

# CHAPTER 6

## DISCUSSION QUESTIONS

1. Revenues should be recognized and reported when (1) the entity has transferred to the buyer the significant risks and rewards of ownership of the goods; (2) the entity retains neither continuing managerial involvement to the degree usually associated with ownership nor effective control over the goods sold; (3) the amount of revenue can be measured reliably; (4) it is probable that the economic benefits associated with the transaction will flow to the entity; and (5) the costs incurred or to be incurred in respect of the transaction can be measured reliably.
2. Some of the reasons revenues are misstated to manipulate financial statements are:
  - a. It is quite easy. All one has to do to overstate revenues is record fictitious sales, record sales earlier than they should be recorded, or overstate the amount of legitimate sales.
  - b. When revenues are overstated, assets (accounts receivables) are also overstated. By overstating revenues and assets, financial statements look good.
  - c. Determining when to recognize revenues is not always easy and requires professional judgment.
3. It is important to have separate sales returns and allowances and sales discounts accounts rather than to reduce Sales Revenue directly because knowledge of the original amount of sales (undisturbed by adjustments for returns and discounts) is valuable when assessing what percentage of sales is returned and/or what the net revenue from sales is. For example, if a company found that a significant percentage of sales was being returned (as calculated by dividing sales returns and allowances by sales), it might decide that it is selling inferior merchandise or has a return policy that is too liberal.
4. Most companies tolerate a small percentage of uncollectible accounts receivable because if they monitored their customers so closely that there were never any bad debts, their credit policy would be so strict that many potential customers would be lost and ill will would be created among others. On the other hand, if a company has too many bad accounts, it could eventually go bankrupt. Thus, it is important that a company walk a fine line in deciding who should and should not be granted credit. If too strict, the firm may lose customers; if too lenient, it may lose profits and possibly even solvency. The optimal position for a company to take is to choose that point at which the marginal revenues from customers just equals the marginal cost of bad debts and other costs of servicing customers.
5. The allowance method of accounting for uncollectible receivables is required by the profession because it provides a better matching of expenses with revenues. For example, if a sale made in the last month of a year eventually became uncollectible, the bad debt would not be recognized until the following year (at the time the bad debt is known) when using the direct write-off method. The revenue would be recognized in the first period and the expense in the second. With the allowance method, the amount of bad debts is estimated on the basis of past experience or industry averages and matched with revenues of that period.
6. The *net* balance of Accounts Receivable does not change when an uncollectible account is written off because the journal entry to write off the receivable decreases the Accounts Receivable balance and the Allowance for bad debts account by the same amount.
7. Aging of accounts receivable is usually more accurate than basing the estimate on total receivables because the aging procedure considers the length of time receivables have been outstanding. Each age category is multiplied by an expected uncollectible rate rather than applying a general uncollectible rate to all receivables.
8. Operating ratios such as accounts receivable turnover tell you how fast a company is collecting receivables. When examined over a period of time, trends in collectibility can be assessed. Having money tied up in ac-

counts receivable is very expensive for an organization. Some companies have even gone bankrupt because they let their receivables get out of hand.

# PRACTICE EXERCISES

## PE 6–1 (LO2)      Revenue Recognition

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## PE 6–2 (LO2)      Revenue Recognition

Cash (95 × \$29) .....	2,755
Accounts Receivable (80 × \$29) .....	2,320
Sales Revenue.....	5,075
Cost of Goods Sold.....	3,500
Inventory.....	3,500

## PE 6–3 (LO2)      Cash Collection

Cash.....	2,320
Accounts Receivable.....	2,320

## PE 6–4 (LO2)      Sales

(1). Cash (\$2,320 × 0.98) .....	2,273.60
Sales Discounts (\$2,320 × 0.02) .....	46.40
Accounts Receivable.....	2,320.00
(2). Cash .....	2,320
Accounts Receivable.....	2,320

## PE 6–5 (LO2)      Sales Returns and Allowances

(1). Sales Returns and Allowances .....	435
Cash.....	435
Inventory .....	300
Cost of Goods Sold .....	300
(2). Sales Returns and Allowances .....	435
Accounts Receivable.....	435
Inventory .....	300
Cost of Goods Sold .....	300

**PE 6–6 (LO2) Computing Net Sales**

Gross sales.....	\$3,750,000
Less: Sales discounts.....	(100,000)
Less: Sales returns and allowances.....	(150,000)
<b>Net sales .....</b>	<b><u>\$3,500,000</u></b>

**PE 6–7 (LO3) The Allowance Method**

1. Bad Debt Expense.....	50,000	
Allowance for Bad Debts.....		50,000
2. Allowance for Bad Debts .....	43,000	
Accounts Receivable.....		43,000

**PE 6–8 (LO3) Computing Net Accounts Receivable**

(1).	<u>Before Write-Off</u>	(2).	<u>After Write-Off</u>
Accounts receivable	\$200,000	Accounts receivable	\$157,000
Less: Allowance for bad debts	<u>50,000</u>	( $\$200,000 - \$43,000$ )	
Net realizable value	<u><b>\$150,000</b></u>	Less: Allowance for bad debts	
		( $\$50,000 - \$43,000$ )	<u>7,000</u>
		Net realizable value	<u><b>\$150,000</b></u>

**PE 6–9 (LO3) Collecting an Account Previously Written Off**

Accounts Receivable .....	7,000	
Allowance for Bad Debts.....		7,000
Cash .....	7,000	
Accounts Receivable.....		7,000

**PE 6–10 (LO3) Estimating Uncollectible Accounts Receivable as a Percentage of Total Receivables**

Bad Debt Expense.....	6,480	
Allowance for Bad Debts.....		6,480*

To adjust the allowance account to the desired balance:

$$*\$102,000 \times 0.09 = \$9,180; \$9,180 - \$2,700 = \$6,480$$

**PE 6–11 (LO3)      Estimating Uncollectible Accounts Receivable Using Aging Accounts Receivable**

<b>Estimate of Losses from Uncollectible Accounts</b>			
<b>Age</b>	<b>Balances</b>	<b>Percentage Estimated to Be Uncollectible</b>	<b>Amount</b>
Current	\$16,450	1.75%	\$ 288
1–30 days past due	8,150	6	489
31–60 days past due	7,150	15	1,073
61–90 days past due	900	35	315
91–120 day past due	2,000	65	1,300
Over 120 days past due	<u>4,000</u>	90	<u>3,600</u>
<b>Totals</b>	<b>\$38,650</b>		<b>\$7,065</b>

1. The \$7,065 represents the receivables that are likely to be uncollectible. We need to adjust the allowance account to this balance with the following entry:

Bad Debt Expense.....	5,065
Allowance for Bad Debts.....	5,065

To adjust the allowance account to the desired ending balance:

$$\$7,065 - \$2,000 = \$5,065$$

2. Bad Debt Expense..... 10,665  
 Allowance for Bad Debts..... 10,665

To adjust the allowance account to the desired ending balance:

$$\$7,065 + \$3,600 = \$10,665$$

**PE 6–12 (LO3)      Evaluating Quality of Accounts Receivable**

Begin the analysis of accounts receivable by dividing the ending allowance for bad debts by the ending accounts receivable balance to get the allowance for bad debts as a percentage of accounts receivable, as shown below.

<b>Year</b>	<b>Ending Accounts Receivable</b>	<b>Ending Allowance for Bad Debts</b>	<b>Allowance for Bad Debts as a Percentage of Accounts Receivable</b>
			<b>of Accounts Receivable</b>
Year 3	\$307,800	\$51,650	17%
Year 2	268,150	37,540	14
Year 1	224,300	21,800	10

In Year 1, the company believed it would not collect 10% of its accounts receivable. This percentage increased to 17% by Year 3. For some reason, the quality of accounts receivable has decreased over the past three years as evidenced by the

fact that the company believes a greater percentage of its accounts receivable will not be collected.

**PE 6–13 (LO4) Accounts Receivable Turnover**

$$\text{A/R Turnover} = \frac{\text{Sales Revenue}}{\text{Average Accounts Receivable}} = \frac{\$520,000}{[(\$46,000 + \$54,000)/2]} = 10.40$$

**PE 6–14 (LO4) Average Collection Period**

$$\text{Average Collection Period} = \frac{365}{\text{Accounts Receivable Turnover}} = \frac{365}{10.40} = 35.1 \text{ days}$$

\*The accounts receivable turnover of 10.40 was calculated in PE 6–13 by dividing sales by the average accounts receivable.

**PE 6–15 (LO5) Recording Notes Receivable**

<b>May 1</b>			
Notes Receivable.....		8,500	
Sales Revenue.....			8,500

**PE 6–16 (LO5) Recording Notes Receivable**

<b>June 30</b>			
Cash .....		8,642	
Notes Receivable .....			8,500
Interest Revenue ( $\$8,500 \times 10\% \times 60/360$ ).....			142

**PE 6–17 (LO5) Recording Notes Receivable**

1. The maturity date is December 31.

- 2.

- Dec. 31

Cash .....	7,837.5		
Notes Receivable .....		7,500	
Interest Revenue ( $\$15,000 \times 9\% \times 3/12$ ).....			337.5

## EXERCISES

### E 6–1 (LO2) Recording Sales Transactions

June	3	Accounts Receivable .....	9,000	
		Sales Revenue.....		9,000
		<i>Sold merchandise to Mary Company, terms 2/10, n/30.</i>		
	7	Sales Returns and Allowances.....	850	
		Accounts Receivable .....		850
		<i>Accepted return of merchandise from Mary Company.</i>		
	21	Cash.....	8,150	
		Accounts Receivable .....		8,150
		<i>Received payment in full from Mary Company.</i>		

### E 6–2 (LO2) Recording Sales Transactions

June	24	Accounts Receivable .....	140,000	
		Sales Revenue.....		140,000
		<i>Sold merchandise to Brooke Bowman, terms 2/10, n/30.</i>		
	30	Cash.....	78,400	
		Sales Discounts.....	1,600	
		Accounts Receivable .....		80,000
		<i>Received partial payment from Brooke Bowman.</i>		
July	20	Cash.....	42,000	
		Sales Returns and Allowances.....	18,000	
		Accounts Receivable .....		60,000
		<i>Received remaining payment from Brooke Bowman and accepted her return of merchandise that originally sold for \$18,000.</i>		

### E 6–3 (LO3) Estimating Bad Debts

1. Bad debt expense =  $\$3,900 + \$1,300 = \$5,200$
2. Bad debt expense =  $(\$66,400 \times 4\%) = \$2,656$ ;  $\$2,656 + \$1,300 = \$3,956$

**E 6–4 (LO3)      Accounting for Bad Debts**
**1. The allowance method:**

Allowance for Bad Debts .....	630,000
Accounts Receivable .....	630,000
<i>To write off uncollectible accounts.</i>	
Accounts Receivable.....	35,000
Allowance for Bad Debts .....	35,000
<i>To reinstate the balance previously written off as uncollectible.</i>	
Cash.....	35,000
Accounts Receivable .....	35,000
<i>Received payment of \$35,000.</i>	
Bad Debt Expense .....	645,000
Allowance for Bad Debts .....	645,000
<i>To adjust the allowance account to the desired balance of \$650,000.*</i>	

\*\$600,000 (beginning balance) – \$630,000 (written off in 2017) + \$35,000 (restored in 2017) = \$5,000 (remaining credit balance).

\$650,000 (desired balance) – \$5,000 (remaining credit balance) = \$645,000 (adjustment needed).

- 2. The direct write-off method is objective in that an account is written off at the time it proves to be uncollectible. This method, however, compromises the matching principle because expenses incurred in generating revenues may not be accurately matched with related revenues on a period-by-period basis. For example, sales made near the end of an accounting period may not be identified as uncollectible until the next period. Alternatively, when using the allowance method, uncollectible balances are accounted for during the period in which the sales occurred. Although the allowance method is generally accepted in practice, it may result in a somewhat imprecise expense amount; this is seen as a less serious problem than the failure to match revenues and expenses (direct write-off).**

**E 6–5 (LO2)      Accounting for Accounts Receivables**

(a)      Accounts Receivable	17,200
Sales Revenue	17,200
(b)      Sales Returns and Allowances	3,800

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**Accounts Receivable**      **3,800**

(c)	<b>Cash (\$13,400 – \$268)</b>	<b>13,132</b>
	<b>Sales Discounts (\$13,400 X 2%)</b>	<b>268</b>
	<b>Accounts Receivable (\$17,200 – \$3,800) 13,400</b>	

**E 6–6 (LO3)      Accounting for Uncollectible Accounts Receivable**
**1.      Allowance for Bad Debts**

<b>Write-offs</b>	<b>50,000</b>	<b>Beg. bal.</b>	<b>45,000</b>
		<b>Bad debt expense</b>	<b>95,000</b>
			<b>End. bal.</b>

90,000

**Answers:** December 31, 2017, balance of Allowance for Bad Debts = \$90,000  
 Bad debt expense for 2017 = \$95,000 (\$45,000 beg. bal. + \$50,000 in 2017) (as computed in the T-account above)

**2.      Accounts Receivable**

<b>Beg. bal.</b>	<b>750,000</b>	<b>Collections</b>	<b>3,075,000</b>
<b>Sales</b>	<b>3,500,000</b>	<b>Write-offs</b>	<b>50,000</b>
<b>End. bal.</b>	<b>1,125,000</b>		

**Answer:** December 31, 2017, balance of gross Accounts Receivable = \$1,125,000

**E 6–7 (LO3)      Aging of Accounts Receivable**

<b>0.5%</b>	<b>×</b>	<b>\$720,000</b>	<b>=</b>	<b>\$ 3,600</b>
<b>3.0%</b>	<b>×</b>	<b>\$395,000</b>	<b>=</b>	<b>11,850</b>
<b>16.0%</b>	<b>×</b>	<b>\$105,000</b>	<b>=</b>	<b>16,800</b>
<b>52.5%</b>	<b>×</b>	<b>\$52,000</b>	<b>=</b>	<b>27,300</b>
<b>92.0%</b>	<b>×</b>	<b>\$13,000</b>	<b>=</b>	<b><u>11,960</u></b>
				<b><u>\$71,510</u></b>

<b>Balance needed</b>	<b>\$71,510</b>
<b>Prior balance</b>	<b>42,000</b>
<b>Adjustment needed</b>	<b><u>\$29,510</u></b>

**Journal Entry**

<b>Bad Debt Expense.....</b>	<b>29,510</b>
<b>Allowance for Bad Debts.....</b>	<b>29,510</b>
<i>To record the bad debt expense.</i>	

**E 6–8 (LO3) Aging of Accounts Receivable**

1.	Category	Amount	Percentage	Total
	Less than 30 days .....	\$122,000	2%	\$ 2,440
	31–60 days .....	24,000	10	2,400
	61–90 days .....	8,000	30	2,400
	Over 90 days.....	9,000	75	<u>6,750</u>
	<b>Total estimated uncollectible accounts .....</b>			<b><u>\$13,990</u></b>

2. **Bad Debt Expense.....** **13,990**

**Allowance for Bad Debts .....** **13,990**

*To record estimated allowance for bad debts.*

3. The net accounts receivable balance at December 31, 2017, is \$149,010 (\$163,000 – \$13,990).

**E 6–9 (LO4) Ratio Analysis**
**1. Accounts Receivable Turnover**

	<u>Formula</u>	<u>Year 3</u>	<u>Year 2</u>
Parker Enterprises, Inc.			
	<u>Sales Revenue</u>	<u>\$3,700</u>	<u>\$3,875</u>
	<u>Average Accounts Receivable</u>	<u>(\$1,400 + \$1,800)/2</u>	<u>(\$1,800 + \$1,725)/2</u>
		2.3 times	2.2 times
Boulder, Inc.	<u>Sales Revenue</u>	<u>\$17,825</u>	<u>\$16,549</u>
	<u>Average Accounts Receivable</u>	<u>(\$5,525 + \$5,800)/2</u>	<u>(\$5,800 + \$6,205)/2</u>
		3.1 times	2.8 times

Average Collection Period

Parker Enterprises, Inc.  $365 \div 2.3 = 159$  days  $365 \div 2.2 = 166$  days

Boulder, Inc.  $365 \div 3.1 = 118$  days  $365 \div 2.8 = 130$  days

2. Boulder, Inc., appears to have the better credit management policy. Its turnover is higher, and its average collection period is shorter than Parker's.

**E 6–10 (LO4) Assessing How Well Companies Manage Their Receivables**

In determining the answer, it is necessary to first compute average receivables for each year. The average receivables for 2016 are \$542,500 [(\$520,000 +

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**\$565,000)/2]. The average receivables for 2017 are \$585,000 [(\$565,000 + \$605,000)/2].**

**The accounts receivable turnover ratios are as follows:**

	<u>2017</u>	<u>2016</u>
<b>Sales Revenue</b>	<b>\$3,040,000</b>	<b>\$2,470,000</b>
<b>Average Accounts Receivable</b>	<b>\$585,000</b>	<b>\$542,500</b>

= 5.2 times      = 4.6 times

**The average collection periods are:**

	<u>2017</u>	<u>2016</u>
<b>Accounts Receivable Turnover</b>	<b>365</b>	<b>365</b>

= 70 days      = 79 days

5.2 times      4.6 times

**Based on the above data, Leif Company appears to be managing its receivables much better in 2017 than it did in 2016. It has increased its receivable turnover (from 4.6 to 5.2 times per year) and has shortened its average collection period from 79 days to 70 days.**

**E 6–11 (LO5)**
**Accounting for Notes Receivable**

$$(1). (31 - 1) + 30 + 31 + 29 = 120$$

The maturity date is June 29.

(2).

Jun. 29	Cash .....	6,160
	Notes Receivable—Kingstone Co. ....	6,000
	Interest Revenue .....	160

**E 6–12 (LO5)**
**Notes Receivable**

Dec. 1	Notes Receivable .....	60,000
	Accounts Receivable .....	60,000
Dec. 31	Interest Receivable .....	400
	Interest Revenue ( $\$0,000 \times 8\% \times 30/360$ ) .....	400

(a)

Mar. 1	Cash .....	61,200
	Notes Receivable.....	60,000
	Interest Receivable.....	400
	Interest Revenue .....	800

(b)

Mar. 1	Accounts Receivable.....	61,200
	Notes Receivable.....	60,000
	Interest Receivable.....	400
	Interest Revenue .....	800

**E 6–13 (LO5)**
**Recording Notes Receivable**

2016

Aug. 1	Notes Receivable—Lala Co. ....	9,600
	Accounts Receivable .....	9,600
Dec. 31	Interest Receivable .....	320
	Interest Revenue .....	320

2017

Jan. 31	Cash .....	9,984
	Notes Receivable—Lala Co. ....	9,600
	Interest Receivable.....	320
	Interest Revenue .....	64

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**E 6–14 (LO5)      Recording Notes Receivable**
**1.**

**Apr. 1** **Notes Receivable** ..... **1,000,000**  
**Cash** ..... **1,000,000**

**2.**

**Oct. 1** **Accounts Receivable** ..... **1,060,000**  
**Notes Receivable** ..... **1,000,000**  
**Interest Revenue** ..... **60,000**

**3.**

**Oct. 1** **Allowance for Doubtful Accounts** ..... **1,060,000**  
**Notes Receivable** ..... **1,000,000**  
**Interest Revenue** ..... **60,000**

## PROBLEMS

**P 6–1 (LO2)      Sales Transactions**
**G.E Company—Seller**

(a)	Accounts Receivable .....	60,000
	Sales Revenue .....	60,000
	<i>Sold merchandise for \$60,000.</i>	
(b)	Sales Returns and Allowances .....	4,000
	Accounts Receivable.....	4,000
	<i>Customer returned \$4,000 of merchandise.</i>	
(c)	Cash .....	54,880
	Sales Discounts .....	1,120
	Accounts Receivable.....	56,000
	<i>Received full amount from STARK Company (included 2% discount).</i>	
(d)	Cash .....	56,000
	Accounts Receivable.....	56,000
	<i>Collected full amount from STARK Company.</i>	

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**P 6–2 (LO3)**
**Accounting for Accounts Receivable**

1.	<b>Accounts Receivable .....</b>	<b>4,200,000</b>
	<b>Sales Revenue .....</b>	<b>4,200,000</b>
<i>To record 2017 sales.</i>		
	<b>Cash .....</b>	<b>3,616,000</b>
	<b>Sales Discounts .....</b>	<b>64,000</b>
	<b>Accounts Receivable.....</b>	<b>3,680,000</b>
<i>To recognize collections of receivables.</i>		
	<b>Sales Returns and Allowances .....</b>	<b>48,000</b>
	<b>Accounts Receivable.....</b>	<b>48,000</b>
<i>To record sales returns from customers.</i>		
	<b>Allowance for Bad Debts .....</b>	<b>18,800</b>
	<b>Accounts Receivable.....</b>	<b>18,800</b>
<i>To write off uncollectible accounts receivable.</i>		
	<b>Bad Debt Expense.....</b>	<b>41,800*</b>
	<b>Allowance for Bad Debts .....</b>	<b>41,800</b>
<i>To record bad debt expense for the year.</i>		
*(\$20,600 – \$18,800 = \$1,800; \$43,600 – \$1,800 = \$41,800)		
2.	a. <b>Gross sales .....</b>	<b>\$4,200,000</b>
	<b>Less: Sales discounts .....</b>	<b>(64,000)</b>
	<b>Sales returns and allowances .....</b>	<b>(48,000)</b>
	<b>Net sales .....</b>	<b><u>\$4,088,000</u></b>
b.		

<b>Accounts Receivable</b>			
<b>Beg. Bal.</b>	<b>640,000</b>	<b>Collected</b>	<b>3,680,000</b>
<b>Sales</b>	<b>4,200,000</b>	<b>Returns</b>	<b>48,000</b>
		<b>Allow. for Bad Debts</b>	<b>18,800</b>
<b>End. Bal.</b>	<b>1,093,200</b>		

**P 6–3 (LO3)**
**Analysis of Allowance for Bad Debts**

1.	<b>Estimated bad debts</b>	2%	x	\$1,140,000	=	\$ 22,800
		10%	x	\$600,000	=	60,000
		23%	x	\$400,000	=	92,000
		75%	x	\$120,000	=	<u>90,000</u>
						<b><u>\$264,800</u></b>

**Allowance for Bad Debts on December 31, 2017:**

December 31, 2016 allowance.....	\$130,000
Accounts written off.....	(90,000)
Accounts recovered.....	<u>15,000</u>
	<b><u>\$ 55,000</u></b>

<b>Bad Debt Expense.....</b>	<b>209,800</b>
Allowance for Bad Debts .....	209,800

*To record estimate of uncollectible accounts receivable (\$264,800 – \$55,000).*

2.	<b>Allowance for Bad Debts .....</b>	<b>90,000</b>
	Accounts Receivable.....	90,000

*To write off uncollectible accounts receivable.*

Accounts Receivable .....	15,000
Allowance for Bad Debts .....	15,000

*To reinstate account balance previously written off.*

Cash .....	15,000
Accounts Receivable.....	15,000

*To recognize collection of previously written off receivables.*

**P 6–4 (LO3)      Analysis of Receivables**

1. The \$5,000 credit balance in the allowance account represents accounts that are expected to be uncollectible but have not yet been written off.

2. The prior year's estimate of uncollectible accounts may have been overstated. However, it is possible that more of the accounts created before January 1, 2017, will be written off after December 31, 2017.

3.	a. <b>Allowance for Bad Debts .....</b>	<b>3,500</b>
	Accounts Receivable.....	3,500

*To write off uncollectible accounts.*

b. <b>Bad Debt Expense.....</b>	<b>7,500</b>
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<b>Allowance for Bad Debts.....</b>	<b>7,500</b>
<i>To record estimate of bad debts for the year.</i>	
<i>(\$9,000 – \$1,500 balance = \$7,500)</i>	

**P 6–5 (LO3) Computing and Recording Bad Debt Expense**

<b>1. Bad Debt Expense.....</b>	<b>63,500</b>
<i>Allowance for Bad Debts.....</i>	
<i>To adjust the allowance account to desired balance.*</i>	

*\$2,300,000	Total accounts receivable
× 0.03	
\$ 69,000	Total estimated uncollectible receivables
(5,500)	Previous balance
<u>\$ 63,500</u>	Net addition to account

When the estimate is based on receivables, the existing balance must be considered. Theoretically, the receivables could relate to any period.

<b>2. Bad Debt Expense.....</b>	<b>58,500</b>
<i>Allowance for Bad Debts .....</i>	
<i>To adjust the allowance account to desired balance.*</i>	

* 1% × \$1,900,000 = \$19,000	
6% × \$200,000 = 12,000	
10% × \$100,000 = 10,000	
20% × \$70,000 = 14,000	
30% × \$30,000 = <u>9,000</u>	
	\$64,000 Total estimated uncollectible receivables
	(5,500) Previous balance
	<u>\$58,500</u> Net addition to account

**P 6–6 (LO3) Unifying Concepts: Aging of Accounts Receivable and Uncollectible Accounts**

<b>1. Dec.31, 2016</b>	
<b>Bad Debt Expense.....</b>	<b>1,387</b>
<i>Allowance for Bad Debts .....</i>	
<i>To adjust the allowance account to desired balance.*</i>	

*\$105,600 × 0.5% = \$ 528.00	
\$31,400 × 3% = 942.00	
\$14,200 × 4.5% = 639.00	
\$3,600 × 8% = 288.00	
\$900 × 10% = <u>90.00</u>	
	\$2,487.00 Total estimated uncollectible receivables

**(1,100.00) Previous balance**  
**\$1,387.00 Net addition to account**

**2. Feb. 14, 2017**

**Allowance for Bad Debts .....** **89**

**Accounts Receivable.....** **89**

**To write off the uncollectible account of Shannon Johnson.**

**3. Jun. 29, 2016**

**Accounts Receivable .....** **89**

**Allowance for Bad Debts .....** **89**

**To reinstate account balance previously written off.**

**Cash .....** **89**

**Accounts Receivable.....** **89**

**Received payment in full from Shannon Johnson of an amount previously written off as uncollectible.**

**4. Dec. 31, 2017**

**Bad Debt Expense .....** **3,587**

**Allowance for Bad Debts .....** **3,587**

**To adjust the allowance account to desired balance.\***

**\*Balance from aging.....** **\$2,487**

**Deficit balance in account.....** **1,100**

**Total entry needed .....** **\$3,587**

**P 6–7 (LO3)**
**Estimating Uncollectible Accounts**

**1. Bad Debt Expense.....** **65,600**

**Allowance for Bad Debts .....** **65,600**

**Estimated uncollectible accounts receivable.**

**$(\$2,320,000 \times 0.03 = \$69,600; \$69,600 - \$4,000 = \$65,600)$**

**Existing balance in Allowance for Bad Debts is considered.)**

**2. Bad Debt Expense.....** **46,000**

**Allowance for Bad Debts .....** **46,000**

**Estimated uncollectible accounts receivable. (Existing balance in Allowance for Bad Debts is considered.)**

$$\$1,200,000 \times 0.5\% = \$ 6,000$$

$$\$800,000 \times 1\% = 8,000$$

$$\$200,000 \times 4\% = 8,000$$

$$\$80,000 \times 20\% = 16,000$$

$$\$40,000 \times 30\% = \underline{12,000}$$

**\$50,000 Total estimated uncollectible receivables**

(4,000) Previous balance  
\$46,000 Net addition to account

3.	a.	<b>Bad Debt Expense.....</b>	<b>64,000</b>
		<b>Accounts Receivable.....</b>	<b>64,000</b>
<i>Wrote off \$64,000 uncollectible account from Petite Corners.</i>			
b.	<b>Allowance for Bad Debts .....</b>	<b>64,000</b>	
	<b>Accounts Receivable.....</b>	<b>64,000</b>	
<i>Wrote off \$64,000 uncollectible account from Petite Corners.</i>			
4.	a.	<b>Accounts Receivable .....</b>	<b>64,000</b>
		<b>Bad Debt Expense .....</b>	<b>64,000</b>
		<b>Cash .....</b>	<b>64,000</b>
		<b>Accounts Receivable.....</b>	<b>64,000</b>
<i>Received payment of \$64,000 from Petite Corners.</i>			
<i>This amount had been previously written off as uncollectible.</i>			
b.	<b>Accounts Receivable .....</b>	<b>64,000</b>	
	<b>Allowance for Bad Debts.....</b>	<b>64,000</b>	
		<b>Cash .....</b>	<b>64,000</b>
		<b>Accounts Receivable.....</b>	<b>64,000</b>
<i>Received payment of \$64,000 from Petite Corners.</i>			
<i>This amount had been previously written off as uncollectible.</i>			
5.	The allowance method, although less precise, is generally accepted because it matches the revenues and expenses for the period. The allowance method uses an estimate rather than the actual amount of loss, but it provides a more realistic measurement of income in the year of sale than does the direct write-off method.		

**P 6–8 (LO3)                  The Aging Method**

1.	Category	Amount	Percentage	Total
	Less than 30 days	\$294,000	1%	\$ 2,940
	31–60 days	66,000	5	3,300
	61–90 days	10,000	30	3,000
	Over 90 days	15,000	90	<u>13,500</u>
	<b>Total</b>			<b><u>\$22,740</u></b>
2.	<b>Bad Debt Expense.....</b>			<b>19,240</b>

<b>Allowance for Bad Debts .....</b>	<b>19,240</b>
<i>To adjust the allowance for bad debts to the appropriate ending balance [\$22,740 + \$16,500 (write-offs) – \$20,000 (beginning) = \$19,240].</i>	

3. The net accounts receivable balance as of December 31, 2017, is \$362,260 (\$385,000 – \$22,740).

### P 6–9 (LO4)      Analysis of Accounts Receivable

1. There is some cause for alarm in the data because Rouge's average collection period has increased dramatically:

	<u>2017</u>	<u>2016</u>
365		
(Sales Revenue/Average Accounts Receivable )	142.2 days	125.1 days

It seems very odd that Rouge would have a lower percentage of bad accounts in its accounts receivable and yet have such an extended collection period. This increase in the average collection period is quite troubling and merits further investigation.

### P6-10(LO4)      Computing Accounts Receivable Turnover and Average Collection Period

(a)	Beginning accounts receivable.....	€ 180,000
	Net credit sales.....	1,500,000
	Cash collections.....	(980,000)
	Accounts written off.....	(50,000)
	Ending accounts receivable.....	€ 650,000

(b)  $\frac{\text{Net credit sales}}{\text{Average accounts receivable}} = \frac{1,500,000}{[(180,000 + 650,000)/2]} = 3.61$

(c)  $365/3.61 = 101.11 \text{ days}$

### P 6–11 (LO5)      Recording Notes Receivable

- (1).  
 Suntory:  $(31 - 4) + 31 + 30 + 2 = 90$ , October 2  
 Toyota:  $(31 - 15) + 30 + 14 = 60$ , October 14  
 Kyoto: 4 months, January 31

**Chapter 6**
**(2).**

Sep. 30	Interest Receivable—Suntory Co.....	6,844
	Interest Receivable—Toyota Co. ....	2,990
	Interest Revenue .....	
		9,834
	 Notes Receivable—Kyoto Inc. ....	580,000
	Cash/ Accounts Receivable.....	
		580,000
	  (3).	
Oct. 2	Cash .....	357,000
	Notes Receivable—Suntory Co.....	350,000
	Interest Receivable—Suntory Co.....	6,844
	Interest Revenue .....	156
Oct. 14	Cash .....	263,900
	Notes Receivable—Toyota Co.....	260,000
	Interest Receivable—Toyota Co.....	2,990
	Interest Revenue .....	910

**P 6–12 (LO5) Recording Notes Receivable**
**(1).**
**KAVALAN:  $(31 - 4) + 23 = 50$ , June 23**
**Glenlivet:  $5 + 6 = 11$ , November 15**
**Macallan:  $31 + 29 = 60$ , August 29**
**(2).**

June 23	Cash .....	16,178
	Notes Receivable—KAVALAN Co.....	16,000
	Interest Revenue .....	178
June 30	Interest Receivable—Glenlivet Inc. ....	210
	Interest Revenue ( $14,000 \times 12\% \times 1.5/12 = 210$ ) ....	210

Notes Receivable—Macallan Co. ....	50,000
Cash/ Accounts Receivable.....	

**(3).**

June 23	Accounts Receivable .....	16,178
	Notes Receivable—KAVALAN Co.....	16,000
	Interest Revenue .....	178

**(4).**

June 23	Allowance for Doubtful Accounts .....	16,178
	Notes Receivable—KAVALAN Co.....	16,000
	Interest Revenue .....	178

**P 6-13 (LO5)      Accounting for Notes Receivable Transactions**

<b>5/1/17</b>	<b>Notes Receivable .....</b>	<b>16,000</b>
	<b>Accounts Receivable—Crane .....</b>	<b>16,000</b>
<b>7/1/17</b>	<b>Notes Receivable .....</b>	<b>25,000</b>
	<b>Cash .....</b>	<b>25,000</b>
<b>12/31/17</b>	<b>Interest Receivable .....</b>	<b>1,280</b>
	<b>Interest Revenue</b>	
	<b>(<math>\\$16,000 \times 12\% \times 8/12</math>).....</b>	<b>1,280</b>
	<b>Interest Receivable .....</b>	<b>1,250</b>
	<b>Interest Revenue</b>	
	<b>(<math>\\$25,000 \times 10\% \times 6/12</math>) .....</b>	<b>1,250</b>
<b>4/1/18</b>	<b>Accounts Receivable—Howard .....</b>	<b>26,875</b>
	<b>Notes Receivable .....</b>	<b>25,000</b>
	<b>Interest Receivable .....</b>	<b>1,250</b>
	<b>Interest Revenue</b>	
	<b>(<math>\\$25,000 \times 10\% \times 3/12 = \\$625</math>) .....</b>	<b>625</b>
<b>5/1/18</b>	<b>Cash.....</b>	<b>17,920</b>
	<b>Notes Receivable .....</b>	<b>16,000</b>
	<b>Interest Receivable .....</b>	<b>1,280</b>
	<b>Interest Revenue</b>	
	<b>(<math>\\$16,000 \times 12\% \times 4/12 = \\$640</math>).....</b>	<b>640</b>

## ANALYTICAL ASSIGNMENTS

### AA 6–1 Credit Policy Review

#### Discussion

##### Sales Manager's Proposal

Increase in income:

Revenues .....	\$ 900,000
Bad debt expense .....	15,000
Net increase in revenue .....	<u>\$ 885,000</u>
Cost of sales .....	225,000
	<u>\$ 660,000</u>

##### Vice Presidents Proposal

Increase in income:

Revenues .....	\$1,500,000
Cost of sales .....	375,000
Gross margin.....	<u>\$1,125,000</u>
Credit card fees.....	60,000
	<u>\$1,065,000</u>

Accepting consumer credit cards would result in \$1,065,000 of additional income, whereas the loosened credit policies would result in only \$660,000 of additional income. The company would be better off accepting credit cards if the assumptions made are valid.

If the company abolished all credit sales, it would lose a significant portion of its revenues and profits. Considering that uncollectibles are only 1.3% of credit sales and gross margin is 75%, the company would benefit from increasing its credit sales, not eliminating them.

**AA 6–2 You Decide: Can pre-billing customers increase revenues?****Judgment Call**

Issues to be discussed with this question are:

1. What your boss is asking you to do is fraud. Pre-billing customers before services have been performed is a type of fraud that has been quite common in many of the recent financial statement fraud cases.
2. Revenues should be recognized when earned and that is most often when the service is performed, not when cash is collected or when bills are sent out.

**AA 6–3 You Decide: Can a company overestimate bad debts in good years and then use lower estimates when times are bad?****Judgment Call**

Issues to be discussed with this question are:

1. What the boss is asking you to do is a form of income smoothing or reserve accounting. While we suspect this happens quite often, it is inappropriate because the allowance (or reserve) needs to be estimated consistently from year to year. It is inappropriate to “reserve whatever the bottom line can afford.”
2. Temptations to do exactly what the boss is asking are great in the business world, and there have been a number of financial statement fraud cases where this issue has been central to the case.

**AA 6–4 Philips****Real Company Analysis**

1. Accounts Receivable .....	24,244,000,000
Sales Revenue .....	24,244,000,000
2. Once we know the beginning and ending Accounts Receivable balances, as well as revenues for the period, we can infer approximately how much cash was collected relating to accounts receivable. The beginning balance (€4,476 million) plus revenues (€24,244 million) less the ending balance (€4,727 million) allows us to infer that \$23,993 million was received during the period. The journal entry to record that cash receipt would be:	
Cash .....	23,993,000,000
Accounts Receivable .....	23,993,000,000

**AA 6–5 Philips Group**
**Real Company Analysis**

1.	Bad Debt Expense.....	78,000,000	
	Allowance for Bad Debts .....		78,000,000
2.	Allowance for Bad Debts .....	25,000,000	
	Accounts (or Loans) Receivable .....		25,000,0000
3.	Allowance for Bad Debts (Amounts are in millions EUR.):		
	Balance on January 1, 2015 (given).....		EUR 227
	Plus: Bad debt expense for 2015 (given) .....		78
	Less: Write-offs for 2015 (given) .....		(25)
	Plus: Other movements (computed).....		21
	Balance on December 31, 2015 (given).....		<u>EUR 301</u>

**AA 6–6 Microsoft and IBM**
**Real Company Analysis**

1. It would be reasonable to expect that Microsoft has the lower average collection period because Microsoft does not sell large computers that would require financing, as IBM does.
2. (in millions)  $\$93,580/[(\$17,908 + \$19,544)/2] = 5 \text{ times}; 365 \text{ days} / 5 = 73 \text{ days}$
3. (in millions)  $\$81,741/[(\$8,333 + \$9,090)/2] = 9.38 \text{ times}; 365 \text{ days} / 9.38 = 38.9 \text{ days}$

**AA 6–7 Samsung**
**International**

1.		<u>1997</u>	<u>1996</u>
	Net sales in trillions of Korean won .....	91,519	74,641
	Exchange rate (end of year) .....	1,695	845
	Net sales in billions of U.S. dollars .....	54.0	88.3

Because of the drastic decline in the value of the won during 1997, Samsung's sales, in terms of U.S. dollars, actually declined in 1997. A more accurate conversion from won to dollars could be made if the average exchange rate for the year were used instead of the end-of-year exchange rate.

2. 1996 Average collection period =  $365 / (\text{Sales}/\text{Accounts Receivable})$   
 $= 365 / (74,641 / 6,233)$   
 $= 30.5 \text{ days}$
- 1997 Average collection period =  $365 / (\text{Sales}/\text{Accounts Receivable})$   
 $= 365 / (91,519 / 10,064)$   
 $= 40.1 \text{ days}$

3. The lengthening of the average collection period in 1997 is consistent with the belief that Samsung's Asian customers suffered from the economic crisis during that period and were accordingly slower in paying their bills.
4. It is also likely that Samsung's accounts payable balance increased in 1997 as it attempted to manage its cash flow by lengthening its own payment period to its suppliers. And, in fact, Samsung's accounts payable balance increased by 50% in 1997.

**AA 6–8****Changing Our Estimates in Order to Meet Analysts' Expectations****Ethics**

John must make sure that the estimates being made are reasonable and are consistent with prior years' estimates. It is not uncommon for estimates to be changed, but any changes that significantly modify the financial results would need to be disclosed and discussed in a note to the financial statements. If the changes being proposed are not reasonable, then what John would be proposing would be wrong. The objective of financial statements is to fairly represent the financial situation of a firm. If the controller *knowingly* makes estimates and assumptions that result in the financial statements not fairly reflecting the performance of the firm, then he would be doing something wrong; he could be held civilly and criminally liable should financial statement users rely on those financial statements and incur a loss.

On the other hand, John is not required to go out of his way to present an overly gloomy picture of Bio-Medic's performance. In many cases involving accounting estimates, reasonable people can honestly disagree over the bad debt percentage of sales or the proper amount of warranty expense. Given this honest disagreement, it is certainly reasonable for John and the board of BioMedic's to prefer to report the most favorable result possible, as *long as the accounting estimates are within an acceptable range*.

This potential honest disagreement over accounting estimates illustrates the importance of the auditor in the financial reporting process. John must be able to convince BioMedic's auditor that all accounting estimates are reasonable.