1-4D: Receivables Assignment - Answer Key

1. Record the following journal entries for Friendly Company.
   a) On September 1, Friendly Co. sold merchandise on account to Meanly Company for $20,000, terms 2/10, n/30. On September 8, Meanly Company returned merchandise worth $4000 to us. On the final possible date, Meanly Co. paid their bill and took the discount. Prepare only the final journal entry, the one to record the payment by Meanly Co.
   (*Application – 7 marks total – 1 mark for each of the date, accounts, and amounts)*

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Sept. 18	Bank	$15,680	
	Discount Allowed	$ 320	
	A/R		$16,000
	(Discount = $16,000 X 2%)		

2. The following invoices were missed before running the December 31, Aged Receivable report: invoice #218 dated Sept. 14, for $7,450; and invoice #568 dated Nov. 9 for $3,175. Correct this Aged Accounts Receivable report by adding the invoices to the correct columns.
   (*Thinking – 2 marks)*

Not Yet Due	1 – 30 Days Past Due	31 – 60 Days Past Due	61 – 90 Days Past Due	Over 90 Days Past Due	Total
$50,000	$20,000	$10,000	$10,000	$10,000	$100,000
	$3,175		$7,450		

3. Happy Company has prepared the following chart summarizing the Aged Receivables and historical uncollectible percentages to estimate the doubtful accounts using the Balance Sheet method. They tell you that the Allowance account currently has a balance of $8000 credit.

Not Yet Due	1 – 30 Days Past Due	31 – 60 Days Past Due	61 – 90 Days Past Due	Over 90 Days Past Due	Total
$458,975	$236,700	$108,350	$22,500	$36,600	$863,125
½ %	2%	20%	50%	75%	

   a) Calculate the estimated amount of uncollectible accounts. Show all your calculations.
   (*Application – 3 marks total – ½ mark for each calculation and the total)*

Not Yet Due	1 – 30 Days Past Due	31 – 60 Days Past Due	61 – 90 Days Past Due	Over 90 Days Past Due	Total
$ 458,975	$ 236,700	$ 108,350	$ 22,500	$ 36,600	$ 863,125
1%	2%	20%	50%	75%	
$2,294.88	**$4,734.00**	**$21,670.00**	**$11,250.00**	**$27,450.00**	**$67,398.88**

b) Prepare the December 31, 2001 journal entry to bring the Allowance for Bad Debts account to the correct balance.
(*Application – 5 marks total – 1 mark each for the accounts, amount and explanation)*

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Dec. 31	Bad Debts Expense	$59,398.88	
	Allowance for Bad Debts		$59,398.88
	($8000 credit + $59,398.88 credit = $67,398.88 credit)		

c) Calculate the **net** Accounts Receivable that would appear on the Balance Sheet. Show your calculation.
(*Thinking – 1 mark)*

$795,726.12 ($863,125 = $67,398.88 = $795,726.12)

d) On January 10, of the following year (2002), an account receivable or $15,398.88 was deemed worthless because the customer, Unhappy Company, is bankrupt. Write off the account.
(*Application – 4 marks total – 1 mark each for the accounts, amounts and explanation)*

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Jan. 10	Allowance for Bad Debts	$15,398.88	
	Accounts Receivable		$15,398.88
	(Unhappy Co., confirmed uncollectible)		

e) On June 22, 2002, the bankruptcy specialist who was liquidating Unhappy Company sends your company a cheque for $2,390.83 which represents $0.15 on every dollar owed. Record this bad debt recovery.
(*Application – 5 marks total – 1 mark each for the accounts and explanation)*

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Jun. 22	Accounts Receivable	$2,390.83	
	Allowance for Bad Debts		$2,390.83
	(Unhappy Co., collected $0.15 on previously written off account of $15,398.88)		
Jun. 22	Bank (or Cash)	$2,390.83	
	Accounts Receivable		$2,390.83
	(Unhappy Co.)		

f) On December 1, 2002, the boss of Happy Company tells you that she has a feeling it has been a bad year for customers going bankrupt. You notice the Allowance for Bad Debts account has a debit balance of $33,000. She asks you to explain to her whether or not she is correct, and whether something should be done when estimating the Allowance account for the upcoming year.
(*Thinking – 4 marks)*

Allowance debit balance means that more A/R were written off than estimated.
She is correct as there were $33,000 more written off than estimated.
There is no correct answer for this question. Logical thinking and creative, realistic solutions are rewarded.
This is 3.8% of total receivables ($33,000/863,125)
If the same is expected in the upcoming year, increase all percentages used by 4%.
Keep a closer watch on overdue accounts.
Offer incentives to pay early.
…your solution
If the same is NOT expected, make no changes.

4. Wonderful Company received from their customer, Excellent Company, a 90-day, 9% note for $30,000 in settlement of an account receivable due today, November 1, 2001.
   a) Record the journal entry to record the Note Receivable.
   (*Application – 4 marks total – 1 each for the accounts, amounts and explanation)*

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Nov. 1	Note Receivable	$30,000	
	Sales		$30,000

	(Excellent Company, 90-day note at 9%)		

b) Record the journal entry to adjust for the interest owed by Excellent Co. on December 31, 2001.
(*Application – 5 marks total – 1 each for the accounts, amount and explanation)*

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Dec. 31	Interest Receivable	$450	
	Interest Revenue		$450
	(Excellent Co., $30,000 X 9% X 2/12 months)		

c) Record the journal entry to record the collection of principal and interest on February 1, 2002.
(*Application – 9 marks total – 1 each for the accounts, amounts, and explanation)*

GENERAL JOURNAL			
Date	**Account Titles and Explanation**	**Debit**	**Credit**
Year			
Feb. 1	Bank/Cash	$30,675	
	Allowance for Bad Debts		$30,000
	Interest Receivable		$ 450
	Interest Revenue		$ 225
	(Excellent Co., note received in full)		

5. Prepare the Balance Sheet Current Asset section with information that follows.
(*Application – 5 marks total – for correct formatting, column usage, order of liquidity)*

Accounts Receivable	$83,000
Allowance for Doubtful Accounts	$6,000
Bank	$3,000
Interest Receivable	$2,000
Inventory	$240,000
Notes Receivable	$40,000
Prepaid Expenses	$55,000

Any Company

Balance Sheet

Any Date				
	<u>Current Assets</u>			
	Bank		$3,000	
	Accounts Receivable	$83,000		
	Less: Allowance for Doubtful Accounts	6,000	77,000	
	Interest Receivable		2,000	
	Notes Receivable		40,000	
	Inventory		240,000	
	Prepaid Expenses		55,000	$417,000

6. When a customer takes their discount upon payment, the Discounts Taken account is debited. Discuss whether this account is an expense or a contra-revenue and declare the section in which you would include it.
(*Thinking – 4 marks total – accounting substantiated argument)*

Expense	a cost of extending credit terms to customers and is a normal day-to-day operating expense; added to expenses
Contra Revenue	it is an offered reduction in the amount of revenue we are willing to take, in settlement of a debt; subtracted from revenue
Declaration	It doesn't matter which answer you picked as long as it matches your argument The actual answer: Discounts allowed is a contra-revenue of the Sales Account And, when we are the buyer, Discounts Earned is a contra-expense of the Purchases or Cost of Goods Sold expense

7. Music Plus Co sells stereo equipment. Traditionally, the company's sales are 25% cash, 35% credit cards, 45% charge sales (accounts receivable). Uncollectible accounts were about 1% of net sales. Music Plus uses the Direct Write-off method.

   Two months ago, the company offered “Double Zero” terms: no down payment and no interest. The accounts are collected over 12 months in equal payments.

   Sales have increased, but cash flow has decreased and now Music Plus is struggling to pay its bills on time.

   The bookkeeper has prepared the following chart of information:

	Before Double Zero	Last Month
Sales:		

Cash Sales	$12,500	$5,000
Credit Card Sales	17,500	10,000
Charge Sales (due in 30 days)	20,000	0
Double Zero Sales	0	75,000
TOTAL MONTHLY SALES	$50,000	$90,000
Expenses	40,000	65,000
Net Income	$10,000	$25,000
Cash Receipts:		
Cash Sales	$12,500	5,000
Credit Card Sales	17,500	10,000
Charge Sales (due in 30 days)	19,500	0
Double Zero Sales	0	11,250
TOTAL MONTHLY CASH RECEIPTS	$49,500	$26,350
Accounts written off as uncollectible	$500	0
Accounts Receivable at month-end (*includes 2 months)	$20,000	$122,000*

The accountant says, “Double Zero is killing us. We’ve increased our receivables six-fold, but our cash receipts are down by half and we need cash so we can pay our bills before we have to declare bankruptcy.” The boss says, “This is the best thing that’s ever happened – our sales and profits have doubled, and uncollectibles are zero!”

a) Clearly explain how the Double Zero initiative is increasing sales and profits, eliminating uncollectible accounts, while also causing a decline in cash.
(Communication – 5 marks total – sound accounting-based logic)

Presented here are not the only way to express these ideas. There may be other insights as well.

Increasing Sales	Sales have increased, but they're mostly Double Zero A/R and won't be collected for another 10-12 months
Increasing Profits	Sales have increased, so profit has increased; however, the matching expense of bad debts has not yet been recorded
Eliminating Bad Debts	There will be a lot of uncollectible accounts but with direct write-off method, they won't be realized until later when payment is due
Decling in Cash	We are not getting cash, we are getting A/R

b) Recommend a course of action for the immediate future.
(Thinking – 2 marks total)

Course of Action	"Doing nothing" is the only wrong answer. Students will be awarded marked for any logically sound, realistic solutions they present.