

SHORT ANSWER – 57 marks 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 |
|----------------|-------------------------|--------------------------|--------------------------|--------------------------|-----------------|
| \$348,000 | \$180,000 | \$78,000 | \$18,000 | \$30,000 | \$654,000 |
| 1% | 3% | 10% | 30% | 50% | |
| \$3,480 | \$5,400 | \$7,800 | \$5,400 | \$15,000 | \$37,080 |
| ½ mark | ½ mark | ½ mark | ½ mark | ½ mark | ½ mark |

- | | | |
|------------|---------------------|----------|
| June 22/02 | Accounts Receivable | \$15,000 |
|------------|---------------------|----------|

Allowance for Bad Debts **\$15,000**
(Nightmare pays in full a previously written off debt)

June 22/02 Bank **\$15,000**
Accounts Receivable **\$15,000**
(Nightmare pays in full a previously written off debt)

2. Using the information from question #1 above, Sweet Dreams Co. is considering using the income statement method rather than the balance sheet method. Using a percentage of 5.5% to estimate bad debts, prepare the journal entry to record the estimated bad debts.

(Application – 5 marks total – 1 mark each for the accounts, amount and explanation)

Dec. 31/01 Bad Debts Expense **\$35,970**
Allowance for Bad Debts **\$35,970**
(\$654,000 X 5.5% = \$35,970)

3. Sleep-time Company received from their customer, Nodding Company, a 6-month, 10% note for \$100,000 in settlement of an account receivable due today, September 1, 2001.

- a) Record the journal entry to record the Note Receivable.
(Application – 4 marks total – 1 each for the accounts, amount and explanation)

Sept.1/01 Note Receivable **\$100,000**
Accounts Receivable **\$100,000**
(Nodding Co, 6-month, 10% note for default receivable)

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

Dec.31/01 Interest Receivable **\$3,333**
Interest Revenue **\$3,333**
(Nodding Co. Note; \$2,500 = \$100,000 X 10% X 4/12 months)

- c) Record the journal entry to record the collection of principal and interest on the due date.
(Application – 10 marks total – 1 each for the date, accounts, amounts, and explanation)

Feb.28/02 Bank/Cash **\$105,000**
Note Receivable **\$100,000**
Interest Receivable **\$ 3,333**
Interest Revenue **\$ 1,667**
(Nodding Co. discharges 6-month, 10%, \$100,000 Note: \$1,667 = \$100,000 X 10% X 2/12 months)

4. On May 1, we sold merchandise to XYZ Company on account (charge sale) for \$2,300 with terms 1/10, n/30. On May 9, they returned \$300 of that sale. XYZ Company sends us a cheque, dated on the last possible day, to pay off the full amount owing minus the allowed discount.

- a) Prepare the journal entry to record the initial sale.
(Application - 3 marks total – 1 mark each for the accounts and amount)

May 1	Accounts Receivable	\$2,300	
	Sales		\$2,300
	(XYZ Co., 1/10, n/30)		

- b) Prepare the journal entry to record the return.
(Application - 3 marks total – 1 mark each for the accounts and amount)

May 9	Sales Returns and Allowances	\$900	
	Accounts Receivable		\$900
	(XYZ Co., 1/10, n/30, \$1,400 outstanding)		

- c) Prepare the journal entry to record the payment.
(Application - 7 marks total – 1 mark each for the date, accounts, amounts and explanation)

May 19	Bank	\$1,386	
	Discount Allowed	\$ 14	
	Accounts Receivable		\$1,400
	(XYZ Co., takes 1% discount on \$1400 outstanding 10 days after return)		

CASES – 8 marks total

5. Recreation Fun Company sells snowmobiles, personal watercrafts, and recreational vehicles. Recently the credit manager retired. The sales staff had always complained that his credit policies restricted their selling ability and convinced management there was no need to replace the credit manager since they could handle this responsibility in addition to their sales positions. Management was thrilled at year end when sales doubled; however, they also noticed that accounts receivable quadrupled and cash flow was reduced by half.

- a) Explain the financial impact of allowing the sales staff to manage the credit function and make a recommendation to management.

(Communication – 5 marks total – sound accounting-based argument)

Impact:

- Customer credit worthiness has not been assessed
- Lots of bad debts in the period's revenues (doubled)
- Most new customers are charge sales (A/R quadrupled)
- Many customers are not paying their receivable (A/R quadrupled and sales only doubled)
- The estimation of bad debts/allowance is unknown but very high
- Danger that company is essentially giving away merchandise
- Conflict of interest – hired to make sales; credit checking curtails credit sales

Recommendation:

- Do not allow overdue account holders to buy more until their account is paid in full
- Meet with sales staff and explain the current problem
- Require your sales staff to collect the accounts they okayed – require documentation of phone calls made and responses/promises received; follow up

- **Discuss possible long-term solutions with sales staff: hire a credit manager, penalize sales staff income/bonuses for delinquent accounts; remove commission sales (if there are some)**
6. Explain why the allowance method of estimating bad debts is better than the Direct Write-off method.
(Communication – 3 marks total – sound accounting-based argument)
- **Shows Accounts Receivable at NRV**
 - **Accounts Receivable and net Revenue are reported with conservative balances**
 - **Records Bad Debt Expense in the same time period as the Revenue it earned**
 - **Allows a confirmed bad debt and write-off to not affect the Balance Sheet or Income Statement at the time of the sale or at the time of the debt**