STUDY & REVIEW

REVIEW OF LEARNING OBJECTIVES

LO 1 Understand the sources and types of receivables.

- Selling goods or providing services to customers on account is a typical transaction for most businesses.
- Accounts receivable and notes receivable are the two types of receivables that arise from providing goods or services.
- Notes receivable have a stronger legal claim than accounts receivable.

LO 2 Understand revenue recognition criteria and properly account for accounts receivable.

- Revenue recognition criteria for the sale of goods.
- Revenue recognition criteria for provision of services.
- Accounting for sales discount and for sales returns.

LO 3 Understand and properly estimate and report the value of receivables.

- The allowance method for the impairment of accounts receivable.
- Estimating allowance for bad debts by the percentage of accounts receivable.
- Estimating allowance for bad debts by aging accounts receivable.
- Reporting accounts receivable, allowance for bad debts, and bad debt expense on the financial statements.

LO 4 Evaluate a company's management of its receivables by computing and analyzing appropriate financial ratios.

- Careful management of accounts receivable is a balance between:
  - Extending credit to increase sales.
  - Collecting cash quickly to reduce the need to borrow.
- Two ratios commonly used in monitoring the level of receivables are:
  - Accounts receivable turnover (Net Sales Revenue ÷ Average Accounts Receivable)
  - Average collection period (365 days ÷ Accounts Receivable Turnover)

LO 5 Properly account for notes receivable from operating activities.

- When a company's customers issue notes to settle the owed amount arising from purchasing goods or services on account, the following issues arise for the seller:
  - Calculation of interest revenue (and receivable) in the case of interest-bearing notes.
  - Accounting for the dishonored notes receivable.

Key Terms & Concepts

- accounts receivable turnover, 235
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Review Problem

Accounting for Receivables

Douglas Company sells furniture. Approximately 10% of its sales are cash; the remainder are on credit. During the year ended December 31, 2017, the company had net credit sales of $2,200,000. As of December 31, 2017, total accounts receivable were $800,000, and Allowance for Bad Debts had a debit balance of $1,100 prior to adjustment. In the past, approximately 1% of credit sales have proved to be uncollectible. An aging analysis of the individual accounts receivable revealed that $32,000 of the Accounts Receivable balance appeared to be uncollectible.

The largest credit sale during the year occurred on December 4, 2017, for $72,000 to Aaron Company. Terms of the sale were 2/10, n/30. On December 13, Aaron Company paid $60,000 of the receivable balance and took advantage of the 2% discount. The remaining $12,000 was still outstanding on March 31, 2018, when Douglas Company learned that Aaron Company had declared bankruptcy. Douglas wrote the receivable off as uncollectible.

Required:

Prepare the following journal entries:

1. The sale of $72,000 of furniture on December 4, 2017, to Aaron Company on credit.
2. The collection of $58,800 from Aaron Company on December 13, 2017, assuming the company allows the discount on partial payment.
3. Record Bad Debt Expense on December 31, 2017, using the aging of receivables method.
4. Write off the balance of the Aaron Company receivable as uncollectible, March 31, 2018.

Solution:

The journal entries would be recorded as follows:

1.

Dec. 4, 2017	Accounts Receivable	72,000	
	Sales Revenue.		72,000
	Sold $72,000 of furniture to Aaron Company on credit.		

2.

Dec. 13, 2017	Cash	58,800	
	Sales Discounts	1,200	
	Accounts Receivable		60,000
	Collected $58,800 from Aaron Company on December 4 sale and recognized the 2% discount taken (0.02 × $60,000 = $1,200).		

3.

Dec. 31, 2017	Bad Debt Expense.	33,100	
	Allowance for Bad Debts		33,100
	Recorded bad debt expense using the aging of accounts receivable method ($32,000 + $1,100 debit balance).		

Note: When using the percentage of total receivables method (e.g., by aging receivables) to estimate bad debt expense, the existing balance in Allowance for Bad Debts must be taken into consideration so that the new balance is the amount of receivables not expected to be collected.

4.

Mar. 31, 2018	Allowance for Bad Debts	12,000	
	Accounts Receivable		12,000
	Wrote off the balance in the Aaron Company account as uncollectible.		

Put it on Paper

Discussion Questions

1. When should sales revenues be recognized and reported?
2. Why do you think misstatement of revenues (e.g., recognizing revenues when the rewards and significant risks of owning the goods have not been transferred to the buyer) is one of the most common ways to manipulate financial statements?
3. Why is it important to have separate sales returns and allowances and sales discounts accounts? Wouldn't it be much easier to directly reduce the sales revenue account for these adjustments?
4. Why do most companies tolerate having a small percentage of uncollectible accounts receivable?
5. Why does the accounting profession require the use of the allowance method of accounting for losses due to bad debts rather than the direct write-off method?
6. With the allowance method, why is the net balance, or net realizable value, of Accounts Receivable the same after the write-off of a receivable as it was prior to the write-off of the uncollectible account?
7. Why is the "aging" of accounts receivable usually more accurate than basing the estimate on total receivables?
8. Why is it important to monitor operating ratios such as accounts receivable turnover?

Practice Exercises

PE 6-1
LO 2

Revenue Recognition

Which one of the following steps is not a necessary step for revenue recognition?

a. Identify the contract with the customer.
b. Make sure that the seller should receive cash upon the transfer of goods to the buyer.
c. Identify separate performance obligation in the contract.
d. Determine the transaction price.
e. Determine when the performance obligation is satisfied so that a revenue can be recognized.

PE 6-2
LO 2

Revenue Recognition

Make the journal entry necessary to record the sale of 175 books at $29 per book. Ninety-five of the books were sold for cash, and 80 were sold on credit. Assume that the performance obligation had been satisfied, and that the cost of the goods sold was $3,500 ($20 each).

PE 6-3
LO 2

Cash Collection

Refer to the data in PE 6-2. Make the journal entry necessary when the company receives payment for the 80 books sold on credit.

PE 6-4
LO 2

Sales

Refer to the data in PE 6-2. Assume that all of the 80 books sold on credit were sold to a single customer and that the terms of the credit sale were 2/10, n/30. Make the journal entry necessary to record the receipt of the cash payment assuming that (1) the customer paid the balance on the account five days after the purchase and (2) the customer paid the balance on the account 20 days after the purchase.

PE 6-5
LO 2

Sales Returns and Allowances

Refer to the data in PE 6-2. Assume a customer found that 15 of the books were misprinted and returned the 15 books for a refund. Prepare the journal entry necessary in the records of the selling company to record the receipt of the returned books assuming that (1) the books were returned by a cash customer and (2) the books were returned by a credit customer.

PE 6-6
LO 2

Computing Net Sales

Using the following data, compute net sales.

Sales discounts	$ 100,000
Accounts receivable, ending	125,000
Gross sales	3,750,000
Inventory, ending	200,000
Sales returns and allowances	150,000

PE 6-7
LO 3

The Allowance Method

Joplin Company used the allowance method and had the beginning balance of $50,000 for Allowance for Bad Debts. Joplin estimated that the ending balance of Allowance for Bad Debts was $100,000. In addition, a year-end review of accounts identified that as of the end of the year, $43,000 were worthless because the business customers associated with those accounts had gone bankrupt. Using the allowance method of accounting for bad debt expense, make the journal entries necessary to record (1) bad debt expense for the year and (2) the write-off of uncollectible accounts at the end of the year.

PE 6-8
LO 3

Computing Net Accounts Receivable

Refer to the data in PE 6-7. Taking into account the allowance for bad debts established at the end of the year, and assuming that the ending balance of accounts receivable is $200,000, compute the net realizable value of accounts receivable (1) before the write-off of uncollectible accounts and (2) after the write-off of uncollectible accounts.

PE 6-9
LO 3

Collecting an Account Previously Written Off

Refer to the data in PE 6-7. Assume that one customer, whose account had previously been written off, returned from exile in the Bahamas and paid his account of $7,000. Make the journal entry or entries necessary to record the receipt of this payment.

PE 6-10
LO 3

Estimating Uncollectible Accounts Receivable As a Percentage of Total Receivables

Cathelin Company had an Accounts Receivable balance of $102,000 and an Allowance for Bad Debts balance of $2,700 (credit) at the end of the year (before any adjusting entry). The accountant determined that 9% of the ending accounts receivable will ultimately be uncollectible. Make the journal entry necessary to record bad debt expense for the year.

PE 6-11
LO 3

Estimating Uncollectible Accounts Receivable Using Aging Accounts Receivable

Harrison Company reports the following aging accounts receivable data:

			Days Past Due				
Customer	**Balance**	**Current**	**1–30**	**31–60**	**61–90**	**91–120**	**Over 120**
T. Gardner	$ 3,750	$ 2,250	$1,500				
J. Gammon	4,000	1,000		$2,500		$ 500	
M. Orser	2,000		2,000				
K. Saxton	1,000			750	$250		
K. Welch	4,000						$4,000
R. Beckstrom	10,900	8,000	2,900				
B. Roberts	3,900			3,900			
L. Wilcox	$ 5,850	$ 5,200			$650		
J. Gagon	1,500					$1,500	
A. Wycherly	1,750		$1,750				
Totals	$38,650	$16,450	$8,150	$7,150	$900	$2,000	$4,000

In addition, the company provides the following estimates for accounts that will ultimately be uncollectible:

Age	Percentage Estimated to Be Uncollectible
Current	1.75%
1–30 days past due	6
31–60 days past due	15
61–90 days past due	35
91–120 days past due	65
Over 120 days past due	90

Using this information, make the journal entry necessary to record bad debt expense. Assume that: (1) the balance in the allowance for bad debts account (before adjustment) is $2,000 (credit) and (2) the balance in the allowance for bad debts account (before adjustment) is $3,600 (debit).

PE 6-12
LO 3

Evaluating Quality of Accounts Receivable

Hillton Company reports the following data for the past three years:

Year	Ending Accounts Receivable	Ending Allowance for Bad Debts
Year 3	$307,800	$51,650
Year 2	268,150	37,540
Year 1	224,300	21,800

Compute the allowance for bad debts as a percentage of accounts receivable and evaluate the quality of accounts receivable over the three-year period.

PE 6-13
LO 4

Accounts Receivable Turnover

Using the following data, calculate this company's accounts receivable turnover.

Accounts receivable balance, December 31	$ 54,000
Inventory balance, December 31	59,000
Sales revenue	520,000
Cost of goods sold	310,000
Accounts receivable balance, January 1	46,000

PE 6-14
LO 4

Average Collection Period

Refer to the data in PE 6-13. Calculate the company's average collection period.

PE 6-15
LO 5

Recording Notes Receivable

Johnnie International Company sold 200 boxes of Whiskey bottles, amounting to €8,500, to Party King Pub by accepting a 60-day, 10% note dated May 1, 2017. Make the entry necessary on May 1 for Johnnie Co.

PE 6-16
LO 5

Recording Notes Receivable

Referring to PE 6-15, make the entry necessary for Johnnie Co. if Party King Pub paid cash and interests after 60 days on June 30. Assume that there are 360 days in a year.

PE 6-17
LO 5

Recording Notes Receivable

Suppose Wal-Mart accepts from Apple Stores a $15,000, 3-month, 9% note dated September 30 in settlement of Apple's overdue account.

(1) What is the maturity date of the note?

(2) Assuming at the maturity date, Apple pays the note and interest in full, what is the entry made by Wal-Mart?

EXERCISES

E 6-1
LO 2

Recording Sales Transactions

Bear Company sold merchandise on account to Mary Company for $9,000 on June 3, 2017, with terms 2/10, n/30. On June 7, 2017, Bear Company received $850 of returned merchandise from Mary Company and issued a credit memorandum for the appropriate amount. Bear Company received payment for the balance of the bill on June 21, 2017.

Record the necessary journal entries for Bear Company on June 3, June 7, and June 21.

E 6-2
LO 2

Recording Sales Transactions

On June 24, 2017, Sunflower Company sold merchandise to Brooke Bowman for $140,000 with terms 2/10, n/30. On June 30, Bowman paid $78,400 on her account and was allowed a discount for the timely payment. On July 20, Bowman paid $42,000 on her account and returned $18,000 of merchandise, claiming that it did not meet contract terms.

Record the necessary journal entries for Sunflower Company on June 24, June 30, and July 20.

E 6-3
LO 3

Estimating Bad Debts

The trial balance of Sparkling Jewelry Company at the end of its 2017 fiscal year included the following account balances:

Account	
Accounts receivable	$66,400
Allowance for bad debts	1,300 (debit balance)

The company has *not yet* recorded any bad debt expense for 2017.

Determine the amount of bad debt expense to be recognized by Sparkling Jewelry Company for 2017, assuming the following independent situations:

1. An aging accounts receivable analysis indicates that probable uncollectible accounts receivable at year-end amount to $3,900.
2. Company policy is to maintain a provision for uncollectible accounts receivable equal to 4% of outstanding accounts receivable.

E 6-4
LO 3

Accounting for Bad Debts

The following data were associated with the accounts receivable and uncollectible accounts of Julia Jay, Inc., during 2017:

a. The opening credit balance in Allowance for Bad Debts was $600,000 at January 1, 2017.
b. During 2017, the company realized that specific accounts receivable totaling $630,000 had gone bad and had been written off.
c. An account receivable of $35,000 was collected during 2017. This account had previously been written off as a bad debt in 2016.
d. The company decided that Allowance for Bad Debts would be $650,000 at the end of 2017.

1. Prepare journal entries to show how these events would be recognized in the accounting system using the allowance method.
2. Discuss the advantages of the allowance method when compared to the direct method with respect to the matching principle.

E 6-5
LO 2

Accounting for Accounts Receivable

(a) On July 1, Orange Co. sold merchandise on account to Treetop Inc. for $17,200, terms 2/10, n/30.
(b) On July 8, Treetop Inc. returned merchandise worth $3,800 to Orange Co.
(c) On July 11, Treetop Inc. paid for the merchandise.

Prepare journal entries for the above transactions for Orange Co.

E 6-6
LO 3

Accounting for Uncollectible Accounts Receivable

Mahogany Company had the following information relating to its accounts receivable at December 31, 2016, and for the year ended December 31, 2017:

Accounts receivable balance at 12/31/16	$ 750,000
Allowance for bad debts at 12/31/16 (credit balance)	45,000
Gross sales during 2017 (all credit)	3,500,000
Collections from customers during 2017	$3,075,000
Accounts written off as uncollectible during 2017	50,000
Estimated uncollectible receivables at 12/31/17	90,000

Mahogany Company uses the allowance method to estimate bad debt expense.

1. At December 31, 2017, what is the balance of Mahogany Company's Allowance for Bad Debts? What is the bad debt expense for 2017?
2. At December 31, 2017, what is the balance of Mahogany Company's gross accounts receivable?

E 6-7
LO 3

Aging of Accounts Receivable

Waffle Company's accounts receivable reveal the following balances:

Age of Accounts	Receivable Balance
Current	$720,000
1–30 days past due	395,000
31–60 days past due	105,000
61–90 days past due	52,000
91–120 days past due	13,000

The credit balance in Allowance for Bad Debts is now $42,000. After a thorough analysis of its collection history, the company estimates that the following percentages of receivables will eventually prove uncollectible:

Current	0.5%
1–30 days past due	3.0
31–60 days past due	16.0
61–90 days past due	52.5
91–120 days past due	92.0

Prepare an aging schedule for the accounts receivable, and give the journal entry for recording the necessary change in the allowance for bad debts account.

E 6-8
LO 3

Aging of Accounts Receivable

The following aging of accounts receivable is for Harry Company at the end of its first year of business:

Aging of Accounts Receivable
December 31, 2017

	Overall	Less Than 30 Days	31 to 60 Days	61 to 90 Days	Over 90 Days
Ken Nelson	$ 10,000	$ 8,000		$1,000	$1,000
Elaine Anderson	40,000	31,000	$ 4,000		5,000
Bryan Crist	12,000	3,000	4,000	2,000	3,000
Renee Warner	60,000	50,000	10,000		
Nelson Hsia	16,000	10,000	6,000		
Stella Valerio	25,000	20,000		5,000	
Totals	$163,000	$122,000	$24,000	$8,000	$9,000

Harry Company has collected the following bad debt information from a consultant familiar with Harry's industry:

Age of Account	Percentage Ultimately Uncollectible
Less than 30 days	2%
31–60 days	10
61–90 days	30
Over 90 days	75

1. Compute the appropriate Allowance for Bad Debts as of December 31, 2017.
2. Make the journal entry required to record this allowance. Remember that, since this is Harry's first year of operations, the allowance account at the beginning of the year was $0.
3. What is Harry's net accounts receivable balance as of December 31, 2017?

E 6-9
LO 4

Ratio Analysis

The following are summary financial data for Parker Enterprises, Inc., and Boulder, Inc., for three recent years:

	Year 3	Year 2	Year 1
Net sales (in millions):			
Parker Enterprises, Inc.	$ 3,700	$ 3,875	$ 3,882
Boulder, Inc.	17,825	16,549	15,242
Net accounts receivable (in millions):			
Parker Enterprises, Inc.	1,400	1,800	1,725
Boulder, Inc.	5,525	5,800	6,205

1. Using the above data, compute the accounts receivable turnover and average collection period for each company for Years 2 and 3.
2. Which company appears to have the better credit management policy?

E 6-10
LO 4

Assessing How Well Companies Manage Their Receivables

Assume that Leif Company has the following data related to its accounts receivable:

	2016	2017
Net sales	$2,470,000	$3,040,000
Net receivables:		
Beginning of year	520,000	565,000
End of year	565,000	605,000

Use these data to compute accounts receivable turnover ratios and average collection periods for 2016 and 2017. Based on your analysis, is Leif Company managing its receivables better or worse in 2017 than it did in 2016?

E 6-11
LO 5

Accounting for Notes Receivable

Tiger Pencil Co. accepted a 120-day, 8% note dated March 1, 2017, in settlement of the accounts receivable from Kingstone Co., which had a balance of NT$6,000. Kingstone Co. paid the note on the maturity date.

(1) What is the maturity date of the note?
(2) Make the journal entries necessary for Tiger Pencil Co.

E 6-12
LO 5

Notes Receivable

Suppose the Body Shop International Co. received from Natural Beauty Co. (NBC), on account, a £60,000, 90-day, 8% note dated December 1, 2016. Make the necessary entries during Dec. 1, 2016 to Mar. 1, 2017 under each of the following conditions:

(a) At Mar. 1, 2017, if NBC paid cash and the interests.
(b) At Mar. 1, 2017, if The Body Shop International Co. didn't receive the money.

E 6-13
LO 5

Recording Notes Receivable

Record the following transactions for Regal Hotels International.

2016
Aug. 1 Received a $9,600, 6-month, 8% note in exchange for Lala Co.'s overdue accounts receivable.
Dec. 31 Accrued interest on the note.
2017
Jan. 31 Received principal plus interest on the note.

E 6-14
LO 5

Recording Notes Receivable

On April 1, Pan Company lends $1,000,000 to Da Inc., and receives a 6-month, 12% note issued by Da Inc. At the maturity date, October 1, Da Inc. indicates that it cannot pay.

(1) Make the entry to record the issuance of the note.
(2) Make the entry to record the dishonor of the note, assuming that Pan Company expects that Da Inc. will be able to pay in the near future.
(3) Make the entry to record the dishonor of the note, assuming that Pan Company expects that Da Inc. will not be able to pay in the future.

PROBLEMS

P 6-1
LO 2

Sales Transactions

G.E Company and STARK Company entered into the following transactions:

a. G.E Company sold merchandise to STARK Company for $60,000, terms 2/10, n/30.
b. Prior to payment, STARK Company returned $4,000 of the merchandise for credit.
c. STARK Company paid G.E Company in full within the discount period.
d. STARK Company paid G.E Company in full after the discount period. [Assume that transaction (c) did not occur.]

Required:

Prepare journal entries to record the transactions for G.E Company (the seller).

P 6-2
LO 3

Accounting for Accounts Receivable

Assume that Dominum Company had the following balances in its receivable accounts on December 31, 2016:

Accounts receivable	$640,000
Allowance for bad debts	20,600 (credit balance)

Transactions during 2017 were as follows:

Gross credit sales	$4,200,000
Collections of accounts receivable ($3,680,000 less cash discounts of $64,000)	3,616,000
Sales returns and allowances (from credit sales)	48,000
Accounts receivable written off as uncollectible	18,800
Balance in Allowance for Bad Debts on December 31, 2017 (based on percent of total accounts receivable)	43,600

Required:

1. Prepare entries for the 2017 transactions.
2. What amount will Dominum Company report for:
   a. Net sales on its 2017 statement of comprehensive income?
   b. Total accounts receivable on its balance sheet of December 31, 2017?

P 6-3
LO 3

Analysis of Allowance for Bad Debts

Boulder View Corporation accounts for uncollectible accounts receivable using the allowance method.

As of December 31, 2016, the credit balance in Allowance for Bad Debts was $130,000. During 2017, credit sales totaled $10,000,000, $90,000 of accounts receivable were written off as uncollectible, and recoveries of accounts previously written off amounted to $15,000. An aging of accounts receivable at December 31, 2017, showed the following:

Classification of Receivable	Accounts Receivable Balance As of December 31, 2017	Percentage Estimated Uncollectible
Current	$1,140,000	2%
1–30 days past due	600,000	10
31–60 days past due	400,000	23
Over 60 days past due	120,000	75
	$2,260,000	

Required:

1. Prepare the journal entry to record bad debt expense for 2017, assuming bad debts are estimated using the aging of receivables method.
2. Record journal entries to account for the actual write-off of $90,000 uncollectible accounts receivable and the collection of $15,000 in receivables that had previously been written off.

P 6-4
LO 3

Analysis of Receivables

Jennifer Company was formed in 2002. Sales have increased on the average of 5% per year during its first 13 years of existence, with total sales for 2016 amounting to $400,000. Since incorporation, Jennifer Company has used the allowance method to account for uncollectible accounts receivable.

On January 1, 2017, the company's Allowance for Bad Debts had a credit balance of $5,000. During 2017, accounts totaling $3,500 were written off as uncollectible.

Required:

1. What does the January 1, 2017, credit balance of $5,000 in Allowance for Bad Debts represent?
2. Since Jennifer Company wrote off $3,500 in uncollectible accounts receivable during 2017, was the prior year's estimate of uncollectible accounts receivable overstated?
3. Prepare journal entries to record:
   a. The $3,500 write-off of receivables during 2017.
   b. Jennifer Company's 2017 bad debt expense, assuming an aging of the December 31, 2017, accounts receivable indicates that potential uncollectible accounts at year-end total $9,000.

P 6-5
LO 3

Computing and Recording Bad Debt Expense

During 2017, Wishbone Corporation had a total of $5,000,000 in sales, of which 80% were on credit. At year-end, the Accounts Receivable balance showed a total of $2,300,000, which had been aged as follows:

Age	Amount
Current	$1,900,000
1–30 days past due	200,000
31–60 days past due	100,000
61–90 days past due	70,000
Over 90 days past due	30,000
	$2,300,000

Prepare the journal entry required at year-end to record the bad debt expense under each of the following independent conditions. Assume, where applicable, that Allowance for Bad Debts had a credit balance of $5,500 immediately before these adjustments.

Required:

1. Based on experience, uncollectible accounts existing at year-end are estimated to be 3% of total accounts receivable.
2. Based on experience, uncollectible accounts are estimated to be the sum of:
   1% of current accounts receivable
   6% of accounts 1–30 days past due
   10% of accounts 31–60 days past due
   20% of accounts 61–90 days past due
   30% of accounts over 90 days past due

P 6-6
LO 3

Unifying Concepts: Aging of Accounts Receivable and Uncollectible Accounts

Capital Edge Company has found that, historically, 0.5% of its current accounts receivable, 3% of accounts 1 to 30 days past due, 4.5% of accounts 31 to 60 days past due, 8% of accounts 61 to 90 days past due, and 10% of accounts over 90 days past due are uncollectible. The following schedule shows an aging of the accounts receivable as of December 31, 2016:

		Days Past Due			
	Current	**1–30**	**31–60**	**61–90**	**Over 90**
Balance	$105,600	$31,400	$14,200	$3,600	$900

The balances at December 31, 2016, in selected accounts are as follows. (Assume that the allowance method is used.)

Sales revenue	$560,100
Sales returns	10,300
Allowance for bad debts	1,100 (credit balance)

Required:

1. Given these data, make the necessary adjusting entry (or entries) for uncollectible accounts receivable on December 31, 2016, on Capital Edge's books.
2. On February 14, 2017, Shannon Johnson, a customer, informed Capital Edge Company that she was going bankrupt and would not be able to pay her account of $89. Make the appropriate entry (or entries).
3. On June 29, 2017, Shannon Johnson was able to pay the amount she owed in full. Make the appropriate entry (or entries).
4. Assume that Allowance for Bad Debts at December 31, 2016, had a debit balance of $1,100 instead of a credit balance of $1,100. Make the necessary adjusting journal entry that would be needed on December 31, 2016.

P 6-7
LO 3

Estimating Uncollectible Accounts

Ulysis Corporation makes and sells clothing to fashion stores throughout the country. On December 31, 2016, before adjusting entries were made, it had the following account balances on its books:

Accounts receivable	$ 2,320,000
Sales revenue, 2016 (60% were credit sales)	16,000,000
Allowance for bad debts (credit balance)	4,000

Required:

1. Make the appropriate adjusting entry on December 31, 2016, to record the allowance for bad debts if uncollectible accounts receivable are estimated to be 3% of accounts receivable.
2. Make the appropriate adjusting entry on December 31, 2016, to record the allowance for bad debts if uncollectible accounts receivable are estimated on the basis of an aging of accounts receivable; the aging schedule reveals the following:

	Balance of Accounts Receivable	Percent Estimated to Become Uncollectible
Current	$1,200,000	0.5%
1–30 days past due	800,000	1
31–60 days past due	200,000	4
61–90 days past due	80,000	20
Over 90 days past due	40,000	30

3. Now assume that on March 3, 2017, it was determined that a $64,000 account receivable from Petite Corners is uncollectible. Record the bad debt, assuming:
   a. The direct write-off method is used.
   b. The allowance method is used.
4. Further assume that on June 4, 2017, Ulysis Corporation paid this previously written-off debt of $64,000. Record the payment, assuming:
   a. The direct write-off method had been used on March 3 to record the bad debt.
   b. The allowance method had been used on March 3 to record the bad debt.
5. **Interpretive Question:** Which method of accounting for bad debts, direct write-off or allowance, is generally used? Why?

P 6-8
LO 3

The Aging Method

The following aging of accounts receivable is for Coby Company at the end of 2017:

Aging of Accounts Receivable
December 31, 2017

	Overall	Less Than 30 Days	31 to 60 Days	61 to 90 Days	Over 90 Days
Travis Campbell	$ 50,000	$ 40,000	$ 5,000	$ 2,000	$ 3,000
Linda Reed	35,000	31,000	4,000		
Jack Riding	110,000	100,000	10,000		
Joy Riddle	20,000	3,000	10,000	4,000	3,000
Afzal Shah	90,000	60,000	21,000	4,000	5,000
Edna Ramos	80,000	60,000	16,000		4,000
Totals	$385,000	$294,000	$66,000	$10,000	$15,000

Coby Company had a credit balance of $20,000 in its allowance for bad debts account at the beginning of 2017. Write-offs for the year totaled $16,500. Coby Company makes only one adjusting entry to record bad debt expense at the end of the year. Historically, Coby Company has experienced the following with respect to the collection of its accounts receivable:

Age of Account	Percentage Ultimately Uncollectible
Less than 30 days	1%
31–60 days	5
61–90 days	30
Over 90 days	90

Required:

1. Compute the appropriate balance of allowance for bad debts as of December 31, 2017.
2. Make the journal entry required to record this allowance for bad debts balance. Remember that the allowance account already has an existing balance.
3. What is Coby's net accounts receivable balance as of December 31, 2017?

P 6-9
LO 4

Analysis of Accounts Receivable

The following accounts receivable information is for Rouge Company:

	2017	2016	2015
Accounts receivable	$ 98,000	$ 50,000	$ 70,000
Sales revenue	190,000	175,000	240,000

Required:

Is there any cause for alarm in the accounts receivable data for 2017? Explain.

P 6-10
LO 4

Computing Accounts Receivable Turnover and Average Collection Period

Luxury Co. had accounts receivable of €180,000 on January 1, 2017. The only transactions that affected accounts receivable during 2017 were net credit sales of €1,500,000, cash collections of €980,000, and accounts written off of €50,000.

Required:

1. Compute the 2017 ending balance of accounts receivable.
2. Compute the accounts receivable turnover ratio for 2017.
3. Compute the average collection period in days for 2017.

P 6-11
LO 5

Recording Notes Receivable

On September 30, Q. Computer Inc. has the following Notes Receivable:

Date	Maker	Face value	Term	Interest rate
July 4	Suntory Co.	$350,000	90 days	8%
Aug. 15	Toyota Co.	260,000	60 days	9%
Sep. 30	Kyoto Inc.	580,000	4 months	10%

Interest is computed following the practice that there are 360 days a year.

Required:

1. What's the maturity date of these three notes?
2. Suppose that Q. Computer Inc. prepares financial statements as of September 30. Make the entries necessary on September 30.
3. Make the entries necessary during October for Q. Computer Inc., assuming that on the maturity date the note maker pays the note and interest in full.

P 6-12
LO 5

Recording Notes Receivable

Wine Ltd. closes its books every month. On June 30 the Notes Receivable accounts balance is $80,000, including the following:

Date	Maker	Face value	Term	Interest rate
May 4	KAVALAN Co.	$16,000	50 days	8%
May 15	Glenlivet Inc.	14,000	6 months	12%
June 30	Macallan Co.	50,000	60 days	10%

Interest is computed following the practice that there are 360 days a year.

Required:

1. What's the maturity date of these three notes?
2. Suppose that Wine Ltd. prepares financial statements as of June 30. Make the entries necessary during June. Assume KAVALAN pays the note and interest in full at the maturity date.
3. Following (2), assume KAVALAN cannot pay the note and Wine Ltd. expects that there's hope for collection. Make the entry at the maturity date.
4. Following (2), assume KAVALAN cannot pay the note and Wine Ltd. expects that there's no hope for collection. Make the entry at the maturity date.

P 6-13
LO 5

Accounting for Notes Receivable Transactions

Bob Ltd. had the following transactions.

May	1, 2017	Accepted Crane Company's 12-month, 12% note in settlement of a £16,000 accounts receivable.
July	1, 2017	Loaned £25,000 cash to Sam Howard on a 9-month, 10% note.
Dec.	31, 2017	Accrued interest on all notes receivable.
Apr.	1, 2018	Sam Howard dishonored its note; Bob expects that it will eventually collect.
May	1, 2018	Received principal plus interest on the Crane note.

Required:

Prepare journal entries to record the transactions. Bob prepares adjusting entries once a year on December 31.

Analytical Assignments

AA 6-1
Discussion

Credit Policy Review

The president, vice president, and sales manager of Moorer Corporation were discussing the company's present credit policy. The sales manager suggested that potential sales were being lost to competitors because of Moorer Corporation's tight restrictions on granting credit to consumers. He stated that if credit policies were loosened, the current year's estimated credit sales of $3,000,000 could be increased by at least 30% next year with an increase in uncollectible accounts receivable of only $15,000 over this year's amount of $37,500. He argued that because the company's cost of sales is only 25% of revenues, the company would certainly come out ahead.

The vice president, however, suggested that a better alternative to easier credit terms would be to accept consumer credit cards such as Visa or MasterCard. She argued that this alternative could increase sales by 50%. The credit card finance charges to Moorer Corporation would be 4% of the additional sales.

The president said that he wasn't at all sure that increasing credit sales of any kind was a good thing. In fact, he suggested that the $37,500 of uncollectible accounts receivable was altogether too high. He wondered whether the company should discontinue offering sales on account.

With the information given, determine whether Moorer Corporation would be better off under the sales manager's proposal or the vice president's proposal. Also, address the president's suggestion that credit sales of all types be abolished.

AA 6-2
Judgment Call

You Decide: **Can pre-billing customers increase revenues?**

For the past year, you have been working as an accountant for a local Internet Service Provider. Business is growing steadily with the holiday season just around the corner. The company hopes to reach more customers next year through additional advertising. In order to do so, it will need a loan from the bank. You overheard your boss say that if revenues increase 5% by year-end, the company will be in good enough shape to receive the loan. Your boss asks you to send out invoices to a handful of customers charging them for a service that won't be provided until the next year and to recognize the billings as revenue. He says they will eventually receive the service but it is more important to recognize the sale now. What should you do?

AA 6-3
Judgment Call

You Decide: **Can a company overestimate bad debts in good years and then use lower estimates when times are bad?**

The company you work for has been highly profitable this year. Your boss tells you to overestimate the allowance for doubtful accounts. He says the statement of comprehensive income can handle the charge this year and the excess reserve can be used to increase earnings in future years. Is his proposal acceptable?

AA 6-4

Real Company Analysis

Philips

Locate the 2015 financial statements for Philips in Appendix B and consider the following questions:

1. Provide the summary journal entry that Philips would have made to record its net sales for the fiscal year ended December 31, 2015 (assume all sales were on account).
2. Given Philips's beginning and ending balances in Accounts Receivable, along with your journal entry from part (1), estimate the amount of cash collected from customers during the year.

AA 6-5

Real Company Analysis

Philips Group

Philips Group is a Dutch Technology company with primary business focused in electronics, healthcare, and lighting. It is one of the largest electronics companies in the world and has divisions across more than 60 countries. Information from Philips Group's annual report is as follows. (Amounts are in millions EUR.)

	2015	2014
Bad debt expense	$ 78	$ 48
Write-off of uncollectible accounts	25	46
Allowance for bad debts (year-end)	301	227

Using this information, answer the following questions:

1. Provide the journal entry made by Philips Group to record bad debt expense for 2015.
2. Provide the journal entry made by Philips Group to record the write-off of actual bad debts during 2015.
3. Estimate the amount of other movements (e.g., bad debts previously written off that Philips recovered) in 2015.

AA 6-6

Real Company Analysis

Microsoft and IBM

Information from comparative statements of comprehensive income and balance sheets for Microsoft and IBM is given below. (Amounts are in millions.)

	Microsoft		IBM	
	2015	2014	2015	2014
Sales	$93,580	$86,833	$81,741	$92,793
Accounts receivable	17,908	19,544	8,333	9,090

Use this information to answer the following questions:

1. Without doing any computations, which company do you think has the lowest average collection period?
2. Compute Microsoft's average collection period for 2015.
3. Compute IBM's average collection period for 2015.

AA 6-7

International

Samsung

The economic downturn in South Korea in late 1997 focused world attention on what had heretofore been viewed as one of the world's economic powerhouses. Symptomatic of the economic collapse was the freefall in Korea's currency, the won, which declined in value from 845 won per U.S. dollar on December 31, 1996, to 1,695 won per dollar on December 31, 1997.

When Korea's economy soured, many sought to blame the economy's unusual structure, which concentrates a large fraction of the economic activity in the hands of just a few companies, called chaebol. Chaebol are large Korean conglomerates (groups of loosely connected firms with central ownership) that are usually centered around a family-owned parent company. The growth of the chaebol in the years since the Korean War has been aided by government nurturing.

In Korea, there are now four super-chaebol—Hyundai, Samsung, Daewoo, and Lucky Goldstar. Collectively, these four conglomerates account for between 40 and 45% of South Korea's gross national product.

The following information is from Samsung's 1997 annual report. All numbers are in trillions of Korean won.

	1997	1996
Net sales	91,519	74,641
Accounts receivable	10,064	6,233

1. Did Samsung's sales increase in 1997, relative to 1996, in terms of U.S. dollars? Explain. What exchange rate information would allow you to make a more accurate calculation?
2. Compute Samsung's average collection period for both 1996 and 1997. Instead of using the average accounts receivable balance, use the end-of-year balance.
3. Comment on the change in the average collection period from 1996 to 1997, especially in light of the economic conditions in Korea in 1997.
4. What do you think happened to Samsung's accounts payable balance in 1997, relative to 1996? Explain.

AA 6-8

Ethics

Changing Our Estimates in Order to Meet Analysts' Expectations

John Verner is the controller for BioMedic, Inc., a biotechnology company. John is finishing his preparation of the preliminary financial statements for a meeting of the board of directors scheduled for later in the day. At the board's prior meeting, members discussed the need to report earnings of at least $1.32 per share. It was not mentioned specifically at the meeting, but everyone on the board knows that financial analysts have forecast that BioMedic will report earnings per share (EPS) of $1.32; failure to meet analysts' expectations could hurt BioMedic's chances of going forward with its planned initial public offering (IPO) later this year.

Unfortunately, the preliminary EPS figure is coming up short. John knows that the board will take a serious look at the estimates and assumptions made in preparing the statement of comprehensive income. In anticipation of the board's review, John has identified the following two issues:

1. In the past, bad debt expense has been computed using the percentage of sales method. The percentage used has varied between 3 and 35%. This year, John assumed a rate of 3%. If he were to modify his estimate of bad debt expense to 2.5% of sales, income would increase by $700,000.
2. BioMedic, Inc., offers a warranty on many of the products it sells. Like bad debt expense, warranty expense is computed as a percentage of sales. John is considering modifying his estimate of warranty expense from 1.4% of sales down to 1.1%. This modification would result in a $420,000 increase in net income.

These two changes, considered together, would result in BioMedic being able to report EPS of $1.33 per share, thereby allowing the company to publicly announce that it had exceeded analysts' expectations. Without these changes, BioMedic will report EPS of $1.21 per share.

What issues should John consider before he makes the changes to the statement of comprehensive income? Would John be doing something wrong by making these changes? Would John be breaking the law?