Accounting for Receivables

Chapter 9

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Fundamental Accounting Principles

3rd Edition

Chapter 9 Learning Objectives

CONCEPTUAL

C1 Describe accounts receivable and how they occur and are recorded.

C2 Describe a note receivable, the computation of its maturity date, and the recording of its existence.

C3 Explain how receivables can be converted to cash before maturity.

ANALYTICAL

A1 Compute accounts receivable turnover and use it to help assess financial condition.

PROCEDURAL

P1 Apply the direct write-off method to accounts receivable.

P2 Apply the allowance method to accounts receivable.

P3 Estimate uncollectibles based on accounts receivable.

P4 Record the honoring and dishonoring of a note and adjustments for interest.

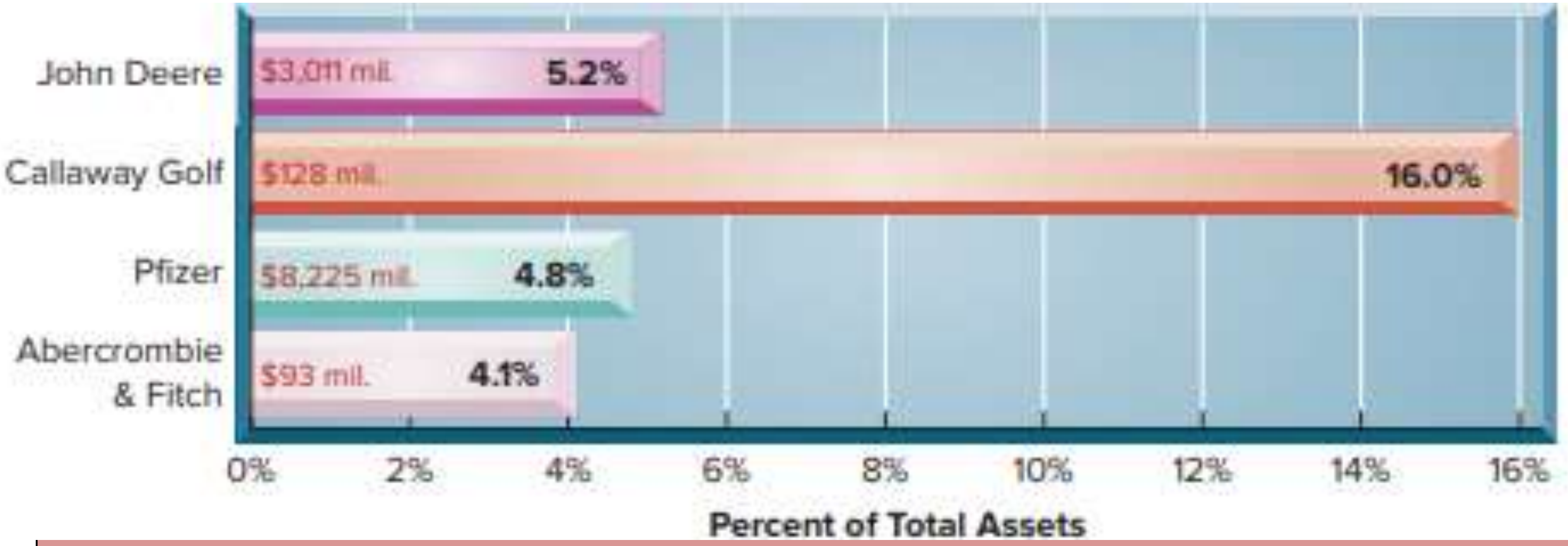
Learning Objective C1

Describe accounts receivable and how they occur and are recorded.

Valuing Accounts Receivable

Exhibit 9.1

A receivable is an amount due from another party.
Accounts receivable are amounts due from customer for credit sales.



A company uses a separate account for each customer to tracks how much that customer purchases, has already paid, and still owes.

Learning Objective C1: Describe accounts receivable and how they occur and are recorded.

Sales on Credit

On July 1, TechCom had a credit sale of $950 to CompStore and a collection of $720 from RDA Electronics from a prior credit sale.

Exhibit 9.3

July 1	Accounts Receivable—CompStore	950	
	Sales		950
	*Record credit sales.**		
July 1	Cash	720	
	Accounts Receivable—RDA Electronics.		720
	Record collection of credit sales.		

Learning Objective C1: Describe accounts receivable and how they occur and are recorded.

Sales on Credit: Accounts Receivable Ledger

July 1	Accounts Receivable—CompStore	950	
	Sales		950
	*Record credit sales.**		
July 1	Cash	720	
	Accounts Receivable—RDA Electronics.		720
	Record collection of credit sales.		

Exhibit 9.4

Sales on Store Credit Card

On November 1, TechCom recorded sales on their own credit card in the amount of $1,000.

On December 31, TechCom recorded an adjusting entry for the interest earned of $15 on store credit card.

Nov. 1	Accounts Receivable	1,000	
	Sales		1,000
	Record sales on store credit card.		
Dec. 31	Accounts Receivable	15	
	Interest Revenue		15
	Interest of $15 earned on store card sales past due.		

Sales on Bank Credit Card

On July 15, TechCom has $100 of credit card sales with a 4% fee, and its $96 cash is received immediately on deposit.

July 15	Cash	96	
	Credit Card Expense	4	
	Sales		100
	*Record credit card sales less a 4% credit card expense.**		

* We omit the entry to Dr. Cost of Sales and Cr. Inventory to focus on credit card expense.

Sales on Installment

Amounts owed by customers from credit sales for which payment is required in periodic amounts over an extended time period. The customer is usually charged interest.

Learning Objective C1: Describe accounts receivable and how they occur and are recorded.

Learning Objective P1

Apply the direct write-off method to accounts receivable.

Direct Write-Off Method

Some customers may not pay their account. Uncollectible amounts are referred to as bad debts.

There are two methods of accounting for bad debts:

- Direct Write-Off Method
- Allowance Method

Direct Write-Off Method - Recording and Writing Off Bad Debts

TechCom determines on January 23 that it cannot collect $520 owed to it by its customer J. Kent.

Jan. 23	Bad Debts Expense	520	
	Accounts Receivable—J. Kent		520
	Write off an uncollectible account.		

Notice that the specific customer is noted in the transaction so we can make the proper entry in the customer's Accounts Receivable subsidiary ledger.

Learning Objective P1: Apply the direct write-off method to accounts receivable.

Direct Write-Off Method – Recovering a Bad Debt

On March 11, J. Kent was able to make full payment to TechCom for the amount previously written-off.

Mar. 11	Accounts Receivable—J. Kent.	520	
	Bad Debts Expense		520
	Reinstate account previously written off.		
Mar. 11	Cash	520	
	Accounts Receivable—J. Kent		520
	Record full payment of account.		

Learning Objective P1: Apply the direct write-off method to accounts receivable.

Assessing the Direct Write-off Method

Useful in illustrating the superiority of the allowance method

Use in special tax situations

Advantage: simple; no estimates needed
Disadvantage: receivables and profit temporary overstated; bad debt expense often not matched with sales.

Learning Objective P1: Apply the direct write-off method to accounts receivable.

Discussion Question

Q: Why does the direct write-off method of accounting for bad debts usually fail to match revenues and expenses?

Discussion Question

Q: Why does the direct write-off method of accounting for bad debts usually fail to match revenues and expenses?

Revenues and expenses usually are not matched under the direct write-off method because the revenues recorded from the uncollectible accounts often appear on the income statement of one period while the bad debts expenses of those revenues appear on the income statement of a later period when the account(s) is known to be uncollectible.

Learning Objective P2

Apply the allowance method to accounts receivable.

Allowance Method

At the end of each period, estimate total bad debts expected to be realized.

Two advantages to the allowance method:

1. It records estimated bad debts expense in the period when the related sales are recorded.
2. It reports accounts receivable on the balance sheet at the estimated amount of cash to be collected.

Method	Bad Debts Expense Recorded . . .
Direct write-off	*In future,* when accounts are uncollectible.
Allowance	*Currently,* using estimated uncollectibles.

Learning Objective P2: Apply the allowance method to accounts receivable.

Allowance Method - Recording Bad Debts Expense

TechCom had credit sales of $300,000 during its first year of operations. At the end of the first year, $20,000 of credit sales remained uncollected. Based on the experience of similar businesses, TechCom estimated that $1,500 of its accounts receivable would be uncollectible.

Dec. 31	Bad Debts Expense	1,500	
	Allowance for Doubtful Accounts		1,500
	Record estimated bad debts.		

Accounts Receivable			
Dec. 31	20,000		

Allowance for Doubtful Accounts			
		Dec. 31	1,500

Learning Objective P2: Apply the allowance method to accounts receivable.

Balance Sheet Presentation

TechCom had credit sales of $300,000 during its first year of operations. At the end of the first year, $20,000 of credit sales remained uncollected. Based on the experience of similar businesses, TechCom estimated that $1,500 of its accounts receivable would be uncollectible.

Current assets		
Accounts receivable	$20,000	
Less allowance for doubtful accounts	1,500	$18,500

Current assets	
Accounts receivable (net of $1,500 doubtful accounts)	$18,500

Learning Objective P2: Apply the allowance method to accounts receivable.

Allowance Method – Writing Off a Bad Debt

TechCom has determined that J. Kent's $520 account is uncollectible.

Jan. 23	Allowance for Doubtful Accounts	520	
	Accounts Receivable—J. Kent		520
	Write off an uncollectible account.		

Accounts Receivable			
Dec. 31	20,000		
		Jan. 23	520

Allowance for Doubtful Accounts			
		Dec. 31	1,500
Jan. 23	520		

Learning Objective P2: Apply the allowance method to accounts receivable.

Writing Off a Bad Debt

Exhibit 9.5

The write-off does not affect the realizable value of accounts receivable.

	Before Write-Off	After Write-Off
Accounts receivable	$ 20,000	$ 19,480
Less allowance for doubtful accounts	1,500	980
Realizable value of accounts receivable	**$18,500**	**$18,500**

Learning Objective P2: Apply the allowance method to accounts receivable.

Allowance Method - Recovering a Bad Debt

To help restore credit standing, a customer sometimes pays all or part of the amount owed on an account even after it has been written off.

On March 11, Kent pays in full his $520 account previously written off.

Mar. 11	Accounts Receivable—J. Kent	520	
	Allowance for Doubtful Accounts		520
	Reinstate account previously written off.		
Mar. 11	Cash	520	
	Accounts Receivable—J. Kent		520
	Record full payment of account.		

Learning Objective P2: Apply the allowance method to accounts receivable.

Learning Objective P3

Estimate uncollectibles based on accounts receivable.

Estimating Bad Debts Expense

Accounts Receivable Methods

- Percent of Accounts Receivable
- Aging of Accounts Receivable

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Percent of Receivables Method

Compute the estimate of the Allowance for Doubtful Accounts.

Year-end Accounts Receivable x Bad Debt %

Bad Debts Expense is computed as:

Total Estimated Bad Debts Expense

– Previous Balance in Allowance Account

= Current Bad Debts Expense

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Percent of Receivables Method: Example

Musicland has $50,000 in accounts receivable and $200 credit balance in Allowance for Doubtful Accounts. 5% of receivables are uncollectible. $50,000 x 5% = $2,500 ending balance.

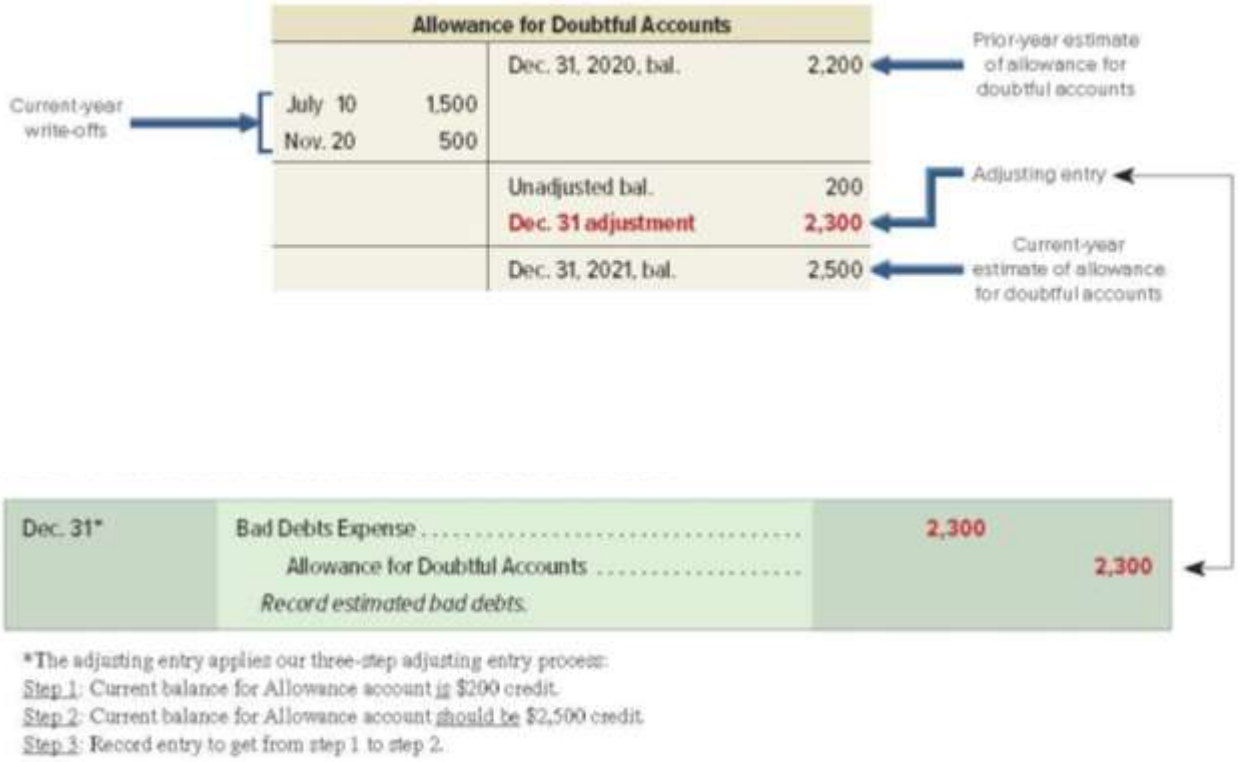


Exhibit 9.7

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Aging of Receivables Method

Classify each receivable by how long it is past due.

Each age group is multiplied by its estimated bad debts percentage.

Estimated bad debts for each group are totaled.

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Aging of Accounts Receivable: Musicland

Exhibit 9.8

MUSICLAND
Schedule of Accounts Receivable by Age
December 31, 2021

Customer	Totals	Not Yet Due	1 to 30 Days Past Due	31 to 60 Days Past Due	61 to 90 Days Past Due	Over 90 Days Past Due
Carlie Abbott	$ 5,890	$ 5,890				
Jamie Allen	710			$ 710		
Chavez Andres	10,500	10,300	$ 200			
Balicia Company	2,800				$1,900	$ 900
Texas Rawhide	9,100		6,110	2,990		
Zem Services	21,000	20,810	190			
Total receivables	$50,000	$37,000	$6,500	$3,700	$1,900	$ 900
Percent uncollectible		× 2%	× 5%	× 10%	× 25%	× 40%
Estimated uncollectible	$ 2,270	$ 740	$ 325	$ 370	$ 475	$ 360

Each receivable is grouped by how long it is past its due date.

Each age group is multiplied by its estimated bad debts percent.

Estimated bad debts for each group are totaled.

Aging of Accounts Receivable: Adjusting Entry with Credit Balance

Step 1:	Current account balance equals	Unadjusted balance	$ 200 credit
Step 2:	Determine what account balance should be	Estimated balance.	2,270 credit
Step 3:	Make adjustment to get from step 1 to step 2	**Required adjustment**	**$2,070 credit**

Exhibit 9.9

Dec. 31	Bad Debts Expense	2,070	
	Allowance for Doubtful Accounts		2,070
	Record estimated bad debts.		

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Aging of Accounts Receivable: Adjusting Entry with Debit Balance

Step 1: Current account balance equals	Unadjusted balance	$ 500 debit
Step 2: Determine what account balance should be	Estimated balance.	2,270 credit
Step 3: Make adjustment to get from step 1 to step 2	**Required adjustment**	**$2,770 credit**

Current-year estimate of allowance for doubtful accounts

Adjusting entry amount

Dec. 31	Bad Debts Expense	**2,770**	
	Allowance for Doubtful Accounts		**2,770**
	Record estimated bad debts.		

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Summary of Allowance for Doubtful Accounts

Exhibit 9.10

Allowance for Doubtful Accounts	
Debit balance when the total amount of accounts receivable written off is greater than the estimated allowance. Must adjust to become a credit balance before preparing the financial statements.	**Credit balance** when the total amount of accounts receivable written off is less than the estimated allowance. This is the normal balance for this account.

Learning Objective P3: Estimate uncollectibles based on sales and accounts receivable.

Discussion Question

Q: Why does the Bad Debt Expense account usually not have the same adjusted balance as the Allowance for Doubtful Accounts?

Discussion Question

Q: Why does the Bad Debt Expense account usually not have the same adjusted balance as the Allowance for Doubtful Accounts?

The adjusted balances of Bad Debts Expense and Allowance for Doubtful Accounts are virtually never equal because the expense amount reflects only the events of the current period (because it is a temporary account that is closed at the end of each period), and the allowance is the accumulated result of events over a number of prior periods. The only way that they could be equal would be if write-offs during the prior period exactly equaled the beginning balance of the Allowance account.

P 9-2A

At December 31, Hawke Company's unadjusted trial balance includes the following items.

Accounts receivable	$1,270,100 debit	Allowance for doubtful accounts	$16,580 debit

Required:

1. Prepare the adjusting entry to record bad debts assuming an aging analysis estimates that 5% of year-end accounts receivable are uncollectible.

Unadjusted balance	$16,580 debit
Estimated balance ($1,270,100 x 5%)	63,505 credit
Required adjustment	$80,085 credit

Dec. 31	Bad Debts Expense	80,085	
	Allowance for Doubtful Account		80,085

P 9-2A

At December 31, Hawke Company's unadjusted trial balance includes the following items.

Accounts receivable	$1,270,100 debit	Allowance for doubtful accounts	$16,580 debit

Required:
2. Show how Accounts Receivable and the Allowance for Doubtful Accounts appear on its December 31 balance sheet given the facts in part 1.

Current assets

	Accounts receivable	$1,270,100	
	Less allowance for doubtful accts.	(63,505)	$1,206,595

Learning Objective C2

Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Notes Receivable

A promissory note is a written promise to pay a specified amount of money, usually with interest, either on demand or at a stated future date.

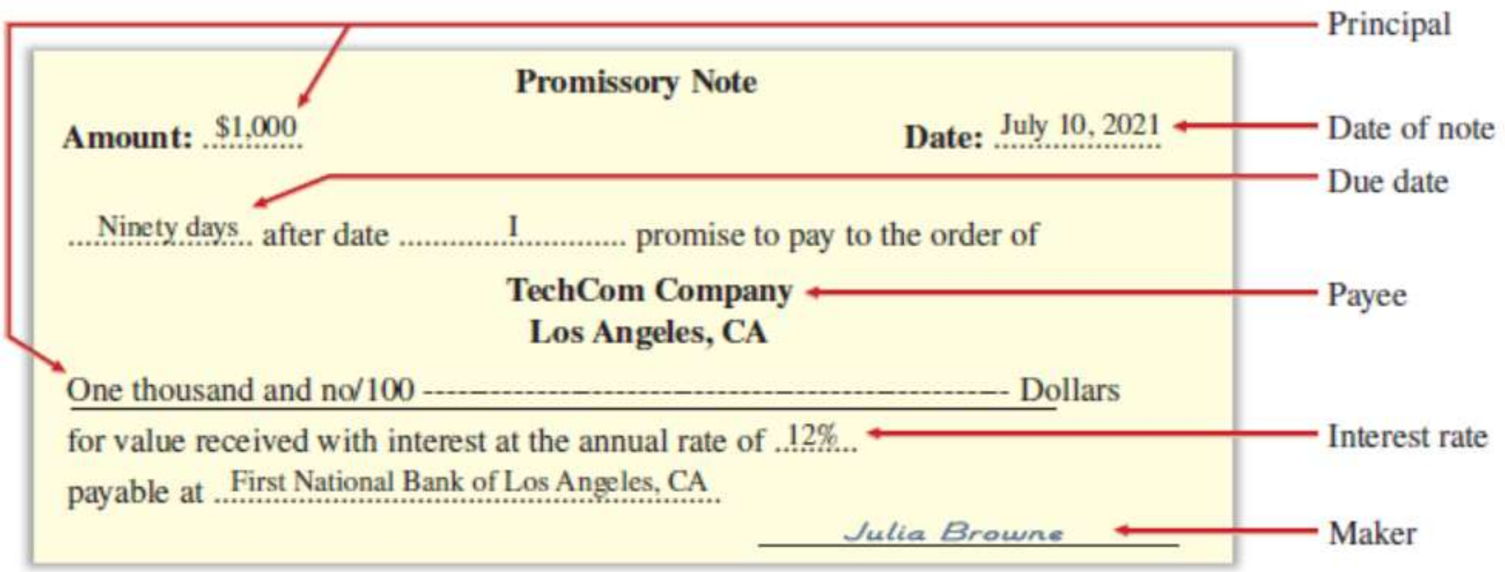


Exhibit 9.11

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Computing Maturity Date

The maturity date of a note is the day the note (principal and interest) must be repaid. When counting days, omit the day the note is issued, but count the due date.

A 90-day note dated July 10 matures on October 8.

Exhibit 9.12

Days in July	31		
Minus the date of the note	10		
Days remaining in July		21	July 11–31
Add days in August		31	Aug. 1–31
Add days in September		30	Sept. 1–30
Days to equal 90 days, or **maturity date of October 8**		8	Oct. 1–8
Period of the note in days		90	

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Interest Computation

Exhibit 9.13

$$\text{Principal of the note} \times \text{Annual interest rate} \times \text{Time expressed in fraction of year} = \text{Interest}$$

Even for maturities less than one year, the rate is annualized.

If the note is expressed in days, base a year on 360 days using the "banker's rule."

$$\$1{,}000 \times 12\% \times \frac{90}{360} = \$1{,}000 \times 0.12 \times 0.25 = \$30$$

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Recording Notes Receivable

Notes receivable are usually recorded in a single Notes Receivable account to simplify recordkeeping.

To illustrate the recording for the receipt of a note, we use the $1,000, 90-day, 12% promissory note from Julia Browne to TechCom. TechCom received this note at the time of a product sale to Julia Browne.

July 10*	Notes Receivable	1,000	
	Sales		1,000
	Sell goods in exchange for a 90-day, 12% note.		

*We omit the entry to Dr. Cost of Sales and Cr. Inventory to focus on sales and receivables.

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Notes Receivable in Acceptance of Past-Due Accounts Receivable

A seller may accept a note receivable from an account receivable customer to allow an extension to pay a past-due accounts receivable.

To illustrate, assume Tech-Com agreed to accept $232 in cash along with a $600, 60-day, 15% note from Jo Cook to settle her $832 past-due account.

Oct. 5	Cash	232	
	Notes Receivable	600	
	Accounts Receivable—J. Cook		832
	Receive cash and note to settle account.		

Learning Objective C2: Describe a note receivable, the computation of its maturity date, and the recording of its existence.

Learning Objective P4

Record the honoring and dishonoring of a note and adjustments for interest.

Recording an Honored Note

The principal and interest of a note are due on its maturity date.

J. Cook has a $600, 15%, 60-day note receivable due to TechCom on December 4.

Dec. 4	Cash	615	
	Notes Receivable		600
	Interest Revenue		15
	Collect note with interest of $600 × 15% × 60/360.		

Learning Objective P4: Record the honoring and dishonoring of a note and adjustments for interest.

Recording a Dishonored Note

The act of dishonoring a note does not relieve the maker of the obligation to repay the principal and interest due.

J. Cook has a $600, 15%, 60-day note receivable due to TechCom on December 4.

Dec. 4	Accounts Receivable—J. Cook	615	
	Interest Revenue		15
	Notes Receivable		600
	Charge account of J. Cook for a dishonored note and interest of $600 × 15% × 60/360.		

Recording End-of-Period Interest Adjustment

On December 16, TechCom accepts a $3,000, 60-day, 12% note from a customer in granting an extension on a past-due account. When TechCom's accounting period ends on December 31, $15 of interest has accrued on the note.

$3,000 x 12% x 15/360 = $15

Dec. 31	Interest Receivable	15	
	Interest Revenue		15
	Record accrued interest earned.		

Learning Objective P4: Record the honoring and dishonoring of a note and adjustments for interest.

Recording End-of-Period Interest Adjustments

Recording collection on note at maturity.

Feb. 14	Cash	3,060	
	Interest Revenue		45
	Interest Receivable		15
	Notes Receivable		3,000
	Receive payment of note and its interest.		

$3,000 x 12% x 60/360 = $60

Learning Objective P4: Record the honoring and dishonoring of a note and adjustments for interest.

Learning Objective C3

Explain how receivables can be converted to cash before maturity.

Disposal of Receivables

Companies can convert receivables to cash before they are due.

Selling Receivables

Aug. 15	Cash	19,200	
	Factoring Fee Expense	800	
	Accounts Receivable		20,000
	Sell accounts receivable for cash less 4% fee.		

Pledging Receivables

Aug. 20	Cash	35,000	
	Notes Payable		35,000
	Borrow with a note secured by pledging receivables.		

Learning Objective C3: Explain how receivables can be converted to cash before maturity.

P 9-4A

Liang Company began operations in Year 1. During its first two years, the company completed a number of transactions involving sales on credit, account receivable collections, and bad debts. Theses transactions are summarized as follows.

Year 1

a. Sold $1,345,434 of merchandise (that had cost $975,000) on credit, terms n/30.

b. Wrote off $18,300 of uncollectible accounts receivable.

c. Received $669,200 cash in payment of accounts receivable.

d. In adjusting the accounts on December 31, the company estimated that 1.5% of accounts receivable would be uncollectible.

Year 2

e. Sold $1,525,634 of merchandise on credit (that had cost $1,250,000), terms n/30.

f. Wrote off $27,800 of uncollectible account receivable.

g. Received $1,204,600 cash in payment of accounts receivable.

h. In adjusting the accounts on December 31, the company estimated that 1.5% of accounts receivable would be uncollectible.

Required:

Prepare journal entries to record Liang's summarized transactions and its year-end adjustments to record bad debts expense. (The company uses the perpetual inventory system, and it applies the allowance method for its accounts receivable. Round to the nearest dollar.)

P 9-4A

Year 1

a. Sold $1,345,434 of merchandise (that had cost $975,000) on credit, terms n/30.

Dr. Accounts Receivable	1,345,434	
Cr. Sales		1,345,434
Dr. Cost of Goods Sold	975,000	
Cr. Merchandise Inventory		975,000

P 9-4A

Year 1

b. Wrote off $18,300 of uncollectible accounts receivable.

Dr. Allowance for Doubtful Accounts	18,300	
Cr. Accounts Receivable		18,300

P 9-4A

Year 1

c. Received $669,200 cash in payment of accounts receivable.

Dr. Cash	669,200	
Cr. Accounts Receivable		669,200

P 9-4A

Year 1

d. In adjusting the accounts on December 31, the company estimated that 1.5% of accounts receivable would be uncollectible.

Dr. Bad Debts Expense	28,169	
Cr. Allowance for Doubtful Accounts		28,169

*Beginning receivables	$ 0	
Credit sales	1,345,434	
Collections	(669,200)	
Write-offs	(18,300)	
Ending receivables	657,934	
Percent uncollectible	x 1.5%	
Required ending allowance	9,869	Cr.
Unadjusted balance	18,300	Dr.
Adjustment to the allowance	$ 28,169	Cr.

P 9-4A

Year 2

e. Sold $1,525,634 of merchandise on credit (that had cost $1,250,000), terms n/30.

Dr. Accounts Receivable	1,525,634	
Cr. Sales		1,525,634
Dr. Cost of Goods Sold	1,250,000	
Cr. Merchandise Inventory		1,250,000

P 9-4A

Year 2

f. Wrote off $27,800 of uncollectible account receivable.

Dr. Allowance for Doubtful Accounts	27,800	
Cr. Accounts Receivable		27,800

P 9-4A

Year 2

g. Received $1,204,600 cash in payment of accounts receivable.

Dr. Cash	1,204,600	
Cr. Accounts Receivable		1,204,600

P 9-4A

Year 2

h. In adjusting the accounts on December 31, the company estimated that 1.5% of accounts receivable would be uncollectible.

Dr. Bad Debts Expense	32,199	
Cr. Allowance for Doubtful Accounts		32,199

*Beginning receivables		$ 657,934	
Credit sales		1,525,634	
Collections		(1,204,600)	
Write-offs		(27,800)	
Ending receivables		951,168	
Percent uncollectible		x 1.5%	
Required ending allowance		14,268	Cr.
Unadjusted balance			
Beginning (Cr.)	9,869		
Write-offs (Dr.)	27,800	17,931	Dr.
Adjustment to the allowance		$ 32,199	Cr.

End of Chapter 9