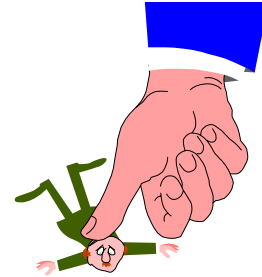


Accounting for Accruals - Advanced Topics

I. Bad Debts

- A. Affect on financial statements.
- B. Percent of sales - method for estimating bad debts.
- C. Demonstration Problem 8-1.
 1. Students record first two events.
 2. After recording the two events, what amount could be collected if everyone paid the company?
 3. Assets are overstated.
 4. Estimate amount that will not be collected (Allowance for Doubtful Accounts).
 5. **Net Realizable Value** = Accounts Receivable - Allowance for Doubtful Accounts
 6. Recognizing potential bad debts does not affect cash flow.
 7. Second period:
 - a. Write-offs
 - b. Recoveries
 - c. Additional adjustments for estimated uncollectibles.



II. Credit Card Sales and Warranty Obligations

- A. Do Demonstration Problem 8-2.
- B. Students do Exercises 8-7B and 8-9B.

III. Ratios

- A. Accounts Receivable Turnover = Sales (or net sales) / Accounts Receivable
- B. Average Days to Collect = 365 days / Accounts Receivable Turnover

Demonstration Problem 8-1 Accounting for Bad Debts

The Solo Company was started on January 1, 2003. The following events occurred during 2003 and 2004.

2003

1. Provided \$4,000 of services on account.
2. Collected \$3,000 cash from accounts receivable.
3. Estimated uncollectible accounts expense to be 1.5 percent of 2003 credit sales.

2004

1. Wrote off \$40 of accounts receivable that were deemed uncollectible.
2. Provided \$6,500 of services on account.
3. Collected \$5,400 cash from accounts receivable.
4. Received \$5 from a bad debt that had been previously written off. Reinstated the account.
5. Recorded the \$5 cash received from the receivable reinstated in Event No. 4.
6. Estimated uncollectible accounts expense to be 1 percent of 2004 credit sales.

Required

Record the events in a statements model under the titles of the affected accounts. Place a zero under each heading that is not affected by a given event. Compare the final balances in the T-accounts from part a with the ending balances in the statements model.

Event	Assets			=	Liab. + Equity		Rev. - Exp. = Net Inc.	Cash Flow	
No.	Cash +	Acct. Rec.	+(Allow)	=		Ret. Ear.			
Beg. Bal.	-0-	+	-0-	+	-0-	+	-0-	-0-	
1.									
2.									
3.									
Totals	3,000	+	1,000	+	(60)	=	-0-	+	3,940
							4,000	-	60
							=	3,940	+3,000 NC

Event	Assets			=	Liab. + Equity		Rev. - Exp. = Net Inc.	Cash Flow	
No.	Cash +	Acct. Rec.	+(Allow)	=		Ret. Ear.			
Beg. Bal.	3,000	+	1,000	+	(60)	=	-0-	+	3,940
1.									
2.									
3.									
4.									
5.									
6.									
Totals	8,405	+	2,060	+	(90)	=	-0-	+	10,375
							6,500	-	65
							=	6,435	+5,405 NC

Demonstration Problem 8-2 Credit Card Sales and Warranty Expense

Versa Training Services provides instruction on how to pass the CPA examination. Versa has attained phenomenal growth by offering its customers a money-back guarantee. Any student who attends classes and completes all homework assignments is entitled to a complete refund if he or she fails to pass the exam. The following events pertain to a new course that was recently established by Versa.

1. Versa accepted credit card payments for \$8,000 of instructional services it provided to CPA exam candidates. The credit card company charged Versa a 5 percent service fee.
2. Versa collected the receivable due from the credit card company.
3. Versa estimated that 20 percent of the students would fail the exam and demand a cash refund. Versa agreed to provide cash back to its customers even though the customers had paid for the review course with a charge card.
4. Versa paid a \$400 cash refund to a customer after he received his exam results. This refund was the first of several Versa expected to grant to unsuccessful candidates.

Required

Record the events in a statements model under the titles of the affected accounts. Place a zero under each heading that is not affected by the event. Compare the final balances in the T-accounts from part a with the ending balances in the statements model.

Demonstration Problem 8-2 Statements Model

Event	Assets		=	Liab. + Equity		Rev. - Exp. = Net Inc.			Cash Flow	
	<i>Cash</i> +	<i>Acct. Rec.</i>	=	<i>W. Pay</i>	<i>Ret. Ear.</i>					
No. Beg. Bal.	-0- +	-0-	=	-0- +	-0-	-0-	-0-	-0-	-0-	
1.										
2.										
3.										
4.										
Totals	<u>7,200</u> +	<u>-0-</u>	=	<u>1,200</u> +	<u>6,000</u>	<u>8,000</u>	<u>-2,000</u>	=	<u>6,000</u>	<u>+7,200 NC</u>

EXERCISE 8-7B

a.

Denver One-Day Spa Horizontal Statements Model												
	Balance Sheet					Income Statement				Statement of		
	Assets		=	Liab	+	S. Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flows
Event	Cash	+	Acct. Rec.	=		+	Ret. Ear					
1.												
2.												

b. 1. Total assets: Cash

2. Revenue recognized:

3. Cash Flow from Operating Activities:

4.

EXERCISE 8-9B

Long's Stereos Financial Statements			
Income Statement			
Sales Revenue			
Cost of Goods Sold			
Gross Margin			
Warranty Expense			
Net Income			
Statement of Cash Flows			
Cash Flows From Operating Activities:			
Inflow from Customers			
Outflow for Inventory			
Outflow for Warranty Expense			
Net Cash Flow from Operating Activities			
Cash Flows From Investing Activities			
Cash Flows From Financing Activities			
Net Change in Cash			
Plus: Beginning Cash Balance			
Ending Cash Balance			

Problem 8-15A

	Balance Sheet					Income Statement			
Date	Cash	Accounts Receivable	Allowance for Doubtful Accounts	Contributed Capital	Retained Earnings	Service Revenues	Bad Debt Expense	Operating Expenses	('000s) Cash Flow
1 06									
2									
3									
End									
Beg									
1 07									
2									
3									
4a									
4b									
5									
6									
End									

d. (2006)

Sharp Consulting Financial Statements For the Year Ended 2006			
Income Statement			
	Service Revenue		
	Bad Debts Expense		
	Net Income		
Statement of Changes in Stockholders' Equity			
	Beginning Common Stock		
	Plus: Stock Issued		
	Ending Common Stock		
	Beginning Retained Earnings		
	Plus: Net Income		
	Ending Retained Earnings		
	Total Stockholders' Equity		

**PROBLEM 8-15A d. (cont.)
(2006)**

Sharp Consulting Financial Statements			
Balance Sheet As of December 31, 2006			
Assets			
Cash			
Accounts Receivable			
Less: Allowance for Doubtful Accounts			
Total Assets			
Liabilities			
Stockholders' Equity			
Common Stock			
Retained Earnings			
Total Stockholders' Equity			
Total Liabilities and Stockholders' Equity			
Statement of Cash Flows For the Year Ended 2006			
Cash Flows From Operating Activities:			
Inflow from Customers			
Net Cash Flow from Operating Activities			
Cash Flows From Investing Activities			
Cash Flows From Financing Activities			
Net Change in Cash			
Plus: Beginning Cash Balance			
Ending Cash Balance			

d. (2007)

Sharp Consulting Financial Statements For the Year Ended 2007			
Income Statement			
Service Revenue			
Expenses			
Operating Expenses			
Bad Debts Expense			
Total Expenses			
Net Income			
Statement of Changes in Stockholders' Equity			
Beginning Common Stock			
Plus: Stock Issued			
Ending Common Stock			
Beginning Retained Earnings			
Plus: Net Income			
Ending Retained Earnings			
Total Stockholders' Equity			

**PROBLEM 8-15A d. (cont.)
(2007)**

Sharp Consulting Financial Statements			
Balance Sheet As December 31, 2007			
Assets			
Cash			
Accounts Receivable			
Less: Allowance for Doubtful Accounts			
Total Assets			
Liabilities			
Stockholders' Equity			
Common Stock			
Retained Earnings			
Total Stockholders' Equity			
Total Liabilities and Stockholders' Equity			
Statement of Cash Flows For the Year Ended 2007			
Cash Flows From Operating Activities:			
Inflow from Customers			
Outflow for Expenses			
Net Cash Flow from Operating Activities			
Cash Flows From Investing Activities			
Cash Flows From Financing Activities			
Net Change in Cash			
Plus: Beginning Cash Balance			
Ending Cash Balance			

ATC 8-1

Financial Statement Analysis

Part 1.

a.

b.

c.

Part 2.

a.

b.

c.

d.

Quiz Questions for Chapter 8

Use the following information to answer the next three questions. Echo Company started the year with a \$4,600 balance in accounts receivable and a \$150 balance in the allowance for doubtful accounts. The company had credit sales of \$12,000, collections on accounts receivable of \$13,000, and wrote off uncollectible accounts of \$200 during the year. The company believes that 2 percent of its credit sales will be uncollectible.

- The balance in the accounts receivable account at the end of the year would be
 - \$3,400.
 - \$3,600.
 - \$3,250.
 - \$4,360.
- The amount of bad debts expense appearing on the year's income statement would be
 - \$532.
 - \$332.
 - \$440.
 - \$240.
- The net realizable value of receivables at the end of the year would be
 - \$3,250.
 - \$3,350.
 - \$3,210.
 - \$3,410.
- Recording the write-off of an uncollectible account will have what effect on the accounting equation?
 - Total assets decrease and equity decreases.
 - Total assets increase and equity decreases.
 - Total assets remain unchanged.
 - Liabilities increase and equity decreases.
- ABC Company accepts a credit card in payment for \$1,500 of services performed for a customer. The credit card company charges a 4 percent service fee. Recording the transaction on ABC's records will
 - increase assets by \$1,440.
 - increase expenses by \$60.
 - increase revenue by \$1,500.
 - All of the above.
- Under the direct write-off method, the write-off of a \$500 uncollectible account will
 - decrease assets by \$500 and decrease liabilities by \$500.
 - have no effect on total assets.
 - decrease assets by \$500 and increase bad debt expense by \$500.
 - decrease assets by \$500 and increase equity by \$500.

7. Training Services, Inc. (TSI) guarantees the quality of its instructional services. TSI earned \$40,000 of cash revenue from instructional services in 2003. The company estimates that future warranty claims will be 6 percent of revenue. During 2003, TSI paid \$700 cash on warranty claims. Based on this information, the amount of net income and the net change in cash for 2003 would be
- \$37,600 / \$37,600.
 - \$37,600 / \$39,300.
 - \$39,300 / 39,300.
 - \$38,300 / \$39,300.
11. EFG Company uses the allowance method to account for bad debts. The company wrote off an uncollectible account receivable. Which of the following reflects how the write-off affects EFG's financial statements?

	Assets		=	Liab.	+	Equity	Rev.	-	Exp.	=	Net Inc.	Cash Flow
a.	+	-		NA		NA	NA		NA		NA	NA
b.	+	-		NA		NA	NA		+		-	NA
c.	-			NA		-	NA		+		-	- OA
d.	+			+		NA	NA		NA		NA	- OA