PRACTICE MULTIPLE-CHOICE QUESTIONS

**8-1.** (LO 1)

Receivables are frequently classified as:

(a) accounts receivable, company receivables, and other receivables.

(b) accounts receivable, notes receivable, and employee receivables.

(c) accounts receivable and general receivables.

(d) accounts receivable, notes receivable, and other receivables.

**Answer**

(d) accounts receivable, notes receivable, and other receivables.

**8-2.** (LO 2)

Buehler Company Ltd. on June 15 sells merchandise on account to Chaz Co. for HK$10,000, terms 2/10, n/30. On June 20, Chaz Co. returns merchandise worth HK$3,000 to Buehler. On June 24, payment is received from Chaz Co. for the balance due. What is the amount of cash received?

(a) HK$7,000.

(b) HK$6,800.

(c) HK$6,860.

(d) None of the above.

**Answer**

(c) HK$6,860.

**8-3.** (LO 3)

Which of the following approaches for bad debts is best described as a statement of financial position method?

(a) Percentage-of-receivables basis.

(b) Direct write-off method.

(c) Percentage-of-sales basis.

(d) Both percentage-of-receivables basis and direct write-off method.

**Answer**

(a) Percentage-of-receivables basis.

**8-4.** (LO 3)

Hughes plc has a credit balance of £5,000 in its Allowance for Doubtful Accounts before any adjustments are made at the end of the year. Based on review and aging of its accounts receivable at the end of the year, Hughes estimates that £60,000 of its receivables are uncollectible. The amount of bad debt expense which should be reported for the year is:

(a) £5,000.

(b) £55,000.

(c) £60,000.

(d) £65,000.

**Answer**

(b) £55,000.

**8-5.** (LO 3)

Use the same information as in Question 8-4, except that Hughes has a debit balance of £5,000 in its Allowance for Doubtful Accounts before any adjustments are made at the end of the year. In this situation, the amount of bad debt expense that should be reported for the year is:

(a) £5,000.

(b) £55,000.

(c) £60,000.

(d) £65,000.

**Answer**

(d) £65,000.

**8-6.** (LO 3)

Net sales for the month are ₩800,000,000 and bad debts are expected to be 1.5% of net sales. The company uses the percentage-of-sales basis. If Allowance for Doubtful Accounts has a credit balance of ₩15,000,000 before adjustment, what is the balance after adjustment?

(a) ₩15,000,000.

(b) ₩27,000,000.

(c) ₩23,000,000.

(d) ₩31,000,000.

**Answer**

(b) ₩27,000,000.

**8-7.** (LO 3)

In 2017, Roso Carlson Ltd. had net credit sales of NT$7,500,000. On January 1, 2017, Allowance for Doubtful Accounts had a credit balance of NT$180,000. During 2017, NT$300,000 of uncollectible accounts receivable were written off. Past experience indicates that 3% of net credit sales become uncollectible. What should be the adjusted balance of Allowance for Doubtful Accounts at December 31, 2017?

(a) NT$100,500.

(b) NT$105,000.

(c) NT$225,000.

(d) NT$405,000.

**Answer**

(b) NT$105,000.

**8-8.** (LO 3)

An analysis and aging of the accounts receivable of Prince Company at December 31 reveals the following data.

|  |  |
| --- | --- |
| Accounts receivable | £800,000 |
| Allowance for doubtful accounts |  |
| per books before adjustment | 50,000 |
| Amounts expected to become |  |
| uncollectible | 65,000 |

The cash realizable value of the accounts receivable at December 31, after adjustment, is:

(a) £685,000.

(b) £750,000.

(c) £800,000.

(d) £735,000.

**Answer**

(d) £735,000.

**8-9.** (LO 4)

Which of the following statements about Visa credit sales is **incorrect**?

(a) The credit card issuer makes the credit investigation of the customer.

(b) The retailer is not involved in the collection process.

(c) Two parties are involved.

(d) The retailer receives cash more quickly than it would from individual customers on account.

**Answer**

(c) Two parties are involved.

**8-10.** (LO 4)

Blinka Retailers accepted €50,000 of Citibank Visa credit card charges for merchandise sold on July 1. Citibank charges 4% for its credit card use. The entry to record this transaction by Blinka Retailers will include a credit to Sales Revenue of €50,000 and a debit(s) to:

(a) Cash €48,000

and Service Charge Expense €2,000

(b) Accounts Receivable €48,000

and Service Charge Expense €2,000

(c) Cash €50,000

(d) Accounts Receivable €50,000

**Answer**

(a) Cash €48,000

and Service Charge Expense €2,000

**8-11.** (LO 5)

One of the following statements about promissory notes is incorrect. The **incorrect** statement is:

(a) The party making the promise to pay is called the maker.

(b) The party to whom payment is to be made is called the payee.

(c) A promissory note is not a negotiable instrument.

(d) A promissory note is often required from high-risk customers.

**Answer**

(c) A promissory note is not a negotiable instrument.

**8-12.** (LO 6)

Foti Co. accepts a $1,000, 3-month, 6% promissory note in settlement of an account with Bartelt Co. The entry to record this transaction is as follows.

|  |  |  |  |
| --- | --- | --- | --- |
| (a) | Notes Receivable | 1,015 |  |
|  | Accounts Receivable |  | 1,015 |
|  |  |  |  |
| (b) | Notes Receivable | 1,000 |  |
|  | Accounts Receivable |  | 1,000 |
|  |  |  |  |
| (c) | Notes Receivable | 1,000 |  |
|  | Sales Revenue |  | 1,000 |
|  |  |  |  |
| (d) | Notes Receivable | 1,030 |  |
|  | Accounts Receivable |  | 1,030 |

**Answer**

|  |  |  |  |
| --- | --- | --- | --- |
| (b) | Notes Receivable | 1,000 |  |
|  | Accounts Receivable |  | 1,000 |

**8-13.** (LO 8)

Ginter Co. Ltd. holds Kolar plc's €10,000, 120-day, 9% note. The entry made by Ginter when the note is collected, assuming no interest has been previously accrued, is:

|  |  |  |  |
| --- | --- | --- | --- |
| (a) | Cash | 1,0300 |  |
|  | Notes Receivable |  | 10,300 |
|  |  |  |  |
| (b) | Cash | 10,000 |  |
|  | Notes Receivable |  | 10,000 |
|  |  |  |  |
| (c) | Accounts Receivable | 10,300 |  |
|  | Notes Receivable |  | 10,000 |
|  | Interest Revenue |  | 300 |
|  |  |  |  |
| (d) | Cash | 10,300 |  |
|  | Notes Receivable |  | 10,000 |
|  | Interest Revenue |  | 300 |

**Answer**

|  |  |  |  |
| --- | --- | --- | --- |
| (d) | Cash | 10,300 |  |
|  | Notes Receivable |  | 10,000 |
|  | Interest Revenue |  | 300 |

**8-14.** (LO 9)

Accounts and notes receivable are reported in the current assets section of the statement of financial position at:

(a) cash (net) realizable value.

(b) net book value.

(c) lower-of-cost-or-net realizable value.

(d) invoice cost.

**Answer**

(a) cash (net) realizable value.

**8-15.** (LO 9)

Oliveras Company Ltd. had net credit sales during the year of HK$8,000,000 and cost of goods sold of HK$5,000,000. The balance in accounts receivable at the beginning of the year was HK$1,000,000, and the end of the year it was HK$1,500,000. What were the accounts receivable turnover ratio and the average collection period in days?

(a) 4.0 and 91.3 days.

(b) 5.3 and 68.9 days.

(c) 6.4 and 57 days.

(d) 8.0 and 45.6 days.

**Answer**

(c) 6.4 and 57 days.

QUESTIONS

**8-1.** What is the difference between an account receivable and a note receivable?

**8-2.** What are some common types of receivables other than accounts receivable and notes receivable?

**8-3.** Texaco Oil Company (USA) issues its own credit cards. Assume that Texaco charges you $40 interest on an unpaid balance. Prepare the journal entry that Texaco makes to record this revenue.

**8-4.** What are the essential features of the allowance method of accounting for bad debts?

**8-5.** Roger Holloway cannot understand why cash realizable value does not decrease when an uncollectible account is written off under the allowance method. Clarify this point for Roger Holloway.

**8-6.** Distinguish between the two bases that may be used in estimating uncollectible accounts.

**8-7.** Borke Ltd. has a credit balance of NT$320,000 in Allowance for Doubtful Accounts. The estimated bad debt expense under the percentage-of-sales basis is NT$370,000. The total estimated uncollectibles under the percentage-of-receivables basis is NT$580,000. Prepare the adjusting entry under each basis.

**8-8.** How are bad debts accounted for under the direct write-off method? What are the disadvantages of this method?

**8-9.** Freida ASA accepts both its own credit cards and national credit cards. What are the advantages of accepting both types of cards?

**8-10.** An article recently appeared in the *Wall Street Journal* indicating that companies are selling their receivables at a record rate. Why are companies selling their receivables?

**8-11.** WestSide Textiles decides to sell HK$8,000,000 of its accounts receivable to First Factors Ltd. First Factors assesses a service charge of 3% of the amount of receivables sold. Prepare the journal entry that WestSide Textiles makes to record this sale.

**8-12.** Your roommate is uncertain about the advantages of a promissory note. Compare the advantages of a note receivable with those of an account receivable.

**8-13.** How may the maturity date of a promissory note be stated?

**8-14.** Indicate the maturity date of each of the following promissory notes:

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Date of Note** |  | **Terms** |
| (a) | March 13 |  | one year after date of note |
| (b) | May 4 |  | 3 months after date |
| (c) | June 20 |  | 30 days after date |
| (d) | July 1 |  | 60 days after date |

**8-15.** Compute the missing amounts for each of the following notes.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Principal** |  | **Annual Interest Rate** |  | **Time** |  | **Total Interest** |
| (a) | ? |  | 9% |  | 120 days |  | € 450 |
| (b) | €30,000 |  | 10% |  | 3 years |  | ? |
| (c) | €60,000 |  | ? |  | 5 months |  | €3,000 |
| (d) | €45,000 |  | 8% |  | ? |  | €1,200 |

**8-16.** In determining interest revenue, some financial institutions use 365 days per year and others use 360 days. Why might a financial institution use 360 days?

**8-17.** Jana Company dishonors a note at maturity. What are the options available to the lender?

**8-18.** General Motors Corporation (USA) has accounts receivable and notes receivable. How should the receivables be reported on the statement of financial position?

**8-19.** The accounts receivable turnover ratio is 8.14, and average net receivables during the period are £400,000. What is the amount of net credit sales for the period?

BRIEF EXERCISES

**BE8-1.** *Identify different types of receivables.*

(LO 1)

Presented below are three receivables transactions. Indicate whether these receivables are reported as accounts receivable, notes receivable, or other receivables on a statement of financial position.

(a) Sold merchandise on account for ₩64,000,000 to a customer.

(b) Received a promissory note of ₩57,000,000 for services performed.

(c) Advanced ₩8,000,000 to an employee.

**BE8-2.** *Record basic accounts receivable transactions.*

(LO 2)

Record the following transactions on the books of Galaxy Co.

(a) On July 1, Galaxy Co. sold merchandise on account to Kingston Inc. for $17,200, terms 2/10, n/30.

(b) On July 8, Kingston Inc. returned merchandise worth $3,800 to Galaxy Co.

(c) On July 11, Kingston Inc. paid for the merchandise.

**BE8-3.** *Prepare entry for allowance method and partial statement of financial position.*

(LO 3, 9)

During its first year of operations, Energy Company SE had credit sales of €3,000,000; €600,000 remained uncollected at year-end. The credit manager estimates that €28,000 of these receivables will become uncollectible.

(a) Prepare the journal entry to record the estimated uncollectibles.

(b) Prepare the current assets section of the statement of financial position for Energy Company. Assume that in addition to the receivables it has cash of €90,000, inventory of €118,000, and prepaid insurance of €7,500.

**BE8-4.** *Prepare entry for write-off; determine cash realizable value.*

(LO 3)

At the end of 2017, Endrun Ltd. has accounts receivable of £700,000 and an allowance for doubtful accounts of £54,000. On January 24, 2018, the company learns that its receivable from Marcello is not collectible, and management authorizes a write-off of £6,200.

(a) Prepare the journal entry to record the write-off.

(b) What is the cash realizable value of the accounts receivable (1) before the write-off and (2) after the write-off?

**BE8-5.** *Prepare entries for collection of bad debt write-off.*

(LO 3)

Assume the same information as BE8-4. On March 4, 20158, Endrun Ltd. receives payment of £6,200 in full from Marcello. Prepare the journal entries to record this transaction.

**BE8-6.** *Prepare entry using percentage- of-sales method.*

(LO 3)

Hamblin Co. elects to use the percentage-of-sales basis in 2017 to record bad debt expense. It estimates that 2% of net credit sales will become uncollectible. Sales revenues are $800,000 for 2017, sales returns and allowances are $38,000, and the allowance for doubtful accounts has a credit balance of $9,000. Prepare the adjusting entry to record bad debt expense in 2017.

**BE8-7.** *Prepare entry using percentage- of-receivables method.*

(LO 3)

Shenzhen Co. uses the percentage-of-receivables basis to record bad debt expense. It estimates that 1% of accounts receivable will become uncollectible. Accounts receivable are £420,000 at the end of the year, and the allowance for doubtful accounts has a credit balance of £1,500.

(a) Prepare the adjusting journal entry to record bad debt expense for the year.

(b) If the allowance for doubtful accounts had a debit balance of £740 instead of a credit balance of £1,500, determine the amount to be reported for bad debt expense.

**BE8-8.** *Prepare entries to dispose of accounts receivable.*

(LO 4)

Presented below are two independent transactions.

(a) Fiesta Restaurant accepted a Visa card in payment of a €175 lunch bill. The bank charges a 4% fee. What entry should Fiesta make?

(b) St. Pierre Company AG sold its accounts receivable of €70,000. What entry should St. Pierre make, given a service charge of 3% on the amount of receivables sold?

**BE8-9.** *Compute interest and determine maturity dates on notes.*

(LO 5)

Compute interest and find the maturity date for the following notes.

|  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Date of Note** |  | **Principal** |  | **Interest Rate (%)** |  | **Terms** |
| (a) | June 10 |  | £80,000 |  | 6% |  | 60 days |
| (b) | July 14 |  | £64,000 |  | 7% |  | 90 days |
| (c) | April 27 |  | £12,000 |  | 4% |  | 75 days |

**BE8-10.** *Determine maturity dates and compute interest and rates on notes.*

(LO 5)

Presented below are data on three promissory notes. Determine the missing amounts.

|  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
|  | **Date of Note** |  | **Terms** |  | **Maturity Date** |  | **Principal** |  | **Annual Interest Rate** |  | **Total Interest** |
| (a) | April 1 |  | 60 days |  | ? |  | €600,000 |  | 5% |  | ? |
| (b) | July 2 |  | 30 days |  | ? |  | 90,000 |  | ? |  | €600 |
| (c) | March 7 |  | 6 months |  | ? |  | 120,000 |  | 10% |  | ? |

**BE8-11.** *Prepare entry for notes receivable exchanged for account receivable.*

(LO 6)

On January 10, 2017, Wilfer Ltd. sold merchandise on account to Elgin Co. for HK$80,400, n/30. On February 9, Elgin Co. gave Wilfer Ltd. a 7% promissory note in settlement of this account. Prepare the journal entry to record the sale and the settlement of the account receivable.

**BE8-12.** *Compute ratios to analyze receivables.*

(LO 9)

The financial statements of Minnesota Mining and Manufacturing Company (3M) (USA) report net sales of $20.0 billion. Accounts receivable (net) are $2.7 billion at the beginning of the year and $2.8 billion at the end of the year. Compute 3M's accounts receivable turnover ratio. Compute 3M's average collection period for accounts receivable in days.

**DO IT! REVIEW**

**DO IT! 8-1.** *Prepare entries to recognize accounts receivable.*

(LO 2)

On March 1, Lincoln sold merchandise on account to Amelia SA for €28,000, terms 1/10, net 45. On March 6, Amelia returns merchandise with a sales price of €1,000. On March 11, Lincoln receives payment from Amelia for the balance due. Prepare journal entries to record the March transactions on Lincoln’s books. (You may ignore cost of goods sold entries and explanations.)

**DO IT! 8-2.** *Prepare entry for uncollectible accounts.*

(LO 3)

Amazon SA has been in business several years. At the end of the current year, the ledger shows:

|  |  |
| --- | --- |
| Accounts Receivable | R$ 310,000 Dr. |
| Sales Revenue | 2,200,000 Cr. |
| Allowance for Doubtful Accounts | 4,700 Cr. |

Bad debts are estimated to be 4% of receivables. Prepare the entry to adjust Allowance for Doubtful Accounts.

**DO IT! 8-3.** *Prepare entry for factored accounts.*

(LO 4)

Paltrow Distributors is a growing company whose ability to raise capital has not been growing as quickly as its expanding assets and sales. Paltrow's local banker has indicated that the company cannot increase its borrowing for the foreseeable future. Paltrow's suppliers are demanding payment for goods acquired within 30 days of the invoice date, but Paltrow's customers are slow in paying for their purchases (60-90 days). As a result, Paltrow has a cash flow problem.

Paltrow needs £860,000 to cover next Friday's payroll. Its balance of outstanding accounts receivable totals £1,000,000. To alleviate this cash crunch, the company sells all of its accounts receivable (£1,000,000). Record the entry that Paltrow would make when it raises the needed cash. (Assume a 3% service charge.)

**DO IT! 8-4.** *Prepare entries for notes receivable.*

(LO 5, 8)

Karbon Wholesalers accepts from Bazaar Stores a €6,000, 4-month, 7% note dated May 30 in settlement of Bazaar's overdue account. (a) What is the maturity date of the note? (b) What is the entry made by Karbon at the maturity date, assuming Bazaar pays the note and interest in full at that time?

**DO IT! 8-5.** *Compute ratios for receivables.*

(LO 9)

In 2017, Lauren plc has net credit sales of £1,480,000 for the year. It had a beginning accounts receivable (net) balance of £112,000 and an ending accounts receivable (net) balance of £108,000. Compute Lauren plc's (a) accounts receivable turnover and (b) average collection period in days.

EXERCISES

**E8-1.** *Journalize entries related to accounts receivable.*

(LO 2)

Presented below are selected transactions of Federer AG. Federer sells in large quantities to other companies and also sells its product in a small retail outlet.

March 1 Sold merchandise on account to Lynda Co. for CHF3,800, terms 2/10, n/30.

3 Lynda Co. returned merchandise worth CHF600 to Federer.

9 Federer collected the amount due from Lynda Co. from the March 1 sale.

15 Federer sold merchandise for CHF200 in its retail outlet. The customer used his Federer credit card.

31 Federer added 1.5% monthly interest to the customer's credit card balance.

***Instructions***

Prepare journal entries for the transactions above.

**E8-2.** *Journalize entries for recognizing accounts receivable.*

(LO 2)

Presented below are two independent situations.

(a) On January 6, Bennett Co. sells merchandise on account to Jackie Ltd. for £7,000, terms 2/10, n/30. On January 16, Jackie Inc. pays the amount due. Prepare the entries on Bennett's books to record the sale and related collection.

(b) On January 10, Connor Bybee uses his Sheridan Co. credit card to purchase merchandise from Sheridan Co. for £9,000. On February 10, Bybee is billed for the amount due of £9,000. On February 12, Bybee pays £6,000 on the balance due. On March 10, Bybee is billed for the amount due, including interest at 2% per month on the unpaid balance as of February 12. Prepare the entries on Sheridan Co.'s books related to the transactions that occurred on January 10, February 12, and March 10.

**E8-3.** *Journalize entries to record allowance for doubtful accounts using two different bases.*

(LO 3)

The ledger of Elburn ASA at the end of the current year shows Accounts Receivable €110,000, Sales Revenue €840,000, and Sales Returns and Allowances €28,000.

***Instructions***

(a) If Elburn uses the direct write-off method to account for uncollectible accounts, journalize the adjusting entry at December 31, assuming Elburn determines that T. Thum's €1,500 balance is uncollectible.

(b) If Allowance for Doubtful Accounts has a credit balance of €2,500 in the trial balance, journalize the adjusting entry at December 31, assuming bad debts are expected to be (1) 1% of net sales, and (2) 10% of accounts receivable.

(c) If Allowance for Doubtful Accounts has a debit balance of €200 in the trial balance, journalize the adjusting entry at December 31, assuming bad debts are expected to be (1) 0.75% of net sales and (2) 6% of accounts receivable.

**E8-4.** *Determine bad debt expense; prepare the adjusting entry for bad debt expense.*

(LO 3)

Leland Ltd. has accounts receivable of £98,100 at March 31. Credit terms are 2/10, n/30. At March 31, Allowance for Doubtful Accounts has a credit balance of £900 prior to adjustment. The company uses the percentage-of-receivables basis for estimating uncollectible accounts. The company's estimate of bad debts is shown below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Age of Accounts** |  | **Balance, March 31** |  | **Estimated Percentage Uncollectible** |
| 1-30 days |  | £65,000 |  | 2.0% |
| 31-60 days |  | 17,600 |  | 5.0% |
| 61-90 days |  | 8,500 |  | 30.0% |
| Over 90 days |  | 7,000 |  | 50.0% |
|  |  | £98,100 |  |  |

***Instructions***

(a) Determine the total estimated uncollectibles.

(b) Prepare the adjusting entry at March 31 to record bad debt expense.

**E8-5.** *Journalize write-off and recovery.*

(LO 3)

At December 31, 2016, Crawford Ltd. had a credit balance of £15,000 in Allowance for Doubtful Accounts. During 2017, Crawford wrote off accounts totaling £14,100. One of those accounts (£1,800) was later collected. At December 31, 2017, an aging schedule indicated that the balance in Allowance for Doubtful Accounts should be £17,800.

***Instructions***

Prepare journal entries to record the 2017 transactions of Crawford Ltd.

**E8-6.** *Journalize percentage-of-sales basis, write-off, recovery.*

(LO 3)

On December 31, 2016, Russell NV estimated that 2% of its net sales of €360,000 will become uncollectible. The company recorded this amount as an addition to Allowance for Doubtful Accounts. On May 11, 2017, Russell NV determined that the B. Vetter account was uncollectible and wrote off €1,100. On June 12, 2017, Vetter paid the amount previously written off.

***Instructions***

Prepare the journal entries on December 31, 2016, May 11, 2017, and June 12, 2017.

**E8-7.** *Journalize entries for the sale of accounts receivable.*

(LO 4)

Presented below and on page 412 are two independent situations.

(a) On March 3, Pusan Appliances sells ₩620,000,000 of its receivables to Universal Factors Ltd. Universal Factors assesses a finance charge of 4% of the amount of receivables sold. Prepare the entry on Pusan Appliances' books to record the sale of the receivables.

(b) On May 10, Taejeon Ltd. sold merchandise for ₩3,200,000 and accepted the customer's America Bank MasterCard. America Bank charges a 5% service charge for credit card sales. Prepare the entry on Taejeon's books to record the sale of merchandise.

**E8-8.** *Journalize entries for credit card sales.*

(LO 4)

Presented below are two independent situations.

(a) On April 2, Julie Keiser uses her JCPenney Company credit card to purchase merchandise from a JCPenney store for $1,500. On May 1, Keiser is billed for the $1,500 amount due. Keiser pays $900 on the balance due on May 3. On June 1, Keiser receives a bill for the amount due, including interest at 1.0% per month on the unpaid balance as of May 3. Prepare the entries on JCPenney Co.'s books related to the transactions that occurred on April 2, May 3, and June 1.

(b) On July 4, Avalon Restaurant accepts a Visa card for a $200 dinner bill. Visa charges a 3% service fee. Prepare the entry on Avalon's books related to this transaction.

**E8-9.** *Journalize credit card sales.*

(LO 4)

Hong Kong Stores accepts both its own and national credit cards. During the year, the following selected summary transactions occurred.

Jan. 15 Made Hong Kong credit card sales totaling HK$17,000. (There were no balances prior to January 15.)

20 Made Visa credit card sales (service charge fee 2%) totaling HK$4,800.

Feb. 10 Collected HK$11,000 on Hong Kong credit card sales.

15 Added finance charges of 1.5% to Hong Kong credit card account balances.

***Instructions***

(a) Journalize the transactions for Hong Kong Stores.

(b) Indicate the statement presentation of the financing charges and the credit card service charge expense for Hong Kong Stores.

**E8-10.** *Journalize entries for notes receivable transactions.*

(LO 5, 6)

Reeves Supply plc has the following transactions related to notes receivable during the last 2 months of 2017. The company does not make entries to accrue interest except at December 31.

Nov. 1 Loaned £15,000 cash to Norma Jeanne on a 12-month, 9% note.

Dec. 11 Sold goods to Bob Sharbo, Inc., receiving a £6,750, 90-day, 8% note.

16 Received a £4,400, 180-day, 12% note in exchange for Richard Russo's outstanding accounts receivable.

31 Accrued interest revenue on all notes receivable.

***Instructions***

(a) Journalize the transactions for Reeves Supply.

(b) Record the collection of the Jeanne note at its maturity in 2018.

**E8-11.** *Journalize entries for notes receivable.*

(LO 5, 6)

Record the following transactions for Taylor Co. in the general journal.

|  |  |  |
| --- | --- | --- |
| **2017** |  |  |
| May 1 | | Received a €7,500, 12-month, 8% note in exchange for Len Monroe's outstanding accounts receivable. |
| Dec. 31 | | Accrued interest on the Monroe note. |
| Dec. 31 | | Closed the interest revenue account. |
|  | |  |
| **2018** |  |  |
| May 1 | | Received principal plus interest on the Monroe note. (No interest has been accrued in 2018.) |

**E8-12.** *Prepare entries for note receivable transactions.*

(LO 5, 6, 8)

Bieber Ltd. had the following select transactions.

May 1, 2017 Accepted Crane Company's 12-month, 12% note in settlement of a £16,000 account 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; Bieber expects it will eventually collect.

May 1, 2018 Received principal plus interest on the Crane note.

***Instructions***

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

**E8-13.** *Journalize entries for dishonor of notes receivable.*

(LO 5, 8)

On May 2, Nanjing Ltd. lends ¥7,600,000 to Cortland Ltd., issuing a 3-month, 7% note. At the maturity date, August 2, Cortland indicates that it cannot pay.

***Instructions***

(a) Prepare the entry to record the issuance of the note.

(b) Prepare the entry to record the dishonor of the note, assuming that Nanjing Company expects collection will occur.

(c) Prepare the entry to record the dishonor of the note, assuming that Nanjing Company does not expect collection in the future.

**E8-14.** *Compute accounts receivable turnover and average collection period.*

(LO 9)

Lashkova A/S had accounts receivable of €100,000 on January 1, 2017. The only transactions that affected accounts receivable during 2017 were net credit sales of €1,000,000, cash collections of €920,000, and accounts written off of €30,000.

***Instructions***

(a) Compute the ending balance of accounts receivable.

(b) Compute the accounts receivable turnover ratio for 2017.

(c) Compute the average collection period in days.

PROBLEMS: SET A AND PROBLEMS: SET B

**P8-1A** *Prepare journal entries related to bad debt expense.*

(LO 2, 3, 9)

At December 31, 2016, Cafu SA reported the following information on its statement of financial position.

|  |  |
| --- | --- |
| Accounts receivable | R$960,000 |
| Less: Allowance for doubtful accounts | 66,000 |

During 2017, the company had the following transactions related to receivables.

|  |  |
| --- | --- |
| 1. Sales on account | R$3,315,000 |
| 2. Sales returns and allowances | 50,000 |
| 3. Collections of accounts receivable | 2,810,000 |
| 4. Write-offs of accounts receivable deemed uncollectible | 88,000 |
| 5. Recovery of bad debts previously written off as uncollectible | 29,000 |

***Instructions***

(a) Prepare the journal entries to record each of these five transactions. Assume that no cash discounts were taken on the collections of accounts receivable.

(b) Enter the January 1, 2017, balances in Accounts Receivable and Allowance for Doubtful Accounts, post the entries to the two accounts (use T-accounts), and determine the balances.

Accounts receivable R$1,327,000 ADA R$7,000

(c) Prepare the journal entry to record bad debt expense for 2017, assuming that an aging of accounts receivable indicates that expected bad debts are R$125,000.

Bad debt expense R$118,000

(d) Compute the accounts receivable turnover ratio for 2017, assuming the expected bad debt information presented in (c).

**P8-2A** *Compute bad debt amounts.*

(LO 3)

Information related to Hamilton plc for 2017 is summarized below.

|  |  |
| --- | --- |
| Total credit sales | £2,500,000 |
| Accounts receivable at December 31 | 970,000 |
| Bad debts written off | 66,000 |

***Instructions***

(a) What amount of bad debt expense will Hamilton report if it uses the direct write-off method of accounting for bad debts?

(b) Assume that Hamilton estimates its bad debt expense to be 3% of credit sales. What amount of bad debt expense will Hamilton record if it has an Allowance for Doubtful Accounts credit balance of £4,000?

(c) Assume that Hamilton estimates its bad debt expense based on 7% of accounts receivable. What amount of bad debt expense will Hamilton record if it has an Allowance for Doubtful Accounts credit balance of £3,000?

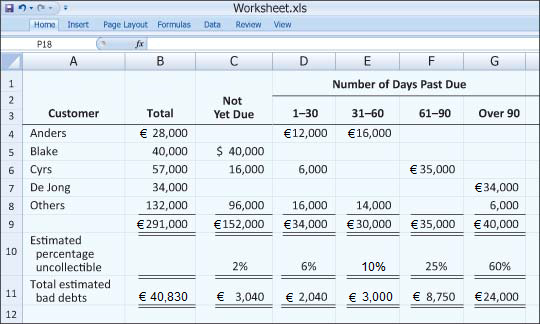
(d) Assume the same facts as in (c), except that there is a £3,000 debit balance in Allowance for Doubtful Accounts. What amount of bad debt expense will Hamilton record?

(e) What is the weakness of the direct write-off method of reporting bad debt expense?

**P8-3A** *Journalize entries to record transactions related to bad debts.*

(LO 2, 3)

Presented below is an aging schedule for Sycamore AG.



At December 31, 2017, the unadjusted balance in Allowance for Doubtful Accounts is a credit of €9,200.

***Instructions***

(a) Journalize and post the adjusting entry for bad debts at December 31, 2017.

Bad debt expense €31,630

(b) Journalize and post to the allowance account the following events and transactions in the year 2018.

1. On March 31, a €1,000 customer balance originating in 2017 is judged uncollectible.

2. On May 31, a check for €1,000 is received from the customer whose account was written off as uncollectible on March 31.

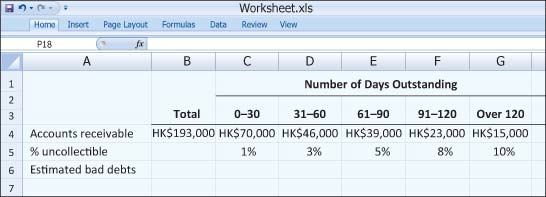
(c) Journalize the adjusting entry for bad debts on December 31, 2018, assuming that the unadjusted balance in Allowance for Doubtful Accounts is a debit of €1,100 and the aging schedule indicates that total estimated bad debts will be €31,600.

Bad debt expense €32,700

**P8-4A** *Journalize transactions related to bad debts.*

(LO 2, 3)

Hú Ltd. uses the allowance method to estimate uncollectible accounts receivable. The company produced the following aging of the accounts receivable at year-end.



***Instructions***

(a) Calculate the total estimated bad debts based on the above information.

Tot. est. bad debts HK$7,370

(b) Prepare the year-end adjusting journal entry to record the bad debts using the aged uncollectible accounts receivable determined in (a). Assume the current balance in Allowance for Doubtful Accounts is a HK$3,000 debit.

(c) Of the above accounts, HK$5,000 is determined to be specifically uncollectible. Prepare the journal entry to write off the uncollectible account.

(d) The company collects HK$5,000 subsequently on a specific account that had previously been determined to be uncollectible in (c). Prepare the journal entry(ies) necessary to restore the account and record the cash collection.

(e) Comment on how your answers to (a)-(d) would change if Hú Ltd. used 3% of **total** accounts receivable, rather than aging the accounts receivable. What are the advantages to the company of aging the accounts receivable rather than applying a percentage to total accounts receivable?

**P8-5A** *Journalize entries to record transactions related to bad debts.*

(LO 3)

At December 31, 2017, the trial balance of Roberto SpA contained the following amounts before adjustment.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Debits** |  | **Credits** |
| Accounts Receivable | €385,000 |  |  |
| Allowance for Doubtful Accounts |  |  | € 800 |
| Sales Revenue |  |  | 918,000 |

***Instructions***

(a) Based on the information given, which method of accounting for bad debts is Roberto using—the direct write-off method or the allowance method? How can you tell?

(b) Prepare the adjusting entry at December 31, 2017, for bad debt expense under each of the following independent assumptions.

(2) €9,180

1. An aging schedule indicates that €12,400 of accounts receivable will be uncollectible.

2. The company estimates that 1% of sales will be uncollectible.

(c) Repeat part (b) assuming that instead of a credit balance there is an €960 debit balance in Allowance for Doubtful Accounts.

(d) During the next month, January 2018, a €3,000 account receivable is written off as uncollectible. Prepare the journal entry to record the write-off.

(e) Repeat part (d) assuming that Roberto uses the direct write-off method instead of the allowance method in accounting for uncollectible accounts receivable.

(f) What type of account is Allowance for Doubtful Accounts? How does it affect how accounts receivable is reported on the statement of financial position at the end of the accounting period?

**P8-6A** *Prepare entries for various notes receivable transactions.*

(LO 2, 4, 5, 8, 9)

Hilo Ltd. closes its books monthly. On September 30, selected ledger account balances are:

|  |  |
| --- | --- |
| Notes Receivable | £31,000 |
| Interest Receivable | 170 |

Notes Receivable include the following.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** |  | **Maker** |  | **Face** |  | **Term** |  | **Interest** |
| Aug. 16 |  | Demaster Ltd. |  | £8,000 |  | 60 days |  | 8% |
| Aug. 25 |  | Skinner Co. |  | 9,000 |  | 60 days |  | 10% |
| Sept. 30 |  | Almer Ltd. |  | 14,000 |  | 6 months |  | 9% |

Interest is computed using a 360-day year. During October, the following transactions were completed.

Oct. 7 Made sales of £6,300 on Hilo credit cards.

12 Made sales of £1,200 on MasterCard credit cards. The credit card service charge is 3%.

15 Added £460 to Hilo customer balance for finance charges on unpaid balances.

15 Received payment in full from Demaster Ltd. on the amount due.

24 Received notice that the Skinner note has been dishonored. (Assume that Skinner is expected to pay in the future.)

***Instructions***

(a) Journalize the October transactions and the October 31 adjusting entry for accrued interest receivable.

(b) Enter the balances at October 1 in the receivable accounts. Post the entries to all of the receivable accounts.

Accounts receivable £15,910

(c) Show the statement of financial position presentation of the receivable accounts at October 31.

Total receivables £30,015

**P8-7A** *Prepare entries for various receivable transactions.*

(LO 2, 4, 5, 6, 7, 8)

On January 1, 2017, Derek Co. had Accounts Receivable €139,000, Notes Receivable €30,000, and Allowance for Doubtful Accounts €13,200. The note receivable is from Kaye Noonan Ltd. It is a 4-month, 9% note dated December 31, 2016. Derek prepares financial statements annually at December 31. During the year, the following selected transactions occurred.

Jan. 5 Sold €24,000 of merchandise to Zwingle SE, terms n/15.

20 Accepted Zwingle's €24,000, 3-month, 6% note for balance due.

Feb. 18 Sold €8,000 of merchandise to Gerard AG and accepted Gerard's €8,000, 6-month, 7% note for the amount due.

Apr. 20 Collected Zwingle note in full.

30 Received payment in full from Kaye Noonan on the amount due.

May 25 Accepted Isabella Ltd.'s €4,000, 3-month, 7% note in settlement of a past-due balance on account.

Aug. 18 Received payment in full from Gerard on note due.

25 The Isabella note was dishonored. Isabella is not bankrupt; future payment is anticipated.

Sept. 1 Sold €10,000 of merchandise to Fernando Co. and accepted a €10,000, 6-month, 8% note for the amount due.

***Instructions***

Journalize the transactions.

**Problems: Set B**

**P8-1B** *Prepare journal entries related to bad debt expense.*

(LO 2, 3, 9)

At December 31, 2016, Globe Trotter Imports reported the following information on its statement of financial position.

|  |  |
| --- | --- |
| Accounts receivable | €220,000 |
| Less: Allowance for doubtful accounts | 15,000 |

During 2017, the company had the following transactions related to receivables.

|  |  |
| --- | --- |
| 1. Sales on account | €2,400,000 |
| 2. Sales returns and allowances | 45,000 |
| 3. Collections of accounts receivable | 2,250,000 |
| 4. Write-offs of accounts receivable deemed uncollectible | 10,600 |
| 5. Recovery of bad debts previously written off as uncollectible | 2,000 |

***Instructions***

(a) Prepare the journal entries to record each of these five transactions. Assume that no cash discounts were taken on the collections of accounts receivable.

(b) Enter the January 1, 2017, balances in Accounts Receivable and Allowance for Doubtful Accounts. Post the entries to the two accounts (use T-accounts), and determine the balances.

Accounts receivable €314,400

ADA €6,400

(c) Prepare the journal entry to record bad debt expense for 2017, assuming that an aging of accounts receivable indicates that estimated bad debts are €21,400.

Bad debt expense €15,000

(d) Compute the accounts receivable turnover ratio for the year 2017, assuming the expected bad debt information presented in (c).

**P8-2B** *Compute bad debt amounts.*

(LO 3)

Information related to Izmir A.S. for 2017 is summarized below.

|  |  |
| --- | --- |
| Total credit sales | [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)920,000 |
| Accounts receivable at December 31 | 369,000 |
| Bad debts written off | 23,400 |

***Instructions***

(a) What amount of bad debt expense will Izmir report if it uses the direct write-off method of accounting for bad debts?

(b) Assume that Izmir decides to estimate its bad debt expense to be 3% of credit sales. What amount of bad debt expense will Izmir record if Allowance for Doubtful Accounts has a credit balance of [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)3,000?

(c) Assume that Izmir Company decides to estimate its bad debt expense based on 7% of accounts receivable. What amount of bad debt expense will Izmir Company record if Allowance for Doubtful Accounts has a credit balance of   
4,000?



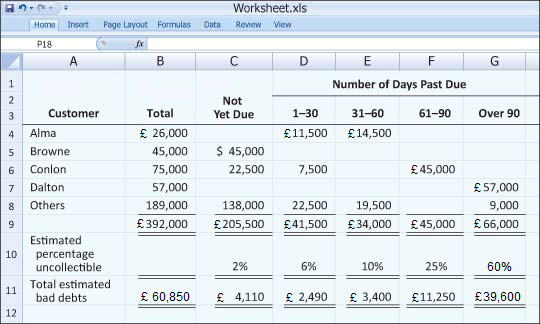
(d) Assume the same facts as in (c), except that there is a [Turkish lira symbol black.svg](http://zh.wikipedia.org/wiki/%E5%9C%9F%E8%80%B3%E5%85%B6%E9%87%8C%E6%8B%89%E7%AC%A6%E5%8F%B7)2,000 debit balance in Allowance for Doubtful Accounts. What amount of bad debt expense will Izmir record?

(e) What is the weakness of the direct write-off method of reporting bad debt expense?

**P8-3B** *Journalize entries to record transactions related to bad debts.*

(LO 2, 3)

Presented below is an aging schedule for Garry Owen plc.



At December 31, 2017, the unadjusted balance in Allowance for Doubtful Accounts is a credit of £14,000.

***Instructions***

(a) Journalize and post the adjusting entry for bad debts at December 31, 2017.

Bad debt expense £46,850

(b) Journalize and post to the allowance account the following events and transactions in the year 2018.

1. March 1, a £1,900 customer balance originating in 2017 is judged uncollectible.

2. May 1, a check for £1,900 is received from the customer whose account was written off as uncollectible on March 1.

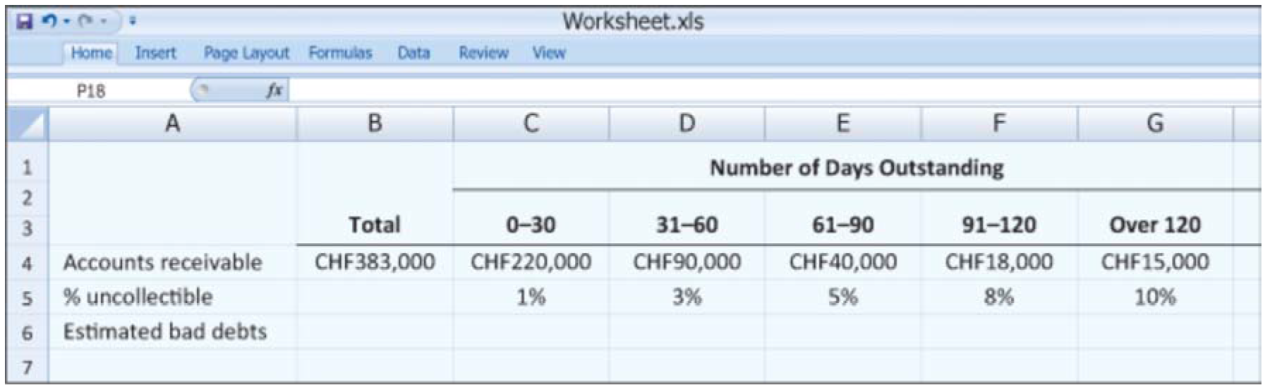
(c) Journalize the adjusting entry for bad debts on December 31, 2018. Assume that the unadjusted balance in Allowance for Doubtful Accounts is a debit of £3,400, and the aging schedule indicates that total estimated bad debts will be £48,300.

Bad debt expense £51,700

**P8-4B** *Journalize transactions related to bad debts.*

(LO 3)

The following represents selected information taken from a company's aging schedule to estimate uncollectible accounts receivable at year-end.



***Instructions***

(a) Calculate the total estimated bad debts based on the above information.

Tot. est. bad debts CHF9,840

(b) Prepare the year-end adjusting journal entry to record the bad debts using the allowance method and the aged uncollectible accounts receivable determined in (a). Assume the current balance in Allowance for Doubtful Accounts is a CHF1,600 credit.

(c) Of the above accounts, CHF1,100 is determined to be specifically uncollectible. Prepare the journal entry to write off the uncollectible accounts.

(d) The company subsequently collects CHF700 on a specific account that had previously been determined to be uncollectible in (c). Prepare the journal entry(ies) necessary to restore the account and record the cash collection.

(e) Explain how establishing an allowance account satisfies the expense recognition principle.

**P8-5B** *Journalize entries to record transactions related to bad debts.*

(LO 3)

At December 31, 2017, the trial balance of Mariette SA contained the following amounts before adjustment.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Debits** |  | **Credits** |
| Accounts Receivable | €250,000 |  |  |
| Allowance for Doubtful Accounts |  |  | € 1,900 |
| Sales Revenue |  |  | 600,000 |

***Instructions***

(a) Prepare the adjusting entry at December 31, 2017, to record bad debt expense under each of the following independent assumptions.

1. An aging schedule indicates that €13,800 of accounts receivable will be uncollectible.

2. The company estimates that 2% of sales will be uncollectible.

(2) €12,000

(b) Repeat part (a) assuming that instead of a credit balance, there is a €1,900 debit balance in Allowance for Doubtful Accounts.

(c) During the next month, January 2018, a €3,000 account receivable is written off as uncollectible. Prepare the journal entry to record the write-off.

(d) Repeat part (c) assuming that Mariette Company uses the direct write-off method instead of the allowance method in accounting for uncollectible accounts receivable.

(e) What are the advantages of using the allowance method in accounting for uncollectible accounts as compared to the direct write-off method?

**P8-6B** *Prepare entries for various notes receivable transactions.*

(LO 2, 4, 5, 8, 9)

Gehrig Co. closes its books monthly. On June 30, selected ledger account balances are:

|  |  |
| --- | --- |
| Notes Receivable | €60,000 |
| Interest Receivable | 435 |

Notes Receivable include the following.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Date** |  | **Maker** |  | **Face** |  | **Term** |  | **Interest** |
| May 16 |  | Fulton Ltd. |  | €12,000 |  | 60 days |  | 9% |
| May 25 |  | Ascot Co. |  | 30,000 |  | 60 days |  | 10% |
| June 30 |  | Trayer Corp. |  | 18,000 |  | 6 months |  | 12% |

During July, the following transactions were completed.

July 5 Made sales of €7,200 on Gehrig Co. credit cards.

14 Made sales of €1,300 on Visa credit cards. The credit card service charge is 3%.

14 Added €510 to Gehrig Co. credit card customer balances for finance charges on unpaid balances.

15 Received payment in full from Fulton Ltd. on the amount due.

24 Received notice that the Ascot Co. note has been dishonored. (Assume that Ascot Co. is expected to pay in the future.)

***Instructions***

(a) Journalize the July transactions and the July 31 adjusting entry for accrued interest receivable. (Interest is computed using 360 days.)

(b) Enter the balances at July 1 in the receivable accounts. Post the entries to all of the receivable accounts.

Accounts receivable €38,210

(c) Show the statement of financial position presentation of the receivable accounts at July 31.

Total receivables €56,390

**P8-7B** *Prepare entries for various receivable transactions.*

(LO 2, 4, 5, 6, 7, 8)

On January 1, 2017, Valdez SA had Accounts Receivable €91,000 and Allowance for Doubtful Accounts €8,100. Valdez Company prepares financial statements annually at December 31. During the year, the following selected transactions occurred.

Jan. 5 Sold €8,400 of merchandise to Patrick Co., terms n/30.

Feb. 2 Accepted an €8,400, 4-month, 5% promissory note from Patrick Company for the balance due.

12 Sold €13,500 of merchandise to Marguerite SA and accepted Marguerite's €13,500, 2-month, 6% note for the balance due.

26 Sold €7,000 of merchandise to Felton Co., terms n/10.

Apr. 5 Accepted a €7,000, 3-month, 8% note from Felton Co. for the balance due.

12 Collected Marguerite Company note in full.

June 2 Collected Patrick Company note in full.

July 5 Felton Co. dishonors its note of April 5. It is expected that Felton will eventually pay the amount owed.

15 Sold €11,000 of merchandise to Planke Co. and accepted Planke's €11,000, 3-month, 8% note for the amount due.

Oct. 15 Planke Co.'s note was dishonored. Planke Co. is bankrupt, and there is no hope of future settlement.

***Instructions***

Journalize the transactions.

COMPREHENSIVE PROBLEM

**8-CP8** Victoria Company's statement of financial position at December 31, 2016, is presented below.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **VICTORIA COMPANY, LTD**  **Statement of Financial Position**  **December 31, 2016** | | | | |
| Inventory | £9,400 |  | Share capital—ordinary | £20,000 |
| Accounts receivable | 19,780 |  | Retained earnings | 12,730 |
| Allowance for doubtful accounts | (800) |  | Accounts payable | 8,750 |
| Cash | 13,100 |  |  | £41,480 |
|  | £41,480 |  |  |  |

During January 2017, the following transactions occurred. Victoria uses the perpetual inventory method.

Jan. 1 Victoria accepted a 4-month, 8% note from Leon plc in payment of Leon's £1,500 account.

3 Victoria wrote off as uncollectible the accounts of Barker Ltd. (£450) and Elmo Co. (£330).

8 Victoria purchased £17,200 of inventory on account.

11 Victoria sold for £25,000 on account inventory that cost £17,500.

15 Victoria sold inventory that cost £780 to Joe Haribo for £1,200. Haribo charged this amount on his Visa First Bank card. The service fee charged Victoria by First Bank is 3%.

17 Victoria collected £22,900 from customers on account.

21 Victoria paid £16,300 on accounts payable.

24 Victoria received payment in full (£330) from Elmo Company on the account written off on January 3.

27 Victoria purchased supplies for £1,400 cash.

31 Victoria paid other operating expenses, £3,218.

Adjustment data:

1. Interest is recorded for the month on the note from January 1.

2. Bad debts are expected to be 5% of the January 31, 2017, accounts receivable.

3. A count of supplies on January 31, 2017, reveals that £470 remains unused.

***Instructions***

(You may want to set up T-accounts to determine ending balances.)

(a) Prepare journal entries for the transactions listed above and adjusting entries. (Include entries for cost of goods sold using the perpetual system.)

(b) Prepare an adjusted trial balance at January 31, 2017.

(c) Prepare an income statement and a retained earnings statement for the month ending January 31, 2017, and a classified statement of financial position as of January 31, 2017.

MATCHA CREATIONS

(*Note*: This is a continuation of the Matcha Creations problem from Chapter 1-7.)

**MC8**One of Mei-ling's friends, Curtis Lesperance, runs a coffee shop where he sells specialty coffees and prepares and sells muffins and cookies. He is eager to buy one of Mei-ling's fine European mixers, which would enable him to make larger batches of muffins and cookies. However, Curtis cannot afford to pay for the mixer for at least 30 days. He asks Mei-ling if she would be willing to sell him the mixer on credit. Mei-ling comes to you for advice.

**Broadening Your Perspective**

Financial Reporting and Analysis

**BYP8-1. Financial Reporting Problem**

CAF AG sells office equipment and supplies to many organizations in the city and surrounding area on contract terms of 2/10, n/30. In the past, over 75% of the credit customers have taken advantage of the discount by paying within 10 days of the invoice date.

The number of customers taking the full 30 days to pay has increased within the last year. Current indications are that less than 60% of the customers are now taking the discount. Bad debts as a percentage of gross credit sales have risen from the 2.5% provided in past years to about 4.5% in the current year.

The company's Finance Committee has requested more information on the collections of accounts receivable. The controller responded to this request with the report reproduced below.

**CAF AG**

**Accounts Receivable Collections**

**May 31, 2017**

The fact that some credit accounts will prove uncollectible is normal. Annual bad debt write-offs have been 2.5% of gross credit sales over the past 5 years. During the last fiscal year, this percentage increased to slightly less than 4.5%. The current Accounts Receivable balance is €1,400,000. The condition of this balance in terms of age and probability of collection is as follows.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Proportion of Total** |  | **Age Categories** |  | **Probability of Collection** |
| 60% |  | not yet due |  | 98% |
| 22% |  | less than 30 days past due |  | 96% |
| 9% |  | 30 to 60 days past due |  | 94% |
| 5% |  | 61 to 120 days past due |  | 91% |
| % |  | 121 to 180 days past due |  | 75% |
| % |  | over 180 days past due |  | 30% |

Allowance for Doubtful Accounts had a credit balance of €29,500 on June 1, 2016. CAF has provided for a monthly bad debt expense accrual during the current fiscal year based on the assumption that 4.5% of gross credit sales will be uncollectible. Total gross credit sales for the 2016-2017 fiscal year amounted to €2,800,000. Write-offs of bad accounts during the year totaled €102,000.

***Instructions***

(a) Prepare an accounts receivable aging schedule for CAF Company using the age categories identified in the controller's report to the Finance Committee showing the following.

1. The amount of accounts receivable outstanding for each age category and in total.

2. The estimated amount that is uncollectible for each category and in total.

(b) Compute the amount of the year-end adjustment necessary to bring Allowance for Doubtful Accounts to the balance indicated by the age analysis. Then prepare the necessary journal entry to adjust the accounting records.

(c) In a recessionary environment with tight credit and high interest rates:

1. Identify steps CAF Company might consider to improve the accounts receivable situation.

2. Then evaluate each step identified in terms of the risks and costs involved.

**BYP8-2. Comparative Analysis Problem: Nestlé SA (CHE) vs. Petra Foods Ltd. (SGP)**

Nestlé's financial statements are presented in Appendix B. Financial statements of Petra Foods are presented in Appendix C.

***Instructions***

(a) Based on the information in these financial statements, compute the following ratios for each company for the most recent fiscal year shown. (Assume all sales are credit sales and that all receivables are trade receivables.)

1. Accounts receivable turnover ratio.

2. Average collection period for receivables.

(b) What conclusions about managing accounts receivable can you draw from these data?

**BYP8-3. Real-World Focus**

***Purpose:*** To learn more about factoring from websites that provide factoring services.

***Address:* www.comccapfactoring.com**

***Steps:*** Go to the website, click on **Invoice Factoring**, and answer the following questions.

(a) What are some of the benefits of factoring?

(b) What is the range of the percentages of the typical discount rate?

(c) If a company factors its receivables, what percentage of the value of the receivables can it expect to receive from the factor in the form of cash, and how quickly will it receive the cash?

Critical Thinking

**BYP8-4. Decision-Making Across the Organization**

Hilda and Tim Piwek own Campus Fashions. From its inception, Campus Fashions has sold merchandise on either a cash or credit basis, but no credit cards have been accepted. During the past several months, the Piweks have begun to question their sales policies. First, they have lost some sales because of refusing to accept credit cards. Second, representatives of two metropolitan banks have been persuasive in almost convincing them to accept their national credit cards. One bank, City National Bank, has stated that its credit card fee is 4%.

The Piweks decide that they should determine the cost of carrying their own credit sales. From the accounting records of the past 3 years, they accumulate the following data.

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
|  | **2017** |  | **2016** |  | **2015** |
| Net credit sales | €500,000 |  | €650,000 |  | €400,000 |
| Collection agency fees for slow-paying |  |  |  |  |  |
| customers | 2,450 |  | 2,500 |  | 2,300 |
| Salary of part-time accounts receivable clerk | 4,100 |  | 4,100 |  | 4,100 |

Credit and collection expenses as a percentage of net credit sales are uncollectible accounts 1.6%, billing and mailing costs 0.5%, and credit investigation fee on new customers 0.15%.

Hilda and Tim also determine that the average accounts receivable balance outstanding during the year is 5% of net credit sales. The Piweks estimate that they could earn an average of 8% annually on cash invested in other business opportunities.

***Instructions***

With the class divided into groups, answer the following.

(a) Prepare a table showing, for each year, total credit and collection expenses in dollars and as a percentage of net credit sales.

(b) Determine the net credit and collection expense in dollars and as a percentage of sales after considering the revenue not earned from other investment opportunities.

(c) Discuss both the financial and non-financial factors that are relevant to the decision.

**BYP8-5. Communication Activity**

Lily Pao, a friend of yours, overheard a discussion at work about changes her employer wants to make in accounting for uncollectible accounts. Lily knows little about accounting, and she asks you to help make sense of what she heard. Specifically, she asks you to explain the differences between the percentage-of-sales, percentage-of-receivables, and the direct write-off methods for uncollectible accounts.

***Instructions***

In a letter of one page (or less), explain to Lily the three methods of accounting for uncollectibles. Be sure to discuss differences among these methods.

**BYP8-6. Ethics Case**

The controller of Vestin Co. believes that the yearly allowance for doubtful accounts for Vestin Co. should be 2% of net credit sales. The president of Vestin Co., nervous that the shareholders might expect the company to sustain its 10% growth rate, suggests that the controller increase the allowance for doubtful accounts to 4%. The president thinks that the lower net income, which reflects a 6% growth rate, will be a more sustainable rate for Vestin Co.

***Instructions***

(a) Who are the stakeholders in this case?

(b) Does the president's request pose an ethical dilemma for the controller?

(c) Should the controller be concerned with Vestin Co.'s growth rate? Explain your answer.

A LOOK at U.S. GAAP

The basic accounting and reporting issues related to recognition and measurement of receivables, such as the use of allowance accounts, how to record trade and sales discounts, use of percentage-of-sales and percentage-of-receivables methods, and factoring, are essentially the same under both IFRS and GAAP.

**Key Points**

* Receivables are generally reported in the current assets section of the statement of financial position (balance sheet) under GAAP and IFRS. However, companies that use GAAP report receivables in the current assets section generally after cash, based on liquidity. IFRS often does not use liquidity as a basis for placement in the current assets section. As a result, receivables are often reported after inventory and other current assets except for cash.
* Like the IASB, the FASB has worked to implement fair value measurement for all financial instruments, but both Boards have faced bitter opposition from various factions. As a consequence, the Boards have adopted a piecemeal approach; the first step is disclosure of fair value information in the notes. The second step is the fair value option, which permits, but does not require, companies to record some types of financial instruments at fair value in the financial statements. Both Boards have indicated that they believe all financial instruments should be recorded and reported at fair value.
* Recently, the FASB and IASB completed a project on how to measure fair value. The project, however, was silent on when to report fair value.

**Similarities**

* + GAAP and IFRS account for bad debts in a similar fashion. Both account for short-term receivables at amortized cost, adjusted for allowances for doubtful accounts.

**Differences**

* + IFRS and GAAP differ in the criteria used to derecognize (generally through a sale or factoring) a receivable. IFRS uses a combination approach focused on risks and rewards and loss of control. GAAP uses loss of control as the primary criterion. In addition, IFRS permits partial derecognition; GAAP does not.
  + IFRS specifies a two-step process for determining the impairment of receivables for a period. This process starts by identifying individual impairments of specific receivables and then estimating impairments of groups of receivables. GAAP does not specify a similar approach.

**Looking to the Future**

It appears likely that the question of recording fair values for financial instruments will continue to be an important issue to resolve as the Boards work toward convergence. Both the IASB and the FASB have indicated that they believe that financial statements would be more transparent and understandable if companies recorded and reported all financial instruments at fair value.

That said, in *IFRS 9*, which was issued in 2009, the IASB created a split model, where some financial instruments are recorded at fair value, but other financial assets, such as loans and receivables, can be accounted for at amortized cost if certain criteria are met. Critics say that this can result in two companies with identical securities accounting for those securities in different ways. A proposal by the FASB would require that nearly all financial instruments, including loans and receivables, be accounted for at fair value. It has been suggested that *IFRS 9* will likely be changed or replaced as the FASB and IASB continue to deliberate the best treatment for financial instruments. In fact, one past member of the IASB said that companies should ignore *IFRS 9* and continue to report under the old standard because, in his opinion, it was extremely likely that it would be changed before the mandatory adoption date of the standard.

**GAAP Practice**

**GAAP Self-Test Questions**

**1.** Under GAAP, receivables are reported on the balance sheet at:

(a) amortized cost.

(b) amortized cost adjusted for estimated loss allowances.

(c) historical cost.

(d) replacement cost.

**Answer**

(b) amortized cost adjusted for estimated loss allowances.

**2.** Which of the following statements is **false**?

(a) Receivables include equity securities purchased by the company.

(b) Receivables include credit card receivables.

(c) Receivables include amounts owed by employees as a result of company loans to employees.

(d) Receivables include amounts resulting from transactions with customers.

**Answer**

(a) Receivables include equity securities purchased by the company.

**3.** In recording a factoring transaction:

(a) IFRS focuses on loss of control.

(b) GAAP focuses on loss of control and risks and rewards.

(c) IFRS and GAAP allow partial derecognition.

(d) IFRS allows partial derecognition.

**Answer**

(d) IFRS allows partial derecognition.

**4.** Under IFRS:

(a) the entry to record estimated uncollected accounts is the same as GAAP.

(b) receivables should only be tested for impairment as a group.

(c) it is always acceptable to use the direct write-off method.

(d) all financial instruments are recorded at fair value.

**Answer**

(a) the entry to record estimated uncollected accounts is the same as GAAP.

**5.** Which of the following statements is **true**?

(a) The fair value option requires that some types of financial instruments be recorded at fair value.

(b) The fair value option requires that some types of financial instruments be recorded at amortized cost.

(c) The fair value option allows, but does not require, that some types of financial instruments be recorded at fair value.

(d) The FASB and IASB would like to reduce the reliance on fair value accounting for financial instruments in the future.

**Answer**

(c) The fair value option allows, but does not require, that some types of financial instruments be recorded at fair value.

**GAAP Exercises**

**GAAP8-1.** What are some steps taken by both the FASB and IASB to move to fair value measurement for financial instruments? In what ways have some of the approaches differed?

**GAAP Financial Reporting Problem: Apple Inc.**

**GAAP8-2.** The financial statements of Apple are presented in Appendix D. The company's complete annual report, including the notes to its financial statements, is available at *http://investor.apple.com*.

**Instructions**

Use the company's financial statements and notes to the financial statements to answer the following questions.

(a) Calculate the accounts receivable turnover ratio and average collection period for 2013 and 2012. Accounts receivable at September 25, 2011, was $5,369 (in thousands).

(b) What conclusions can you draw from the information in part (a)?