Issuing Credit and Creating Accounts Receivable (AR)

While sales are going great soon a few of your very thirsty friends from the football team arrive. They would love to try your tasty lemonade but, they don't have their wallets with them. Infact they don't have any money with them at all.

What to do? Upon a quick thought you decide they are not a terrible credit risk and pour them 4 glasses of lemonade on credit. They promise to pay you next week after the big game. How do you remember and post that on your balance sheet?

Youy remove $2.00 out of finished Inventory by subtracting that amount. And you add a new journal entry in Assets for Accounts Receivable. Then you add $2.00 there and voila you are still in balance. Just to keep the paperwork in order and have a written record you have each of the four players sign an IOU note that states they owe your business 50 cents, for a total of $2.00 in exchange for receiving your tasty lemonade.

Sometimes issuing credit to customers are a great way to increase business. However customers and clients may have to be vetted to demonstrate they are responsible and have the ability to pay their debts. Often a credit report may be requested by you the vendor (seller). Another way to determine if you should issue credit is by studying the amount of their cash on hand or savings, other debts, income and creating certain ratios often called solvency ratios. These will be covered in future chapters.