

Chapter 7 • Accounting for Sales, Accounts Receivable, and Cash Receipts

TEACHING OBJECTIVES

- 7-1) Record sales on account, credit card sales, sales returns, and cash receipt transactions in a general journal.
- 7-2) Compute trade discounts.
- 7-3) Compute and record cash discounts on sales.
- 7-4) Post from the general journal to the general ledger accounts and to the subsidiary ledger.
- 7-5) Prepare a schedule of accounts receivable.
- 7-6) Record the payment of sales taxes.

SECTIONS

- 1. Understanding Merchandising Companies
- 2. Special Topics in Merchandising

CHAPTER OVERVIEW/ LEARNING OBJECTIVES

Learning Link: Chapter 6 explained the closing process and post-closing trial balance. Chapter 7 explains the accounting processes for retail and wholesale sales.

- 7-1. This chapter illustrates how to record sales on account, credit card sales, sales returns and cash receipt transactions in a general journal.
 - a. The *Sales* account is a new revenue account that is used by retailers who sell a product.
 - b. The chapter introduces the contra revenue account--*Sales Returns and Allowances* account. It explains that customer returns are debited to this account instead of the *Sales* account.
 - c. The chapter discusses the posting procedures required for sales returns and allowances.
 - d. It explains that the balance of the *Sales Returns and Allowances* account is subtracted from the balance of the *Sales* account on the income statement.
- 7-2. The chapter discusses how to compute a trade discount given to a customer on a sale.
- 7-3. This chapter also discusses how to calculate and record cash discounts on sales.
- 7-4. The steps to post from the general journal to the general ledger and to the subsidiary ledger accounts are explained.

- 7-5. The chapter reviews the steps required to prepare a schedule of accounts receivable based on the *Accounts Receivable Subsidiary Ledger*.
- 7-6. This chapter discusses how to record the payment of sales taxes. In states and cities that have a sales tax, the retailer must prepare a sales tax return and send the total tax collected to the taxing authority. A typical sales tax form is explained and the journal entry required to submit the tax monies collected is explained.

At the beginning of the chapter, there is a short paragraph about *Kellogg's*. Let's read this together. . .



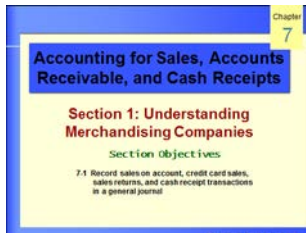
Ask. . . "What are important factors related to Accounts Receivable that Kellogg's must consider?"

Answer--Students should recognize that policies of strong customer service and attention to detail are important.

FAST FACTS:

- More than 100 years ago, Kellogg's created the first breakfast cereal.
- Other brands include Keebler, Cheez-Its and Townhouse.
- In the first quarter of 2013, net sales were 3.913 Billion and Accounts Receivable was 1.6 Billion.
- Keeping track of all the various product sales, as well as all of the store's Accounts Receivable's balances and details can be a major chore for even the best accountants.

Section 1. UNDERSTANDING MERCHANDISING COMPANIES



Accounts of a Merchandising Companies

Name of Accounts	Type of Account	Normal Balance	Used to Record:
Sales	Revenue	CR	Sales of merchandise inventory
Sales Tax Payable	Liability	CR	Sales tax charged to customers
Sales Discounts	Contra revenue	DR	Early payment discounts given to buyer by seller
Sales Returns and Allowances	Contra revenue	DR	Products returned by buyer on the seller's books
Credit Card Expense	Expense	DR	Fees charged by credit card companies to seller

- Explain that in previous chapters we have examined the journal entries required for a service business. This chapter introduces transactions for a merchandising business.
- Explain the three types of businesses:
 1. Service business- which sells services.
 2. Merchandising business or retail business - which sells goods that it purchases for resale.
 3. Manufacturing business- which sells goods that it produces or makes.
- Point out that there will be several new accounts introduced in this chapter including:

Sales—our new revenue account

Sales Tax Payable—a new liability account.

Sales Returns and Allowances—a new contra-revenue account.

Sales Discount—a new contra-revenue account.

Credit Card Expense—our new expense account.

- In this section, we learn to record transactions for a retailer. We will use a general journal to record transactions and later we will learn to post transactions from the general journal to the general ledger and the subsidiary ledger.

- Explain that the **Sales** account is the revenue account used by retailers to record sales of merchandise. (We will not be using Fees Income as we did in previous chapters.)
- Emphasize that a retail business requires an accounting system to account for merchandise inventory that is purchased, that has been sold, and that is on hand at any time during the accounting cycle.

Objective 7-1 Recording Sales for Cash and On Account.

The journal entry to record a sale of \$500 for cash on January 2

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
2018				
Jan. 2	Cash		500.00	
	Sales			500.00
	Record cash sales			

Recording Sales for Cash and On Account

On January 3, Maxx-Out Sporting Goods sold merchandise on credit to Roy Anderson, issuing Sales Slip 1101 for \$400. The journal entry to record the sale

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
2018				
Jan. 3	Accounts Receivable		400.00	
	Sales			400.00
	Sold merchandise on credit to Roy Anderson, Sales Slip 1101			

Recording Sales for Cash and On Account

The journal entry records Roy Anderson's payment of the amount due on January 31.

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
2018				
Jan. 31	Cash		400.00	
	Accounts Receivable			400.00
	Received cash from Roy Anderson on account			

Recording Sales with Sales Tax Payable for Cash and On Account

The journal entry to record a sale of \$500 plus tax for cash follows.

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
2018				
Jan. 2	Cash		545.00	
	Sales			500.00
	Sales Tax Payable			45.00
	Record cash sales			

Recording Sales with Sales Tax Payable for Cash and On Account

The journal entry to record the sale of merchandise on credit.

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
2018				
Jan. 3	Accounts Receivable		545.00	
	Sales Tax Payable			45.00
	Sales			500.00
	Sold merchandise on credit to Roy Anderson, Sales Slip 1101			

Sales Slip

Maxx-Out Sporting Goods

2007 Frederick Lane
 10000
 2/10/18
 2 items

Customer Name: _____
 Salesperson: _____

Net Total: 400.00
 Tax: 45.00
 Total: 445.00

Authorized Signature: _____
 Signature: _____
 SALES SLIP 1102

Objective 1

◆ **Recording Sales**

- The Sales account is the primary revenue account for a merchandising company.
- Review the general journal entries of Maxx-Out Sporting Goods provided in the text.

◆ **Recording Sales with Sales Tax Payable for Cash and on Account:**

- Review the general journal entries in Figure 7-1 which are required to record sales on account and also the collection of sales tax.
- Review the Sales Slip of Maxx-Out Sporting Goods

◆ **Sales Return and Allowances**

- Explain that when a customer returns a product the business makes an opposite entry of that of a sale, but instead of debiting the Sales account, we debit the *Sales Returns and Allowances* account.

- Point out that the *Sales Returns and Allowances* account is a **contra-revenue** account that keeps track of all customer returns.
- It is a *temporary* account that is closed at the end of the accounting period.
- Remind students that it would appear on the Income Statement as a subtraction from the Sales account.

Recording Sales Returns and Sales Allowances

If something is wrong with the goods sold, the firm may

- take a **sales return**, or
- give a **sales allowance**.

A cash refund is given in the case of a cash sale
 A **credit memorandum** is given in the case of a credit sale

$$\begin{aligned} &\text{Sales} \\ &\underline{- \text{Sales Returns and Allowances}} \\ &= \text{Net Sales} \end{aligned}$$

The Sales Returns and Allowances account is debited to record returns and allowances.

Sales Returns and Allowances

Returns and Allowances

Cash Refund

The journal entry to record a cash refund.

GENERAL JOURNAL					PAGE	7
DATE	DESCRIPTION	DEBIT	CREDIT			
1 Jan.	Sales Returns and Allowances	1,000.00				
	Sales Tax Payable	8.00				
	Cash		1,008.00			
	Refund to customer for returned merchandise and sales tax paid					

Credit Memorandum

Maxx-Out Sporting Goods CREDIT MEMORANDUM NO. 101

2007 Transboro Lane, Dallas, TX 75288-0847
 972-251-1100 (Mo., Tu., We., Th., Fr.)
 972-251-1101 (Sat., Sun.)

DATE: January 25, 2016
 TO: *Wright, Set* AMOUNT: \$400.00

NAME: *Alan Job*
 ADDRESS: 7227 Blossom Ridge, Springdale, AR 72762

REASON FOR RETURN: *RETURNED* () *REFUSED* () *OTHER* ()
 THE TOTAL AMOUNT OF THE RETURN WILL BE CREDITED TO THE CUSTOMER'S ACCOUNT. TOTAL: \$400.00

CUSTOMER SIGNATURE: _____

- ◆ **Recording Sales Returns and Sales Allowances**
 - Explain what a credit memorandum is and state that credit memorandum documents the reduction in the customer's account balance by the amount of the return or allowance.
 - The sales tax paid on the goods returned will also be credited to the customer's account.
 - Review the credit memorandum and general journal entry in Figure 7.2 that records the refund to the customer for returned merchandise and sales tax paid.

Sales Allowance

Sales Returns and Allowances	Sales Tax Payable	Accounts Receivable
200	16	216

- ◆ **Credit Policies**
 - The use of credit is considered to be one of the most important factors in the rapid growth of businesses today.



Ask, "Why do stores grant credit to customers?" **Stores grant credit to make it easier for customers to purchase goods.**

- Challenge your students to hypothesize about factors that may impact credit limits authorized to different individuals.

◆ Accounting for Different Types of Credit Sales

Explain that the four most common types of credit cards are:

- open-account credit
- business credit cards
- bank credit cards (*Visa, MasterCard*)
 - Point out that the same accounts are affected by a *bank card sale* as a *cash sale*. Explain that the banks that issued the card pay the business directly, which means that the business receives its money soon after it deposits the bank credit card sales slips.
- credit card companies or non-bank credit cards (*American Express, Diners Club*)
 - Point out that a *receivable* is set up due from the credit card company.

◆ Accounting for Credit Card Sales

Remind students that *Accounts Receivable* is debited when a customer uses a non-bank credit card like *American Express* or *Diners Club* to purchase merchandise.

Advantages of Credit Sales

The volume of both sales and profits will increase, if buyers are given a period of a month or more to pay for the goods or services they purchase.

Disadvantages of Credit Sales

- Sales on credit will lead to increases in profit only if each customer completes the transaction by paying for the goods or services purchased.
- If payment is not received, the expected profits become actual losses and the purpose for granting the credit is defeated.
- Therefore businesses need to closely analyze a customer's ability to pay before granting credit.

Credit Policies

Each business must develop well-balanced credit policies:

- Tight credit policies results in a low level of losses.
- Lenient credit policies may result in increased sales volume with a high level of losses.

Types of Credit Sales

- Open-account credit
- Business credit cards
- Bank credit cards
- Cards issued by credit card companies

Open-account credit

Open-account credit sales and business credit card sales are accounted for as sales on credit.

Accounting for Credit Card Sales

- Sales made to customers using bank credit cards, such as MasterCard and VISA are treated as cash sales.
- The processing fees charged by the credit card company are debited to the *Credit Card Expense* account.

Max-Out Sporting Goods sells merchandise on January 15 totaling \$900 to customers using bank credit cards, plus 8 percent sales tax. The bank credit card company charges a 3 percent discount fee.

Merchandise sale	\$900.00
Plus sales tax (\$900.00 × 8%)	72.00
	\$972.00
Less: bank fee (\$972.00 × 3%)	-29.16
Debit to Cash	\$942.84

Credit Card Transactions

Journal entry to record the sales made to customers using bank credit cards on January 15.

DATE	DESCRIPTION	POST	DEBIT	CREDIT
1/15/2018	Cash		942.84	
	Credit Card Expense			29.16
	Sales			900.00
	Sales Tax Payable			72.00
	Record sales to customers using bank credit cards			

Credit Card Companies

- Sales to customers using nonbank credit cards such as American Express and Diners Club are accounted for as sales on account.
- Nonbank credit cards usually take a few days to pay the seller.
- The amount remitted to the seller is net of the discount fee.

- Max-Out Sporting Goods sells merchandise on January 16 totaling \$1,000 to customers paying with American Express, plus 8 percent sales tax.
- American Express charges a 7 percent discount fee.
- The discount withheld by American Express would be \$75.60 (\$1,000.00 × 7%).

American Express Charges and Payments

Journal entry to record the sales on January 16 and the subsequent payment on January 23 by American Express

DATE	DESCRIPTION	POST	DEBIT	CREDIT
1/16/2018	Accounts Receivable		1,000.00	
	Sales			1,000.00
	Sales Tax Payable			80.00
	Record sales to customers using American Express			
1/23/2018	Cash		924.40	
	Accounts Receivable			1,000.00
	Record payment received from American Express			

Accounting for Sales, Accounts Receivable, and Cash Receipts

Section 2: Special Topics in Merchandising

Section Objectives

- 17.2. Compute trade discounts.
- 17.3. Compute and record cash discounts on sales.
- 17.4. Post from the general journal to the general ledger accounts and to the subsidiary ledger.
- 17.5. Prepare a schedule of accounts receivable.
- 17.6. Record the payment of sales taxes.

Objective 17-2 Computing Trade Discounts.

The basic procedures used by wholesalers to handle sales and accounts receivable are the same as those used by retailers.

However, many wholesalers offer

- Cash discounts
- Trade discounts

- Point out that the credit card company will charge a fee for processing these sales
- When payment is received from the credit card company, the fee charged will be debited to an account called *Credit Card Expense*.
- **TEACHING TIP** -Write three general journal entries to record credit sales on the board. (Dr. Accts Rec. and Cr. Sales)

Post each entry to the general ledger T accounts involved.

Section 2. SPECIAL TOPICS IN MERCHANDISING

Objective 2

◆ Compute trade discounts

- Explain that the trade/cash discount is a discount based on the volume purchased at less than retail price.
- Also explain that the business might offer goods to different customers at different trade discounts.

A 40% trade discount would mean (\$1,000 × 40%) or \$400 discount in the invoice price.

Objective 3

◆ Compute and record cash discounts on sales.

- Explain that many business offer cash discounts to customers who



Ask, "How about *Visa* or *MasterCard Co*? How do they keep track of customer charges and payments?" **Account numbers track customer activity.**

The Accounts Receivable Ledger					
NAME: Ann Ann					
ADDRESS: 7517 Woodbine Wilson Lane, Dallas, Texas 75267-6205					
DATE	DESCRIPTION	DEBIT	CREDIT	BALANCE	

• The accounts receivable ledger has three money columns.
• The BALANCE column is presumed to contain debit amounts.

The Accounts Receivable Ledger

- The accounts receivable ledger is a supporting ledger for the accounts receivable account in the general ledger.
- Explain the format of the Accounts Receivable Ledger to the students. It contains three money columns.

Objective 4

◆ Post from the general journal to the general ledger accounts and to the subsidiary ledger.

objective: 7-4 Posting from the General Journal					
10	201 Sales Returns and Allowances	450		2500 00	
11	201 Sales Tax Payable	75		2500 00	
12	Accounts Receivable/Ann Ann		1125		2575 00
13	Accept return of defective merchandise				
14	Merchandise 201, original				
15	Sales made on Sale Slip 1102 of January 4				

J11 indicates that the amount was posted to the Accounts Receivable account in the general ledger. The check mark indicates that the amount was posted to the customer's account.

NAME: Ann Ann					
ADDRESS: 7517 Woodbine Wilson Lane, Dallas, Texas 75267-6205					
DATE	DESCRIPTION	DEBIT	CREDIT	BALANCE	
2014					
Jan. 4	Sale Slip 1102	75			75 00
20	OK 111		2500 00		2425 00
31					2425 00

◆ Posting a Credit Sale

- Point out that because a business doesn't want to wait until the end of the month to find out which customers still owe them money, anytime a customer's account is affected, the subsidiary ledger must be updated that same day.
- Point out that the type of journal and page number is indicated by the J1 in the Post. Ref. Column.
 - Explain the use of a ✓ in the Post. Ref. Column to indicate that a subsidiary ledger was updated.

◆ Posting Cash Received on Account

- Explain that the same posting rules apply when a customer makes a payment. The subsidiary ledger must be updated on the same day, to reduce the amount owed by that particular customer.

◆ **Posting a Sales Return or Allowance**

- Remind students that if a return is recorded in the General Journal, then posting to both the general ledger and the subsidiary ledger would need to be done at the end of the day.
- Indicate that the subsidiary ledger for the customer would need to be updated on the day of the return.
- Point out that the '111' in the Post. Ref. Column of the general journal indicates that the general ledger has been posted and the check ✓ indicates that the subsidiary ledger has been posted.

Objective 7-5 Prepare a schedule of accounts receivable.

- The use of an accounts receivable ledger does not eliminate the need for the Accounts Receivable account in the general ledger.
- However, the Accounts Receivable account (in the General Ledger) is now considered a **control account**.

At the end of each month, after all the postings have been made, the balances in the accounts receivable ledger must be proved against the balance of the Accounts Receivable general ledger account.

TOTAL OF INDIVIDUAL CUSTOMER BALANCES = ACCOUNTS RECEIVABLE BALANCE

Prepare a schedule of accounts receivable

Maxx-Out Sporting Goods
 address: 2013 South Main Street, Suite 200, Portland, ME 04102

Date	Description	DEBIT	CREDIT	Balance
1/1	Balance			1,114.00
1/5	Sales Slip 1100	100.00	10.00	1,214.00
1/10	Sales Slip 1105	200.00	20.00	1,414.00
1/15	Sales Slip 1110	300.00	30.00	1,714.00
1/31				1,714.00

Maxx-Out Sporting Goods
 Schedule of Accounts Receivable
 January 31, 2016

Customer	Balance
Maxx-Out Sporting Goods	1,714.00
John Doe	100.00
Jane Smith	200.00
Bob Jones	300.00
Total	1,714.00

Accounts Receivable Ledger

Schedule of Accounts Receivable

Accounts Receivable Balance in General Ledger

Objective 17-6 Record the payment of sales taxes.

At the end of each month, after all the accounts have been posted, Maxx-Out Sporting Goods prepares the sales tax return.

Three accounts are involved:

- Sales Tax Payable
- Sales
- Sales Returns and Allowances

Objective 5

Prepare a schedule of accounts receivable

- Point out that the text shows individual account balances for 4 credit customers.

Then refer students to the *Schedule of Accounts Receivable* and the *Accounts Receivable* controlling account. It displays the balances of the 4 customer accounts in a *Schedule of Accounts Receivable* and shows the activity in the *Accounts Receivable* general ledger account.

- Emphasize that the schedule of accounts receivable is particularly important to a business owner or credit manager in keeping track of how much money someone owes the company and for how long that amount has been outstanding.

Objective 6

Payment of sales taxes

- Emphasize that, at the retail level, all merchants must collect sales tax.
 - Using \$100 as the sales price, use your local sales tax rate to compute the sales tax.
 - Show the class the complete journal entry for a \$100 purchase with sales tax at one of your local stores.
 - Point out that the sales tax is a liability.
- ◆ **Preparing the State Sales Tax Return**
 (Refer to Figure 7-4)

SALES TAX COMPUTATION	
Taxable Gross Sales for January	\$12,500.00
Sales Tax Rate	6.00%
Tax Due	\$750.00
Discount	\$150.00
Net Sales Tax Due	\$600.00

- Explain that sales tax returns are filed monthly or quarterly depending on the state.
- Emphasize that the amount of sales recorded on the sales tax return is the amount in the *Sales* account. (both cash and credit).
- Show that the amount of tax due is computed by multiplying total sales by the tax rate.
- Explain that a *discount* is given by the state for meeting certain conditions.
- Show that net sales tax due is the tax less the discount.
- Point out that after posting the payment of the sales tax, the amount in the sales tax payable account will be the amount of the discount.
- Explain that the discount is considered *income*.

◆ **Recording Sales Tax in the Sales Account**

- Point out that some businesses record the sale and its sales tax together in the *Sales* account.
- Emphasize that at month-end, the sales tax must be separated out and transferred to the *Sales Tax Payable* account.

Managerial Implications

Ask, "What are some possible consequences of out-of-date accounts receivable records?"

Answers A company which fails to maintain up-to-date accounts receivable records may face the following:

- ❑ **Customer dissatisfaction:** Businesses who extend credit to their customers risk customer dissatisfaction if accounts are not updated frequently.
- ❑ **Ineffective collections efforts:** Effective accounts receivable collection efforts rely on accurate account balances.
- ❑ **Cash flow:** Negative cash flow situations may stem from improper maintenance of accounts receivable or from delayed accounts receivable billings.