



Università
Cattaneo

Management & Principles of Accounting

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Recording sales and employee compensation

Patrizia Tettamanzi

Sophie Goodman

Source: E-Book: (Basic accounting - how to prepare and analyze financial statements)
edited by Patrizia Tettamanzi, Gaia Blandano, Sophie Goodman, Ipsoa Gruppo
Wolters Kluwer

E-Book

After this lesson you should be able to:

- Explain the recording of sales
- Explain the recording of employees compensation

Recording Sales of Merchandise

In accordance with the revenue recognition principle, companies record sales revenue, like service revenue, when the performance obligation is satisfied.

Typically, that performance obligation is satisfied when the goods are transferred from the seller to the buyer.

At this point, the sales transaction is completed and the sale price is established.

Sales may be made on credit or for cash. Every sales transaction should be supported by **a business document** that provides written evidence of the sale. **Cash register documents** provide of cash sales.

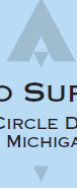
Recording Sales of Merchandise

A **sale invoice** provides support of each sale. The original copy of the invoice goes to the customer, and the seller keeps a copy for use in recording the sale. The invoice shows the date of sale, customer name, total sales price, and other relevant information.

The seller makes two entries for each sale.

- (1) It increases (debits) Accounts Receivable or Cash, as well as increase (credits) Sales Revenue.
- (2) It increases (debits) Cost of Goods Sold and decreases (credit) Inventory. As a result, the Inventory account will show at all times the amount of inventory that should be on hand.

INVOICE NO. 731



PW AUDIO SUPPLY, INC.
27 CIRCLE DRIVE
HARDING, MICHIGAN 48281

S
O
L
D

Firm Name Sauk Stereo

Attention of James Hoover, Purchasing Agent

Address 125 Main Street

Chelsea Illinois 60918
City State Zip

Date	Salesperson	Terms	FOB Shipping Point		
5/4/14	Malone	2/10, n/30			
Catalog No.	Description	Quantity	Price	Amount	
X572Y9820	Printed Circuit Board-prototype	1	2,300	\$2,300	
A2547Z45	Production Model Circuits	5	300	1,500	
IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS				TOTAL	\$3,800

Recording sales: cash vs. accounts receivable

- When we sell goods or services paying cash we make the following entry:

Cash (A)	3.500	
	Service revenue (R)	3.500
<i>Sold Services for 3.500 euros, collected cash</i>		

- If we sell something “on account” we first record the credit and later the collection:

Account receivable (A)	3.500	
	Service revenue (R)	3.500
<i>Sold Services for 3.500 euros, collection postponed</i>		

Cash (A)	3.500	
	Accounts receivable (A)	3.500
<i>Collected the accounts receivable related to the sale of services</i>		

Recording sales: returns, allowances and discounts

- Sometime if our customer pays before the agreed deadline we can allow a cash discount:

Cash (A)	1.940	
Sales discounts (E)	60	
Accounts receivable (A)		2.000

Recording sales: returns, allowances and discounts

If our customer returns part of the purchased goods or asks us for an allowance (reduction in price) we record:

Sales revenue (R)	300	
Accounts receivable (A)		300
<i>Returned 300 euros of goods by the customer</i>		

In case of returns (not of allowances!), we have to record also an increase in inventory (for the cost of goods returned) according to the perpetual inventory system:

Inventory (A)	140	
Cost of goods sold (E)		140
<i>Increased the inventory of 140 euros, that is the cost of the goods returned by the customer</i>		

Recording sales of goods

- If we sell goods instead of services, we record:

Cash (A)	3.500	
		Sales revenue (R) 3.500

Sold goods for 3.500 collected cash

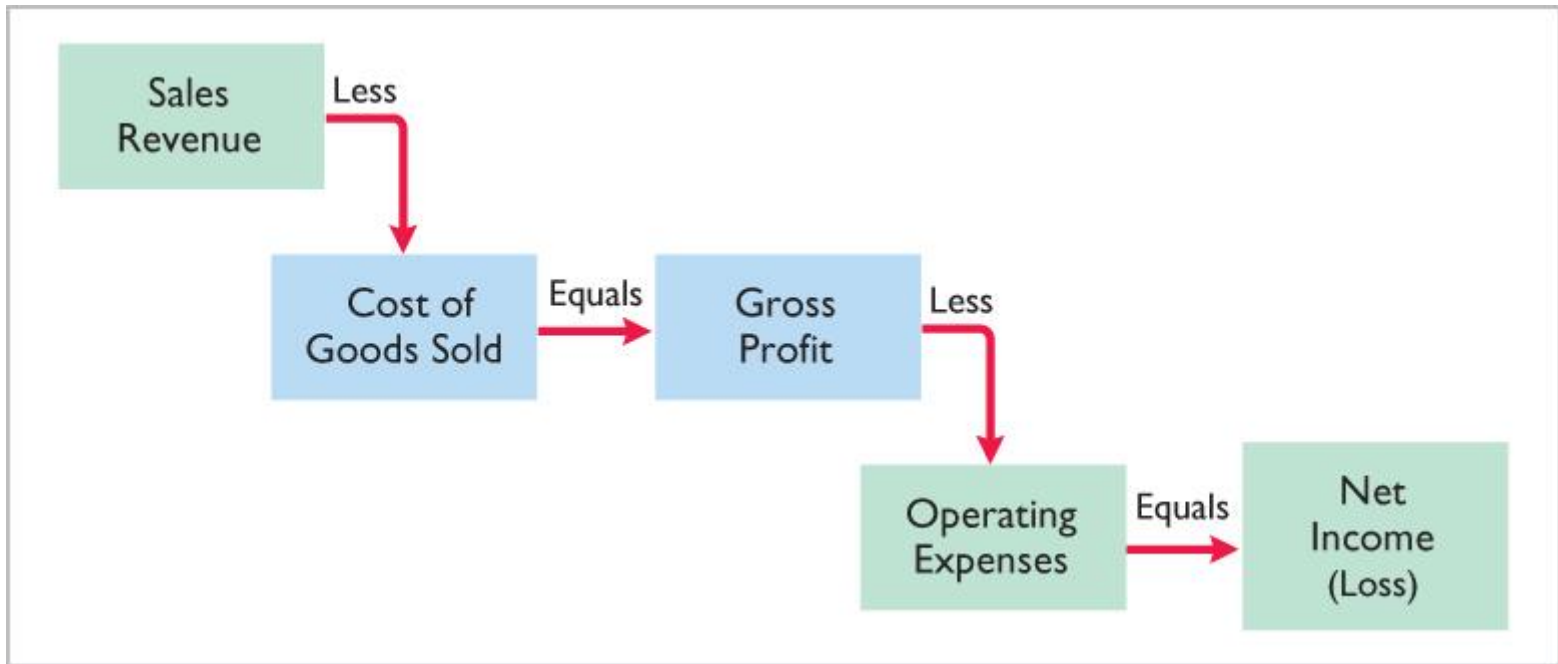
- But when we sell goods, we are actually losing an asset (inventory). Therefore we should record, at the same time, the cost of the goods sold (which represent an expense, that is a decrease of owner's equity):

Cost of goods sold (E)	2.400	
		Inventory (A) 2.400

Recorded the cost of good sold as an expense for 2.400 euros

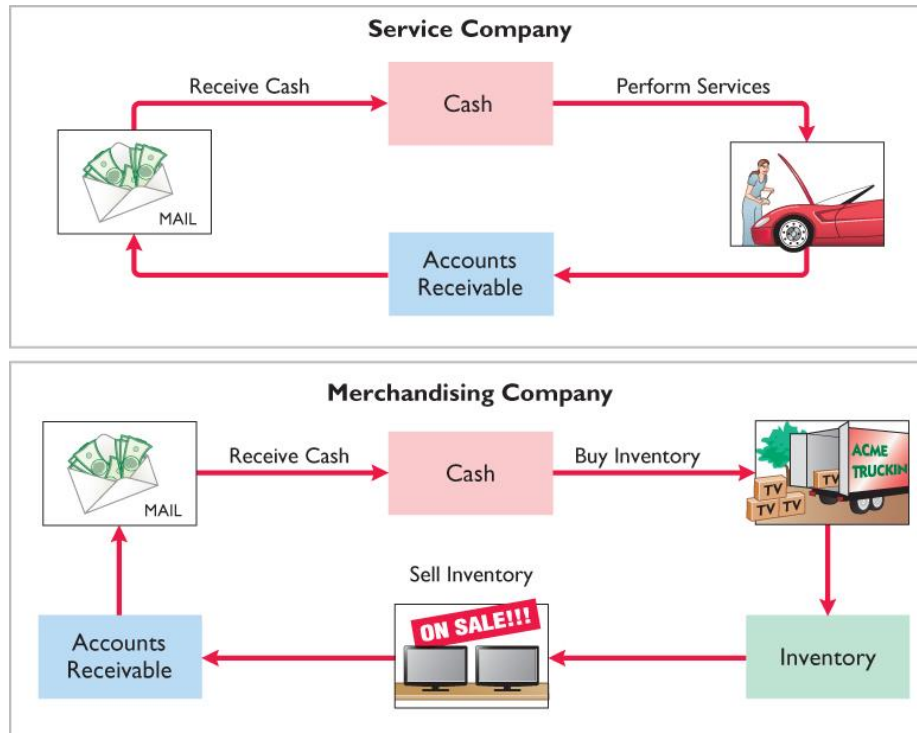
- This way of recording sales and goods sold is called “perpetual inventory system”. We’ll talk about it and about alternative systems to record the same transaction later in the course

Perpetual Inventory System - Illustration



Operating cycles

The operating cycle of a merchandising company ordinarily is longer than that of a service company. The purchase of inventory and its eventual sale lengthen the cycle. Illustration below contrast the operating cycle of service and merchandising companies. Note that the added account of merchandising company is the Inventory account.



Recording sales: advance payment

- If our customer pays us in advance, that is before receiving the goods or services purchased, we have to record a liability (a debt), representing the obligation to deliver something in the future:

Cash (A)	1.200	
Payable for advances for customers (L)		1.200
<i>Collected 1.200 euros as advances from customers</i>		

- When we deliver the goods or services:

Payable for advances for customers (L)	1.200	
Cash (A)	800	
Service revenue (R)		2.000

Delivered services for 2.000 euros and collected the amount left

Recording sales: note receivable

- We may also ask for interests in case of delayed payment. Such interests are collected at maturity. Using the same example

Cash (A)	2.100	
Interest revenue (R)		100
Note receivable (A)		2.000

Collected the note payable + interest for 100 euros

Recording sales: notes receivable

- We may ask our customer to issue a “note receivable”, that is a formal promise to pay a definite sum at a specific date in the future, including also the promise that we may claim certain assets (collateral) if the debtor fails to pay the amount due. In this case we record:

Note receivable (A)	2.200	
Service revenue (R)		2.200

Sold services for 2.000 euros. Received a note receivable, deadline in two months

- At maturity we'll record:

Cash (A)	2.200	
Note receivable (A)		2.200

Collected the note receivable

Recording sales: sales tax payable

- In some countries (like Italy) there are taxes on sales, e.g. VAT. We charge on the customers the taxes in addition to the price of the sold items, but we owe to the government the collected taxes. Such taxes, then, represent a liability.

Cash (A)	2.440	
Sales revenues (R)		2.000
VAT payable (L)		440

Sold 2.000 euros – VAT 22% of services, collected cash.

Recording sales: Summary

TRANSACTIONS		PERPETUAL INVENTORY SYSTEM	
MAY 4	Sales of merchandise on credit	Account Receivable (A)	3.500
		Sales Revenue (R)	3.500
		Cost of goods sold (E)	2.400
		Inventory (A)	2.400
MAY 8	Return of merch sold/allow only section1	Sales revenues (R)	300
		Account Receivables (A)	300
		Inventory (A)	140
		Cost of goods sold (E)	140
MAY 14	Cash received on account with a discount	Cash (A)	1.940
		Sales Discounts (E)	60
		Account Receivables (A)	2.000
MAY 16	Advance payment when we deliver the goods or services	Cash (A)	1.200
		Payable for advances from customer (L)	1.200
		Payable for advances from customer (L)	1.200
		Cash A)	800
		Service Revenue (R)	2.000

EMPLOYEE COMPENSATION

Wages and Salaries

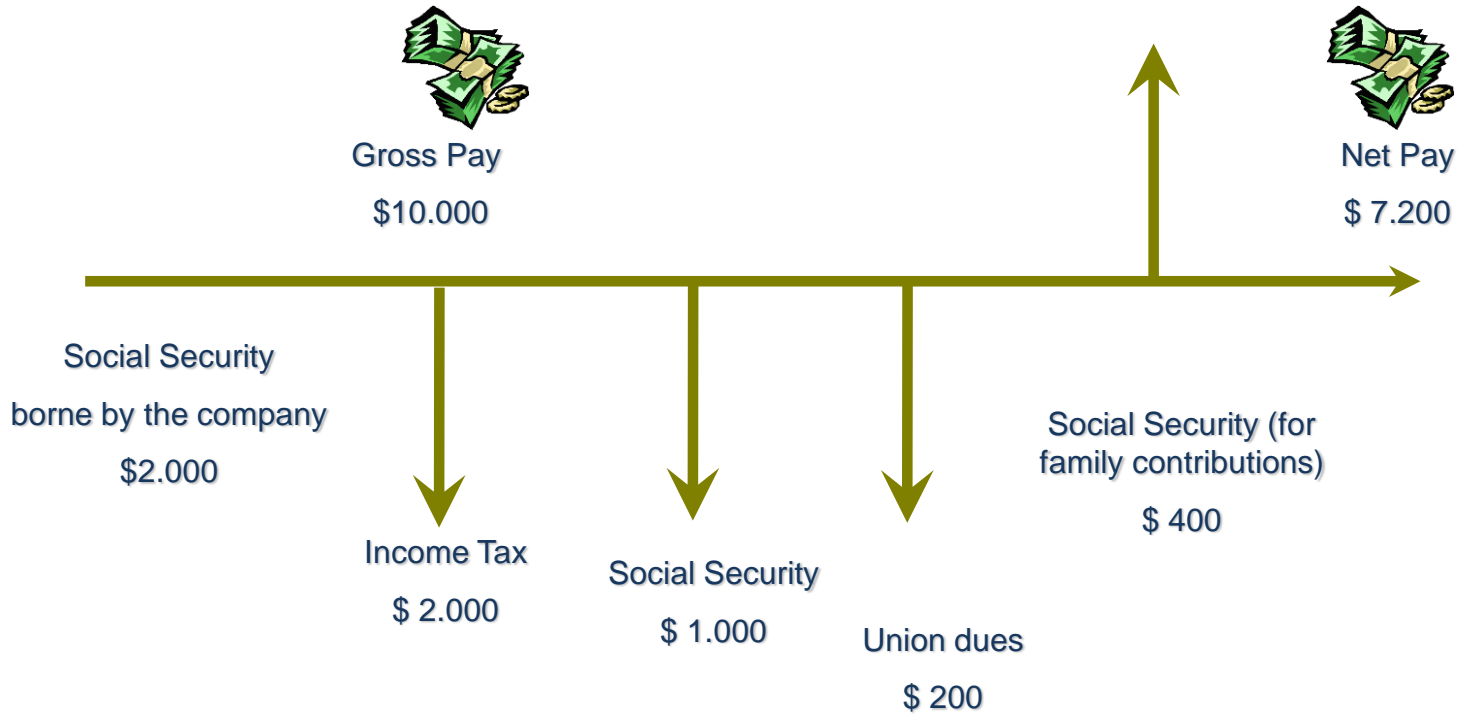
In the national accounts, in accordance with the [System of National Accounts](#), **wages and salaries** include the values of any social contributions, [income taxes](#), etc., payable by the [employee](#) even if they are actually withheld by the employer for administrative convenience or other reasons and paid directly to social insurance schemes, tax authorities, etc., on behalf of the employee.

Wages and salaries may be paid in various ways, including goods or services provided to employees for remuneration in kind instead of, or in addition to, remuneration in cash.

Wages and salaries in cash consist of wages or salaries payable at regular weekly, monthly or other intervals, including payments by results and piecework payments; plus allowances such as those for working overtime; plus amounts paid to employees away from work for short periods (e.g., on holiday); plus ad hoc bonuses and similar payments; plus commissions, gratuities and tips received by employees.

Wages and salaries in kind consist of remuneration in the form of goods and/or services that are not necessary for work and can be used by employees in their own time, and at their own discretion, for the satisfaction of their own needs or wants or those of other members of their households (i.e. car, transportation, cell phones, kindergarten etc.).

Compensation deductions



$$\$10.000 - 2.000 - 1.000 - 200 + 400 = \$7.200$$

Recording employee compensation

Employee compensation represents a major expense for businesses
 When we record employee compensation, we have to consider that the employees actually receive a lower amount of money, since their compensation is subject to a number of deductions and subtractions for taxes and other items

We record the gross amount of salary and wage expense as follows:

Wage and salary expense (E)	10.000	
Employee compensation payable (L)		10.000

Accounted for wages and salaries related to May for 10.000 euros

- For tax deduction we record:

Employee compensation payable (L)	2.000	
Employee income tax payable (L)		2.000

Deducted taxes from the gross salaries to be paid to the employees

Recording employee compensation

- For social contribution (for the part charged to the employees) we record:

Employee compensation payable (L)	1.000	
Social security contribution payable (L)		1.000
<i>Deducted SSC from the gross salaries to be paid to the employees</i>		

- For union dues we record:

Employee compensation payable (L)	200	
Union dues payable (L)		200
<i>Deducted union dues from the gross salaries to be paid to the employees</i>		

In some countries (like Italy) employees also receive family contributions from social security institutions. This reduces the total liability with the SSI

Social security contribution payable (L)	400	
Employee compensation payable (L)		400
<i>Accounted for family contributions to be paid to the employees on behalf of the SSI</i>		

Recording employee compensation

- The business pays the net amount to the employees:

Employee compensation payable (L)	7.200	
Cash (A)		7.200

Paid the net salary to the employees

- In some countries (like Italy) each business bears part of the cost of social security for its employees. For this cost we record:

Social security expense (E)	2.000	
Social security contribution payable (L)		2.000

Recorded the expense for SSC borne by the company

Recording employee compensation

- When we pay our liabilities to the social security institutions, to the government and to the unions we just record:

Social security contribution payable (L)	2.600	
Union dues payable (L)	200	
Employee income tax payable (L)	2.000	
Cash (A)		4.800

Paid the SSI, the unions and the taxes related to the employee compensation of May

Recording employee compensation

- In some countries (like Italy), employees have the right to receive a certain amount of money as a benefit when they leave the company (if they retire, they quit the job or even if they are fired)
- Such amount of money is proportional to what they earned during the period they spent in the company as employees
- Therefore, every year, at the end of the accounting period, the companies account for the expense and for the increase in the liability related to such employee benefit, technically called “severance pay”:

Severance pay expense (E)	500	
		Severance pay payable (L) 500

Recorded the share of severance pay related to this accounting period

Employee compensation: example

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Source: Google
Recording sales and employee compensation

Review Questions

Review Question

If sales revenues are \$400,000, cost of goods sold is \$310,000 what is the gross profit?

1. \$30,000
2. \$90,000
3. \$340,000
4. \$400,000

Review Question

Which sale accounts normally have a debit balance?

1. Sales discounts
2. Sales returns and allowances
3. Both 1. and 2.
4. Neither 1. nor 2.