

## **ADMS 2500 - Introduction to Financial Accounting**

### Receivables

1. What are Receivables?
2. Accounting for Bad Debts
3. Direct Write Off Method
4. Allowance Method
  - a. Percentage of Sales Method
  - b. Percentage of Receivables Method
5. Balance Sheet Presentation
  - o NRV - Net Realizable Value

## What are Receivables?

- Receivables is an account that is designated as an asset
- Applicable to all debts, unsettled transactions or other monetary obligations owed to a company by its debtors or customers
- Recorded by accountants and reported on the balance sheet, and they include all debts owed to the company
- Can be categorized as both current assets or long term assets
- Common accounts you can come across:
  - Accounts Receivables
  - Interest Receivables
  - Notes Receivables
  - Others as needed

### Sample Balance Sheet - Loblaw Companies Ltd. - Fiscal 2016

#### Consolidated Balance Sheets

(millions of Canadian dollars)	As at December 31, 2016	As at January 2, 2016 <sup>(i)</sup>
<b>Assets</b>		
Current Assets		
Cash and cash equivalents (note 9)	\$ 1,314	\$ 1,018
Short term investments (note 9)	241	64
Accounts receivable (note 10)	1,122	1,325
Credit card receivables (note 11)	2,926	2,790
Inventories (note 12)	4,371	4,322
Prepaid expenses and other assets	190	265
Assets held for sale (note 13)	40	71
<b>Total Current Assets</b>	<b>\$ 10,204</b>	<b>\$ 9,855</b>
Fixed Assets (note 14)	10,559	10,480
Investment Properties (note 15)	218	160
Intangible Assets (note 16)	8,745	9,164
Goodwill (note 17)	3,895	3,780
Deferred Income Tax Assets (note 7)	130	132
Franchise Loans Receivable (note 30)	233	329
Other Assets (note 18)	452	457
<b>Total Assets</b>	<b>\$ 34,436</b>	<b>\$ 34,357</b>

## Accounting for Bad Debts

- Bad debt expense relates to sales that were made on credit that are not likely to be collected by the company
- Reasons:
  - Customers are unwilling to pay
  - Customers are unable to pay
- Strategies to minimize bad debts:
  - i. Receivables manager
  - ii. Formalized credit & collection policies
  - iii. Incentives such as sales discounts
  - iv. Regular review of receivables
  - v. Use of collection agencies
- Two methods to handle accounting for bad debts
  - *Direct Write Off Method*
  - *Allowance Method*

## Accounting for Bad Debts

1. *Direct Write Off Method (Reactive)*
  2. *Allowance Method (Proactive: Estimate)*
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### *Direct Write-Off Method*

When a particular receivable becomes uncollectible the bad debt is recognized with the following entry:

Dr. Bad Debt Expense	\$
Cr. Accounts Receivable	\$

### **Example 1 - Direct Write-Off Method**

ABC Company has just received word that one of its customers has just filed for bankruptcy. This customer owes ABC Company \$3,300 for an outstanding invoice from 8 months ago. ABC Company uses the direct write off method to account for bad debts. How should this entry be recorded?

## Accounting for Bad Debts - Direct Write Off Method

When a particular receivable becomes uncollectible the bad debt is recognized with the following entry:

Dr. Bad Debt Expense	\$	
Cr. Accounts Receivable		\$

### Example 2 - Direct Write Off Method

ABC Company has been in business for three years. The company makes all sales on account, does not offer cash discounts and uses the direct write-off method. The firm's credit sales, collections from customers, and write-offs of uncollectible accounts for the three-year period are summarized below:

Year	Sales	Collections	Accounts Written Off
1	\$400,000	\$380,000	\$1,000
2	600,000	590,000	1,400
3	720,000	704,000	2,000

What total amount of bad debt expense would have appeared on the firm's income statement during the three-year period?

- A) \$7,400
- B) \$38,600
- C) \$2,467
- D) \$4,400
- E) None of the above

## Accounting for Bad Debts - Allowance Method

- Takes a proactive approach to dealing with bad debts
- Periodically examine receivables & estimate an amount of bad debts
- Three entries to know:

### **1. Estimate Entry**

- % of Credit Sales
- % of Receivables / Aging Method

### **2. Write Off Entry**

### **3. Recovery Entry**

#### *Journal Entries – Allowance Method*

##### *1. Estimate Entry*

Dr. Bad Debt Expense	\$	
Cr. AFDA*		\$

##### *2. Write-Off Entry*

Dr. AFDA	\$	
Cr. Accounts Receivable		\$

##### *3. Recovery Entry*

Dr. Accounts Receivable	\$	
Cr. AFDA		\$

Dr. Cash	\$	
Cr. Accounts Receivable		\$

*\*AFDA - Allowance for Doubtful Accounts*

## Accounting for Bad Debts - Allowance Method - % of Sales Method

### Example 3 - % of sales method

ABC Company has been in business for three years. The company makes all sales on account, does not offer cash discounts and uses the allowance method. If the company had used a sales percentage allowance method of recognizing credit losses and had provided for such losses at the rate of 1% of sales, what amount of Allowance for Uncollectible Accounts (or Allowance for Doubtful Accounts) would appear on the firm's balance sheet at the end of the third year?

Year	Sales	Collections	Accounts Written Off
1	\$400,000	\$380,000	\$1,000
2	600,000	590,000	1,400
3	720,000	704,000	2,000

- A) \$5,500
- B) \$9,800
- C) \$12,800
- D) \$17,200
- E) None of the above

If the company had used a sales percentage allowance method of recognizing credit losses and had provided for such losses at the rate of 1% of sales, what total amount of uncollectible accounts expense would have appeared on the firm's income statement during the three-year period?

- A) \$5,500
- B) \$9,800
- C) \$12,900
- D) \$17,200
- E) None of the above

Accounting for Bad Debts - Allowance Method - % Receivables/Aging Method

**Example 4 - % of Receivable method/Aging**

ANC Company reported the following items:

Accounts receivable balance - Jan 1	\$ 125,000.00
AFDA - Jan 1 (credit balance)	\$ 3,000.00
Total credit sales	\$ 653,000.00
Total collections on AR	\$ 567,000.00

Experience indicates that 3% of the outstanding accounts receivable at the end of each year ultimately will be uncollectible. What should be the December 31st adjusting entry amount for doubtful accounts?

- A) \$3,330
- B) \$6,330
- C) \$9,330
- D) \$19,590
- E) None of the above

## Accounting for Bad Debts - Allowance Method - % Receivables/Aging Method

### **Example 5 - % of Receivable method/Aging**

ABC Limited has prepared the following aging schedule for the company at December 31st. The company uses the percentage of receivables basis to estimate bad debts.

	Total	Number of Days Outstanding				
		Current	30-Jan	31-60	61-90	Over 90
Accounts Receivable	\$168,500	\$85,600	\$31,200	\$24,500	\$18,000	\$9,200
% Uncollectible		1%	4%	10%	30%	50%

Assuming the company has a \$1,230 credit balance in the allowance for doubtful account at the beginning of the period, the journal entry to record bad debt expense will include a

- (A) Debit to bad debt expense for \$15,100.
- (B) Credit to bad debt expense for \$13,324.
- (C) Debit to the allowance for doubtful account for \$14,554.
- (D) Credit to the allowance for doubtful account for \$13,324.
- (E) None of the above is correct.

Assume that the company has a \$1,000 debit balance in the allowance account before any adjustment for the current year's bad debt expense. The entry to record bad debt expense will include a

- (A) Debit to bad debt expense for \$14,554.
- (B) Debit to bad debt expense for \$15,554.
- (C) Credit to the allowance account for \$15,554.
- (D) Debit to the allowance account for \$14,554.
- (E) None of the above is correct.

The net realizable value of accounts receivable will be:

- A) \$ 168500
- B) \$ 153, 946
- C) \$ 154,176
- D) \$169,730
- E. None of the above

## Accounting for Bad Debts - (NRV) *Net Realizable Value*

### **Example 6 - NRV**

ABC Company had accounts receivable of \$770,000 and an allowance for doubtful accounts of the \$23,500 just prior to writing off as worthless an account receivable for Special Company of \$8,000. The net realizable value of accounts receivable as shown by the accounting records before and after the write-off was as follows:

	<u>Before</u>	<u>After</u>
a)	\$770,000	\$770,000
b)	\$738,500	\$762,000
c)	\$746,500	\$738,500
d)	\$746,500	\$746,500
e)	\$770,000	\$762,000