$$\frac{\text{Credit sale}}{\text{Avg A/R}} = \text{A R turnover}$$

$$\frac{365}{\text{A/R turnover}} = \text{DSO}$$

compare which is weighted more
- Pro: Increase Seller's receivable
- Cons: Increase wage cost
  - Bad debt cost
  - Delayed reciept of cash

when inventory going to be old, bad thing would happen, so ⇒ cost of good sold

how to match bed debt and A/R

same period sales has expense

has to calculate bad debt (uncollectiable) ratio

GAAP: estimate bad debt expense:
- Percentage of credit sale
- aging of A/R

$\boxed{\text{footnote}}$

Public offering, footnotes on financial statement disclose everything

A/R

Sale Revenue

when estimate the Bad debt

BD (+E, −SE)

ADA (+XA, −A)

ADA (−XA) ↓

A/R (−A) ↓

B/S

cash

A/R

Less: ADA

A/R net

inventory

...

Allowance method

1. Record the estimated bad debts in the period credit sales occur, using an end-of-period adjustment, and

2. Remove ("write off") specific customer balances when they are known to be uncollectible.

write off 800 Receivable because company could not pay its account

ADA 800
 A/R 800

impact of working capital:

	Beginning of month	Write off	End of month
A/R	100,000	(1,000)	99,000
(ADA)	(10,000)	1,000	(9,000)
net A/R	9,000	— 0 —	90,000

WC = CA − CL, so there is no impact on WC

		Increase of credit sales (increase of ADA)			
A/R	200,000	—	(800)	199200	199200
(ADA)	14,100	(900)	800	13,300	(14,200)
net A/R	185,900	(900)	- 0 —	185900	5,000

Estimate Bad debt
① percentage of credit sale — simply
② aging of AR — accurate

Credit sale	xxx
− Bad debt loss rate	7.5%
Bad debt expense	

	Total	0-30	31-60	61-90	Over 90
Total A/R	$x_1+x_2+x_3+x_4$	x_1	x_2	x_3	x_4
Estimate uncollected		1%	10%	20%	40%
BD	$0.01x_1+0.1x_2+0.2x_3+0.4x_4$	$0.01x_1$	$0.1x_2$	$0.2x_3$	$0.4x_4$

Compare to benchmark

A/R turnover

$$DSO = \frac{365}{\text{A/R turnover}} = \frac{365}{\frac{\text{Net sale}}{\text{Avg net A/R}}} = \frac{365 \times \text{Avg net A/R}}{\text{net sales}}$$

write off specific customers

ADA

A/R

write off — decrease R/E

E8-9 Recording and Determining the Effects of Write-Offs, Recoveries, and Bad Debt Expense Estimates on the Balance Sheet and Income Statement

Fraud Investigators Inc. operates a fraud detection service.

Required:

1. Prepare journal entries for each transaction below.
   - **a.** On March 31, 10 customers were billed for detection services totaling $25,000.
   - **b.** On October 31, a customer balance of $1,500 from a prior year was determined to be uncollectible and was written off.
   - **c.** On December 15, a customer paid an old balance of $900, which had been written off in a prior year.
   - **d.** On December 31, $500 of bad debts were estimated and recorded for the year.

2. Complete the following table, indicating the amount and effect (+ for increase, – for decrease, and NE for no effect) of each transaction.

Transaction	Net Receivables	Net Sales	Income from Operations
a.			
b.			
c.			
d.			

Practice
E8-9.

① A/R 25000
  Sales 25000] March

cash xx
  inventory xx

② ADA 1,500
  A/R 1,500 ; write off

③ reverse write off
  A/R 900
  ADA 900
  allowance

  cash 900 (collect cash)
  A/R 900

④ Bad debt expense 500
  ADA 500] ~~DEC~~ Mar (2% uncollectible)

	Net A/R	Net sales	OP income
a.	25000	25000	25000 −XX
b.	NA	NA	NA
c	(−900) because reverse write off, A/R ⇒ cash so A/R reduced	NA	NA
d	(500)	NA	(500)

LO 8-2, 8-3

MCI
WorldCom

S8-4 Ethical Decision Making: A Real-Life Example

You work for a company named MCI and you have been assigned the job of adjusting the company's Allowance for Doubtful Accounts balance. You obtained the following aged listing of customer account balances for December.

Accounts Receivable Aged Listing—December 31

Customer	Total	0–30 days	31–60 days	61–90 days	91–120 days	>120 days
AfriTel	40,000	20,000	10,000	5,000	5,000	0
CT&T	0	0	0	0	0	0
GlobeCom	28,000	0	18,000	8,000	1,000	1,000
Hi-Rim	35,000	0	0	0	0	35,000
Level 8	162,000	63,000	44,000	29,000	13,000	13,000
NewTel	0	0	0	0	0	0
Telemedia	0	0	0	0	0	0
Others	485,000	257,000	188,000	28,000	11,000	1,000
TOTAL	**750,000**	**340,000**	**260,000**	**70,000**	**30,000**	**50,000**

Bad debt loss rates for each aging category are estimated to be 1% (0–30 days), 5% (31–60 days), 8% (61–90 days), 10% (91–120 days), and 50% (> 120 days). Using these rates, you calculate a desired balance for the allowance. No entries have been made to the account since the end of November, when the account had a credit balance of $46,820.

To check the reasonableness of the calculated balance, you obtain the aged listings for prior months (shown below). As you scan the listings, you notice an interesting pattern. Several account balances, which had grown quite large by the end of November, had disappeared in the final month of the year. You ask the accounts receivable manager, Walter Pavlo, what happened. He said the customers "obtained some financing . . . I guess out of nowhere" and they must have used it to pay off their account balances.

Customer	Q1 (March 31)	Q2 (June 30)	Q3 (September 30)	Q4 (October 31)	Q4 (November 30)	Q4 (December 31)
	Total Accounts Receivable as of . . .					
AfriTel	19,000	19,000	21,000	16,000	20,000	40,000
CT&T	0	30,000	100,000	100,000	100,000	0
GlobeCom	29,000	28,000	31,000	27,000	28,000	28,000
Hi-Rim	0	0	25,000	35,000	35,000	35,000
Level 8	229,000	229,000	198,000	174,000	190,000	162,000
NewTel	0	0	25,000	25,000	25,000	0
Telemedia	0	0	2,000	2,000	2,000	0
Others	524,000	489,000	375,000	503,000	463,000	485,000
TOTAL	**801,000**	**795,000**	**777,000**	**882,000**	**863,000**	**750,000**

Required:

1. Calculate the balance that should be reported in Allowance for Doubtful Accounts as of December 31.
2. Prepare the adjusting journal entry that is required on December 31.
3. Show how Accounts Receivable would be reported on the balance sheet at December 31.
4. If the balances for CT&T, NewTel, and Telemedia at the end of November continued to exist at the end of December (in the over-120-days category), what balance would you have estimated for the Allowance for Doubtful Accounts on December 31? Would this have changed MCI's net income in the current year? Explain.

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②

Total	0-30	31-60	61-90	91-120	>120
	1%	5%	8%	10%	50%
750,000	340,000	260,000	70,000	30,000	50,000
$\boxed{50,000}$	= 3400	13000	5,600	3,000	25,000

this is Allowance

75,000 - 5000

Allowance	
	46,820, BEG
	$\boxed{3180}$
	50,000

use allowance info to calculate the BD

Bad Debt Exp 3180
ADA 3180

③ A/R - [Net of 50,000 Allowance] = 700,000

④

$ 50,000 (still exist)

127,000
100,000 CT&T
25,000 NewTEL
2,000 TELEMedia
177,000
50%
88,500

Total A/R
877000

$\boxed{113,500}$ 3400 13,000 5,600 30,000

Allowance	
	46,820
	$\boxed{66,680}$
	113,500

Bad debt Exp 66680
Allow 66680

S8-6 Critical Thinking: Analyzing the Impact of Credit Policies

Problem Solved Company has been operating for five years as a software consulting firm. During this period, it has experienced rapid growth in Sales Revenue and in Accounts Receivable. To solve its growing receivables problem, the company hired you as its first corporate controller. You have put into place more stringent credit-granting and collection procedures that you expect will reduce receivables by approximately one-third by year-end. You have gathered the following data related to the changes (in thousands):

	(in thousands)	
	Beginning of Year	End of Year (projected)
Accounts Receivable	$1,000,608	$660,495
Allowance for Doubtful Accounts	36,800	10,225
Accounts Receivable, Net	$ 963,808	$650,270
	Prior Year	Current Year (projected)
Net Sales (assume all on credit)	$7,515,444	$7,015,069

Required:

1. Compute, to one decimal place, the accounts receivable turnover ratio based on three different assumptions:
   a. The stringent credit policies reduce Accounts Receivable, Net, and decrease Net Sales as projected in the table.
   b. The stringent credit policies reduce Accounts Receivable, Net, as projected in the table but do not decrease Net Sales from the prior year.
   c. The stringent credit policies are not implemented, resulting in no change from the beginning of the year Accounts Receivable balance and no change in Net Sales from the prior year.

S8-6

a) A/R turnover $= \frac{\text{Sales}}{\text{AVG A/R}} = \frac{7015069}{(650,270 + 963808)/2} = 8.7x \quad \frac{365}{8.7} = 42 \text{ days}$

b) FLAT Sales $= \frac{7515444}{(650,270 + 963808)/2} = 9.3x \quad \frac{365}{9.3} = 39 \text{ Days}$

c) $= \frac{7,515,444}{(963808 + 963808)/2} = 7.8 \quad \frac{365}{7.8} = 47 \text{ days}$