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. . .

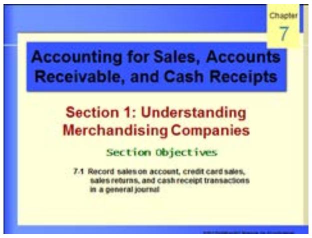
Ask. . . "What are important factors related to Accounts Receivable that Kellogg's must consider?"

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

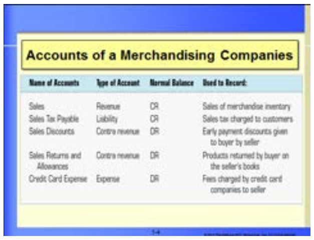


- Explain that in previous chapters we have examined the journal entries required for a service business. This chapter introduces transactions for a merchandising business.
- Explain the three types of businesses:
  1. Service business- which sells services.
  2. Merchandising business or retail business - 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.

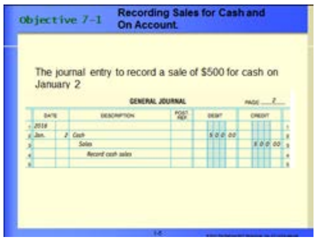


  Sales Returns and Allowances—a new contra-revenue account.
  Sales Discount—a new contra-revenue account.
  Credit Card Expense—our new expense account.

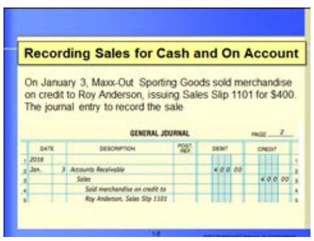
- In this section, we learn to record transactions for a retailer. We will use a general journal to record transactions and later we will learn to post transactions from the general journal to the general ledger and the subsidiary ledger.

POWER POINT	Section	Topics/ Discussion

- 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.)



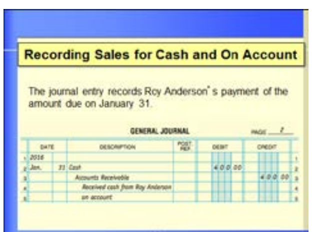
- Emphasize that a retail business requires an accounting system to account for merchandise inventory that is <u>purchased</u>, that has been <u>sold</u>, and that <u>is on hand</u> at any time during the accounting cycle.



<u>Objective 1</u>

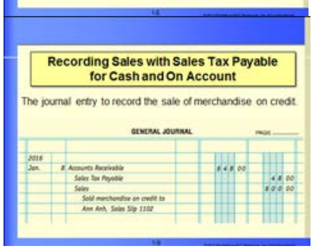
♦ <u>Recording Sales</u>

- 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

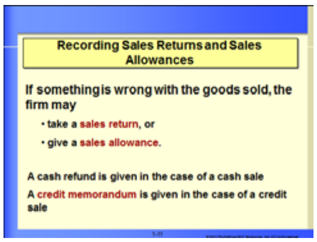


♦ **Sales Return and Allowances**

- 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.

POWER POINT	Section	Topics/ Discussion

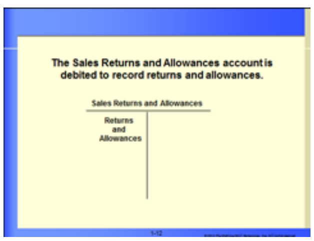
- Point out that the *Sales Returns and Allowances* account is a ***contra-revenue*** account that keeps track of all customer returns.



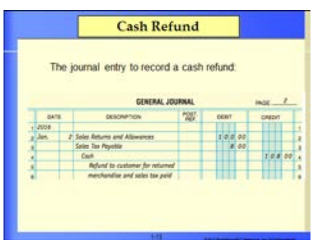
- It is a *temporary* account that is closed at the end of the accounting period.

- Remind students that it would appear on the Income Statement as a subtraction from the Sales account.

Sales
- Sales Returns and Allowances
= Net Sales

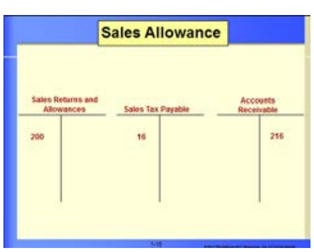


♦ Recording Sales Returns and Sales Allowances



- 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.

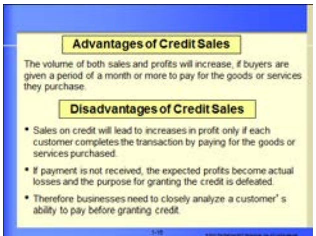


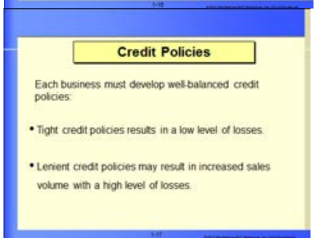
♦ Credit Policies

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

POWER POINT	Section	Topics/ Discussion

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

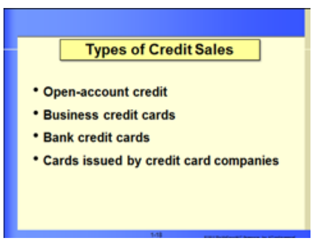




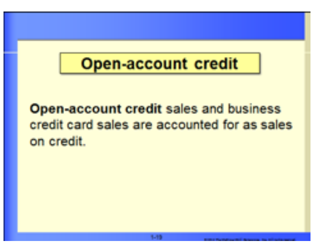
- Challenge your students to hypothesize about factors that may impact credit limits authorized to different individuals.

♦ <u>**Accounting for Different Types of Credit Sales**</u>

<u>Explain that the four most common types of credit cards are</u>:

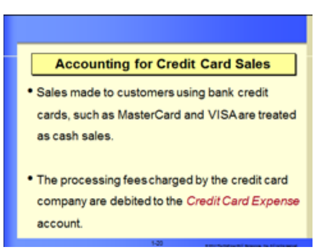


- open-account credit
- business credit cards
- bank credit cards (*Visa, MasterCard*)
  -Point out that the <u>same</u> accounts are affected by a *bank card sale* as a *cash sale*. Explain that the banks that issued the card pay the business directly, which means that the business receives its money soon after it deposits the bank credit card sales slips.



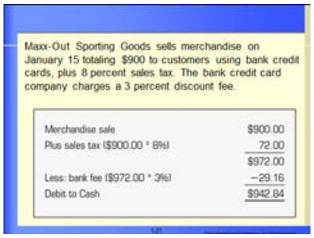
- credit card companies or non-bank credit cards (*American Express, Diners Club*)
  -Point out that a *receivable* is set up due from the credit card company.

♦ <u>**Accounting for Credit Card Sales**</u>

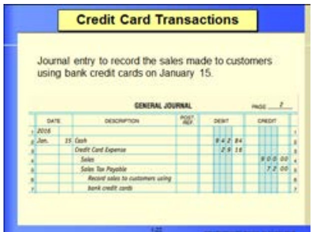


Remind students that *Accounts Receivable* is debited when a customer uses a non-bank credit card like *American Express* or *Diners Club* to purchase merchandise.

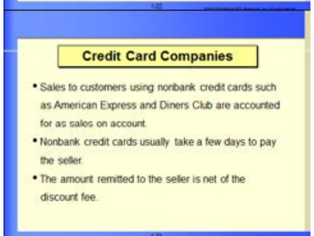
POWER POINT	Section	Topics/ Discussion



- 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.*

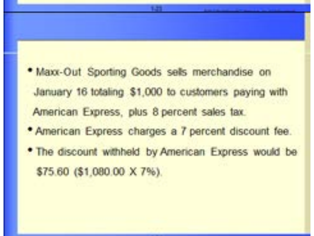


- TEACHING TIP -Write three general journal entries to record credit sales on the board. (Dr. Accts Rec. and Cr. Sales)



Post each entry to the general ledger T accounts involved.

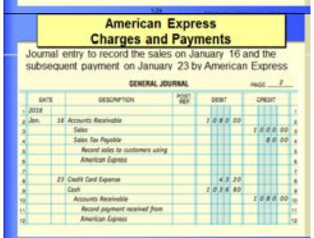
Section 2. SPECIAL TOPICS IN MERCHANDISING



Objective 2

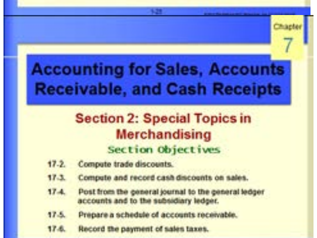
♦ Compute trade discounts

- Explain that the trade/cash discount is a discount based on the volume purchased at less than retail price.



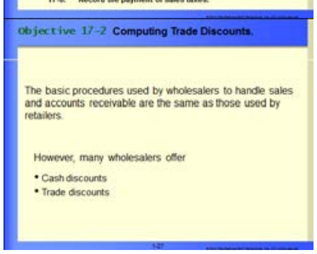
- Also explain that the business might offer goods to different customers at different trade discounts.

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



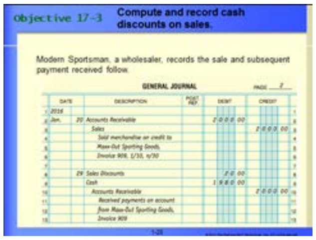
Objective 3

♦ **Compute and record cash discounts on sales.**



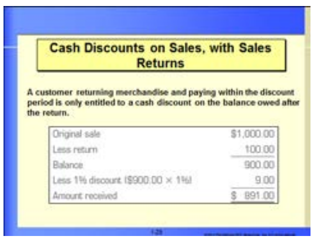
- Explain that many business offer cash discounts to customers who pay within a certain time (also known as *credit terms*.)

- Explain that the net sales value is obtained by subtracting Sales Return and Allowances and Sales Discount from Total Sales.



♦ **<u>Reporting Net Sales</u>**

- Remind students that the *Sales Returns and Allowances* account is a ***contra-revenue*** account.
- It will have a balance opposite that of the *Sales* account.



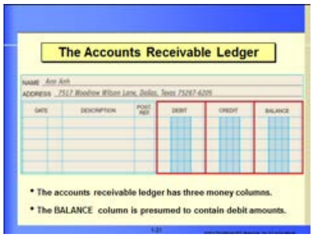
- It is a *temporary* account that is closed at the end of the accounting period.
- Write the following formula on the board and remind students that it would appear on the Income Statement as a subtraction from the Sales account.

Sales *<u>- Sales Returns and Allowances</u>* *<u>- Sales Discount</u>* = NET SALES

<u>Review the concept of accounts receivable with students.</u>

Ask, "Do you think *McDonald's* or *Pizza Hut* have a problem with accounts receivable?" No - they operate on a cash basis and do not deal with accounts receivables from customers.

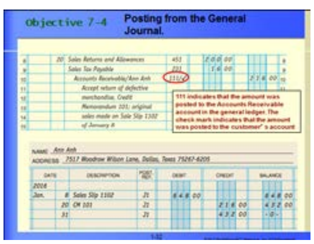
Ask, “How about *Visa* or *MasterCard* Co? How do they keep track of customer charges and payments?” Account numbers track customer activity.



The Accounts Receivable Ledger

- 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.

<u>Objective 4</u>



♦ <u>**Post from the general journal to the general ledger accounts and to the subsidiary ledger.**</u>

♦ <u>**Posting a Credit Sale**</u>

- 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 <u>must</u> be updated that <u>same day.</u>

- 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.

♦ <u>**Posting Cash Received on Account**</u>

- 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.

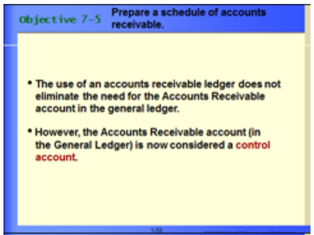
♦ **Posting a Sales Return or Allowance**

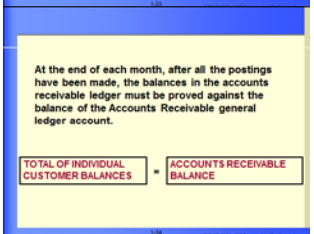
- Remind students that if a return is recorded in the *General Journal*, then posting to both the general ledger and the subsidiary ledger would need to be done at the end of the day.

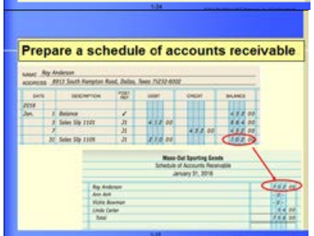
- Indicate that the subsidiary ledger for the customer would need to be updated on the day of the return.

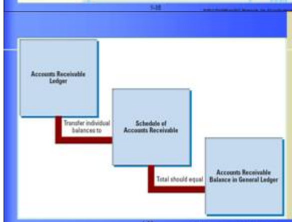
- Point out that the '111' in the Post. Ref. Column of the general journal indicates that the general ledger has been posted and the check ✓ indicates that the subsidiary ledger has been posted.

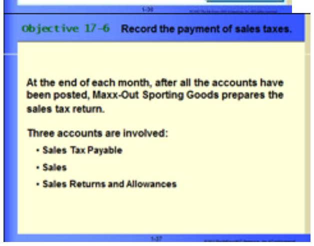
POWER POINT	Section	Topics/ Discussion











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.

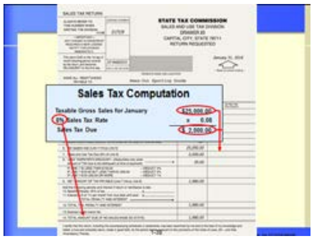
- Using $100 as the sales price, use your local sales tax rate to compute the sales tax.

- 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)



- 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*.

♦ **<u>Recording Sales Tax in the Sales Account</u>**

- 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 <u>transferred</u> to the *Sales Tax Payable* account.

POWER POINT	Section	Topics/ Discussion

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.