

Quick Ratio (p. 424)

Ratio of the sum of cash plus short-term investments plus net current receivables to total current liabilities. Tells whether the entity could pay all its current liabilities if they came due immediately. Also called the **acid-test ratio**.

Receivable (p. 405)

Monetary claim against a business or an individual.

Subsidiary Accounts (p. 405)

Contains the details by individual account that are summarized in the control account.

Subsidiary Ledger (p. 405)

A ledger that contains the details, for example by customer or vendor, of individual account balances. The sum of all related subsidiary ledger accounts will equal the control account.

Time (Period) (p. 419)

The period of time during which interest is computed. It extends from the original date of the note to the maturity date. Also called the **note term** or **interest period**.

Trade Receivables (p. 405)

Amounts to be collected from customers from sales made on credit. Also called **Accounts receivable**.

Uncollectible Account Expense (p. 407)

Cost to the seller of extending credit. Arises from the failure to collect from credit customers. Also called **doubtful account expense** or **bad debt expense**.

● Destination: Student Success

Student Success Tips

The following are hints on some common trouble areas for students in this chapter:

- Recall that the main difference between the allowance method and the direct write-off method is **MATCHING**. The allowance method records the expense in the same period as the sale. The direct write-off method records the expense when the identification occurs, usually several months later than the sale.
- Remember that there are two ways illustrated in the chapter to calculate/adjust the amount that is in the allowance for uncollectible accounts: **percentage of sales** and the **target balance through aging-of-accounts method**.
- Keep in mind that when a business accepts credit cards and debit cards as payment for sales, the card issuer assesses a fee based on a small percentage of the sale. This fee is called **Card discount expense**, and it reduces the amount of cash the company receives from the sale.
- The formula for calculating interest is $\text{Principal} \times \text{Interest Rate} \times \text{Time}$. Interest must be calculated as time goes by on the note.
- When counting the number of days, don't count the day the note was made when determining how many days have passed. Also, consider using the knuckle trick to help you recall the number of days in each month (Make two fists and put them together: knuckles have 31 days, joints between your knuckles don't.)

Getting Help

If there's a learning objective from the chapter you aren't confident about, try using one or more of the following resources:

- Review Exhibits 8-3 and 8-4 to recall the difference between the allowance method and the direct write-off method.
- Practice additional exercises or problems at the end of Chapter 8 that cover the specific learning objective that is challenging you.
- Watch the white board videos for Chapter 8 located at myaccountinglab.com under the Chapter Resources button.
- Go to myaccountinglab.com and select the Study Plan button. Choose Chapter 8 and work the questions covering that specific learning objective until you've mastered it.
- Work the Chapter 8 pre/post tests in myaccountinglab.com.
- Visit the learning resource center on your campus for tutoring.

● Quick Check

1. With good internal controls, the person who handles cash can also
 - a. account for cash payments.
 - b. account for cash receipts from customers.
 - c. issue credits to customers for sales returns.
 - d. None of the above
2. "Bad debts" are the same as
 - a. doubtful accounts.
 - b. uncollectible accounts.
 - c. Neither of the above
 - d. Both a and b.

Experience the Power of Practice!

As denoted by the logo, all of these questions, as well as additional practice materials, can be found in

MyAccountingLab

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3. When recording credit- or debit-card sales using the net method,
 - a. cash received equals sales.
 - b. cash received equals sales minus the fee assessed by the card processing company.
 - c. cash received equals sales plus the fee assessed by the card processing company.
 - d. cash isn't received by the seller until the customer pays his or her credit card statement.
4. Your company uses the allowance method to account for uncollectible receivables. At the beginning of the year, Allowance for uncollectible accounts had a credit balance of \$1,000. During the year you recorded Uncollectible account expense of \$2,700 and wrote off bad receivables of \$2,100. What is your year-end balance in Allowance for uncollectible accounts?
 - a. \$1,600
 - b. \$4,800
 - c. \$3,700
 - d. \$600
5. Your ending balance of Accounts receivable is \$19,500. Use the data in the preceding question to compute the net realizable value of Accounts receivable at year-end.
 - a. \$16,800
 - b. \$19,500
 - c. \$17,400
 - d. \$17,900
6. What is wrong with the direct write-off method of accounting for uncollectibles?
 - a. The direct write-off method overstates assets on the balance sheet.
 - b. The direct write-off method does not match expenses against revenue very well.
 - c. The direct write-off method does not set up an allowance for uncollectibles.
 - d. All of the above
7. At January 31, you have a \$8,400 note receivable from a customer. Interest of 10% has accrued for 10 months on the note. What will your financial statements report for this situation?
 - a. The balance sheet will report the note receivable of \$8,400.
 - b. The balance sheet will report the note receivable of \$8,400 and interest receivable of \$700.
 - c. Nothing, because you have not received the cash yet.
 - d. The income statement will report a note receivable of \$8,400.
8. Return to the data in the preceding question. What will the income statement report for this situation?
 - a. Nothing, because you have not received the cash yet
 - b. Note receivable of \$8,400
 - c. Interest revenue of \$700
 - d. Both b and c.
9. At year-end, your company has cash of \$11,600, receivables of \$48,900, inventory of \$37,900, and prepaid expenses totaling \$5,100. Liabilities of \$55,900 must be paid next year. What is your acid-test ratio?
 - a. 1.08
 - b. 0.21
 - c. 1.76
 - d. Cannot be determined from the data given
10. Return to the data in the preceding question. A year ago receivables stood at \$67,400, and sales for the current year totaled \$807,800. How many days did it take you to collect your average level of receivables?
 - a. 49
 - b. 35
 - c. 29
 - d. 26

Answers are given after Apply Your Knowledge (p. 449).

Assess Your Progress

• Short Exercises

S8-1 1 Different types of receivables [5 min]

Consider accounts receivable and notes receivable.

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Requirement

1. What is the difference between accounts receivable and notes receivable?

S8-2 1 Internal control over the collection of receivables [5 min]

Consider internal control over receivables collections.

Requirement

1. What job must be withheld from a company's credit department in order to safeguard its cash? If the credit department does perform this job, what can a credit department employee do to hurt the company?

S8-3 2 Applying the allowance method (percentage of sales) to account for uncollectibles [5 min]

During its first year of operations, Spring Garden Plans earned revenue of \$322,000 on account. Industry experience suggests that bad debts will amount to 2% of revenues. At December 31, 2012, accounts receivable total \$36,000. The company uses the allowance method to account for uncollectibles.

Requirements

1. Journalize Spring's sales and uncollectible account expense using the percent-of-sales method.
2. Show how to report accounts receivable on the balance sheet at December 31, 2012. Use the long reporting format illustrated in the chapter.

S8-4 2 Applying the allowance method (percentage of sales) to account for uncollectibles [5–10 min]

The Accounts receivable balance for Winter Retreats at December 31, 2011, was \$18,000. During 2012, Winter completed the following transactions:

- a. Sales revenue on account, \$447,000 (ignore cost of goods sold).
- b. Collections on account, \$424,000.
- c. Write-offs of uncollectibles, \$5,900.
- d. Uncollectible account expense, 2% of credit sales.

Requirement

1. Journalize Winter's 2012 transactions.

S8-5 2 Applying the allowance method (aging of accounts) to account for uncollectibles [10 min]

Summer and Sandcastles Resort had the following balances at December 31, 2012, before the year-end adjustments:

Accounts receivable	Allowance for uncollectible accounts
78,000	1,900

The aging of accounts receivable yields the following data:

	Age of Accounts receivable		Total Receivables
	0–60 Days	Over 60 Days	
Accounts receivable . . .	\$75,000	\$3,000	\$78,000
Percent uncollectible . . .	× 4%	× 24%	

Requirements

1. Journalize Summer's entry to adjust the allowance account to its correct balance at December 31, 2012.
2. Prepare a T-account to compute the ending balance of Allowance for uncollectible accounts.

S8-6 **3 Applying the direct write-off method to account for uncollectibles [10 min]**
 Sherman Peterson is an attorney in Los Angeles. Peterson uses the direct write-off method to account for uncollectible receivables.

At January 31, 2012, Peterson's accounts receivable totaled \$15,000. During February, he earned revenue of \$18,000 on account and collected \$19,000 on account. He also wrote off uncollectible receivables of \$1,800 on February 29, 2012.

Requirements

1. Use the direct write-off method to journalize Peterson's write-off of the uncollectible receivables.
2. What is Peterson's balance of Accounts receivable at February 29, 2012? Does Peterson expect to collect the total amount?

S8-7 **3 Collecting a receivable previously written off—direct write-off method [5–10 min]**

Gate City Cycles had trouble collecting its account receivable from Sue Ann Noel. On June 19, 2012, Gate City finally wrote off Noel's \$700 account receivable. Gate City turned the account over to an attorney, who hounded Noel for the rest of the year. On December 31, Noel sent a \$700 check to Gate City Cycles with a note that said, "Here's your money. Please call off your bloodhound!"

Requirement

1. Journalize the entries required for Gate City Cycles, assuming Gate City uses the direct write-off method.

S8-8 **4 Recording credit-card and debit-card sales [5 min]**

Restaurants do a large volume of business by credit and debit cards. Suppose Chocolate Passion restaurant had these transactions on January 28, 2012:

National Express credit-card sales	\$ 9,300
ValueCard debit-card sales	9,000

Suppose Chocolate Passion's processor charges a 3% fee and deposits sales net of the fee.

Requirement

1. Journalize these sale transactions for the restaurant.

S8-9 **5 Computing interest amounts on notes receivable [10 min]**

A table of notes receivable for 2012 follows:

	Principal	Interest Rate	Interest Period During 2012
Note 1	\$ 30,000	8%	4 months
Note 2	10,000	11%	45 days
Note 3	19,000	10%	75 days
Note 4	100,000	7%	10 months

Requirement

1. For each of the notes receivable, compute the amount of interest revenue earned during 2012. Use a 360-day year, and round to the nearest dollar.

S8-10 5 Accounting for a note receivable [5–10 min]

Lakeland Bank & Trust Company lent \$110,000 to Samantha Michael on a 90-day, 9% note.

Requirement

1. Journalize the following transactions for the bank (explanations are not required):
 - a. Lending the money on June 6.
 - b. Collecting the principal and interest at maturity. Specify the date.
For the computation of interest, use a 360-day year.

S8-11 6 Reporting receivables and other accounts in the financial statements [10–15 min]

Northend Medical Center included the following selected items in its financial statements:

Allowance for doubtful accounts	\$ 150	Service revenue	\$ 14,700
Cash	1,010	Other assets	380
Accounts receivable	2,590	Cost of services sold and other expenses	12,400
Accounts payable	900	Notes payable	3,490

Requirements

1. How much net income did Northend earn for the month?
2. Show two ways Northend can report receivables on its classified balance sheet.

S8-12 6 Using the acid-test ratio and days' sales in receivables to evaluate a company [10–15 min]

Southside Clothiers reported the following selected items at September 30, 2012 (last year's—2011—amounts also given as needed):

Accounts payable	\$ 320,000	Accounts receivable, net:	
Cash	260,000	September 30, 2012	\$ 270,000
Inventories		September 30, 2011	170,000
September 30, 2012	290,000	Cost of goods sold	1,150,000
September 30, 2011	200,000	Short-term investments	140,000
Net sales revenue	2,920,000	Other current assets	120,000
Long-term assets	420,000	Other current liabilities	180,000
Long-term liabilities	130,000		

Requirement

1. Compute Southside's (a) acid-test ratio, (b) days' sales in average receivables for 2012, and (c) accounts receivable turnover ratio. Evaluate each ratio value as strong or weak. Southside sells on terms of net 30.

Exercises
E8-13 1 Common receivables terms [10–15 min]

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TERMS:
DEFINITIONS:

1. Account receivable
 2. Promissory note
 3. Borrower
 4. Note receivable
 5. Maturity date
 6. Creditor
- A. Transaction results in a liability for this party
 - B. Transaction results in a receivable for this party
 - C. The debtor promises to pay the creditor a definite sum at a future date usually with interest
 - D. Amounts to be collected from customers from sales made on credit
 - E. Serves as evidence of the indebtedness and includes the terms of the debt
 - F. The date a note is due to be paid in full

Requirement

1. Match the terms with their correct definition.

E8-14 1 Identifying and correcting internal control weakness [10 min]

Suppose The Right Rig Dealership is opening a regional office in Omaha. Cary Regal, the office manager, is designing the internal control system. Regal proposes the following procedures for credit checks on new customers, sales on account, cash collections, and write-offs of uncollectible receivables:

- The credit department runs a credit check on all customers who apply for credit. When an account proves uncollectible, the credit department authorizes the write-off of the account receivable.
- Cash receipts come into the credit department, which separates the cash received from the customer remittance slips. The credit department lists all cash receipts by customer name and amount of cash received.
- The cash goes to the treasurer for deposit in the bank. The remittance slips go to the accounting department for posting to customer accounts.
- The controller compares the daily deposit slip to the total amount posted to customer accounts. Both amounts must agree.

Requirement

1. Recall the components of internal control you learned in Chapter 7. Identify the internal control weakness in this situation, and propose a way to correct it.

E8-15 2 6 Accounting for uncollectible accounts using the allowance method and reporting receivables on the balance sheet [15–30 min]

At December 31, 2012, the Accounts receivable balance of GPS Technology is \$190,000. The Allowance for doubtful accounts has an \$8,600 credit balance. GPS Technology prepares the following aging schedule for its accounts receivable:

	Age of Accounts			
	1–30 Days	31–60 Days	61–90 Days	Over 90 Days
Accounts receivable	\$80,000	\$60,000	\$40,000	\$10,000
Estimated percent uncollectible	0.4 %	5.0 %	6.0 %	50.0 %

Requirements

1. Journalize the year-end adjusting entry for doubtful accounts on the basis of the aging schedule. Show the T-account for the Allowance for uncollectible accounts at December 31, 2012.
2. Show how GPS Technology will report its net Accounts receivable on its December 31, 2012 balance sheet.

E8-16 2 6 Accounting for uncollectible accounts using the allowance method and reporting receivables on the balance sheet [15–20 min]

At September 30, 2012, Windy Mountain Flagpoles had Accounts receivable of \$34,000 and Allowance for uncollectible accounts had a credit balance of \$3,000. During October 2012, Windy Mountain Flagpoles recorded the following:

- Sales of \$189,000 (\$165,000 on account; \$24,000 for cash).
- Collections on account, \$133,000.
- Uncollectible account expense, estimated as 1% of credit sales.
- Write-offs of uncollectible receivables, \$2,800.

Requirements

1. Journalize sales, collections, uncollectible account expense using the allowance method (percent-of-sales method), and write-offs of uncollectibles during October 2012.

2. Prepare T-accounts to show the ending balances in Accounts receivable and Allowance for uncollectible accounts. Compute *net* accounts receivable at October 31. How much does Windy Mountain expect to collect?
3. Show how Windy Mountain Flagpoles will report net Accounts receivable on its October 31, 2012 balance sheet.

E8-17 3 6 Accounting for uncollectible accounts using the direct write-off method and reporting receivables on the balance sheet [10–15 min]

Refer to the facts presented in Exercise 8-16.

Requirements

1. Journalize sales, collections, uncollectible account expense using the direct write-off method, and write-offs of uncollectibles during October 2012.
2. Show how Accounts receivable would be reported for Windy Mountain Flagpoles on its October 31, 2012 balance sheet under the direct write-off method.

E8-18 3 6 Journalizing transactions using the direct-write off method and reporting receivables on the balance sheet [10–20 min]

High Performance Cell Phones sold \$23,000 of merchandise to Anthony Trucking Company on account. Anthony fell on hard times and paid only \$8,000 of the account receivable. After repeated attempts to collect, High Performance finally wrote off its accounts receivable from Anthony. Six months later High Performance received Anthony's check for \$15,000 with a note apologizing for the late payment.

Requirements

1. Journalize for High Performance:
 - a. Sale on account, \$23,000. (Ignore cost of goods sold.)
 - b. Collection of \$8,000 on account.
 - c. Write-off of the remaining portion of Anthony's account receivable. High Performance uses the direct write-off method for uncollectibles.
 - d. Reinstatement of Anthony's account receivable.
 - e. Collection in full from Anthony, \$15,000.
2. Show how High Performance would report receivables on its balance sheet after all entries have been posted.

E8-19 4 5 Journalizing card sales, note receivable transactions, and accruing interest [10–15 min]

Marathon Running Shoes reports the following:

2012		
May 4	Recorded Estate credit-card sales of \$107,000, net of processor fee of 3%.	
Sep 1	Loaned \$17,000 to Jean Porter, an executive with the company, on a one-year, 15% note.	
Dec 31	Accrued interest revenue on the Porter note.	
2013		
Sep 1	Collected the maturity value of the Porter note.	

Requirement

1. Journalize all entries required for Marathon Running Shoes.

E8-20 5 Computing note receivable amounts [15–25 min]

On September 30, 2012, Synergy Bank loaned \$88,000 to Kendall Kelsing on a one-year, 12% note.

Requirements

1. Journalize all entries for Synergy Bank related to the note for 2012 and 2013.

2. Which party has a
 - a. note receivable?
 - b. note payable?
 - c. interest revenue?
 - d. interest expense?
3. How much in total would Kelsing pay the bank if she pays off the note early on April 30, 2013?

E8-21 5 Journalizing note receivable transactions [10–15 min]

The following selected transactions occurred during 2012 for Caspian Importers. The company ends its accounting year on April 30, 2012:

Feb 1	Loaned \$14,000 cash to Brett Dowling on a one-year, 8% note.
Apr 6	Sold goods to Putt Masters, receiving a 90-day, 6% note for \$9,000.
30	Made a single entry to accrue interest revenue on both notes.

Requirement

1. Journalize all required entries from February 1 through April 30, 2012. Use a 360-day year for interest computations.

E8-22 5 Journalizing note receivable transactions [10 min]

Hot Heat Steam Cleaning performs services on account. When a customer account becomes four months old, Hot Heat converts the account to a note receivable. During 2012, the company completed the following transactions:

Apr 28	Performed service on account for Sinclair Club, \$18,000.
Sep 1	Received an \$18,000, 60-day, 9% note from Sinclair Club in satisfaction of its past-due account receivable.
Oct 31	Collected the Sinclair Club note at maturity.

Requirement

1. Record the transactions in Hot Heat's journal.

E8-23 6 Evaluating ratio data [15–20 min]

Algonquin Carpets reported the following amounts in its 2013 financial statements. The 2012 figures are given for comparison.

	2013	2012
Current assets:		
Cash	\$ 4,000	\$ 10,000
Short-term investments	20,000	9,000
Accounts receivable	\$ 63,000	\$ 76,000
Less: Allowance for uncollectibles ..	<u>6,000</u>	<u>5,000</u>
	57,000	71,000
Inventory	195,000	191,000
Prepaid insurance	<u>4,000</u>	<u>4,000</u>
Total current assets	\$ 280,000	\$ 285,000
Total current liabilities	\$ 104,000	\$ 106,000
Net sales (all on account)	\$ 732,000	\$ 735,000

Requirements

1. Calculate Algonquin's acid-test ratio for 2013. Determine whether Algonquin's acid-test ratio improved or deteriorated from 2012 to 2013. How does Algonquin's acid-test ratio compare with the industry average of 0.80?
2. Calculate the days' sales in receivables for 2013. How do the results compare with Algonquin's credit terms of net 30?

- Calculate Algonquin's accounts receivable turnover ratio. How does Algonquin's ratio compare to the industry average accounts receivable turnover of 10?

E8-24 6 Collection period for receivables [10–15 min]

Contemporary Media Sign Company sells on account. Recently, Contemporary reported the following figures:

	2012	2011
Net sales	\$ 572,000	\$ 600,000
Receivables at end of year	38,700	46,100

Requirements

- Compute Contemporary's average collection period on receivables during 2012.
- Suppose Contemporary's normal credit terms for a sale on account are "2/10, net 30." How well does Contemporary's collection period compare to the company's credit terms? Is this good or bad for Contemporary?

Problems (Group A)

P8-25A 1 Explaining common types of receivables and designing internal controls for receivables [20–30 min]

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Organizational Kings performs organizational consulting services on account, so virtually all cash receipts arrive in the mail. Average daily cash receipts are \$36,000. Katie Stykle, the owner, has just returned from a meeting with new ideas for the business. Among other things, Stykle plans to institute stronger internal controls over cash receipts from customers.

Requirements

- What types of receivables are most likely to be collected by Organizational Kings?
- List the following procedures in the correct order.
 - Another person, such as the owner or the manager, compares the amount of the bank deposit to the total of the customer credits posted by the accountant. This gives some assurance that the day's cash receipts went into the bank and that the same amount was posted to customer accounts.
 - The person who handles cash should not prepare the bank reconciliation.
 - An employee with no access to the accounting records deposits the cash in the bank immediately.
 - The remittance slips go to the accountant, who uses them for posting credits to the customer accounts.
 - Someone other than the accountant opens the mail. This person separates customer checks from the accompanying remittance slips.

P8-26A 2 3 6 Accounting for uncollectible accounts using the allowance and direct write-off methods, and reporting receivables on the balance sheet [20–30 min]

On August 31, 2012, Daisy Floral Supply had a \$155,000 debit balance in Accounts receivable and a \$6,200 credit balance in Allowance for uncollectible accounts. During September, Daisy made

- sales on account, \$590,000.
- collections on account, \$627,000.
- write-offs of uncollectible receivables, \$7,000.

Requirements

- Journalize all September entries using the *allowance* method. Uncollectible account expense was estimated at 3% of credit sales. Show all September activity in Accounts receivable, Allowance for uncollectible accounts, and Uncollectible account expense (post to these T-accounts).

- Using the same facts, assume instead that Daisy used the direct write-off method to account for uncollectible receivables. Journalize all September entries using the *direct write-off* method. Post to Accounts receivable and Uncollectible account expense and show their balances at September 30, 2012.
- What amount of uncollectible account expense would Daisy report on its September income statement under each of the two methods? Which amount better matches expense with revenue? Give your reason.
- What amount of *net* accounts receivable would Daisy report on its September 30, 2012 balance sheet under each of the two methods? Which amount is more realistic? Give your reason.

P8-27A 2 6 Accounting for uncollectible accounts using the allowance method, and reporting receivables on the balance sheet [25–35 min]

At September 30, 2012, the accounts of Mountain Terrace Medical Center (MTMC) include the following:

Accounts receivable	\$ 145,000
Allowance for uncollectible accounts (credit balance) ...	3,500

During the last quarter of 2012, MTMC completed the following selected transactions:

Dec 28	Wrote off accounts receivable as uncollectible: Regan, Co., \$1,300; Owen Mac, \$900; and Rain, Inc., \$700.
Dec 31	Recorded uncollectible account expense based on the aging of accounts receivable, as follows:

	Age of Accounts			
	1–30 Days	31–60 Days	61–90 Days	Over 90 Days
Accounts receivable				
\$165,000	\$97,000	\$ 37,000	\$ 14,000	\$ 17,000
Estimated percent uncollectible	0.3%	3%	30%	35%

Requirements

- Journalize the transactions.
- Open the Allowance for uncollectible accounts T-account, and post entries affecting that account. Keep a running balance.
- Show how Mountain Terrace Medical Center should report net accounts receivable on its December 31, 2012 balance sheet. Use the three line reporting format.

P8-28A 2 6 Accounting for uncollectible accounts using the allowance method (percentage of sales), and reporting receivables on the balance sheet [20–30 min]

Quality Watches completed the following selected transactions during 2012 and 2013:

2012	
Dec 31	Estimated that uncollectible account expense for the year was 2% of credit sales of \$450,000 and recorded that amount as expense. Use the allowance method.
31	Made the closing entry for uncollectible account expense.
2013	
Jan 17	Sold inventory to Malcom Monet, \$700, on account. Ignore cost of goods sold.
Jun 29	Wrote off Malcom Monet's account as uncollectible after repeated efforts to collect from him.
Aug 6	Received \$700 from Malcom Monet, along with a letter apologizing for being so late. Reinstated Monet's account in full and recorded the cash receipt.
Dec 31	Made a compound entry to write off the following accounts as uncollectible: Brian Kemper, \$1,600; May Milford, \$1,000; and Ronald Richter, \$400.
31	Estimated that uncollectible account expense for the year was 2% on credit sales of \$460,000 and recorded the expense.
31	Made the closing entry for uncollectible account expense.

Requirements

1. Open T-accounts for Allowance for uncollectible accounts and Uncollectible account expense. Keep running balances, assuming all accounts begin with a zero balance.
2. Record the transactions in the general journal, and post to the two T-accounts.
3. Assume the December 31, 2013, balance of Accounts receivable is \$135,000. Show how net Accounts receivable would be reported on the balance sheet at that date. Use the three line format of reporting the net accounts receivable.

P8-29A **2 4 5 Accounting for uncollectible accounts (aging of accounts method), card sales, notes receivable, and accrued interest revenue [20–30 min]**
 Relaxing Recliner Chairs completed the following selected transactions:

2011	
Jul 1	Sold inventory to Great – Mart, receiving a \$45,000, nine-month, 12% note. Ignore cost of goods sold.
Oct 31	Recorded credit- and debit-card sales for the period of \$21,000.
Nov 3	Card processor drafted company's checking account for processing fee of \$410.
Dec 31	Made an adjusting entry to accrue interest on the Great – Mart note.
31	Made an adjusting entry to record uncollectible account expense based on an aging of accounts receivable. The aging schedule shows that \$15,200 of accounts receivable will not be collected. Prior to this adjustment, the credit balance in Allowance for uncollectible accounts is \$11,600.
2012	
Apr 1	Collected the maturity value of the Great – Mart note.
Jun 23	Sold merchandise to Ambiance, Corp., receiving a 60-day, 9% note for \$13,000. Ignore cost of goods sold.
Aug 22	Ambiance, Corp., dishonored its note (failed to pay) at maturity; we converted the maturity value of the note to an account receivable.
Nov 16	Loaned \$21,000 cash to Creed, Inc., receiving a 90-day, 8% note.
Dec 5	Collected in full on account from Ambiance, Corp.
31	Accrued the interest on the Creed, Inc., note.

Requirement

- Record the transactions in the journal of Relaxing Recliner Chairs. Explanations are not required. (For notes stated in days, use a 360-day year. Round to the nearest dollar.)

P8-30A 5 Accounting for notes receivable and accruing interest [35–45 min]

Kelly Realty loaned money and received the following notes during 2012.

Note	Date	Principal Amount	Interest Rate	Term
(1)	Aug 1	\$ 24,000	17%	1 year
(2)	Nov 30	18,000	6%	6 months
(3)	Dec 19	12,000	12%	30 days

Requirements

For each note, compute interest using a 360-day year. Explanations are not required.

- Determine the due date and maturity value of each note.
- Journalize the entry to record the inception of each of the three notes and also journalize a single adjusting entry at December 31, 2012, the fiscal year end, to record accrued interest revenue on all three notes.
- Journalize the collection of principal and interest at maturity of all three notes.

P8-31A 5 Accounting for notes receivable, dishonored notes, and accrued interest revenue [20–30 min]

Consider the following transactions for Jo Jo Music.

2011		
Dec 6	Received a \$7,000, 90-day, 12% note on account from Dark Star Music.	
31	Made an adjusting entry to accrue interest on the Dark Star Music note.	
31	Made a closing entry for interest revenue.	
2012		
Mar 4	Collected the maturity value of the Dark Star Music note.	
Jun 30	Loaned \$11,000 cash to Love Joy Music, receiving a six-month, 11% note.	
Oct 2	Received a \$2,400, 60-day, 11% note for a sale to Voice Publishing. Ignore cost of goods sold.	
Dec 1	Voice Publishing dishonored its note at maturity; wrote off the note as uncollectible, debiting Allowance for uncollectible accounts.	
30	Collected the maturity value of the Love Joy Music note.	

Requirement

- Journalize all transactions for Jo Jo Music. Round all amounts to the nearest dollar. (For notes stated in days, use a 360-day year.)

P8-32A 6 Using ratio data to evaluate a company's financial position [20–30 min]

The comparative financial statements of Lakeland Cosmetic Supply for 2012, 2011, and 2010 include the data shown here:

	2012	2011	2010
Balance sheet—partial			
Current assets:			
Cash	\$ 90,000	\$ 70,000	\$ 30,000
Short-term investments	145,000	175,000	125,000
Receivables, net	290,000	260,000	250,000
Inventories	370,000	335,000	325,000
Prepaid expenses	60,000	15,000	50,000
Total current assets	\$ 955,000	\$ 855,000	\$ 780,000
Total current liabilities	\$ 560,000	\$ 600,000	\$ 690,000
Income statement—partial			
Sales revenue (all on account) ...	\$5,860,000	\$5,140,000	\$4,200,000

Requirements

- Compute these ratios for 2012 and 2011:
 - Acid-test ratio
 - Days' sales in receivables
 - Accounts receivable turnover
- Considering each ratio individually, which ratios improved from 2011 to 2012 and which ratios deteriorated? Is the trend favorable or unfavorable for the company?

Problems (Group B)**P8-33B 1 Explaining common types of receivables and designing internal controls for receivables [20–30 min]**

MyAccountingLab

Tutor Tots performs tutoring services on account, so virtually all cash receipts arrive by mail and are then placed in the petty cash box for a week. Average daily cash receipts are \$24,000. Jennifer Swanson, the owner, has just returned from a meeting with new ideas for the business. Among other things, Swanson plans to institute stronger internal controls over cash receipts from customers.

Requirements

- What types of receivables are most likely to be collected by Tutor Tots?
- List the following procedures in the correct order.
 - Another person, such as the owner or the manager, compares the amount of the bank deposit to the total of the customer credits posted by the accountant. This gives some assurance that the day's cash receipts went into the bank and that the same amount was posted to customer accounts.
 - The person who handles cash should not prepare the bank reconciliation.
 - An employee with no access to the accounting records deposits the cash in the bank immediately.
 - The remittance slips go to the accountant, who uses them for posting credits to the customer accounts.
 - Someone other than the accountant opens the mail. This person separates customer checks from the accompanying remittance slips.

P8-34B 2 3 6 Accounting for uncollectible accounts using the allowance and direct write-off methods, and reporting receivables on the balance sheet [20–30 min]

On October 31, 2012, Blossom Floral Supply had a \$180,000 debit balance in Accounts receivable and a \$7,200 credit balance in Allowance for uncollectible accounts. During November, Blossom made

- sales on account, \$560,000.
- collections on account, \$598,000.
- write-offs of uncollectible receivables, \$9,000.

Requirements

1. Journalize all November entries using the *allowance* method. Uncollectible account expense was estimated at 1% of credit sales. Show all November activity in Accounts receivable, Allowance for uncollectible accounts, and Uncollectible account expense (post to these T-accounts).
2. Using the same facts, assume instead that Blossom used the direct write-off method to account for uncollectible receivables. Journalize all November entries using the *direct write-off* method. Post to Accounts receivable and Uncollectible account expense and show their balances at November 30, 2012.
3. What amount of uncollectible account expense would Blossom report on its November income statement under each of the two methods? Which amount better matches expense with revenue? Give your reason.
4. What amount of *net* accounts receivable would Blossom report on its November 30, 2012 balance sheet under each of the two methods? Which amount is more realistic? Give your reason.

P8-35B 2 6 Accounting for uncollectible accounts using the allowance method, and reporting receivables on the balance sheet [25–35 min]

At September 30, 2012, the accounts of Park Terrace Medical Center (PTMC) include the following:

Accounts receivable	\$ 141,000
Allowance for uncollectible accounts (credit balance) ...	3,400

During the last quarter of 2012, PTMC completed the following selected transactions:

- | | |
|--------|--|
| Dec 28 | Wrote off accounts receivable as uncollectible: Red Co., \$1,600; Jacob Weiss, \$1,300; and Star, Inc., \$300. |
| Dec 31 | Recorded uncollectible account expense based on the aging of accounts receivable, as follows: |

	Age of Accounts			
	1–30 Days	31–60 Days	61–90 Days	Over 90 Days
Accounts receivable				
\$161,000	\$99,000	\$ 42,000	\$ 15,000	\$ 5,000
Estimated percent uncollectible	0.2%	2%	20%	25%

Requirements

1. Journalize the transactions.
2. Open the Allowance for uncollectible accounts T-account, and post entries affecting that account. Keep a running balance.
3. Show how Park Terrace Medical Center should report net Accounts receivable on its December 31, 2012 balance sheet. Use the three line reporting format.

P8-36B 2 6 Accounting for uncollectible accounts using the allowance method (percentage of sales), and reporting receivables on the balance sheet [20–30 min]

Beta Watches completed the following selected transactions during 2011 and 2012:

2011

- Dec 31 Estimated that uncollectible account expense for the year was 3% of credit sales of \$440,000 and recorded that amount as expense. Use the allowance method.
- 31 Made the closing entry for uncollectible account expense.

2012

- Jan 17 Sold inventory to Manny Vasquez, \$800, on account. Ignore cost of goods sold.
- Jun 29 Wrote off Manny Vasquez's account as uncollectible after repeated efforts to collect from him.
- Aug 6 Received \$800 from Manny Vasquez, along with a letter apologizing for being so late. Reinstated Vasquez's account in full and recorded the cash receipt.
- Dec 31 Made a compound entry to write off the following accounts as uncollectible: Bill Kappy, \$1,400; Mike Venture, \$1,100; and Russell Reeves, \$200.
- 31 Estimated that uncollectible account expense for the year was 3% on credit sales of \$470,000 and recorded the expense.
- 31 Made the closing entry for uncollectible account expense.
-

Requirements

1. Open T-accounts for Allowance for uncollectible accounts and Uncollectible account expense. Keep running balances, assuming all accounts begin with a zero balance.
2. Record the transactions in the general journal, and post to the two T-accounts.
3. Assume the December 31, 2012, balance of Accounts receivable is \$139,000. Show how net Accounts receivable would be reported on the balance sheet at that date. Use the three line format of reporting the net accounts receivable.

P8-37B 2 4 5 **Accounting for uncollectible accounts (aging of accounts method), card sales, notes receivable, and accrued interest revenue [20–30 min]**
 Sleepy Recliner Chairs completed the following selected transactions:

2011

- Jul 1 Sold inventory to Go – Mart, receiving a \$37,000, nine-month, 8% note. Ignore cost of goods sold.
- Oct 31 Recorded credit- and debit-card sales for the period of \$19,000.
- Nov 3 Card processor drafted company's checking account for processing fee of \$420.
- Dec 31 Made an adjusting entry to accrue interest on the Go – Mart note.
- 31 Made an adjusting entry to record uncollectible account expense based on an aging of accounts receivable. The aging schedule shows that \$14,100 of accounts receivable will not be collected. Prior to this adjustment, the credit balance in Allowance for uncollectible accounts is \$10,200.

2012

- Apr 1 Collected the maturity value of the Go – Mart note.
- Jun 23 Sold merchandise to Appeal, Corp., receiving a 60-day, 12% note for \$7,000. Ignore cost of goods sold.
- Aug 22 Appeal, Corp., dishonored its note (failed to pay) at maturity; we converted the maturity value of the note to an account receivable.
- Nov 16 Loaned \$23,000 cash to Creed, Inc., receiving a 90-day, 16% note.
- Dec 5 Collected in full on account from Appeal, Corp.
- 31 Accrued the interest on the Creed, Inc., note.
-

Requirement

- Record the transactions in the journal of Sleepy Recliner Chairs. Explanations are not required. (For notes stated in days, use a 360-day year. Round to the nearest dollar.)

P8-38B 5 Accounting for notes receivable and accruing interest [35–45 min]

Christie Realty loaned money and received the following notes during 2012.

Note	Date	Principal Amount	Interest Rate	Term
(1)	Jun 1	\$ 12,000	10%	1 year
(2)	Sep 30	20,000	9%	6 months
(3)	Oct 19	10,000	12%	30 days

Requirements

For each note, compute interest using a 360-day year. Explanations are not required.

- Determine the due date and maturity value of each note.
- Journalize the entry to record the inception of each of the three notes and also journalize a single adjusting entry at October 31, 2012, the fiscal year end, to record accrued interest revenue on all three notes.
- Journalize the collection of principal and interest at maturity of all three notes.

P8-39B 5 Accounting for notes receivable, dishonored notes, and accrued interest revenue [20–30 min]

Consider the following transactions for Rural Beginnings.

2011	
Dec 6	Received a \$4,000, 90-day, 9% note on account from AM Publishing.
31	Made an adjusting entry to accrue interest on the AM Publishing note.
31	Made a closing entry for interest revenue.
2012	
Mar 4	Collected the maturity value of the AM Publishing note.
Jun 30	Loaned \$15,000 cash to Johnathon's Publishing, receiving a six-month, 8% note.
Oct 2	Received a \$2,000, 60-day, 8% note for a sale to Ying Yang Music. Ignore cost of goods sold.
Dec 1	Ying Yang Music dishonored its note at maturity; wrote off the note as uncollectible, debiting Allowance for uncollectible accounts.
30	Collected the maturity value of the Johnathon's Publishing note.

Requirement

- Journalize all transactions for Rural Beginnings. Round all amounts to the nearest dollar. (For notes stated in days, use a 360-day year.)

P8-40B 6 Using ratio data to evaluate a company's financial position [20–30 min]

The comparative financial statements of Perfection Cosmetic Supply for 2012, 2011, and 2010 include the data that follow:

	2012	2011	2010
Balance sheet—partial			
Current assets:			
Cash	\$ 60,000	\$ 50,000	\$ 60,000
Short-term investments	155,000	155,000	120,000
Receivables, net	300,000	240,000	260,000
Inventories	355,000	320,000	320,000
Prepaid expenses	75,000	25,000	55,000
Total current assets	\$ 945,000	\$ 790,000	\$ 815,000
Total current liabilities	\$ 590,000	\$ 580,000	\$ 680,000
Income statement—partial			
Sales revenue (all on account) ...	\$5,830,000	\$5,110,000	\$4,210,000

Requirements

- Compute these ratios for 2012 and 2011:
 - Acid-test ratio
 - Days' sales in receivables
 - Accounts receivable turnover
- Considering each ratio individually, which ratios improved from 2011 to 2012 and which ratios deteriorated? Is the trend favorable or unfavorable for the company?

Continuing Exercise
E8-41 3 Applying the direct write-off method to account for uncollectibles [10 min]

MyAccountingLab

This exercise continues the Lawlor Lawn Service situation from Exercise 7-41 of Chapter 7. Lawlor reviewed the receivables list from the June transactions (from Chapter 6). Lawlor identified on July 31 that Johnson was not going to pay his receivable from June 15. Lawlor uses the direct write-off method to account for uncollectible accounts.

Requirement

- Journalize the entry to record Johnson's uncollectible account.

Continuing Problem
P8-42 2 Accounting for uncollectible accounts using the allowance method [15–20 min]

MyAccountingLab

This problem continues the Draper Consulting situation from Problem 7-42 of Chapter 7. Draper reviewed the receivables list from the January transactions (from Chapter 6). Draper identified on February 15 that a customer was not going to pay his receivable of \$200 from December 9. Draper uses the allowance method for receivables, estimating uncollectibles to be 5% of January credit sales.

Requirements

- Journalize the entry to record and establish the allowance using the percentage method for January credit sales.
- Journalize the entry to record the identification of the customer's bad debt.

• Practice Set



This problem continues the Shine King Cleaning problem begun in Chapter 1 and continued through Chapters 2–7.

P8-43 **2 6** Accounting for uncollectible accounts using the allowance and reporting accounts receivable on the balance sheet method [25–30 min]

Consider the following January transactions for Shine King Cleaning:

Jan 1	Performed cleaning services for Debbie's D-list for \$8,000 on terms 3/10, n/20.
3	Shine King decides to adopt the allowance method. Uncollectible account expense is estimated at 2% of credit sales.
10	Borrowed money from North Spot Bank, \$10,000, 7% for 180 days.
12	After discussions with Pierre's Wig Stand, Shine King has determined that \$225 of the receivable owed will not be collected. Write off this portion of the receivable.
15	Sold goods to Watertown for \$4,000 on terms 4/10, n/30. Cost of goods sold was \$600.
15	Recorded uncollectible account expense estimate for Watertown sale.
28	Sold goods to Bridget, Inc., for cash of \$1,200 (cost \$280).
28	Collected from Pierre's Wig Stand \$225 of receivable previously written off. Reinstated the remaining balance of Pierre's receivable.
29	Paid cash for utilities of \$350.
31	Created an aging schedule for Shine King for accounts receivable. Shine King determined that accounts 1–20 days old were 2% uncollectible and accounts over 20 days old were 15% uncollectible. Prepared an aging schedule and adjusted the Allowance for uncollectible accounts to the aging schedule.
31	Shine King prepared all other adjusting entries necessary for January.

Requirements

1. Prepare all required journal entries and post them to Shine King's ledger.
2. Reconcile the Accounts receivable control account to the Accounts receivable subsidiary ledger.

Apply Your Knowledge

• Decision Cases

Decision Case 8-1 Weddings on Demand sells on account and manages its own receivables. Average experience for the past three years has been as follows:

	Total
Sales.....	\$350,000
Cost of goods sold.....	210,000
Bad debt expense.....	4,000
Other expenses.....	61,000

Unhappy with the amount of bad debt expense she has been experiencing, Aledia Sanchez, owner of Weddings on Demand, is considering a major change in her business. Her plan would be to stop selling on account altogether but accept either cash, credit, or debit cards from her customers. Her market research indicates that if she does so, her sales will increase by 10% (i.e., from \$350,000 to \$385,000), of which \$200,000 will be credit or debit card sales, and the rest will be cash sales. With a 10% increase in sales, there will also be a 10% increase in Cost of goods sold. If she adopts this plan, she will no longer have bad debt expense, but she will have to pay a fee on debit/credit card transactions of 2% of sales. She also believes this plan will allow her to save \$5,000 per year in other operating expenses.

Requirement

1. Should Sanchez start accepting debit and credit cards? Show the computations of net income under her present arrangement and under the plan. (Challenge)

Decision Case 8-2 Pauline's Pottery has always used the direct write-off method to account for uncollectibles. The company's revenues, bad-debt write offs, and year-end receivables for the most recent year follow:

Year	Revenues	Write-Offs	Receivables at Year-End
2011	\$150,000	\$3,900	\$14,000

The business is applying for a bank loan, and the loan officer requires figures based on the allowance method of accounting for bad debts. In the past, bad debts have run about 4% of revenues.

Requirements

Pauline must give the banker the following information:

1. How much more or less would net income be for 2011 if Pauline's Pottery were to use the allowance method for bad debts? Please use the percentage-of-sales method.
2. How much of the receivables balance at the end of 2011 does Pauline's Pottery actually expect to collect? (Disregard beginning account balances for the purpose of this question.)
3. Compute these amounts, and then explain for Pauline's Pottery why net income is more or less using the allowance method versus the direct write-off method for uncollectibles.

• Ethical Issue 8-1

E-Z Loan, Co., makes loans to high-risk borrowers. E-Z borrows from its bank and then lends money to people with bad credit. The bank requires E-Z Loan to submit quarterly financial statements in order to keep its line of credit. E-Z's main asset is Notes receivable. Therefore, Uncollectible note expense and Allowance for uncollectible notes are important accounts.

Slade McMurphy, the owner of E-Z Loan, wants net income to increase in a smooth pattern, rather than increase in some periods and decrease in others. To report smoothly increasing net income, McMurphy underestimates Uncollectible note expense in some periods. In other periods, McMurphy overestimates the expense. He reasons that over time the income overstatements roughly offset the income understatements.

Requirement

1. Is McMurphy's practice of smoothing income ethical? Why or why not?

• Fraud Case 8-1

Dylan worked for a propane gas distributor as an accounting clerk in a small Midwestern town. Last winter, his brother Mike lost his job at the machine plant. By January, temperatures were sub-zero, and Mike had run out of money. Dylan saw that Mike's account was overdue, and he knew Mike needed another delivery to heat his home. He decided to credit Mike's account and debit the balance to the parts inventory, because he knew the parts manager, the owner's son, was incompetent and would never notice the extra entry. Months went by, and Dylan repeated the process until an auditor ran across the charges by chance. When the owner fired Dylan, he said "if you had only come to me and told me about Mike's situation, we could have worked something out."

Requirements

1. What can a business like this do to prevent employee fraud of this kind?
2. What effect would Dylan's actions have on the balance sheet? The income statement?
3. How much discretion does a business have with regard to accommodating hardship situations? (Challenge)

• Financial Statement Case 8-1

Use Amazon.com's balance sheet and the Note 1 data on "Allowance for doubtful accounts" in Appendix A at the end of this book.

Requirements

1. Do accounts receivable appear to be an important asset for Amazon.com?
2. Assume that all of "Accounts receivable, Net, and Other" is accounts receivable. Further assume that gross receivables at December 31, 2009, were \$908 million. Answer the following questions based on these data, plus what is reported on the balance sheet.
 - a. How much did customers owe Amazon.com at December 31, 2009?
 - b. How much did Amazon.com expect to collect from customers after December 31, 2008?
 - c. Of the total receivable amount at December 31, 2009, how much did Amazon.com expect *not* to collect?
3. Compute Amazon.com's acid-test ratio at the end of 2009. Marketable securities are short-term investments. Disregard deferred tax assets. If all the current liabilities came due immediately, could Amazon pay them?

• Team Project 8-1

Bob Davidson and Sheila Thornton worked for several years as sales representatives for Xerox Corporation. During this time, they became close friends as they acquired expertise with the company's full range of copier equipment. Now they see an opportunity to put their experience to work and fulfill lifelong desires to establish their own business. Rolltide College, located in their city, is expanding, and there is no copy center within five miles of the campus. Business in the area is booming, and the population in this section of the city is growing.

Davidson and Thornton want to open a copy center, similar to a FedEx Office, near the campus. A small shopping center across the street from the college has a vacancy that would fit their needs. Davidson and Thornton each have \$20,000 to invest in the business, and they forecast the need for \$30,000 to renovate the store. Xerox Corporation will lease two large copiers to them at a total monthly rental of \$4,000. With enough cash to see them through the first six months of operation, they are confident they can make the business succeed. The two work very well together, and both have excellent credit ratings. Davidson and Thornton must borrow \$40,000 to amass a total startup capital of \$80,000, which will allow them to start the business, advertise its opening, and keep it running for its first six months.

Assume the role of Davidson and Thornton, the partners who will own Rolltide Copy Center.

Requirements

1. As a group, visit a copy center to familiarize yourselves with its operations. If possible, interview the manager or another employee. Then write a loan request that Davidson and Thornton will submit to a bank with the intent of borrowing \$40,000 to be paid back over three years. The loan will be a personal loan to the partnership of Davidson and Thornton, not to Rolltide Copy Center. The request should specify all the details of Davidson and Thornton's plan that will motivate the bank to grant the loan. Include a budgeted income statement for the first six months of the copy center's operation.
2. As a group, interview a loan officer in a bank. Have the loan officer evaluate your loan request. Write a report, or make a presentation to your class—as directed by your instructor—to reveal the loan officer's decision.

• Communication Activity 8-1

In 50 words or fewer, explain the difference between the percentage-of-sales method and the aging method for calculating the journal entry to adjust the allowance for uncollectible accounts.

Quick Check Answers

1. *d* 2. *d* 3. *b* 4. *a* 5. *d* 6. *d* 7. *b* 8. *c* 9. *a* 10. *d*

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Appendix 8A

Discounting a Note Receivable

7 Discount a note receivable

A payee of a note receivable may need cash before the maturity date of the note. When this occurs, the payee may sell the note, a practice called **discounting a note receivable**. The price to be received for the note is determined by present-value concepts. But the transaction between the seller and the buyer of the note can take any form agreeable to the two parties. Here we illustrate one procedure used for discounting short-term notes receivable. To receive cash immediately, the seller accepts a lower price than the note's maturity value.

To illustrate discounting a note receivable, recall that earlier in the chapter, Greg's Tunes loaned \$1,000 to L. Holland on September 30, 2014. Greg's Tunes took a note receivable from Holland. The maturity date of the one-year, 6% Holland note is September 30, 2015. Suppose Greg's Tunes discounts the Holland note at First City Bank on November 30, 2014, when the note is two months old. The bank applies a 12% annual interest rate to determine the discounted value of the note. The bank will use a discount rate that is higher than the note's interest rate in order to earn some interest on the transaction. The discounted value, called the *proceeds*, is the amount Greg's Tunes receives from the bank. The proceeds can be computed in five steps, as shown in Exhibit 8A-1.

EXHIBIT 8A-1 Discounting (Selling) a Note Receivable

Step	Computation
1. Compute the original amount of interest on the note receivable.	$\$1,000 \times 0.06 \times 12/12 = \$ 60$
2. Maturity value of the note = Principal + Interest	$\$1,000 + \$60 = \$1,060$
3. Determine the period (number of days, months, or years) the bank will hold the note (the discount period).	Dec 1, 2014 to Sep 30, 2015 = 10 months
4. Compute the bank's discount on the note. This is the bank's interest revenue from holding the note.	$\$1,060 \times 0.12 \times 10/12 = \$ 106$
5. Seller's proceeds from discounting the note receivable = Maturity value of the note - Bank's discount on the note.	$\$1,060 - \$106 = \underline{\underline{\$ 954}}$

The authors thank Doug Hamilton for suggesting this exhibit.

Greg's Tunes' entry to record discounting (selling) the note on November 30, 2014, is as follows:

2014				
Nov 30	Cash (A+)		954	
	Interest expense (E+)		46	
	Note receivable—L. Holland (A-)			1,000
	Discounted a note receivable.			

When the proceeds from discounting a note receivable are less than the principal amount of the note, the payee records a debit to Interest expense for the amount of the difference. When the proceeds from discounting the note are more than the note principal, the payee records a credit to Interest revenue. For example, assume Greg's Tunes discounts the note receivable for cash proceeds of \$1,020. The entry to record this discounting transaction is as follows:

2014				
Nov 30	Cash (A+)		1,020	
	Note receivable—L. Holland (A-)			1,000
	Interest revenue (R+)			20
	Discounted a note receivable.			

Appendix 8A Assignments

• Exercise

E8A-1 7 Journalizing notes receivable transactions [10–15 min]

Big Ted Toys sells on account. When a customer account becomes three months old, Big Ted converts the account to a note receivable and immediately discounts the note to a bank. During 2012, Big Ted completed the following transactions:

Aug 29	Sold goods on account to V. Mayer, \$3,000.
Dec 1	Received a \$3,000, 60-day, 11% note from Mayer in satisfaction of his past-due account receivable.
1	Sold the Mayer note by discounting it to a bank for \$2,600.

Requirement

- Record the transactions in Big Ted's journal.

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• Problem (Group A)

P8A-2A 7 Journalizing notes receivable transactions [15–20 min]

A company received the following notes during 2012. The notes were discounted on the dates and at the rates indicated:

Note	Date	Principal Amount	Interest Rate	Term	Date Discounted	Discount Rate
(1)	Jun 1	\$ 13,000	10%	120 days	Aug 15	13%
(2)	Aug 19	10,000	9%	90 days	Aug 30	11%
(3)	Jul 15	4,000	7%	6 months	Oct 15	9%

Requirements

Identify each note by number, compute interest using a 360-day year, and round all interest amounts to the nearest dollar. Explanations are not required.

- Determine the due date and maturity value of each note.
- Determine the discount and proceeds from the sale (discounting) of each note.
- Journalize the discounting of notes (1) and (2).

• Problem (Group B)

P8A-3B 7 Journalizing notes receivable transactions [15–20 min]

A company received the following notes during 2012. The notes were discounted on the dates and at the rates indicated:

Note	Date	Principal Amount	Interest Rate	Term	Date Discounted	Discount Rate
(1)	Jul 1	\$ 12,000	13%	120 days	Sep 10	16%
(2)	Jun 19	11,000	8%	90 days	Jun 20	10%
(3)	Jul 15	8,000	6%	6 months	Oct 15	8%

Requirements

Identify each note by number, compute interest using a 360-day year, and round all interest amounts to the nearest dollar. Explanations are not required.

- Determine the due date and maturity value of each note.
- Determine the discount and proceeds from the sale (discounting) of each note.
- Journalize the discounting of notes (1) and (2).

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9

Plant Assets and Intangibles

How do we determine what value to report for our assets?

SMART TOUCH LEARNING Balance Sheet May 31, 2013

Assets				Liabilities	
Current assets:				Current liabilities:	
Cash			\$ 4,800	Accounts payable	\$ 48,700
Accounts receivable			2,600	Salary payable	900
Inventory			30,500	Interest payable	100
Supplies			600	Unearned service revenue	400
Prepaid rent			2,000	Total current liabilities	50,100
Total current assets			\$ 40,500	Long-term liabilities:	
Plant assets:				Notes payable	20,000
Furniture	\$18,000			Total liabilities	70,100
Less: Accumulated depreciation—furniture	300	17,700		Owner's Equity	
Building	48,000			Bright, capital	35,900
Less: Accumulated depreciation—building	200	47,800		Total liabilities and owner's equity	\$106,000
Total plant assets			65,500		
Total assets			\$106,000		

Learning Objectives

- 1 Measure the cost of a plant asset
- 2 Account for depreciation
- 3 Record the disposal of an asset by sale or trade
- 4 Account for natural resources
- 5 Account for intangible assets
- 6 Describe ethical issues related to plant assets

You've been working at your business now for a few months. Things are going great—sales are increasing every month. Until now, you've been handling the paperwork manually, but you need a better way to keep up with it all. You're considering buying several laptop computers, a server, and computerized software. The total cost of the system, including installation, will be \$20,000. This will help you operate the business more efficiently, but what about the cost of the system? Do you expense it all or set up asset accounts for each of the assets? How long do you think each component will last before you need to upgrade your computers? How do you recover/match the cost of the system to the revenue you earn?

The computer system you plan to buy for your business is one type of plant asset. Other types include land, buildings, equipment, and furniture. Often, plant assets are referred to as Property, Plant, and Equipment. Plant assets have some