# 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 accounts 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

b

### 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)

Net sales $3,500,000

### 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). Before Write-Off

|  |  |
| --- | --- |
| Accounts receivable | $200,000 |
| Less: Allowance for bad debts | 50,000 |
| Net realizable value | $150,000 |

(2). After Write-Off

|  |  |
| --- | --- |
| Accounts receivable ($200,000 – $43,000) | $157,000 |
| Less: Allowance for bad debts  ($50,000 – $43,000) | 7,000 |
| Net realizable value | $150,000 |

### 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 × 0.09 = $9,180; $9,180 – $2,700 = $6,480

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

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Estimate of Losses from Uncollectible Accounts | | | | | |
|  |  |  | Percentage Estimated |  |  |
| Age | Balances |  | to Be Uncollectible |  | Amount |
| 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 | 4,000 |  | 90 |  | 3,600 |
| Totals | $38,650 |  |  |  | $7,065 |

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.

Allowance for Bad Debts

Ending Ending Allowance as a Percentage

Year Accounts Receivable for Bad Debts of Accounts Receivable

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

A/R Turnover =  =  = 10.40

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

Average Collection Period =  =  = 35.1 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

**May 1**

Notes Receivable 8,500

Sales Revenue 8,500

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

**June 30**

Cash 8,642

Notes Receivable 8,500

Interest Revenue (€8,500 × 10% × 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 × 9% × 3/12) 337.5

## EXERCISES

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

June 3 Accounts Receivable 9,000

Sales Revenue 9,000

*Sold merchandise to Mary Company,*

*terms 2/10, n/30.*

7 Sales Returns and Allowances 850

Accounts Receivable 850

*Accepted return of merchandise from*

*Mary Company.*

21 Cash 8,150

Accounts Receivable 8,150

*Received payment in full from Mary Company.*

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

June 24 Accounts Receivable 140,000

Sales Revenue 140,000

*Sold merchandise to Brooke Bowman,*

*terms 2/10, n/30.*

30 Cash 78,400

Sales Discounts 1,600

Accounts Receivable 80,000

*Received partial payment from Brooke*

*Bowman.*

July 20 Cash 42,000

Sales Returns and Allowances 18,000

Accounts Receivable 60,000

*Received remaining payment from Brooke*

*Bowman and accepted her return of*

*merchandise that originally sold for $18,000.*

### E 6–3 (LO3) Estimating Bad Debts

1. Bad debt expense = $3,900 + $1,300 = $5,200

2. Bad debt expense = ($66,400 × 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

*To write off uncollectible accounts.*

Accounts Receivable 35,000

Allowance for Bad Debts 35,000

*To reinstate the balance previously written off*

*as uncollectible.*

Cash 35,000

Accounts Receivable 35,000

*Received payment of $35,000.*

Bad Debt Expense 645,000

Allowance for Bad Debts 645,000

*To adjust the allowance account to the desired*

*balance of $650,000.\**

\*$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

Accounts Receivable  3,800

(c) Cash ($13,400 – $268) 13,132

Sales Discounts ($13,400 X 2%) 268

Accounts Receivable ($17,200 – $3,800) 13,400

### E 6–6 (LO3) Accounting for Uncollectible Accounts Receivable

|  |  |  |  |
| --- | --- | --- | --- |
| 1. Allowance for Bad Debts | | | |
| Write-offs | 50,000 | Beg. bal. | 45,000 |
|  |  | Bad debt |  |
|  |  | expense | 95,000 |
|  |  | End. bal. | 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 | | | |
| Beg. bal. | 750,000 | Collections | 3,075,000 |
| Sales | 3,500,000 | Write-offs | 50,000 |
| End. bal. | 1,125,000 |  |  |
|  |  |  |  |

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

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

0.5% × $720,000 = $ 3,600

3.0% × $395,000 = 11,850

16.0% × $105,000 = 16,800

52.5% × $52,000 = 27,300

92.0% × $13,000 = 11,960

$71,510

Balance needed $71,510

Prior balance 42,000

Adjustment needed $29,510

Journal Entry

Bad Debt Expense 29,510

Allowance for Bad Debts 29,510

*To record the bad debt expense.*

### 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 6,750

Total estimated uncollectible accounts $13,990

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

**Formula Year 3 Year 2**

**Parker Enterprises, Inc.**

**  **

**2.3 times 2.2 times**

**Boulder, Inc.   **

**3.1 times 2.8 times**

**Average Collection Period**

**Parker Enterprises, Inc. 365 ÷ 2.3 = 159 days 365 ÷ 2.2 = 166 days**

**Boulder, Inc. 365 ÷ 3.1 = 118 days 365 ÷ 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 + $565,000)/2]. The average receivables for 2017 are $585,000 [($565,000 + $605,000)/2].

The accounts receivable turnover ratios are as follows:

2017 2016

  = 5.2 times  = 4.6 times

The average collection periods are:

2017 2016

  = 70 days  = 79 days

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 × 8% × 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

### 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

*Sold merchandise for $60,000.*

(b) Sales Returns and Allowances 4,000

Accounts Receivable 4,000

*Customer returned $4,000 of merchandise.*

(c) Cash 54,880

Sales Discounts 1,120

Accounts Receivable 56,000

*Received full amount from STARK Company (included*

*2% discount).*

(d) Cash 56,000

Accounts Receivable 56,000

*Collected full amount from STARK Company.*

P 6–2 (LO3) Accounting for Accounts Receivable

1. Accounts Receivable 4,200,000

Sales Revenue 4,200,000

*To record 2017 sales.*

Cash 3,616,000

Sales Discounts 64,000

Accounts Receivable 3,680,000

*To recognize collections of receivables.*

Sales Returns and Allowances 48,000

Accounts Receivable 48,000

*To record sales returns from customers.*

Allowance for Bad Debts 18,800

Accounts Receivable 18,800

*To write off uncollectible accounts receivable.*

Bad Debt Expense 41,800\*

Allowance for Bad Debts 41,800

*To record bad debt expense for the year.*

\*($20,600 – $18,800 = $1,800; $43,600 – $1,800 = $41,800)

2. a. Gross sales $4,200,000

Less: Sales discounts (64,000)

Sales returns and allowances (48,000)

Net sales $4,088,000

b.

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

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
|  |  |  |  |  |  |  |

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

1. Estimated bad debts 2% × $1,140,000 = $ 22,800

10% × $600,000 = 60,000

23% × $400,000 = 92,000

75% × $120,000 = 90,000

$264,800

Allowance for Bad Debts on December 31, 2017:

December 31, 2016 allowance $130,000

Accounts written off (90,000)

Accounts recovered 15,000

$ 55,000

Bad Debt Expense 209,800

Allowance for Bad Debts 209,800

*To record estimate of uncollectible accounts*

*receivable ($264,800 – $55,000).*

2. Allowance for Bad Debts 90,000

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. Allowance for Bad Debts 3,500

Accounts Receivable 3,500

*To write off uncollectible accounts.*

b. Bad Debt Expense 7,500

Allowance for Bad Debts 7,500

*To record estimate of bad debts for the year.*

*($9,000 – $1,500 balance = $7,500)*

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

1. Bad Debt Expense 63,500

Allowance for Bad Debts 63,500

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

\*$2,300,000 Total accounts receivable

× 0.03

$ 69,000 Total estimated uncollectible receivables

(5,500) Previous balance

$ 63,500 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.

2. Bad Debt Expense 58,500

Allowance for Bad Debts 58,500

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

\* 1% × $1,900,000 = $19,000

6% × $200,000 = 12,000

10% × $100,000 = 10,000

20% × $70,000 = 14,000

30% × $30,000 = 9,000

$64,000 Total estimated uncollectible receivables

(5,500) Previous balance

$58,500 Net addition to account

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

1. Dec.31, 2016

Bad Debt Expense 1,387

Allowance for Bad Debts 1,387

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

\*$105,600 × 0.5% = $ 528.00

$31,400 × 3% = 942.00

$14,200 × 4.5% = 639.00

$3,600 × 8% = 288.00

$900 × 10% = 90.00

$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 × 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 × 0.5% = $ 6,000

$800,000 × 1% = 8,000

$200,000 × 4% = 8,000

$80,000 × 20% = 16,000

$40,000 × 30% = 12,000

$50,000 Total estimated uncollectible receivables

(4,000) Previous balance

$46,000 Net addition to account

3. a. Bad Debt Expense 64,000

Accounts Receivable 64,000

*Wrote off $64,000 uncollectible account from*

*Petite Corners.*

b. Allowance for Bad Debts 64,000

Accounts Receivable 64,000

*Wrote off $64,000 uncollectible account from*

*Petite Corners.*

4. a. Accounts Receivable 64,000

Bad Debt Expense 64,000

Cash 64,000

Accounts Receivable 64,000

*Received payment of $64,000 from Petite Corners.*

*This amount had been previously written off as*

*uncollectible.*

b. Accounts Receivable 64,000

Allowance for Bad Debts 64,000

Cash 64,000

Accounts Receivable 64,000

*Received payment of $64,000 from Petite Corners.*

*This amount had been previously written off as*

*uncollectible.*

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 13,500

Total $22,740

2. Bad Debt Expense 19,240

Allowance for Bad Debts 19,240

*To adjust the allowance for bad debts to the*

*appropriate ending balance [$22,740 + $16,500*

*(write-offs) – $20,000 (beginning) = $19,240].*

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:

2017 2016

 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) €1,500,000/[(€180,000 + €650,000)/2] = 3.61

(c) 365/3.61 = 101.11 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

(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 × 12% × 1.5/12 = 210) 210

Notes Receivable—Macallan Co. 50,000

Cash/ Accounts Receivable 50,000

**(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

5/1/17 Notes Receivable 16,000

Accounts Receivable—Crane 16,000

7/1/17 Notes Receivable 25,000

Cash 25,000

12/31/17 Interest Receivable 1,280

Interest Revenue

($16,000 X 12% X 8/12) 1,280

Interest Receivable 1,250

Interest Revenue

($25,000 X 10% X 6/12) 1,250

4/1/18 Accounts Receivable—Howard 26,875

Notes Receivable 25,000

Interest Receivable 1,250

Interest Revenue

    ($25,000 X 10% X 3/12 = $625) 625

5/1/18 Cash 17,920

Notes Receivable 16,000

Interest Receivable 1,280

Interest Revenue

($16,000 X 12% X 4/12 = $640) 640

## 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 $ 885,000

Cost of sales 225,000

$ 660,000

Vice Presidents Proposal

Increase in income:

Revenues $1,500,000

Cost of sales 375,000

Gross margin $ 1,125,000

Credit card fees 60,000

$ 1,065,000

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 ([€](http://en.wikipedia.org/wiki/Euro_sign)4,476 million) plus revenues ([€](http://en.wikipedia.org/wiki/Euro_sign)24,244 million) less the ending balance ([€](http://en.wikipedia.org/wiki/Euro_sign)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) EUR 301

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 times; 365 days/ = 73 days

**3.** (in millions) $81,741/[($8,333+ $9,090)/2)] = 9.38 times; 365 days/9.38 = 38.9 days

AA 6–7 Samsung

International

**1.** 1997 1996

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/(Sales/Accounts Receivable)

= 365/(74,641/6,233)

= 30.5 days

1997 Average collection period = 365/(Sales/Accounts Receivable)

= 365/(91,519/10,064)

= 40.1 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 BioMedic'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.