CHAPTER 6

SALES & RECEIVABLES - SELL MORE AND GENERATE CASH

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35 BOOKS OF ACCOUNTS – A QUICK RECAP

We have already discussed Books of Accounts in Chapter 3 which are normally used by Businesses. Of these, the following Books of Accounts are usually used in Sales & Receivables Accounting:

- Sales Day Book.
- Sales Ledger (also called Receivables Ledger).
- Cash & Bank Book.
- Inventory Ledger.

In this chapter, wherever Accounting entries are required to be shown, we will use these Books of Accounts for illustration purposes.

36 WHY IS IT IMPORTANT TO RECORD SALES?

While every individual aspect of a Business is very important, Sales is probably one area which drives the Business as a whole. Sales will determine:

- When should I buy raw material?
- When should I manufacture?
- How much should I manufacture?
- At what price should I buy?
- Do I need to employ more people, or to reduce employees?
- Do I need to buy more machines to be able to produce for the orders in hand?

Plus, there are also many other areas which are affected by how much a Business can sell. Proper recording of Sales enables Businesses to:

- Assess, analyse and repeat successful trade and marketing promotions.
- Identify specific concerns and requirements of each customer.
- Pre-empt and understand seasonality impact on sale of products.

In this day and age, where competition is becoming tougher, understanding how your sales have been and how you can sell more can make the difference between a successful and a failed Business.

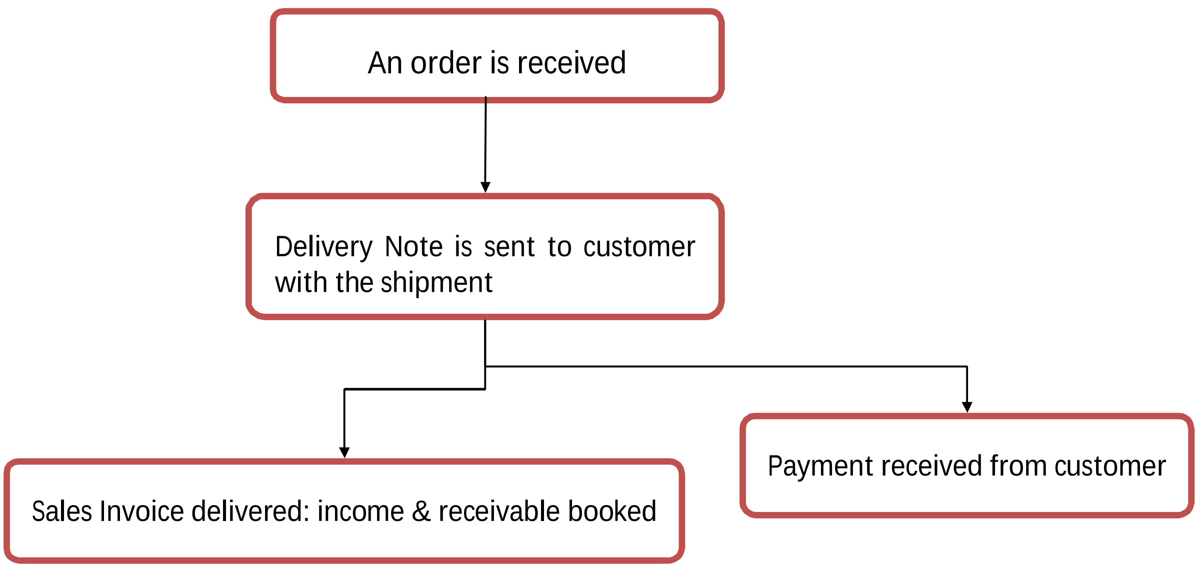
37 HOW SHOULD SALES BE RECORDED?

Sales Cycle is the various procedures which are usually included, in one form or other, when Businesses are recording sales related transactions. The number, extent and sophistication of processes can vary between Businesses depending on their sizes, nature of Business, number of employees and the complexity of reporting required by Owners.

Some of the typical processes which would be included within the Sales cycle are: order receiving, order confirmation, production scheduling, delivery of items ordered, invoice dispatch & recording and receiving payment. For our purposes, we have simplified the processes and shall recommend the following Sales Cycle which will adequately cover SMEs' requirements:

- Dispatching items sold – Delivery Note.
- Booking income and receivable - Sales Invoice.
- Receiving payment.

By way of a flowchart, the recommended processes are shown below:



37.1 Receiving & confirming orders – Sales Order

As was explained in Chapter 5, Orders and Order Confirmation documents are exchanged between Buyers and Sellers in order to put down, in writing, the important terms and conditions which have been mutually agreed upon.

From Sales perspective, the other benefits can be to name a few of them:

- To estimate and plan inventory requirements.
- To quantify the impact on working capital requirements.
- To assess whether capacity is available to process the order.
- To pre-determine the manpower / labor requirements.

Chapter 5 also has a format of a typical order document that can be used – although that format is specifically made for Purchases, the same can also be used for Sales.

EXAMPLE # 6.1

Receiving an Order

On 12/8/05, Hussain Khaddar receives order to supply 50 meters of Khaddar to Rehan Textile worth Rs. 50,000, delivery is expected to be made on 16/8/05. Khaddar will be delivered directly to the factory on Sheikhupura Road along with the sales invoice. Payment date is 25/8/05.

No Accounting entries are passed on receiving this Order. The Order will enable the receiving Business to check its inventory levels and to plan its production and / or purchasing schedules so that the order can be fulfilled on time.

37.2 DISPATCHING THE ORDERED ITEMS – DELIVERY NOTE

When an order is fulfilled and the Seller is dispatching the items ordered, a Delivery Note is usually sent along with the shipment. This Note serves useful purposes, as follows:

- To document what is being dispatched.
- To ensure that dispatches are in accordance with orders received.
- To take acceptance from receiving party that the latter has received the shipment.
- To have on-the-spot confirmation from buyer's representatives that shipment received was complete and in accordance with specifications.

A copy of the accepted / signed Delivery Note is kept for record.

EXAMPLE # 6.2

Dispatching Ordered Items

Continuing from example 6.1, 50 meters of Khaddar was dispatched on 16/8/05 and was also received on the same date. Delivery Note was prepared and handed over to the Driver. For the purposes of this example, we will assume that the cost of manufactured Khaddar was Rs. 35,000 for 50 meters of Khaddar.

Since Khaddar has been sold, the quantity has to be taken out from the Books:

INVENTORY LEDGER										
KHADDAR									IL-8	
Date	Ref No.	Receipt			Issue			Balance		
		Quantity	Rate (Rs.)	Amount (Rs.)	Quantity	Rate (Rs.)	Amount (Rs.)	Quantity	Rate (Rs.)	Amount (Rs.)
								50	700	35,000
16/8/05					50	700	35,000			Nil

37.3 RAISING AN INVOICE – SALES INVOICE

Normally completed as part of dispatch procedures, Sales Invoices may or may not be sent along with the Delivery Notes.

The format of a typical Sales Invoice has already been shown in Chapter 3.

EXAMPLE # 6.3
Issuing Invoice

Continuing from example 6.2, Sales Invoice # 003/05 was also dispatched to Rehan Textile on 16/8/05. This was recorded in Sales Day Book on page number 20.

To record the sale and the amount receivable from Rehan Textile:

GENERAL LEDGER							
CUSTOMERS CONTROL ACCOUNT							GL-15
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
16/8/05	GL-16	Sales Account	50,000				

GENERAL LEDGER							
SALES ACCOUNT							GL-16
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				16/8/05	GL-15	Customers Control Account	50,000

SALES LEDGER					
	REHAN TEXTILE			SL-1	
			Amount (Rs.)		
Date	Ref	Description	Debit	Credit	Balance (Rs.)
16/8/05	20	50 meters of Khaddar	50,000		50,000

37.4 RECEIVING PAYMENTS

Receipts or payments by customers can be in any form and shape i.e. cash, crossed cheque or pay orders etc. – most sellers do not have control on how payments are received by them.

EXAMPLE # 6.4

Recording receipts

Again, taking the Example # 6.1 above, full payment was received from Rehan Textile through cross cheque # 200845 on 25/8/05.

The following entries are processed to record this transaction:

CASH & BANK BOOK							
	BANK ACCOUNT						GL-20
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
25/8/05	GL-15	Customers Control Account	50,000				

GENERAL LEDGER							
CUSTOMERS CONTROL ACCOUNT							GL-15
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				25/8/05	GL-20	Bank Account	50,000

And, the memorandum Sales Ledger Account is also updated:

SALES LEDGER					
REHAN TEXTILE			SL-1		
			Amount (Rs.)		Balance
Date	Ref	Description	Debit	Credit	(Rs.)
					50,000
25/8/05	BRV18	Cheque #200845 against SI#003/05		50,000	Nil

38 KNOW YOUR SELLING PRICE

This is probably the most important issue that a Business can be faced with. Whenever a Business is faced with this question, the obvious problems are:

- Am I selling too cheap?
- Am I selling too high? – Will the buyer run away?

Knowing the right price is the key to running a successful Business. However, there is no right or wrong answer vis-à-vis how much should you sell your products for. The important thing to remember is that no Business should sell below its cost!

There are two very simple and commonly used pricing strategies through which a Business may be able to determine its Selling Price – the main assumption behind both of these strategies is that the Business knows its costs.

38.1 COST-PLUS BASIS

This strategy requires a Business to add profit as a percentage to its cost of the product (cost of a product will be covered in more detail in Chapter No. 10) to arrive at a selling price. This can be shown as follows:

		Rs.
Cost of a Product	A	200,000
Profit (25%)	B	50,000
Selling Price	A+B	250,000

38.2 GROSS MARGIN BASIS

This strategy requires a Business to apply profit as a percentage to the potential selling price to arrive at the "cost of a product" to determine whether it is viable for a Business or not.

		Rs.
Selling Price	A	250,000
Cost of a Product	B	187,500
Gross Margin (25%)	A-B	62,500

You will observe from the above that, if either the cost or the selling price of a product is available, the Business can use either of the two strategies to work out the selling price.

39 MY CUSTOMER HAS NOT PAID ME – WHAT DO I DO?

What we have described so far is the normal sales cycle i.e. order received, goods dispatched, no differences, invoice dispatched and payment is received. We will use this section to describe some other situations which Businesses are also faced with as part of their day to day operations.

The most common problem, relating to the Sales Cycle, which any SME Business will commonly face is the recovery of amounts due from (some of) its customers.

In the following paragraphs, we have described some of these situations:

39.1 BAD & DOUBTFUL DEBTS

Selling products and services is what Businesses do. Whether a Business is able to sell its products or its services is called a Business Risk. Once a Business has sold its products or rendered services, whether it is able to get its money back is called a Credit Risk i.e. a risk that the customers may not pay the monies that they owe. And, when a customer is unable to pay, it becomes a "Bad Debt".

You will recall from Chapter No. 2 where we discussed the Prudence concept. Just to recap, prudence requires that where there is a reasonable certainty or likelihood that a loss will be incurred, it should be recognized in the Books of Accounts - the concept behind Bad & Doubtful Debts is same.

When a Business makes a provision for "Bad" and / or "Doubtful Debts", there are two kinds of situations which may lead to such a situation:

- A specific provision, on the basis of known reasons & circumstances, against particular debts.
- Bad debt, where there is definitive reasons to be believe that the debt will not be recovered.

The difference between the above is an assessment of the likelihood whether the customer is or will be in a position to pay.

In Accounting terms, in first case the balance owed by the customer is kept in the Books of Accounts in anticipation that the customer may pay – in second case, the amount and balances are completely eliminated from the Books of Accounts.

The following example will illustrate the accounting relevant to both these situations:

EXAMPLE # 6.5

Bad & Doubtful Debts

On 1/8/05, a customer walks into Hanif Auto Engineering with an accidental car. Major repair work including denting and painting had to be carried out to bring the car to its original shape and color. The car belongs to the owner of a company, Abid & Co., which is a regular customer of Hanif Auto Engineering. Car was repaired, and an invoice for Rs. 90,000 was sent to Abid & Co. Rs. 85,000 was received on 7/8/05 in partial settlement, while the remaining amount remained outstanding.

On 23/8/05, Hanif Ahmed heard that the company has closed down due to some financial problems, and on 26/8/05 it was learnt that the owners have sold their Business and the company office has been shut down.

When Abid & Co. was invoiced:

GENERAL LEDGER							
CUSTOMERS CONTROL ACCOUNT							GL-15
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
1/8/05	GL-16	Sales Account	90,000				

GENERAL LEDGER							
SALES ACCOUNT							GL-16
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				1/8/05	GL-15	Customers Control Account	90,000

SALES LEDGER					
ABID & CO				SL-1	
			Amount (Rs.)		Balance
Date	Ref	Description	Debit	Credit	(Rs.)
1/8/05	33	Repair work on Car LXZ 555	90,000		

When partial payment of Rs. 5,000 was received:

GENERAL LEDGER							
CUSTOMERS CONTROL ACCOUNT							GL-15
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				7/8/05	GL-25	Bank Account	85,000

CASH & BANK BOOK							
	BANK ACCOUNT						GL-25
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
7/8/05	GL-15	Customers Control Account	85,000				

SALES LEDGER					
ABID & CO				SL-1	
			Amount (Rs.)		Balance
Date	Ref	Description	Debit	Credit	(Rs.)
					90,000
7/8/05	BRV16	Cheque #200687 against SI#002/05		85,000	5,000

When Hanif Auto came to know about the financial problems, a specific provision was made against the balance owed by Abid & Co.

GENERAL LEDGER							
PROVISION FOR BAD & DOUBTFUL DEBTS ACCOUNT							GL-28
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				23/8/05	GL-27	Bad Debts Expense Account	5,000

GENERAL LEDGER							
BAD DEBTS EXPENSE ACCOUNT							GL-27
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
23/8/05	GL-28	Provision for Bad & Doubtful Debts Account	5,000				

You will note that, at this stage, no entry has been passed through either the Control Account, or the Sales Ledger. Which means that the balance recoverable is still shown against Abid & Co.

And lastly, when it was learnt that the offices have been closed down and that the Business has been sold.

GENERAL LEDGER							
CUSTOMERS CONTROL ACCOUNT							GL-15
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				26/8/05	GL-28	Provision for Bad & Doubtful Debts Account	5,000

GENERAL LEDGER							
PROVISION FOR BAD & DOUBTFUL DEBTS ACCOUNT							GL-28
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
26/8/05	GL-15	Customers Control Account	5,000				

SALES LEDGER					
ABID & CO			SL-1		
			Amount (Rs.)		Balance
Date	Ref	Description	Debit	Credit	(Rs.)
					5,000
23/8/05	JV 5	Bad Debts		5,000	Nil

Please note that, in these examples, we have shown how a provision for a bad & doubtful debt converts and changes into a complete write off. However, please note that a debt could also have been directly written off as a "Bad Debt" as well without passing the entry through the provision account first. In such a case, where bad debt is directly written off, the Accounting entries would have been as follows.

GENERAL LEDGER							
CUSTOMERS CONTROL ACCOUNT							GL-15
Debit				Credit			
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				7/8/05	GL-27	Bad Debts Expense Account	5,000

GENERAL LEDGER							
BAD DEBTS EXPENSE ACCOUNT							GL-27
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
7/8/05	GL-15	Customers Control Account	5,000				

SALES LEDGER					
	ABID & CO			SL-1	
			Amount (Rs.)		Balance
Date	Ref	Description	Debit	Credit	(Rs.)
					5,000
7/8/05		Bad Debts		5,000	Nil

39.2 BAD DEBTS RECOVERED

There may be occasions where despite the fact that a provision has already been made against a certain balance, or where a debt may have been written off in the past, a Business is able to make a recovery from such customers. In such cases, because the Business has already incurred an "expense" (by debiting the Bad Debt Expense Account) in its Books of Accounts, the recovery from customer will be treated as "Income". The following example will show how entries will be passed in such cases:

EXAMPLE # 6.6

Recovery of Bad Debts

Continuing from Example 6.5, on 28/7/05 the owners of Abid & Co contacted Hanif Auto Engineering and gave a cheque for Rs. 5,000 to settle their outstanding bills.

GENERAL LEDGER							
BAD DEBTS RECOVERED ACCOUNT							GL-26
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
				28/7/05	GL-25	Bank Account	5,000

CASH & BANK BOOK							
	BANK ACCOUNT						GL-25
	Debit				Credit		
Date	Folio	Description	Amount (Rs.)	Date	Folio	Description	Amount (Rs.)
28/7/05	GL-26	Bad Debts Recovered Account	5,000				

39.3 ADVANCES, DISCOUNTS AND RETURNS

We have already covered these situations in Chapter 5. In case of Sales & Receivables, the basis of such entries is very similar except that Sales & Receivables are a mirror image of Purchases & Payables i.e. the exact opposite of each other. This can be shown through the following table:

Situation	Sales & Receivables	Purchases & Payables
Advances:	Advance received is a "Liability" i.e. Credit Balance.	Advance paid is an "Asset" i.e. Debit Balance.
Discounts:	Discount given is an expense i.e. Debit Balance..	Discount received is Income i.e. Credit Balance.
Returns:	Return inwards is an Expense i.e. Debit Balance	Return Outwards is Income i.e. Credit Balance.

40 CONVERT YOUR RECEIVABLES INTO CASH

We all know that selling is important for Business's survival. But, if cash is not recovered from customers, selling is of no use.

Some Businesses can sell on cash or against advance payments – more commonly, Businesses have to extend credit to customers in order to secure an order. Whatever the case be, it is important to get customers to pay their debts on time. Systems, procedures and people are employed in Businesses to look after this function which is called "Credit Control".

A very important tool to facilitate monitoring and recovery of your receivables is to use the "Customer Ageing Report". This report is a direct output from the Sales Ledger which gives a customer-wise break down of the sums owed by customers. More importantly, for amounts owed by each customer, this report also tells the number of days that have lapsed since the invoice was raised. The benefit is obvious: a Business may extend certain credit i.e. the number of days that the customers can take to settle the invoices - once the credit period has lapsed, it is time for the Business to start making active follow up, be it telephone calls, visits, letters etc. to expedite payment of their debts.

41 SOME SUGGESTIONS ON IMPROVING LIQUIDITY

41.1 LIQUIDITY MANAGEMENT

You will recall that while profitability is important for a Business, cash flow is equally (if not more) important. Cash flow, or cash generation, is the ability of a Business to convert its various assets into cash.

Receivables are one such important asset. Receivables not only include actual cash spent by a Business (to purchase materials, salaries and other overheads) but also include an element of profit that the Business stands to earn from that sale. Reducing outstanding receivables i.e. encouraging or forcing your customers to pay on time is a useful strategy to improve your cash flow position. This is even more important where a Business has taken bank financing or has even taken credit from the market.

Constantly following up with customers to pay on time is called "Credit Control" – every Business should have active Credit Control procedures in place without which the risk of a Business venturing into cash flow problems is inevitable.

41.2 EARLY SETTLEMENT DISCOUNTS

It is normal for Businesses to offer early settlement discounts to their customers. The timing and amount of discount to be offered to a customer depends on liquidity position of the Business.

Some of the factors to consider when offering these discounts are: financing costs, cost of money borrowed from other sources and opportunity cost i.e. the cost that if this receivable was to be realized early, there may be an alternate opportunity which could have been pursued – if such an alternate was available, a Business may offer an attractive discount to take on this alternate opportunity.

As an example, a Business may have taken on bank financing for its working capital purposes – the mark up rate on this financing may be such that it may be more worthwhile for the Business to offer a discount and use these funds to reduce the outstanding balance on its working capital borrowings.

CHAPTER HIGHLIGHTS

What have we covered?

1. Sales is probably the most important part of a Business.

2. Sales Cycle is the various processes which are usually included, in one form or other, when Businesses are conducting sales related transactions.

3. Orders and Order Confirmation documents are exchanged between a Buyer and a Seller.

4. When an order is dispatched, the Seller will normally send a Delivery Note and an Invoice.

5. Payment is received in form of cash or cheque.

6. “Cost Plus” and “Gross Margin” are two commonly used and easy to understand techniques to determine selling price.

7. When a customer is unable to pay its debts, the amount receivable from that customer becomes a “Bad Debt”.

8. Cash received from a customer against whom a provision for bad debt has already been made is Income for the Business.

9. Advance received from a customer is a “Liability” for the receiving Business.

10. Discount given to a customer is an Expense.

11. Return inwards is an Expense for the selling Business.

12. Constant follow up with a customer to pay is referred to as Credit Control.

13. Early settlement discounts can be given to customers to generate liquidity for a Business.