

Chapter 9

Accounting for Receivables
Classes: A/R, Notes Receivable, Other Receivable

Recognizing and Valuing A/R


Recognizing A/R

- ✓ When a business sells merchandise to a customer on credit,
DR A/R
CR Sales
- ✓ When a business collects cash from a customer for A/R,
DR Cash
CR A/R

Recognizing and Valuing A/R

Valuing A/R


- ✓ To ensure receivables are not overstated in \$, they are stated at their net realizable value.
- ✓ $NRV = A/R - \text{Actual Uncollectibles}$
- ✓ $NRV = A/R - ADA$
- ✓ 2 methods of valuing uncollectible amounts:
 - § Direct write-off method
 - § Allowance method



Direct Write-off Method


General Journal			
Date	Account Titles and Explanation	Debit	Credit
Jan 12	Bad Debts Expense	200	
	Accounts Receivable — E. Schaefer		200
	For write-off of E. Schaefer's account		

Perera Company writes off E. Schaefer's \$200 balance as uncollectible on January 12. When the **direct write-off method** is used, **Bad Debts Expense** will show only actual losses from uncollectibles.




Direct Write-Off Method

- ✓ No entries are made for bad debts until an account is determined to be uncollectible.
- ✓ When uncollectible,
DR Bad Debts Expense
CR A/R
- ✓ No attempt is made to match bad debts to sales
- ✓ $NRV = A/R - \text{Actual Uncollectibles}$
- ✓ This method is used when bad debts are immaterial



The Allowance Method

- ✓ The allowance method is required when bad debts are deemed to be material.
- ✓ Uncollectible amounts are **estimated** and the expense for the uncollectible is matched against sales or A/R in the same fiscal year:
DR Bad Debt Expense
CR Allowance for Doubtful Accounts
- ✓ When an invoice is **actually not collected** and it needs to be written off, then
DR Allowance for Doubtful Accounts
CR A/R
- ✓ $NRV = A/R - ADA$



The Allowance Method

General Journal			
Date	Account Titles and Explanation	Debit	Credit
Dec 31	Bad Debts Expense	24,000	
	Allowance for Doubtful Accounts		24,000
	<i>To record estimate of uncollectible accounts</i>		

Estimated uncollectible amounts are DR to **Bad Debts Expense** & CR to **Allowance for Doubtful Accounts** (a contra asset account) at the end of each period.



Example of NRV

Adorable Junior Garmet Balance Sheet [Partial]		
Current Assets		
Cash		14,800
Accounts Receivables	200,000	
Less: Allowance for Doubtful Accounts	12,000	188,000

**Net
Realizable
Value**



Bases for the Allowance Method

- Companies use either of the following 2 methods in the estimation of ADA as both are within GAAP:

Percentage of Sales

Percentage of Receivables



Percentage of Sales -
Emphasis on I/S
Relationships



Percentage of Receivables -
Emphasis on B/S
Relationships

Getting Rid of A/R

- Factoring Company**
A factor buys A/R from businesses for a fee and collects the payments directly from customers.
- Credit Card Sales**
 - Credit cards are used by retailers who wish to avoid the paperwork of issuing credit.
 - Credit card companies pay the retailers directly.
 - The retailer pays the credit card company a percentage of credit card sales.



Notes Receivables

- § A note is a written promise or a contract to pay a specified amount of money on demand or at a definite time.
- § The party making the promise is the maker.
- § The party to whom payment is made is called the payee.



N/R VS A/R

A/R	N/R
§ usually decreases in amount with time	§ usually decreases in amount with time
§ usually due within 60 days	§ usually due after 60 days
§ invoice	§ contract
§ can convert A/R to N/R	§ can not convert N/R into A/R



Journal Entries

§ When you receive cash and promise to pay a note:

DR Cash
CR Note Payable

§ When someone writes a note to you that they will pay you:

DR Note Receivable
CR Cash or A/R

§ When you pay the note:

DR Note Payable
DR Interest Expense
CR Cash



§ When they pay you:

DR Cash
CR Note Receivable
CR Interest Revenue

Recognizing Notes Receivables

General Journal			
Date	Account Titles and Explanation	Debit	Credit
May 1	Notes Receivable	1,000	
	Accounts Receivable – Brent Company		1,000
	<i>To record acceptance of Brent Company note.</i>		

Wilma Company receives a \$1,000, 6% promissory note, due in two months (July 1) from Brent Company to settle an A/R.



Valuing Notes Receivable

- ✓ Like A/R, short-term notes receivable are reported at their net realizable value (NRV).
- ✓ The notes receivable allowance account is called Allowance for Doubtful Notes or ADN.
- ✓ Bad Debts Expense and Allowance for Doubtful Notes – the process is the same as A/R.



B/S Presentation – Receivables

- § Each of the major types of receivables (A/R, N/R, Other Receivables) should be identified in the B/S or in the notes
 - § In the B/S, receivables are reported in the **current assets** section.
- § Both the **total amount of receivables** and the **allowance for doubtful accounts** should be reported.
- § I/S – accounts are Bad Debts Expense, Interest Expense, Interest Revenue.
- § B/S – accounts are A/R, N/R, ADA



Using info in F/S – Ratios

- ✓ The current ratio is a widely used measure for evaluating a company's liquidity and short-term debt-paying ability.

Current Ratio = CA / CL

- ✓ The quick ratio is a measure of a company's short-term liquidity.

Quick Ratio = (Cash + Short-term Investments + Receivables) / CL



Using info in F/S – Ratios

- ✓ The ratio used to assess the liquidity of the receivables is the receivables turnover ratio.

Receivables Turnover = Net Credit Sales / Average Net Receivables

- ✓ The collection period in days is a variant of the receivables turnover ratio & makes liquidity even more evident.
- ✓ The *general rule* is that the collection period should not exceed the credit term period.

Collection Period in Days = Days in Year / Receivables Turnover

