

ACC101 – CHAPTER 7

Accounting for Receivables



Key Terms and Concepts to Know

Accounts Receivable:

Result from sales on account (credit sales), not cash sales.

May also result from credit card sales if there is a delay between when sale is made and when the cash is received from the credit card company.

Accounting for Uncollectible Accounts:

Not all sales on account result in cash being collected from the customer.

The Allowance Method debits bad debt expense in the period when the sale is recorded and credits a contra-asset account, Allowance for Uncollectible Accounts. When a specific account is determined to be uncollectible, the Allowance is debited and Accounts Receivable is credited.

The Direct Write-off Method debits bad debt expense and credits Accounts Receivable in the period when a specific account is determined to be uncollectible. The Direct Write-off Method violates the matching principle because it does not match revenues and expenses in the same period.

Determining the Amount of Uncollectible Receivables and Bad Debt Expense:

The Percent of Sales Method uses one income statement account, Sales, to estimate the change in another income statement account, Bad Debt Expense, for the period. This is the amount of the adjusting entry required. The balance in the Allowance account is then the balance in the ledger before adjustment plus the adjusting entry for bad debt expense.

The Percent of Receivables Method uses the balance in one balance sheet account, Accounts Receivable, to estimate the balance in another balance sheet account, Allowance for Uncollectible Accounts, at the end of the period. The adjusting entry for bad debt expense is the difference between the balance in the ledger before adjustment and the estimated balance in the allowance account.

Accounts Receivable on the Balance Sheet:

Allowance account is deducted from Accounts Receivable to determine Net Realizable Value.

Notes Receivable:

Notes Receivable may be accepted by the seller in payment for a sale or to replace an account receivable from a prior sale.

Notes bear interest for their term which is paid at the end of the term, the maturity date. Interest rates are typically stated as a percent per annum, that is, as a yearly or annual rate.

Interest revenue is earned as time passes, regardless of whether payment has been received.

Interest revenue for outstanding notes receivable is typically accrued at the end of the year, although it may be accrued at the end of a quarter or month.

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If the note is not paid or dishonored at maturity, the amount of the principal and interest is debited to accounts receivable because it is still payable to the seller by the buyer. Another note may also be accepted by the buyer in place of the account receivable.

Accounts Receivable Turnover Ratio

UNCOLLECTIBLE ACCOUNTS RECEIVABLE: THE ALLOWANCE METHOD

- Uncollectible accounts expense is estimated at the end of each accounting period in order to properly match the expense with the revenue earned for the period.

December 31	Uncollectible Accounts Expense	5,000	
	Allowance for Doubtful Accounts		5,000

- Uncollectible Accounts Expense is reported on the Income Statement
- Allowance for Doubtful Accounts is a contra asset account and is reported on the Balance Sheet as a deduction from Accounts Receivable. The result is called Net Realizable Value.

Current Assets:

Accounts Receivable	25,000
less allowance for doubtful accounts	3,000
Net Realizable Value	22,000

- To write-off Customer A's account:

June 5	Allowance for Doubtful Accounts	1,000	
	Accounts Receivable-Customer A		1,000

- To reinstate Customer A when the balance is subsequently paid:

July 10	Accounts Receivable-Customer A	1,000	
	Allowance for Doubtful Accounts		1,000
10	Cash	1,000	
	Accounts Receivable-Customer A		1,000

Example #1: Journalize the following transactions.

- 2001 12/31 Estimated that \$7,000 of accounts receivable would become uncollectible.
 2002 1/05 Wrote-off the \$800 balance owed by Jane Camp and the \$500 balance owed by Friends, Inc.
 3/18 Reinstated the account of Jane Camp that had been written off as Uncollectible and recorded receipt of the \$800 cash in full payment.

Solution #1

2001	12/31	Uncollectible Accounts Expense	7,000	
		Allowance for Doubtful Accounts		7,000
2002	01/05	Allowance for Doubtful Accounts	1,300	
		Accounts Receivable – Jane Camp	800	
		Accounts Receivable – Friends, Inc.	500	
	03/18	Accounts Receivable – Jane Camp	800	
		Allowance for Doubtful Accounts		800
		Cash	800	

METHODS FOR ESTIMATING THE UNCOLLECTIBLE AMOUNT

PERCENTAGE OF SALES METHOD

Multiply the percentage times the given to the sales to determine the uncollectible accounts expense for the period. This will be the amount of the adjusting entry.

Example #2: Uncollectible accounts expense is estimated at $\frac{1}{4}$ of 1% of net sales of \$4,000,000 for the year. The current balance in Allowance for Doubtful Accounts is \$300 credit. Determine the following:

- a. The uncollectible accounts expense for the year.
- b. The adjusting entry to be made on December 31.
- c. The balance in Allowance for Doubtful Accounts after adjustment.

Solution #2

- a. $4,000,000 * .0025 = \$10,000$
- b.

Uncollectible Accounts Expense	10,000
Allowance for Doubtful Accounts	10,000
- c. $\$300 \text{ credit balance} + 10,000 \text{ additional credit} = \$10,300 \text{ credit balance}$

AGING OF ACCOUNTS RECEIVABLE METHOD

The current balance of accounts receivable is analyzed by use of an aging schedule to determine the desired ending balance for the Allowance for Doubtful Accounts. The uncollectible accounts expense for the period is determined based on the current (unadjusted) balance in the Allowance, the desired ending balance in the Allowance account and any write-offs of uncollectible accounts during the period.

Example #3: The balance of Allowance for Doubtful Accounts before adjustment at the end of the period is \$400 debit. Based on an analysis of Accounts Receivable, it was estimated that \$9,000 would become uncollectible. Determine the following:

- a. The uncollectible accounts expense for the year.
- b. The adjusting entry to be made of December 31.
- c. The balance in Allowance for Doubtful Accounts after adjustment.

Solution #3

a.

<u>Allowance for Doubtful Accounts</u>	
Bal. 400	
	Uncollectible Accounts Expense for the year
	9,000 Desired Ending Balance

$$\text{Uncollectible Accounts Expense} = 400 + 9,000 = 9,400$$

b. Uncollectible Accounts Expense 9,400
 Allowance for Doubtful Accounts 9,400

c. 9,000

Practice Problem #1: Journalize the following transactions assuming the allowance method is used to account for uncollectible receivables.

- 05/14 Received 75% of the \$20,000 balance owed by Webb Co., a bankrupt business, and wrote off the remainder as uncollectible.
- 06/20 Reinstated the account of Zorn Co., which had been written off in the preceding year as uncollectible. Received \$5,225 cash as full payment of Zorn's account.
- 07/27 Wrote off the \$2,500 balance owed by Schmich, Inc. which had no assets.
- 12/31 Based on an analysis of Accounts Receivable it is determined that \$11,500 will become uncollectible. The balance of Allowance for Doubtful Accounts prior to adjustment is \$200 credit.

1. Based on the above what is the ending balance in Allowance for Doubtful Accounts?
2. If the balance of Accounts Receivable is \$62,000, what is the Net Realizable Value of Accounts Receivable?
3. Redo the entry of 12/31 and questions 1 and 2, if the percent of sales method had been used to estimate uncollectible accounts at the rate of 1/2 of 1% of net sales of \$2,000,000.

NOTES RECEIVABLE

Promissory Note – a written promise to pay a specific dollar amount on demand or at a specific time, usually with interest.

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On July 17, 2001, received a \$12,000, 90-day, 10% note on account from Adams Co

<u>Due Date:</u> Term of the note =	90	days
Days remaining in July 31 – 17 =	<u>14</u>	<u>days</u>
Remaining term of the note	76	days
Days in August	<u>31</u>	<u>days</u>
Remaining term of the note	45	days
Days in September	<u>30</u>	<u>days</u>
Remaining term of the note	15	days

Since the remaining 15 days are less than the 31 days in October, the note is due on October 15.

Interest: Calculated as Principal X Rate X Time
$$\$12,000 * .10 * 90/360 = \$300$$

Time is calculated as the term of the note divided by 360 days for the year. Time is always based on a 360-day year.

Maturity Value: Calculated as Principal + Interest
$$\$12,000 + \$300 = \$12,300$$

Journal Entries:

07/17 Notes Receivable	12,000	
Accounts Receivable		12,000
10/15 Cash	12,300	
Notes Receivable		12,000
Interest Revenue		300

Dishonoring the Note: If the maker of the note failed to pay (dishonored) the note on October 15, the following entry would be made:

10/15 Accounts Receivable	12,300	
Notes Receivable		12,000
Interest Revenue		300

Note that the differences between the two entries for 10/15 are the account to be debited.

Adjusting Entries for accrued interest: At the end of the accounting period, in order to comply with the matching principle, interest must be accrued for the number of days between the most recent interest payment date and the end of the accounting period using the calculation method shown above.

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Example #4: Journalize the adjusting entry for accrued interest on December 31 for the following outstanding notes receivable. Journalize the receipt of the amount due on the due date for each note.

1. \$24,000, 60-day, 10% note dated December 1.
2. \$12,000, 90-day, 15% note dated October 22.

Solution #4

1. Interest has been earned for 30 days on this note:
Days remaining in December 31 – 1 = 30 days

$$\$24,000 * .10 * 30/360 = \$200$$

2. We have earned 65 days of interest on this note:
Days remaining in October 31 – 22 = 9 days
Days in November = 30 days
Days in December = 31 days
Total days to accrue 70 days

$$\$12,000 * .15 * 70/360 = \$350$$

12/31	Interest Receivable	550	
	Interest Revenue	550	
01/20	Cash	12,450	<i>(12,000 * .15 * 90/360)</i>
	Notes Receivable	12,000	
	Interest Receivable	350	<i>(interest earned last year)</i>
	Interest Revenue	100	<i>(interest earned this year)</i>
01/30	Cash	24,400	<i>(24,000 * .10 * 60/360)</i>
	Notes Receivable	24,000	
	Interest Receivable	200	<i>(interest earned last year)</i>
	Interest Revenue	200	<i>(interest earned this year)</i>

Practice Problem #2: Journalize the following transactions

- 09/12 Received a \$30,000, 12%, 120-day note on account.
10/09 Received a \$15,000, 10%, 60-day note on account.
11/15 Received an \$18,000, 15%, 30-day note on account.
12/08 Received the amount due on the note of October 9.
12/15 The note of November 15 was dishonored.
12/31 Accrued interest on the note of September 12.

SAMPLE MULTIPLE CHOICE QUESTIONS

1. The internal control procedure most relevant to receivables is:
 - a. Cost-benefit balance
 - b. Safeguard assets
 - c. Efficient operations
 - d. Separate entity

2. A note receivable due in 5 years is listed on the balance sheet under the caption:
 - a. Investments
 - b. Current Assets
 - c. Plant Assets
 - d. Stockholders' Equity

3. The two methods of accounting for uncollectible receivables are the direct write-off method and the:
 - a. Percentage of receivables method
 - b. Aging of credit sales method
 - c. Interest method
 - d. Allowance method

4. The Allowance for Doubtful Accounts has a debit balance of \$1,000 at the end of the year (before adjustment), and uncollectible accounts expense is estimated at 2% of net sales. If net sales are \$600,000, the amount of the adjusting entry to record the provision for doubtful accounts is:
 - a. \$1,000
 - b. \$13,000
 - c. \$11,000
 - d. \$12,000

5. The Allowance for Doubtful Accounts has a debit balance of \$1,000 at the end of the year (before adjustment), and uncollectible accounts estimate based on an aging schedule is \$10,000. If accounts receivable are \$600,000 the amount of the adjusting entry to record the provision for doubtful accounts is:
 - a. \$10,000
 - b. \$11,000
 - c. \$9,000
 - d. \$16,000

6. Allowance for Doubtful Accounts has a credit balance of \$500 at the end of the year (before adjustment), and an analysis of customers' accounts indicates doubtful accounts of \$11,500. Which of the following entries records the proper provision for doubtful accounts?
 - a. Debit Uncollectible Accounts Expense, \$11,000; credit Allowance for Doubtful Accounts, \$11,000.
 - b. Debit Uncollectible Accounts Expense, \$12,000; credit Allowance for Doubtful Accounts, \$12,000.
 - c. Debit Allowance for Doubtful Accounts, \$12,000; credit Uncollectible Accounts Expense, \$12,000.
 - d. Debit Allowance for Doubtful Accounts, \$11,000; credit Uncollectible Accounts Expense, \$11,000.

7. If the direct write-off method of accounting for uncollectible receivables is used, what general ledger account is debited to write off a customer's account as uncollectible?
 - a. Uncollectible Accounts Payable
 - b. Accounts Receivable
 - c. Uncollectible Accounts Expense
 - d. Allowance for Doubtful Accounts

8. The amount of the promissory note plus the interest earned on the due date is called the:
 - a. Realizable value
 - b. Face value
 - c. Net realizable value
 - d. Maturity value

9. A \$7,000, 30-day, 12% note recorded on November 21 is not paid by the maker at maturity. The journal entry to recognize this event is:
 - a. Debit Cash 7,070; Credit Notes Receivable 7,070
 - b. Debit Accounts Receivable 7,070; Credit Notes Receivable 7,000; Credit Interest Revenue 70.
 - c. Debit Notes Receivable 7,070; Credit Accounts Receivable 7,070
 - d. Debit Accounts Receivable 7,070; Credit Notes Receivable 7,000; Credit Interest Receivable 70.

10. In reference to a promissory note, another word(s) for "discount" is:
 - a. Fair Value
 - b. Interest
 - c. To buy for more than face value
 - d. Maturity

11. Receivables are usually listed on the Balance Sheet after cash in what order?
 - a. Cash, Accounts Receivable, Notes Receivable, Interest Receivable
 - b. Cash, Interest Receivable, Notes Receivable, Accounts Receivable
 - c. Cash, Notes Receivable, Accounts Receivable, Interest Receivable
 - d. Cash, Notes Receivable, Interest Receivable, Accounts Receivable

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12. Receivables are usually listed in order
 - a. Of liquidity
 - b. Of the due date
 - c. Of the size
 - d. Alphabetically

13. Accounts Receivable Turnover measures
 - a. Number of days outstanding
 - b. Fair market value of Accounts Receivables
 - c. The efficiency of the accounts payable function
 - d. How frequently during the year the Accounts Receivable are converted to cash

14. The Number of Days Sales in Receivables
 - a. Measures the number of times the receivables turn over each year
 - b. Is Net Credit Sales divided by Average Receivables
 - c. Is not meaningful and therefore not used
 - d. Is an estimate of the length of time the receivables have been outstanding

15. Accounts receivable are reported on the balance sheet at their
 - a. Fair market value
 - b. Present value
 - c. Net realizable value
 - d. Maturity value

16. Under the allowance method the write-off of an account receivable leaves the net realizable value of the accounts receivable unchanged.
 - a. True
 - b. False

17. The direct write-off method violates the matching principle.
 - a. True
 - b. False

18. When an account is written off under the allowance method the
 - a. Uncollectible Accounts Expense account is debited.
 - b. Accounts Receivable account is debited.
 - c. Allowance for Doubtful Accounts is debited.
 - d. Loss on Accounts Receivable account is debited.

19. A note receivable is recorded at its
 - a. Face Value
 - b. Fair market value
 - c. Present value
 - d. Maturity value

20. A 90-day note dated April 13 has a maturity date of
- July 10
 - July 11
 - July 12
 - July 13
21. The interest on a \$6,000, 8%, 240-day note receivable is
- \$320
 - \$480
 - \$32
 - \$48
22. Winter Company receives a \$3,000, 120-day, 10% note from Futon Company as a payment of its account receivable. What entry will Winter Company make when it receives the note?
- Debit Notes Receivable, 3,100; Credit Accounts Receivable 3,100
 - Debit Notes Receivable, 3,100; Credit Accounts Receivable 3,000
 - Debit Notes Receivable, 3,000 and Interest Receivable, 100; Credit Accounts Receivable, 3,000 and Interest Revenue, 100
 - Debit Notes Receivable, 3,000; Credit Accounts Receivable, 3,000
23. Craft Co. loaned \$24,000 to Sims Co. on December 1, at 10% interest for 90 days. What adjusting entry will Craft Co. have to make on December 31 before preparing the financial statements.
- Debit Interest Receivable, 600; Credit Interest Revenue, 600
 - Debit Interest Receivable, 200; Credit Interest Revenue, 200
 - Debit Interest Receivable, 1,000; Credit Interest Revenue, 1,000
 - Debit Interest Receivable, 2,400; Credit Interest Revenue, 2,400

SOLUTIONS TO PRACTICE PROBLEMS

Practice Problem #1

05/14	Cash	15,000
	Allowance for Doubtful Accts	5,000
	Accounts Receivable-Webb	20,000

06/20	Accounts Receivable	5,225
	Allowance for Doubtful Accts	5,225
	Cash	5,225
	Accounts Receivable	5,225

07/27	Allowance for Doubtful Accts	2,500
	Accounts Receivable	2,500

12/31	Uncollectible Accounts Expense	11,300
	<i>(11,500 – 200 credit bal = 11,300)</i>	
	Allowance for Doubtful Accts	11,300

- 1) 11,500 *(based on analysis of A/R)*
- 2) $62,000 - 11,500 = \$50,500$

12/31	Uncollectible Accounts Expense	10,000
	<i>(2,000,000 * .005 = 10,000)</i>	
	Allowance for Doubtful Accts	10,000
	1) 10,200 <i>(10,000 + 200 credit bal)</i>	
	2) $62,000 - 10,200 = \$51,800$	

Practice Problem #2

09/12	Notes Receivable	30,000
	Accounts Receivable	30,000

10/09	Notes Receivable	15,000
	Accounts Receivable	15,000

11/15	Notes Receivable	18,000
	Accounts Receivable	18,000

12/08	Cash	15,250
	Notes Receivable	15,000
	Interest Revenue	250
	<i>(15,000 * .10 * 60/360 = \$250 interest)</i>	

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12/15 Accounts Receivable 18,225
Notes Receivable 18,000
Interest Revenue 225
*(18,000 * .15 * 30/360 = \$225 interest)*

12/31 Interest Receivable 1,100
Interest Revenue 1,100
*(30,000 * .12 * 110/360 = \$1,100 interest)*
(Sept 12 – Dec 31 = 110 days)

Practice Problem #3

01/07 Notes Receivable 12,000
Cash 12,000

02/05 Accounts Receivable-Joshua 22,200
Sales 22,200
COMS 13,500
Mdse Inventory 13,500

02/06 Cash 12,154
Notes Receivable 12,000
Interest Revenue 154
*(Maturity Value: 12,000 * .12 * 90/360 = 360 + 12,000 = 12,360)*
*(Discount: 12,360 * .10 * 60/360 = 206; 30 days from 01/07 to 02/06)*
(Proceeds: 12,360 – 206 = 12,154)

02/15 Accounts Receivable-Jade, Inc. 33,000
Sales 33,000
COMS 19,800
Mdse Inventory 19,800

03/09 Notes Receivable 22,200
Accounts Receivable-Joshua 22,200

03/20 Notes Receivable 33,000
Accounts Receivable-Jade, Inc. 33,000

05/08 Cash 22,496
Notes Receivable 22,200
Interest Revenue 296
*(22,200 * .08 * 60/360 = \$296)*

07/18 Accounts Receivable-Jade, Inc. 34,320
Notes Receivable 33,000
Interest Revenue 1,320
*(33,000 * .12 * 120/360 = \$1,320)*

SOLUTIONS TO MULTIPLE CHOICE QUESTIONS

1. B
2. A
3. D
4. D: $600,000 * .02 = \$12,000$
5. B: $10,000 + 1,000 \text{ debit balance} = 11,000 \text{ expense}$
6. A: $11,500 - 500 \text{ credit balance} = 11,000 \text{ expense}$
7. C
8. D
9. B: $7,000 * .12 * 30/360 = \$70 \text{ interest revenue}$
10. B
11. C
12. A
13. D
14. D
15. C
16. A
17. A
18. C
19. A
20. C: $90 - 17 \text{ days Apr.} = 73 - 31 \text{ days May} = 42 - 30 \text{ days June} = \text{July 12}$
21. A
22. D
23. B: $24,000 * .10 * 30/360 = 200 \text{ interest earned for December}$