

Prof. Aida R. Lozada Rivera, CPA, MBA, Ph.D.

aida.lozada@upr.edu

**University of Puerto Rico
Río Piedras Campus
Business School**



BALANCE SHEET

CURRENT ASSETS:

- Cash and Equivalents
- **ACCOUNT RECEIVABLE**
- Inventory
- Prepaid Expenses
- Supplies

This presentation contains information, in addition to the material prepared and provided by the professor, from:

1. Financial Accounting, David Spiceland, 6th Ed., McGraw-Hill
2. Intermediate Accounting, David Spiceland, 11th Ed., McGraw-Hill
3. Intermediate Accounting, Donald Kieso, 18th Ed., Wiley
4. Other: Official Websites

ACCOUNT RECEIVABLE

- Most businesses provide credit to their customers.
- To promote sales.
- An informal agreement is generated with a maturity of 30 to 60 days.
- Income is recognized even if the cash has not been received.
- Uncollectible accounts may arise.

ACCOUNT RECEIVABLE

VALUATION

- Recorded at the amount of consideration the seller is entitled to receive.
- Reduced by cash discounts, sales discounts and sales returns.
- Reduced by allowance for uncollectible accounts.
- Reported at Net Realizable Value (cash expects to receive)

ACCOUNT RECEIVABLE

Example: Credit Sales: T accounts and Journal Entry

T accounts

ACCOUNT RECEIVABLE		SALES REVENUE	
+		-	+
1/1/Year 1	\$0		
	\$200,000		\$200,000
12/31/Year 1	\$200,000		12/31/ Year 1 \$200,000
			This account is closed at 12/31/Year 1

Journal Entry

Dr. Account Receivable 200,000
 Cr. Sales Revenue 200,000
To record credit sales.

ACCOUNT RECEIVABLE

Transactions

- discounts and others guarantees that can reduce the amount of cash the company is entitled to receive from those customers:
- **Trade Discount**
- **Cash Discount**
- **Sales Returns**
- **Sales Allowances**

ACCOUNT RECEIVABLE

Trade Discount

- Reduction in the selling price
- Awarded to clients who have a good relationship with the company.
- Awarded when the amount of the sale is substantial.

Sales Discount

- It is offered to encourage quick payment from customers.
- Reductions in the amount to be paid by customer if paid within a specified period of time.

Discount Terms

- 2/10- 2% discount if paid within 10 days
- n/30- full payment within 30 days

ACCOUNT RECEIVABLE

SALES DISCOUNT

Example: ABC sold Inventory on January 1, for \$50,000. The repayments terms are: 2/10, n/30. (No Cost of Goods Sold details)

Gross Method

January 1

Dr. Account Receivable	20,000	
Cr. Sales Revenue		20,000

To record sale.

January 10

Dr. Cash	49,000	
Dr. Sales Discount (revenue contra account)	1,000	
Cr. Account Receivable		50,000

To register collection of Account Receivable with discount.

ACCOUNT RECEIVABLE

Transactions

Discounts and others transactions that can **reduce the amount of cash** the company is entitled to receive from those customers:

➤ **Trade Discount**

➤ **Cash Discount**

*CONTRA ACCOUNTS

To keep a record of the total revenue recognized.

➤ ***Sales Returns**

The clients returns inventory.

➤ ***Sales Allowances**

The seller reduces the customer's balance owed or provides a partial refund to compensate the bad service provided or for defects in the products.

***Reduce revenues (debit balance).**

ACCOUNT RECEIVABLE

SALES RETURNS

Customer

1. Customer returns goods
2. Customer receives a cash refund
(credit to the credit card)

Company

1. Reduces balance of accounts receivable if
original sale was on account

Journal Entry

Sales Returns

Accounts Receivable

To register sales allowance for previous credit sale.

SALES ALLOWANCES

Customer

1. Customer **does not** returns goods
2. Customer receives a cash refund
(credit to the credit card)

Company

1. Reduces balance of accounts receivable if
original sale was on account

Journal Entry

Sales Allowances

Accounts Receivable

To register sales allowance for previous credit sale.

ACCOUNT RECEIVABLE

SALES RETURN

Cash Sales

Dr. Cash 100,000
Cr. Sales Revenue 100,000

To record sale in cash.

Dr. Cost of Goods Sold 50,000
Cr. Inventory 50,000

To record the cost of Inventory.

Return Transaction

Dr. *Sales Returns 25,000
Cr. Cash 25,000

To record Inventory returned by client.

Dr. Inventory 10,000
Cr. Cost of Goods Sold 10,000

To record reduce in CGS and restore Inventory.

Credit Sales

Dr. Account receivable 100,000
Cr. Sales Revenue 100,000

To record sale on account.

Dr. Cost of Goods Sold 50,000
Cr. Inventory 50,000

To record the cost of Inventory.

Dr. *Sales Returns 25,000
Cr. Account Receivable 25,000

To record Inventory returned by client.

Dr. Inventory 10,000
Cr. Cost of Goods Sold 10,000

To record reduce in CGS and restore Inventory.

***Contra account: reduce revenues**

ACCOUNT RECEIVABLE

SALES ALLOWANCE

Cash Sales

Dr. Cash 100,000
Cr. Sales Revenue 100,000

To record sale in cash.

Dr. Cost of Goods Sold 50,000
Cr. Inventory 50,000

To record the cost of Inventory.

Credit Sales

Dr. Account receivable 100,000
Cr. Sales Revenue 100,000

To record sale on account.

Dr. Cost of Goods Sold 50,000
Cr. Inventory 50,000

To record the cost of Inventory.

Return Transaction

Dr. *Sales Allowances 25,000
Cr. Cash 25,000

To record a refund to the client.

Dr. *Sales Allowances 25,000
Cr. Account Receivable 25,000

To record a refund to the client.

***Contra account: reduce revenues**

ACCOUNT RECEIVABLE

VALUATION OF ACCOUNT RECEIVABLE: UNCOLLECTIBLE ACCOUNTS

- Customers don't always pay.
- There is an inherent cost of selling on credit (bad debts).
- Paying for something in cash or not receiving cash is the same cost.

Methods

- To account for accounts receivable that are unlikely to be collected.

❖ **Direct Write-Off Method**

1. Wait until a particular account is deemed uncollectible and write it off at that time
2. Not allowed by GAAP
3. Required for income tax purposes for most companies

❖ **Allowance Method**

1. Companies use a contra-asset account, **the allowance for uncollectible accounts**, to reduce the carrying value of accounts receivable to the amount of cash they expect to collect.
2. Not allowed for income tax purposes

ACCOUNT RECEIVABLE

METHODS

Direct Write-Off Method: Not Estimated

- ❖ When an uncollectible account arises, the expense is recorded, and the account receivable is eliminated.

Dr. Bad Debts Expense

Cr. Account Receivable

Allowance Method: Estimate in advance the amount that will not be collected.

- ❖ Bad Debt Expense is recognized when the allowance is created.

Dr. Bad Debts Expense

Cr. Allowance for Uncollectible Accounts

ACCOUNT RECEIVABLE

Journal Entry: Credit Sales Transaction

ACCOUNT RECEIVABLE			SALES REVENUE	
+		-	-	+
1/1/Year 1	\$0			
	\$200,000			\$200,000
12/31/Year 1	\$200,000			12/31/ Year 1 \$200,000
				This account is closed at 12/31/Year 1

Dr. Account Receivable 200,000

Cr. Sales Revenue

200,000

To record sales on account.

ACCOUNT RECEIVABLE

TRANSACTIONS

ACCOUNT RECEIVABLE			SALES REVENUE			CASH	
+	-		-	+		+	-
1/1/Year 1	\$0						
Credit Sales	\$200,000	Cash Collection	\$175,000		\$200,000	\$175,000	
12/31/Year 1	\$25,000			12/31/ Year 1	\$200,000	12/31/Year 1	1755,000
10% Uncollectible							

Dr. Account Receivable 200,000

Cr. Sales Revenue 200,000

To record sales on account.

Dr. Cash 175,000

Cr. Account Receivable 175,000

To record collection of Account Receivable.

ACCOUNT RECEIVABLE		
+		-
1/1/Year 1	\$0	
Credit Sales	\$200,000	Cash Collection \$175,000
12/31/Year 1	\$25,000	
10% Uncollectible		

BAD DEBT EXPENSE		ALLOWANCE: UNCOLLECTIBLE ACCOUNTS	
+	-	-	+
			\$0
\$2,500			\$2,500
			12/31/Year 1 \$2,500

Dr. Bad Debts Expense 2,500

Cr. Allowance... 2,500

To record Bad Debt Expense.

PRESENTATION: 12/31/Year 1

Account Receivable	\$25,000
* Allowance for Uncollectible Accounts <small>(\$25,000 x .10)</small>	(\$2,500)
** Net Realizable Value	\$22,500

* Allowance... Estimated amount that will not be collected.

** Net Realizable Value... Estimated amount that will be collected.

ACCOUNT RECEIVABLE

ABC Co. has at the beginning \$200,000 in Accounts Receivable and \$50,000 in Allowance for Uncollectible Account as of 01/01/Year 1. During the year, the company sold \$500,000 on credit. Total collection was \$400,000 during the year. Uncollectible Accounts were \$10,000. What will be the balance of the **Provision** as of 12/31/ Year 1? What will be the **net realizable value** at 12/31/Year 1?

ACCOUNT RECEIVABLE		ALLOWANCE: UNCOLLECTIBLE ACCOUNTS		
+	-	-	+	
1/1/Year 1	\$200,000		1/1/Year 1	\$50,000
		\$10,000		
	\$500,000	\$400,000		
		\$10,000		
12/31/Year 1	\$290,000		12/31/ Year 1	\$40,000

12/31/ Year 1

Account Receivable	\$290,000
<u>Allowance for Uncollectible Accounts</u>	<u>(\$40,000)</u>
Net Realizable Value	\$250,000

ACCOUNT RECEIVABLE

ABC Co. has at the beginning \$200,000 in Accounts Receivable and \$50,000 in Allowance for Uncollectible Account as of 01/01/Year 1. During the year, the company sold \$500,000 on credit. Total collection was \$400,000 during the year. Uncollectible Accounts were \$10,000. What will be the balance of the Provision as of 12/31/ Year 1? What will be the journal entry to record the write off of the Account Receivable 12/31/Year 1?

ACCOUNT RECEIVABLE		ALLOWANCE: UNCOLLECTIBLE ACCOUNTS		
+	-	-	+	
1/1/Year 1	\$200,000		1/1/Year 1	\$50,000
		\$10,000		
	\$500,000			
		\$400,000		
		\$10,000		
12/31/Year 1	\$290,000		12/31/ Year 1	\$40,000

Dr. Allowance for Uncollectible Account

10,000

Cr. Account Receivable

10,000

To record uncollectible account.

ACCOUNT RECEIVABLE

ABC Co. has \$200,000 in Accounts Receivable and \$50,000 in Allowance for Uncollectible Account as of 01/01/01. During the year, the company sold \$ 500,000 on credit. Total collection was \$400,000 during the year. \$10,000 was uncollectible. The company wants a total of \$75,000 in the provision account at the end of the year. What is the bad debt expense to be recorded? What will be the balance of the Provision as of 12/31/01? What will be the net realizable value at 12/31/01?

ACCOUNT RECEIVABLE		
01/01/01	\$200,000	
	\$500,000	\$400,000
		\$10,000
12/31/2001	\$290,000	

BAD DEBT EXPENSE	
\$35,000	

ALLOWANCE FOR UNCOLLECTIBLE ACCOUNT		
	01/01/01	\$50,000
		\$10,000
		\$35,000
	12/31/2000	\$75,000

12/31/01

Account Receivable	\$290,000	
Allowance for Uncollectible Accounts	(\$75,000)	
Net Realizable Value	\$215,000	

Dr. Bad Debt Expense	35,000
Cr. Allowance...	35,000
To record bad debt expense.	

Aging of Accounts Receivable

- Experience with customer collection is the best way to determine the amount of uncollectible accounts.
- Analyze the payment behavior of customers.
- Apply different percentages to accounts receivable balances depending on the length of time outstanding.

ACCOUNT RECEIVABLE: AGING SCHEDULE

DAYS OUTSTANDING	AMOUNT	% OF UNCOLLECTIBLE	ESTIMATED AMOUNT UNCOLLECTIBLE
0-60	\$100,000	5%	\$5,000
61-90	\$200,000	20%	\$40,000
91-120	\$300,000	30%	\$90,000
over 120	\$400,000	50%	\$200,000
	\$1,000,000		\$335,000

BAD DEBT EXPENSE		ALLOWANCE FOR UNCOLLECTIBLE ACCOUNT		ACCOUNT RECEIVABLE	
		01/01/01	\$0.00	01/01/01	\$0.00
\$335,000			\$335,000		
		12/31/2000	\$335,000	12/31/2001	\$1,000,000

Aging of Accounts Receivable

BAD DEBT EXPENSE		ALLOWANCE FOR UNCOLLECTIBLE ACCOUNT		ACCOUNT RECEIVABLE	
		01/01/01	\$0.00	01/01/01	\$0.00
\$335,000			\$335,000		
		12/31/2000	\$335,000	12/31/2001	\$1,000,000

Dr. Bad Debts Expense	335,000	
Cr. Allowance...		335,000
To record Bad Debt Expense.		

PRESENTATION:12/31/2001

Account Receivable	\$1,000,000
<u>Allowance for Uncollectible Accounts</u>	(\$335,000)
Net Realizable Value	\$665,000

Aging of Accounts Receivable

Allowance Account with Beginning Balance

BAD DEBT EXPENSE		ALLOWANCE FOR UNCOLLECTIBLE ACCOUNT		ACCOUNT RECEIVABLE	
		01/01/01	\$200,000	01/01/01	\$0.00
\$135,000			\$135,000		
		12/31/2000	\$335,000	12/31/2001	\$1,000,000

Dr. Bad Debts Expense

135,000

Cr. Allowance...

135,000

To record Bad Debt Expense.

PRESENTATION:12/31/Year 1

Account Receivable

\$1,000,000

Allowance for Uncollectible Accounts

(\$335,000)

Net Realizable Value

\$665,000

ACCOUNT RECEIVABLE

Financing Account Receivable

- Use their receivables to obtain immediate cash.
- Provide immediate cash instead of waiting for customers to pay.
- Avoid the difficulties of billing and collecting receivables.

Secured Borrowing: Pledge

- Pledge accounts receivable as collateral for a loan.
- No particular receivables are associated with the loan.

Secured Borrowing: Assign

- Assign particular receivables to serve as collateral for loans.

Sale of Receivables

- Can be sold at a gain or a loss like other assets.

NOTES RECEIVABLE

Definition

- Formal credit arrangements between a creditor (lender) and a debtor (borrower)
- Specify payment terms.
- Classified as either current or noncurrent depending on the expected collection date.

Interest-Bearing Note Receivable:

- Requires payment of a specified principal amount and maturity date.
- Interest is paid at a stated % of principal.

Interest Calculation

Face amount × Annual rate × period

NOTES RECEIVABLE

EXAMPLE:

ABC signed a \$500,000, 6-month, 10% Note Receivable. Loan money to a third party.

January 1, Year 1

Dr. Note Receivable	500,000	
Cr. Cash		500,000

Collection of Principal and Interest

June 30, Year1

Dr. Cash	525,000	
Cr. Notes Receivable		500,000
Cr. Interest Revenue (500,000 x .10 x 6/12)		25,000

NONINTEREST BEARING NOTES RECEIVABLE

- Have interest
- Interest is **discounted** from the face amount to determine the cash made available.

Example:

ABC signed a \$500,000, 6-month, 10% None Interest Bearing Note Receivable.

January 1, Year 1

The debtor receives \$475,000 ($500,000 \times .10 \times 6/12 = 25,000$)

Dr. Note Receivable	500,000	
Cr. Discount on Notes Receivable (deferred interest revenue)		25,000
Cr. Cash		475,000