1. On December 3, R. Humphrey Company Sold $570,000 Of Merchandise On Account To Frazier Co., Terms 1/10,

Understanding the Sale Transaction Between R. Humphrey Company and Frazier Co.

Introduction to the Transaction

1. On December 3, R. Humphrey Company Sold $570,000 Of Merchandise On Account To Frazier Co., Terms 1/10, marks a significant sale transaction that encapsulates key principles of credit sales, payment terms, and accounting procedures. This transaction involves the sale of merchandise valued at $570,000 on credit, with specific payment terms that influence how and when the sale is recorded and how subsequent payments are processed. Understanding the details of this sale provides insight into the company's revenue recognition, receivables management, and the impact of early payment discounts.

Key Components of the Transaction

Sale of Merchandise on Credit

In this scenario, R. Humphrey Company extends credit to Frazier Co., meaning the latter is permitted to purchase merchandise now and pay for it later. Credit sales are common in business-to-business transactions, enabling Frazier Co. to manage cash flow and inventory more flexibly.

- Sale amount: $570,000
- Type of sale: On account (credit sale)
- Customer: Frazier Co.

Payment Terms: 1/10

The terms "1/10" refer to a discount offered to the buyer for early payment. Specifically:

1. **1%** discount is available if payment is made within **10 days** of the invoice date.

2. Otherwise, the full amount is due after the discount period.

In addition, the transaction may specify the due date and the method of payment, but the critical factor is the discount clause which incentivizes early settlement.

Implications of the Payment Terms

Early Payment Discount

The 1/10, n/30 terms (if n/30 is assumed as the net period) mean that Frazier Co. can deduct 1% from the invoice amount if they pay within 10 days. This practice benefits R. Humphrey Company by encouraging early cash inflow, reducing accounts receivable days, and improving liquidity.

Accounting for the Discount

When Frazier Co. makes an early payment, R. Humphrey must record the receipt of cash, reduce accounts receivable, and account for the discount. If payment is made within the discount period, the journal entry will reflect the discount as a reduction in revenue or as a separate discount allowed account.

Recording the Sale in the Accounting Records

Initial Sale Entry

At the time of sale on December 3, R. Humphrey records a receivable and recognizes revenue. The journal entry typically looks like:

- Debit: Accounts Receivable $570,000
- Credit: Sales Revenue $570,000

This entry recognizes the amount owed by Frazier Co. and the revenue earned from the sale.

Consideration of Cost of Goods Sold (COGS)

If the inventory cost of the merchandise sold is known, R. Humphrey will also record COGS and reduce inventory accordingly:

- Debit: Cost of Goods Sold (amount)

- Credit: Inventory (amount)

This step ensures the expenses are matched with revenues, aligning with accrual accounting principles.

Receiving Payment and Adjusting Entries

Payment Within the Discount Period

If Frazier Co. pays within 10 days, the company will record the cash receipt and adjust for the discount:

1. Calculate the discount: 1% of $570,000 = $5,700

2. Determine the amount received: $570,000 - $5,700 = $564,300

The journal entry upon receipt of early payment is:

- Debit: Cash $564,300

- Debit: Sales Discounts Allowed $5,700

- Credit: Accounts Receivable $570,000

This entry reflects the receipt of cash, the discount granted, and the clearing of the receivable.

Payment After the Discount Period

If Frazier Co. pays after the 10-day discount window, the company records:

- Debit: Cash $570,000

- Credit: Accounts Receivable $570,000

No discount is involved in this case.

Impact on Financial Statements

Income Statement Effects

The sale affects revenue and potentially the gross profit margin, depending on the COGS. Early payment discounts reduce net sales revenue but encourage quicker cash collection.

Balance Sheet Effects

Accounts receivable are increased upon sale and decreased upon payment. The receipt of early payment reduces accounts receivable and increases cash balances.

Additional Considerations and Best Practices

Monitoring Accounts Receivable

- Regularly review outstanding receivables to identify overdue accounts.
- Implement collection procedures for delinquent accounts.

Importance of Accurate Discount Recording

- Ensure discounts are properly recorded to reflect actual revenue.
- Use separate accounts such as "Sales Discounts Allowed" for clarity.

Tax Implications

Early payment discounts can influence taxable income calculations. Companies should consult tax regulations to understand how discounts impact gross income and deductions.

Conclusion

The sale transaction on December 3, involving R. Humphrey Company and Frazier Co., is a textbook example of credit sales with early payment discounts. Properly recording and managing these transactions ensures accurate financial reporting, effective cash flow management, and compliance with accounting standards. The 1/10 discount term incentivizes Frazier Co. to pay promptly, benefiting both parties by reducing receivables days and improving liquidity. For accountants and financial managers, understanding the nuances of such terms and their proper recording is essential for maintaining the integrity and clarity of financial statements.

Frequently Asked Questions

What does the sales transaction on December 3 involve between R. Humphrey Company and Frazier Co.?

R. Humphrey Company sold $570,000 worth of merchandise on account to Frazier Co., with payment terms of 1/10, meaning a 1% discount is available if paid within 10 days.

What are the payment terms 1/10 in the sales transaction, and how do they benefit Frazier Co.?

The terms 1/10 mean that Frazier Co. can receive a 1% discount if they pay the invoice within 10 days, encouraging early payment and reducing the amount payable.

How would R. Humphrey Company record the sale on December 3 in their accounting books?

They would record a debit to Accounts Receivable for $570,000 and a credit to Sales Revenue for the same amount, reflecting the sale on account.

If Frazier Co. pays within the 10-day discount period, how much will they pay for the merchandise?

They will pay $570,000 minus 1% ($5,700), totaling $564,300 if they pay within the discount period.

What journal entry should R. Humphrey Company make if Frazier Co. takes advantage of the 1% discount and pays within 10 days?

They would debit Cash for $564,300, debit Sales Discounts for $5,700, and credit Accounts Receivable for $570,000.

Why are sales terms like 1/10 important for businesses and customers?

They incentivize early payment, improve cash flow for sellers, and offer cost savings to buyers who pay promptly.

What impact does the sales transaction have on R. Humphrey Company's revenue and receivables?

It increases sales revenue by $570,000 and accounts receivable by the same amount until payment is received.

What considerations should Frazier Co. keep in mind regarding the payment deadline and discount?

Frazier Co. should ensure they pay within 10 days to take advantage of the 1% discount, thereby reducing their purchase cost.

Additional Resources

On December 3, R. Humphrey Company Sold $570,000 Of Merchandise On Account To Frazier Co., Terms 1/10, is a transaction that encapsulates several fundamental accounting principles and practices crucial for understanding revenue recognition, receivables management, and sales discount policies. This transaction illustrates how a business records sales made on credit, manages sales discounts, and processes subsequent payments. Whether you are an accounting student, a small business owner, or a finance professional, understanding the nuances of such sales transactions is essential for accurate financial reporting and effective cash flow management.

Understanding the Transaction in Context

At its core, this transaction involves a sale made by R. Humphrey Company to Frazier Co., where merchandise worth $570,000 is sold on credit, with specific payment terms of 1/10. The key components include:

- The sale amount: $570,000
- The sale date: December 3
- The customer: Frazier Co.
- Payment terms: 1/10, net 30 (implied, as typical terms are 1/10, net 30 unless otherwise specified)

This scenario provides a practical example of how companies record sales, recognize revenue, and handle potential discounts for early payment.

Breaking Down the Sale: Key Elements and Terminology

1. Sale on Account (Credit Sale)

A sale on account means that the customer is purchasing goods or services now but paying at a later date. This is a common practice in business-to-business transactions, enabling Frazier Co. to manage cash flow and inventory.

2. Sales Terms: 1/10

The terms 1/10 indicate that Frazier Co. can take a 1% discount if the invoice is paid within 10 days. This incentivizes early payment, reducing the company's accounts receivable and improving cash flow.

3. Net 30 (Assumed)

While not explicitly stated, typical credit terms include net 30, meaning the full amount is due within 30 days if the discount is not taken.

The Impact of Terms on Revenue Recognition and Receivables

Revenue Recognition Principles
According to Generally Accepted Accounting Principles (GAAP), revenue from the sale is recognized when earned, which in this case is upon delivery or transfer of ownership, typically on December 3. The amount recognized initially is the gross sales amount, before any discounts.

Accounts Receivable
Since the sale is made on credit, R. Humphrey Company will record an accounts receivable for $570,000. This asset reflects the company's right to collect cash from Frazier Co. in the future.

Recording the Sale: Journal Entry on December 3

The initial journal entry to record this sale would be:

- Debit: Accounts Receivable $570,000
- Credit: Sales Revenue $570,000

This entry recognizes the revenue earned and creates an asset (accounts receivable) for the amount owed by Frazier Co.

Handling the Potential Discount: 1% if Paid Within 10 Days

Calculating the Discount
If Frazier Co. pays within 10 days, they are entitled to a 1% discount:

- Discount amount = 1% of $570,000 = $5,700

Impact on the Sale
The net amount Frazier Co. pays if they take the discount:

- Net payment = $570,000 - $5,700 = $564,300

Recording the Discount
In practice, the company will record the receivable at the gross amount ($570,000) initially. When the customer pays early, the company will recognize the discount as a reduction in sales revenue or as a separate sales discount account, depending on the company's accounting policies.

When Frazier Co. Pays Within the Discount Period

Journal Entry Upon Payment (Within 10 Days)
Assuming Frazier Co. pays within 10 days, the journal entry would be:

- Debit: Cash $564,300
- Debit: Sales Discounts Forfeited (or similar account) $5,700
- Credit: Accounts Receivable $570,000

Alternatively, some companies record the discount directly:

- Debit: Cash $564,300
- Debit: Sales Discount Allowed (or similar) $5,700
- Credit: Accounts Receivable $570,000

This reflects collection of the net amount and the discount granted.

What Happens if Payment is Made After 10 Days?

If Frazier Co. pays after the 10-day window but within 30 days, they are not eligible for the discount, and the payment will be the full $570,000:

Journal Entry Upon Payment (After 10 Days)
- Debit: Cash $570,000
- Credit: Accounts Receivable $570,000

In this case, no discount is recorded, and the full receivable amount is settled.

Analyzing the Impact on Financial Statements

Income Statement
- The sale of $570,000 will be recorded as revenue.
- If discounts are granted, they reduce gross sales and are reflected as a sales discount expense or contra-revenue account, decreasing net sales.

Balance Sheet
- Accounts receivable increases by $570,000 initially.
- Upon payment, receivables decrease accordingly.
- Cash increases when payment is received.

Cash Flow Statement
- Sales on account do not immediately impact cash flows.
- When Frazier Co. pays, cash inflows increase, reflecting collections.

Best Practices for Managing Credit Sales and Discounts

1. Clear Credit Policies

Establish clear credit terms and communicate them to customers to reduce misunderstandings.

2. Efficient Receivables Management
Monitor receivables closely to ensure timely payments, especially for early payment discounts.

3. Accurate Record-Keeping
Maintain detailed records of sales, discounts, and payments to ensure accurate financial reporting.

4. Use of Sales Discount Accounts
Properly account for discounts granted to reflect true revenue and receivables.

5. Regular Reconciliation
Perform regular reconciliations of accounts receivable to identify overdue accounts and minimize bad debts.

Implications for Business Strategy

Offering discounts for early payment (like 1/10) can improve cash flow and reduce the risks of bad debts. However, it also shortens the window for full payment, requiring diligent receivables management. Businesses should weigh the benefits of prompt cash inflow against the potential revenue loss from discounts.

Summary: Key Takeaways for the December 3 Sale

- The sale on December 3 of $570,000 on account recognizes revenue and creates an accounts receivable.
- The terms 1/10 incentivize early payment with a 1% discount.
- Proper journal entries are essential to accurately reflect the transaction.
- The timing of payment influences whether the discount is applied.
- Effective receivables management and clear policies are critical for maximizing cash flow and maintaining financial health.

Final Thoughts

The transaction involving R. Humphrey Company and Frazier Co. exemplifies core accounting processes related to credit sales, discounts, and revenue recognition. Understanding these principles ensures accurate financial reporting, better cash flow management, and improved strategic decision-making. Whether you’re preparing financial statements, analyzing company performance, or designing credit policies, grasping the intricacies of such sales transactions is fundamental to sound financial practice.

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