CHAPTER 9

Accounting for Receivables

ASSIGNMENT CLASSIFICATION TABLE

<u>Stu</u>	dy Objectives	Questions	Brief Exercises	Exercises	A Problems	B Problems
1.	Identify the different types of receivables.	1, 2	1			
2.	Explain how companies recognize accounts receivable.	3	2	1, 2, 14	1A, 3A, 4A, 6A, 7A	1B, 3B, 4B, 6B, 7B
3.	Distinguish between the methods and bases companies use to value accounts receivable.	4, 5, 6, 7, 8	3, 4, 5, 6, 7	3, 4, 5, 6	1A, 2A, 3A, 4A, 5A	1B, 2B, 3B, 4B, 5B
4.	Describe the entries to record the disposition of accounts receivable.	9, 10, 11	8	7, 8, 9, 14	6A, 7A	6B, 7B
5.	Compute the maturity date of and interest on notes receivable.	12, 13, 14, 15, 16	9, 10	10, 11, 12, 13	6A, 7A	6B, 7B
6.	Explain how companies recognize notes receivable.		11	10, 11, 12	7A	7B
7.	Describe how companies value notes receivable.				7A	7B
8.	Describe the entries to record the disposition of notes receivable.	17		12, 13	6A, 7A	6B, 7B
9.	Explain the statement presentation and analysis of receivables.	18, 19	3, 12	14, 15	1A, 6A	1B, 6B

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Prepare journal entries related to bad debts expense.	Simple	15–20
2A	Compute bad debts amounts.	Moderate	20–25
ЗA	Journalize entries to record transactions related to bad debts.	Moderate	20–30
4A	Journalize transactions related to bad debts.	Moderate	20–30
5A	Journalize entries to record transactions related to bad debts.	Moderate	20–30
6A	Prepare entries for various notes receivable transactions.	Moderate	40–50
7A	Prepare entries for various receivable transactions.	Complex	50–60
1B	Prepare journal entries related to bad debts expense.	Simple	15–20
2B	Compute bad debts amounts.	Moderate	20–25
3B	Journalize entries to record transactions related to bad debts.	Moderate	20–30
4B	Journalize transactions related to bad debts.	Moderate	20–30
5B	Journalize entries to record transactions related to bad debts.	Moderate	20–30
6B	Prepare entries for various notes receivable transactions.	Moderate	40–50
7B	Prepare entries for various receivable transactions.	Complex	50–60

	Study Objective	Knowledge	Comprehension	n Application		Analysis	Syn	Synthesis	Evaluation
÷	Identify the different types of receivables.	Q9-2	Q9-1 BE9-1	Ļ					
N,	Explain how companies recognize accounts receivable.			Q9-3 E9-2 BE9-2 P9-7A E9-1 P9-7B	E9-14 \ P9-1A 3 P9-3A	P9-4A P9 P9-6A P9 P9-1B P9	P9-3B P9-4B P9-6B		
r.	Distinguish between the methods and bases used to value accounts receivable.	8-6D	Q9-4 Q9-6 Q9-6	BE9-4 BE9-5 BE9-5 E9-5 E9-6	Q9-7 BE9-3 BE9-7 E9-3 E9-4	P9-1A P9 P9-2A P9 P9-3A P9 P9-4A P9 P9-5A P9	P9-18 P9-28 P9-38 P9-48 P9-58		
4.	Describe the entries to record the disposition of accounts receivable.	6-60	Q9-10	Q9-11 E9-9 BE9-8 P9-7A E9-7 P9-7B E9-8	E9-14 A P9-6A 3 P9-6B				
5.	Compute the maturity date of and interest on notes receivable.	Q9-13	Q9-12 Q9-16	Q9-14 E9-12 Q9-15 E9-13 BE9-9 P9-7A BE9-10 P9-7B	E9-12 E9-10 E9-13 E9-11 P9-78 P9-6A P9-7B P9-6B				
6.	Explain how companies recognize notes receivable.			BE9-11 P9-7B P9-7A E9-12	8 E9-10 2 E9-11				
7.	Describe how companies value notes receivable.			P9-7A P9-7B					
8.	Describe the entries to record the disposition of notes receivable.		Q9-17	E9-12 P9-7A E9-13 P9-7B	A P9-6A 8 P9-6B				
9.	Explain the statement presentation and analysis of receivables.	Q9-18		Q9-19 BE9-12 E9-15	BE9-3 E9-14 P9-1A	6 6 6 6 7 6 7	P9-6A P9-1B P9-6B		
Bro	Broadening Your Perspective			Exploring the Web		Decision Making Across the Organization Comparative Analysis	ssc		All About You Financial Reporting Comparative Analysis Ethics Case

Correlation Chart between Bloom's Taxonomy, Study Objectives and End-of-Chapter Exercises and Problems

ANSWERS TO QUESTIONS

- 1. Accounts receivable are amounts owed by customers on account. They result from the sale of goods and services in the normal course of business operations (i.e., in trade). Notes receivable represent claims that are evidenced by formal instruments of credit.
- 2. Other receivables include nontrade receivables such as interest receivable, loans to company officers, advances to employees, and income taxes refundable.
- 3. Accounts Receivable
 40

 Interest Revenue
 40
- 4. The essential features of the allowance method of accounting for bad debts are:
 - (1) Uncollectible accounts receivable are estimated and matched against revenue in the same accounting period in which the revenue occurred.
 - (2) Estimated uncollectibles are debited to Bad Debts Expense and credited to Allowance for Doubtful Accounts through an adjusting entry at the end of each period.
 - (3) Actual uncollectibles are debited to Allowance for Doubtful Accounts and credited to Accounts Receivable at the time the specific account is written off.
- 5. Jerry Gatewood should realize that the decrease in cash realizable value occurs when estimated uncollectibles are recognized in an adjusting entry. The write-off of an uncollectible account reduces both accounts receivable and the allowance for doubtful accounts by the same amount. Thus, cash realizable value does not change.
- 6. The two bases of estimating uncollectibles are: (1) percentage-of-sales and (2) percentage-of-receivables. The percentage-of-sales basis establishes a percentage relationship between the amount of credit sales and expected losses from uncollectible accounts. This method emphasizes the matching of expenses with revenues. Under the percentage-of-receivables basis, the balance in the allowance for doubtful accounts is derived from an analysis of individual customer accounts. This method emphasizes cash realizable value.

7.	The adjusting entry under the percentage-of-sales basis is: Bad Debts Expense Allowance for Doubtful Accounts	4,100	4,100
	The adjusting entry under the percentage-of-receivables basis is: Bad Debts Expense	2,300	
	Allowance for Doubtful Accounts (\$5,800 – \$3,500)	·	2,300

- 8. Under the direct write-off method, bad debt losses are not estimated and no allowance account is used. When an account is determined to be uncollectible, the loss is debited to Bad Debts Expense. The direct write-off method makes no attempt to match bad debts expense to sales revenues or to show the cash realizable value of the receivables in the balance sheet.
- **9.** From its own credit cards, the DeVito Company may realize financing charges from customers who do not pay the balance due within a specified grace period. National credit cards offer the following advantages:
 - (1) The credit card issuer makes the credit investigation of the customer.
 - (2) The issuer maintains individual customer accounts.

Questions Chapter 9 (Continued)

- (3) The issuer undertakes the collection process and absorbs any losses from uncollectible accounts.
- (4) The retailer receives cash more quickly from the credit card issuer than it would from individual customers.
- **10.** The reasons companies are selling their receivables are:
 - (1) Receivables may be sold because they may be the only reasonable source of cash.
 - (2) Billing and collection are often time-consuming and costly. It is often easier for a retailer to sell the receivables to another party with expertise in billing and collection matters.
- **12.** A promissory note gives the holder a stronger legal claim than one on an accounts receivable. As a result, it is easier to sell to another party. Promissory notes are negotiable instruments, which means they can be transferred to another party by endorsement. The holder of a promissory note also can earn interest.
- **13.** The maturity date of a promissory note may be stated in one of three ways: (1) on demand, (2) on a stated date, and (3) at the end of a stated period of time.
- 14. The maturity dates are: (a) March 13 of the next year, (b) August 4, (c) July 20, and (d) August 30.
- **15.** The missing amounts are: (a) \$20,000, (b) \$9,000, (c) 8%, and (d) four months.
- **16.** If a financial institution uses 360 days rather than 365 days, it will receive more interest revenue. The reason is that the denominator is smaller, which makes the fraction larger and, therefore, the interest revenue larger.
- 17. When Cain Company dishonors a note, it may: (1) issue a new note for the maturity value of the dishonored note, or (2) refuse to make any settlement, or (3) it might make partial payment and issue a new note for the unpaid balance.
- **18.** Each of the major types of receivables should be identified in the balance sheet or in the notes to the financial statements. Both the gross amount of receivables and the allowance for doubtful accounts should be reported. If collectible within a year or the operating cycle, whichever is longer, these receivables are reported as current assets immediately below short-term investments.
- **19.** Net credit sales for the period are 8.14 X \$400,000 = \$3,256,000.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 9-1

- (a) Accounts receivable.
- (b) Notes receivable.
- (c) Other receivables.

BRIEF EXERCISE 9-2

(a)	Accounts Receivable Sales	15,200	15,200
(b)	Sales Returns and Allowances Accounts Receivable	3,800	3,800
(c)	Cash (\$11,400 – \$228) Sales Discounts (\$11,400 X 2%) Accounts Receivable (\$15,200 – \$3,800)	11,172 228	11,400
BRI	EF EXERCISE 9-3		
(a)	Bad Debts Expense	25 000	
(4)	Allowance for Doubtful Accounts	35,000	35,000
(u) (b)	•	35,000	35,000
	Allowance for Doubtful Accounts	35,000 \$600,000	35,000 \$ 90,000
	Allowance for Doubtful Accounts Current assets Cash Accounts receivable	·	,
	Allowance for Doubtful Accounts Current assets Cash Accounts receivable Less: Allowance for doubtful Accounts Merchandise inventory	\$600,000	\$ 90,000 565,000 130,000
	Allowance for Doubtful Accounts Current assets Cash Accounts receivable Less: Allowance for doubtful Accounts	\$600,000	\$ 90,000 565,000

BRIEF EXERCISE 9-4

(a)	Allowance for Doubtful A Accounts Receivabl		5,400	5,400	
(b)		(1) Before Write-Off	(2)	After Wri	te-Off
	Accounts receivable Allowance for doubful	\$700,000		\$694,6	600
	accounts	<u>54,000</u>		<u>48,6</u>	
C	Cash realizable value	<u>\$646,000</u>		<u>\$646,0</u>	000
BRI	EF EXERCISE 9-5				
Acc	ounts Receivable—Ristau Allowance for Doubtful A			5,400	5,400
Cas	h			5,400	
	Accounts Receivable—R	istau	••••		5,400
	EF EXERCISE 9-6				
Bad	Debts Expense [(\$800,00 Allowance for Doubtful A	·		15,100	15,100
BRI	EF EXERCISE 9-7				
(a)	Bad Debts Expense [(\$450 Allowance for Doubt),000 X 1%) – \$1,500] Iful Accounts		3,000	3,000
(b)	Bad Debts Expense [(\$45	50,000 X 1%) + \$800] = 5,	300		
BRI	EF EXERCISE 9-8				
(a)	Cash (\$150 – \$6)			144	
	Service Charge Expense Sales	(\$150 X 4%)		6	150
(b)	Cash (\$60,000 – \$1,800)			58,200	
	Service Charge Expense Accounts Receivabl	(\$60,000 X 3%) e		1,800	60,000

BRIEF EXERCISE 9-9

Interest Maturity Dat

- (a) \$800 August 9
- (b) \$875 October 12
- (c) \$200 July 11

BRIEF EXERCISE 9-10

Maturity Date	Annual Interest Rate	Total Interest
(a) May 31	9%	\$9,000
(b) August 1	8%	\$ 600
(c) September 7	10%	\$6,000

BRIEF EXERCISE 9-11

Jan. 10	Accounts Receivable Sales	13,600	13,600
Feb. 9	Notes Receivable Accounts Receivable	13,600	13,600

BRIEF EXERCISE 9-12

Accounts Receivable Turnover Ratio:

 $\frac{\$20B}{(\$2.7B + \$2.8B) \div 2} = \frac{\$20B}{\$2.75B} = 7.3 \text{ times}$

Average Collection Period for Accounts Receivable:

 $\frac{365 \text{ days}}{7.3 \text{ times}} = 50 \text{ days}$

SOLUTIONS TO EXERCISES

EXERCISE 9-1

March 1	Accounts Receivable—CC Company Sales	3,000	3,000
3	Sales Returns and Allowances Accounts Receivable—CC Company	500	500
9	Cash Sales Discounts Accounts Receivable—CC Company	2,450 50	2,500
15	Accounts Receivable Sales	400	400
31	Accounts Receivable Interest Revenue	6	6
EXERCISE 9-2	2		
(a) Jan. 6	Accounts Receivable—Cortez Sales	9,000	9,000
16	Cash (\$9,000 – \$180) Sales Discounts (2% X \$9,000) Accounts Receivable—Cortez	8,820 180	9,000
(b) Jan. 10	Accounts Receivable—Dawes Sales	9,000	9,000
Feb. 12	Cash Accounts Receivable—Dawes	5,000	5,000
Mar. 10	Accounts Receivable—Dawes	80	

Interest Revenue

[2% X (\$9,000 - \$5,000)]

80

(a)		Dec. 31	Bad Debts Expense Accounts Receivable—Fell	1,400	1,400
(b)	(1)	Dec. 31	Bad Debts Expense [(\$840,000 – \$30,000) X 1%] Allowance for Doubtful Accounts	8,100	8,100
	(2)	Dec. 31	Bad Debts Expense Allowance for Doubtful Accounts [(\$120,000 X 10%) – \$2,100]	9,900	9,900
(c)	(1)	Dec. 31	Bad Debts Expense [(\$840,000 – \$30,000) X .75%] Allowance for Doubtful Accounts	6,075	6,075
	(2)	Dec. 31	Bad Debts Expense Allowance for Doubtful Accounts [(\$120,000 X 6%) + \$200]	7,400	7,400

EXERCISE 9-4

(a) Accounts Receivable	Amount	%	Estimated Uncollec	tible
1–30 days	\$60,000	2.0	\$1,200	
30–60 days	17,600	5.0	880	
60–90 days	8,500	30.0	2,550	
Over 90 days	7,000	50.0	3,500	
-			<u>\$8,130</u>	
Allowan	xpense ice for Doubti 30 – \$1,200)		•	6,930

Allowance for Doubtful Accounts Accounts Receivable	13,000	13,000
Accounts Receivable Allowance for Doubtful Accounts	1,800	1,800
Cash Accounts Receivable	1,800	1,800
Bad Debts Expense Allowance for Doubtful Accounts [\$19,000 – (\$15,000 – \$13,000 + \$1,800)]	15,200	15,200
EXERCISE 9-6		
December 31, 2008 Bad Debts Expense (2% X \$400,000) Allowance for Doubtful Accounts	8,000	8,000
May 11, 2009 Allowance for Doubtful Accounts Accounts Receivable—Frye	1,100	1,100
June 12, 2009 Accounts Receivable—Frye Allowance for Doubtful Accounts	1,100	1,100
Cash Accounts Receivable—Frye	1,100	1,100
EXERCISE 9-7		
(a) Mar. 3 Cash (\$680,000 – \$20,400) Service Charge Expense (3% X \$680,000) Accounts Receivable	659,600 20,400	680,000
(b) May 10 Cash (\$3,500 – \$140) Service Charge Expense	3,360 140	-,
Sales		3,500

(a)	Apr.	2	Accounts Receivable—Nancy Hansel Sales	1,500	1,500
	May	3	Cash Accounts Receivable—Nancy Hansel	700	700
	June	1	Accounts Receivable—Nancy Hansel Interest Revenue [(\$1,500 – \$700) X 1%]	8	8
(b)	July	4	Cash Service Charge Expense (3% X \$200) Sales	194 6	200
EXE	ERCISI	E 9-9	9		
(a)	Jan.	15	Accounts Receivable Sales	18,000	18,000
	:	20	Cash (\$4,300 – \$86) Service Charge Expense (\$4,300 X 2%)	4,214 86	4 200
			Sales		4,300
	Feb.	10	Cash Accounts Receivable	10,000	10,000
		15	Accounts Receivable (\$8,000 X 1%) Interest Revenue	80	80

(b) Interest Revenue is reported under other revenues and gains. Service Charge Expense is a selling expense.

(a)	2008	15 000	
Nov. 1	Notes Receivable Cash	15,000	15,000
Dec. 11	Notes Receivable Sales	6,750	6,750
16	Notes Receivable Accounts Receivable—Reber	4,000	4,000
31	Interest Receivable Interest Revenue*	295	295
Give Cou	ion of interest revenue: ens's note: \$15,000 X 10% X 2/12 = \$250 intryman's note: 6,750 X 8% X 20/360 = 30 er's note: 4,000 X 9% X 15/360 = <u>15</u> Total accrued interest <u>\$295</u>		
(b) Nov. 1	2009 Cash Interest Receivable Interest Revenue* Notes Receivable *(\$15,000 X 10% X 10/12)	16,500	250 1,250 15,000
EXERCIS	E 9-11		
May 1	2008 Notes Receivable Accounts Receivable—Julia Gonzalez	7,500	7,500
Dec. 31	Interest Receivable Interest Revenue (\$7,500 X 10% X 8/12)	500	500
31	Interest Revenue Income Summary	500	500

EXERCISE 9-11 (Continued)

2009

May	1	Cash	8,250	
-		Notes Receivable		7,500
		Interest Receivable		500
		Interest Revenue		250
		(\$7,500 X 10% X 4/12)		

EXERCISE 9-12

4/1/08	Notes Receivable Accounts Receivable—Wilson	20,000	20,000
7/1/08	Notes Receivable Cash	25,000	25,000
12/31/08	Interest Receivable Interest Revenue (\$20,000 X 12% X 9/12)	1,800	1,800
	Interest Receivable Interest Revenue (\$25,000 X 10% X 6/12)	1,250	1,250
4/1/09	Cash Notes Receivable Interest Receivable Interest Revenue (\$20,000 X 12% X 3/12 = \$600)	22,400	20,000 1,800 600
	Accounts Receivable Notes Receivable Interest Receivable Interest Revenue (\$25,000 X 10% X 3/12 = \$625)	26,875	25,000 1,250 625

(a)	May 2	Notes Receivable Cash	7,600	7,600
(b)	Nov. 2	Accounts Receivable—Everhart Inc Notes Receivable Interest Revenue (\$7,600 X 9% X 1/2) (To record the dishonor of Everhart Inc. note with expectation of collection)	7,942	7,600 342
(c)	Nov. 2	Allowance for Doubtful Accounts Notes Receivable (To record the dishonor of Everhart Inc. note with no expectation of collection)	7,600	7,600

EXERCISE 9-14

(a)	Sales		\$83,000
	Cost of Goods Sold		
	Beginning Inventory	\$36,000	
	Add: Purchases (net)	60,000	
	Goods Available for Sale	96,000	
	Less: Ending Inventory	33,000	
	Cost of Goods Sold		63,000
	Gross Profit		<u>\$20,000</u>

Total Sales = \$83,000 (\$20,000 + \$63,000)Cash Sales = \$18,000Credit Sales = \$65,000

(b) Accounts Receivable at December 31 is \$10,000, as shown below:

Accounts Receivable					
Beg. Bal. \$24,000 Write-offs 1,00					
Credit sales	65,000	Collections	78,000		
End bal.	10,000				

(a)	Beginning accounts receivable	\$ 100,000
	Net credit sales	1,000,000
	Cash collections	(900,000)
	Accounts written off	(30,000)
	Ending accounts receivable	<u>\$ 170,000</u>

(b) 1,000,000/[(100,000 + 170,000)/2] = 7.41

(c) 365/7.41 = 49.3 days

SOLUTIONS TO PROBLEMS

PROBLEM 9-1A

(a)	1.	Accounts Receivable Sales	3,200,000	3,200,000
	2.	Sales Returns and Allowances Accounts Receivable	50,000	50,000
	3.	Cash Accounts Receivable	2,810,000	2,810,000
	4.	Allowance for Doubtful Accounts Accounts Receivable	90,000	90,000
	5.	Accounts Receivable Allowance for Doubtful Accounts	24,000	24,000
		Cash Accounts Receivable	24,000	24,000

(b)

Accounts Receivable				Allow	ance for Do	bubtful /	Accounts
Bal.	960,000	(2)	50,000	(4)	90,000	Bal.	80,000
(1)	3,200,000	(3)	2,810,000			(5)	24,000
(5)	24,000	(4)	90,000				
		(5)	24,000				
Bal.	1,210,000					Bal.	14,000

(c)	Balance before adjustment [see (b)] Balance needed Adjustment required	\$ 14,000 <u>115,000</u> <u>\$101,000</u>
	The journal entry would therefore be as follows:	
	Bad Debts Expense 101,000 Allowance for Doubtful Accounts	101,000
(d)	$\frac{\$3,200,000 - \$50,000}{(\$880,000 + \$1,095,000) \div 2} = \frac{\$3,150,000}{\$987,500} = 3.19 \text{ times}$	

- (a) \$33,000.
- (b) \$44,000 (\$2,200,000 X 2%).
- (c) \$46,500 [(\$825,000 X 6%) \$3,000].
- (d) \$52,500 [(\$825,000 X 6%) + \$3,000].
- (e) The weakness of the direct write-off method is two-fold. First, it does not match expenses with revenues. Second, the accounts receivable are not stated at cash realizable value at the balance sheet date.

PROBLEM 9-3A

(a)	Dec. 31	Bad Debts Expense	30,610	
		Allowance for Doubtful Accounts		30,610
		(\$42,610 – \$12,000)		

(a) & (b)

Bad Debts Expense

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Dec. 31	Adjusting		30,610		30,610

Allowance for Doubtful Accounts

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Dec. 31	Balance				12,000
31	Adjusting			30,610	42,610
2009					
Mar. 31			1,000		41,610
May 31				1,000	42,610
(b)		2009			
		(1)			
Mar. 3	31 Allowance for Doub	otful Acco	unts	. 1,000	
	Accounts Rece	eivable			1,000
		(2)			
May 3				,	
	Allowance for E	oubtful A	ccounts	•	1,000
				1 000	
Ċ	31 Cash			•	1 000
	Accounts Rece	eivable		•	1,000
		2000			
(c) Dec. 3	1 Rad Dabta Expanse	2009		20 400	
Dec. a	31 Bad Debts Expense Allowance for D				20 400
	(\$28,600 + \$8			•	29,400
	(\$20,000 + \$6	500)			

		Number of Days Outstanding				
	Total	0–30	31–60	61–90	91–120	Over 120
Accounts						
receivable	\$375,000	\$220,000	\$90,000	\$40,000	\$10,000	\$15,000
% uncollectible		1%	4%	5%	8%	10%
Estimated						
Bad debts	\$ 10,100	\$ 2,200	\$ 3,600	\$ 2,000	\$ 800	\$ 1,500

(a) Total estimated bad debts

(b)	Bad Debts Expense Allowance for Doubtful Accounts (\$10,100 + \$8,000)	18,100	18,100
(c)	Allowance for Doubtful Accounts Accounts Receivable	5,000	5,000
(d)	Accounts Receivable Allowance for Doubtful Accounts	5,000	5,000
	Cash Accounts Receivable	5,000	5,000

(e) If Wall Inc. used 3% of total accounts receivable rather than aging the individual accounts the bad debt expense adjustment would be \$19,250 [(\$375,000 X 3%) + \$8,000]. The rest of the entries would be the same as they were when aging the accounts receivable.

Aging the individual accounts rather than applying a percentage to the total accounts receivable should produce a more accurate allowance account and bad debts expense.

PROBLEM 9-5A

(a) The allowance method. Since the balance in the allowance for doubtful accounts is given, they must be using this method because the account would not exist if they were using the direct write-off method.

(b)	(1)	Dec. 31	Bad Debts Expense (\$11,750 – \$2,000) Allowance for Doubtful Accounts	9,750	9,750
	(2)	Dec. 31	Bad Debts Expense (\$950,000 X 1%) Allowance for Doubtful	9,500	
			Accounts		9,500
(c)	(1)	Dec. 31	Bad Debts Expense (\$11,750 + \$2,000) Allowance for Doubtful Accounts	13,750	13,750
					10,700
	(2)	Dec. 31	Bad Debts Expense Allowance for Doubtful	9,500	
			Accounts		9,500
(d)	Allo		^r Doubtful Accountss Receivable	3,000	3,000

<u>Note:</u> The entry is the same whether the amount of bad debts expense at the end of 2008 was estimated using the percentage of receivables or the percentage of sales method.

- (f) Allowance for Doubtful Accounts is a contra-asset account. It is subtracted from the gross amount of accounts receivable so that accounts receivable is reported at its cash realizable value.

PROBLEM 9-6A

(a)	Oct. 7	Accounts Receivable Sales	6,900	6,900
	12	Cash (\$900 – \$27) Service Charge Expense (\$900 X 3%)	873 27	
		Sales		900
	15	Accounts Receivable Interest Revenue	460	460
	15	Cash Notes Receivable Interest Receivable (\$8,000 X 8% X 45/360) Interest Revenue (\$8,000 X 8% X 15/360)	8,107	8,000 80 27
	24	Accounts Receivable—Hughey Notes Receivable Interest Receivable (\$9,000 X 10% X 36/360) Interest Revenue (\$9,000 X 10% X 24/360)	9,150	9,000 90 60
	31	Interest Receivable (\$16,000 X 9% X 1/12) Interest Revenue	120	120

(b)

Notes Receivable

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	\checkmark			33,000
15				8,000	25,000
24				9,000	16,000

PROBLEM 9-6A (Continued)

Accounts	Receivable	

Date	Explanation	Ref. Debit	Credit	Balance
Oct. 7		6,900		6,900
15		460		7,360
24		9,150		16,510

Interest Receivable

Date	Explanation	Ref.	Debit	Credit	Balance
Oct. 1	Balance	✓			170
15				80	90
24				90	0
31			120		120

(c) Current assets

Notes receivable	\$16,000
Accounts receivable	16,510
Interest receivable	120
Total receivables	<u>\$32,630</u>

PROBLEM 9-7A

Jan.	5	Accounts Receivable—Dedonder Company Sales	20,000	20,000
	20	Notes Receivable Accounts Receivable—Dedonder	20,000	
		Company		20,000
Feb.	18	Notes Receivable	8,000	
		Sales		8,000
Apr.	20	Cash (\$20,000 + \$450)	20,450	
		Notes Receivable		20,000
		Interest Revenue		450
		(\$20,000 X 9% X 3/12)		
	30	Cash (\$25,000 + \$1,000)	26,000	
		Notes Receivable		25,000
		Interest Revenue		1,000
		(\$25,000 X 12% X 4/12)		
May	25	Notes Receivable	4,000	
		Accounts Receivable—Jenks Inc		4,000
Aug.	18	Cash (\$8,000 + \$360)	8,360	
		Notes Receivable		8,000
		Interest Revenue		360
		(\$8,000 X 9% X 6/12)		
	25	Accounts Receivable—Jenks Inc	4,070	
		(\$4,000 + \$70)		
		Notes Receivable		4,000
		Interest Revenue		70
		(\$4,000 X 7% X 3/12)		
Sept.	. 1	Notes Receivable	12,000	
		Sales		12,000

PROBLEM 9-1B

(a)	1.	Accounts Receivable Sales	2,570,000	2,570,000
	2.	Sales Returns and Allowances Accounts Receivable	40,000	40,000
	3.	Cash Accounts Receivable	2,300,000	2,300,000
	4.	Allowance for Doubtful Accounts Accounts Receivable	65,000	65,000
	5.	Accounts Receivable Allowance for Doubtful Accounts	25,000	25,000
		Cash Accounts Receivable	25,000	25,000

(b)

()		Accounts	Receiva	able	Allowance	for Dou	ubtful A	ccounts
	Bal.	1,000,000	(2)	40,000	(4) 6	5,000 E	Bal.	60,000
	(1)	2,570,000	(3)	2,300,000		(5)	25,000
	(5)	25,000	(4)	65,000				
			(5)	25,000				
	Bal.	1,165,000				E	Bal.	20,000
(c)) Balance before adjustment [see (b)] Balance needed Adjustment required						\$20,000 <u>90,000</u> \$70,000	
	The journal entry would therefore be as follows:							
	Bad Debts Expense 70,000 Allowance for Doubtful Accounts							70,000
(م)	\$2	, 570, 000 – \$	40,000	\$2,530,	000 _ 0 51 til	200		
(d)	(\$1,0	75,000 + \$94	0, 000) ÷	$\frac{1}{2} = \frac{1}{1,007}$	000 500 = 2.51 tii	lies		

- (a) \$26,000.
- (b) \$30,800 (\$1,540,000 X 2%).
- (c) \$22,000 [(\$520,000 X 5%) \$4,000].
- (d) \$28,000 [(\$520,000 X 5%) + \$2,000].
- (e) There are two major weaknesses with the direct write-off method. First, it does not match expenses with the associated revenues. Second, the accounts receivable are not stated at cash realizable value at the balance sheet date.

PROBLEM 9-3B

(a)	Dec. 31	Bad Debts Expense	25,790	
		Allowance for Doubtful Accounts		25,790
		(\$35,790 – \$10,000)		

(a) & (b)

Bad Debts Expense

Date	Explanation	Ref.	Debit	Credit	Balance
2008					
Dec. 31	Adjusting		25,790		25,790

Allowance for Doubtful Accounts

Date	Exp	lanation	Ref.	Debit	Credit	Balance
2008						
Dec. 31	Bala	ance				10,000
31	Adj	usting			25,790	35,790
2009						
Mar. 1				1,100		34,690
May 1					1,100	35,790
(b)			2009			
			(1)			
Mar.	1	Allowance for Doubtf			•	
		Accounts Receiv	able			1,100
			(2)			
May	1	Accounts Receivable	• •		1,100	
may	•	Allowance for Do			•	1,100
						.,
	1	Cash			1,100	
		Accounts Receive	able			1,100
(c)			2009			
Dec.	31	Bad Debts Expense				
		Allowance for Do		ccounts		29,500
		(\$28,300 + \$1,2	200)			

		Number of Days Outstanding				9
	Total	0–30	31–60	61–90	91–120	Over 120
Accounts						
receivable	\$260,000	\$100,000	\$60,000	\$50,000	\$30,000	\$20,000
% uncollectible		1%	5%	7.5%	10%	15%
Estimated						
Bad debts	\$ 13,750	\$ 1,000	\$ 3,000	\$ 3,750	\$ 3,000	\$ 3,000
(b) Bad Debts Expense						3,750
(c) Allowance for Doubtful Accounts Accounts Receivable					2,000	2,000
(d) Accounts R Allowa	eceivable nce for Do				1,000	1,000

(a) Total estimated bad debts

(e) When an allowance account is used, an adjusting journal entry is made at the end of each accounting period. This entry satisfies the matching principle by recording the bad debts expense in the period in which the sales occur.

PROBLEM 9-5B

(a)	(1)	Dec. 31	Bad Debts Expense	,050 16,050			
	(2)	Dec. 31		,000 17,000			
(b)	(1)	Dec. 31	Bad Debts Expense	,050 19,050			
	(2)	Dec. 31	Bad Debts Expense 17 Allowance for Doubtful Accounts	,000 17,000			
(c)	Allo		r Doubtful Accounts	,500 4,500			
	<u>Note:</u> The entry is the same whether the amount of bad debts expense at the end of 2008 was estimated using the percentage of receivables or the percentage of sales method.						
(d)	Bad Debts Expense4,500Accounts Receivable4,500						
(e)	The advantages of the allowance method over the direct write-off method are:						
	(1)	•	ots to match bad debts expense related t s receivable with sales revenues on the inco				
	())	It attamp	to to above the each realizable value of the e	accurto receiv			

(2) It attempts to show the cash realizable value of the accounts receivable on the balance sheet.

PROBLEM 9-6B

(a)	July 5	Accounts Receivable Sales	6,200	6,200
	14	Cash (\$700 – \$21) Service Charge Expense (\$700 X 3%)	679 21	
		Sales		700
	14	Accounts Receivable Interest Revenue	440	440
	15	Cash Notes Receivable Interest Receivable (\$6,000 X 10% X 45/360) Interest Revenue (\$6,000 X 10% X 15/360)	6,100	6,000 75 25
	25	Accounts Receivable Notes Receivable Interest Receivable (\$25,000 X 9% X 36/360) Interest Revenue (\$25,000 X 9% X 24/360)	25,375	25,000 225 150
	31	Interest Receivable (\$15,000 X 8% X 1/12) Interest Revenue	100	100

(b)

Notes Receivable

Date	Explanation	Ref.	Debit	Credit	Balance
July 1	Balance	\checkmark			46,000
15				6,000	40,000
25				25,000	15,000

PROBLEM 9-6B (Continued)

Accounts Receivable Explanation Debit Credit Date Ref. Balance July 5 6,200 6,200 14 440 6,640 25 25,375 32,015

Interest Receivable

Date	Explanation	Ref.	Debit	Credit	Balance
July 1	Balance	\checkmark			300
15				75	225
25				225	0
31	Adjusting		100		100

(c) Current assets

Notes receivable	\$15,000
Accounts receivable	32,015
Interest receivable	100
Total receivables	<u>\$47,115</u>

PROBLEM 9-7B

Jan.	5	Accounts Receivable—Klostermann Company Sales	6,300	6,300
Feb.	2	Notes Receivable Accounts Receivable—Klostermann Company	6,300	6,300
	12	Notes Receivable Sales	7,800	7,800
	26	Accounts Receivable—Louk Co Sales	4,000	4,000
Apr.	5	Notes Receivable Accounts Receivable—Louk Co	4,000	4,000
	12	Cash (\$7,800 + \$130) Notes Receivable Interest Revenue (\$7,800 X 10% X 2/12)	7,930	7,800 130
June	2	Cash (\$6,300 + \$210) Notes Receivable Interest Revenue (\$6,300 X 10% X 4/12)	6,510	6,300 210
July	5	Accounts Receivable—Louk Co (\$4,000 + \$80) Notes Receivable Interest Revenue (\$4,000 X 8% X 3/12)	4,080	4,000 80
	15	Notes Receivable Sales	7,000	7,000
Oct.	15	Allowance for Doubtful Accounts Notes Receivable	7,000	7,000

(a)

SEK COMPANY Accounts Receivable Aging Schedule May 31, 2008

	Proportion of Total	Amount in Category	Probability of Non- Collection	Estimated Uncollectible Amount
Not yet due	.620	\$ 868,000	.02	\$17,360
Less than 30 days past due	.200	280,000	.04	11,200
30 to 60 days past due	.090	126,000	.06	7,560
61 to 120 days past due	.050	70,000	.09	6,300
121 to 180 days past due	.025	35,000	.25	8,750
Over 180 days past due	<u>.015</u>	21,000	.70	14,700
	<u>1.000</u>	<u>\$1,400,000</u>		<u>\$65,870</u>

(b)

SEK COMPANY Analysis of Allowance for Doubtful Accounts May 31, 2008

June 1, 2007 balance		\$ 29,500
Bad debts expense accrual (\$2,900,000 X .045)		130,500
Balance before write-offs of bad accounts		160,000
Write-offs of bad accounts		102,000
Balance before year-end adjustment		58,000
Estimated uncollectible amount		65,870
Additional allowance needed		<u>\$ 7,870</u>
Bad Debts Expense	7,870	
Allowance for Doubtful Accounts	-	7,870

BYP 9-1 (Continued)

(c) 1. Steps to Improve the Accounts Receivable Situation

> Establish more selective creditgranting policies, such as more restrictive credit requirements or more thorough credit investigations.

> Establish a more rigorous collection policy either through external collection agencies or by its own personnel.

> Charge interest on overdue accounts. Insist on cash on delivery (COD) or cash on order (COO) for new customers or poor credit risks.

2. Risks and Costs Involved

> This policy could result in lost sales and increased costs of credit evaluation. The company may be all but forced to adhere to the prevailing credit-granting policies of the office equipment and supplies industry.

> This policy may offend current customers and thus risk future sales. Increased collection costs could result from this policy.

> This policy could result in lost sales and increased administrative costs.

BYP 9-2

(2)

10.4

(a) (1) Accounts receivable turnover ratio

PepsiCo		Coca-Cola		
	\$32,562	\$23,104		
_	(\$2,999* + \$3,261) ÷ 2 *See note 14	(\$2,244 + \$2,281) ÷ 2		
	$\frac{\$32,562}{\$3,130} = 10.4 \text{ times}$	\$23,104 \$2,262.5 = 10.2 times		
)	Average collection period			
	$\frac{365}{10.4}$ = 35.1 days	$\frac{365}{10.2} = 35.8$ days		

(b) Both companies have reasonable accounts receivable turnovers and collection periods of slightly greater than 30 days. This collection period probably approximates their credit terms that they provide to customers.

10.2

BYP 9-3

(a) Benefits of Factoring Receivables

Factoring is a flexible financial solution that can help your business be more competitive while improving your cash flow, credit rating, and supplier discounts. Unlike traditional bank financing, factoring relies on the financial strength and credit worthiness of your customers, not you. You can use factoring services as much as you want or as little as you want. There are no obligations, no minimums, and no maximums. Here are the most common reasons businesses use factoring services:

<u>Offer better terms to win more business.</u> With factoring you can attract more business by offering better terms on your invoices. Most companies negotiate on price to win business in a competitive market, but with factoring you can negotiate with terms instead of price. To your customers, better terms can be more attractive than better prices. When using attractive terms to win business, you can build the cost of factoring into your costs of goods and services.

Example: A new customer may choose to do business with your company because you can offer NET 30 or NET 45 terms while your competitor (who isn't factoring) requires payment up front but has a 3% better price. If you factor the subsequent invoice at a discount of 3%, you have leveraged factoring services to win the business at no extra cost and improved your cash flow at the same time.

Improve cash flow without additional debt. Eliminate long billing cycles. Receive cash for your outstanding invoices in 24 hours or less. No new debt is created. Factoring is not a loan. This allows you to preserve your financial leverage to take on new debt.

<u>Customer Credit Services.</u> Reduce bad debt expense, streamline credit approvals for new customers, improve decision-making on new business, and reduce administrative costs.

BYP 9-3 (Continued)

<u>Accounts Receivable Management.</u> Reduce administrative costs, improve customer relationships, improve receivable turns, improve accounting, and redirect critical resources to marketing and production.

<u>Flexibility</u>. Factor as much as you want or as little as you want. You decide. No obligations. No binding contracts. There are no minimums and no maximums in the amount you can factor. Funding is based on the strength of your customers.

- (b) Factoring fees are based on a per Diem Rate. The factor will assess the risk of the particular situation and determine a discount rate. This usually ranges from 3% to 9% of the gross invoices sold, and is the fee for the duties the factor assumes and the cost of using their money. The sooner a receivable is paid, the lower the discount rate.
- (c) Upon approval, the factor will advance the manufacturer 70%–90% of the total value of their invoices. This percentage is called the Advance Rate, and the cash is often delivered within 24 hours after an application is received.

The rest of the cash minus the factor's fees is then returned to the manufacturer as the receivables are collected. If the manufacturer's customers pay slowly, the discount rates that apply grow accordingly larger.

BYP 9-4 DECISION MAKING ACROSS THE ORGANIZATION

(a)	2008	2007	2006
Net credit sales	<u>\$500,000</u>	<u>\$600,000</u>	<u>\$400,000</u>
Credit and collection expenses			
Collection agency fees Salary of accounts receivable	\$ 2,450	\$ 2,500	\$ 2,400
clerk	4,100	4,100	4,100
Uncollectible accounts	8,000	9,600	6,400
Billing and mailing costs	2,500	3,000	2,000
Credit investigation fees	750	900	600
Total	<u>\$ 17,800</u>	<u>\$ 20,100</u>	<u>\$ 15,500</u>
Total expenses as a percentage of			
net credit sales	<u>3.56%</u>	<u>3.35%</u>	<u>3.88%</u>
(b) Average accounts receivable (5%)	<u>\$ 25,000</u>	<u>\$ 30,000</u>	<u>\$ 20,000</u>
Investment earnings (8%)	<u>\$ 2,000</u>	<u>\$ 2,400</u>	<u>\$ 1,600</u>
Total credit and collection expenses			
per above	\$ 17,800	\$ 20,100	\$ 15,500
Add: Investment earnings*	2,000	2,400	<u>1,600</u>
Net credit and collection expenses	<u>\$ 19,800</u>	<u>\$ 22,500</u>	<u>\$ 17,100</u>
Net expenses as a percentage of net credit sales	<u>3.96%</u>	<u>3.75%</u>	<u>4.28%</u>

*The investment earnings on the cash tied up in accounts receivable is an additional expense of continuing the existing credit policies.

(c) The analysis shows that the credit card fee of 4% of net credit sales will be higher than the percentage cost of credit and collection expenses in each year before considering the effect of earnings from other investment opportunities. However, after considering investment earnings, the credit card fee of 4% will be less than the company's percentage cost if annual net credit sales are less than \$500,000.

BYP 9-4 (Continued)

Finally, the decision hinges on: (1) the accuracy of the estimate of investment earnings, (2) the expected trend in credit sales, and (3) the effect the new policy will have on sales. Nonfinancial factors include the effects on customer relationships of the alternative credit policies and whether the Maynes want to continue with the problem of handling their own accounts receivable. Of course, this solution will differ from student to student. Important factors to look for would be definitions of the methods, how they are similar and how they differ. Also, use of good sentence structure, correct spelling, etc.

Example:

Dear Rene,

The three methods you asked about are methods of dealing with uncollectible accounts receivable. Two of them, percentage-of-sales and percentage-of-receivables, are "allowance" methods used to estimate the amount uncollectible. Under the percentage-of-sales basis, management establishes a percentage relationship between the amount of credit sales and expected losses from uncollectible accounts. This is based on past experience and anticipated credit policy. The percentage is then applied to either total credit sales or net credit sales of the current year. This basis of estimating emphasizes the matching of expenses with revenues.

Under the percentage-of-receivables basis, management establishes a percentage relationship between the amount of receivables and expected losses from uncollectible accounts. Customer accounts are classified by the length of time they have been unpaid. This basis emphasizes cash realizable value of receivables and is therefore deemed a "balance sheet" approach.

The direct write-off method does not estimate losses and an allowance account is not used. Instead, when an account is determined to be uncollectible, it is written off directly to Bad Debts Expense. Unless bad debt losses are insignificant, this method is not acceptable for financial reporting purposes.

Sincerely,

BYP 9-6

- (a) The stakeholders in this situation are:
 - The president of Ruiz Co.
 - ► The controller of Ruiz Co.
 - The stockholders.
- (b) Yes. The controller is posed with an ethical dilemma—should he/she follow the president's "suggestion" and prepare misleading financial statements (understated net income) or should he/she attempt to stand up to and possibly anger the president by preparing a fair (realistic) income statement.
- (c) Ruiz Co.'s growth rate should be a product of fair and accurate financial statements, not vice versa. That is, one should not prepare financial statements with the objective of achieving or sustaining a predetermined growth rate. The growth rate should be a product of management and operating results, not of creative accounting.

BYP 9-7

- (a) There are a number of sources that compare features of credit cards. Here are three: <u>www.creditcards.com/</u>, <u>www.federalreserve.gov/pubs/shop/</u>, and <u>www.creditorweb.com/</u>.
- (b) Here are some of the features you should consider: annual percentage rate, credit limit, annual fees, billing and due dates, minimum payment, penalties and fees, premiums received (airlines miles, hotel discounts etc.), and cash rebates.
- (c) Answer depends on present credit card and your personal situation.