Solutions to E6-5, 6-19, P6-7, E6-29, CP6-1

Financial Accounting (Concordia University)

Solutions to E6-5, 6-19, P6-7, E6-29 and CP6-1

E6–5 Recording Credit Sales, Sales Discounts, Sales Returns, and Credit Card Sales

The following transactions were selected from among those completed by Hailey Retailers in 2020:

Nov. 20	Sold two items of merchandise to Baja, who charged the $450 sales amount on her Visa credit card. Visa charges Hailey a 2 percent credit card fee.
25	Sold 14 items of merchandise to Christine for $2,800; terms 2/10, n/30.
28	Sold 12 identical items of merchandise to Daoud for $7,200; terms 2/10, n/30.
30	Daoud returned one of the items purchased on the 28th; the item was defective, and credit was given to the customer.
Dec. 6	Daoud paid the account balance in full.
30	Christine paid in full the amount due for the purchase on November 25, 2020.

Required:

1. Prepare the appropriate journal entry for each of these transactions, assuming the company uses the gross method to record sales revenue. Do not record the cost of sales.
2. Assuming that sales discounts and credit card discounts are treated as contra revenues, compute net sales for the two months ended December 31, 2020.

1.

Nov. 20	Cash (+A)	441	
	Credit card discounts (+XR, –SE)	9	
	Sales revenue (+R, +SE)		450
Nov. 25	Accounts receivable – Christine (+A)	2,800	
	Sales revenue (+R, +SE)		2,800
	Cost of sales (+E, –SE)	$$$	
	Inventory (–A)		$$$
Nov. 28	Accounts receivable – Daoud (+A)	7,200	
	Sales revenue (+R, +SE)		7,200
Nov. 30	Sales returns and allowances (+XR, –SE)	600	
	Accounts receivable – Daoud (–A)		600
	$7,200 / 12 items = $600		
	Inventory (+A)	$$$	
	Cost of sales (–E, +SE)		$$$
Dec. 6	Cash (+A) [$6,600 – 132]	6,468	
	Sales discounts (+XR, –SE)	132	
	Accounts receivable – Daoud (–A)		6,600
	Sales discount = $6,600 x 2% = 132		
Dec. 30	Cash (+A)	2,800	
	Accounts receivable – Christine (–A)		2,800

2.

Sales revenue	$10,450
Less: Credit card discounts	(9)
Sales returns and allowances	(600)
Sales discounts	(132)
Net sales	$ 9,079

E6–19 Recording, Reporting, and Evaluating a Bad Debt Estimate Using the Percentage of Credit Sales Method

During the current year, Robby's Camera Shop had sales revenue of $170,000, of which $75,000 was on credit. At the start of the current year, Accounts Receivable showed a $16,000 debit balance and the Allowance for Doubtful Accounts showed a $900 credit balance. Collections of accounts receivable during the current year amounted to $60,000.

Data during the current year follow:

a. On December 31 an account receivable (J. Doe) of $1,700 from a prior year was determined to be uncollectible; therefore, it was written off immediately as a bad debt.
b. On December 31, on the basis of experience, a decision was made to continue the accounting policy of basing estimated bad debt losses on 1.5 percent of credit sales for the year.

Required:

1. Prepare the required journal entries for the two transactions that occurred on December 31, the end of the fiscal year.
2. Show how the amounts related to accounts receivable and bad debt expense would be reported on the statement of earnings and the statement of financial position for the current year. Disregard income tax considerations.
3. On the basis of the data available, does the 1.5 percent rate appear to be reasonable? Explain.

Summary of information

Sales revenue	$170,000 Cr
Credit sales	75,000
Accounts receivable, beg.	16,000 Dr
Allowance for doubtful accounts	900 Cr
Collections from customers	60,000

1.

Dec. 31	Allowance for doubtful accounts (–XA, +A)	1,700	
	Accounts receivable – J. Doe (–A)		1,700
Dec. 31	Bad debt expense (+E, –SE)	1,125	
	Allowance for doubtful accounts (+XA, –A)		1,125
	$75,000 x 1.5% = $1,125		

2.

Accounts Receivable			
Jan. 1	16,000		
	Credit sales 75,000	Collections 60,000	
		Write-off 1,700	
Dec. 31	29,300		

Allowance for Doubtful Accounts			
		900	Jan. 1
Dec. 31	Write-off 1,700		
	Unadjusted bal. 800		
		Bad debt exp. 1,125	Dec. 31
		325	Dec. 31

	Statement of earnings: *Operating expenses:* Bad debt expense $1,125 Statement of financial position: *Current assets* Accounts receivable $29,300 Less: Allowance for doubtful accounts 325 Accounts receivable, net $28,975

Gildan Activewear Inc.

4. TRADE ACCOUNTS RECEIVABLE:

		September 27, 2020		December 29, 2019
Trade accounts receivable	**$**	**228,982**	$	328,115
Allowance for expected credit losses		**(18,789)**		(7,184)
	$	**210,193**	$	320,931

P6–7 Recording Receivables Transactions, Determining Bad Debt Expense, and Interpreting Ratios

At December 1, 2020, Imalda Inc. reported the following information on its statement of financial position:

Accounts receivable	$154,000
Allowance for doubtful accounts	4,500 (credit balance)

The following transactions were completed during December 2020:

Dec. 5 Sold merchandise items for $67,000. An amount of $19,000 was received in cash and the rest on account; terms 2/10, n/60. The total cost of sales was $35,000.

Dec. 12 Collected cash for *half* of the credit sales made on December 5.

Dec. 20 Collected $90,000 in cash from customers for credit sales made in November 2020.

Dec. 26 One of Imalda's customers that owed $3,000 to the company experienced financial problems and was forced to close its business in December. The full amount was considered uncollectible.

Required

1. Prepare the journal entries to record the transactions that occurred in December 2020.

1.

Dec. 5	Cash (+A)	19,000	
	Accounts receivable (+A)	48,000	
	Sales revenue (+R, +SE)		67,000
	Cost of sales (+E, –SE)	35,000	
	Inventory (–A)		35,000
Dec. 12	Cash (+A) [$24,000 – 480]	23,520	
	Sales discounts (+XR, –SE)	480	
	Accounts receivable (–A)		24,000
	Sales discounts = $24,000 x 2% = $480		
Dec. 20	Cash (+A)	90,000	
	Accounts receivable (–A)		90,000
Dec. 26	Allowance for doubtful accounts (–XA, +A)	3,000	
	Accounts receivable (–A)		3,000

Imalda uses the aging of accounts receivable method to determine bad debt expense. The aging schedule at December 31, 2020, gives the following information about the accounts receivable estimated uncollectible:

Aging of Accounts Receivable

	Current (Not Yet Due)	**1–30 Days Past Due**	**31–60 Days Past Due**	**Over 60 Days Past Due**
Total	$42,000	$31,500	$5,000	$6,500
Estimated % uncollectible	1%	2%	10%	30%

Required:

2. Using the aging schedule, compute the bad debt expense for December 2020 and prepare the related adjusting entry.

Aging of Accounts Receivable

	Current (Not Yet Due)	**1–30 Days Past Due**	**31–60 Days Past Due**	**Over 60 Days Past Due**	**Total**
Total	$42,000	$31,500	$5,000	$6,500	$85,000
Estimated % uncollectible	1%	2%	10%	30%	
Allowance	$420	$630	$500	$1,950	$3,500

Allowance for Doubtful Accounts					
			Beg. Balance	4,500	Dec. 1
Dec. 31	Write off	3,000			
			Unadjusted bal.	1,500	Dec. 31
	Adjustment		Bad debt exp. = ?	2,000	Dec. 31
			Ending balance	3,500	Dec. 31

Dec. 31	Bad debt expense (+E, –SE)	2,000	
	Allowance for doubtful accounts (+XA, –A)		2,000

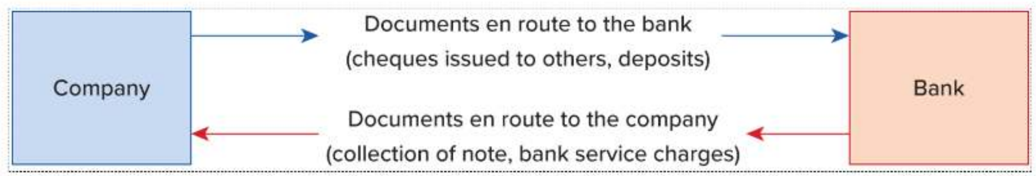
3. Compute the gross profit percentage and the receivables turnover ratio for December 2020 and explain their meaning.	3. Gross profit percentage = Gross profit / Net sales Gross profit = Net sales – Cost of sales = ($67,000 – 480) – 35,000 = $31,520 Gross profit percentage = $31,520 / $66,520 = 0.4738 or 47.38% Receivables turnover ratio = Net credit sales / Average net acc. receivable Net credit sales = credit sales – sales discounts – sales returns & allowances = $48,000 – 480 – 0 = $47,520 Net accounts receivable = Accounts Receivable – All. for Doubtful Accounts Net A/R, Dec. 1 = $154,000 – 4,500 = $149,500 Net A/R, Dec. 31 = $85,000 – 3,500 = $81,500 Average net A/R = ($149,500 + 81,500) / 2 = $115,500 Receivables turnover ratio = $47,520 /$115,500 = 0.41 times (December Assume that the receivable turnover is 7 times per year, calculate the average collection period (average days to collect receivables). Average collection period = 365 days / Receivables turnover = 365 / 7 = 52 days (rounded)

E6–29 Preparing Bank Reconciliation, Entries, and Reporting Cash

The bank statement for Mini Mart Corporation shows a balance of $1,330 on June 30, but the company's cash in bank account had a balance of $499 on the same date. Comparison of the amounts reported on the bank statement with the company's records indicates (*a*) deposits of $160, representing cash receipts of June 30 that did not appear on the bank statement; (*b*) outstanding cheques totalling $240; (*c*) bank service charges for June amounting to $9; (*d*) collection of a note receivable by the bank on behalf of the company for $800 plus $40 in interest revenue; and (*e*) a cheque for $80 from a customer that was returned with the bank statement and marked NSF.

Required:

1. Prepare a bank reconciliation statement for Mini Mart Corporation as at June 30.



Balance in bank account = $1,330

Balance in Cash in Bank account = $499

1.

Mini Mart Corporation
Bank Reconciliation
June 30

Cash balance per bank	$1,330
Add: (a) Deposit in transit	160
	1,490
Less: (b) Outstanding cheques	(240)
Adjusted cash balance per bank	$1,250
Cash balance per books	$ 499
Add: (d) Note collected by bank and interest $40	840
	1,339
Less: (c) Bank service charge	(9)
(e) NSF Cheque	(80)
	(89)
Adjusted cash balance per books	$1,250

2. Prepare any journal entries that should be made as a result of the bank reconciliation.

3. Why is it important to reconcile the balance in the bank statement with the cash balance in the company's records?

4. What is the amount of cash that the company should report on its statement of financial position at June 30?

2.

(d)	Cash in Bank (+A)	840	
	Notes receivable (–A)		800
	Interest revenue (+R, +SE)		40
(e)	Bank service charge expense (+E, –SE)	9	
	Cash in Bank (–A)		9
	Sales discounts = $24,000 x 2% = $480		
(c)	Accounts receivable (+A)	80	
	Cash in Bank (–A)		80

3.

Control of cash

Determine correct balance of cash

Adjusting the balance of cash

4. Cash balance = $1,250

CP6–1 Finding Financial Information **METRO Inc.** Refer to the financial statements of METRO Inc. in Appendix A of this book. ***Required:***	
1. Does the company disclose its revenue recognition policy? What point in time does it use to recognize revenue?	1. The Company discloses its revenue recognition policy in Note 2 – Significant Accounting Policies. METRO's sales "come essentially from the sale of goods. Retail sales made by corporate stores and stores that are structured entities are recognized at the time of sale to the customer, and sales to affiliated stores and other customers when the goods are delivered."
2. Compute the company's gross profit percentage for fiscal years 2017 and 2018. Has it risen or fallen? Explain the meaning of the change.	2. Gross profit percentage = Gross profit / Net sales 2020: \$3,581.8 ÷ \$17,997.5 = 0.199 (19.9%) 2019: \$3,328.7 ÷ \$16,767.5 = 0.199 (19.9%) 2018: \$2,826.9 ÷ \$14,383.4 = 0.197 (19.7%) 2017: \$2,595.7 ÷ \$13,175.3 = 0.197 (19.7%) METRO's gross profit percentage is relatively stable over the years 2017-2020. The Company maintained its mark-up on the cost of merchandise it purchased and prepared for resale to customers.
3. Does the company report an allowance for doubtful accounts in the notes to its financial statements? If so, review the details disclosed by the company and explain what they mean.	3. The Company discusses credit risk in Note 28 – Financial Instruments, but did not disclose any details about an allowance for doubtful accounts, presumably because the balance of that account is not material.

4. Compute METRO's receivables turnover ratio for 2018. Is it significantly different from the ratio computed for Gildan in the Key Ratio Analysis section in the chapter? If so, what are some possible reasons for the difference?	4. $$\text{Receivables turnover ratio, 2020} = \frac{\text{Net Sales}}{\text{Average Net Accounts Receivable}} = \frac{\$17{,}997.5}{626.5^*} = 28.73 \text{ times}$$ * (\$611.2 + \$641.8) ÷ 2 The receivables turnover for Gildan is 10.38. METRO's ratio is much higher than Gildan's because of the nature of the products it sells, its credit policy, and the speed of collection from customers. Another possible difference is the amount of credit sales for each company. The computation of the ratio assumes that all sales are on credit, but this may not be true.
5. What does the company include in "cash and cash equivalents"? How close do you think the disclosed amount is to the actual fair market value of these assets?	5. According to Note 2 to its financial statements, METRO defines cash and cash equivalents as consisting of "… cash on hand, bank balances, highly liquid investments (with an initial term of three months or less) and outstanding deposits." Because cash and cash equivalents are essentially cash, the fair market value is extremely close to the disclosed amount.