ILLUSTRATION 7-1
METHODS OF ESTIMATING THE YEAR-END ADJUSTING ENTRY FOR BAD DEBTS

(A) Percentage-of-Sales (Income Statement Approach)

Year-end adjusting entry for bad debts = Percentage × Credit sales

(B) Percentage-of-Receivables (Balance Sheet Approach)

First Step: Required ending balance in Allowance for Doubtful Accounts = Percentage × Ending balance in Accounts Receivables

Second Step: Year-end adjusting entry for bad debts = Required ending balance in Allowance for Doubtful Accounts − Beginning balance in Allowance for Doubtful Accounts + Write-offs of uncollectible accounts

Comparison of Methods for Estimating Uncollectibles

Income Statement Approach	Balance Sheet Approach
Percentage-of-Sales	Percentage-of-Receivables
Matching	Net Realizable Value
Sales ↔ Bad Debts Expense	Receivables ↔ Allowances for Bad Debts

ILLUSTRATION 7-2
ESTIMATING BAD DEBT EXPENSE

Data

Credit sales	$500,000
Estimated % of credit sales not collectible	1 1/4%
Accounts receivable balance	$72,500
Estimated % of accounts receivable not collectible	8%
Case I Allowance for Doubtful Accounts	$150 (Credit balance)
Case II Allowance for Doubtful Accounts	$150 (Debit balance)

Percentage-of-Sales Approach

Step 1: Determine sales figure to be used.

Credit sales = $500,000

Step 2: Compute estimated expense

.0125 × $500,000 = $6,250

Step 3: Make entry.

Bad Debt Expense	6,250	
Allowance for Doubtful Accounts		6,250

Percentage-of-Receivables Approach

Step 1: Determine balance in the Accounts Receivable account.

Accounts receivable balance = $72,500

Step 2: Compute desired balance for the Allowance for Doubtful Accounts account

.08 × $72,500 = $5,800

Step 3: Computed estimated bad debt expense.

Case I

Desired balance	$5,800	Cr
Actual balance	– 150	Cr
Amount of expense	$5,650	

Case II

Desired balance	$5,800	Cr
Actual balance	150	Dr
Amount of expense	$5,950	

Step 4: Make entry.

Case I

Bad Debt Expense	5,650	
Allowance for Doubtful Accounts		5,650

Case II

Bad Debt Expense	5,950	
Allowance for Doubtful Accounts		5,950

ILLUSTRATION 7-3
INTEREST BEARING AND NONINTEREST-BEARING NOTES RECEIVABLE

Interest-Bearing Note	Noninterest-Bearing Note
Date: January 1, 2004 I, Borrower Company, promise to pay to Lender Company the sum of $5,000 on January 1, 2007, plus interest computed at the rate of 12% per year on the outstanding balance of such sum.	**Date:** January 1, 2004 I, Borrower Company, promise to pay to Lender Company the sum of $5,000 on January 1, 2007.
Face Amount: $5,000	**Face Amount:** $5,000
Stated Interest Rate: 12%	**Stated Interest Rate:** Zero
Annual Interest Payments: $5,000 × 12% = $600	**Annual Interest Payments:** Zero
Present Value of 10% Market Rate: $\$5{,}000 \times PVF_{3,10\%}$ $= \$5{,}000 \times 0.75132 = \$3{,}756.60$ $\$600 \times PVF\text{-}OA_{3,10\%}$ $= \$600 \times 2.48685 \quad = 1{,}492.11$ $\$5{,}248.71$	**Present Value of 10% Market Rate:** $\$5{,}000 \times PVF_{3,10\%}$ $= \$5{,}000 \times 0.75132 = \$3{,}756.60$
Present Value of 12% Market Rate: $\$5{,}000 \times PVF_{3,12\%}$ $= \$5{,}000 \times 0.71178 = \$3{,}558.90$ $\$600 \times PVF\text{-}OA_{3,12\%}$ $= \$600 \times 2.40183 \quad = 1{,}4441.10$ $\$5{,}000.00$	**Present Value of 12% Market Rate:** $\$5{,}000 \times PVF_{3,12\%}$ $= \$5{,}000 \times 0.71178 = \$3{,}558.90$
Present Value of 15% Market Rate: $\$5{,}000 \times PVF_{3,15\%}$ $= \$5{,}000 \times 0.65752 = \$3{,}287.60$ $\$600 \times PVF\text{-}OA_{3,15\%}$ $= \$600 \times 2.28323 \quad = 1{,}369.94$ $\$4{,}657.54$	**Present Value of 15% Market Rate:** $\$5{,}000 \times PVF_{3,15\%}$ $= \$5{,}000 \times 0.65752 = \$3{,}287.60$

Amortization tables in the case where the market rate is 15% are provided on the following page.

ILLUSTRATION 7-3 (continued)
INTEREST BEARING AND NONINTEREST-BEARING NOTES RECEIVABLE

Schedule on Note Discount Amortization
Effective Interest Method
12% Note Discounted at 15%

Date	Cash Interest 12%	Effective Interest 15%	Discount Amortized	Unamortized Balance	Prese Value of Not
1/1/04				$342	$4,65
12/31/04	$600[a]	$699[b]	$ 99[c]	243[d]	4,75
12/31/05	600	714	114	129	4,87
12/31/06	600	729[e]	129	0	5,00

[a]$5,000 × 12% = $600
[b]$4,658 × 15% = $699
[c]$699 – $600 = $99
[d]$342 – $99 = $243
[e]$2 adjusted to compensate for rounding.

Schedule on Note Discount Amortization
Effective Interest Method
Noninterest-Bearing Note Discounted at 15%

	Journal Entries		Balance Sheet				
Date	Credit to Interest Revenue	Debit to Discount on Notes Receivable	Dr. Bal. in Notes Receivable	–	Cr. Bal. in Discount on Notes Receivable	=	Net Carryi Amou of No
1/1/04			$5,000		$1,712		$3,28
12/31/04	$493[a]	$493	5,000		1,219[b]		3,78
12/31/05	567	567	5,000		652		4,34
12/31/06	652	652	5,000		0		5,00

[a]$3,288 × 15% = $493

[b]$1,712 – $493 = $1,219.

ILLUSTRATION 7-4
SECURED BORROWING VS SALE OF RECEIVABLES

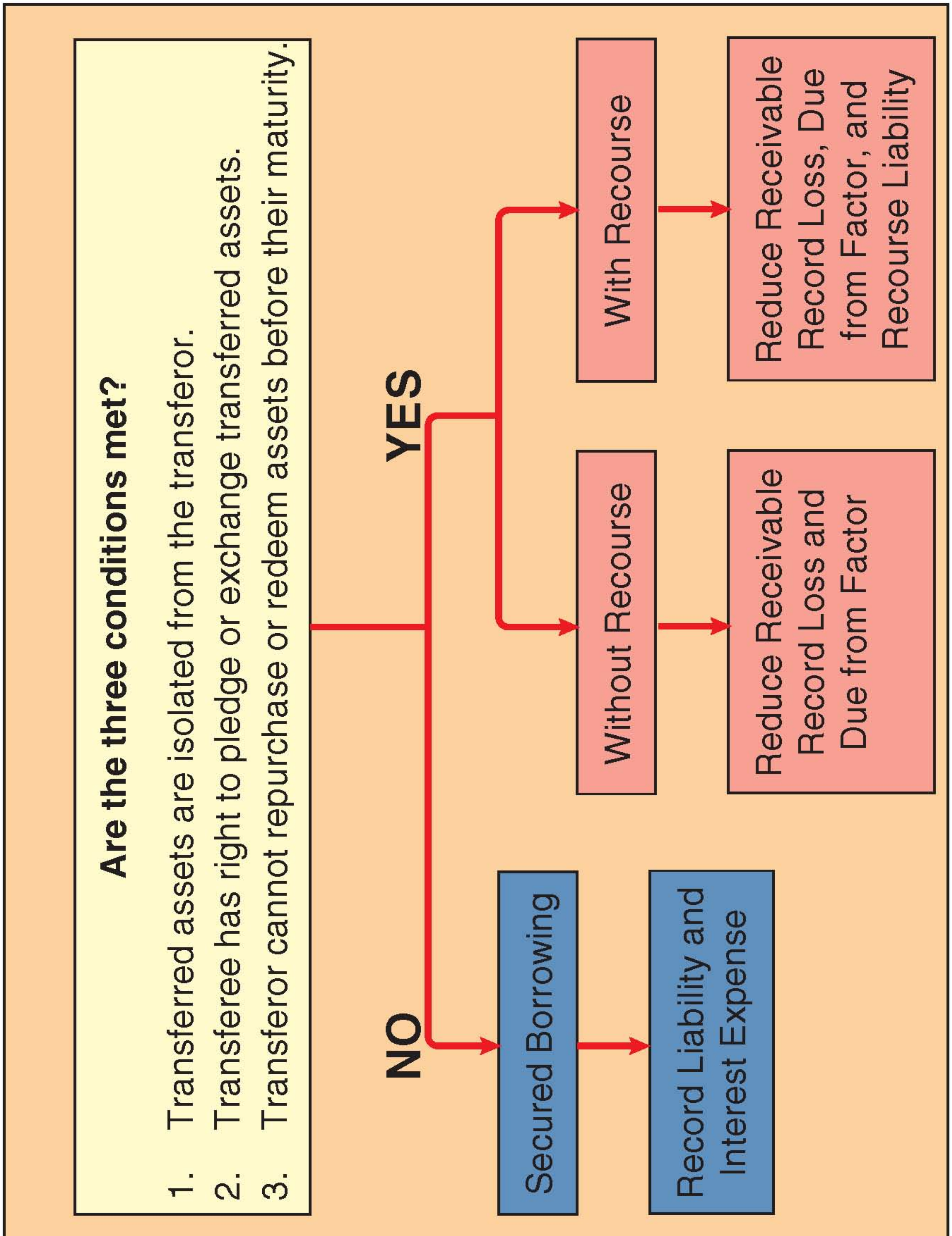

ILLUSTRATION 7-5
PETTY CASH

Imprest system—an advance of money for a designated purpose.

Action (What people are doing)	Accounting (Making—or *not* making entries)
1. A person is chosen to be the petty cash custodian. *A check is written, cashed, and the money given to the petty cash custodian.	1. Petty Cash Fund 300 Cash 300 To record check no.xxx and to set up the petty cash account.
2. The petty cash custodian pays for such things as office supplies, postage, entertainment, etc. *A receipt is obtained from the person to whom cash is paid.	2. No entries.
3. When the cash fund is low The cash is counted = $127 The receipts are totaled = 171 The two are added = $298 This total is compared to the original amount (300) The difference represents the cash (shortage) or overage. $ (2) *A check is written for the amount necessary to get the fund amount back to the original total. (300 – 127 = 173) *The check is cashed and the money given to the petty cash custodian.	3. Office Supplies Expense 42 Postage Expense 53 Entertainment Expense 76 Cash Over and Short 2 Cash 173 To record the petty cash receipts and cash shortage.

Source: C.G. Avery

ILLUSTRATION 7-6
BANK RECONCILIATION

Balance per bank statement		$xxx
Add:	Deposits recorded by business but not by bank (Example: Deposits in transit)	xxx
Deduct:	Charges recorded by business but not by bank (Example: Outstanding checks)	(xxx)
Corrected balance		$xxx
Balance per books		$xxx
Add:	Deposits recorded by bank but not by business (Example: Note collection)	xxx
Deduct:	Charges recorded by bank but not by business (Examples: Service charges, NSF checks)	(xxx)
Corrected balance		$xxx

Note: Information recorded by the bank but not the business will have to be recorded by journal entries.

Sample Test Questions
CHAPTER 7

CASH AND RECEIVABLES

MULTIPLE CHOICE—Conceptual

Answer	No.	Description
d	1.	Identification of cash items.
b	2.	Identification of cash items.
d	3.	Classification of travel advance.
d	4.	Classification of bank overdraft.
d	5.	Classification of compensating balances.
d	6.	Definition of trade receivables.
d	7.	Identification of trade receivables.
a	8.	Classification of sales discounts.
c	9.	Valuation of short-term receivables.
d	10.	Bad debt provision and the matching concept.
a	11.	Bad debts as a percentage of sales.
b	12.	Bad debts as a percentage of sales.
a	13.	Bad debts as a percentage of receivables.
d	14.	Financial statement effect of a note recorded incorrectly.
c	15.	Factoring accounts receivable without recourse.
d	16.	Accounts receivable turnover ratio.
c	*17.	Entry to replenish Petty Cash.
c	*18.	Purpose of Cash Over & Short account.
b	*19.	Classification of bank service charges.
c	*20.	Treatment of bank credits on bank reconciliation.

MULTIPLE CHOICE—Computational

Answer	No.	Description
d	21.	Calculate effective interest on loan with required compensatory balance.
c	22.	Determine effective annual interest rate of sales discount.
b	23.	Calculate balance of accounts receivable.
b	24.	Calculate net realizable value of accounts receivable.
d	25.	Calculate net realizable value of accounts receivable.
c	26.	Calculate bad debt expense using aging of receivables.
b	27.	Calculate bad debt expense using percent of sales.
a	28.	Calculate bad debt expense using percent of receivables.
b	29.	Determine appropriate interest rate for a zero-interest-bearing note.
a	30.	Calculate present value of a zero-interest-bearing note.
c	31.	Calculate cash proceeds from transfer of receivables.
c	32.	Entry to record collection of assigned receivables.
b	33.	Factoring receivables without recourse.
b	34.	Factoring receivables with recourse.
d	*35.	Entry to replenish petty cash.
b	*36.	Calculate correct balance in bank account.
b	*37.	Calculate correct cash balance.
c	*38.	Calculate correct cash balance.
b	*39.	Calculate correct cash balance.

c	*40.	Calculate correct cash balance.

*This topic is dealt with in an Appendix to the chapter.

MULTIPLE CHOICE—CPA Adapted

Answer	No.	Description
a	41.	Determine current net receivables.
d	42.	Calculate adjustment for bad debts.
d	43.	Calculate bad debt expense.
b	44.	Calculate adjustment to write off bad debts.
c	45.	Effect of a write-off under the allowance method.
d	46.	Determine balance in the Allowance for Doubtful Accounts.
c	47.	Determine interest revenue of a zero-interest-bearing note.
c	48.	Determine interest receivable at year end.
b	49.	Assignment and factoring of accounts receivable.
a	*50.	Calculate correct cash balance.
a	*51.	Calculate the cash balance per books.

EXERCISES

Item	Description
E7-52	Asset classification.
E7-53	Allowance for doubtful accounts.
E7-54	Entries for bad debt expense.
E7-55	Accounts receivable assigned.

CHAPTER LEARNING OBJECTIVES

1. Identify items considered cash.
2. Indicate how cash and related items are reported.
3. Define receivables and identify the different types of receivables.
4. Explain accounting issues related to recognition of accounts receivable.
5. Explain accounting issues related to valuation of accounts receivable.
6. Explain accounting issues related to recognition of notes receivable.
7. Explain accounting issues related to valuation of notes receivable.
8. Explain accounting issues related to disposition of accounts and notes receivable.
9. Explain how receivables are reported and analyzed.

*10. Explain common techniques employed to control cash.

MULTIPLE CHOICE—Conceptual

1. Which of the following is *not* considered cash for financial reporting purposes?
   a. Petty cash funds and change funds
   b. Money orders, certified checks, and personal checks
   c. Coin, currency, and available funds
   d. Postdated checks and I.O.U.'s

2. Which of the following is considered cash?
   a. Certificates of deposit (CDs)
   b. Money market checking accounts
   c. Money market savings certificates
   d. Postdated checks

3. Travel advances should be reported as
   a. supplies.
   b. cash because they represent the equivalent of money.
   c. investments.
   d. none of these.
4. Bank overdrafts, if material, should
   a. be reported as a deduction from the current asset section.
   b. be reported as a deduction from cash.
   c. be netted against cash and a net cash amount reported.
   d. be reported as a current liability.

5. Deposits held as compensating balances
   a. usually do not earn interest.
   b. if legally restricted and held against short-term credit may be included as cash.
   c. if legally restricted and held against long-term credit may be included among current assets.
   d. none of these.

6. The category "trade receivables" includes
   a. advances to officers and employees.
   b. income tax refunds receivable.
   c. claims against insurance companies for casualties sustained.
   d. none of these.

7. Which of the following should be recorded in Accounts Receivable?
   a. receivables from officers.
   b. receivables from subsidiaries.
   c. dividends receivable.
   d. none of these.

8. If a company employs the gross method of recording accounts receivable from customers, then sales discounts taken should be
   a. reported as a deduction from sales in the income statement.
   b. reported as an item of "other expense" in the income statement.
   c. reported as a deduction from accounts receivable in determining the net realizable value of accounts receivable.
   d. reported as sales discounts forfeited in the cost of goods sold section of the income statement.
9. Assuming that the ideal measure of short-term receivables in the balance sheet is the discounted value of the cash to be received in the future, failure to follow this practice usually does not make the balance sheet misleading because
   a. most short-term receivables are not interest-bearing.
   b. the allowance for uncollectible accounts includes a discount element.
   c. the amount of the discount is not material.
   d. most receivables can be sold to a bank or factor.

10. Which of the following methods of determining bad debts expense does not properly match expense and revenue?
   a. Charging bad debts with a percentage of sales under the allowance method.
   b. Charging bad debts with an amount derived from a percentage of accounts receivable under the allowance method.
   c. Charging bad debts with an amount derived from aging accounts receivable under the allowance method.
   d. Charging bad debts as accounts are written off as uncollectible.

11. Which of the following methods of determining annual bad debts expense best achieves the matching concept?
    a. Percentage of sales
    b. Percentage of ending accounts receivable
    c. Percentage of average accounts receivable
    d. Direct write-off

12. Which of the following is a generally accepted method of determining the amount of the adjustment to bad debts expense?
    a. A percentage of sales adjusted for the balance in the allowance
    b. A percentage of sales not adjusted for the balance in the allowance
    c. A percentage of accounts receivable not adjusted for the balance in the allowance
    d. An amount derived from aging accounts receivable and not adjusted for the balance in the allowance

13. The advantage of relating a company's bad debt expense to its outstanding accounts receivable is that this approach
    a. gives a reasonably correct statement of receivables in the balance sheet.
    b. best relates bad debts expense to the period of sale.
    c. is the only generally accepted method for valuing accounts receivable.
    d. makes estimates of uncollectible accounts unnecessary.

14. At the beginning of 2000, Finney Company received a three-year zero-interest-bearing $1,000 trade note. The market rate for equivalent notes was 8% at that time. Finney reported this note as a $1,000 trade note receivable on its 2000 year-end statement of financial position and $1,000 as sales revenue for 2000. What effect did this accounting for the note have on Finney's net earnings for 2000, 2001, 2002, and its retained earnings at the end of 2002, respectively?
    a. Overstate, overstate, understate, zero
    b. Overstate, understate, understate, understate
    c. Overstate, overstate, overstate, overstate
    d. None of these

15. Which of the following is true when accounts receivable are factored without recourse?
    a. The transaction may be accounted for either as a secured borrowing or as a sale, depending upon the substance of the transaction.
    b. The receivables are used as collateral for a promissory note issued to the factor by the owner of the receivables.
    c. The factor assumes the risk of collectibility and absorbs any credit losses in collecting the receivables.
    d. The financing cost (interest expense) should be recognized ratably over the collection period of the receivables.

16. The accounts receivable turnover ratio is computed by dividing
    a. gross sales by ending net receivables.
    b. gross sales by average net receivables.
    c. net sales by ending net receivables.
    d. net sales by average net receivables.

*17. Which of the following is *not* true?
    a. The imprest petty cash system in effect adheres to the rule of disbursement by check.
    b. Entries are made to the Petty Cash account only to increase or decrease the size of the fund or to adjust the balance if not replenished at year-end.
    c. The Petty Cash account is debited when the fund is replenished.
    d. All of these are not true.

*18. A Cash Over and Short account
- a. is not generally accepted.
- b. is debited when the petty cash fund proves out over.
- c. is debited when the petty cash fund proves out short.
- d. is a contra account to Cash.

*19. The journal entries for a bank reconciliation
- a. are taken from the "balance per bank" section only.
- b. may include a debit to Office Expense for bank service charges.
- c. may include a credit to Accounts Receivable for an NSF check.
- d. may include a debit to Accounts Payable for an NSF check.

*20. When preparing a bank reconciliation, bank credits are
- a. added to the bank statement balance.
- b. deducted from the bank statement balance.
- c. added to the balance per books.
- d. deducted from the balance per books.

Multiple Choice Answers—Conceptual

1.	d	4.	d	7.	d	10.	d	13.	a	16.	d	*19.	b
2.	b	5.	d	8.	a	11	a	14.	d	*17.	c	*20.	c
3.	d	6.	d	9.	c	12.	b	15.	c	*18.	c		

Solutions to those Multiple Choice questions for which the answer is “none of these.”

3. As receivables.
5. Many answers are possible.
6. Open accounts resulting from short-term extensions of credit to customers.
7. Open accounts resulting from short-term extensions of credit to customers.
14. Overstate, understate, understate, zero.

MULTIPLE CHOICE—Computational

21. On January 1, 2001, Olin Company borrows $2,000,000 from National Bank at 12% annual interest. In addition, Olin is required to keep a compensatory balance of $200,000 on deposit at National Bank which will earn interest at 4%. The effective interest that Olin pays on its $2,000,000 loan is
- a. 10.0%.
- b. 11.6%.
- c. 12.0%.
- d. 12.8%.

22. If a company purchases merchandise on terms of 2/10, n/30, the cash discount available is equivalent to what effective annual rate of interest (assuming a 360-day year)?
- a. 2%
- b. 24%
- c. 36%
- d. 72%

23. At the close of its first year of operations, December 31, 2001, Linn Company had accounts receivable of $440,000, after deducting the related allowance for doubtful accounts. During 2001, the company had charges to bad debt expense of $90,000 and wrote off, as uncollectible, accounts receivable of $40,000. What should the company report on its balance sheet at December 31, 2001, as accounts receivable before the allowance for doubtful accounts?
- a. $570,000

b. $490,000
c. $390,000
d. $310,000

24. Before year-end adjusting entries, Bass Company's account balances at December 31, 2001, for accounts receivable and the related allowance for uncollectible accounts were $500,000 and $45,000, respectively. An aging of accounts receivable indicated that $62,500 of the December 31 receivables are expected to be uncollectible. The net realizable value of accounts receivable after adjustment is
a. $482,500.
b. $437,500.
c. $392,500.
d. $455,000.

25. During the year, Jantz Company made an entry to write off a $4,000 uncollectible account. Before this entry was made, the balance in accounts receivable was $60,000 and the balance in the allowance account was $4,500. The net realizable value of accounts receivable after the write-off entry was
a. $60,000.
b. $59,500.
c. $51,500.
d. $55,500. 26. The following information is available for theTerry Company:

Allowance for doubtful accounts at December 31, 2000	$ 8,000
Credit sales during 2001	400,000
Accounts receivable deemed worthless and written off during 2001	9,000

As a result of a review and aging of accounts receivable in early January 2002, however, it has been determined that an allowance for doubtful accounts of $7,500 is needed at December 31, 2001.

What amount should Terry record as "bad debt expense" for the year ended December 31, 2001?
a. $6,500
b. $7,500
c. $8,500
d. $15,500

Use the following information for questions 27 and 28.

A trial balance before adjustments included the following:

	Debit	Credit
Sales		$425,000
Sales returns and allowance	$14,000	
Accounts receivable	43,000	
Allowance for doubtful accounts		760

27. If the estimate of uncollectibles is made by taking 2% of net sales, the amount of the adjustment is
a. $6,700.
b. $8,220.
c. $8,500.
d. $9,740.

28. If the estimate of uncollectibles is made by taking 10% of gross account receivables, the amount of the adjustment is
a. $3,540.

b. $4,300.
c. $4,224.
d. $5,060.

29. Marley Company received a seven-year zero-interest-bearing note on February 22, 2001, in exchange for property it sold to O'Rear Company. There was no established exchange price for this property and the note has no ready market. The prevailing rate of interest for a note of this type was 7% on February 22, 2001, 7.5% on December 31, 2001, 7.7% on February 22, 2002, and 8% on December 31, 2002. What interest rate should be used to calculate the interest revenue from this transaction for the years ended December 31, 2001 and 2002, respectively?
    a. 0% and 0%
    b. 7% and 7%
    c. 7% and 7.7%
    d. 7.5% and 8%

30. On December 31, 2001, Eller Corporation sold for $70,000 an old machine having an original cost of $90,000 and a book value of $40,000. The terms of the sale were as follows:

    $10,000 down payment
    $30,000 payable on December 31 each of the next two years

    The agreement of sale made no mention of interest; however, 9% would be a fair rate for this type of transaction. What should be the amount of the notes receivable net of the unamortized discount on December 31, 2001 rounded to the nearest dollar? (The present value of an ordinary annuity of 1 at 9% for 2 years is 1.75911.)
    a. $52,773.
    b. $62,773.
    c. $60,000.
    d. $105,546.

Use the following information for questions 31 and 32.

Isaac Co. assigned $500,000 of accounts receivable to Dixon Finance Co. as security for a loan of $420,000. Dixon charged a 2% commission on the amount of the loan; the interest rate on the note was 10%. During the first month, Isaac collected $110,000 on assigned accounts after deducting $380 of discounts. Isaac accepted returns worth $1,350 and wrote off assigned accounts totaling $3,700.

31. The amount of cash Isaac received from Dixon at the time of the transfer was
    a. $378,000.
    b. $410,000.
    c. $411,600.
    d. $420,000.

32. Entries during the first month would include a
    a. debit to Cash of $110,380.
    b. debit to Bad Debts Expense of $3,700.
    c. debit to Allowance for Doubtful Accounts of $3,700.
    d. debit to Accounts Receivable of $115,430.

Use the following information for questions 33 and 34.

On February 1, 2001, Oswald Company factored receivables with a carrying amount of $200,000 to Koch Company. Koch Company assesses a finance charge of 3% of the receivables and retains 5% of the receivables. Relative to this transaction, you are to determine the amount of loss on sale to be reported in the income statement of Oswald Company for February.

33. Assume that Oswald factors the receivables on a without recourse basis. The loss to be reported is
  a. $0.
  b. $6,000.
  c. $10,000.
  d. $16,000.

34. Assume that Oswald factors the receivables on a recourse basis. The recourse obligation has a fair value of $1,000. The loss to be reported is
  a. $6,000.
  b. $7,000.
  c. $10,000.
  d. $17,000.

*35. If a petty cash fund is established in the amount of $250, and contains $200 in cash and $45 in receipts for disbursements when it is replenished, the journal entry to record replenishment should include credits to the following accounts
  a. Petty Cash, $45.
  b. Petty Cash, $50.
  c. Cash, $45; Cash Over and Short, $5.
  d. Cash, $50.

*36. If the month-end bank statement shows a balance of $31,000, outstanding checks are $12,000, a deposit of $4,000 was in transit at month end, and a check for $500 was erroneously charged by the bank against the account, the correct balance in the bank account at month end is
  a. $22,500.
  b. $23,500.
  c. $15,500.
  d. $38,500.

*37. In preparing its bank reconciliation for the month of April 2001, Gregg, Inc. has available the following information.

Balance per bank statement, 4/30/01	$35,140
NSF check returned with 4/30/01 bank statement	450
Deposits in transit, 4/30/01	4,000
Outstanding checks, 4/30/01	5,200
Bank service charges for April	20

What should be the correct balance of cash at April 30, 2001?
  a. $34,370
  b. $33,940
  c. $33,490
  d. $33,470

*38. Tanner, Inc.'s checkbook balance on December 31, 2001 was $24,200. In addition, Tanner held the following items in its safe on December 31.
  (1) A check for $450 from Peters, Inc. received December 30, 2001, which was not included in the checkbook balance.
  (2) An NSF check from Garner Company in the amount of $700 that had been deposited at the bank, but was returned for lack of sufficient funds on December 29. The check was to be redeposited on January 3, 2002. The original deposit has been included in the December 31 checkbook balance.
  (3) Coin and currency on hand amounted to $1,450.

The proper amount to be reported on Tanner's balance sheet for cash at December 31, 2001 is

a. $24,500.
b. $23,950.
c. $25,400.
d. $24,950.

*39. The cash account shows a balance of $42,000 before reconciliation. The bank statement does not include a deposit of $2,300 made on the last day of the month. The bank statement shows a collection by the bank of $940 and a customer's check for $220 was returned because it was NSF. A customer's check for $450 was recorded on the books as $540, and a check written for $79 was recorded as $97. The correct balance in the cash account was

a. $42,612.
b. $42,648.
c. $42,828.
d. $44,948.

40. In preparing its May 31, 2001 bank reconciliation, Dogg Co. has the following information available:

Balance per bank statement, 5/31/01	$32,000
Deposit in transit, 5/31/01	5,400
Outstanding checks, 5/31/01	4,900
Note collected by bank in May	1,250

The correct balance of cash at May 31, 2001 is

a. $37,400.
b. $31,250.
c. $32,500.
d. $33,750.

Multiple Choice Answers—Computational

21.	d	25.	d	29.	b	33.	b	*37.	b
22.	c	26.	c	30.	a	34.	b	*38.	c
23.	b	27.	b	31.	c	*35.	d	*39.	b
24.	b	28.	a	32.	c	*36.	b	*40.	c

MULTIPLE CHOICE—CPA Adapted

41. On the December 31, 2001 balance sheet of Yount Co., the current receivables consisted of the following:

Trade accounts receivable	$ 65,000
Allowance for uncollectible accounts	(2,000)
Claim against shipper for goods lost in transit (November 2001)	3,000
Selling price of unsold goods sent by Yount on consignment at 130% of cost (not included in Yount's ending inventory)	26,000
Security deposit on lease of warehouse used for storing some inventories	30,000
Total	$122,000

At December 31, 2001, the correct total of Yount's current net receivables was

a. $66,000.
b. $92,000.

c. $96,000.
d. $122,000.

42. May Co. prepared an aging of its accounts receivable at December 31, 2001 and determined that the net realizable value of the receivables was $290,000. Additional information is available as follows:

Allowance for uncollectible accounts at 1/1/01—credit balance	$ 34,000
Accounts written off as uncollectible during 2001	23,000
Accounts receivable at 12/31/01	320,000
Uncollectible accounts recovery recovered during 2001	5,000

For the year ended December 31, 2001, May's uncollectible accounts expense would be
a. $20,000.
b. $23,000.
c. $16,000.
d. $14,000.

43. For the year ended December 31, 2001, Cott Co. estimated its allowance for uncollectible accounts using the year-end aging of accounts receivable. The following data are available:

Allowance for uncollectible accounts, 1/1/01	$51,000
Provision for uncollectible accounts during 2001 (2% on credit sales of $2,000,000)	40,000
Uncollectible accounts written off, 11/30/01	46,000
Estimated uncollectible accounts per aging, 12/31/01	69,000

After year-end adjustment, the uncollectible accounts expense for 2001 should be
a. $46,000.
b. $57,000.
c. $69,000.
d. $64,000.

44. Linn Co.'s allowance for uncollectible accounts was $92,000 at the end of 2001 and $90,000 at the end of 2000. For the year ended December 31, 2001, Linn reported bad debt expense of $13,000 in its income statement. What amount did Linn debit to the appropriate account in 2001 to write off actual bad debts?
a. $2,000
b. $11,000
c. $13,000
d. $15,000

45. Under the allowance method of recognizing uncollectible accounts, the entry to write off an uncollectible account
a. increases the allowance for uncollectible accounts.
b. has no effect on the allowance for uncollectible accounts.
c. has no effect on net income.
d. decreases net income.

46. The following accounts were abstracted from Uler Co.'s unadjusted trial balance at December 31, 2001:

	Debit	Credit
Accounts receivable	$700,000	
Allowance for uncollectible accounts	8,000	
Net credit sales		$3,000,000

Uler estimates that 1% of the gross accounts receivable will become uncollectible. After adjustment at December 31, 2001, the allowance for uncollectible accounts should have a credit balance of

a. $30,000.
b. $22,000.
c. $15,000.
d. $7,000.

47. On January 1, 2001, North Co. exchanged equipment for a $200,000 zero-interest-bearing note due on January 1, 2004. The prevailing rate of interest for a note of this type at January 1, 2001 was 10%. The present value of $1 at 10% for three periods is 0.75. What amount of interest revenue should be included in North's 2002 income statement?

a. $0
b. $15,000
c. $16,500
d. $20,000

48. On June 1, 2001, Vent Corp. loaned Irvin $200,000 on a 12% note, payable in five annual installments of $40,000 beginning January 2, 2002. In connection with this loan, Irvin was required to deposit $2,000 in a zero-interest-bearing escrow account. The amount held in escrow is to be returned to Irvin after all principal and interest payments have been made. Interest on the note is payable on the first day of each month beginning July 1, 2001. Irvin made timely payments through November 1, 2001. On January 2, 2002, Vent received payment of the first principal installment plus all interest due. At December 31, 2001, Vent's interest receivable on the loan to Irvin should be

a. $0.
b. $2,000.
c. $4,000.
d. $6,000.

49. Which of the following is a method to generate cash from accounts receivable?

	Assignment	Factoring
a.	Yes	No
b.	Yes	Yes
c.	No	Yes
d.	No	No

*50. In preparing its August 31, 2001 bank reconciliation, Baker Corp. has available the following information:

Balance per bank statement, 8/31/01	$21,650
Deposit in transit, 8/31/01	5,900
Return of customer's check for insufficient funds, 8/30/01	600
Outstanding checks, 8/31/01	2,750
Bank service charges for August	100

At August 31, 2001, Baker's correct cash balance is

a. $24,800.
b. $24,200.
c. $24,100.
d. $22,500.

*51. Sandy, Inc. had the following bank reconciliation at March 31, 2001:

Balance per bank statement, 3/31/01	$37,200
Add: Deposit in transit	10,300
	47,500
Less: Outstanding checks	12,600
Balance per books, 3/31/01	$34,900

Data per bank for the month of April 2001 follow:

Deposits	$47,700
Disbursements	49,700

All reconciling items at March 31, 2001 cleared the bank in April. Outstanding checks at April 30, 2001 totaled $5,000. There were no deposits in transit at April 30, 2001. What is the cash balance per books at April 30, 2001?

a. $30,200
b. $32,900
c. $35,200
d. $40,500

Multiple Choice Answers—CPA Adapted

41.	a	43.	d	45.	c	47.	c	49.	b	*51.	a
42.	d	44.	b	46.	d	48.	c	*50.	a		

DERIVATIONS — Computational

No.	Answer	Derivation
21.	d	$2,000,000 × .12 = $240,000 $200,000 × (.12 – .04) = 16,000 Interest $256,000 $256,000 ÷ $2,000,000 = .128 = 12.8%.
22.	c	.02 × 360 ÷ 20 = 36%.
23.	b	$440,000 + ($90,000 – $40,000) = $490,000.
24.	b	$500,000 – $62,500 = $437,500.
25.	d	($60,000 – $4,000) – ($4,500 – $4,000) = $55,500.
26.	c	$8,000 – $9,000 + $8,500 = $7,500.
27.	b	($425,000 – $14,000) × .02 = $8,220.
28.	a	($43,000 × .10) – $760 = $3,540.
29.	b	7% and 7%.
30.	a	$30,000 × 1.75911 = $52,773.
31.	c	$420,000 – $8,400 = $411,600.
32.	c	
33.	b	$200,000 × .03 = $6,000.

34.	b	($200,000 × .03) + $1,000 = $7,000.
*35.	d	$250 – $200 = $50.
*36.	b	$31,000 – $12,000 + $4,000 + $500 = $23,500.
*37.	b	$35,140 + $4,000 – $5,200 = $33,940.
*38.	c	$24,200 + $450 – $700 + $1,450 = $25,400.
*39.	b	$42,000 + $940 – $220 – $90 + $18 = $42,648.
*40.	c	$32,000 + $5,400 – $4,900 = $32,500.

DERIVATIONS — CPA Adapted

No.	**Answer**	**Derivation**
41.	a	$65,000 – $2,000 + $3,000 = $66,000.
42.	d	Allowance for Doubtful Acct. balance $34,000 + $5,000 – $23,000 = $16,000 (before bad debt expense) $320,000 – $290,000 – $16,000 = $14,000 (bad debt expense).
43.	d	$69,000 – $51,000 + $46,000 = $64,000.
44.	b	$90,000 + $13,000 – $92,000 = $11,000.
45.	c	Conceptual.
46.	d	$700,000 × .01 = $7,000.
47.	c	$200,000 × .75 = $150,000 present value $150,000 × .10 = $15,000 (2001 interest) ($150,000 + $15,000) × .10 = $16,500 (2002 interest).
48.	c	$200,000 × 12% × 2 ÷ 12 = $4,000.
49.	b	Conceptual.
*50.	a	$21,650 + $5,900 – $2,750 = $24,800.
*51.	a	$37,200 + $47,700 – $49,700 = $35,200 (4/30 balance per bank) $35,200 – $5,000 = $30,200.

EXERCISES

Ex. 7-52—Asset classification.

Below is a list of items. Classify each into one of the following balance sheet categories:

a. Cash c. Marketable Securities
b. Receivables d. Other

___ 1. Compensating balances held in long-term borrowing arrangements

___ 2. Savings account

___ 3. Trust fund

___ 4. Checking account

___ 5. Postage stamps

___ 6. Treasury bills maturing in six months

___ 7. Post-dated checks from customers

___ 8. Certificate of deposit maturing in five years

___ 9. Common stock of another company (to be sold by December 31, this year)

___ 10. Change fund

Solution 7-52

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

Ex. 7-53—Allowance for doubtful accounts.

When a company has a policy of making sales for which credit is extended, it is reasonable to expect a portion of those sales to be uncollectible. As a result of this, a company must recognize bad debt expense. There are basically two methods of recognizing bad debt expense: (1) direct write-off method, and (2) allowance method.

Instructions

(a) Describe fully both the direct write-off method and the allowance method of recognizing bad debt expense.

(b) Discuss the reasons why one of the above methods is preferable to the other and the reasons why the other method is not usually in accordance with generally accepted accounting principles.

Solution 7-53

(a) There are basically two methods of recognizing bad debt expense: (1) direct write-off and (2) allowance.

The direct write-off method requires the identification of specific balances that are deemed to be uncollectible before any bad debt expense is recognized. At the time a specific account is deemed uncollectible, the account is removed from accounts receivable and a corresponding amount of bad debt expense is recognized.

The allowance method requires an estimate of bad debt expense for a period of time by reference to the composition of the accounts receivable balance at a specific point in time (aging) or to the overall experience with credit sales over a period of time. Thus, total bad debt expense expected to arise as a result of operations for a specific period is estimated, the valuation account (allowance for doubtful accounts) is appropriately adjusted, and a corresponding amount of bad debt expense is recognized. As specific accounts are identified as uncollectible, the account is written off. It is removed from accounts receivable and a corresponding amount is removed from the valuation account (allowance for doubtful accounts). Net accounts receivable do not change, and there is no charge to bad debt expense when specific accounts are identified as uncollectible and written off using the allowance method.

(b) The allowance method is preferable because it matches the cost of making a credit sale with the revenues generated by the sale in the same period and achieves a proper carrying value for accounts receivable at the end of a period. Since the direct write-off method does not recognize the bad debt expense until a specific amount is deemed uncollectible, which may be in a subsequent period, it does not comply with the matching principle and does not achieve a proper carrying value for accounts receivable at the end of a period.

Ex. 7-54—Entries for bad debt expense.

A trial balance before adjustment included the following:

	Debit	Credit
Accounts receivable	$90,000	
Allowance for doubtful accounts		730
Sales		$360,000
Sales returns and allowances	8,000	

Give journal entries assuming that the estimate of uncollectibles is determined by taking (1) 5% of gross accounts receivable and (2) 1% of net sales.

Solution 7-54

			Debit	Credit
(1)	Bad Debts Expense		3,770	
	Allowance for Doubtful Accounts			3,770
	Gross receivables	$90,000		
	Rate	5%		
	Total allowance needed	4,500		
	Present allowance	(730)		
	Adjustment needed	$ 3,770		

Solution 7-54 (cont.)

			Debit	Credit
(2)	Bad Debts Expense		3,520	
	Allowance for Doubtful Accounts			3,520
	Sales	$360,000		
	Sales returns and allowances	8,000		
	Net sales	352,000		
	Rate	1%		
	Bad debts expense	$ 3,520		

Ex. 7-55—Accounts receivable assigned.

Accounts receivable in the amount of $380,000 were assigned to the Fast Finance Company by Nance, Inc., as security for a loan of $300,000. The finance company charged a 4% commission on the face amount of the loan, and the note bears interest at 8% per year.

During the first month, Nance collected $190,000 on assigned accounts. This amount was remitted to the finance company along with one month's interest on the note.

Instructions
Make all the entries for Nance. Inc. associated with the transfer of the accounts receivable, the loan, and the remittance to the finance company.

Solution 7-55

Cash	288,000	
Finance Charge	12,000	
Notes Payable		300,000
Cash	190,000	
Accounts Receivable		190,000
Notes Payable 190,000		
Interest Expense	2,000	
Cash		192,000

PROBLEMS

Pr. 7-56—Entries for bad debts expense.

The trial balance before adjustment of Pratt Company reports the following balances:

	Dr.	Cr.
Accounts receivable	$100,000	
Allowance for doubtful accounts		$ 2,500
Sales (all on credit)		650,000
Sales returns and allowances	40,000	

Instructions

(a) Prepare the entries for estimated bad debts assuming that doubtful accounts are estimated to be (1) 7% of gross accounts receivable and (2) 1% of net sales.

(b) Assume that all the information above is the same, except that the Allowance for Doubtful Accounts has a debit balance of $2,500 instead of a credit balance. How will this difference affect the journal entries in part (a)?

Solution 7-56

(a) (1) Bad Debts Expense 4,500
Allowance for Doubtful Accounts 4,500

Gross receivables	$100,000
Rate	7%
Total allowance needed	7,000
Present allowance	(2,500)
Bad debts expense	$ 4,500

(2) Bad Debts Expense 6,100
Allowance for Doubtful Accounts 6,100

Sales	$650,000
Sales returns and allowances	(40,000)
Net sales	610,000
Rate	1%
Bad debts expense	$ 6,100

(b) The percentage of receivables approach would be affected as follows:

Gross receivables	$100,000
Rate	7%
Total allowance needed	7,000
Present allowance	2,500
Additional amount required	$ 9,500

The journal entry is therefore as follows:

Bad Debts Expense	9,500	
Allowance for Doubtful Accounts		9,500

The entry would not change under the percentage of sales method.

Pr. 7-57—Amortization of discount on note.

On December 31, 2001, Hall Company finished consultation services and accepted in exchange a promissory note with a face value of $300,000, a due date of December 31, 2004, and a stated rate of 5%, with interest receivable at the end of each year. The fair value of the services is not readily determinable and the note is not readily marketable. Under the circumstances, the note is considered to have an appropriate imputed rate of interest of 10%.

The following interest factors are provided:

	Interest Rate	
Table Factors For Three Periods	5%	10%
Future Value of 1	1.15763	1.33100
Present Value of 1	.86384	.75132
Future Value of Ordinary Annuity of 1	3.15250	3.31000
Present Value of Ordinary Annuity of 1	2.72325	2.48685

Instructions

(a) Determine the present value of the note.

(b) Prepare a Schedule of Note Discount Amortization for Hall Company under the effective interest method. (Round to whole dollars.)

Solution 7-57

(a)	Present value of interest	=	$15,000 × 2.48685	=	$ 37,303
	Present value of maturity value	=	$300,000 × .75132	=	225,396
					$262,699

(b) Hall Company

Schedule of Note Discount Amortization
Effective Interest Method
5% Note Discounted at 10% (Imputed)

Date	Cash Interest (5%)	Effective Interest (10%)	Discount Amortized	Unamortized Discount Balance	Present Value of Note
12/31/01				$37,301	$262,699
12/31/02	$15,000	$26,270	$11,270	26,031	273,969
12/31/03	15,000	27,397	12,397	13,634	286,366
12/31/04	15,000	28,634*	13,634	0	300,000
	$45,000	$82,301	$37,301		

*$3 adjustment to compensate for rounding.

Pr. 7-58—Accounts receivable assigned.

Prepare journal entries for Law Co. for:

(a) Accounts receivable in the amount of $600,000 were assigned to Yount Finance Co. by Law as security for a loan of $500,000. Yount charged a 3% commission on the accounts; the interest rate on the note is 12%.

(b) During the first month, Law collected $250,000 on assigned accounts after deducting $560 of discounts. Law wrote off a $530 assigned account.

(c) Law paid to Yount the amount collected plus one month's interest on the note.

Solution 7-58

	Account	Debit	Credit
(a)	Cash	482,000	
	Finance Charge	18,000	
	Notes Payable		500,000
(b)	Cash	250,000	
	Sales Discounts	560	
	Allowance for Doubtful Accounts	530	
	Accounts Receivable		251,090
(c)	Notes Payable	250,000	
	Interest Expense	5,000	
	Cash		255,000

Pr. 7-59—Factoring Accounts Receivable.

On May 1, Costas, Inc. factored $600,000 of accounts receivable with Ready Finance on a without recourse basis. Under the arrangement, Costas was to handle disputes concerning service, and Ready Finance was to make the collections, handle the sales discounts, and absorb the credit losses. Ready Finance assessed a finance charge of 6% of the total accounts receivable factored and retained an amount equal to 2% of the total receivables to cover sales discounts.

Instructions

(a) Prepare the journal entry required on Costas' books on May 1.

(b) Prepare the journal entry required on Ready Finance's books on May 1.

(c) Assume Costas factors the $600,000 of accounts receivable with Ready Finance on a *with* recourse basis instead. The recourse provision has a fair value of $10,000. Prepare the journal entry required on Costas' books on May 1.

Solution 7-59

(a) Cash	552,000	
Due from Factor (2% × $600,000)	12,000	
Loss on Sale of Receivables (6% × $600,000)	36,000	
Accounts Receivable		600,000

(b) Accounts Receivable	600,000	
Due to Costas		12,000
Financing Revenue		36,000
Cash		552,000

(c) Cash	552,000	
Due from Factor	12,000	
Loss on Sale of Receivables	46,000	
Accounts Receivable		600,000
Recourse Liability..		10,000

***Pr. 7-60**—Bank reconciliation.

Adcock Plastics Company deposits all receipts and makes all payments by check. The following information is available from the cash records:

MARCH 31 BANK RECONCILIATION

Balance per bank	$26,746
Add: Deposits in transit	2,100
Deduct: Outstanding checks	(3,800)
Balance per books	$25,046

Month of April Results

	Per Bank	Per Books
Balance April 30	$27,995	$30,355
April deposits	10,784	15,889
April checks	11,100	10,080
April note collected (not included in April deposits)	3,000	-0-
April bank service charge	35	-0-
April NSF check of a customer returned by the bank (recorded by bank as a charge)	900	-0-

Instructions

(a) Calculate the amount of the April 30:
1. Deposits in transit
2. Outstanding checks

(b) What is the April 30 adjusted cash balance? Show all work.

***Solution 7-60**

(a) 1. Deposits in transit, $7,205 [$15,889 – ($10,784 – $2,100)]
    2. Outstanding checks, $2,780 [$10,080 – ($11,100 – $3,800)]

(b) Adjusted cash balance at April 30, $32,420
    ($27,995 + $7,205 – $2,780) OR ($30,355 + $3,000 – $35 – $900)