cHAPTER 8  
receivables, bad debt expense,   
and interest revenue

# Student Learning Objectives and Related Assignment Materials

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| **Student Learning Objectives** | **Mini-Exercises** | **Exercises** | **Coached Problems** | **Problems (Groups  A & B)** | **Compre-hensive Problems** | **Skills Develop-ment Cases** | **Continuing Cases** |
| LO 8-1 Describe the trade-offs of extending credit. | 1, 2 |  |  |  |  | 6 |  |
| LO 8-2 Estimate and report the effects of uncollectible accounts. | 3, 4, 5, 6, 7, 8, 9, 13 | 1, 2, 3, 4, 5, 6, 7\*, 8\*, 9\*, 13, 14, 15 | 1, 2, 4\*^ | A1, A2, A4^, B1, B2, B4^ | 1\*^+, 3^+ | 1, 2, 3, 4, 5^, 7 | 1† |
| LO 8-3 Compute and report interest on notes receivable. | 10\*, 11, 12, 13 | 10, 11, 12 | 2, 3, 4\*^ | A3, A4^, B3, B4^ | 3^+ | 4 | 2^£ |
| LO 8-4 Compute and interpret the receivables turnover ratio. | 14, 15 | 13, 15, 16 | 5 | A5, B5 | 2^+ | 1, 2, 3, 6 | 1†  2^£ |
| LO 8-S1 Record bad debts using the direct write-off method. | 16 | 17 |  |  |  |  |  |

\* Animated solution included in the PowerPoint Slides.

^ Particularly challenging; requires students to combine multiple concepts in order to advance to the next level of accounting knowledge.

+ The Comprehensive Problems are comprised of CP8-1, which also covers LO 6-6, CP8-2, which also covers LO 6-4, and CP8-3, which also covers LO 3-3, 4-2, 4-3, 4-4, 6-3, 6-4, 6-5, and 7-3.

† Continuing Case 8-1 builds on the story of Nicole’s Getaway Spa, introduced in earlier chapters. This case focuses on analyzing transactions and preparing journal entries for Sales, estimating the Allowance for Doubtful Accounts required, analyzing and preparing the journal entry for Bad Debt Expense, and calculating and interpreting the accounts receivable turnover ratio. This case will be extended in future chapters.

£ Continuing Case 8-2 builds on the story of Wiki Art Gallery (WAG), an instructional case in Connect. This case focuses on the methods to record bad debts, the adequacy of the allowance for bad debts, determining write-offs given information set forth in the financial statements, and calculation and interpretation of the number of days to collect. The case will be extended in future chapters.

**Overview**

The challenging job of monitoring and managing receivables, especially during difficult economic times, is explained.

Students learn how to estimate and report the effects of uncollectible accounts, charge interest on outstanding balances, and evaluate accounts receivable collection performance. Chapter supplement A illustrates the non-GAAP direct write-off method.

# Synopsis of Chapter Revisions

* Updated focus company illustrations with VF Corp.—the maker of North Face jackets, JanSport backpacks, Wrangler jeans, and Vans shoes
* Updated Spotlight on Financial Reporting showing credit card costs at Target
* New numbers in aging method illustration
* Updated receivables turnover analysis in Exhibit 8.7, involving VF Corp, Kellogg’s, and Skechers
* Updated demonstration case featuring Rocky Mountain Chocolate Factory
* Reviewed, updated, and introduced new end-of-chapter material, including comprehensive problem with automatic posting from journal entries to T-accounts and trial balance preparation

# PowerPoint Slides

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| --- | --- |
| **Student Learning Objective** | **PowerPoint® Slides** |
| LO 8-1 Describe the trade-offs of extending credit. | 8-2 through 8-3 |
| LO 8-2 Estimate and report the effects of uncollectible accounts. | 8-4 through 8-23 |
| LO 8-3 Compute and report interest on notes receivable. | 8-24 through 8-33 |
| LO 8-4 Compute and interpret the receivables turnover ratio. | 8-34 through 8-38 |
| LO 8-S1 Record bad debts using the direct write-off method. | 8-39 through 8-42 |

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| **Animated Builds and Animated Solutions** | **PowerPoint® Slides** |
| Mini-Exercise 8-10 | 8-44 |
| Exercise 8-7 | 8-45 through 8-46 |
| Exercise 8-8 | 8-47 through 8-49 |
| Exercise 8-9 | 8-50 through 8-52 |
| Coached Problem 8-4 | 8-52 through 8-61 |
| Comprehensive Problem 8-1 | 8-62 through 8-65 |

# Summary of Related Video Program

**Spotlight Video Series   
Chapter 8 – Resetting the Clock (approximately 4:00)**

This video describes how a credit manager at MCI used his knowledge of the allowance method to avoid recording $70 million in bad debts. The video shows students how small initial missteps led the credit manager to redirect his genuine ambition into criminal actions, which ended in a prison sentence and personal ruin.

# Chapter Summary

**LO 8-1 Describe the trade-offs of extending credit.**

* By extending credit to customers, a company is likely to attract a greater number of customers willing to buy from it.
* The additional costs of extending credit include increased wage costs, bad debt costs, and delayed receipt of cash.

**LO 8-2 Estimate and report the effects of uncollectible accounts.**

* Under generally accepted accounting principles, companies must use the allowance method to account for uncollectibles. This method involves the following steps:

1. Estimate and record uncollectibles with an end-of-period adjusting journal entry that increases Bad Debt Expense (debit) and increases the Allowance for Doubtful Accounts (credit).

2. Identify and write off specific customer balances in the period that they are determined to be uncollectible.

* The adjusting entry (in 1) reduces Net Income as well as Net Accounts Receivable. The write-off (in 2) has offsetting effects on Accounts Receivable and the Allowance for Doubtful Accounts, ultimately yielding no net effect on Net Accounts Receivable or on Net Income.

**LO 8-3 Compute and report interest on notes receivable.**

* Interest is calculated by multiplying the principal, interest rate, and time period (number of months out of 12). As time passes and interest is earned on the note, accountants must record an adjusting journal entry that accrues the interest revenue that is receivable on the note.

**LO 8-4 Compute and interpret the receivables turnover ratio.**

* The receivables turnover ratio measures the effectiveness of credit-granting and collection activities. It reflects how many times average trade receivables were recorded and collected during the period.
* Analysts and creditors watch this ratio because a sudden decline may mean that a company is extending payment deadlines in an attempt to prop up lagging sales. Or it may mean that a company is recording sales of merchandise that customers are likely to return later.

***Accounting Decision Tools***

1. **Receivables Turnover Ratio = Net Sales Revenue ÷ Average Net Receivables**

* It tells you the number of times receivables turn over during the period
* A higher ratio means faster (better) turnover

1. **Days to Collect = 365 ÷ Receivables Turnover Ratio**

* It tells you the average number of days from sale on account to collection
* A higher number means a longer (worse) time to collect

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| Chapter Outline | Teaching Notes |
| I. Understand the Business |  |
| ***LO 8-1 Describe the trade-offs of extending credit.*** | |
| A. Pros and Cons of Extending Credit |  |
| 1. The advantage of extending credit is that it allows the company to remain competitive with its competitors who also extend credit to business customers. |  |
| 2. Disadvantages of Extending Credit |  |
| a. Increased wage costs—If credit is extended, the company will have to hire people to (a) evaluate whether each customer is creditworthy, (b) track how much each customer owes, and (c) follow up to collect the receivable from each customer. |  |
| b. Bad debt costs—Inevitably, some customers dispute what they owe and pay only a portion of the total amount that they’ve been charged; these “bad debts” can be a significant additional cost of extending credit. |  |
| c. Delayed receipt of cash—Even if the company was to collect in full from customers, it will likely have to wait 30–60 days before receiving the cash. During this time, the company may need to take out a short-term bank loan to pay for other business activities; the interest on such a loan is another cost of extending credit to customers. | The “Spotlight on Business Decisions” feature addresses deciding whether to grant credit. |
| 3. Most managers find that the additional revenue (i.e., gross profit) gained from selling on account exceeds the additional costs listed above. |  |
| 4. **Note Receivable**—Promise that requires another party to pay the business according to a written agreement. |  |
| a. Differ from accounts receivable in that notes generally charge interest. |  |
| b. Stronger legal claim than accounts receivable. |  |
| c. New note needs to be created for each transaction so they are used less frequently. |  |

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| Chapter Outline | Teaching Notes |
| II. Accounting for Accounts Receivable |  |
| A. Accounts Receivable and Bad Debts |  |
| ***LO 8-2 Estimate and report the effects of uncollectible accounts.*** | |
| 1. **Accounts Receivable**—Amounts owed to a business by its customers. | * Supplemental Enrichment Activity (Activity) #1 |
| 2. The two objectives in accounting for accounts receivable and bad debts relate to the need to: |  |
| a. Report accounts receivable on the balance sheet at the amount the company expects to collect (“net realizable value”). | * Video Spotlight Series - Chapter 8 |
| b. Match the cost of bad debts to the accounting period in which the related credit sales are made. |  |
| 3. **Allowance Method**—Method of accounting that reduces accounts receivable (as well as net income) for an estimate of uncollectible accounts (bad debts) following a two-step process: |  |
| a. Make an end-of-period adjustment to record the estimated bad debts in the period credit sales occur. |  |
| b. Remove (“write off”) specific customer balances when they are known to be uncollectible. |  |
| 4. Adjust for Estimated Bad Debts |  |
| a. Credit sales, when first recorded, affect both balance sheet (increase in Accounts Receivable) and the income statement (increase in Sales Revenue). |  |
| b. To account for any bad credit sales, an adjustment is made at the end of each accounting period to reduce accounts receivable (using a contra-asset account called Allowance for Doubtful Accounts) and reduce net income (using an expense account called Bad Debt Expense). |  |
| c. **Bad Debt Expense**—Estimated amount of this period’s credit sales that customers will fail to pay. |  |
| d. The company estimates $900 of bad debts this period. | Recording and reporting |
| i. Analyze:  Assets = Liabilities + Stockholders’ Equity Allowance for Doubtful Accounts (xA) –900; Bad Debt Expense (E) –900 | estimated bad debts illustrated in Exhibit 8.2 |
| ii. Record: |  |
| |  |  |  | | --- | --- | --- | | Bad Debt Expense | 900 |  | | Allowance for Doubtful Accounts |  | 900 | |  |
| e. The Allowance for Doubtful Accounts, a contra-asset account, is a permanent account, so its balance carries forward from one accounting period to the next. |  |
| f. Bad Debt Expense, which is a temporary account, will have its balance zeroed out at the end of each year. |  |
| g. The two account balances will be equal only during the first accounting period. |  |

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| Chapter Outline | Teaching Notes |
| h. For billing and collection, a separate accounts receivable account (called a subsidiary account) is maintained for each customer; total of these accounts is reported as Accounts Receivable on balance sheet. |  |
| i. At the time the estimate is made, there is no way to know which particular customers’ accounts receivable are uncollectible. If the company were to remove the customer accounts believed to be uncollectible, it would lose track of which customers still owed money. |  |
| j. Accounts Receivable, Net of Allowance is a subtotal on the balance sheet that is computed by subtracting the contra-asset account Allowance for Doubtful Accounts from the asset account Accounts Receivable. |  |
| 5. Remove (Write Off) Specific Customer Balances |  |
| a. **Write-Off**—The act of removing an uncollectible account and its corresponding allowance from the accounting records. |  |
| b. When it becomes clear that a particular customer will not pay its balance, the company will remove that customer’s account from its accounts receivable records. |  |
| i. With the receivable removed, there’s no longer a need to include an allowance for it, so the corresponding amount also is removed from the allowance for doubtful accounts. |  |
| ii. A write-off does not affect income statement accounts; the estimated bad debt expense relating to these uncollectible accounts was already recorded with an adjusting journal entry in the period the sale was recorded. |  |
| c. The company writes off an $800 receivable from one of its customers. |  |
| i. Analyze:  Assets = Liabilities + Stockholders’ Equity Accounts Receivable (A) –800; Allowance for Doubtful Accounts (xA) –800 |  |
| ii. Record: |  |
| |  |  |  | | --- | --- | --- | | Allowance for Doubtful Accounts | 800 |  | | Accounts Receivable |  | 800 | |  |
| d. The write-off decreased both total Accounts Receivable and Allowance for Doubtful Accounts by the same amount ($800). |  |
| e. Consequently, the net accounts receivable balance after the write-off is unchanged from the net accounts receivable balance before the write-off. |  |

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| Chapter Outline | Teaching Notes |
| B. Methods for Estimating Bad Debts—Uncollectibles can be estimated using one of two methods: |  |
| 1. **Percentage of Credit Sales Method** (also called the income statement approach) | * Activity #3 |
| a. Simpler to apply. | *Simpler for the company* |
| b. Estimates bad debts based on the historical percentage of sales that lead to bad debt losses. | *and for students!* |
| b. Focus is on estimating Bad Debt Expense for the period. |  |
| 2. **Aging of** **Accounts Receivable Method** (also called the balance sheet approach) | * Activity #2 |
| a. Harder to apply but generally more accurate. | *Harder for the company* |
| b. Focuses on estimated the ending balance in the Allowance for Doubtful Accounts. | *and for students!* |
| c. Gets its name because it is based on the “age” of each amount in Accounts Receivable. |  |
| d. Follows three steps: |  |
| i. Step 1—Prepare an aged listing of accounts receivable with totals for each aging category. | Illustrated in Exhibit 8.3 |
| ii. Step 2—Estimate bad debt loss percentages for each category; generally, higher percentages are applied to increasingly old receivables. |  |
| iii. Step 3—Compute the total estimate by multiplying the totals in Step 1 by the percentages in Step 2 and then summing across all aging categories; the total across all aging categories represents the balance to which the Allowance for Doubtful Accounts will need to be adjusted at the end of the period. |  |
| 3. The amount is Step 3 is the desired balance in the Allowance for Doubtful Accounts, not the amount of the adjustment. To compute the amount of the adjustment, subtract the existing unadjusted balance from the desired adjusted balance computed above in Step 3. | The “Spotlight on Business Decisions” feature addresses collection efforts based on the aged listing of accounts receivable. |
| 4. Although the Allowance for Doubtful Accounts normally has a credit balance, it might have a debit balance prior to adjusting for uncollectible accounts. |  |
| a. A debit balance occurs when a company has recorded write-offs that exceed its previous estimates of uncollectible accounts. | *A debit balance means that last year’s estimate was simply too low.* |
| b. The amount of the adjustment needed to reach the desired balance still needs to be calculated under the aging of accounts receivable method. |  |
| c. The only difference is that to reach the desired balance, an amount equal to the desired balance plus the existing debit balance must be recorded. |  |
| d. After the adjustment is recorded, the Allowance for Doubtful Accounts will return to a credit balance. |  |

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| Chapter Outline | Teaching Notes |
| 5. Other Issues |  |
| a. Revising Estimates |  |
| i. Bad debt estimates will always differ somewhat from the amount that is later written off. |  |
| ii. To ensure bad debts and the allowance for doubtful accounts do not become materially misstated over time, companies revise overestimates of prior periods by lowering estimates in the current period, or they raise estimates in the current period to correct underestimates of prior periods. |  |
| b. Account Recoveries |  |
| i. Collection of a previously written off account is called a recovery and it is accounted for in two parts. First, put the receivable back on the books by recording the opposite of the write-off. Second, record the collection of the account. |  |
| ii. The company collects the $800 previously written off from one of its customers. |  |
| * i. Analyze:  Assets = Liabilities + Stockholders’ Equity Accounts Receivable (A) +800; Allowance for Doubtful Accounts (xA) +800; Cash (A) +800; Accounts Receivable (A) –800 |  |
| * ii. Record: |  |
| |  |  |  | | --- | --- | --- | | Accounts Receivable | 800 |  | | Allowance for Doubtful Accounts |  | 800 | | Cash | 800 |  | | Accounts Receivable |  | 800 | |  |
| iii. In the two entries above, Accounts Receivable is debited and then credited for the same amount. It’s tempting to cancel these two out; however, doing so would create an inaccurate credit history for the customer. |  |
| c. Alternative Methods |  |
| i. An alternative approach, the direct write-off method, is easier to use, but it overstates the value of Accounts Receivable and violates the expense recognition principle; as such, it is not considered a generally accepted accounting method. | Covered in Supplement 8A |
| ii. However, the Internal Revenue Service (IRS) requires the use of this method for tax purposes. | *The IRS does not like estimates.* |

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| Chapter Outline | Teaching Notes |
| ***LO 8-3 Compute and report interest on notes receivable.*** | |
| III. Notes Receivable and Interest Revenue |  |
| A. A company reports Notes Receivable in three situations: | * Activity #4 |
| 1. It loans money to employee or businesses. |  |
| 2. It sells expensive items for which customers require an extended payment period. |  |
| 3. It converts an existing accounts receivable to a note receivable to allow an extended payment period. |  |
| 4. The accounting issues are similar to those for accounts receivable except that notes receivable charged interest from the day they are created to the day they are due (maturity date). |  |
| B. Calculating Interest Interest (I) = Principal (P) × Interest Rate (R) × Time (T) | Illustrated in Exhibit 8.4 |
| 1. Principal—The amount of the note receivable. |  |
| 2. Interest rates are always stated as an annual percentage even if the note is for less than a year. |  |
| 3. The time period is the portion of a year for which interest is calculated. | *Homework assignments assume that the time is* |
| 4. Most financial institutions use the number of days out of 365 to compute interest. | *measured in terms of the number of months out of 12.* |
| C. Recording Notes Receivable and Interest Revenue |  |
| 1. Establishing a Note Receivable |  |
| The company loans $100,000 to another company. |  |
| a. Analyze: Assets = Liabilities + Stockholders’ Equity Notes Receivable (A) +100,000; Cash (A) –100,000 |  |
| b. Record: |  |
| |  |  |  | | --- | --- | --- | | Notes Receivable | 100,000 |  | | Cash |  | 100,000 | |  |
| 2. Accruing Interest Earned |  |
| a. Under accrual basis accounting, interest revenue is recorded when it is earned (at the end of each accounting period). | Timeline illustrated in Exhibit 8.5 |
| b. At the end of each accounting period, a company must make an adjusting journal entry to accrue the interest earned but not yet received by debiting Interest Receivable and crediting Interest Revenue. |  |
| c. The company earned two months of interest revenue during the accounting period. |  |
| i. Interest = Principal × Interest Rate × Time $1,000 = $100,000 × 6% × 2/12 |  |
| ii. Analyze:  Assets = Liabilities + Stockholders’ Equity Interest Receivable (A) +1,000; Interest Revenue (R) +1,000 |  |

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| Chapter Outline | Teaching Notes |
| iii. Record: |  |
| |  |  |  | | --- | --- | --- | | Interest Receivable | 1,000 |  | | Interest Revenue |  | 1,000 | |  |
| 3. Recording Interest Received |  |
| At maturity, the company receives a cash interest payment of $6,000 (= $100,000 × 6% × 12/12) earned two months of interest revenue during the accounting period. |  |
| a. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) +6,000, Interest Receivable (A) –1,000; Interest Revenue (R) +5,000 |  |
| b. Record: |  |
| |  |  |  | | --- | --- | --- | | Cash | 6,000 |  | | Interest Receivable |  | 1,000 | | Interest Revenue |  | 5,000 | |  |
| 4. Recording Principal Received |  |
| The company receives the $100,000 principal due at maturity. |  |
| a. Analyze: Assets = Liabilities + Stockholders’ Equity Cash (A) +100,000, Notes Receivable (A) –100,000 |  |
| b. Record: |  |
| |  |  |  | | --- | --- | --- | | Cash | 100,000 |  | | Notes Receivable |  | 100,000 | |  |
| 5. Accounting for Uncollectible Notes |  |
| a. Companies might not collect the full principal and interest that they are owed on a note receivable. | The “Spotlight on Ethics” |
| b. When collection is in doubt, company should record an Allowance for Doubtful Accounts against the Notes Receivable, just as is records an Allowance for Doubtful Accounts against Accounts Receivable. | feature addresses the avoidance of recording bad debts by replacing accounts receivable with notes. |
| ***LO 8-4 Compute and interpret the receivables turnover ratio.*** | |
| III. Evaluate Receivables Management |  |
| A. Receivables Turnover Analysis |  |
| 1. **Receivables Turnover**—The process of selling and collecting on account. |  |
| a. The receivables turnover ratio determines the average number of times this process occurs during the period. |  |
| b. Receivables Turnover Ratio = Net Sales Revenue ÷ Average Net Receivables. |  |
| c. The receivables turnover ratio measures the number of times receivables turn over during the period. |  |
| d. A higher receivables turnover ratio means faster (better) turnover. |  |
| e. Channel stuffing—Company allows customers more time to pay their accounts to entice them to buy as much as possible. |  |

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| Chapter Outline | Teaching Notes |
| 2. **Days to Collect**—Measures the average number of days from the time from sale on account to collection. |  |
| a. Days to Collect = 365 ÷ Receivables Turnover Ratio. |  |
| b. Days to collect ratio measures the average number of days from sale on account to collection. |  |
| c. Higher days to collect mean a longer (worse) time to collect. |  |
| 3. Comparison to Benchmarks |  |
| a. Credit Terms | The “Spotlight on Financial |
| i. By calculating days to collect you can compare a company’s collection performance to its stated collections policy. | Reporting” feature addresses the impact of the financial crisis on days to collect. |
| ii. By comparing the number of days to collect to the length of credit period, you can gain a sense of whether customers are complying with the stated policy. |  |
| iii. If customers appear to be disregarding the stated credit period, that may be a sign they are dissatisfied with the product or service. |  |
| b. Other Companies |  |
| i. Receivables turnover ratios and the number of days to collect often vary across industries. |  |
| ii. A company’s turnover should only be compared with other companies in the same industry or with its figures from prior periods. |  |
| 4. Speeding Up Collections |  |
| a. Factoring Receivables |  |
| i. **Factoring**—An arrangement where receivables are sold to another company (called a factor) for immediate cash (minus a factoring fee). |  |
| ii. Factoring could send a potentially negative message because it often is a last resort for collecting accounts. |  |
| iii. The factoring fee can be as much as 3%. |  |
| b. Credit Card Sales |  |
| ii. Unlike private credit card programs, where the seller pursues collection from customers, national credit card companies and PayPal pay the seller within one to three days of the sale. |  |
| iii. Most banks accept credit card receipts as overnight deposits into the company’s bank account as if they’re cash. |  |
| iii. A fee is charged for their services, often around 3% of the total sales price; transaction fees are included with selling expenses on the income statement. | The “Spotlight on Controls” feature addresses the need to segregate collections and write-offs. |

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| Chapter Outline | Teaching Notes |
| IV. Supplement 8A – Direct Write-Off Method |  |
| ***S1 Record bad debts using the direct write-off method.*** | |
| A. **Direct Write-Off Method**—A non-GAAP alternative to the allowance method of accounting for uncollectible accounts. |  |
| 1. Does not estimate bad debts and does not use an Allowance for Doubtful Accounts. |  |
| 2. Reports sales when they occur and bad debt expense when it is discovered. |  |
| 3. Appropriate for tax purposes but it is not under GAAP. |  |
| a. It breaks the conservatism concept by reporting accounts receivable at the total amount owed by customers (an overly optimistic point of view) rather than what is estimated to actually be collectible (a more realistic viewpoint). |  |
| b. It breaks the matching principle by recording bad debt expense in the period that customer accounts are determined to be bad rather than matching the expense to the revenues reported in the period when the credit sales are actually made. |  |
| B. Journal Entries |  |
| 1. Under the direct write-off method, no journal entries are made until a bad debt is discovered. |  |
| 2. Company determines a $1,000 customer account to be uncollectible; entry using the direct write-off method: |  |
| |  |  |  | | --- | --- | --- | | Bad Debt Expense | 1,000 |  | | Accounts Receivable |  | 1,000 | |  |

# Supplemental Enrichment Activities

Note: These activities would be suitable for individual or group activities.

1. Handout 8–1

Use Handout 8–1 for an in-class activity designed to review journal entries relating to accounts receivable (sales, collections on account, write-off, and recoveries). The solution follows the handout master.

1. Handout 8–2

Use Handout 8–2 for an in-class activity designed to review the estimation of uncollectible accounts using the aging of accounts method. The solution follows the handout master.

1. Handout 8–3

Use Handout 8–3 for an in-class activity designed to review the estimation of uncollectible accounts using the percentage of credit sales method. The solution follows the handout master.

1. Handout 8–4

Use Handout 8–4 for an in-class activity designed to review journal entries relating to notes receivable. The solution follows the handout master.

# HANDOUT 8–1

# ACCOUNTS RECEIVABLE JOURNAL ENTRIES

Prepare journal entries to record the following transactions:

(1) On December 15, 2016, the company recorded $150,000 sales on credit.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 15 |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(2) On December 31, 2016, the company estimated bad debt expenses of $15,000.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |

(3) On January 12, 2017, collect $100,000 worth of accounts receivable.

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| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Jan. 12 |  |  |  | | 2017 |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | |

# HANDOUT 8–1, CONTINUED

(4) After many collection attempts, the Company determined on June 15, 2017 that it would not collect $10,000 in accounts receivables from Pendant Publishing. It decided to write-off this account.

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| |  |  |  |  | | --- | --- | --- | --- | | Jun. 15 |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | |

(5) On July 15, 2017, Pendant Publishing called to say that they have had financial problems but can afford to pay $7,000 to settle their $10,000 debt in full. Vandolay Industries agreed to these terms, and reversed $7,000 of the prior write-off. It received a $7,000 check from Pendant the next day.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Jul. 16 |  |  |  | |  |  |  |  | |  |  |  |  | | Jul. 16 |  |  |  | |  |  |  |  | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | |

Post the above entries to the following T-accounts:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| + Accounts Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | | − Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

# HANDOUT 8–1 SOLUTION

# ACCOUNTS RECEIVABLE JOURNAL ENTRIES

Prepare journal entries to record the following transactions:

(1) On December 15, 2016, the company recorded $150,000 sales on credit.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 15 | Accounts Receivable | 150,000 |  | |  | Sales |  | 150,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Accounts Receivable | +150,000 |  |  |  |  | Sales | +150,000 | |

(2) On December 31, 2016, the company estimated bad debt expenses of $15,000.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Bad Debt Expense | 15,000 |  | |  | Allowance for Doubtful Accounts |  | 15,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Allowance for Doubtful Accounts | –15,000 |  |  |  |  | Bad Debt Expense | –15,000 | |

(3) On January 12, 2017, collect $100,000 worth of accounts receivable.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Jan. 12 | Cash | 100,000 |  | | 2017 | Accounts Receivable |  | 100,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Cash | +100,000 |  |  |  |  |  |  | | Accounts Receivable | –100,000 |  |  |  |  |  |  | |

# HANDOUT 8–1 SOLUTION, CONTINUED

(4) After many collection attempts, the Company determined on June 15, 2017 that it would not collect $10,000 in accounts receivables from Pendant Publishing. It decided to write-off this account.

|  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Jun. 15 | Allowance for Doubtful Accounts | 10,000 |  | | 2017 | Accounts Receivable |  | 10,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Allowance for Doubtful Accounts | +10,000 |  |  |  |  |  |  | | Accounts Receivable | –10,000 |  |  |  |  |  |  | |

(5) On July 15, Pendant Publishing called to say that they have had financial problems but can afford to pay $7,000 to settle their $10,000 debt in full. Vandolay Industries agreed to these terms, and reversed $7,000 of the prior write-off. It received a $7,000 check from Pendant the next day.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Jul. 16 | Accounts Receivable | 7,000 |  | |  | Allowance for Doubtful Accounts |  | 7,000 | |  |  |  |  | | Jul. 16 | Cash | 7,000 |  | |  | Accounts Receivable |  | 7,000 | |
| Ensure the equation still balances and debits = credits |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Allowance for Doubtful Accounts | +7,000 |  |  |  |  |  |  | | Accounts Receivable | –7,000 |  |  |  |  |  |  | | Cash | +7,000 |  |  |  |  |  |  | | Accounts Receivable | –7,000 |  |  |  |  |  |  | |

Post the above entries to the following T-accounts:

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| + Accounts Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | | Dec. 15 | 150,000 |  |  | |  |  | 100,000 | Jan. 12 | |  |  | 10,000 | Jun. 15 | | Jul. 15 | 7,000 | 7,000 | Jul. 15 | | End. Bal. | 40,000 |  |  | | − Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 15,000 | Dec. 31 | | Jun. 15 | 10,000 |  |  | |  |  | 7,000 | Jul. 15 | |  |  | 12,000 | End. Bal. | |

# HANDOUT 8–2

# ESTIMATION AND RECORDING OF UNCOLLECTIBLE ACCOUNTS – AGING OF ACCOUNTS RECEIVABLE METHOD

Part 1

In 2016, Vandolay reported $300,000 in sales. The company’s allowance for doubtful accounts has an unadjusted credit balance of $12,000. Vandolay Industries accountants prepared the following Aging of Accounts Receivable:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Customer | Total | Number of days unpaid | | | |
| 0-30 | 30-60 | 60-90 | Over 90 |
| Alpha Sales | $ 700 |  | $700 |  |  |
| Gamma Manufacturing Co. | 1,900 | $1,900 |  |  |  |
| Delta Shipping Corp. | 2,200 |  |  | $2,200 |  |
| Epsilon Industries | 6,000 |  |  |  | $6,000 |
| Theta Manufacturing | 1,800 |  | 1,800 |  |  |
| Zeta Industries | 600 |  | 600 |  |  |
| Other customers | 248,800 | 140,100 | 36,900 | 29,800 | 42,000 |
| Totals | $262,000 | $142,000 | $40,000 | $32,000 | $48,000 |

Vandolay accountants believe that receivables 0-30 days old have a 2% chance of noncollection. Receivables 30-60 days old have a 4% chance of noncollection. Receivables 60-90 days old have an 8% chance of noncollection. Receivables over 90 days old have a 20% chance of noncollection. The company’s allowance for doubtful accounts has an unadjusted credit balance of $12,000. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | – Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

# HANDOUT 8–2, CONTINUED

Part 2

Assume instead that the company’s allowance for doubtful accounts has an unadjusted debit balance of $400. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | – Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

# HANDOUT 8–2 SOLUTION

# ESTIMATION AND RECORDING OF UNCOLLECTIBLE ACCOUNTS – AGING OF ACCOUNTS RECEIVABLE METHOD

Part 1

In 2016, Vandolay reported $300,000 in sales. The company’s allowance for doubtful accounts has an unadjusted credit balance of $12,000. Vandolay Industries accountants prepared the following Aging of Accounts Receivable:

|  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- |
| Customer | Total | Number of days unpaid | | | |
| 0-30 | 30-60 | 60-90 | Over 90 |
| Alpha Sales | $ 700 |  | $700 |  |  |
| Gamma Manufacturing Co. | 1,900 | $1,900 |  |  |  |
| Delta Shipping Corp. | 2,200 |  |  | $2,200 |  |
| Epsilon Industries | 6,000 |  |  |  | $6,000 |
| Theta Manufacturing | 1,800 |  | 1,800 |  |  |
| Zeta Industries | 600 |  | 600 |  |  |
| Other customers | 248,800 | 140,100 | 36,900 | 29,800 | 42,000 |
| Totals | $262,000 | $142,000 | $40,000 | $32,000 | $48,000 |
| Estimated percentage |  | 2% | 4% | 8% | 20% |
| Estimated uncollectible | $ 16,600 | $ 2,840 | $ 1,600 | $ 2,560 | $9,600 |

Vandolay accountants believe that receivables 0-30 days old have a 2% chance of noncollection. Receivables 30-60 days old have a 4% chance of noncollection. Receivables 60-90 days old have an 8% chance of noncollection. Receivables over 90 days old have a 20% chance of noncollection. The company’s allowance for doubtful accounts has an unadjusted credit balance of $12,000. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Bad Debt Expense | 4,600 |  | |  | Allowance for Doubtful Accounts |  | 4,600 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Allowance for Doubtful Accounts | –4,600 |  |  |  |  | Bad Debt Expense | –4,600 | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | | Dec. 31 | 4,600 |  |  | | End. Bal. | 4,600 |  |  | | – Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 12,000 | Beg. Bal. | |  |  | 4,600 | Dec. 31 | |  |  | 16,600 | End. Bal. | |

# HANDOUT 8–2 SOLUTION, CONTINUED

Part 2

Assume instead that the company’s allowance for doubtful accounts has an unadjusted debit balance of $400. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Bad Debt Expense | 17,000 |  | |  | Allowance for Doubtful Accounts |  | 17,000 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Allowance for Doubtful Accounts | –17,000 |  |  |  |  | Bad Debt Expense | –17,000 | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | | Dec. 31 | 17,000 |  |  | | End. Bal. | 17,000 |  |  | | – Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | | Beg. Bal. | 400 |  |  | |  |  | 17,000 | Dec. 31 | |  |  | 16,600 | End. Bal. | |

# HANDOUT 8–3

# ESTIMATION AND RECORDING OF UNCOLLECTIBLE ACCOUNTS – PERCENTAGE OF CREDIT SALES RECEIVABLE METHOD

Part 1

In 2016, Vandolay reported $300,000 in sales. The company’s allowance for doubtful accounts has an unadjusted credit balance of $12,000. Based on prior experience, management estimates that 2.5% of sales will result in bad debts. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | − Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

Part 2

Assume instead that the company’s allowance for doubtful accounts has an unadjusted debit balance of $400. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | | − Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |  |  |  |  | |

# HANDOUT 8–3 SOLUTION

# ESTIMATION AND RECORDING OF UNCOLLECTIBLE ACCOUNTS – PERCENTAGE OF CREDIT SALES RECEIVABLE METHOD

Part 1

In 2016, Vandolay reported $300,000 in sales. The company’s allowance for doubtful accounts has an unadjusted credit balance of $12,000. Based on prior experience, management estimates that 2.5% of sales will result in bad debts. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Bad Debt Expense | 7,500 |  | |  | Allowance for Doubtful Accounts |  | 7,500 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Allowance for Doubtful Accounts | –7,500 |  |  |  |  | Bad Debt Expense | –7,500 | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | | Dec. 31 | 7,500 |  |  | | End. Bal. | 7,500 |  |  | | − Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 12,000 | Beg. Bal. | |  |  | 7,500 | Dec. 31 | |  |  | 19,500 | End. Bal. | |

Part 2

Assume instead that the company’s allowance for doubtful accounts has an unadjusted debit balance of $400. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Bad Debt Expense | 7,500 |  | |  | Allowance for Doubtful Accounts |  | 7,500 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Allowance for Doubtful Accounts | –7,500 |  |  |  |  | Bad Debt Expense | –7,500 | | |
|  |  |
| + Bad Debt Expense (E) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | | Dec. 31 | 7,500 |  |  | | End. Bal. | 7,500 |  |  | | − Allowance for Doubtful Accounts (xA) +   |  |  |  |  | | --- | --- | --- | --- | | Beg. Bal. | 400 |  |  | |  |  | 7,500 | Dec. 31 | |  |  | 7,100 | End. Bal. | |

# HANDOUT 8–4

# NOTES RECEIVABLE

On April 1, 2016, Vandolay loans a $10,000 note to a customer opening a new store. The note, which bears 10% annual interest, becomes due on March 31, 2017. Prepare the required journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Apr. 1 |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Note Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | | + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |

On December 31, 2016, Vandolay accrued interest for the portion of the year that the note was outstanding. Prepare the required adjusting journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Interest Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | | – Interest Revenue (R, SE) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  | |  |  |  |  | |

# HANDOUT 8–4, CONTINUED

On March 31, 2017, Vandolay received all interest and principal for the note. Prepare the required journal entry for the receipt of interest.

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 |  |  |  | |  |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Interest Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | | Beg. Bal | 750 |  |  | |  |  |  |  | |  |  |  |  | | – Interest Revenue (R, SE) +   |  |  |  |  | | --- | --- | --- | --- | |  |  |  |  |   *[Cash account omitted]* |

Prepare the required journal entry for the receipt of principal.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Apr. 1 |  |  |  | |  |  |  |  | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | |  |  |  |  |  |  |  |  | |  |  |  |  |  |  |  |  | | |
|  |  |
| + Note Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | | Beg. Bal. | 10,000 |  |  | |  |  |  |  | |  |  |  |  | | *[Cash account omitted]* |

# HANDOUT 8–4 SOLUTION

# NOTES RECEIVABLE

On April 1, 2016, Vandolay loans a $10,000 note to a customer opening a new store. The note, which bears 10% annual interest, becomes due on March 31, 2017. Prepare the required journal entry.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Apr. 1 | Note Receivable | 10,000 |  | |  | Cash |  | 10,000 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Note Receivable | +10,000 |  |  |  |  |  |  | | Cash | –10,000 |  |  |  |  |  |  | | |
|  |  |
| + Note Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | | Apr. 1 | 10,000 |  |  | |  |  |  |  | | + Cash (A) –   |  |  |  |  | | --- | --- | --- | --- | |  |  | 10,000 | Apr. 1 | |  |  |  |  | |

On December 31, 2016, Vandolay accrued interest for the portion of the year that the note was outstanding. Prepare the required adjusting journal entry.

Period outstanding: April 1 through December 31 is 9 months.

Interest = Principal × Rate × Time = 10,000 × 10% × 9/12 = $750.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Interest Receivable | 750 |  | |  | Interest Revenue |  | 750 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Interest Receivable | +750 |  |  |  |  | Interest Revenue | +750 | | |
|  |  |
| + Interest Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | 750 |  |  | |  |  |  |  | | – Interest Revenue (R, SE) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 750 | Dec. 31 | |  |  |  |  | |

# HANDOUT 8–4 SOLUTION, CONTINUED

On March 31, 2017, Vandolay received all interest and principal for the note. Prepare the required journal entry for the receipt of interest.

Period outstanding: January 1 through March 31 is 3 months.

Interest = Principal × Rate × Time = 10,000 × 10% × 3/12 = $250.

Total amount of interest received: 12 months

Interest = Principal × Rate × Time = 10,000 × 10% × 1 = $1,000

|  |  |  |  |  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Dec. 31 | Cash | 1,000 |  | |  | Interest Revenue |  | 250 | |  | Interest Receivable |  | 750 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Interest Receivable | –750 |  |  |  |  | Interest Revenue | +250 | | Cash | +1,000 |  |  |  |  |  |  | | |
|  |  |
| + Interest Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | | Beg. Bal | 750 |  |  | |  |  | 750 | Mar. 31 | | End. Bal. | 0 |  |  | | – Interest Revenue (R, SE) +   |  |  |  |  | | --- | --- | --- | --- | |  |  | 250 | Mar. 31 |   *[Cash Account omitted]* |

Next, record the journal entry for receipt of the principal.

|  |  |  |  |  |  |  |  |  |  |
| --- | --- | --- | --- | --- | --- | --- | --- | --- | --- |
| |  |  |  |  | | --- | --- | --- | --- | | Apr. 1 | Cash | 10,000 |  | |  | Note Receivable |  | 10,000 | | |
| Ensure the equation still balances and debits = credits | |
| |  |  |  |  |  |  |  |  | | --- | --- | --- | --- | --- | --- | --- | --- | | **Assets** | | **=** | **Liabilities** | | **+** | **Stockholders’ Equity** | | | Note Receivable | –10,000 |  |  |  |  |  |  | | Cash | +10,000 |  |  |  |  |  |  | | |
|  |  |
| + Note Receivable (A) –   |  |  |  |  | | --- | --- | --- | --- | | Beg. Bal. | 10,000 |  |  | |  |  | 10,000 | Mar. 31 | | End. Bal. | 0 |  |  | | *[Cash Account omitted]* |