

Dutchess Community College
ACC 104 – Financial Accounting
Quiz Prep Chapter 8
Reporting & Analyzing Receivables

Peter Rivera
April, 2007
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Disclaimer

This *Quiz Prep* is provided as an outline of the key concepts from the chapter.

It is not intended to be comprehensive or exhaustive.

Quizzes may include material from the classroom lectures, the text or the homework assignments.

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Receivables

Accounts Receivable

Amounts owed by customers for goods or services

Notes Receivable

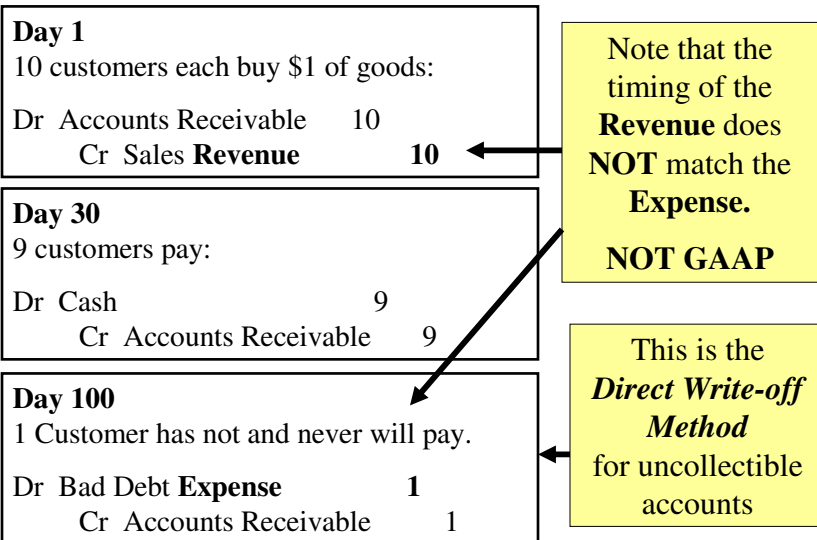
The amounts owed, either by customers or others, are formally documented and carry an interest charge.

Other Receivables

Amounts owed for things other than from customers, e.g., interest receivable

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Direct Write-off Method



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Allowance Method

<p>Day 1 10 customers each buy \$1 of goods:</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Dr Accounts Receivable</td> <td style="width: 20%; text-align: right;">10</td> <td style="width: 20%;"></td> </tr> <tr> <td style="padding-left: 20px;">Cr Sales Revenue</td> <td></td> <td style="text-align: right;">10</td> </tr> <tr> <td colspan="3"> </td> </tr> <tr> <td>Dr Bad Debt Expense</td> <td style="text-align: right;">1</td> <td></td> </tr> <tr> <td style="padding-left: 20px;">Cr Allowance for Doubtful Accounts</td> <td></td> <td style="text-align: right;">1</td> </tr> </table>	Dr Accounts Receivable	10		Cr Sales Revenue		10				Dr Bad Debt Expense	1		Cr Allowance for Doubtful Accounts		1	<div style="border: 1px solid black; background-color: #ffffcc; padding: 5px; margin-bottom: 5px;"> <p>Note that the timing of the Revenue matches Expense</p> </div> <div style="border: 1px solid black; background-color: #ffffcc; padding: 5px;"> <p>Contra-asset account; Credit normal balance</p> </div>
Dr Accounts Receivable	10															
Cr Sales Revenue		10														
Dr Bad Debt Expense	1															
Cr Allowance for Doubtful Accounts		1														
<p>Day 30 9 customers pay (same entry as prior example)</p>																
<p>Day 100 1 Customer has not and never will pay.</p> <table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 60%;">Dr Allowance for Doubtful Accounts</td> <td style="width: 20%; text-align: right;">1</td> <td style="width: 20%;"></td> </tr> <tr> <td style="padding-left: 20px;">Cr Accounts Receivable</td> <td></td> <td style="text-align: right;">1</td> </tr> </table>	Dr Allowance for Doubtful Accounts	1		Cr Accounts Receivable		1	<div style="border: 1px solid black; background-color: #ffffcc; padding: 5px;"> <p>Note that write-off does NOT affect P&L</p> </div>									
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Allowance Method

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Dr Accounts Receivable	10															
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Estimation Techniques

The two most common techniques to estimate bad debt expense are:

- **Percentage Of Receivables**
- **Aging of Accounts Receivable**

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Estimation Techniques

Percentage Of Receivables

Through analysis, management estimates the % of Accounts Receivable that may ultimately be uncollectible.

Accounts Receivable	\$ 100,000
Estimated Uncollectible	x 5%
Estimated Allowance	\$ 5,000

VERY IMPORTANT: Similar to *Ending Supplies*, the estimated allowance is what the Allowance for Doubtful Accounts balance should be after the journal entry; It is NOT the entry amount.

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Estimation Techniques

Percentage Of Receivables

Estimated Allowance = \$ 5,000

Current Balance in Allowance account = \$4,200 Cr

Allowance		
	4,200	← The Beginning Balance is a normal Credit
	800	
	5,000	
Ending Balance = Estimated Allowance		→

	Dr	Cr
Bad Debt Expense	800	
Allowance for Doubtful Accounts		800

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Estimation Techniques

Percentage Of Receivables

Estimated Allowance = \$ 5,000

Current Balance in Allowance account = \$4,200 Cr

Allowance		
	4,200	← The Expense does NOT equal the Allowance amount
	800	
	5,000	
→		→

	Dr	Cr
Bad Debt Expense	800	
Allowance for Doubtful Accounts		800

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Estimation Techniques

Percentage Of Receivables

Estimated Allowance = \$ 5,000

Current Balance in Allowance account = \$600 **Dr**

<div style="border: 1px solid black; background-color: #ffffcc; padding: 2px; margin-bottom: 5px;"> The Beginning Balance is a Debit; i.e., NOT normal </div> <div style="border: 1px solid black; background-color: #ffffcc; padding: 2px;"> Ending Balance = Estimated Allowance </div>	<table style="margin-left: auto; margin-right: auto;"> <tr><td colspan="2" style="border-top: 1px solid black; border-bottom: 1px solid black;">Allowance</td></tr> <tr><td style="border-right: 1px solid black; padding: 5px;">600</td><td style="padding: 5px;"></td></tr> <tr><td style="border-right: 1px solid black; padding: 5px;"></td><td style="padding: 5px;">5,600</td></tr> <tr><td style="border-right: 1px solid black; padding: 5px;"></td><td style="border-top: 1px solid black; padding: 5px;">5,000</td></tr> </table>	Allowance		600			5,600		5,000		
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Estimation Techniques

Percentage Of Receivables

Estimated Allowance = \$ 5,000

Current Balance in Allowance account = \$600 **Dr**

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Estimation Techniques

Aging of Accounts Receivables

(amounts in \$ 000)

	Total	Not Yet Due	1-30 Days	31-60 Days	61-90 Days	90+ Days
Accts Rec	100	65	20	9	5	1

Each individual *Accounts Receivable* balance is categorized based on how many days past due they are and summed.

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Estimation Techniques

Aging of Accounts Receivables

(amounts in \$ 000)

	Total	Not Yet Due	1-30 Days	31-60 Days	61-90 Days	90+ Days
Accts Rec	100	65	20	9	5	1
Estimated % Uncollectible		1%	5%	15%	30%	50%

Through analysis, management estimates the % of *Accounts Receivable* in each aging category that may ultimately be uncollectible.

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Estimation Techniques

Aging of Accounts Receivables

(amounts in \$ 000)

	Total	Not Yet Due	1-30 Days	31-60 Days	61-90 Days	90+ Days
Accts Rec	100	65	20	9	5	1
Estimated % Uncollectible		1%	5%	15%	30%	50%
Estimated \$ Uncollectible		.65	1.00	1.35	1.50	.50

↑ ↑ ↑ ↑ ↑

The *Accounts Receivable* is multiplied by the *Estimated % Uncollectible* for each category

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Estimation Techniques

Aging of Accounts Receivables

(amounts in \$ 000)

	Total	Not Yet Due	1-30 Days	31-60 Days	61-90 Days	90+ Days
	100	65	20	9	5	1
Estimated % Uncollectible		1%	5%	15%	30%	50%
Estimated \$ Uncollectible	5.0	.65	1.00	1.35	1.50	.50

↑

The sum of the individual calculations = the *Estimated Allowance*

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Estimation Techniques

Aging of Accounts Receivables

The journal entries are the same as described for the % of Sales estimation technique, e.g.:

Estimated Allowance = \$ 5,000

Current Balance in Allowance account = \$4,200 Cr

	Dr	Cr
Bad Debt Expense	800	
Allowance for Doubtful Accounts		800

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Allowance Method

Balance Sheet Presentation:

Assume a Write-off of 3:

Dr Allow. for Doubtful Accts	3
Cr Accts Receivable	3

	Before Write-off	After Write-off
Accounts Receivable	100	97
Less: Allow. for Doubtful Accts	<u>5</u>	<u>2</u>
Net Accounts Receivable	95	95
	↑	↑

Note that the write-off does not change the *Net Accounts Receivable* balance

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Allowance Method

Recap of Key Concepts (1):

- Matches Revenues and Expenses
 - Consistent with *Matching Principal*
 - GAAP
- Allowance Account is a *contra-asset* account
 - Credit Normal Balance
- Write-offs
 - Do NOT affect the Income Statement
 - Do NOT change *Net Accounts Receivable*

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Allowance Method

Recap of Key Concepts (2):

- Journal Entries
 - Are for the amount that will bring the *Allowance for Doubtful Accounts* balance to the Estimated Allowance amount
 - **IMPORTANT:** Pay attention to whether the Beginning Balance is a Debit or a Credit

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Notes Receivable

Notes Receivable earn interest which, according to the *Revenue Recognition Principal*, must be accrued in a manner similar to *Accrued Revenue*.

On January 1 a customer has borrowed \$100,000 for one year at 12% per year paid semi-annually.

On March 31, you have earned
 $\$100,000 \times 12\% / 12 \times 3 = \$3,000$ Interest Revenue.

Adjusting Entry:

	Dr	Cr
Interest Receivable	3,000	
Interest Revenue		3,000

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Notes Receivable

When the customer pays you 6 months of interest on June 30 the entry would be:

	Dr	Cr
Cash	6,000	
Interest Receivable		3,000
Interest Revenue		3,000

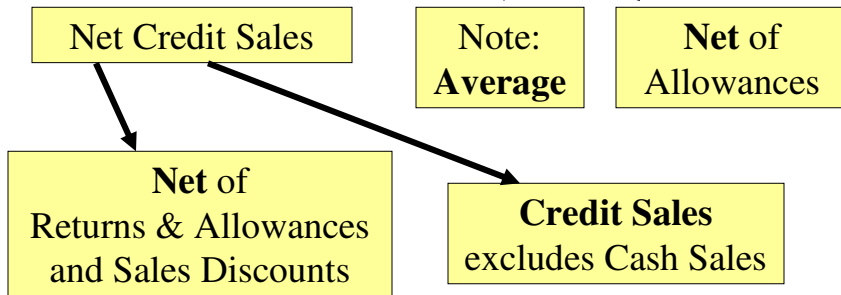
This reverses the accrual made on March 31

This recognizes the interest earned over the 3 months from April 1 though June 30

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Receivables Turnover Ratio

$$\text{Receivables Turnover} = \frac{\text{Net Credit Sales}}{\text{Average Net Receivables}}$$



Higher is Better

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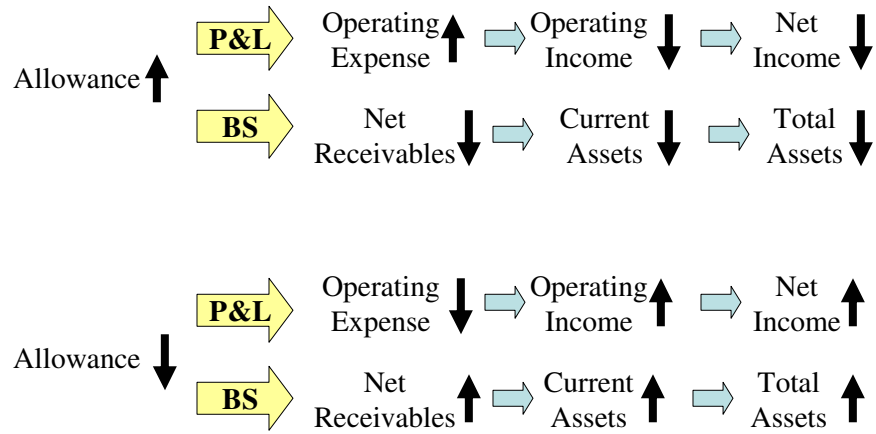
Average Collection Period

$$\text{Average Collection Period} = \frac{365}{\text{Receivables Turnover Ratio}}$$

Lower is Better

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Impact of Allowance Estimate



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Impact of Allowance Estimate

Net Receivables	Working Capital Current Ratio
Total Assets	Debt / Total Assets
Net Income	Profit Margin Earnings Per Share

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