Chapter 6

Reporting and Interpreting Sales Revenue, Receivables, and Cash

ANSWERS TO QUESTIONS

1. The difference between sales revenue and net sales includes the amount of goods returned by customers because the goods were either unsatisfactory or not desired, sales discounts given to business customers, and credit card fees charged by credit card companies (also refer to the answers given below to questions 3, 4 and 5).

2. Gross profit or gross margin on sales is the difference between net sales and cost of goods sold. For example, assuming sales of $100,000, and cost of goods sold of $60,000, the gross profit on sales would be $40,000.

3. A credit card discount is the fee charged by the credit card company for services. When a company deposits its credit card receipts in the bank, it only receives credit for the sales amount less the discount. The credit card discount account either decreases net sales (it is a contra revenue) or increases selling expense.

4. A sales discount is a discount given to customers for payment of accounts within a specified short period of time. Sales discounts arise only when goods are sold on credit and the seller extends credit terms that provide for a cash discount. For example, the credit terms may be 1/10, n/30. These terms mean that if the customer pays within 10 days, 1% can be deducted from the invoice price of the goods. Alternatively, if payment is not made within the 10-day period, no discount is permitted and the total invoice amount is due within 30 days from the purchase, after which the debt is past due. To illustrate, assume a $1,000 sale with these terms. If the customer paid within 10 days, $990 would have been paid. Thus, a sales discount of $10 was granted for early payment.

5. A sales allowance is an amount allowed to a customer for unsatisfactory merchandise or for an overcharge in the sales price. A sales allowance reduces the amount the customer must pay, or if already paid, a cash refund is required. Sales allowances may occur whether the sale was for cash or credit. In contrast, a sales discount is a cash discount given to a customer who has bought on credit, with payment made within the specified period of time. (Refer to explanation of sales discount in Question 4, above.)

6. An account receivable is an amount owed to the business on open account by a trade customer for merchandise or services purchased. In contrast, a note receivable is a short-term obligation owed to the company based on a formal written document.

7. In conformity with the expense matching principle, the allowance method records bad debt expense in the same period in which the credit was granted and the sale was made.

8. Using the allowance method, bad debt expense is recognized in the period in which the sale related to the uncollectible account was recorded.

9. The write-off of bad debts using the allowance method decreases the asset accounts receivable and the contra-asset allowance for doubtful accounts by the same amount. As a consequence, (a) net income is unaffected and (b) accounts receivable, net, is unaffected.

10. An increase in the receivables turnover ratio generally indicates faster collection of receivables. A higher receivables turnover ratio reflects an increase in the number of times average trade receivables were recorded and collected during the period.

11. Cash includes money and any instrument, such as a check, money order, or bank draft, which banks normally will accept for deposit and immediate credit to the depositor’s account. Cash equivalents are short-term investments with original maturities of three months or less that are readily convertible to cash, and whose value is unlikely to change (e.g., bank certificates of deposit and treasury bills).

12. The primary characteristics of an internal control system for cash are: (a) separation of the functions of cash receiving from cash payments, (b) separation of accounting for cash receiving and cash paying, (c) separation of the physical handling of cash from the accounting function, (d) deposit all cash receipts daily and make all cash payments by check, (e) require separate approval of all checks and electronic funds transfers, and (f) require monthly reconciliation of bank accounts.

13. Cash-handling and cash-recording activities should be separated to remove the opportunity for theft of cash and a cover-up by altering the records. This separation is accomplished best by assigning the responsibility for cash handling to individuals other than those who have the responsibility for record-keeping. In fact, it usually is desirable that these two functions be performed in different departments of the business.

14. The purposes of a bank reconciliation are (a) to determine the “true” cash balance and (b) to provide data to adjust the Cash account to that balance. A bank reconciliation involves reconciling the balance in the Cash account at the end of the period with the balance shown on the bank statement (which is not the “true” cash balance) at the end of that same period. Seldom will these two balances be identical because of such items as deposits in transit; that is, deposits that have been made by the company but not yet entered on the bank statement. Another cause of the difference is outstanding checks, that is, checks that have been written and recorded in the accounts of the company that have not cleared the bank (and thus have not been deducted from the bank's balance). Usually the reconciliation of the two balances, per books against per bank, requires recording of one or more items that are reflected on the bank statement but have not been recorded in the accounting records of the company. An example is the usual bank service charge.

15. The **total** amount of cash that should be reported on the balance sheet is the sum of (a) the true cash balances in all checking accounts (verified by a bank reconciliation of each checking account), (b) cash held in all “cash on hand” (or “petty cash”) funds, and (c) any cash physically on hand (any cash not transferred to a bank for deposit—usually cash held for change purposes).

16. (Chapter Supplement) Under the gross method of recording sales discounts, the amount of sales discount taken is recorded at the time the collection of the account is recorded.

ANSWERS TO MULTIPLE CHOICE

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| 1. b) | 1. c) | 1. b) | 1. d) | 1. c) |
| 1. c) | 1. d) | 1. b) | 1. d) | 1. c) |

Authors' Recommended Solution Time

**(Time in minutes)**

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| *Mini-exercises* | | *Exercises* | | *Problems* | | *Alternate Problems* | | *Cases and Projects* | |
| *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* | *No.* | *Time* |
| 1 | 5 | 1 | 15 | 1 | 25 | 1 | 35 | 1 | 25 |
| 2 | 5 | 2 | 15 | 2 | 35 | 2 | 35 | 2 | 30 |
| 3 | 10 | 3 | 15 | 3 | 35 | 3 | 50 | 3 | 35 |
| 4 | 10 | 4 | 20 | 4 | 50 | 4 | 40 | 4 | 20 |
| 5 | 10 | 5 | 20 | 5 | 40 | 5 | 45 | 5 | 35 |
| 6 | 10 | 6 | 15 | 6 | 45 |  |  | 6 | 45 |
| 7 | 5 | 7 | 15 | 7 | 45 |  |  | 7 | \* |
| 8 | 10 | 8 | 15 | 8 | 45 |  |  |  |  |
|  |  | 9 | 15 |  |  |  |  |  |  |
|  |  | 10 | 15 |  |  |  |  |  |  |
|  |  | 11 | 20 |  |  |  |  |  |  |
|  |  | 12 | 20 |  |  |  |  |  |  |
|  |  | 13 | 20 |  |  |  |  | *Continuing Case* | |
|  |  | 14 | 20 |  |  |  |  | 1 | 30 |
|  |  | 15 | 20 |  |  |  |  |  |  |
|  |  | 16 | 30 |  |  |  |  |  |  |
|  |  | 17 | 30 |  |  |  |  |  |  |
|  |  | 18 | 15 |  |  |  |  |  |  |
|  |  | 19 | 15 |  |  |  |  |  |  |
|  |  | 20 | 20 |  |  |  |  |  |  |
|  |  | 21 | 20 |  |  |  |  |  |  |
|  |  | 22 | 20 |  |  |  |  |  |  |
|  |  | 23 | 30 |  |  |  |  |  |  |
|  |  | 24 | 30 |  |  |  |  |  |  |
|  |  |  |  |  |  |  |  |  |  |

\* Due to the nature of these cases and projects, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time to discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

**MINI-EXERCISES**

**M6–1.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Transaction |  | Point A |  | Point B |
| *(a)* Sale of inventory to a business customer on open account | x | Shipment |  | Collection of account |
| *(b)* Computer sold by mail order company on a credit card | x | Shipment |  | Delivery |
| *(c)* Airline tickets sold by an airline on a credit card |  | Point of sale | x | Completion of flight |

**M6–2.**

If the buyer pays within the discount period, the income statement will report $9,405 as net sales ($9,500 x 0.99).

**M6–3.**

|  |  |
| --- | --- |
| Credit card sales (R) | $9,400.00 |
| Less: Credit card discount (XR) | 282.00 |
| Net credit card sales | $9,118.00 |
|  |  |
| Sales on account (R) | $12,000.00 |
| Less: Sales returns (XR) | 650.00 |
|  | 11,350.00 |
| Less: Sales discounts (1/2 x $11,350 x 2%) (XR) | 113.50 |
| Net sales on account | 11,236.50 |
| Net sales (reported on income statement) | $20,354.50 |

**M6–4.**

(a) Allowance for doubtful accounts (–XA, +A) 14,500

Accounts receivable (–A) 14,500

To write off specific bad debts.

(b) Bad debt expense (+E, –SE) 16,000

Allowance for doubtful accounts (+XA, –A) 16,000

To record estimated bad debt expense.

**M6–5.**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Assets | Liabilities | Stockholders’ Equity |
| (a) | Allowance for doubtful accounts –15,000 |  | Bad debt expense –15,000 |
| (b) | Allowance for doubtful accounts +9,500  Accounts receivable –9,500 |  |  |

**M6–6.**

|  |  |  |
| --- | --- | --- |
| + | (*a*) | Granted credit with shorter payment deadlines. |
| + | *(b)* | Increased effectiveness of collection methods. |
| – | (*c*) | Granted credit to less creditworthy customers. |

**M6–7.**

|  |  |  |
| --- | --- | --- |
| Reconciling Item | Company’s Books | Bank Statement |
| *(a)* Outstanding checks |  | – |
| *(b)* Bank service charge | – |  |
| *(c)* Deposit in transit |  | + |

**M6–8. (Supplement)**

A $6,000 credit sale with terms, 3/10, n/30, should be recorded as follows:

Accounts receivable (+A) 6,000

Sales revenue (+R, +SE) 6,000

This entry records the sale at the gross amount. If the customer does pay within the discount period, only $5,820 must be paid, in which case the entry for payment would be as follows:

Cash (+A) 5,820

Sales discounts (+XR, –R, –SE) 180

Accounts receivable (–A) 6,000

**EXERCISES**

**E6–1.**

Sales revenue ($1,500 + $850 + $500) $2,850

Less: Sales discount ($1,500 collected from S. Green x 2%) 30

Net sales $2,820

**E6–2.**

Sales revenue ($3,000 + $9,000 +$4,000) $16,000

Less: Sales discounts ($9,000 collected from S x 3%) 270

Less: Credit card discounts ($3,000 from R x 2%) 60

Net sales $15,670

**E6–3.**

Sales revenue ($5,500 + $400 + $9,000) $14,900

Less: Sales returns and allowances (1/10 x $9,000 from D) 900

Less: Sales discounts (9/10 x $9,000 from D x 3%) 243

Less: Credit card discounts ($400 from C x 2%) 8

Net sales $13,749

**E6–4.**

|  |  |  |  |
| --- | --- | --- | --- |
|  |  | Cost of |  |
| Transaction | Net Sales | Goods Sold | Gross Profit |
| July 12 | + 297 | + 175 | + 122 |
| July 15 | + 5,000 | + 2,500 | + 2,500 |
| July 20 | – 150 | NE | – 150 |
| July 21 | – 1,000 | – 600 | – 400 |

**E6–5.**

Req. 1 (Amount saved ÷ Amount paid) = Interest rate for 40 days.

(3% ÷ 97%) = 3.09% for 40 days.

Interest rate for 40 days x (365 days ÷ 40 days) = Annual interest rate

3.09% x (365 ÷ 40 days) = 28.22%

Req. 2 Yes, because the 15% rate charged by the bank is less than the 28.22% rate implicit in the discount. The customer will earn 13.22% by doing so (28.22% – 15%).

**E6–6.**

(a) Bad debt expense (+E, –SE) ($1,300,000 x 0.01) 13,000

Allowance for doubtful accounts (+XA, –A) 13,000

To record estimated bad debt expense.

(b) Allowance for doubtful accounts (–XA, +A) 4,000

Accounts receivable (–A) 4,000

To write off a specific bad debt.

**E6–7.**

(a) Bad debt expense (+E, –SE) ($5,000,000 x 0.02) 100,000

Allowance for doubtful accounts (+XA, –A) 100,000

To record estimated bad debt expense.

(b) Allowance for doubtful accounts (–XA, +A) 98,000

Accounts receivable (–A) 98,000

To write off a specific bad debt.

**E6–8.**

|  |  |  |  |
| --- | --- | --- | --- |
|  | Assets | Liabilities | Stockholders’ Equity |
| (a) | Allowance for doubtful accounts –100,000 |  | Bad debt expense –100,000 |
| (b) | Allowance for doubtful accounts +98,000  Accounts receivable –98,000 |  |  |

**E6–9.**

Req. 1

(a) Bad debt expense (+E, –SE) ($680,000 x 0.035) 23,800

Allowance for doubtful accounts (+XA, –A) 23,800

To record estimated bad debt expense.

(b) Allowance for doubtful accounts (–XA, +A) 2,800

Accounts receivable (–A) 2,800

To write off a specific bad debt.

Req. 2

|  |  |  |  |
| --- | --- | --- | --- |
|  |  |  | Income from |
| Transaction | Net Sales | Gross Profit | Operations |
| a. | NE | NE | – 23,800 |
| b. | NE | NE | NE |

**E6–10.**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Aged accounts receivable | |  | Estimated percentage uncollectible |  | Estimated amount uncollectible |
| Not yet due | $22,000 | x | 3% | = | $ 660 |
| Up to 120 days past due | 6,500 | x | 14% | = | 910 |
| Over 120 days past due | 2,800 | x | 34% | = | 952 |
| Estimated balance in Allowance for Doubtful Accounts | | | | | 2,522 |
| Current balance in Allowance for Doubtful Accounts | | | | | 1,200 |
| Bad Debt Expense for the year | | | | | $1,322 |

**E6–11.**

Req. 1

December 31, 2013-Adjusting entry:

Bad debt expense (+E, –SE) 4,180

Allowance for doubtful accounts (+XA, –A) 4,180

To adjust for estimated bad debt expense for 2013 computed as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Aged accounts receivable | |  | Estimated percentage uncollectible |  | Estimated amount uncollectible |
| Not yet due | $50,000 | x | 3% | = | $ 1,500 |
| Up to 180 days past due | 14,000 | x | 12% | = | 1,680 |
| Over 180 days past due | 4,000 | x | 30% | = | 1,200 |
| Estimated balance in Allowance for Doubtful Accounts | | | | | 4,380 |
| Current balance in Allowance for Doubtful Accounts | | | | | 200 |
| Bad Debt Expense for the year | | | | | $4,180 |

Req. 2

Balance sheet:

Accounts receivable ($50,000 + $14,000 + $4,000) $68,000

Less allowance for doubtful accounts 4,380

Accounts receivable, net of allowance for

doubtful accounts $63,620

**E6–12.**

Req. 1

December 31, 2015-Adjusting entry:

Bad debt expense (+E, –SE) 18,725

Allowance for doubtful accounts (+XA, –A) 18,725

To adjust for estimated bad debt expense for 2015 computed as follows:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Aged accounts receivable | |  | Estimated percentage uncollectible |  | Estimated amount uncollectible |
| Not yet due | $295,000 | x | 2.5% | = | $7,375 |
| Up to 120 days past due | 55,000 | x | 11% | = | 6,050 |
| Over 120 days past due | 18,000 | x | 30% | = | 5,400 |
| Estimated balance in Allowance for Doubtful Accounts | | | | | 18,825 |
| Current balance in Allowance for Doubtful Accounts | | | | | 100 |
| Bad Debt Expense for the year | | | | | $18,725 |

Req. 2

Balance sheet:

Accounts receivable ($295,000 + $55,000 + $18,000) $368,000

Less allowance for doubtful accounts 18,825

Accounts receivable, net of allowance for

doubtful accounts $349,175

**E6–13.**

1. Bad debt expense (+E, –SE) 213

Allowance for doubtful accounts (+XA, –A) 213

To record estimated bad debt expense.

Allowance for doubtful accounts (–XA, +A) 201

Accounts receivable (–A) 201

To write off specific bad debts.

2. It would have no effect because the asset “Accounts receivable” and contra-asset “Allowance for doubtful accounts” would both decline by Euro 10 million. Neither “Receivables, net” nor “Net income” would be affected.

**E6–14.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Req. 1 **Allowance for Doubtful Accounts** | | | | |
|  |  | 117 | Beg. balance |
| Write-offs | 52 | 88 | Bad debt exp. |
|  |  | 153 | End. balance |

Beg. Balance + Bad debt exp. – Write-offs = End. Balance

Beg. Balance + Bad debt exp. – End. Balance = Write-offs

117 + 88 – 153 = 52

Bad debt expense increases (is credited to) the allowance. Since we are given the beginning and ending balances in the allowance, we can solve for write-offs, which decrease (are debited to) the allowance.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Req. 2 **Accounts Receivable (Gross)** | | | | |
| Beg. balance\* | 11,455 | 52 | Write-offs |
| Net sales | 60,420 | 58,081 | Cash collections |
| End. balance \*\* | 13,742 |  |  |

\* 11,338 + 117

\*\* 13,589 + 153

Beg. balance + Net sales – Write-offs – Cash collections = End. Balance

Beg. balance + Net sales – Write-offs – End. Balance = Cash collections

11,455 + 60,420 – 52 – 13,742 = 58,081

Accounts receivable gross is increased by recording credit sales and decreased by recording cash collections and write-offs of bad debts. Thus, we can solve for cash collections as the missing value.

**E6–15.**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Req. 1 **Allowance for Doubtful Accounts** | | | | |
|  |  | 375 | Beg. balance |
| Write-offs | 56 | 14 | Bad debt exp. |
|  |  | 333 | End. balance |

Beg. Balance + Bad debt exp. – Write-offs = End. Balance

Beg. Balance + Bad debt exp. – End. Balance = Write-offs

375 + 14 – 333 = 56

Bad debt expense increases (is credited to) the allowance. Since we are given the beginning and ending balances in the allowance, we can solve for write-offs, which decrease (are debited to) the allowance.

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Req. 2 **Accounts Receivable (Gross)** | | | | |
| Beg. balance\* | 13,389 | 56 | Write-offs |
| Net sales | 69,943 | 67,956 | Cash collections |
| End. balance \*\* | 15,320 |  |  |

\* 13,014 + 375

\*\* 14,987 + 333

Beg. balance + Net sales – Write-offs – Cash collections = End. Balance

Beg. balance + Net sales – Write-offs – End. Balance = Cash collections

13,389 + 69,943 – 56 – 15,320 = 67,956

Accounts receivable gross is increased by recording credit sales and decreased by recording cash collections and write-offs of bad debts. Thus, we can solve for cash collections as the missing value.

**E6–16.**

Req. 1

The allowance for doubtful accounts is increased (credited) when bad debt expense is recorded and decreased (debited) when uncollectible accounts are written off. This case gives the beginning and ending balances of the allowance account and the amount of uncollectible accounts that were written off. Therefore, the amount of bad debt expense (in thousands) can be computed as follows:

|  |  |  |  |
| --- | --- | --- | --- |
| **Allowance for Doubtful Accounts** | | | |
|  |  | 690,000 | Beg. balance | |
| Write-offs | 414,000 | 154,000 | Bad debt exp. | |
|  |  | 430,000 | End. balance | |

Beg. Balance + Bad debt exp. – Write-offs = End. Balance

End. Balance – Beg. Balance + Write-offs = Bad debt exp.

430,000– 690,000 + 414,000 = 154,000

Req. 2

Working capital is unaffected by the write-off of an uncollectible account when the allowance method is used. The asset account (accounts receivable) and the contra- asset account (allowance for doubtful accounts) are both reduced by the same amount; therefore, the book value of net accounts receivable is unchanged.

Working capital is decreased when bad debt expense is recorded because the contra- asset account (allowance for doubtful accounts) is increased. From requirement (1), we know that net accounts receivable was reduced by $154,000 when bad debt expense was recorded in year 2, reducing working capital by $154,000.

Note that income before taxes was reduced by the amount of bad debt expense that was recorded, therefore tax expense and tax payable will decrease. The decrease in tax payable caused working capital to increase; therefore, the net decrease was $154,000 – ($154,000 x 30%) = $107,800.

Req. 3

The entry to record the write-off of an uncollectible account did not affect any income statement accounts; therefore, net income is unaffected by the $414,000 write-off in year 2.

The recording of bad debt expense reduced income before taxes in year 2 by $154,000 and reduced tax expense by $46,200 (i.e., $154,000 x 30%). Therefore, year 2 net income was reduced by $107,800 (as computed in Req. 2).

**E6–17.**

Req. 1

Dec. 31, 2014

Allowance for doubtful accounts (–XA, +A) 1,700

Accounts receivable (J. Doe) (–A) 1,700

To write off an account receivable determined to

be uncollectible.

Dec. 31, 2014

Bad debt expense (+E, –SE) 1,125

Allowance for doubtful accounts (+XA, –A) 1,125

Adjusting entry--estimated loss on uncollectible

accounts; based on credit sales ($75,000 x 1.5%

= $1,125).

Req. 2

Income statement:

Operating expenses:

Bad debt expense $1,125

Balance sheet:

*Current assets*

Accounts receivable ($16,000 + $75,000

- $60,000 - $1,700) $29,300

Less: Allowance for doubtful accounts

($900 - $1,700 + $1,125) 325 $28,975

Req. 3

The 1.5% rate on credit sales may be too low because it resulted in bad debt expense only two-thirds the amount of receivables written off ($1,700) during the year. However, if the uncollectible account receivable written off during 2014 is not indicative of average uncollectibles written off over a period of time, the 1.5% rate may be appropriate. There is not sufficient historical data to make a definitive decision.

**E6–18.**

Req. 1

Dec. 31, 2014

Allowance for doubtful accounts (–XA, +A) 550

Accounts receivable (Toby’s Gift Shop) (–A) 550

To write off an account receivable determined to

be uncollectible.

Dec. 31, 2014

Bad debt expense (+E, –SE) 500

Allowance for doubtful accounts (+XA, –A) 500

Adjusting entry--estimated loss on uncollectible

accounts; based on credit sales ($25,000 x 2%

= $500).

Req. 2

Income statement:

Operating expenses:

Bad debt expense $500

Balance sheet:

*Current assets*

Accounts receivable ($3,500 + $25,000

- $18,000 - $550) $9,950

Less: Allowance for doubtful accounts

($300 - $550 + $500) 250 $9,700

Req. 3

The 2% rate on credit sales appears reasonable because it approximates the amount of receivables written off ($550) during the year. However, if the uncollectible account receivable written off during 2014 is not indicative of average uncollectibles written off over a period of time, the 2% rate may not be appropriate. There is not sufficient historical data to make a definitive decision.

**E6–19.**

Req. 1

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Receivables turnover | = | Net Sales | = | $39,304,000 | = | 8.99 times |
|  |  | Average Net Trade Accounts Receivable |  | $4,372,000\* |  |  |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Average days sales | = | 365 | = | 365 | = | 40.60 days |
| in receivables |  | Receivables Turnover |  | 8.99 |  |  |

\* ($4,163,000 + $4,581,000) ÷ 2

Req. 2

The receivables turnover ratio reflects how many times average trade receivables were recorded and collected during the period. The average days sales in receivables indicates the average time it takes a customer to pay its account.

**E6–20.**

Req. 1

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Receivables turnover | = | Net Sales | = | $62,071,000 | = | 9.5722 times |
|  |  | Average Net Trade Accounts Receivable |  | $6,484,500\* |  |  |

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Average days sales | = | 365 | = | 365 | = | 38.13 days |
| in receivables |  | Receivables Turnover |  | 9.5722 |  |  |

\* ($6,493,000 + $6,476,000) ÷ 2

Req. 2

The receivables turnover ratio reflects how many times average trade receivables were recorded and collected during the period. The average days sales in receivables indicates the average time it takes a customer to pay its account.

**E6–21.**

Req. 1

The change in the accounts receivable balance ($48,066 – 63,403 = –$15,337) would increase cash flow from operations by $15,337 thousand. This happens because the Company is collecting cash faster than it is recording credit sales revenue.

Req. 2

(a) Declining sales revenue leads to lower accounts receivable because fewer new credit sales are available to replace the receivables that are being collected.

(b) Cash collections from the prior period's higher credit sales are greater than the new credit sales revenue. Note that in the next period, cash collections will also decline.

**E6–22.**

Req. 1

**JACKSON COMPANY**

**Bank Reconciliation, June 30, 2014**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| ***Company's Books*** |  |  | ***Bank Statement*** |  |
| Ending balance per Cash  account……………………… | $5,600 |  | Ending balance per bank  statement……………… | $6,060 |
| **Additions:** |  |  | **Additions:** |  |
| None |  |  | Deposit in transit………… | 1,900\* |
| **Deductions:** |  |  | **Deductions:** | 7,960 |
| Bank service charge…… | 40 |  | Outstanding checks… | 2,400 |
| Correct cash balance……… | $5,560 |  | Correct cash balance…… | $5,560 |

\*$18,100 – $16,200 = $1,900.

Req. 2

Bank service charge expense (+E, –SE) 40

Cash (–A) 40

To record deduction from bank account for service charges.

Req. 3

The correct cash balance per the bank reconciliation ($5,600 – $40), $5,560

Req. 4

Balance sheet (June 30, 2014):

Current assets:

Cash $5,560

**E6–23.**

Req. 1

**BENNETT COMPANY**

**Bank Reconciliation, September 30, 2014**

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| ***Company's Books*** |  |  |  | ***Bank Statement*** |  |
| Ending balance per Cash account |  | $5,700 |  | Ending balance per bank statement | $5,770 |
|  |  |  |  |  |  |
| **Additions:** |  |  |  | **Additions:** |  |
| None |  |  |  | Deposit in transit\* | 1,200\* |
|  |  |  |  |  | 6,970 |
| **Deductions:** |  |  |  | **Deductions:** |  |
| Bank service charges | $ 60 |  |  |  |  |
| NSF check –  Betty Brown | 170 | 230 |  | Outstanding checks  ($28,900 – $27,400) | 1,500 |
| Correct cash balance |  | $5,470 |  | Correct cash balance | $5,470 |

\*$28,100 - $26,900 = $1,200.

Req. 2

(1) Bank service charge expense (+E, –SE) 60

Cash (–A) 60

To record bank service charges deducted from bank balance.

(2) Accounts receivable (Betty Brown) (+A) 170

Cash (–A) 170

To record customer check returned due to insufficient funds.

Req. 3

Same as the correct balance on the reconciliation, $5,470.

Req. 4

Balance Sheet (September 30, 2014):

Current Assets:

Cash $5,470

**E6–24 (Based on Supplement A)**

November 20, 2013

Cash (+A) 441

Credit card discount (+XR, –R, –SE) 9

Sales revenue (+R, +SE) 450

To record credit card sale.

November 25, 2013:

Accounts receivable (Customer C) (+A) 2,800

Sales revenue (+R, +SE) 2,800

To record a credit sale.

November 28, 2013:

Accounts receivable (Customer D) (+A) 7,200

Sales revenue (+R, +SE) 7,200

To record a credit sale.

November 30, 2013:

Sales returns and allowances (+XR, –R, –SE) 600

Accounts receivable (Customer D) (–A) 600

To record return of defective goods, $7,200 x 1/12 = $600.

December 6, 2013:

Cash (+A) 6,468

Sales discounts (+XR, –R, –SE) 132

Accounts receivable (Customer D) (–A) 6,600

To record collection within the discount period,   
 98% × ($7,200 – $600) = $6,468

December 30, 2013:

Cash (+A) 2,800

Accounts receivable (Customer C) (–A) 2,800

To record collection after the discount period.

Sales revenue ($450 + $2,800 + $7,200) $10,450

Less: Sales returns and allowances ($7,200 x 1/12) 600

Less: Sales discounts (2% × ($7,200 – $600)) 132

Less: Credit card discounts ($450 x 2%) 9

Net sales $9,709

**PROBLEMS**

**P6–1.**

Case A

Because Wendy's collects cash when the coupon books are sold, cash collection is not an issue in this case. In order to determine if the revenue has been earned, the student must be careful in analyzing what Wendy's actually sold. Students who focus on the sale of the coupon book often conclude that the earning process is complete with the delivery of the book to the customer. In reality, Wendy's has a significant additional service to perform; it has to serve a meal. The correct point for revenue recognition in this case is when the customer uses the coupon or when the coupon expires and Wendy's has no further obligation.

Case B

In this case there is an extremely low down payment and some reason to believe that Uptown Builders may default on the contract because of prior actions. If students believe that Russell Land Development could sue and collect on the contract, they will probably argue for revenue recognition. Given the risk of cash collection, most students will argue that revenue should be recognized as cash is collected. The text does not discuss FASB #66 (ASC 360-20-40), but the instructor may want to mention during the discussion that there is authoritative guidance concerning minimum down payments before revenue can be recorded on a land sale.

Case C

While warranty work on refrigerators can involve significant amounts of effort and money, companies are permitted to record revenue at the point of sale. The text does not discuss this specific issue, but the matching concept is mentioned in the context of revenue and expense recognition. This is an excellent opportunity to mention the need to accrue estimated warranty expense at the time that sales revenue is recorded. Some students are surprised to see that costs that will be incurred in the future can be recorded as an expense in the current accounting period.

**P6–2.**

Req. 1

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Sales  Revenue | Sales Discounts (taken) | Sales Returns and Allowances | Bad Debt Expense |
| (a) | +235,000 | NE | NE | NE |
| (b) | +11,500 | NE | NE | NE |
| (c) | +26,500 | NE | NE | NE |
| (d) | NE | NE | +500 | NE |
| (e) | +24,000 | NE | NE | NE |
| (f) | NE | +220 | NE | NE |
| (g) | NE | +2,000\* | NE | NE |
| (h) | NE | +530 | NE | NE |
| (i) | +19,000 | NE | NE | NE |
| (j) | NE | –70 | +3,500 | NE |
| (k) | NE | NE | NE | NE |
| (l) | NE | NE | NE | NE |
| (m) | NE | NE | NE | +1,155\*\* |
| Total | +$316,000 | +$2,680 | +$4,000 | +$1,155 |

\*$98,000 ÷ (1 ─ .02) = $100,000 gross sales; $100,000 x .02 = $2,000

\*\*Credit sales ($11,500 + $26,500 + $24,000 + $19,000) $81,000

Less: Sales returns ($500 + $3,500) 4,000

Net sales revenue 77,000

Estimated bad debt rate x 1.5%

Bad debt expense $1,155

Req. 2

Income statement:

Sales revenue $316,000

Less: Sales returns and allowances 4,000

Sales discounts 2,680

Net sales revenue $309,320

Operating expenses

Bad debt expense 1,155

**P6–3.**

1. Bad debt expense (+E, –SE) 42

Allowance for doubtful accounts (+XA, –A) 42

End-of-period bad debt expense estimate.

Allowance for doubtful accounts (–XA, +A) 201

Accounts receivable (–A) 201

Write-off of bad debts.

2. Year 2 $132 + $187 – $36 = $283

Year 1 $128 + $4 – $0 = $132

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Allowance for DA Year 2** | | | |  | | **Allowance for DA Year 1** | | | |
|  |  | 132 | Beg. bal. |  |  | |  | 128 | Beg. bal | |
| Write-offs | 36 | 187 | Bad debt exp. |  | Write-offs | | 0 | 4 | Bad debt exp. | |
|  |  | 283 | End. bal. |  |  | |  | 132 | Ending Bal. | |

The solution involves solving for the missing value in the T-account.

**P6–4.**

Req. 1

***Aging Analysis of Accounts Receivable***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| Customer | Total Receivables | (a) Not Yet Due | (b) Up to One Year Past Due | (c) More Than One Year Past Due |
| B. Brown………….. | $ 6,200 |  |  | $6,200 |
| D. Donalds……….. | 7,000 |  | $ 7,000 |  |
| N. Napier…………. | 7,000 | $ 7,000 |  |  |
| S. Strothers……… | 24,500 | 4,000 | 20,500 |  |
| T. Thomas………... | 4,000 | 4,000 |  |  |
| Totals…………… | $48,700 | $15,000 | $27,500 | $6,200 |
|  |  |  |  |  |

Req. 2

***Aging Schedule--Estimated Amounts Uncollectible***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Age | Amount of Receivables | Estimated Uncollectible Percentage | Estimated Amount Uncollectible |
| a. | Not yet due…………………… | $15,000 | 3% | $ 450 |
| b. | Up to one year past due……. | 27,500 | 9% | 2,475 |
| c. | Over one year past due…….. | 6,200 | 28% | 1,736 |
|  | Estimated ending balance in Allowance for Doubtful Accounts |  |  | 4,661 |
|  | Balance before adjustment |  |  | 920 |
|  | Bad Debt Expense for the year |  |  | $3,741 |

Req. 3

Bad debt expense (+E, –SE) 3,741

Allowance for doubtful accounts (+XA, –A) 3,741

Req. 4

Income statement:

Operating expenses

Bad debt expense $3,741

Balance sheet:

Current Assets:

Accounts receivable $48,700

Less: Allowance for doubtful accounts 4,661

Accounts receivable (net) $44,039

**P6–5.**

Req. 1

**TUNGSTEN COMPANY, INC.**

**Income Statement**

**For the Year Ended December 31, 2014**

Net sales revenue ($147,100 − $5,600 − $6,400) $135,100

Cost of goods sold 78,400

Gross profit on sales 56,700

Operating expenses:

Selling expense $14,100

Administrative expense 15,400

Bad debt expense 1,600 31,100

Income from operations 25,600

Income tax expense 7,680

Net income $ 17,920

Earnings per share on capital stock outstanding

($17,920 ÷ 10,000 shares) $1.79

Req. 2

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Receivables | = | Net Sales |  | = | $135,100 | = | 8.89 |  |
| Turnover |  | Average Net Trade Accounts Receivable |  |  | $15,200\* |  |  |  |

\* ($16,000 + $14,400) ÷ 2

The receivables turnover ratio measures the effectiveness of credit-granting and collection activities.

**P6–6.**

Req. 1

**JEFFERSON COMPANY**

**Bank Reconciliation, April 30, 2014**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Company's Books** | | | **Bank Statement** | |
|  |  |  |  |  |
| Ending balance per Cash  account |  | $23,900 | Ending balance per bank  statement | $26,070 |
|  |  |  |  |  |
| **Additions:** |  |  | **Additions:** |  |
| Interest collected |  | 1,180 | Deposits in transit\* | 4,400 |
|  |  | 25,080 |  | 30,470 |
|  |  |  |  |  |
| **Deductions:** |  |  | **Deductions:** |  |
| NSF—A.B. Wright | 160 |  | Outstanding checks | 5,600 |
| Bank charges | 50 | 210 |  |  |
| Correct cash balance |  | $24,870 | Correct cash balance | $24,870 |

\*$41,500 - $37,100 = $4,400.

Req. 2

(1) Cash (+A) 1,180

Interest revenue (+R, +SE) 1,180

Interest collected.

(2) Accounts receivable (A. B. Wright) (+A) 160

Cash (–A) 160

Customer's check returned, insufficient funds.

(3) Bank service charge expense (+E, –SE) 50

Cash (–A) 50

Bank service charges deducted from bank statement.

These entries are necessary because of the changes to the regular Cash account that have not yet been recorded by the company. The bank already has recorded them in its accounts. The Cash account (and the other accounts in the entries) must be brought up to date for financial statement purposes.

Req. 3

Balance in regular Cash account $24,870

Req. 4

Balance Sheet (April 30, 2014):

Current Assets:

Cash $24,870

**P6–7.**

Req. 1

Comparison of deposits listed in the Cash account with deposits listed on the bank statement reveals a $5,200 deposit in transit on August 31.

Req. 2

Comparison of the checks cleared on the bank statement with (a) outstanding checks from July, and (b) checks written in August reveals two outstanding checks at the end of August ($280 + $510 = $790).

Req. 3 **ALLISON COMPANY**

**Bank Reconciliation, August 31, 2014**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Company's Books** | | | **Bank Statement** | |
| Ending balance per Cash  account |  | $20,370 | Ending balance per bank  statement | $18,190 |
|  |  |  |  |  |
| **Additions:** |  |  | **Additions:** |  |
| Interest collected |  | 2,350 | Deposits in transit | 5,200 |
|  |  | 22,720 |  | 23,390 |
|  |  |  |  |  |
| **Deductions:** |  |  | **Deductions:** |  |
| Bank service charges | | 120 | Outstanding checks | 790 |
| Correct cash balance | | $22,600 | Correct cash balance | $22,600 |

Req. 4

(1) Cash (+A) 2,350

Interest revenue (+R, +SE) 2,350

Interest collected.

(2) Bank service charge expense (+E, –SE) 120

Cash (–A) 120

Service charges deducted from bank balance.

These entries are necessary because of the changes in the regular Cash account that have not yet been recorded by the company. The bank already has recorded them in its accounts. The Cash account (and the other accounts in the entries) must be brought up to date for financial statement purposes.

Req. 5

Current Assets:

Cash $22,600

**P6–8. (Based on Supplement A)**

Req. 1

(a) Cash (+A) 235,000

Sales revenue (+R, +SE) 235,000

Cash sales for 2014.

(b) Accounts receivable (R. Smith) (+A) 11,500

Sales revenue (+R, +SE) 11,500

Credit sale, $11,500.

(c) Accounts receivable (K. Miller) (+A) 26,500

Sales revenue (+R, +SE) 26,500

Credit sale, $26,500.

(d) Sales returns and allowances (+XR, –R, –SE) 500

Accounts receivable (R. Smith) (–A) 500

Sale return, 1 unit @ $500.

(e) Accounts receivable (B. Sears) (+A) 24,000

Sales revenue (+R, +SE) 24,000

Credit sale, $24,000.

(f) Cash (+A) 10,780

Sales discounts (+XR, –R, –SE) 220

Accounts receivable (R. Smith) (–A) 11,000

Paid account in full within discount period,

($11,500 - $500) x (1 - .02) = $10,780.

(g) Cash (+A) 98,000

Sales discounts (+XR, –R, –SE) 2,000

Accounts receivable (prior year) (–A) 100,000

Collected receivables of prior year, all within

discount periods $98,000 ÷ .98 = $100,000.

(h) Cash (+A) 25,970

Sales discounts (+XR, –R, –SE) 530

Accounts receivable (K. Miller) (–A) 26,500

Collected receivable within the discount period

$26,500 x .98 = $25,970.

(i) Accounts receivable (R. Roy) (+A) 19,000

Sales revenue (+R, +SE) 19,000

Credit sale, $19,000.

**P6–8. (continued)**

(j) Sales returns and allowances (+XR, –R, –SE) 3,500

Cash (–A) 3,430

Sales discounts (–XR, +R, +SE) 70

Sales return, 7 units @ $500 less sales discounts taken

= $3,500 x .98.

(k) Cash (+A) 6,000

Accounts receivable (–A) 6,000

Collected receivable of prior year, after the discount

period.

(l) Allowance for doubtful accounts (–XA, +A) 3,000

Accounts receivable (2013 account) (–A) 3,000

Wrote off uncollectible account from 2013.

(m) Bad debt expense (+E, –SE) 1,155

Allowance for doubtful accounts (+XA, –A) 1,155

To adjust for estimated bad debt expense

Credit sales ($11,500 + $26,500 + $24,000 + $19,000) $81,000

Less: Sales returns ($500 + $3,500) 4,000

Net sales revenue 77,000

Estimated bad debt rate x 1.5%

Bad debt expense $1,155

.

Req. 2

Income statement:

Sales revenue ($235,000 + $11,500 + $26,500

+ $24,000 + $19,000) $316,000

Less: Sales returns and

allowances ($3,500 + $500) 4,000

Sales discounts ($220 + $2,000

+ $530 – $70) 2,680

Net sales revenue $309,320

Operating expenses

Bad debt expense 1,155

**ALTERNATE PROBLEMS**

**AP6–1.**

Req. 1

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Sales  Revenue | Sales Discounts (taken) | Sales Returns and Allowances | Bad Debt Expense |
| (a) | +227,000 | NE | NE | NE |
| (b) | +12,000 | NE | NE | NE |
| (c) | +23,500 | NE | NE | NE |
| (d) | NE | +240 | NE | NE |
| (e) | +26,000 | NE | NE | NE |
| (f) | NE | -10 | +500 | NE |
| (g) | NE | +1,800\* | NE | NE |
| (h) | NE | NE | +3,500 | NE |
| (i) | NE | +400 | NE | NE |
| (j) | +18,500 | NE | NE | NE |
| (k) | NE | NE | NE | NE |
| (l) | NE | NE | NE | NE |
| (m) | NE | NE | NE | +3,040\*\* |
| Total | +$307,000 | +$2,430 | +$4,000 | +$3,040 |

\* [($88,200/.98) x .02] = $1,800

\*\*Credit sales ($12,000 + $23,500 + $26,000 + $18,500) $80,000

Less: Sales returns ($500 + $3,500) 4,000

Net sales revenue $76,000

Estimated bad debt rate x 4%

Bad debt expense $3,040

Req. 2

Income statement:

Sales revenue $307,000

Less: Sales returns and allowances 4,000

Sales discounts 2,430

Net sales revenue $300,570

Operating expenses

Bad debt expense $3,040

**AP6–2.**

1. Bad debt expense (+E, –SE) 6,014

Allowance for doubtful accounts (+XA, –A) 6,014

End of period bad debt expense estimate.

Allowance for doubtful accounts (–XA, +A) 5,941

Accounts receivable (–A) 5,941

Write-off of bad debts.

2.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Allowances for Doubtful Accounts |  | Balance at Beginning of Year |  | Additions Charged to Costs and Expenses |  | Deductions from Reserve |  | Balance at End  of Year |
| Year 3 |  | $1,108 |  | $6,014 |  | $5,941 |  | $1,181 |
| Year 2 |  | 2,406 |  | 4,453 |  | 5,751 |  | 1,108 |
| Year 1 |  | 2,457 |  | 4,752 |  | 4,803 |  | 2,406 |

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Year 3** | **Allowance for Doubtful Accounts** | | | |
|  |  |  | 1,108 | Beg. bal. |
|  | Write-offs | 5,941 | 6,014 | Bad debt exp. |
|  |  |  | 1,181 | End. bal. |
|  |  |  |  |  |
|  |  |  |  |  |
| **Year 2** | **Allowance for Doubtful Accounts** | | | |
|  |  |  | 2,406 | Beg. bal. |
|  | Write-offs | 5,751 | 4,453 | Bad debt exp. |
|  |  |  | 1,108 | End. bal. |
|  |  |  |  |  |
|  |  |  |  |  |
| **Year 1** | **Allowance for Doubtful Accounts** | | | |
|  |  |  | 2,457 | Beg. bal |
|  | Write-offs | 4,803 | 4,752 | Bad debt exp. |
|  |  |  | 2,406 | Ending bal. |

The solution involves solving for the missing value in the T-account.

**AP6–3.**

Req. 1

***Aging Analysis of Accounts Receivable***

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Customer | Total Receivable | (a)  Not Yet  Due | (b)  Up to  6 Mo.  Past Due | (c)  6 to  12 Mo.  Past Due | (d)  More Than 12 Mo.  Past Due |
| R. Devens ……….. | $ 2,000 |  |  | $2,000 |  |
| C. Howard ……….. | 6,000 |  |  |  | $6,000 |
| D. McClain .………. | 4,000 |  | $ 4,000 |  |  |
| T. Skibinski ……… | 14,500 | $ 4,500 | 10,000 |  |  |
| H. Wu ………..…... | 13,000 | 13,000 |  |  |  |
| Totals…………… | $39,500 | $17,500 | $14,000 | $2,000 | $6,000 |

Req. 2

***Estimated Amounts Uncollectible***

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
|  | Age | Amount of Receivable | Estimated Loss Rate | Estimated Uncollectible |
| a. | Not yet due…………………… | $17,500 | 1% | $ 175 |
| b. | Up to 6 months past due...…. | 14,000 | 5% | 700 |
| c. | 6 to 12 months past due.…. | 2,000 | 20% | 400 |
| d. | Over 12 months past due…... | 6,000 | 50% | 3,000 |
|  | Estimated ending balance in Allowance for Doubtful Accounts |  |  | 4,275 |
|  | Balance before adjustment |  |  | 1,550 |
|  | Bad Debt Expense for the year |  |  | $2,725 |

Req. 3

Bad debt expense (+E, –SE) 2,725

Allowance for doubtful accounts (+XA, –A) 2,725

Req. 4

Income statement:

Operating expenses

Bad debt expense $2,725

Balance sheet:

Current Assets:

Accounts receivable $39,500

Less: Allowance for doubtful accounts 4,275

Accounts receivable, net $35,225

**AP6–4.**

Req. 1

**PERRY CORPORATION**

**Income Statement**

**For the Year Ended December 31, 2014**

Net sales revenue ($184,000 - $9,000- $8,000) $167,000

Cost of goods sold 98,000

Gross profit 69,000

Operating expenses:

Selling expense $17,000

Administrative and general expense 18,000

Bad debt expense 2,000

Total operating expenses 37,000

Income from operations 32,000

Income tax expense 10,900

Net income $ 21,100

Earnings per share on common stock outstanding   
 ($21,100 ÷ 10,000 shares) $2.11

Req. 2

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| Receivables | = | Net Sales |  | = | $167,000 | = | 9.82 |  |
| Turnover |  | Average Net Trade Accounts Receivable |  |  | $17,000\* |  |  |  |

\* ($16,000 + $18,000) ÷ 2

The receivables turnover ratio measures the effectiveness of credit-granting and collection activities.

**AP6–5.**

Req. 1

Comparison of (a) the unrecorded deposit carried over from November and (b) the deposits listed on the bank statement reveals that the $13,000 deposit for December 31 is in transit.

Req. 2

Comparison of the checks cleared on the bank statement with (a) outstanding checks from November and (b) checks written in December reveals that the outstanding checks at the end of December are $5,000 + $3,500 + 500 = $9,000.

Req. 3

**RIVAS COMPANY**

**Bank Reconciliation, December 31, 2014**

|  |  |  |  |  |
| --- | --- | --- | --- | --- |
| **Company's Books** | | | **Bank Statement** | |
|  |  |  |  |  |
| Ending balance per Cash  account |  | $61,060 | Ending balance per bank  statement | $61,860 |
|  |  |  |  |  |
| **Additions:** |  |  | **Additions:** |  |
| Interest collected |  | 5,250 | Deposits in transit | 13,000 |
|  |  | 66,310 |  | 74,860 |
|  |  |  |  |  |
| **Deductions:** |  |  | **Deductions:** |  |
| NSF check—J. Left | $300 |  |  |  |
| Bank service charges | 150 | 450 | Outstanding checks | 9,000 |
| Correct cash balance |  | $65,860 | Correct cash balance | $65,860 |

**AP6–5. *(continued)***

Req. 4

(1) Accounts receivable (J. Left) (+A) 300

Cash (–A) 300

To record NSF check.

(2) Cash (+A) 5,250

Interest revenue (+R, +SE) 5,250

Interest collected.

(3) Bank service charge expense (+E, –SE) 150

Cash (–A) 150

Service charges deducted from bank balance.

These entries are necessary because of the changes in the regular Cash account that have not yet been recorded by the company. The bank already has recorded them in its accounts. The Cash account (and the other accounts in the entries) must be brought up to date for financial statement purposes.

Req. 5

Balance Sheet (2014):

Current Assets:

Cash $65,860

**CASES AND PROJECTS**

*ANNUAL REPORT CASES*

**CP6–1.**

1. The company includes liquid financial instruments with remaining maturity of three months or less to be cash and cash equivalents. This information is from note 2 of the financial statements. The amount disclosed is likely to be close to the fair market value of the securities, given the short maturity date of the securities.
2. In addition to Cost of Goods Sold, American Eagle Outfitters subtracts buying, occupancy and warehousing costs from Net Sales in its computation of Gross Profit. This follows standard practice among retailers. No such additional expenses are subtracted in Deckers’s (a footwear manufacturer) computation of Gross Profit. This makes the interpretation of gross profit percentages across different industries difficult.

|  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- |
| Receivables turnover | = | Net Sales | = | $3,159,818 | = | 82.0 times |
|  |  | Average Net Trade Accounts Receivable |  | $38,516\* |  |  |

\* ($36,721 + 40,310) ÷ 2

This question is designed to focus student attention on the mechanics of the computation of the receivables turnover ratio and the effect of industry differences. The receivables turnover is so high because of the nature of the company’s business. Retail sales are likely to be made with cash or credit card. As a consequence, most retailers would not have accounts receivable related to sales unless they had private store credit card accounts. The accounts receivable on American Eagle’s balance sheet relate primarily to amounts owed from landlords for construction allowances for building new stores in malls.

4. No, the company does not report an allowance for doubtful accounts on the balance sheet or in the notes. As a retailer, its trade receivables from customers are immaterial—the company’s receivables consist of non-trade receivables and notes receivable.

**CP6–2.**

1. The company held $145,273 thousand of cash and cash equivalents at the end of the current year. This is disclosed on the balance sheet and the statement of cash flows.
2. Accounts receivable increased by $171 thousand, decreasing Net Cash Provided by Operating Activities for the current year. You may wish to note to students that this amount does not agree with the amount on the statement of cash flows which indicates a $251 thousand increase. This difference is the result of the translation of foreign currency receivables.

3. The accounts receivable are primarily due from wholesale customers and credit card customers. Bad debt expense increased between 2010 and 2011 from $2,397 to $3,920. These amounts are disclosed in Note 2 of the annual report.

4. It discloses its revenue recognition policies in note 2 which summarizes significant accounting policies. The company recognizes revenue from selling gift cards when customers redeem a gift card for merchandise rather than when the gift card is sold. When gift cards are sold, a current liability (deferred revenue) is recorded.

**CP6–3.**

1.

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| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| **Current year** | | | | **American Eagle Outfitters** | | | | | **Urban Outfitters** | | | | |
| Receivables | = | Net Sales |  |  | $3,159,818 | = | 82.0 |  |  | $2,473,801 | = | 67.6 |  |
| Turnover Ratio |  | Average Net Trade Accounts Receivable |  |  | 38,516\*  \*($36,721 + 40,310) ÷ 2 | | |  |  | 36,588  \*($36,673 + 36,502) ÷ 2 | | | |

2. American Eagle Outfitters has a higher ratio than Urban Outfitters because American Eagle and Urban Outfitters sell to different classes of customers. American Eagle sells its products almost exclusively to retail and online customers, who are likely to pay with cash or credit card. Urban Outfitters sells its product not only to retail and online customers, but also to wholesale customers, who are likely to purchase merchandise on credit. As seen in Note 2 of the financial statements, the accounts receivable on Urban Outfitter’s balance sheet relate primarily to amounts owed from wholesale customers and third-party credit card vendors. The accounts receivable on American Eagle’s balance sheet relate primarily to amounts owed from the company’s 21 franchise stores.

3.

|  |  |  |  |
| --- | --- | --- | --- |
|  | **Industry  Average** | **American Eagle Outfitters** | **Urban Outfitters** |
| Receivables Turnover = | 97.5 | 82.0 | 67.6 |

Both companies have a lower receivables turnover ratio than the industry average. For American Eagle Outfitters this lower ratio likely reflects the company’s recent decision to expand internationally through franchises, who owe the company approximately 400% more in receivables than last year. For Urban Outfitters, this lower ratio likely reflects the company’s wholesale operations, as discussed in requirement 2.

## FINANCIAL REPORTING AND ANALYSIS CASES

**CP6–4.**

1. Yes. Given that only one three-year project is worked on at a time, the completed contract method would result in no revenue being recognized for two out of every three years, and all of the revenue from each project being recognized during the third. If the same amount of work was completed each year, the percentage of completion method would result in an approximately equal amount of revenue each period.

2. If the company regularly started and completed a larger constant number of equal sized projects each reporting period, the size of any difference between revenues reported under the two methods would decline.

3. Under generally accepted accounting principles, the appropriate method would be determined by whether the costs to complete can be accurately assessed. If they can be accurately estimated, the percentage of completion method is appropriate. If not, the completed contract method should be used. However, managers generally prefer to report the smoother earnings pattern conveyed by the percentage of completion method because smoother earnings are generally thought to convey lower risk to investors.

*CRITICAL THINKING CASES*

**CP6–5.**

1. Recording sales for goods or services that had not been delivered as of year-end violates the revenue principle. Recording revenue for sales that were subject to cancellation, without estimating returns properly, is also a violation.

2. It should establish a sales returns and allowances account (a contra revenue) for potential cancellations. An estimate of future cancellations should be made and the amount should reduce net sales in the period the revenue is recognized.

3. Profiting from sales of stock they owned at an inflated stock price and perhaps receiving bonuses determined on the basis of growth in net income probably motivated management. Management was very focused on reporting increased growth because the growth fueled the run-up in the stock price.

**CP6–5. (continued)**

4. The other investors who paid inflated amounts for the stock, customers who were poorly served during the period, and employees of the company who were drawn into the fraud and suffered damage to their reputations were all hurt by management’s conduct.

5. Sales transactions booked near the end of the quarter and sales with special terms, e.g. right of return or cancellation, should receive special attention from auditors. Channel stuffing often lowers the receivables turnover ratio. To cover up this change, management improperly reclassified some accounts receivable as notes receivable.

**CP6–6.**

Req. 1

(a) $50 x 12 months = $ 600

(b) $12 x (52 weeks x 5 days per week) = 3,120

(c,d) Accounts receivable collections ($300 + $800) = 1,100

Total approximate amount stolen $4,820

Req. 2

Basic recommendations:

(1) Install a tight system of internal control, including the following:

a. Separate cash handling from recordkeeping.

b. Deposit all cash daily.

c. Make all payments by check. Consider a separate cash on hand system for small expense payments.

d. Reconcile bank statement monthly.

e. Institute a system of spot checks.

f. Establish cash and paperwork flows.

(2) a. Arrange for an annual independent audit on a continuing basis.

b. Carefully plan and assign definite responsibilities for all employees. Focus on attaining internal control. Isolate the once trusted employee from all cash handling and accounting activities and consider dismissing and bringing charges against the employee.

## FINANCIAL REPORTING AND ANALYSIS PROJECTS

**CP6–7.**

The solutions to this case will depend on the company and/or accounting period selected for analysis.

## **CONTINUING CASE**

**CC6–1.**

Req. 1

Bad debt expense (+E, –SE) 2,958

Allowance for doubtful accounts (+XA, –A) 2,958

To record estimated bad debt expense.

Allowance for doubtful accounts (–XA, +A) 4,160

Accounts receivable (–A) 4,160

To write off total of specific bad debts.

Req. 2

Sales revenue $137,256

Less: Sales returns and allowances 856

Less: Sales discounts 1,134

Less: Credit card discounts 1,849

Net sales $133,417