

# ANSWERS TO QUESTIONS

1. Accounts receivable are amounts owed by customers on account. They result from the sale of goods and services. Notes receivable represent claims that are evidenced by formal instruments of credit.
2. Other receivables include nontrade receivables such as interest receivable, loans to company officers, advances to employees, and income taxes refundable.
3. Accounts Receivable ..... 40  
Interest Revenue ..... 40
4. The essential features of the allowance method of accounting for bad debts are:
  - (1) Uncollectible accounts receivable are estimated and matched against revenue in the same accounting period in which the revenue occurred.
  - (2) Estimated uncollectibles are debited to Bad Debts Expense and credited to Allowance for Doubtful Accounts through an adjusting entry at the end of each period.
  - (3) Actual uncollectibles are debited to Allowance for Doubtful Accounts and credited to Accounts Receivable at the time the specific account is written off.
5. Jerry Gatewood should realize that the decrease in cash realizable value occurs when estimated uncollectibles are recognized in an adjusting entry. The write-off of an uncollectible account reduces both accounts receivable and the allowance for doubtful accounts by the same amount. Thus, cash realizable value does not change.
6. The two bases of estimating uncollectibles are: (1) percentage-of-sales and (2) percentage-of-receivables. The percentage-of-sales basis establishes a percentage relationship between the amount of credit sales and expected losses from uncollectible accounts. This method emphasizes the matching of expenses with revenues. Under the percentage-of-receivables basis, the balance in the allowance for doubtful accounts is derived from an analysis of individual customer accounts. This method emphasizes cash realizable value.
7. The adjusting entry under the percentage-of-sales basis is:  
Bad Debts Expense ..... 4,100  
Allowance for Doubtful Accounts ..... 4,100
- The adjusting entry under the percentage-of-receivables basis is:  
Bad Debts Expense ..... 2,300  
Allowance for Doubtful Accounts ( $\$5,800 - \$3,500$ ) ..... 2,300
8. Under the direct write-off method, bad debt losses are not estimated and no allowance account is used. When an account is determined to be uncollectible, the loss is debited to Bad Debts Expense. The direct write-off method makes no attempt to match bad debts expense to sales revenues or to show the cash realizable value of the receivables in the balance sheet.
9. From its own credit cards, the DeVito Company may realize financing charges from customers who do not pay the balance due within a specified grace period. National credit cards offer the following advantages:
  - (1) The credit card issuer makes the credit investigation of the customer.
  - (2) The issuer maintains individual customer accounts.

## Questions Chapter 9 (Continued)

- (3) The issuer undertakes the collection process and absorbs any losses from uncollectible accounts.  
(4) The retailer receives cash more quickly from the credit card issuer than it would from individual customers.
10. The reasons companies are selling their receivables are:  
(1) Receivables may be sold because they may be the only reasonable source of cash.  
(2) Billing and collection are often time-consuming and costly. It is often easier for a retailer to sell the receivables to another party with expertise in billing and collection matters.
11. Cash..... 582,000  
Service Charge Expense (3% X \$600,000) ..... 18,000  
Accounts Receivable..... 600,000
12. A promissory note gives the holder a stronger legal claim than one on an accounts receivable. As a result, it is easier to sell to another party. Promissory notes are negotiable instruments, which means they can be transferred to another party by endorsement. The holder of a promissory note also can earn interest.
13. The maturity date of a promissory note may be stated in one of three ways: (1) on demand, (2) on a stated date, and (3) at the end of a stated period of time.
14. The maturity dates are: (a) March 13 of the next year, (b) August 4, (c) July 20, and (d) August 30.
15. The missing amounts are: (a) \$20,000, (b) \$9,000, (c) 8%, and (d) four months.
16. If a financial institution uses 360 days rather than 365 days, it will receive more interest revenue. The reason is that the denominator is smaller, which makes the fraction larger and, therefore, the interest revenue larger.
17. When Cain Company has dishonored a note, the ledger can set up a receivable equal to the face amount of the note plus the interest due. It will then try to collect the balance due, or as much as possible. If there is no hope of collection it will write-off the receivable.
18. Each of the major types of receivables should be identified in the balance sheet or in the notes to the financial statements. Both the gross amount of receivables and the allowance for doubtful accounts should be reported. If collectible within a year or the operating cycle, whichever is longer, these receivables are reported as current assets immediately below short-term investments.
19. Net credit sales for the period are  $8.14 \times \$400,000 = \$3,256,000$ .
20. PepsiCo's 2009 allowance for doubtful accounts of \$90 million represents 1.9% of its gross receivables of \$4,714 million (See Note 14).