CHAPTER 8

Accounting for Receivables

ASSIGNMENT CLASSIFICATION TABLE

Learning Objectives	Questions	Brief Exercises	Do It!	Exercises	A Problems	B Problems
1. Identify the different types of receivables.	1, 2	1				
2. Explain how companies recognize accounts receivable.	3	2	1	1, 2	1A, 6A, 7A,	1B, 6B, 7B
3. Distinguish between the methods and bases companies use to value accounts receivable.	4, 5, 6, 7, 8	3, 4, 5, 6, 7	2	3, 4, 5, 6	1A, 2A, 3A, 4A, 5A	1B, 2B, 3B, 4B, 5B
4. Describe the entries to record the disposition of accounts receivable.	9, 10, 11	8	3	7, 8, 9	6A, 7A	6B, 7B
5. Compute the maturity date of and interest on notes receivable.	12, 13, 14, 15, 16	9, 10	4	10, 11, 12, 13	6A, 7A	6B, 7B
6. Explain how companies recognize notes receivable.		11		10, 11, 12	7A	7B
7. Describe how companies value notes receivable.					7A	7B
8. Describe the entries to record the disposition of notes receivable.	17		4	12, 13	6A, 7A	6B, 7B
9. Explain the statement presentation and analysis of receivables.	18, 19	3, 12	5	14	1A, 6A	1B, 6B

ASSIGNMENT CHARACTERISTICS TABLE

Problem Number	Description	Difficulty Level	Time Allotted (min.)
1A	Prepare journal entries related to bad debt expense.	Simple	15–20
2A	Compute bad debt amounts.	Moderate	20–25
3A	Journalize entries to record transactions related to bad debts.	Moderate	20–30
4A	Journalize transactions related to bad debts.	Moderate	20–30
5A	Journalize entries to record transactions related to bad debts.	Moderate	20–30
6A	Prepare entries for various notes receivable transactions.	Moderate	40–50
7A	Prepare entries for various receivable transactions.	Complex	50–60
1B	Prepare journal entries related to bad debt expense.	Simple	15–20
2B	Compute bad debt amounts.	Moderate	20–25
3B	Journalize entries to record transactions related to bad debts.	Moderate	20–30
4B	Journalize transactions related to bad debts.	Moderate	20–30
5B	Journalize entries to record transactions related to bad debts.	Moderate	20–30
6B	Prepare entries for various notes receivable transactions.	Moderate	40–50
7B	Prepare entries for various receivable transactions.	Complex	50–60

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Number	LO	BT	Difficulty	Time (min.)
BE1	1	C	Simple	1–2
BE2	2	AP	Simple	5–7
BE3	3, 9	AN	Simple	4–6
BE4	3	AP	Simple	4–6
BE5	3	AP	Simple	4–6
BE6	3	AP	Simple	2–4
BE7	3	AN	Simple	4–6
BE8	4	AP	Simple	6–8
BE9	5	AP	Simple	8–10
BE10	5	AP	Moderate	8–10
BE11	6	AP	Simple	2–4
BE12	9	AP	Simple	4–6
DI1	2	AP	Simple	5–7
DI2	3	AP	Simple	2–4
DI3	4	AP	Simple	4–6
DI4	5, 8	AP	Simple	6–8
DI5	9	AN	Simple	4–6
EX1	2	AP	Simple	8–10
EX2	2	AP	Simple	8–10
EX3	3	AN	Simple	8–10
EX4	3	AN	Simple	6–8
EX5	3	AP	Simple	6–8
EX6	3	AP	Simple	6–8
EX7	4	AP	Simple	4–6
EX8	4	AP	Simple	6–8
EX9	4	AP	Simple	6–8
EX10	5, 6	AN	Simple	8–10
EX11	5, 6	AN	Simple	6–8
EX12	5, 6, 8	AP	Moderate	10–12
EX13	5, 8	AP	Simple	8–10
EX14	9	AP	Simple	8–10

ACCOUNTING FOR RECEIVABLES (Continued)

Number	LO	BT	Difficulty	Time (min.)
P1A	2, 3, 9	AN	Simple	15–20
P2A	3	AN	Moderate	20–25
P3A	3	AN	Moderate	20–30
P4A	3	AN	Moderate	20–30
P5A	3	AN	Moderate	20–30
P6A	2, 4, 5, 8, 9	AN	Moderate	40–50
P7A	2, 4–8	AP	Complex	50–60
P1B	2, 3, 9	AN	Simple	15–20
P2B	3	AN	Moderate	20–25
P3B	3	AN	Moderate	20–30
P4B	3	AN	Moderate	20–30
P5B	3	AN	Moderate	20–30
P6B	2, 4, 5, 8, 9	AN	Moderate	40–50
P7B	2, 4–8	AP	Complex	50–60
BYP1	3	E	Moderate	20–25
BYP2	9	AN, E	Simple	10–15
BYP3	8	AP	Simple	10–15
BYP4	4	AN	Moderate	20–30
BYP5	3	E	Simple	10–15
BYP6	3	E	Simple	10–15

Correlation Chart between Bloom's Taxonomy, Learning Objectives and End-of-Chapter Exercises and Problems

Learning Objective	Knowledge	Comprehension	Application	Analysis	Synthesis	Evaluation
1. Identify the different types of receivables.	Q8-2	Q8-1 BE8-1				
2. Explain how companies recognize accounts receivable.			Q8-3 E8-2 BE8-2 P8-7A DI8-1 P8-7B E8-1	P8-1A P8-6A P8-1B P8-6B		
3. Distinguish between the methods and bases companies used to value accounts receivable.	Q8-8	Q8-4 Q8-5 Q8-6	BE8-4 E8-6 BE8-5 BE8-6 DI8-2 E8-5	Q8-7 P8-1A P8-1B BE8-3 P8-2A P8-2B BE8-7 P8-3A P8-3B E8-3 P8-4A P8-4B E8-4 P8-5A P8-5B		
4. Describe the entries to record the disposition of accounts receivable.	Q8-9	Q8-10	Q8-11 E8-8 BE8-8 E8-9 DI8-3 P8-7A E8-7 P8-7B	P8-6A P8-6B		
5. Compute the maturity date of and interest on notes receivable.	Q8-13	Q8-12 Q8-16	Q8-14 E8-12 Q8-15 E8-13 BE8-9 P8-7A BE8-10 P8-7B DI8-4	E8-10 E8-11 P8-6A P8-6B		
6. Explain how companies recognize notes receivable.			BE8-11 P8-7B P8-7A E8-12	E8-10 E8-11		
7. Describe how companies value notes receivable.			P8-7A P8-7B			
8. Describe the entries to record the disposition of notes receivable.		Q8-17	DI8-4 P8-7A E8-12 P8-7B E8-13	P8-6A P8-6B		
9. Explain the statement presentation and analysis of receivables.	Q8-18		Q8-19 BE8-12 E8-14	BE8-3 P8-1B DI8-5 P8-6B P8-1A P8-6A		
Broadening Your Perspective			Real-World Focus	Decision-Making Across the Organization Comparative Analysis		Financial Reporting Comparative Analysis Ethics Case Communication

ANSWERS TO QUESTIONS

1. Accounts receivable are amounts owed by customers on account. They result from the sale of goods and services. Notes receivable represent claims that are evidenced by formal instruments of credit.

2. Other receivables include nontrade receivables such as interest receivable, loans to company officers, advances to employees, and income taxes refundable.

3.

Accounts Receivable	40	
Interest Revenue..		40

4. The essential features of the allowance method of accounting for bad debts are:
(1) Uncollectible accounts receivable are estimated and matched against revenue in the same accounting period in which the revenue occurred.
(2) Estimated uncollectibles are debited to Bad Debt Expense and credited to Allowance for Doubtful Accounts through an adjusting entry at the end of each period.
(3) Actual uncollectibles are debited to Allowance for Doubtful Accounts and credited to Accounts Receivable at the time the specific account is written off.

5. Roger Holloway should realize that the decrease in cash realizable value occurs when estimated uncollectibles are recognized in an adjusting entry. The write-off of an uncollectible account reduces both accounts receivable and the allowance for doubtful accounts by the same amount. Thus, cash realizable value does not change.

6. The two bases of estimating uncollectibles are: (1) percentage-of-sales and (2) percentage-of-receivables. The percentage-of-sales basis establishes a percentage relationship between the amount of credit sales and expected losses from uncollectible accounts. This method emphasizes the matching of expenses with revenues. Under the percentage-of-receivables basis, the balance in the allowance for doubtful accounts is derived from an analysis of individual customer accounts. This method emphasizes cash realizable value.

7. The adjusting entry under the percentage-of-sales basis is:

Bad Debt Expense	370,000	
Allowance for Doubtful Accounts		370,000

The adjusting entry under the percentage-of-receivables basis is:

Bad Debt Expense	260,000	
Allowance for Doubtful Accounts (NT$580,000 – NT$320,000)....		260,000

8. Under the direct write-off method, bad debt losses are not estimated and no allowance account is used. When an account is determined to be uncollectible, the loss is debited to Bad Debt Expense. The direct write-off method makes no attempt to match bad debts expense to sales revenues or to show the cash realizable value of the receivables in the statement of financial position.

9. From its own credit cards, the Freida Company may realize financing charges from customers who do not pay the balance due within a specified grace period. National credit cards offer the following advantages:
(1) The credit card issuer makes the credit investigation of the customer.
(2) The issuer maintains individual customer accounts.

(3) The issuer undertakes the collection process and absorbs any losses from uncollectible accounts.
(4) The retailer receives cash more quickly from the credit card issuer than it would from individual customers.

10. The reasons companies are selling their receivables are:
(1) Receivables may be sold because they may be the only reasonable source of cash.
(2) Billing and collection are often time-consuming and costly. It is often easier for a retailer to sell the receivables to another party with expertise in billing and collection matters.

11.

Cash	7,760,000	
Service Charge Expense (3% X HK$800,000)	240,000	
Accounts Receivable		8,000,000

12. A promissory note gives the holder a stronger legal claim than one on an accounts receivable. As a result, it is easier to sell to another party. Promissory notes are negotiable instruments, which means they can be transferred to another party by endorsement. The holder of a promissory note also can earn interest.

13. The maturity date of a promissory note may be stated in one of three ways: (1) on demand, (2) on a stated date, and (3) at the end of a stated period of time.

14. The maturity dates are: (a) March 13 of the next year, (b) August 4, (c) July 20, and (d) August 30.

15. The missing amounts are: (a) €15,000, (b) €9,000, (c) 12%, and (d) four months.

16. If a financial institution uses 360 days rather than 365 days, it will receive more interest revenue. The reason is that the denominator is smaller, which makes the fraction larger and, therefore, the interest revenue larger.

17. When Jana Company has dishonored a note, the ledger can set up a receivable equal to the face amount of the note plus the interest due. It will then try to collect the balance due, or as much as possible. If there is no hope of collection it will write-off the receivable.

18. Each of the major types of receivables should be identified in the statement of financial position or in the notes to the financial statements. Both the gross amount of receivables and the allowance for doubtful accounts should be reported. If collectible within a year or the operating cycle, whichever is longer, these receivables are reported as current assets immediately above short-term investments.

19. Net credit sales for the period are 8.14 X £400,000 = £3,256,000.

SOLUTIONS TO BRIEF EXERCISES

BRIEF EXERCISE 8-1

(a) Accounts receivable.
(b) Notes receivable.
(c) Other receivables.

BRIEF EXERCISE 8-2

(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

BRIEF EXERCISE 8-3

(a)	Bad Debt Expense	28,000	
	Allowance for Doubtful Accounts		28,000

(b)	Current assets		
	Prepaid insurance		€ 7,500
	Inventory		118,000
	Accounts receivable	€600,000	
	Less: Allowance for doubtful Accounts	28,000	572,000
	Cash		90,000
	Total current assets		€787,500

BRIEF EXERCISE 8-4

(a)	Allowance for Doubtful Accounts	6,200	
	Accounts Receivable—Marcello		6,200

(b)

	(1) Before Write-Off	(2) After Write-Off
Accounts receivable	£700,000	£693,800
Allowance for doubtful accounts	54,000	47,800
Cash realizable value	£646,000	£646,000

BRIEF EXERCISE 8-5

Accounts Receivable—Marcello	6,200	
Allowance for Doubtful Accounts		6,200
Cash	6,200	
Accounts Receivable—Marcello		6,200

BRIEF EXERCISE 8-6

Bad Debt Expense [($800,000 – $38,000) X 2%]	15,240	
Allowance for Doubtful Accounts		15,240

BRIEF EXERCISE 8-7

(a)	Bad Debt Expense [(£420,000 X 1%) – £1,280]	2,920	
	Allowance for Doubtful Accounts		2,920

(b) Bad Debt Expense [(£420,000 X 1%) + £740] = £4,940

BRIEF EXERCISE 8-8

(a)	Cash (€175 – €7)	168	
	Service Charge Expense (€175 X 4%)	7	
	Sales Revenue		175
(b)	Cash (€70,000 – €2,100)	67,900	
	Service Charge Expense (€70,000 X 3%)	2,100	
	Accounts Receivable		70,000

BRIEF EXERCISE 8-9

	Interest	Maturity Date
(a)	£800	August 9
(b)	£1,120	October 12
(c)	£100	July 11

BRIEF EXERCISE 8-10

	Maturity Date	Annual Interest Rate	Total Interest
(a)	May 31	5%	€5,000
(b)	August 1	8%	€ 600
(c)	September 7	10%	€6,000

BRIEF EXERCISE 8-11

Jan. 10	Accounts Receivable	80,400	
	Sales Revenue		80,400
Feb. 9	Notes Receivable	80,400	
	Accounts Receivable		80,400

BRIEF EXERCISE 8-12

Accounts Receivable Turnover Ratio:

$$\frac{\$20B}{(\$2.7B + \$2.8B) \div 2} = \frac{\$20B}{\$2.75B} = 7.3 \text{ times}$$

Average Collection Period for Accounts Receivable:

$$\frac{365 \text{ days}}{7.3 \text{ times}} = 50 \text{ days}$$

SOLUTIONS FOR DO IT! REVIEW EXERCISES

DO IT! 8-1

March 1	Accounts Receivable	28,000	
	Sales Revenue		28,000
March 6	Sales Returns and Allowances	1,000	
	Accounts Receivable		1,000
March 11	Cash (€27,000 – €270)	26,730	
	Sales Discounts (€27,000 $\times$ 1%)	270	
	Accounts Receivable		27,000

DO IT! 8-2

The following entry should be prepared to increase the balance in the Allowance for Doubtful Accounts from R$4,100 credit to R$12,400 credit (4% X R$310,000):

Bad Debt Expense	8,300	
Allowance for Doubtful Accounts		8,300
(To record estimate of uncollectible accounts)		

DO IT! 8-3

To speed up the collection of cash, Paltrow could sell its accounts receivable to a factor. Assuming the factor charges Paltrow a 3% service charge, it would make the following entry:

Cash	970,000	
Service Charge Expense	30,000	
Accounts Receivable		1,000,000
(To record sale of receivables to factor)		

DO IT! 8-4

(a) The maturity date is September 10. When the life of a note is expressed in terms of months, you find the date it matures by counting the months from the date of issue. When a note is drawn on the last day of a month, it matures on the last day of a subsequent month.

(b) The interest to be received at maturity is €140:

Face X Rate X Time = Interest
€6,000 X 7% X 4/12 = €140

The entry recorded by Karbon Wholesalers at the maturity date is:

Cash	6,140	
Notes Receivable		6,000
Interest Revenue		140
(To record collection of Bazaar note)		

DO IT! 8-5

(a)

Net credit sales	÷	Average net accounts receivable	=	Accounts receivable turnover
£1,480,000	÷	$\frac{£112,000 + £108,000}{2}$	=	13.5 times

(b)

Days in year	÷	Accounts receivable turnover	=	Average collection period in days
365	÷	13.5 times	=	27 days

SOLUTIONS TO EXERCISES

EXERCISE 8-1

March 1	Accounts Receivable—Lynda Company	3,800	
	Sales Revenue		3,800
3	Sales Returns and Allowances....................	600	
	Accounts Receivable— Lynda Company		600
9	Cash	3,136	
	Sales Discounts..	64	
	Accounts Receivable— Lynda Company		3,200
15	Accounts Receivable	200	
	Sales Revenue		200
31	Accounts Receivable (CHF200 X 1.5%).......	3	
	Interest Revenue		3

EXERCISE 8-2

(a)	Jan. 6	Accounts Receivable—Jackie Ltd..............	7,000	
		Sales Revenue		7,000
	16	Cash (£7,000 – £140)	6,860	
		Sales Discounts (2% X £7,000)	140	
		Accounts Receivable—Jackie Ltd		7,000
(b)	Jan. 10	Accounts Receivable—C. Bybee.................	9,000	
		Sales Revenue		9,000
	Feb. 12	Cash	6,000	
		Accounts Receivable—C. Bybee		6,000
	Mar. 10	Accounts Receivable—C. Bybee.................	60	
		Interest Revenue [2% X (£9,000 – £6,000)]....................		60

EXERCISE 8-3

(a)		Dec. 31	Bad Debt Expense	1,500	
			Accounts Receivable—T.Thum......		1,500
(b)	(1)	Dec. 31	Bad Debt Expense		
			[(€840,000 – €28,000) X 1%]...........	8,120	
			Allowance for Doubtful		
			Accounts................................		8,120
	(2)	Dec. 31	Bad Debt Expense	8,500	
			Allowance for Doubtful Accounts		
			[(€110,000 X 10%) – €2,500].....		8,500
(c)	(1)	Dec. 31	Bad Debt Expense		
			[(€840,000 – €28,000) X .75%].........	6,090	
			Allowance for Doubtful		
			Accounts................................		6,090
	(2)	Dec. 31	Bad Debt Expense	6,800	
			Allowance for Doubtful Accounts		
			[(€110,000 X 6%) + €200].........		6,800

EXERCISE 8-4

(a)

Accounts Receivable	Amount	%	Estimated Uncollectible
1–30 days	£65,000	2.0	£1,300
31–60 days	17,600	5.0	880
61–90 days	8,500	30.0	2,550
Over 90 days	7,000	50.0	3,500
			£8,230

(b)	Mar. 31	Bad Debt Expense	7,330	
		Allowance for Doubtful Accounts		
		(£8,230 – £900)................................		7,330

EXERCISE 8-5

Allowance for Doubtful Accounts	14,100	
Accounts Receivable		14,100
Accounts Receivable	1,800	
Allowance for Doubtful Accounts		1,800
Cash	1,800	
Accounts Receivable		1,800
Bad Debt Expense	15,100	
Allowance for Doubtful Accounts [£17,800 – (£15,000 – £14,100 + £1,800)]		15,100

EXERCISE 8-6

December 31, 2016		
Bad Debt Expense (2% X €360,000)	7,200	
Allowance for Doubtful Accounts		7,200
May 11, 2017		
Allowance for Doubtful Accounts	1,100	
Accounts Receivable—Vetter		1,100
June 12, 2017		
Accounts Receivable—Vetter	1,100	
Allowance for Doubtful Accounts		1,100
Cash	1,100	
Accounts Receivable—Vetter		1,100

EXERCISE 8-7

(a)	Mar. 3	Cash (₩620,000,000 – ₩24,800,000)	595,200,000	
		Service Charge Expense (4% X ₩620,000,000)	24,800,000	
		Accounts Receivable		620,000,000
(b)	May 10	Cash (₩3,200,000 – ₩160,000)	3,040,000	
		Service Charge Expense (5% X ₩3,200,000)	160,000	
		Sales Revenue		3,200,000

EXERCISE 8-8

(a)	Apr.	2	Accounts Receivable—J. Keiser	1,500	
			Sales Revenue..................................		1,500
	May	3	Cash..	900	
			Accounts Receivable— J. Keiser		900
	June	1	Accounts Receivable—J. Keiser	6	
			Interest Revenue [($1,500 – $900) X 1%]		6
(b)	July	4	Cash..	194	
			Service Charge Expense (3% X $200)...	6	
			Sales Revenue..................................		200

EXERCISE 8-9

Jan.	15	Accounts Receivable..............................	17,000	
		Sales Revenue..................................		17,000
	20	Cash (HK$4,800 – HK$96)	4,704	
		Service Charge Expense (HK$4,800 X 2%)..................................	96	
		Sales Revenue..................................		4,800
Feb.	10	Cash..	11,000	
		Accounts Receivable		11,000
	15	Accounts Receivable (HK$6,000 X 1.5%)	90	
		Interest Revenue		90

EXERCISE 8-10

(a)

	2017		
Nov. 1	Notes Receivable	15,000	
	Cash		15,000
Dec. 11	Notes Receivable	6,750	
	Sales Revenue		6,750
16	Notes Receivable	4,400	
	Accounts Receivable—Russo		4,400
31	Interest Receivable	277	
	Interest Revenue*		277

*Calculation of interest revenue:

Jeanne's note:	£15,000 X 9% X 2/12 =	£225
Sharbo's note:	6,750 X 8% X 20/360 =	30
Russo's note:	4,400 X 12% X 15/360 =	22
Total accrued interest		£277

(b)

	2018		
Nov. 1	Cash	16,350	
	Interest Receivable		225
	Interest Revenue*		1,125
	Notes Receivable		15,000
	*(£15,000 X 9% X 10/12)		

EXERCISE 8-11

	2017		
May 1	Notes Receivable	7,500	
	Accounts Receivable—Monroe		7,500
Dec. 31	Interest Receivable	400	
	Interest Revenue (€7,500 X 8% X 8/12)		400
31	Interest Revenue	400	
	Income Summary		400

EXERCISE 8-11 (Continued)

	2018		
May 1	Cash	8,100	
	Notes Receivable		7,500
	Interest Receivable		400
	Interest Revenue (€7,500 X 8% X 4/12)		200

EXERCISE 8-12

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

EXERCISE 8-13

(a)	May 2	Notes Receivable	7,600,000	
		Cash		7,600,000
(b)	Aug. 2	Accounts Receivable—Cortland Ltd.	7,733,000	
		Notes Receivable		7,600,000
		Interest Revenue (¥7,600,000 X 7% X 3/12)		133,000
		(To record the dishonor of Cortland Ltd. note with expectation of collection)		
(c)	Aug. 2	Allowance for Doubtful Accounts	7,600,000	
		Notes Receivable		7,600,000
		(To record the dishonor of Cortland Ltd. note with no expectation of collection)		

EXERCISE 8-14

(a)

Beginning accounts receivable	€ 100,000
Net credit sales	1,000,000
Cash collections	(920,000)
Accounts written off	(30,000)
Ending accounts receivable	€ 150,000

(b) €1,000,000/[(€100,000 + €150,000)/2] = 8

(c) 365/8 = 45.6 days

SOLUTIONS TO PROBLEMS

PROBLEM 8-1A

(a)

			Debit	Credit
1.	Accounts Receivable		3,315,000	
		Sales Revenue		3,315,000
2.	Sales Returns and Allowances		50,000	
		Accounts Receivable		50,000
3.	Cash		2,810,000	
		Accounts Receivable		2,810,000
4.	Allowance for Doubtful Accounts		88,000	
		Accounts Receivable		88,000
5.	Accounts Receivable		29,000	
		Allowance for Doubtful Accounts		29,000
	Cash		29,000	
		Accounts Receivable		29,000

(b)

Accounts Receivable

Bal.	960,000	(2)	50,000
(1)	3,315,000	(3)	2,810,000
(5)	29,000	(4)	88,000
		(5)	29,000
Bal.	1,327,000		

Allowance for Doubtful Accounts

(4)	88,000	Bal.	66,000
		(5)	29,000
		Bal.	7,000

PROBLEM 8-1A (Continued)

(c)

Balance before adjustment [see (b)]	R$ 7,000
Balance needed	125,000
Adjustment required	R$118,000

The journal entry would therefore be as follows:

Bad Debt Expense	118,000	
Allowance for Doubtful Accounts		118,000

(d) $$\frac{R\$3{,}315{,}000 - R\$50{,}000}{(R\$894{,}000 + R\$1{,}202{,}000) \div 2} = \frac{R\$3{,}265{,}000}{R\$1{,}048{,}000} = 3.12 \text{ times}$$

PROBLEM 8-2A

(a) £66,000.

(b) £75,000 (£2,500,000 X 3%).

(c) £64,900 [(£970,000 X 7%) – £3,000].

(d) £70,900 [(£970,000 X 7%) + £3,000].

(e) The weakness of the direct write-off method is two-fold. First, it does not match expenses with revenues. Second, the accounts receivable are not stated at cash realizable value at the statement of financial position date.

PROBLEM 8-3A

(a)	Dec. 31	Bad Debt Expense....................................	31,630	
		Allowance for Doubtful Accounts		
		(€40,830 – €9,200)		31,630

(a) & (b)

Bad Debt Expense

Date		Explanation	Ref.	Debit	Credit	Balance
2017						
Dec.	31	Adjusting		31,630		31,630

Allowance for Doubtful Accounts

Date		Explanation	Ref.	Debit	Credit	Balance
2017						
Dec.	31	Balance				9,200
	31	Adjusting			31,630	40,830
2018						
Mar.	31			1,000		39,830
May	31				1,000	40,830

(b) 2018

(1)

Mar. 31	Allowance for Doubtful Accounts...........	1,000	
	Accounts Receivable........................		1,000

(2)

May 31	Accounts Receivable	1,000	
	Allowance for Doubtful Accounts......		1,000
31	Cash	1,000	
	Accounts Receivable........................		1,000

(c) 2018

Dec. 31	Bad Debt Expense....................................	32,700	
	Allowance for Doubtful Accounts		
	(€31,600 + €1,100)		32,700

PROBLEM 8-4A

(a) Total estimated bad debts

		Number of Days Outstanding				
	Total	0–30	31–60	61–90	91–120	Over 120
Accounts receivable	HK$193,000	HK$70,000	HK$46,000	HK$39,000	HK$23,000	HK$15,000
% uncollectible		1%	3%	5%	8%	10%
Estimated Bad debts	HK$7,370	HK$700	HK$1,380	HK$1,950	HK$1,840	HK$1,500

		Debit	Credit
(b)	Bad Debt Expense	10,370	
	Allowance for Doubtful Accounts [HK$7,370 + HK$3,000]....................................		10,370
(c)	Allowance for Doubtful Accounts...........................	5,000	
	Accounts Receivable		5,000
(d)	Accounts Receivable..	5,000	
	Allowance for Doubtful Accounts		5,000
	Cash..	5,000	
	Accounts Receivable		5,000

(e) If Hú Ltd. used 3% of total accounts receivable rather than aging the individual accounts the bad debt expense adjustment would be HK$8,790 [(HK$193,000 X 3%) + HK$3,000]. The rest of the entries would be the same as they were when aging the accounts receivable.

Aging the individual accounts rather than applying a percentage to the total accounts receivable should produce a more accurate allowance account and bad debts expense.

PROBLEM 8-5A

(a) The allowance method. Since the balance in the allowance for doubtful accounts is given, they must be using this method because the account would not exist if they were using the direct write-off method.

(b)	(1)	Dec. 31	Bad Debt Expense (€12,400 – €800)	11,600	
			Allowance for Doubtful Accounts		11,600
	(2)	Dec. 31	Bad Debt Expense (€918,000 X 1%)	9,180	
			Allowance for Doubtful Accounts		9,180
(c)	(1)	Dec. 31	Bad Debt Expense (€12,400 + €960)	13,360	
			Allowance for Doubtful Accounts		13,360
	(2)	Dec. 31	Bad Debt Expense	9,180	
			Allowance for Doubtful Accounts		9,180

(d)	Allowance for Doubtful Accounts	3,000	
	Accounts Receivable		3,000

Note: The entry is the same whether the amount of bad debt expense at the end of 2017 was estimated using the percentage-of-receivables or the percentage-of-sales method.

(e)	Bad Debt Expense	3,000	
	Accounts Receivable		3,000

(f) Allowance for Doubtful Accounts is a contra-asset account. It is subtracted from the gross amount of accounts receivable so that accounts receivable is reported at its cash realizable value.

PROBLEM 8-6A

(a)

Oct.	7	Accounts Receivable	6,300	
		Sales Revenue		6,300
	12	Cash (£1,200 – £36)	1,164	
		Service Charge Expense (£1,200 X 3%)	36	
		Sales Revenue		1,200
	15	Accounts Receivable	460	
		Interest Revenue		460
	15	Cash	8,107	
		Notes Receivable		8,000
		Interest Receivable (£8,000 X 8% X 45/360)		80
		Interest Revenue (£8,000 X 8% X 15/360)		27
	24	Accounts Receivable—Skinner	9,150	
		Notes Receivable		9,000
		Interest Receivable (£9,000 X 10% X 36/360)		90
		Interest Revenue (£9,000 X 10% X 24/360)		60
	31	Interest Receivable (£14,000 X 9% X 1/12)	105	
		Interest Revenue		105

(b)

Notes Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
Oct.	1	Balance	✓			31,000
	15				8,000	23,000
	24				9,000	14,000

PROBLEM 8-6A (Continued)

Accounts Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
Oct.	7			6,300		6,300
	15			460		6,760
	24			9,150		15,910

Interest Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
Oct.	1	Balance	✓			170
	15				80	90
	24				90	0
	31			105		105

(c) Current assets

Notes receivable..	£14,000
Accounts receivable	15,910
Interest receivable...	105
Total receivables	£30,015

PROBLEM 8-7A

Jan.	5	Accounts Receivable—Zwingle Company..........	24,000	
		Sales Revenue...		24,000
	20	Notes Receivable...	24,000	
		Accounts Receivable— Zwingle Company...		24,000
Feb.	18	Notes Receivable...	8,000	
		Sales Revenue...		8,000
Apr.	20	Cash (€24,000 + €360)......................................	24,360	
		Notes Receivable		24,000
		Interest Revenue (€24,000 X 6% X 3/12)............................		360
	30	Cash (€30,000 + €900)......................................	30,900	
		Notes Receivable		30,000
		Interest Revenue (€30,000 X 9% X 4/12)............................		900
May	25	Notes Receivable...	4,000	
		Accounts Receivable— Isabella Ltd.		4,000
Aug.	18	Cash (€8,000 + €280)..	8,280	
		Notes Receivable		8,000
		Interest Revenue (€8,000 X 7% X 6/12)..............................		280
	25	Accounts Receivable—Isabella Inc. (€4,000 + €70)	4,070	
		Notes Receivable		4,000
		Interest Revenue (€4,000 X 7% X 3/12)..............................		70
Sept.	1	Notes Receivable...	10,000	
		Sales Revenue...		10,000

PROBLEM 8-1B

(a)

1.	Accounts Receivable	2,400,000	
	Sales Revenue		2,400,000
2.	Sales Returns and Allowances	45,000	
	Accounts Receivable		45,000
3.	Cash	2,250,000	
	Accounts Receivable		2,250,000
4.	Allowance for Doubtful Accounts	10,600	
	Accounts Receivable		10,600
5.	Accounts Receivable	2,000	
	Allowance for Doubtful Accounts		2,000
	Cash	2,000	
	Accounts Receivable		2,000

(b)

Accounts Receivable

Bal.	220,000	(2)	45,000
(1)	2,400,000	(3)	2,250,000
(5)	2,000	(4)	10,600
		(5)	2,000
Bal.	314,400		

Allowance for Doubtful Accounts

(4)	10,600	Bal.	15,000
		(5)	2,000
		Bal.	6,400

(c)

Balance before adjustment [see (b)]	€ 6,400
Balance needed	21,400
Adjustment required	€15,000

The journal entry would therefore be as follows:

Bad Debt Expense	15,000	
Allowance for Doubtful Accounts		15,000

(d) $\dfrac{€2,400,000 - €45,000}{(€293,000 + €205,000) \div 2} = \dfrac{€2,355,000}{€249,000} = 9.46 \text{ times}$

PROBLEM 8-2B

(a) ₺23,400.

(b) ₺27,600 (₺920,000 X 3%).

(c) ₺21,830 [(₺369,000 X 7%) – ₺4,000].

(d) ₺27,830 [(₺369,000 X 7%) + ₺2,000].

(e) There are two major weaknesses with the direct write-off method. First, it does not match expenses with the associated revenues. Second, the accounts receivable are not stated at cash realizable value at the statement of financial position date.

PROBLEM 8-3B

(a)	Dec. 31	Bad Debt Expense..................................	46,850	
		Allowance for Doubtful Accounts		
		(£60,850 – £14,000)		46,850

(a) & (b)

Bad Debt Expense

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Dec. 31	Adjusting		46,850		46,850

Allowance for Doubtful Accounts

Date	Explanation	Ref.	Debit	Credit	Balance
2017					
Dec. 31	Balance				14,000
31	Adjusting			46,850	60,850
2018					
Mar. 1			1,900		58,950
May 1				1,900	60,850

(b) 2018

(1)

Mar. 1	Allowance for Doubtful Accounts...........	1,900	
	Accounts Receivable........................		1,900

(2)

May 1	Accounts Receivable	1,900	
	Allowance for Doubtful Accounts.......		1,900
1	Cash	1,900	
	Accounts Receivable........................		1,900

(c) 2018

Dec. 31	Bad Debt Expense...................................	51,700	
	Allowance for Doubtful Accounts		
	(£48,300 + £3,400)		51,700

PROBLEM 8-4B

(a) Total estimated bad debts

				Number of Days Outstanding		
	Total	0–30	31–60	61–90	91–120	Over 120
Accounts receivable	CHF383,000	CHF220,000	CHF90,000	CHF40,000	CHF18,000	CHF15,000
% uncollectible		1%	3%	5%	8%	10%
Estimated Bad debts	CHF9,840	CHF2,200	CHF2,700	CHF2,000	CHF1,440	CHF1,500

(b)	Bad Debt Expense	8,240	
	Allowance for Doubtful Accounts (CHF9,840 – CHF1,600)		8,240
(c)	Allowance for Doubtful Accounts	1,100	
	Accounts Receivable		1,100
(d)	Accounts Receivable	700	
	Allowance for Doubtful Accounts		700
	Cash	700	
	Accounts Receivable		700

(e) When an allowance account is used, an adjusting journal entry is made at the end of each accounting period. This entry satisfies the expense recognition principle by recording the bad debt expense in the period in which the sales occur.

PROBLEM 8-5B

(a)	(1)	Dec. 31	Bad Debt Expense (€13,800 – €1,900)	11,900	
			Allowance for Doubtful Accounts		11,900
	(2)	Dec. 31	Bad Debt Expense (€600,000 X 2%)	12,000	
			Allowance for Doubtful Accounts		12,000
(b)	(1)	Dec. 31	Bad Debt Expense (€13,800 + €1,900)	15,700	
			Allowance for Doubtful Accounts		15,700
	(2)	Dec. 31	Bad Debt Expense	12,000	
			Allowance for Doubtful Accounts		12,000

(c)	Allowance for Doubtful Accounts	3,000	
	Accounts Receivable		3,000

Note: The entry is the same whether the amount of bad debt expense at the end of 2017 was estimated using the percentage-of-receivables or the percentage-of-sales method.

(d)	Bad Debt Expense	3,000	
	Accounts Receivable		3,000

(e) The advantages of the allowance method over the direct write-off method are:

(1) It attempts to match bad debt expense related to uncollectible accounts receivable with sales revenues on the income statement.

(2) It attempts to show the cash realizable value of the accounts receivable on the statement of financial position.

PROBLEM 8-6B

(a)

July	5	Accounts Receivable	7,200	
		Sales Revenue		7,200
	14	Cash (€1,300 – €39)	1,261	
		Service Charge Expense (€1,300 X 3%)	39	
		Sales Revenue		1,300
	14	Accounts Receivable	510	
		Interest Revenue		510
	15	Cash	12,180	
		Notes Receivable		12,000
		Interest Receivable (€12,000 X 9% X 45/360)		135
		Interest Revenue (€12,000 X 9% X 15/360)		45
	24	Accounts Receivable—Ascot Co	30,500	
		Notes Receivable		30,000
		Interest Receivable (€30,000 X 10% X 36/360)		300
		Interest Revenue (€30,000 X 10% X 24/360)		200
	31	Interest Receivable (€18,000 X 12% X 1/12)	180	
		Interest Revenue		180

(b)

Notes Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
July	1	Balance	✓			60,000
	15				12,000	48,000
	24				30,000	18,000

PROBLEM 8-6B (Continued)

Accounts Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
July	5			7,200		7,200
	14			510		7,710
	24			30,500		38,210

Interest Receivable

Date		Explanation	Ref.	Debit	Credit	Balance
July	1	Balance	✓			435
	15				135	300
	24				300	0
	31	Adjusting		180		180

(c) Current assets

Notes receivable..	€18,000
Accounts receivable	38,210
Interest receivable..	180
Total receivables	€56,390

PROBLEM 8-7B

Jan.	5	Accounts Receivable—Patrick Company	8,400	
		Sales Revenue		8,400
Feb.	2	Notes Receivable	8,400	
		Accounts Receivable—Patrick Company		8,400
	12	Notes Receivable	13,500	
		Sales Revenue		13,500
	26	Accounts Receivable—Felton Co.	7,000	
		Sales Revenue		7,000
Apr.	5	Notes Receivable	7,000	
		Accounts Receivable— Felton Co.		7,000
	12	Cash (€13,500 + €135)	13,635	
		Notes Receivable		13,500
		Interest Revenue (€13,500 X 6% X 2/12)		135
June	2	Cash (€8,400 + $140)	8,540	
		Notes Receivable		8,400
		Interest Revenue (€8,400 X 5% X 4/12)		140
July	5	Accounts Receivable—Felton Co. (€7,000 + €140)	7,140	
		Notes Receivable		7,000
		Interest Revenue (€7,000 X 8% X 3/12)		140
	15	Notes Receivable	11,000	
		Sales Revenue		11,000
Oct.	15	Allowance for Doubtful Accounts	11,000	
		Notes Receivable		11,000

COMPREHENSIVE PROBLEM SOLUTION

(a)	Jan. 1	Notes Receivable	1,500	
		Accounts Receivable—Leon Company		1,500
	3	Allowance for Doubtful Accounts	780	
		Accounts Receivable		780
	8	Inventory	17,200	
		Accounts Payable		17,200
	11	Accounts Receivable	25,000	
		Sales Revenue		25,000
		Cost of Goods Sold	17,500	
		Inventory		17,500
	15	Cash	1,164	
		Service Charge Expense	36	
		Sales Revenue		1,200
		Cost of Goods Sold	780	
		Inventory		780
	17	Cash	22,900	
		Accounts Receivable		22,900
	21	Accounts Payable	16,300	
		Cash		16,300
	24	Accounts Receivable	330	
		Allowance for Doubtful Accounts		330
		Cash	330	
		Accounts Receivable		330
	27	Supplies	1,400	
		Cash		1,400
	31	Other Operating Expenses	3,218	
		Cash		3,218

COMPREHENSIVE PROBLEM SOLUTION (Continued)

Adjusting Entries

Jan. 31	Interest Receivable	10	
	Interest Revenue (£1,500 X 8% X 1/12)		10
31	Bad Debt Expense [(£19,600 X 5%) – (£800 – £780 + £330)]	630	
	Allowance for Doubtful Accounts		630
31	Supplies Expense	930	
	Supplies (£1,400 – £470)		930

(b)

VICTORIA COMPANY, LTD.
Adjusted Trial Balance
January 31, 2017

	Debit	Credit
Cash	£16,576	
Notes Receivable	1,500	
Accounts Receivable	19,600	
Allowance for Doubtful Accounts		£ 980
Interest Receivable	10	
Inventory	8,320	
Supplies	470	
Accounts Payable		9,650
Share Capital—Ordinary		20,000
Retained Earnings		12,730
Sales Revenue		26,200
Cost of Goods Sold	18,280	
Supplies Expense	930	
Bad Debt Expense	630	
Service Charge Expense	36	
Other Operating Expenses	3,218	
Interest Revenue		10
	£69,570	£69,570

(b) Optional T accounts for accounts with multiple transactions

Cash

1/1 Bal.	13,100	1/21	16,300
1/15	1,164	1/27	1,400
1/17	22,900	1/31	3,218
1/24	330		
1/31 Bal.	16,576		

Accounts Receivable

1/1 Bal.	19,780	1/1	1,500
1/11	25,000	1/3	780
1/24	330	1/17	22,900
		1/24	330
1/31 Bal.	19,600		

Allowance for Doubtful Accounts

1/3	780	1/1 Bal.	800
		1/24	330
		1/31	630
		1/31 Bal.	980

Inventory

1/1 Bal.	9,400	1/11	17,500
1/8	17,200	1/15	780
1/31 Bal.	8,320		

Supplies

1/27	1,400	1/31	930
1/31 Bal.	470		

Accounts Payable

1/21	16,300	1/1 Bal.	8,750
		1/8	17,200
		1/31 Bal.	9,650

Sales Revenue

		1/11	25,000
		1/15	1,200
		1/31 Bal.	26,200

Cost of Goods Sold

1/11	17,500		
1/15	780		
1/31 Bal.	18,280		

(c)

VICTORIA COMPANY, LTD.
Income Statement
For the Month Ending January 31, 2017

Sales revenue		£26,200
Cost of goods sold		18,280
Gross profit		7,920
Operating expenses		
Other operating expenses	£3,218	
Supplies expense	930	
Bad debt expense	630	
Service charge expense	36	
Total operating expenses		4,814
Income from operations		3,106
Other income and expense		
Interest revenue		10
Net Income		£ 3,116

COMPREHENSIVE PROBLEM SOLUTION (Continued)

VICTORIA COMPANY, LTD.
Retained Earnings Statement
For the Month Ending January 31, 2017

Retained Earnings, January 1	£12,730
Add: Net income	3,116
Retained Earnings, January 31	£15,846

VICTORIA COMPANY, LTD.
Statement of Financial Position
January 31, 2017

Assets		
Current assets		
Supplies		£ 470
Inventory		8,320
Notes receivable		1,500
Accounts receivable	£19,600	
Less: Allowance for doubtful accounts	980	18,620
Interest receivable		10
Cash		16,576
Total assets		£45,496
Equity and Liabilities		
Equity		
Share capital—ordinary	£20,000	
Retained earnings	15,846	£ 35,846
Current liabilities		
Accounts payable		9,650
Total equity and liabilities		£45,496

MC8 MATCHA CREATIONS

(a) Answers to Mei-ling questions

1. Calculations you should perform on the statements are:

- **Working capital = Current assets – Current liabilities**
- **Current ratio = Current assets ÷ Current liabilities**
- **Inventory turnover = Cost of goods sold ÷ Average inventory**
- **Days sales in inventory = Days in the year ÷ Inventory turnover**

Given the type of business it is unlikely that Curtis would have a significant amount of accounts receivable.

Positive working capital and a high current ratio are indications that the company has good liquidity and will be more likely to be able to pay for the mixer. The inventory turnover and days sales in inventory will provide additional information – the days sales in inventory will tell you how long, on average, it takes for inventory to be sold.

2. Other alternatives to extending credit to Curtis include:

- **Waiting for 30 days to make the sale.**
- **Have Curtis borrow from the bank.**
- **Have Curtis use a credit card to finance the purchase.**

MC8 (Continued)

(a) (Continued)

3. **The advantage of extending credit to customers is the anticipated increase in sales expected from customers who will purchase goods only if they can receive credit. The disadvantages of extending credit are the additional costs incurred to keep track of amounts owed, the additional costs incurred when staff need to be assigned to follow up on late account balances, and the risk of not collecting a receivable from a customer who is unable to pay.**

   The advantages of allowing customers to use credit cards include making the purchase easier for the customer, potentially increasing sales, as customers are not limited to the amount of cash in their wallet, and reducing the accounts receivable you have to manage if credit cards are used instead of granting credit to customers. In addition, the credit card company assumes the risk of nonpayment, and if a bank credit card is used the seller has cash immediately.

   The disadvantage is the cost to your business. When a customer makes a purchase using a credit card you will have to pay a percentage of the sale to the credit card company. The rate varies but 3% would not be unusual. You will also have to pay to rent the equipment to process the credit card sales. The fee is not large but is an ongoing expense.

(b)

June 1	**Accounts Receivable—Lesperance .....**	**1,150**	
	Sales Revenue		**1,150**
	Cost of Goods Sold..............................	**620**	
	Inventory		**620**
30	**Notes Receivable................................**	**1,150**	
	Accounts Receivable—Lesperance		**1,150**

MC8 (Continued)

(b) (Continued)

July	**31**	**Accounts Receivable—Lesperance [NT$1,150 + NT$8]**	**1,158**	
		Notes Receivable		**1,150**
		Interest Revenue [NT$1,150 X 8.25% X 1/12]..............		**8**
Aug.	**7**	**Cash...**	**1,158**	
		Accounts Receivable—Lesperance..........................		**1,158**

BYP 8-1 FINANCIAL REPORTING PROBLEM

(a)

CAF AG
Accounts Receivable Aging Schedule
May 31, 2017

	Proportion of Total	Amount in Category	Probability of Non-Collection	Estimated Uncollectible Amount
Not yet due	.600	€ 840,000	.02	€16,800
Less than 30 days past due	.220	308,000	.04	12,320
30 to 60 days past due	.090	126,000	.06	7,560
61 to 120 days past due	.050	70,000	.09	6,300
121 to 180 days past due	.025	35,000	.25	8,750
Over 180 days past due	.015	21,000	.70	14,700
	1.000	€1,400,000		€66,430

(b)

CAF AG
Analysis of Allowance for Doubtful Accounts
May 31, 2017

June 1, 2016 balance	€ 29,500
Bad debts expense accrual (€2,800,000 X .045)	126,000
Balance before write-offs of bad accounts	155,500
Write-offs of bad accounts	(102,000)
Balance before year-end adjustment	53,500
Estimated uncollectible amount	(66,430)
Additional allowance needed	€ (12,930)

Bad Debt Expense	12,930	
Allowance for Doubtful Accounts		12,930

BYP 8-1 (Continued)

(c)

1. Steps to Improve the Accounts Receivable Situation	2. Risks and Costs Involved
Establish more selective credit-granting policies, such as more restrictive credit requirements or more thorough credit investigations.	This policy could result in lost sales and increased costs of credit evaluation. The company may be all but forced to adhere to the prevailing credit-granting policies of the office equipment and supplies industry.
Establish a more rigorous collection policy either through external collection agencies or by its own personnel.	This policy may offend current customers and thus risk future sales. Increased collection costs could result from this policy.
Charge interest on overdue accounts. Insist on cash on delivery (cod) or cash on order (coo) for new customers or poor credit risks.	This policy could result in lost sales and increased administrative costs.

BYP 8-2 COMPARATIVE ANALYSIS PROBLEM

(a) (1) Accounts receivable turnover ratio

Petra Foods	Nestlé
$\dfrac{\text{US\$508,800}}{(\text{US\$67,515} + \text{US\$76,742}) \div 2}$	$\dfrac{\text{CHF92,158}}{(\text{CHF13,048} + \text{CHF12,206}) \div 2}$
$\dfrac{\text{US\$508,800}}{\text{US\$72,128.5}} = 7.05 \text{ times}$	$\dfrac{\text{CHF92,158}}{\text{CHF12,627}} = 7.30 \text{ times}$

(2) Average collection period

$$\frac{365}{7.05} = 51.8 \text{ days} \qquad\qquad \frac{365}{7.30} = 50 \text{ days}$$

(b) Nestlé's average collection period is about 2 days shorter the Petra Foods.

BYP 8-3 REAL-WORLD FOCUS

(a) **Factoring invoices enhances cash flow and allows a company to meet business expenses and take on new opportunities. The benefits of factoring include:**

- **Predictable cash flow and elimination of slow payments.**
- **Flexible financing, as factoring line is tied to sales. It's the ideal tool for growth.**
- **Factoring is easy to obtain. Works well with startups and established companies.**
- **Factoring financing lines can be setup in a few days.**

(b) **Factoring rates range between 1.5% and 3.5% per month. The two major variables considered when determining the rate are: (1) the size of the transaction, and (2) the credit quality of the company's clients.**

(c) **The first installment is paid within a couple of days and is typically 90% of the invoice amount. After customers pay the invoice amount to the factor, the second installment (10%) is paid, less a fee for the transaction.**

BYP 8-4 DECISION-MAKING ACROSS THE ORGANIZATION

(a)

	2017	2016	2015
Net credit sales	€500,000	€650,000	€400,000
Credit and collection expenses			
Collection agency fees	€ 2,450	€ 2,500	€ 2,300
Salary of accounts receivable clerk	4,100	4,100	4,100
Uncollectible accounts (1.6%)	8,000	10,400	6,400
Billing and mailing costs (0.5%)	2,500	3,250	2,000
Credit investigation fees (0.15%)	750	975	600
Total	€ 17,800	€ 21,225	€ 15,400
Total expenses as a percentage of net credit sales	3.56%	3.27%	3.85%

(b)

	2017	2016	2015
Average accounts receivable (5%)	€ 25,000	€ 32,500	€ 20,000
Investment earnings (8% X Ave. acc. rec.)	€ 2,000	€ 2,600	€ 1,600
Total credit and collection expenses per above	€ 17,800	€ 21,225	€ 15,400
Add: Investment earnings*	2,000	2,600	1,600
Net credit and collection expenses	€ 19,800	€ 23,825	€ 17,000
Net expenses as a percentage of net credit sales	3.96%	3.67%	4.25%

*The investment earnings on the cash tied up in accounts receivable is an additional expense of continuing the existing credit policies.

(c) The analysis shows that the credit card fee of 4% of net credit sales will be higher than the percentage cost of credit and collection expenses in each year before considering the effect of earnings from other investment opportunities. However, after considering investment earnings, the credit card fee of 4% will be less than the company's percentage cost if annual net credit sales are less than €500,000.

BYP 8-4 (Continued)

Finally, the decision hinges on: (1) the accuracy of the estimate of investment earnings, (2) the expected trend in credit sales, and (3) the effect the new policy will have on sales. Non-financial factors include the effects on customer relationships of the alternative credit policies and whether the Piweks want to continue with the problem of handling their own accounts receivable.

BYP 8-5 COMMUNICATION ACTIVITY

Of course, this solution will differ from student to student. Important factors to look for would be definitions of the methods, how they are similar and how they differ. Also, look for use of good sentence structure, correct spelling, etc.

Example:

Dear Lily,

The three methods you asked about are methods of dealing with uncollectible accounts receivable. Two of them, percentage-of-sales and percentage-of-receivables, are "allowance" methods used to estimate the amount uncollectible. Under the percentage-of-sales basis, management establishes a percentage relationship between the amount of credit sales and expected losses from uncollectible accounts. This is based on past experience and anticipated credit policy. The percentage is then applied to either total credit sales or net credit sales of the current year. This basis of estimating emphasizes the matching of expenses with revenues.

Under the percentage-of-receivables basis, management establishes a percentage relationship between the amount of receivables and expected losses from uncollectible accounts. Customer accounts are classified by the length of time they have been unpaid. This basis emphasizes cash realizable value of receivables and is therefore deemed a "statement of financial position" approach.

The direct write-off method does not estimate losses and an allowance account is not used. Instead, when an account is determined to be uncollectible, it is written off directly to Bad Debt Expense. Unless bad debt losses are insignificant, this method is not acceptable for financial reporting purposes.

Sincerely,

BYP 8-6 ETHICS CASE

(a) The stakeholders in this situation are:

- **The president of Vestin Co.**
- **The controller of Vestin Co.**
- **The shareholders.**

(b) Yes. The controller is posed with an ethical dilemma—should he/she follow the president's "suggestion" and prepare misleading financial statements (understated net income) or should he/she attempt to stand up to and possibly anger the president by preparing a fair (realistic) income statement.

(c) Vestin Co.'s growth rate should be a product of fair and accurate financial statements, not vice versa. That is, one should not prepare financial statements with the objective of achieving or sustaining a predetermined growth rate. The growth rate should be a product of management and operating results, not of creative accounting.

GAAP EXERCISE

GAAP-1

The FASB and IASB have both worked toward reporting financial instruments at fair value. Both require disclosure of fair value information in notes to financial statements and both permit (but do not require) companies to record some types of financial instruments at fair value.

IFRS requires that specific loans and receivables be reviewed for impairment and then all loans and receivables as a group be reviewed. This "two-tiered" approach is not used by the FASB. IFRS and GAAP also differ in the criteria used to derecognize receivables. IFRS considers risks and rewards as well as loss of control over the receivables sold or factored. GAAP uses only the loss of control as its criteria. In addition, IFRS allows partial derecognition but GAAP does not.

GAAP 8-2

(a) Accounts receivable turnover

	2013	2012
	$\dfrac{\$170{,}910}{(\$13{,}102 + \$10{,}930)/2}$	$\dfrac{\$156{,}508}{(\$10{,}930 + \$5{,}369)/2}$
	$= \dfrac{\$170{,}910}{\$12{,}016}$	$= \dfrac{\$156{,}508}{\$8{,}149.5}$
	= 14.2 times	= 19.2 times

Average collection period

	2013	2012
	$\dfrac{365}{14.2}$ = 25.7 days	$\dfrac{365}{19.2}$ = 19.0 days

(b) The accounts receivable turnover measures the number of times, on average, a company collects accounts receivable during a period. The average collection period measures the number of days it takes to collect a receivable. From the results shown in (a), it is apparent that Apple's accounts receivable collections deteriorated in 2013 over 2012. Both the turnover and the related collection period were worse in 2013 as compared to 2012. However, if Apple's credit terms are 30 days, both years' collection period fall within those terms.