

Chapter 3

SALES AND CASH RECEIPTS CYCLE

This chapter discusses the transactions, documents, and records for sales and cash receipts. First an overview is provided for each of the five subcycles of the overall cycle. The remainder of the chapter covers the actions in each subcycle and the transactions resulting from those actions.

The sales and cash receipts cycle starts with the receipt of an order from a customer for goods or services and ends with the collection and recording of the cash receipt for the sale. An essential part of the cycle is the recording of accounts receivable.

Subcycles, Actions, Common Transactions, and Typical Accounts Affected

There are five primary subcycles in the sales and cash receipts cycle. Several actions take place for each subcycle. The recording of these actions results in transactions, which in turn result in changes in account balances. The five subcycles are shown below.

<u>Subcycles</u>	<u>Actions</u>	<u>Common Transactions</u>	<u>Typical Account Balances Affected</u>
Sales	Receive orders from customers, ship goods, bill customers, record sales in journal and subsidiary ledger, summarize journal and post to general ledger.	Cash sales Credit sales	Sales Cash Accounts receivable
Cash receipts	Receive currency, checks, and electronic payments; enter in cash receipts prelist; deposit currency and checks; record cash receipts in journal and subsidiary ledger; summarize journal and post to general ledger.	Collections on accounts rec. Loans Collections on loans receivable Cash sales Sale of fixed assets or securities	Cash Accounts receivable Notes payable Sales discounts taken Gain or loss on the sale of assets Sales
Sales returns and allowances	Process sales returns and allowances requests, receive goods (returns only), credit customers, record in journal and subsidiary ledger, summarize journal and post to general ledger.	Sales returns Sales allowances	Accounts receivable Sales returns and allowances
Estimate of bad debt expense	Determine provision for bad debts, record in general journal and post to general ledger.	Bad debt provision	Bad debt expense* Allowance for doubtful accounts*
Write-off of uncollectible accounts	Identify uncollectible accounts receivable, record in general journal, post to subsidiary ledger and to general ledger.	Uncollectible accounts written off	Accounts receivable* Allowance for doubtful accounts*

*Assumes the use of the allowance method for recording uncollectible accounts receivable.

ACTIONS	DOCUMENTS
<p>Receive order from customer – Receipt of an order from a customer for goods is the starting point for a sale. The order may be a document or an order can be prepared by a salesperson or receptionist taking orders over the phone or in person.</p>	<p>Customer purchase order – A document prepared to request goods or services from a customer. The form should include the name and address of the customer, goods or services desired, and the desired delivery or performance date.</p>
<p>Ship goods or perform services – In most cases, generally accepted accounting principles require the recognition of a revenue and the transaction recorded as of the date when the goods were shipped or services performed. The shipment of goods or performance of services is therefore an essential function in accounting. In some systems, a shipping document is prepared as a by-product of billing customers. In these systems, billing precedes shipping.</p>	<p>Bill of lading or other shipping document – A document prepared at the time of shipment indicating the description of the merchandise, the quantity shipped, and other relevant data. A bill of lading is a written contract of the receipt and shipment of goods between the seller and the carrier. It must be used when a common carrier (shipper registered with the Interstate Commerce Commission) ships the goods. A different type of shipping document is used when a company ships its own goods, but the document's function is the same. Ordinarily, bills of lading and other shipping documents do not include dollar values. Figure 3-2 (page 36) shows an example of a completed bill of lading for the shipment of goods sold by Simple Example Company. In this example, the freight is being charged to the seller.</p>
<p>Bill customer – Billing is the means by which the customer is informed of the amount that is owed for the merchandise shipped. The proper amount of the bill depends on the quantity shipped and the price charged. The billing must also recognize freight charges, insurance, and terms of payment.</p>	<p>Sales invoice – A document prepared indicating the description and quantity of goods sold, the price including freight, insurance, terms, other relevant data, and the total amount of the sale. It is the method of indicating to the customer the amount of a sale and due date of a payment. The original is sent to a customer and one or more copies are retained. It is also the document used for recording sales in the accounting records.</p>
	<p>Price List – A list prepared by the company indicating product prices for billings. It is usually developed by marketing personnel and approved by management.</p>

FIGURE 3-2
Example of a Typical Bill of Lading

UNIFORM STRAIGHT BILL OF LADING — Domestic



Simple Example Company
19100 Stewart Avenue
Battle Creek, Michigan 49015
(616) 555-2600

Shipper No. 138694

Carrier No. 5439

Date 11-17-22

TO:
Consignee Taylor Products
Street 5005 Territorial Boulevard
City/State East Lansing, MI Zip Code 48826

Lucas Trucking Company
(Name of Carrier)

Route <u>Express</u>		Vehicle Number <u>XY 2497</u>			
No. Shipping Units	Kind of Packaging, Description of Articles, Special Marks and Exceptions	Weight (Subject to Correction)	Rate per 100 lb.	Charges (for Carrier use only)	
<u>4</u>	<u>Cartons UB734 Frames</u>	<u>124 lb.</u>	<u>\$19.00</u>	<u>23.56</u>	
<u>2</u>	<u>Cartons TX201 Photo Albums</u>	<u>113 lb.</u>	<u>\$19.00</u>	<u>21.47</u>	
<u>6</u>	<u>Cartons DF844 Digital Cameras</u>	<u>225 lb.</u>	<u>\$19.00</u>	<u>42.75</u>	
<u>1</u>	<u>Carton VJ693 Scanners</u>	<u>70 lb.</u>	<u>\$19.00</u>	<u>13.30</u>	

REMIT C.O.D. TO: ADDRESS <u>N/A</u>	COD Amt: \$ <u>N/A</u>	C.O.D. FEE: PREPAID <input type="checkbox"/> COLLECT <input type="checkbox"/> \$ <u>N/A</u>
-------------------------------------	-------------------------------	---

Note — Where the rate is dependent on value, shippers are required to state specifically in writing the agreed or declared value of the property.
The agreed or declared value of the property is hereby specifically stated by the shipper to be not exceeding.

\$ N/A per N/A

Subject to Section 7 of the conditions, if this shipment is to be delivered to the consignee without recourse on the consignor, the consignor shall sign the following statement:
The carrier shall not make delivery of this shipment without payment of freight and all other lawful charges.

N/A
(Signature of Consignor)

Total Charges \$ 101.08

FREIGHT CHARGES
Check Appropriate Box:
 Freight Prepaid Collect
 Bill to Shipper

Received subject to the classifications and tariffs in effect on the date of the issue of this Bill of Lading, the property described above in apparent good order, except as noted (contents and condition of contents of packages unknown), marked, consigned, and destined as indicated above which said carrier (the word carrier being understood throughout this contract as meaning any person or corporation in possession of the property under the contract) agrees to carry to its usual place of delivery at said destination, if on its route, otherwise to deliver to another carrier on the route to said destination. It is mutually agreed as to each carrier of all or any of, said property over all or any portion of said route to destination and as to each party at any time interested in all or any said property, that every service to be performed hereunder shall be to all the bill of lading terms and conditions in the governing classification on the date of shipment.

Shipper hereby certifies that he is familiar with all the bill of lading terms and conditions in the governing classification and the said terms and conditions are hereby agreed to by the shipper and accepted for himself and his assigns.

SHIPPER <u>Simple Example Company</u>	CARRIER <u>Lucas Trucking</u>
PER <u>Simple Example's Employee</u>	PER <u>Joe Driver</u> DATE <u>11-17-22</u>

(This Bill of Lading is to be signed by the shipper and agent of the carrier issuing same.)

ACTIONS	DOCUMENTS
<p>Record in sales journal and subsidiary ledger – The sales journal is the record of original entry for sales transactions. Every sales transaction must be recorded in the sales journal, individually or in summary form. (Some companies record cash sales in the cash receipts journal.) Every credit sale must also be recorded in the accounts receivable subsidiary ledger as an increase in a customer's account receivable balance.</p>	<p>Sales journal – A journal for recording sales. It usually indicates gross sales for different classifications, such as product lines, the entry to accounts receivable, and miscellaneous debits and credits. Some companies include only daily summaries in the journals. Copies of each day's duplicate sales invoices are retained, and these copies are totaled to equal the total sales recorded in the journal. Totals of details in the journal are typically posted to the general ledger monthly.</p> <p>Accounts receivable subsidiary ledger – A ledger for recording individual sales, cash receipts, and sales returns and allowances for each customer. The total of the individual account balances in the subsidiary ledger equals the total balance of accounts receivable in the general ledger.</p>
<p>Summarize sales journal and post to general ledger – Periodically, usually monthly, the sales journal is totaled. The totals are then transferred (posted) to the general ledger. When all sales are on account, it is common to have only one column for sales in the sales journal. The total for the month is then posted to both accounts receivable (debit) and sales (credit) in the general ledger. There may also be separate columns for sales to employees, cash sales, trade discounts, and sales returns and allowances.</p>	<p>General ledger – A record used to summarize transactions recorded in the journals. For sales, every account included in the sales journal (e.g., sales, accounts receivable and sales discounts taken) must also be included in the general ledger. Only the totals in the sales journal are posted to the general ledger.</p>

After a billing is made to a customer, including the recording of the receivable, there are three ways the receivable can be eliminated: collection of cash, sales return and allowance, or write-off as uncollectible. An accounting system must provide for all three. Rather than being thought of as independent, these three ways should be thought of as being related to sales.

**Cash Receipts –
Actions and Related Documents**

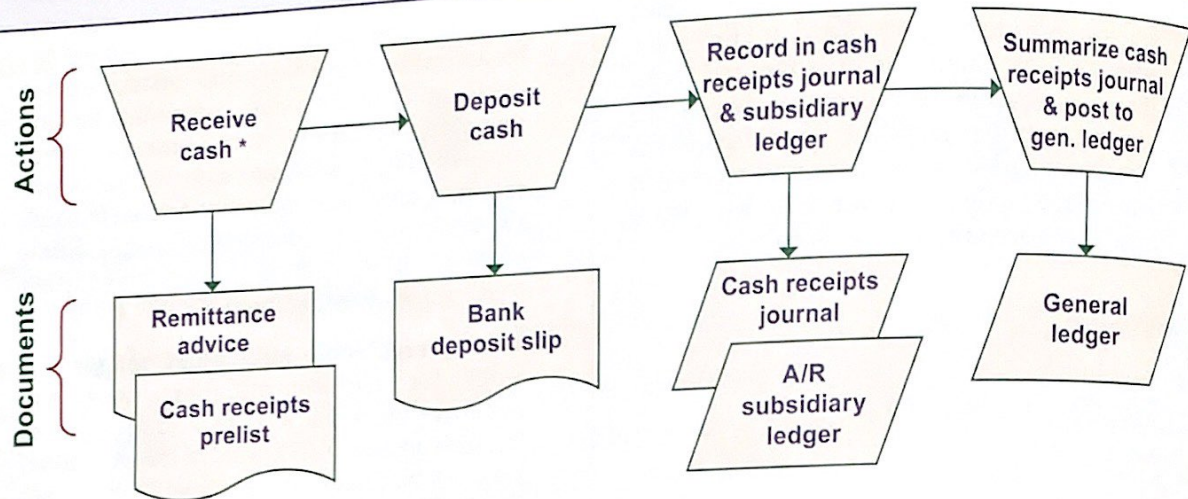
For most companies, it is convenient to categorize cash receipts in three ways: collections on accounts receivable, cash sales, and "all others."

The "all others" category includes cash receipts from such things as borrowing, sales of or interest on investments, and disposal of fixed assets.

Some companies choose to record all cash receipts in a cash receipts journal. Others choose to record both cash and account sales in the sales journal; therefore, only collections and "all others" are included in the cash receipts journal. Either method is satisfactory as long as the accounting records are accurate and cash is properly controlled.

The actions and related documents for a typical company's cash receipts subcycle are shown in Figure 3-3 (page 38). More detailed discussion of the information in Figure 3-3 follows.

FIGURE 3-3
Cash Receipts — Actions and Related Documents



* currency, check, and electronic payments

ACTIONS	DOCUMENTS
<p>Receive cash — The starting point for recording cash, regardless of its source, is its receipt. Customers and other outsiders typically pay with a check or an electronic payment. Electronic payments are often called ACH (Automated Clearing House) payments. Generally accepted accounting principles require recognition of cash as an asset at the receipt date rather than the date of deposit or date of mailing/initiating by the sender.</p>	<p>Remittance advice — A document that accompanies the sales invoice mailed to the customer and can be returned to the seller with the cash payment. It is used to indicate the customer name, the sales invoice number, and the amount of the related invoice when the payment is received. The primary purpose of a remittance advice is to make sure that the proper customer is credited for the proper amount of cash received. Companies whose cash receipts are easily associated with specific sales transactions often do not use remittance advices.</p> <p>The remittance advice can be an extra copy of the sales invoice sent to the customer with the original. The extra copy would probably be stamped "Please return this copy with your payment." When a remittance advice is not returned by the customer, a clerk will prepare one. Remittance advices facilitate the immediate deposit of the cash.</p> <p>When customers pay on the basis of monthly statements, rather than individual invoices (such as company credit cards), the remittance advice is for the total balance due rather than an individual invoice.</p> <p><i>(continued on the following page)</i></p>

ACTIONS	DOCUMENTS
	<p>Cash receipts prelist – A list prepared when cash is received, which lists each cash receipt. This document is used later to verify whether cash received was recorded and deposited at the correct amounts and on a timely basis.</p>
<p>Deposit cash – Currency and checks should be deposited in the bank as quickly as is practical, usually daily. The reasons are to make it available for company use and to reduce the likelihood of accidental loss or theft. For electronic payments, the company's bank typically notifies the company when an electronic payment has been received. Often, this notification is in e-mail form.</p>	<p>Bank deposit slip – A document prepared to accompany bank deposits of currency and checks, which lists each check and all currency being deposited. A separate bank deposit slip is prepared for each deposit. Usually banks require one to reduce the likelihood of bank errors. They are also helpful in recording cash receipts and preparing bank reconciliations. Deposit slips are especially helpful when company or bank personnel have made an error.</p> <p>The bank keeps the original and returns a validated deposit receipt to the depositor, indicating the amount and date of the deposit.</p>
<p>Record in cash receipts journal and subsidiary ledger – The cash receipts journal is the record of original entry for cash receipts transactions. It should look almost the same as the sales journal except for differences in the account titles. The subsidiary ledger is the same record described as a part of sales.</p>	<p>Cash receipts journal – A journal for recording cash receipts from collections, cash sales, and all other cash receipts. It indicates total cash received, the credit to accounts receivable at the gross amount of the original sale, sales discounts taken, and other debits and credits. The daily entries in the cash receipts journal are supported by remittance advices.</p> <p>The accountant must use care in recording the credit to accounts receivable in the cash receipts journal so that it is consistent with the recording of the original sale. Assume, for example, a sale for \$100 with a 2% cash discount allowed. If the receivable was originally recorded at \$100 and \$98 cash was received, the credit to accounts receivable in the cash receipts journal must be \$100, not \$98, if the discount was granted. The credit to accounts receivable in the subsidiary ledger must also be for \$100, not \$98. The \$2 discount is recorded as a debit to the sales discounts taken account.</p> <p>Accounts receivable subsidiary ledger – See Sales (page 37).</p>
<p>Summarize cash receipts journal and post to general ledger – The concepts are the same for this action as for sales and are not repeated.</p>	<p>General ledger – See Sales (page 37).</p>

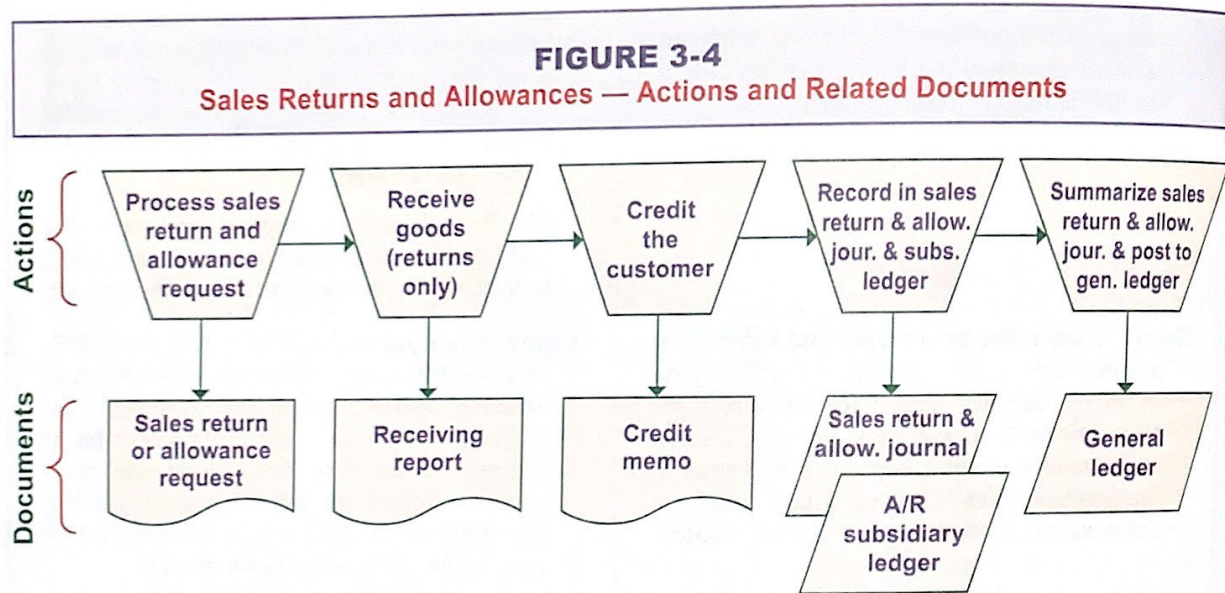
CHAPTER 3

Sales Returns and Allowances – Actions and Related Documents

Sales returns are the returns of merchandise to the seller for such reasons as the incorrect product being sent, defective merchandise, and the customer no longer needing the goods. For sales allowances, the customer keeps the goods purchased but is granted a reduction in the selling price.

The actions and recording of sales returns and allowances are nearly the same as for sales, but instead of a bill to the customer, a credit is granted. A major difference between sales and sales returns and allowances is that sales returns and allowances are often immaterial.

Figure 3-4 shows the actions and related documents for sales returns and allowances business activity. More detailed discussion of the activities and information in Figure 3-4 follows.



ACTIONS	DOCUMENTS
<p>Process sales return and allowance request – Receipt of a request from a customer to return goods or for an allowance is the starting point for recording the sales return or allowance. Typically, it is approved by a salesperson or sales manager. It is common for the parties to negotiate the amount of the credit.</p>	<p>Sales return request – A document requesting authority to return goods. A document is not normally used for allowances. Figure 3-5 (page 42) shows an example of a sales return request received from one of Simple Example Company's customers, Taylor Products. When the sales return request was received from Taylor Products, the last four columns were blank. The handwritten information in these columns was completed by Simple Example Company when the returned goods were received from Taylor Products. This information is later used to prepare a credit memo for the sales return transaction. Credit memos are discussed shortly.</p>

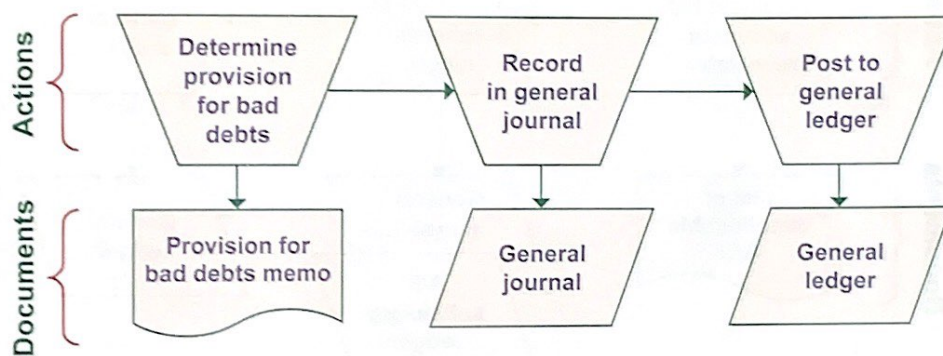
ACTIONS	DOCUMENTS
<p>Receive goods (returns only) – Generally accepted accounting principles require the recognition of sales returns and allowances in the same accounting period that the original sale was made, rather than the period of the actual receipt of the goods. For convenience, many companies recognize returns when the goods are actually received back from customers. An adjustment can be made later for material returns.</p>	<p>Receiving report – A document prepared at the time the goods are received showing the description of the goods received, quantity, and date received. This document serves the same function as a shipping document. Receiving reports are discussed more fully in Chapter 4 as part of the purchases and cash disbursements cycle.</p>
<p>Credit the customer – The credit to the customer performs the same function as billing—to inform the customer of the amount of the credit. It is important in issuing credits for returns and allowances to have agreement from the customer on the amount of the credit. It is not always for the full amount of the sale, even for returned goods.</p>	<p>Credit memo – A document prepared indicating the amount and terms of the return or allowance. The original is sent to the customer and one or more copies are retained. It is also the document used for recording sales returns and allowances in the accounting records.</p>
<p>Record in sales returns and allowances journal and subsidiary ledger – The sales returns and allowances journal is the record of original entry for both sales returns and allowances. It can be a separate journal or a part of the sales journal.</p>	<p>Sales returns and allowances journal – A journal for recording sales returns and allowances. Many companies record returns and allowances in the sales journal. If they are recorded in the sales journal, a separate column is used. A separate journal is used only when there are many sales returns and allowances transactions.</p> <p>Accounts receivable subsidiary ledger – See Sales (page 37).</p>
<p>Summarize sales returns and allowances journal and post to general ledger – The concepts are the same for this action as for sales and are not repeated.</p>	<p>General ledger – See Sales (page 37).</p>

Estimate of Bad Debt Expense – Actions and Related Documents

Generally accepted accounting principles require accountants to recognize the expense for an uncollectible account receivable in the same period that the sale is made rather than when the account becomes uncollectible. Accountants

usually recognize the expense by estimating bad debt expense periodically as a fixed percent of gross or net sales, based on historical experience. The debit is to bad debt expense and the credit to allowance for doubtful accounts. The actions and related documents for the periodic bad debt expense recognition are shown in Figure 3-6. Detailed discussion of Figure 3-6 follows.

FIGURE 3-6
Estimate of Bad Debt Expense — Actions and Related Documents

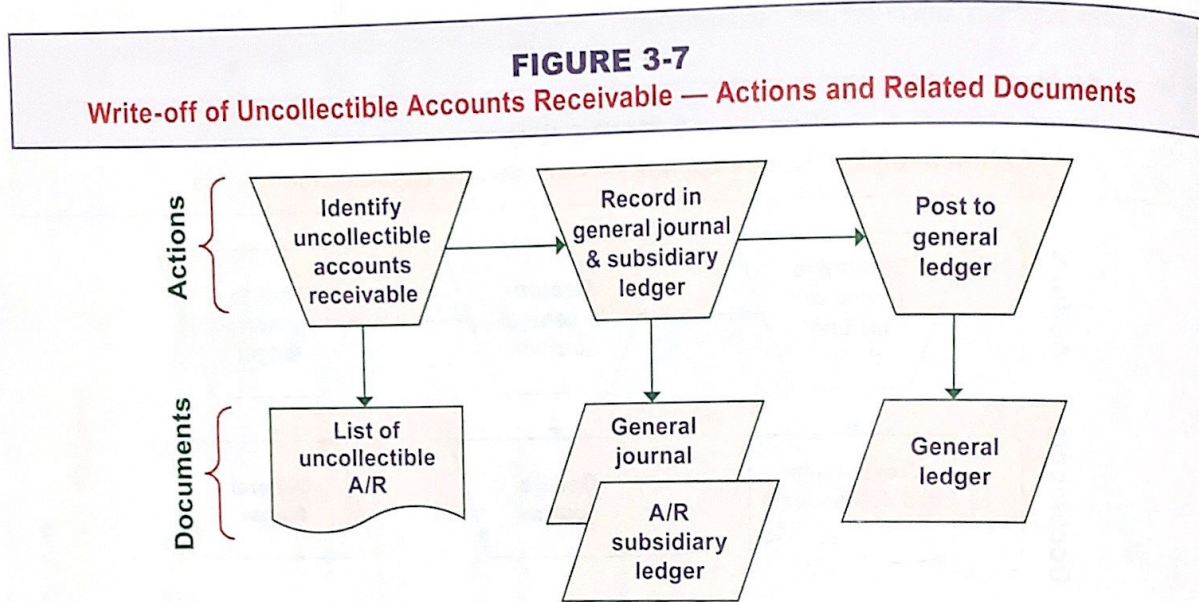


ACTIONS	DOCUMENTS
<p>Determine provision for bad debts – When financial statements are prepared, the periodic provision for bad debts is determined. For example, if 2% of a company’s net sales have historically not been collectible and net sales were \$10,000 for the period, the amount of bad debt expense would be \$200. The amount would be larger or smaller if there was reason to believe that the estimate does not reflect actual bad debt losses.</p>	<p>Provision for bad debts memo – A document indicating the amount of bad debts for a period. Many companies do not prepare this document. Alternatively, the explanation of the calculation can be shown in the general journal. A separate file is usually maintained showing the basis on which the periodic adjustment is made.</p>
<p>Record in general journal – The general journal is the journal of original entry for bad debt expense. The entry is recorded as a debit to bad debt expense and a credit to allowance for doubtful accounts.</p>	<p>General journal – A document for recording transactions not recorded in specialized journals. Transactions such as bad debt expense, where there is only one transaction for each month, are recorded in the general journal. The journal has two columns, one for debits and a second for credits.</p>
<p>Post to general ledger – There are no totals in the general journal to summarize before posting. Each transaction in the general journal is posted individually to the general ledger.</p>	<p>General ledger – See Sales (page 37).</p>

Write-off of Uncollectible Accounts Receivable – Actions and Related Documents

In this subcycle, individual accounts that are no longer collectible are written off. The

accounting entry to reflect the write-off is to debit the allowance for doubtful accounts and credit accounts receivable. The actions and related documents are shown in Figure 3-7. Detailed discussion follows.



ACTIONS	DOCUMENTS
Identify uncollectible accounts receivable – Identifying of individual accounts receivable that are considered uncollectible is usually done by the credit manager. Frequently the accounts are considered uncollectible when a customer files bankruptcy, moves without a forwarding address, or when the account is turned over to a collection agency.	List of uncollectible accounts receivable – A prepared list that identifies accounts receivable that are not likely to be collected. The list is usually prepared periodically, such as monthly.
Record in general journal and subsidiary ledger – The general journal is the journal of original entry for the write-off of uncollectible accounts receivable. The periodic entry is a debit to allowance for doubtful accounts and a credit to accounts receivable in the amount of the total on the list of uncollectible receivables. The subsidiary ledger is credited for customers included on the list of uncollectible accounts receivable, in the amounts listed.	General journal – The journal used for the write-off of uncollectible accounts receivable. Accounts receivable subsidiary ledger – See Sales (page 37).
Post to general ledger – See estimate of bad debt cycle.	General ledger – See Sales (page 37).

Accounts Receivable Aging Report

An accounts receivable aging report is a listing of the ending balances in the subsidiary accounts receivable ledger at a specific point in time. It includes a column for individual account

balances and separate columns showing a breakdown of each balance by the time passed between the date of sale and the date of the report. An illustration of a typical accounts receivable aging report is shown in Figure 3-8.

FIGURE 3-8
Accounts Receivable Aging Report Example

Anycompany, Inc. Accounts Receivable Aging Report November 30, 2022						
Customer Number	Customer	Amount Due	Age in days			
			Current	31-60	61-90	Over 90
2130	James Abel	\$ 342				\$ 342
2131	Robert Bock	618	\$ 318	\$ 300		
2132	Timothy Chazen	1,340		1,300	\$ 40	
2133	Oscar Darwin	6,290	6,000	290		
3134	Juliet Embry	3,412	2,000	1,012		400
3135	George Fain	141	141			
3136	Gayle Gershin	3,300	2,604	696		
3137	Andrew Hart	2,834	2,834			
2138	Terron Ismael	(928)	(928)			
	Totals	<u>\$ 17,349</u>	<u>\$ 12,969</u>	<u>\$ 3,598</u>	<u>\$ 40</u>	<u>\$ 742</u>

The accounts receivable aging report fulfills three purposes for a company:

1. Reconciles the control account to the subsidiary ledger as a check on certain recording errors. Examples of errors that will cause the report not to reconcile with the control account include:
 - recording an account receivable at a different amount in the sales journal than in the subsidiary ledger.
 - incorrectly adding the accounts receivable column in the cash receipts journal.
 - incorrectly adding or subtracting amounts in the subsidiary ledger.

2. Shows a listing of accounts receivable in a convenient format to enable management to review the amount each customer owes. The aging is useful information to help management decide when and where greater collection effort is needed.
3. Provides information about the adequacy of the allowance for doubtful accounts and the need to write off certain accounts as uncollectible.

In preparing an accounts receivable aging report, the accountant obtains the information directly from the subsidiary ledger as of a specific date. Each line on the accounts receivable aging report is taken from the subsidiary ledger for one customer. The information on the line includes:

1. Customer number and name.
2. Total balance due from the customer. In some cases, the balance may be a credit. An example is when a customer has received a credit for returned goods after the receivable has been paid.
3. Aging. The aging is determined on the basis of the date of any sale for which collection has not been made. Usually the date for sales and cash receipts is indicated in the subsidiary ledger. Ordinarily, cash receipts are assumed to apply to the oldest outstanding receivables. For example, assume a November sale in the amount of \$400, a December sale in the amount of \$300, and December collection of \$500. The remaining receivable of \$200 is assumed to be for the December sale unless there is a dispute over the November sale.

Internal Controls

Chapter 1 includes a general introduction of internal controls affecting all cycles. The purpose of this section is to examine specific controls for the sales and cash receipts cycle. The most important controls for the cycle follow.

Adequate documents and records. The documents used in sales, sales returns and allowances, and cash receipts transactions should be pre-numbered and designed for the purpose intended. For example, the use of prenumbered shipping documents is an essential element to the controls that ensure that all goods shipped have been billed. Similarly, the use of prenumbered sales invoices is desirable to make sure that billings have been recorded. The special characteristics of properly designed documents and records were discussed in Chapter 1.

Authorization of transactions. There are five authorizations for sales and cash receipts transactions, each of which should be indicated by initialing the appropriate document:

1. Approval of credit before shipment takes place.
2. Shipment of the goods.
3. Determination of appropriate price to charge for the goods. Price includes terms and freight.
4. Approval of credits to accounts receivable for such things as sales returns and allowances or write-off of uncollectible accounts.
5. Determining cash discounts allowed for customers' payments made before the discount date.

Separation of the custody of assets from accounting. The person responsible for shipping goods or receiving cash should have no accounting responsibility. Without adequate segregation of duties, the potential for fraud increases.

Independent checks on performance. There are several appropriate types of internal verification, including:

- Account for all prenumbered shipping documents. This control helps ensure that all shipments have been billed.
- Account for all prenumbered sales invoices. This control helps to ensure that all sales invoices have been recorded.
- Compare prices on invoices charged to customers for shipments to a price list approved by management.
- Check the mathematical accuracy of the journals and records.
- Reconcile the accounts receivable control account to the related subsidiary ledger.
- Prepare a monthly bank reconciliation. One of the most important controls used by accountants is a bank reconciliation. This control is discussed in greater detail in Chapter 4.