

Receivables

Chapter 8

Learning Objective 1

Define and explain common types of receivables

Receivables

- ▶ Arise from selling goods and services on credit and lending money
- ▶ Right to receive cash in the future from a current transaction

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Accounts Receivable

- ▶ Amounts to be collected from customers for sales on credit
- ▶ Serves as a control account

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Notes Receivable

- ▶ More formal than accounts receivable
- ▶ Usually longer in term
- ▶ Charge interest to the borrower
- ▶ Promissory note

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Learning Objective 2

Design internal controls for receivables

Internal Controls and Receivables

- ▶ Credit department evaluates customers' applications
- ▶ Separation of duties

Accounting for Uncollectibles

- ▶ Selling on credit
- ▶ Two methods to account for uncollectible accounts
 - Allowance method
 - Direct write-off method

Learning Objective 3

Use the allowance method to account for uncollectibles

Allowance Method

- ▶ Based on the matching principle
- ▶ Offset to expense is **Allowance for uncollectible accounts**

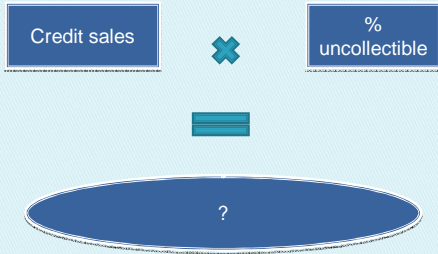
Methods for Estimating Uncollectibles

- ▶ Percent of Sales
 - Income Statement Approach
- ▶ Aging of Accounts Receivable
 - Balance Sheet Approach

Allowance Method

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Uncollectible accounts expense			
	Allowance for uncollectible accounts			
	<i>To estimate bad debts for period</i>			

Percent of Sales Method



Aging Method



What is uncollectible accounts expense?

Short Exercise 8-5 Aging Method

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
Dec 31	Uncollectible account expense		210	
	Allowance for uncollectible accounts			210

0-60 Days	Over 60 days	Total
\$71,000	\$6,000	\$77,000
x 1%	x 20%	
\$710	\$1,200	\$1,910
Allowance for uncollectible accts		\$1,700
Adjustment needed		\$210

Short Exercise 8-5 (continued)

	\$1,700
	\$ 210
	\$1,910

Writing off Uncollectible Accounts

- ▶ When a specific customer account is identified as uncollectible, it is written off

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Allowance for uncollectible accounts			
	Accounts receivable-name			

Recovery of Account

- ▶ Sometimes a customer will pay the amount owed after the customer's account is written off
- ▶ Two entries needed

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Accounts receivable-name			
	Allowance for uncoll. accounts			
	Cash			
	Accounts receivable-name			

Accounts receivable

- | | |
|---|--|
| <p><u>Increases (debits)</u></p> <ul style="list-style-type: none"> ▶ Sales on credit | <p><u>Decreases (credits)</u></p> <ul style="list-style-type: none"> ▶ Customer payments ▶ Write-offs |
|---|--|

Allowance for uncollectible accounts

- | | |
|--|---|
| <p><u>Decreases (debits)</u></p> <ul style="list-style-type: none"> ▶ Write-offs | <p><u>Increases (credits)</u></p> <ul style="list-style-type: none"> ▶ Uncollectible account expense entry ▶ Recoveries of accounts previously written off |
|--|---|

Learning Objective 4

Understand the direct write-off method for uncollectibles

Direct Write-Off Method

- ▶ Used by small businesses
- ▶ No Allowance for uncollectible accounts
- ▶ Records Uncollectible accounts expense when specific account is written off

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Uncollectible account expense			
	Accounts receivable-name			
	<i>Write off account using direct write off method</i>			

Problems with Direct Write-Off Method

- ▶ Overstates Accounts receivable on the balance sheet
- ▶ Violates matching principle

Learning Objective 5

Report receivables on the balance sheet

Accounts receivable on the Balance Sheet

- ▶ Current asset
- ▶ Shown net of Allowance for uncollectible accounts
- ▶ Two presentation styles:

Balance Sheet (Partial) December 31, 2012	
Assets	
Current assets:	
Accounts receivable	\$\$\$\$\$
Less: Allowance for uncollectible accounts	(\$\$\$\$)
Accounts receivable, net	\$\$\$\$\$

Balance Sheet (Partial) December 31, 2012	
Assets	
Current assets:	
Accounts receivable, net of allowance for doubtful accounts of \$\$\$	\$\$\$\$\$

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Learning Objective 6

Journalize credit-card, bank card, and debit-card sales

Credit Card Sales

- ▶ Credit card companies (American Express and Discover) pay the retailer and bill the customer

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Accounts receivable – Discover			
	Credit card discount expense			
	Sales revenue			

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Bank Cards

- ▶ Retailers receive cash at time of sale
- ▶ VISA and MasterCard most common bank cards

GENERAL JOURNAL				
DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Cash			
	Bank card discount expense			
	Sales revenue			

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Debit Cards

- ▶ Different than credit and bank cards
- ▶ Same as cash

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Learning Objective 7

Account for notes receivable

Notes receivable

- ▶ More formal than Accounts receivable
- ▶ Debtor signs **promissory note**

Notes Receivable

Interest starts

PROMISSORY NOTE

\$10,000.00 **Oct. 4, 2010**

Amount Date

Principal I promise to pay to the order of **First National Bank**

Ten thousand and no/100-----Dollars Payee

on **January 2, 2011**

plus interest at the annual rate of **12%**. Maker

Maturity Date Interest Rate **Jeanette Sims**

Identifying Maturity Date

- ▶ Maturity date can be:
 - A specific date such as March 13
 - Stated in terms of number of months
 - Stated in terms of number of days

Determine the Maturity Date

A 90-day note issued March 13

Days in note		90
Days in March	31	
Date of issue	-13	
Days outstanding in March		-18
Days remaining		72
Days in April	30	
Days in May	31	-61
Due date in June		11

Computing Interest

PRINCIPAL



RATE



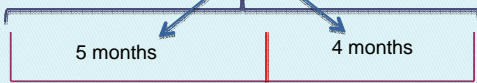
TIME

Accruing Interest Revenue

- ▶ If any notes receivable are outstanding at the end of the period, interest must be accrued
- ▶ Interest is earned over time
- ▶ Revenue must be recorded in the period earned

Accruing Interest Revenue

Note term = 9 months



Date of Note, Aug 1, 2011 End of Fiscal Year, Dec 31, 2011 Maturity Date, May 1, 2012

Exercise 8-19

GENERAL JOURNAL

DATE	DESCRIPTION	REF	DEBIT	CREDIT
2011				
Jan 3	Cash		101,920	
	Bank card discount expense		2,080	
	Sales revenue			104,000
Oct 1	Notes receivable		24,000	
	Cash			24,000
Dec 31	Interest receivable		600	
	Interest revenue			600
	(24,000 x 10% x 3/12)			

Exercise 8-19 (continued)

GENERAL JOURNAL

DATE	DESCRIPTION	REF	DEBIT	CREDIT
2012				
Oct 1	Cash		26,400	
	Interest receivable			600
	Interest revenue			1,800
	Notes receivable			24,000

Dishonored Notes Receivable

- ▶ If the maker does not pay the note on the due date, the note is dishonored
- ▶ The note is expired, but the maker still owes the company for the maturity value
- ▶ An entry is made to convert the note into an account receivable

GENERAL JOURNAL

DATE	DESCRIPTION	REF	DEBIT	CREDIT
	Accounts receivable-name			
	Notes receivable-name			
	Interest revenue			

Learning Objective 8

Use the acid-test ratio and days' sales in receivables to evaluate a company

Acid-Test Ratio

- ▶ Also called the "quick ratio"
- ▶ Measures entity's ability to pay its current liabilities immediately

$$\frac{\text{Cash} + \text{ST Investments} + \text{Net receivables}}{\text{Current liabilities}}$$

Days' Sales in Receivables

- ▶ Also called "collection period"
- ▶ Indicates the number of days it takes to collect the average balance of receivables

Days' Sales in Receivables

$$\text{One day's sales} = \text{Net sales} \div 365 \text{ days}$$

$$\text{Days' sales in average accounts receivable} = \frac{\text{Average net accounts receivable}}{\text{One day's sales}}$$

End of Chapter 8