

**CHAPTER 8**  
**ACCOUNTING FOR RECEIVABLES**

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**Study Objectives:**

After studying this chapter, you should be able to:

- Identify the different types of receivables.
  - Explain how companies recognize accounts receivable.
  - Distinguish between the methods and bases companies use to value accounts receivable.
  - Describe the entries to record the disposition of accounts receivable.
  - Compute the maturity date and interest on notes receivable.
  - Explain how companies recognize notes receivable.
  - Describes how companies value notes receivable.
  - Describe the entries to record the disposition of notes receivable.
  - Explain the statement presentation of receivables.
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**Types of Receivables**

Receivables are amounts due from individuals and other companies that are expected to be collected in cash.

- **Accounts Receivable** are amounts owed by customers that result from the sale of goods and services.
- **Notes Receivable** are written promises (as evidenced by a formal instrument) for amounts to be received.
- **Other Receivables** are nontrade receivables which include interest, loans to officers, and advances to employees.

**ACCOUNTS RECEIVABLE**

Three accounting issues:

1. Recognizing accounts receivable.
2. Valuing accounts receivable
3. Disposing of accounts receivable

**1. Recognizing accounts receivable**

- Service organization – records a receivable when it provides service on account.
- Merchandiser – records accounts receivable at the point of sale of merchandise on account.

**Illustration:** Assume that Hennes & Mauritz on July 1, 2019, sells merchandise on account to Polo Company for \$1,000 terms 2/10, n/30. Prepare the journal entry to record this transaction on the books of Hennes & Mauritz.

July 1	Accounts Receivable	1,000	
	Sales Revenue		1,000

On July 5, Polo returns merchandise worth \$100 to Hennes & Mauritz.

July 5	Sales Returns and Allowances	100	
	Accounts Receivable		100

On July 11, Hennes & Mauritz receives payment from Polo Company for the balance due.

July 11	Cash	882	
	Sales Discounts (900 x 2%)	18	
	Accounts Receivable		900

**2. Valuing Accounts Receivable**

- Some customers of a business may not be trustworthy or credit worthy to pay the cash on or before the due date.
- So such amount of receivables the business cannot collect from customers is treated as ‘bad debts’ or ‘uncollectible account expense’ which is to be **written –off (cancelled)** every year.
- Current asset.
- Valuation (net realizable value).

**Uncollectible Accounts Receivable**

- Sales on account raise the possibility of accounts not being collected.
- Seller records losses that result from extending credit as **Bad Debt Expense**.

**Methods of Accounting for Uncollectible Accounts**

➤ **Direct Write-Off**

Theoretically undesirable:

- No matching.
- Receivable not stated at cash realizable value.
- Not acceptable for financial reporting.

Bad debt expense.....xx  
Accounts receivable..... xx

➤ **Allowance Method**

Losses are estimated:

- Better matching.
- Receivable stated at cash realizable value.
- Required by IFRS

**How are these accounts presented on the Statement of Financial Position?**

ABC Corporation		
Statement of Financial Position (partial)		
Current Assets		
Cash		\$330
Accounts receivable	\$ 257	
Less: Allowance for doubtful accounts	<u>30</u>	227
Supplies		40
Inventory		<u>812</u>
Total current assets		<u>\$1,409</u>

**I. Direct Write-off Method for Uncollectible Accounts**

**Write-off Uncollectible Accounts**

Bad Debt expense..... xx  
Accounts Receivable.... xx

**Illustration:** Assume that Warden Co. writes-off M. E. Doran’s \$1,600 balance as uncollectible on December 12. Warden’s entry is:

Bad Debt Expense                      1,600  
Accounts Receivable                      1,600

**II. Allowance Method for Uncollectible Accounts**

1. Companies **estimate** uncollectible accounts receivable. (Adjusting entry)

Bad Debt Expense..... xx  
Allowance for Doubtful accounts.... xx

2. At the time the specific account is **written-off** as uncollectible.

Allowance for Doubtful accounts.....xx  
Accounts Receivable..... xx

**Illustration:** Hampson Furniture has credit sales of \$1,200,000 in 2019, of which \$200,000 remains uncollected at December 31. The credit manager **estimates** that \$12,000 of these sales will prove uncollectible.

Dec. 31      Bad Debt Expense                      12,000  
                 Allowance for Doubtful accounts                      12,000

**Presentation of allowance for doubtful accounts**

Hampton Furniture		
Statement of Financial Position (Partial)		
Current assets		
Cash		\$14,800
Accounts receivable	\$200,000	
Less: Allowance for doubtful accounts	<u>12,000</u>	188,000
Supplies		25,000
Inventory		<u>310,000</u>
Total current assets		<u>\$537,800</u>

**Recording Write-Off of an Uncollectible Account**

**Illustration:** The financial vice-president of Hampson Furniture **authorizes a write-off** of the \$500 balance owed by R. A. Ware on March 1, 2019. The entry to record the **write-off** is:

Mar. 1	Allowance for Doubtful accounts	500	
	Accounts Receivable		500

**Recovery of an Uncollectible Account (2 journal entries)**

**Illustration:** On July 1, R. A. Ware pays the \$500 amount that Hampson had written off on March 1. Hampson makes these entries:

- **Reinstate the journal entry during write-off of accounts receivable**

Jul. 1	Accounts Receivable	500	
	Allowance for Doubtful accounts		500

- **Record the cash collection**

Jul. 1	Cash	500	
	Accounts Receivable		500

**Methods of estimating uncollectible**

- ❖ **Percentage-of-Sales** :(*No consideration is given to existing balance/Unadjusted balance in the allowance account.*)

**Illustration:** Assume that Gonzalez Company elects to use the percentage-of-sales basis. It concludes that 1% of net credit sales will become uncollectible. If net credit sales for 2018, is \$800,000, the adjusting entry is:

Dec. 31	Bad Debt Expense	8,000	
	Allowance for Doubtful accounts		8,000
	(800,000 x 1% = 8,000)		

- ❖ **Percentage of receivables** :(*Existing balance / unadjusted balance in the allowance account needs to be considered*)

**Aging of the Accounts Receivables**

Customer balances are classified by the length of time they have been unpaid.

Customer	Total	Not Yet Due	Number of Days Past Due			
			1-30	31 - 60	61 - 90	Over 90
T. E. Adert	\$600		\$300		\$200	\$100
B. C. Bortz	300	\$300				
B. A. Carl	450		200	\$250		
O. L. Diker	700	500			200	
T. O. Ebbet	600			300		300
Others	<u>36,950</u>	<u>26,200</u>	<u>5,200</u>	<u>2,450</u>	<u>1,600</u>	<u>1,500</u>
	<u>\$39,600</u>	<u>\$27,000</u>	<u>\$5,700</u>	<u>\$3,000</u>	<u>\$2,000</u>	<u>\$1,900</u>
Estimated Percentage Uncollectible		2%	4%	10%	20%	40%
Total Estimated Bad Debts	<u>\$2,228</u>	<u>\$540</u>	<u>\$228</u>	<u>\$300</u>	<u>\$400</u>	<u>\$760</u>

- **Total estimated bad debts for the company \$ 2,228**
- **\$2,228 represents the required balance/targeted balance/ total allowance/ ending balance in Allowance for doubtful accounts at the balance sheet date.**
- **The amount of the bad debt adjusting entry is the difference between the required balance and the existing balance / unadjusted balance/ prior balance in the allowance account.**

**Estimating the Allowance**

**Illustration:** Assume the unadjusted trial balance shows Allowance for Doubtful Accounts with a credit balance of \$528. Prepare the adjusting entry assuming \$2,228 is the estimate of uncollectible receivables from the aging schedule.

Dec. 31	Bad Debt Expense	1,700	
	Allowance for Doubtful accounts		1,700
	(2,228 – 528 = 1,700)		

**NOTES RECEIVABLE**

Companies may grant credit in exchange for a promissory note. A *promissory note* is a written promise to pay a specified amount of money on demand or at a definite time.

Promissory notes may be used

- 1. when individuals and companies lend or borrow money,
- 2. when amount of transaction and credit period exceed normal limits, or
- 3. in settlement of accounts receivable.

To the Payee, the promissory note is a note receivable. To the Maker, the promissory note is a note payable.

**Determining the Maturity Date**

Note expressed in terms of

- ◆ Months (use 12 as denominator)
- ◆ Days (use 360 days as denominator)

**Computing Interest**

*Face Value x Annual Interest Rate x Time in Terms of One Year = INTEREST*

When counting days, omit the date the note is issued, but include the due date.

**Recognizing Notes Receivable**

**Illustration:** Calhoun Company wrote (issued) a £1,000, two-month, 12% promissory note dated May 1 to Wilma Company, to settle an open account (Accounts receivable). Prepare the journal entry Wilma Company would record for the receipt of the note.

May 1	Notes Receivable	1,000	
	Accounts Receivable		1,000

**Valuing Notes Receivable**

- ◆ Report short-term notes receivable at their **cash (net) realizable value**.
- ◆ Estimation of cash realizable value and bad debts expense are done similarly to accounts receivable.
- ◆ Allowance for Doubtful Accounts is used.

**Disposing of Notes Receivable**

- 1. Notes may be held to their maturity date.
- 2. Maker may default and payee must make an adjustment to the account.
- 3. Holder speeds up conversion to cash by selling the note receivable (will not be discussed)

**◆Honor of Notes Receivable**

- Maker pays it in full at its maturity date.

**◆Dishonor of Notes Receivable**

- Not paid in full at maturity- (*Expect future / eventual collection of cash*)
- No longer negotiable- (*No future collection of cash expected. Write-off the notes receivable at face value/principal amount*)

**Honor of Notes Receivable**

**Illustration:** Wolder Co. lends Higley Co. \$10,000 on June 1, accepting a five-month, 9% interest note. If Wolder presents the note to Higley Co. on November 1, the maturity date, Wolder’s entry to record the collection is:

June 1	Notes Receivable – Higley Co	10,000	
	Cash		10,000
Nov. 1	Cash	10,375	
	Notes Receivable		10,000
	Interest Revenue (10,000 x 9% x 5/12)		375

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**Accrual of Interest Receivable**

Suppose instead that Wolder Co. prepares financial statements as of September 30. The adjusting entry by Wolder is for four months (**June 1- Sept 30**) accrued interest ending Sept. 30.

Sept. 30	Interest Receivable	300	
	Interest Revenue (10,000 x 9% x 4/12)		300

Prepare the entry Wolder would make to record the honoring of the Higley note on November 1.

Nov. 1	Cash	10,375	
	Notes Receivable		10,000
	Interest Receivable		300
	Interest Revenue (10,000 x 9% x 1/12)		75

**Dishonor of Notes Receivable**

**Illustration:** Assume that Higley Co. on November 1 indicates that it cannot pay at the present time. If Wolder Co. does expect eventual collection, it would make the following entry at the time the note is dishonored (assuming no previous accrual of interest).

Nov. 1	Accounts Receivable	10,375	
	Notes Receivable		10,000
	Interest Revenue		375

**Illustration:** Assume that Higley Co. on November 1 indicates that it cannot pay at the present time. If Wolder Co. does NOT expect collection, it would make the following entry at the time the note is dishonored (assuming no previous accrual of interest).

Nov. 1	Allowance for Doubtful account	10,000	
	Notes Receivable		10,000

Note: Write-off only the principal amount.



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**Exercise 4:** At Dec. 31, 2019, Curtis Co. had a credit balance of \$15,000 in Allowance for Doubtful Accounts. During 2020, Curtis wrote-off accounts totaling \$14,100. One of those accounts (\$1,800) was later collected. At Dec. 31, 2020, an aging schedule indicated that the balance in Allowance for Doubtful Accounts should be \$19,000.

Instructions: Prepare journal entries to record the 2020 transactions of Curtis Co.

Date	Account Title	Debit	Credit

Allowance for Doubtful Accounts

**Exercise 5:** On Dec. 31, 2019, Romualdo Co. estimated that 2% of its net sales of \$360,000 will be uncollectible. The company recorded this amount as an addition to Allowance for Doubtful Accounts. On May 11, 2020, Romualdo Co. determined that the B. Ventura’s account was uncollectible and wrote-off \$1,100. On June 12, 2020, Ventura paid the amount previously written off.

Instructions:

Prepare the journal entries on Dec. 31, 2019, May 11, 2020 and June 12, 2020.

Date	Account Title	Debit	Credit

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**Exercise 6:** Matrix Supply Co. has the following transactions related to notes receivable during the last 2 months of 2020. The company does not make entries to accrue interest except at Dec. 31.

- Nov. 1    Loaned \$15,000 cash to Jeanne Harn on a 12-month, 9% note.  
Dec. 11    Sold goods to Bobby Brown, Inc. receiving a \$6,750, 90- day, 8% note.  
16    Received a \$4,400, 180-day, 12% note in exchange for Richard Yap’s outstanding accounts receivable.  
31    Accrued interest revenue on all note receivables.

- Instructions:  
(a) Journalize the transactions for Matrix’s Supply Co.  
(b) Record the collection of the Jeanne Harn’s note at its maturity in 2021.

(a)

Date	Account Title	Debit	Credit

\*Calculation of interest revenue:  
Jeanne Harn’s note:  
Bobby Brown’s note:  
Richard Yap’s note:  
Total accrued interest

(b)

Date	Account Title	Debit	Credit

**Exercise 7:** Mailey Company had the following selected transactions:

- May 1, 2020    Accepted Dianne Co.’s 12-month, 12% note in settlement of a \$16,000 account receivable.  
July 1, 2020    Loaned \$25,000 cash to Sam Davis on a 9-month, 10% note.  
Dec 31, 2020    Accrued interest on all notes receivable.  
Apr. 1, 2021    Sam Davis dishonored its note; Mailey expects it will be eventually collected.  
May 1, 2021    Received principal plus interest on the Dianne’s note.  
Instructions: Prepare Journal entries for above transactions.

Date	Account Title	Debit	Credit



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**Exercise 8:** On May 2, Nancy Co. lends \$7,600,000 to Calver Inc. issuing a 6-month, 8% note. At the maturity, November 2, Calver indicates that it cannot pay.

Instructions:

- (a) Prepare the entry to record the issuance of the note.
- (b) Prepare the entry to record the dishonor of the note, assuming that Nancy Company expects collection will occur.
- (c) Prepare the entry to record the dishonor of the note, assuming that Nancy Co. does not expect collection in the future.

Date	Account Title	Debit	Credit

Problems

Problem 1:

At Dec. 31, 2020 Café Aroma Co. reported the following information on its statement of financial position.

Accounts Receivable	\$975,000
Less: Allowance for Doubtful Accounts	80,000

During 2021, the company had the following transactions related to receivables.

1. Sales on account.....	\$3,325,000
2. Sales returns and allowances.....	52,000
3. Collections of accounts receivable.....	2,824,000
4. Write-offs of accounts receivable deemed uncollectible.....	80,000
5. Recovery of bad debts previously written-off as uncollectible.....	30,000

Instructions:

- (a) Prepare the journal entries to record each of these five transactions. Assume that no cash discounts were taken on the collections of accounts receivable.
- (b) Enter the January 2021 balances in Accounts Receivable and Allowance for Doubtful Accounts, post the entries to the two accounts (use T-accounts), and determine the balances.
- (c) Prepare the journal entry to record bad debt expense for 2021, assuming that an aging of accounts receivable indicates that expected bad debts are \$127,000

(a)

Date	Account Title	Debit	Credit
1.			
2.			
3.			
4.			
5.			

(b)

Accounts Receivable	Allowance for Doubtful Accounts

- (c) Balance before adjustment .....
- Balance needed .....
- Adjustment required.....

The journal entry would therefore be as follows:

Date	Account Title	Debit	Credit

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Problem 2:

Presented below is an aging schedule for Sytango Company.

Customer	Total	Not Yet Due	Number of Days Past Due			
			1-30	31-60	61-90	over 90
Sanders	\$28,000		\$12,000	\$16,000		
Blake	40,000	\$40,000				
Cris	57,000	16,000	6,000		\$35,000	
De Jesus	34,000					\$34,000
Others	132,000	96,000	16,000	14,000		6,000
	\$291,000	\$152,000	\$34,000	\$30,000	\$35,000	\$40,000
Est. % Uncollectible		2%	6%	13%	25%	60%
Total Est. B/D	\$41,730	\$3,040	\$2,040	\$3,900	\$8,750	\$24,000

At Dec. 31, 2020, the unadjusted balance in Allowance for Doubtful Accounts is a credit of \$9,000.

Instructions:

- (a) Journalize and post the adjusting entry for bad debts at Dec. 31, 2020.
- (b) Journalize and post to the allowance account the following events and transactions in the year 2021.
  - (1) On March 31, a \$1,500 customer balance originating in 2020 is judged uncollectible
  - (2) On May 31, a check for \$1,500 is received from the customer whose account was written off as uncollectible on March 31.
- (c) Journalize the adjusting entry for bad debts on Dec. 31, 2021, assuming that the unadjusted balance in Allowance for Doubtful Accounts is a debit of \$800 and the aging schedule indicates that total estimated bad debts will be \$31,000.

(a)

Date	Account Title	Debit	Credit

(a) & (b)

Bad Debt Expense	Allowance for Doubtful Accounts

(b)

Date	Account Title	Debit	Credit

(c)

Date	Account Title	Debit	Credit

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Problem 3:

Henry Sy Inc. uses the allowance method to estimate uncollectible accounts receivable. The company produced the following aging of the accounts receivable at year-end.

		Number of Days Outstanding				
	Total	0–30	31–60	61–90	91–120	Over 120
Accounts receivable	\$193,000	\$70,000	\$46,000	\$39,000	\$23,000	\$15,000
% uncollectible		1%	3%	5%	8%	10%
(a)Estimated Bad debts						

Instructions:

- (a) Calculate the total estimated bad debts based on the above information.
- (b) Prepare the year-end adjusting journal entry to record the bad debts using the aged uncollectible accounts receivable determined in (a). Assume the current balance in Allowance for Doubtful Accounts is a \$3,000 debit.
- (c) Of the above accounts, \$5,000 is determined to be specifically uncollectible. Prepare the journal entry to write-off the uncollectible account.
- (d) The company collects \$5,000 subsequently on a specific account that had previously been determined to be uncollectible in (c). Prepare the journal entry(ies) necessary to restore the account and record the cash collection.

a) Total estimated bad debts=\_\_\_\_\_

Date	Account Title	Debit	Credit
(b)			
(c)			
(d)			

Problem 4:

At December 31, 2020, the trial balance of Roberto Company contained the following amounts before adjustments.

	<u>Debits</u>	<u>Credits</u>
Accounts Receivable	\$385,000	
Allowance for Doubtful Accounts		\$ 800
Sales Revenue		918,000

Instructions:

- (a) Prepare the adjusting entry at Dec. 31, 2020, for bad debt expense under each of the following independent assumptions.
  - (1) An aging schedule indicates that \$11,750 of accounts receivable will be uncollectible.
  - (2) The company estimates that 1% of sales will be uncollectible.
- (b) Repeat part (a) assuming that instead of a credit balance there is an \$800 debit balance in Allowance for Doubtful Accounts.
- (c) During the next month, Jan. 2021, a \$3,000 account receivable is written off as uncollectible. Prepare the journal entry to record the write-off.
- (d) Repeat part (c) assuming that Roberto uses the direct write-off method instead of the allowance method in accounting for uncollectible accounts receivable.

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(a)

Date	Account Title	Debit	Credit
(1) Dec. 31			
(2) Dec. 31			

(b)

Date	Account Title	Debit	Credit
(1) Dec. 31			
(2) Dec. 31			

(c)

Date	Account Title	Debit	Credit
(1)			

(d)

Date	Account Title	Debit	Credit

**Problem 5:**

On January 1, 2021, Don Emilio Co. had Accounts Receivable \$139,000. Notes Receivable \$30,000, and Allowance for Doubtful Accounts \$13,200. The note receivable is from Rachel Co. It is a 4-month, 12% note dated Dec. 31, 2020. Don Emilio Co. prepares financial statements annually at Dec. 31. During the year, the following selected transactions occurred.

- Jan. 5 Sold \$25,000 of merchandise to Thomas Co. terms n/15
- 20 Accepted Thomas Co.'s \$25,000, 3-month, 9% note for balance due.
- Feb. 18 Sold \$9,000 of merchandise to Joaquin Co. and accepted Joaquin's \$9,000, 6-month, 8% note for the amount due.
- Apr. 20 Collected Thomas Co. note in full.
- 30 Received payment in full from Rachel Co. on the amount due.
- May 25 Accepted Ricardo Inc.'s \$4,000, 3-month, 7% note in settlement of a past due balance on account.
- Aug. 18 Received payment in full from Joaquin Co. on note due.
- 25 The Ricardo Inc. note was dishonored. Ricardo Inc. is not bankrupt; future payment is anticipated.
- Sept. 1 Sold \$12,000 of merchandise to Flora Co. and accepted a \$12,000 6-month, 10% note for the amount due.

Instructions: Journalize the transactions.

Date	Account Title	Debit	Credit



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B.

Date	Account Title	Debit	Credit

Problem 7:

On January 1, 2021, Stingy Kee Neiw Company had Accounts receivable \$70,000 and allowance for doubtful accounts \$1,800. Stingy Kee Neiw Company prepares financial statements annually. During the year the following selected transactions occurred.

Jan. 1	Wrote-offs of accounts receivable- Goodrich deemed uncollectible \$2,000.
Jan. 5	Sold \$58,000 of merchandise to Soo Company, terms 2/10, n/30.
Jan. 6	Soo Company returned \$5,000 of the merchandise purchased on Jan. 5.
Feb. 2	Accepted a \$700, 2- month, 10% promissory note from Newnew Company for the balance due.
May 1	Sold goods \$20,000 for a promissory note, 12%, 2 months. Maker of the note is Blue Co.
July 1	Cash collection from Blue Company.
Sept. 30	Recovery of bad debts previously written off (Account of Mr. Qui) as uncollectible \$1,300.
Dec 31	Wrote off the note received from Newnew Company.
Dec. 31	Prepare adjusting entry to record bad debts expense, assuming bad debts are expected (estimated) to be 10% of accounts receivable.

Instructions: Prepare the journal entries for the year 2021.

Date	Account Title	Debit	Credit

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Problem 8:

Pepper Co. follows a one-month accounting period and closes its books monthly.  
At June 30, 2021, the trial balance of Pepper Company contained the following balances:

Accounts Receivable	\$ 585,000
Allowance for Doubtful Accounts	15,100
Notes Receivable	47,000

The Notes Receivable included the following:

<u>Date</u>	<u>Maker</u>	<u>Face</u>	<u>Term</u>	<u>Interest</u>
May 14	Oregano Corp.	\$ 28,000	60 days	12%
May 25	Mango Co.	\$ 19,000	60 days	10%

Interest is computed using a 360-day year. During July 2021, the following transactions were completed.

- July 2 Sold \$25,000 of merchandise to Black Company, terms 2/10, n/30.
- 7 Sold \$56,000 of merchandise to Central Company, terms n/15.
- 8 Collected \$450,000 from the accounts receivable balance of previous month with 2% cash discount allowed.
- ? Received payment in full from Oregano Corp. on the amount due.
- 17 Collected in full from Black Company and another \$20,000 from the balance owed previously.
- 20 Received a check for \$5,000 from the customer whose account was written off as uncollectible previously.
- 20 Sold \$120,000 of merchandise to Dragon Company, terms 2/10, n/30.
- 22 Accepted Central Company’s \$56,000, 60-day, 9% note for the balance due.
- ? Received notice that the Mango Co. note has been dishonored. Mango Company is not bankrupt; **future payment is anticipated**.
- 31 Collected \$50,000 from the accounts balance of Dragon Company.
- 31 Anna Company’s accounts receivable balance of \$12,500 is **judged** to be uncollectible.
- 31 Adjusted the accrued interest on the notes.

Required: -

- (a) Journalize the transactions completed during July and also compute the maturity date of the notes. Explanations not required. (Decimals must be rounded to whole number).
- (b) Enter the balance at July 1 to the accounts receivable and allowance for doubtful accounts ledgers. Post the journal entries of July to the ledgers.
- (c) On July 31, 2021, Pepper Company decided to estimate its bad debts based on 10% of the balance of accounts receivable. What is the journal entry to be recorded at July 31, 2021?

a)

Date	Account Titles	Debit	Credit
July 2, 2021			
July 7			





(c)

Date	Account Titles	Debit	Credit
July 31,			

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