable	Aging of accounts receivable
BALANCE SHEET			
Accounts receivable	\$39,000	\$39,000	\$39,000
Allowance for bad debts	(11,200)	(10,920)	(10,075)
Net accounts receivable	27,800	28,080	28,925
INCOME STATEMENT			
Sales	\$340,000	\$340,000	\$340,000
Bad debt expense	(10,200)	(9,920)	(9,075)

Reviewing the Estimate

Allowance for bad debt	
	Beg balance
	3,000
7,000	
	End balance
ACTUAL	ESTIMATE

	Income Statement Approach	Balance Sheet Approach	Balance Sheet Approach
	% of credit sales	% of accounts receivable	Aging of accounts receivable
BALANCE SHEET			
Accounts receivable	\$39,000	\$39,000	\$39,000
Allowance for bad debts	(11,200)	(10,920)	(10,075)
Net accounts receivable	27,800	28,080	28,925
INCOME STATEMENT			
Sales	\$340,000	\$340,000	\$340,000
Bad debt expense	10,200	9,920	9,075

Which method is correct?

Accounting for Uncollectible

Solution: Uncollectible Account

Identify which of the following statements are true:

- A. The "Allowance for Uncollectible Accounts Receivable" account will always have a credit balance at year end following any adjustment for uncollectible accounts receivable.

TRUE

Allowance for bad debt	
	10,000 Beg Bal
12,000	
	14,000
	2,000 End Bal

Solution: Uncollectible Account

Identify which of the following statements are true:

- C. The ending balance in Allowance for Bad Debt will always equal the amount of "Bad Debt Expense" for the year.

FALSE

Accounts receivable	Allowance for bad debt	Bad Debt Expense
Beg balance	Beg balance	
Credit sales	Bad debt expense	Bad debt expense
Collections Write-off's	Write-off's	
End balance	End balance	

Problem: Estimated Bad Debt

- Beginning Accounts Receivable= \$350,000
- Beginning Allowance for Bad Debts = \$50,000
- Write-offs during the year = \$42,000
- Cash Collections for Accounts Receivable during the year = \$845,000
- Sales during the year = 920,000. 95% of the sales were credit sales, the remaining 5% were cash sales.

- If C&C uses the % of Credit Sales method and estimates 5% of their Sales will prove to be uncollectible, what is the adjusting journal entry and what is Net Accounts Receivable?
- If C&C uses the data analysis below for the aging of accounts receivable to determine what amount will prove to be uncollectible, what is the adjusting journal entry?

Hint: Estimated Bad Debt

- If C&C uses the % of Credit Sales method and estimates 5% of their Sales will prove to be uncollectible, what is the adjusting journal entry and what is Net Accounts Receivable?

Accounts receivable	Allowance for bad debt	Bad Debt Expense
Beg balance	Beg balance	
Credit sales	Bad debt expense	Bad debt expense
Collections Write-off's	Write-off's	
End balance	End balance	

Accounts Receivable
(Allowance for Bad Debt)
Net Accounts Receivable

Walkthrough: Estimated Bad Debt

Solution-Credit Sales Method

Accounts receivable		Allowance for bad debt		Bad Debt Expense	
Beg balance	350,000		50,000 Beg balance		
Credit sales *	874,000	845,000 Collections	43,700	**43,700	
Credit sales *	874,000	845,000 Collections	42,000 Write-off's	42,000	
End balance	337,000		51,700***		

*Credit Sales: \$920,000 X 95% = \$874,000

**Bad Debt Expense: \$874,000 X 5% = \$43,700

***Ending A/R: 50,000 +43,700 - 42,000 = 51,700

Journal Entry

Bad Debt Expense	\$43,700	
Allowance for bad debt		\$43,700

Balance Sheet Reporting
Accounts Rec \$337,000
(Allowance) (\$51,700)
Net A/R \$285,300

Walkthrough: Estimated Bad Debt

- If C&C uses the data analysis below for the aging of accounts receivable to determine what amount will prove to be uncollectible, what is the adjusting journal entry?

	Overall	Less than 30 days	30 days to 60 days	61 days to 90 days	Over 90 days
Total	\$337,000	\$150,000	\$100,000	\$57,000	\$30,000
% Uncollectible		2%	10%	30%	80%

Accounting for Uncollectible

Walkthrough: Estimated Bad Debt

Solution-Aging A/R Method

Accounts receivable	Allowance for bad debt	Bad Debt Expense
Beg balance 350,000	50,000 Beg balance	
Credit sales * 874,000	42,000 Write-off's	???
End balance 337,000	???	

*Credit Sales: \$920,000 X 95% = \$874,000

Walkthrough: Estimated Bad Debt

2. If C&C uses the data analysis below for the **aging of accounts receivable** to determine what amount will prove to be uncollectible, what is the adjusting journal entry?

	Overall	Less than 30 days	30 days to 60 days	61 days to 90 days	Over 90 days
Total	\$337,000	\$150,000	\$100,000	\$57,000	\$57,000
% Uncollectible		2%	10%	30%	80%
		3,000	10,000	17,100	24,000

= \$54,100

Walkthrough: Estimated Bad Debt

Solution-Aging A/R Method

Accounts receivable	Allowance for bad debt	Bad Debt Expense
Beg balance 350,000	50,000 Beg balance	
Credit sales * 874,000	42,000 Write-off's	46,100
End balance 337,000	54,100**	

*Credit Sales: \$920,000 X 95% = \$874,000

**Ending A/R: (\$150,000 X 2%) + (\$100,000 X 10%) + (\$57,00 X 30%) + (\$30,000 X 80%)

***Bad Debt Expense: \$50,000 + ??? - \$42,000 = \$54,100 Solve for ???

Journal Entry

Bad Debt Expense	\$46,100	
Allowance for bad debt		\$46,100

Balance Sheet Reporting	
Accounts Rec	\$337,000
(Allowance)	(54,100)
Net A/R	\$282,900