

**Solution:**

(1)

If Cottonwood decides to use the percentage of sales method, then the allowance for bad debts should be reliably estimated based on the credit sales of that year.

The sales that year on credit was \$7 million. Since an average of 1.1% of these sales were never returned, the allowance for bad debts is 1.1% of \$7 million = \$77,000.

The journal entry to recognize bad debt is given by:

Bad Debts Expense To Allowance for Bad Debts  (Being allowance for bad debts based on sales.)	\$77,000	\$77,000
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This does not affect the Accounts Receivable because the Allowance for Bad Debts acts as contra account to this account.

Thus, the balances of these accounts at the end of 2010, appears as follows:

- (a) **Accounts Receivables:** \$7.48 million (debit)
- (b) **Allowance for Bad Debts:** \$68,800 (credit)

(2)

If Cottonwood decides to use the percentage of accounts receivables method, then the allowance for bad debts should be reliably estimated based on the ending accounts receivables of that year.

The sales that year on credit was \$7 million.

Thus, the accounts deemed receivable is \$7 million + \$0.48 million = \$7.48 million.

Since an average of 17% of these were never returned, the allowance for bad debts is 17% of \$7.48 million = \$1.27 million.

The journal entry to recognize bad debt is given by:

Bad Debts Expense To Allowance for Bad Debts  (Being allowance for bad debts based on sales.)	\$1.2 million	\$1.2 million
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This does not affect the Accounts Receivable because the Allowance for Bad Debts acts as contra account to this account.

Thus, the balances of these accounts at the end of 2010, appears as follows:

- (a) **Accounts Receivables:** \$7.48 million (debit)
- (b) **Allowance for Bad Debts:** \$1.2 million (credit)

(3)

Using the percentage of sales method, seems more appropriate. This is because the accounts deemed uncollectible seems to be an overkill in the use of the accounts receivables.