

ACCOUNTS RECEIVABLE

Key Topics to Know

Direct write-off method

- When an account is determined to be uncollectible, the direct write-off method uses the following entry

Uncollectible account expense	xxx	
Accounts receivable		xxx

- This method violates the matching principle as the uncollectible account expense is not recorded in the same period as the related revenue

Allowance method

- The allowance method follows the matching principle by recording the uncollectible accounts expense in the same period as the related revenue. The account receivable is still written off in the period it is determined to be uncollectible
- The allowance account functions as a bridge between these two transactions, being credited when the expense is recorded and debited when the uncollectible account is identified

Determining bad debt expense

- **Percent of Sales Method** to estimate bad debt expense
 - Uses the activity in one income statement account, revenue, to calculate the activity in another income statement account, bad debt expense
- **Percent of Receivables Method** to estimate bad debt expense
 - Uses the balance in one balance sheet account, accounts receivable, to calculate the balance in another balance sheet account, allowance for uncollectible accounts

Collection of an account receivable previously written off

- Two journal entries to record subsequent customer payment: one to re-establish the account receivable and the second to record the receipt of cash

Net Realizable Value

- The concept of net value is used throughout accounting, the name changing as the account names change.

- For accounts receivable, Net Realizable Value is calculated as:

Accounts receivable balance – Allowance of Uncollectible Accounts balance

Accounts receivable turnover and Average collection period ratios

- All turnover ratios have the same format:
$$\frac{\text{Income statement account balance}}{\text{Average balance sheet account balance}}$$
- Therefore Accounts Receivable Turnover ratio is:
$$\frac{\text{Credit Sales}}{\text{Average accounts receivable}}$$
- Days in Inventory is:
$$\frac{365}{\text{Accounts Receivable Turnover}}$$

Problems

Problem #1 - Uncollectible Receivables

- a) What are the two methods of accounting for uncollectible receivables?
- b) What is the journal entry used to write-off an uncollectible account when using the direct write-off method?
- c) What is the journal entry used to write-off an uncollectible account when using the allowance method?
- d) What is the journal entry used to reinstate an account when using the direct write-off method?
- e) What is the journal entry used to reinstate an account when using the allowance method?
- f) What are the two methods used to estimate uncollectible accounts expense when using the allowance method?

Problem #2 - Estimated uncollectible amounts based on sales

Before year-end adjustment, the Allowance for Doubtful Accounts has a credit balance of \$25,000. Uncollectible accounts are estimated as 1% of credit sales, which were \$1,500,000. The accounts receivable balance is \$325,000.

- Required:
- a) What is the uncollectible accounts expense for the period?
 - b) What is the journal entry required?
 - c) What is the balance of the Allowance for Doubtful Accounts after adjustment?
 - d) What is the net realizable value of the receivables after adjustment?

Problem #3 - Estimated uncollectible amounts based on analysis (aging) of receivables

Before the year-end adjustment the Allowance for Doubtful Accounts has a debit balance of \$5,000. Using the aging of receivables method, the desired balance of the Allowance for Doubtful Accounts is estimated as \$35,000.

- Required:
- a) What is the uncollectible accounts expense for the period?
 - b) What is the journal entry required?
 - c) What is the balance of the Allowance for Doubtful Accounts after adjustment?
 - d) If the accounts receivable balance is \$325,000, what is the net realizable value of the receivables after adjustment?

Problem #4 - Compute Accounts receivable turnover ratio

The N Company had net sales on account of \$6,570,000 during the year. The beginning and ending accounts receivable were \$475,000 and 535,000 respectively.

- Required: Compute the accounts receivable turnover ratio.

Multiple Choice Questions

1. The year-end adjusting entry to recognize uncollectible accounts expense will
 - a) Increase assets and decrease equity.
 - b) Decrease assets and decrease equity.
 - c) Increase liabilities and increase equity.
 - d) Decrease liabilities and increase equity.

2. On January 1, the Accounts Receivable balance was \$18,500 and the balance in the Allowance for Doubtful Accounts was \$1,400. On January 15, a \$400 uncollectible account was written-off. The net realizable value of accounts receivable immediately after the write-off is:
 - a) \$18,100.
 - b) \$16,700.
 - c) \$17,100.
 - d) \$17,500.

The next 2 questions refer to the following information.

The M Company earned \$95,000 of revenue on account during the year. There was no beginning balance in the accounts receivable and allowance accounts. During the year, M collected \$68,000 of cash from customers on account. The company estimates that it will be unable to collect 3% of its sales on account.

3. The amount of uncollectible accounts expense recognized on the income statement was
 - a) \$2,040.
 - b) \$660.
 - c) \$2,850.
 - d) \$27,000.

4. The net realizable value of accounts receivable at the end of the year was
 - a) \$24,150.
 - b) \$24,960.
 - c) \$29,850.
 - d) \$27,000.

5. J Company ended last year with balances in Accounts Receivable and Allowance for Doubtful Accounts of \$46,000 and \$1,800, respectively. During the year, J Company wrote off \$3,000 of Uncollectible Accounts. After aging its receivables, J Company estimates that the ending Allowance for Doubtful Accounts balance should be \$3,200. What will J Company report as Uncollectible Accounts Expense on its income statement?
- a) \$3,200
 - b) \$4,400
 - c) \$1,400
 - d) \$3,000
6. On December 31 of the current year, the unadjusted trial balance of a company using the percent of receivables method to estimate bad debt included the following: Accounts Receivable, debit balance of \$95,250; Allowance for Doubtful Accounts, credit balance of \$921. What amount should be debited to Bad Debts Expense, assuming 6% of outstanding accounts receivable at the end of the current year will be uncollectible?
- a) \$5,715
 - b) \$6,636
 - c) \$4,794
 - d) \$5,770
7. Which one of the following is not an accurate description of the Allowance for Doubtful Accounts?
- a) The account is an income statement account.
 - b) The account is a contra account.
 - c) The amount of the Allowance for Doubtful Accounts decreases the net realizable value of a company's receivables.
 - d) The account is increased by an estimate of uncollectible accounts expense.
8. On October 17 of the current year, a company determined that a customer's account receivable was uncollectible and that the account should be written off. Assuming the allowance method is used to account for bad debts, what effect will this write-off have on the company's net income and total assets?
- a) Decrease in net income; no effect on total assets.
 - b) No effect on net income; no effect on total assets.
 - c) Decrease in net income; decrease in total assets.
 - d) No effect on net income; decrease in total assets.

The following 2 questions refer to the following information.
On December 31, G Company provided the following information:

	<u>January 1</u>	<u>December 31</u>
Accounts receivable	\$3,600	\$4,900
Allowance for doubtful accounts	200	300
Total revenue		\$38,800
Cash sales		2,800

9. G Company's accounts receivable turnover ratio was:
- a) 9.7
 - b) 9.1
 - c) 9.0
 - d) 8.5
10. G Company's average collection period ratio was:
- a) 43.1 days
 - b) 40.6 days
 - c) 40.0 days
 - d) 37.6 days

Solutions to Problems

Problem #1 - Uncollectible Receivables

- a) The two methods of accounting for uncollectible receivables are the direct write-off method and the allowance method.
- b) Uncollectible accounts expense xxx
 Accounts receivable xxx
- c) Allowance for doubtful accounts xxx
 Accounts receivable Xxx
- d) Accounts receivable xxx
 Uncollectible accounts expense xxx
- e) Accounts receivable xxx
 Allowance for doubtful accounts xxx
- f) The two methods used to estimate uncollectible accounts expense when using the allowance method are the percent of sales and the percent of receivables.

Problem #2 - Estimated uncollectible amounts based on sales

- a) The uncollectible accounts expense for the period is $\$15,000 = 1\% \text{ of } \$1,500,000$
- b) Uncollectible accounts expense 15,000
 Allowance for doubtful accounts 15,000
- c) The balance of the Allowance after adjustment is $\$40,000 = 25,000 + 15,000$
- d) The net realizable value after adjustment is $\$285,000 = 325,000 - 40,000$

Problem #3 - Estimated uncollectible amounts based on analysis (aging) of receivables

- a) The uncollectible accounts expense for the period is $\$40,000 = 35,000 + 5,000$
- b) Uncollectible accounts expense 40,000
 Allowance for doubtful accounts 40,000
- c) The balance of the Allowance after adjustment is $\$35,000$
- d) The net realizable-value after adjustment is $\$290,000 = 325,000 - 35,000$

Problem #4 - Compute Accounts receivable turnover ratio

- a) Accounts receivable turnover was 13.0
 $6,570,000 / (475,000 + 535,000) / 2 = 13.0$
- b) The number of days' sales in receivables at year end was 29.7 days
 $535,000 / (6,570,000 / 365) = 29.7$

Solutions to Multiple Choice Questions

- 1. B
- 2. C
- 3. C
- 4. A
- 5. B
- 6. C
- 7. A
- 8. B
- 9. C
- 10. B