Receivables – Practice Case / Problem

BAT Corporation is in the business of providing business consulting services to entrepreneurs and small business owners. The year 2009 was the 2nd year for the business. This was an especially good year as the company had total revenues of $1,000,000, and served 125 clients. All of the consultants in the company were working very hard and were extremely proud of their achievements during the year.

In November of 2009, one of the consultants, Adam Flintstone, realized that 10 clients were not fully able to utilize the services that they had received. Adam approached the president of the company, Alisha Simpson, to suggest that as these clients had very small businesses, it may be a good idea to return a portion of the fees to them so that they can use the cash in their businesses. Alisha agreed and they returned a total of $25,000 to those clients on November 15, 2009. Alisha asked their accountant, James Bond, to explain the concept of returns and how this transaction should be recorded.

As the year came to end, James Bond notifies Alisha that they had a few ageing accounts receivables as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  |  | Number of Days Outstanding | | | |
|  | Total | 0 – 30 | 31 – 60 | 61 – 90 | Over 90 |
| Accounts receivable | $200,000 | $80,000 | $50,000 | $50,000 | $20,000 |
| Percentage uncollectible |  | 0% | 5% | 10% | 20% |
| Estimated bad debts | $11,500 | $0 | $2,500 | $5,000 | $4,000 |

In a meeting with Alisha and Adam, James demonstrates how to calculate the estimated bad debts for each column and the total estimated bad debts in the table above.

After this small demonstration, Alisha gets excited and says that she had ambitions of becoming an accountant when she was in high school. She wants to attempt at the adjusting journal entry to record the bad debts calculated using the allowance method. As Adam is a bit confused, Alisha must also explain the concept behind the bad debts expense and the allowance account. During this discussion, James listens and reviews Alisha’s work. He also provides any suggestions if necessary.

At this time, Adam poses a question: “what happens if $2,000 is determined to be uncollectible from a client as they have gone into bankruptcy?” James then explains the concept of writing-off the $2,000 and asks Adam to attempt at preparing the journal entry to write-off the $2,000. James, of course, reviews the entry afterwards.

Adam is also a bit confused about the differences between A/R and N/R. Both Alisha and James take turns to explain the differences.

**Required:**

In groups of 3, decide who will be Adam Flintstone, Alisha Simpson, and James Bond. Then read this case as a group, concentrating on your role. Perform the tasks that have been assigned or implied for 1 of the 3 people.

Adam: Oh my god some of the clients aren’t using all of the services we are providing them!

Alisha: mios dios! How could this happen?!

Adam: Perhaps we should return a portion of the fees to them so that they can use the cash in their businesses.

Alisha: Good Idea! I’ll return a total of $25,000 to the clients this day of November 15! James, can you explain how I can do this?

**Concept of returns and how this transaction should be recorded**

James: It’s about time you learned about returns and how to record them! Returns occur when either the business or the client returns a good. If we’re going to return something to our clients, we can classify it as a sales return, typically in which the customer returns a good and we pay them the amount for which they had originally bought it. For our case, we simply debit sales returns and allowances, and credit bank. Since we’re going to be returning $25,000 to all of them, we debit sales returns and allowances for $25,000 and credit bank for $25,000.

\*1 day later\*

**how to calculate the estimated bad debts for each column and the total estimated bad debts in the table above.**

James: Alright here’s our meeting, it’s about calculating the bad debts expense and total estimated bad debts. From the table, I showed you our accounts receivable and the percentage of the accounts receivable I estimated we’ll get back. Calculating the estimated bad debts is actually very simple! To fill in each individual column, all you have to do is multiply the Accounts Receivable by the Percentage Uncollectible, like so;

*Estimated Bad Debt = Accounts Receivable \* Percentage Uncollectible*

Once you calculate each column, you’re ready to calculate the total bad debt. It’s simply adding all the estimated bad debts together!;

*Total Estimated Bad Debt = Estimated Bad Debt1 + Estimated Bad Debt2 + … Estimated Bad Debts*

**the concept behind the bad debts expense and the allowance account.**

James: A bad debt expense is recognized when areceivable is no longer collectible because a customer is unable to fulfill their obligation to pay an outstanding debt due to bankruptcy or other financial problems.

Alisha: Adding onto James’ point, Companies that extend credit to their customers report bad debts as an allowance for doubtful accounts on thebalance sheet which is also known as a provision for credit losses.

**concept behind the bad debts expense and the allowance account**

Alisha: omg i love accounting! I want to do the journal entries behind the expenses and accounts!

Adam: That doesn’t make sense.

Alisha: You’re fired, now let me explain. Bad debts expense and allowance accounts are for when we expect an accounts receivable to not make good on their promise. We imagine that they won’t pay us in time, so we turn them into a doubtful account. We account for this behaviour in our journal entries as an “allowance for doubtful accounts”. Moreover, we have the bad debts expense so that this will be reflected in our income statement too, better adhering to GAAP principles.

**Difference between A/R and N/R**

James and Alisha: Accounts receivable is the balance of money due to a firm for goods and services that are delivered or used but not yet paid for by customers. Accounts receivables are listed on the balance sheet as a current asset. It is also any amount of money owed by customers for purchases made on credit. Whereas, notes receivable is a current asset that is also on the balance sheet. Specifically, a note receivable is a written promise to receive money at a future date. It is made up of interest and principal. The main difference is that a written promissory note is a note payable for the borrower and it is a note receivable for the lender.