أكاديمية إعمل بيزنس

e3melbusiness.com

Receivables Accounting

Receivables Content

- Define receivables & its nature & importance.
- Understand the different types of reveivables.
- Explain how companies recognize accounts.
- Describe how companies value accounts receivable & the term discounts.
- Understand the different methods of dealing with uncollectible accounts.
- The direct write off method & the Allowance method.
- Using the Aiiowance method & its 2 different approaches.
- The income statement Approach.
- The balance sheet approach.

What is Receivable?

- The term Receivables refers to amounts due from individuals and companies. Receivables are claims that are expected to be collected in cash.
- The management of receivables is a very important
- activity for any company that sells goods or services
- on credit.

Why Receivables are important?

- Receivables are important because they represent one of a company's most liquid assets.
- For many companies, receivables are also one of the largest assets. For example, receivables represent 13.7% of the current assets of pharmaceutical companies for example.

Company	Receivables as a Percentage of Total Assets
Ford Motor Company	43.2%
General Electric	41.5
Minnesota Mining and Manufacturing Company (3M)	12.7
DuPont Co.	11.7
Intel Corporation	3.9

Why Receivables are important?

- The relative significance of a company's receivables as a percentage of its assets depends on various factors:
    - its industry,
    - the time of year,
    - whether it extends long-term financing,
    - and its credit policies

Classifications of receivables

- Accounts Receivable
- Notes Receivable
- Other receivables

Trade Receivables

Notes and accounts receivable that result from sales transactions are often called trade receivables.

Classifications of receivables

1 - Accounts Receivable:

- Are amounts customers owe on account. They result from the sale of goods and services.

Companies generally expect to collect accounts receivable within 30 to 60 days. They are usually the most significant type of claim held by a company.

Classifications of receivables

2 - Notes Receivable:

- They are enforced by a formal instrument like a promissory note so it has a stronger legal status, they are usually interest bearing because they are considered longer term receivables than accounts and extends for time periods of 60 – 90 days or longer.

Classifications of receivables

3- Other Receivables: Include nontrade receivables such as

- interest receivable,
- loans to company officers,
- advances to employees,
- and income taxes refundable.

- These do not generally result from the operations of the business. Therefore, they are generally classified and reported as separate items in the balance sheet.

Receivables

we all know about receivables but our objective here is how to go with different operational matters that concerns us as we go deal with it.

Like:

1. what makes up the number allocated to receivables on the balance sheet
2. What shall I do when am in doubt of collection.
3. If I write off some of them and then recollect what shall I do and how to deal with it.

Recognizing Accounts Receivable

Recognizing accounts receivable is relatively straightforward.

- A service organization records a receivable when it performs service on account.
- A merchandiser or a manufacturer records accounts receivable at the point of sale of merchandise on account.
- The seller may offer terms that encourage early payment by providing a discount.
- Sales returns also reduce receivables. The buyer might find some of the goods unacceptable and choose to return the unwanted goods.

Recording Accounts Receivable

- When Credit sale is made, it increases (debits) Accounts Receivable and increases (credits) Sales Revenue

Accounting Entry to record the credit sale:

Date	Item	Dr	Cr
****	A/R Sales Revenue Recording a credit sale.	XXXXX	XXXXX

Recording Accounts Receivable

Example

On Jan 1st I sold some of my goods on credit for $ 10,000.

What shall I do.

solution

Date	Item	Dr	Cr
1/1	A/R	10,000	
	Sales Revenue		10,000
	Recording a credit sale.		

Recognizing Accounts Receivable

As we said before.

- The seller may offer terms that encourage early payment by providing a discount.
- Sales returns also reduce receivables. The buyer might find some of the goods unacceptable and choose to return the unwanted goods.

Lets see how we deal with such situations on our books

Recognizing Accounts Receivable

- Assume that ABC Co. on July 1, 2017, sells merchandise on account to XYZ Company for $1,000, terms were to have a 2 % cash discount if they paid within 10 days otherwise they pay the net due within 30 days.
- On July 5, XYZ returns merchandise with a sales price of $100 to ABC Co.
- On July 9, ABC receives payment from XYZ Company for the balance due.

Note that the cost of goods sold are omitted

Lets see how we deal with such situations on our books

Recognizing Accounts Receivable

Date	Item	Dr	Cr
1 JUL	A/R XYZ company Sales Revenue Recording the sale on credit	1,000	1,000
5 JUL	Sales returns & allowance A/R XYZ company To record the goods returned	100	100
9 JUL	Cash 900 -18 Sales discount (900*.02 = 18) A/R XYZ company To record the collection of the amount due	882 18	900

Recognizing Accounts Receivable

- Assume that ABC Co. on July 1, 2017, sells merchandise on account to XYZ Company for $1,000, terms were to have a 2 % cash discount if they paid within 10 days otherwise they pay the net due within 30 days.
- On July 5, XYZ returns merchandise with a sales price of $100 to ABC Co.
- On July 15, ABC receives payment from XYZ Company for the balance due.

Note that the cost of goods sold are omitted

Lets see how we deal with such situations on our books

Recognizing Accounts Receivable

Date	Item	Dr	Cr
1 JUL	A/R XYZ company Sales Revenue Recording the sale on credit	1,000	1,000
5 JUL	Sales returns & allowance A/R XYZ company To record the goods returned	100	100
9 JUL	Cash A/R XYZ company To record the collection of the amount due	900	900

Explaining Cash Discounts

3 / 15, Net 45

A 3% discount on cash payment.

If you pay within 15 days of the purchase

If not you will have to pay the total net amount within 45 days.

Explaining Cash Discounts

2 / 10, N / EOM

A 2% discount on cash payment.

If you pay within 10 days of the purchase.

If not you will have to pay the total net amount by the end of the month.

Explaining Cash Discounts

5 / 12, N / 60

A 5% discount on cash payment.

If you pay within 12 days of the purchase.

If not you will have to pay the total net amount within 60 days.

Exercise 1

- On May 1, Yasser co sold merchandise on account to Farida Co for $50,000, terms 3/15, net 45.
- On May 4, Farida returns merchandise with a sales price of $2,000.
- On May 10, Yasser receives payment from Frida for the balance due. Prepare journal entries to record the May transactions on Yasser's books. (You may ignore cost of goods sold entries and explanations.)

Lets see how we deal with such situations on our books

Exercise 1

Date	Item	Dr	Cr
1 May	A/R Farida company Sales Revenue Recording the sale on credit	50,000	50,000
4 May	Sales returns & allowance A/R Farida company To record the goods returned	2,000	2,000
10 May	Cash 48,000- 1,440 Sales discount (48,000*.03 = 1,440) A/R Farida company To record the collection of the amount due	46,560 1,440	48,000

Valuation of receivables

- Once companies record receivables in the accounts, the next question is: How should they report receivables in the financial statements?
- Companies report accounts receivable on the balance sheet as An Asset. But determining the amount to report is sometimes difficult because some receivables will become uncollectible.

Valuation of receivables

Why do people default on payments?

For example,

- A customer may not be able to pay because of a decline in his sales revenue due to a downturn in the economy.
- Individuals may be laid off from their jobs or faced with unexpected hospital bills.
- Companies record credit losses as Bad Debt Expense or Uncollectible Accounts Expense). Such losses are a normal and necessary risk of doing business on a credit basis.

Valuation of receivables

Example

On Jan 1st I sold some of my goods on credit for $ 10,000, later on I found out that about $ 1000 are not going to be collected for any reason.

What shall I do.

solution

Receivables on B/S has to be Adjusted.

My revenues also has to be adjusted.

Valuation of receivables

To adjust the balance sheet effects we have the following popular names.

Allowance for uncollectible accounts

Bad debt allowance

Accumulated impairment loss of receivables.

To adjust the I/S effects we have the following popular names.

Uncollectible accounts expense

Bad debt Expense

Impairment loss of receivables

Valuation of receivables – bad debts

Methods of handling bad debts

Direct write off method

The allowance method

1- Direct Write – off method

- Under this method, Bad Debt Expense will show only actual losses from uncollectibles.
- The company will report accounts receivable at its gross amount all the time unless there is an actual loss to be deducted.
- What is wrong with the direct write off method?
- Although this method is simple, its use can reduce the usefulness of both the income statement and balance sheet.

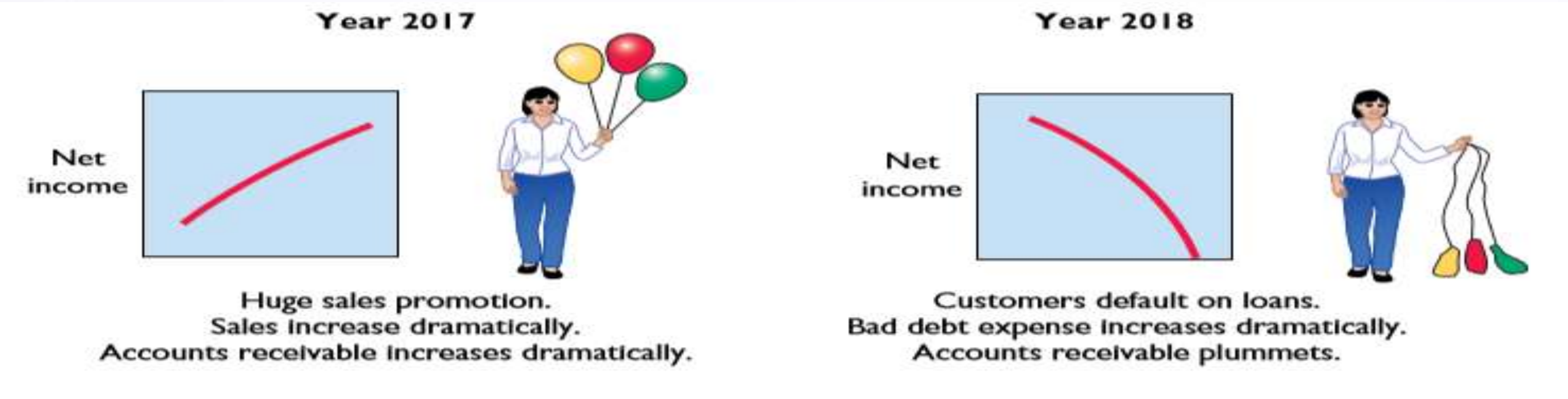
1- Direct Write – off method

2017 B/S

A/R	100,000		
		R/E	100,000

2018 B/S

A/R	50,000		
		R/E	(50,000)



1- Direct Write – off method

- Under the direct write-off method, when a company determines a particular account to be uncollectible, it charges the loss to Bad Debt Expense.
- Assume, for example, that ABC Co. writes off as uncollectible XYZ's $200 balance on December 12. ABC co. entry is as follows.

Date	Item	Dr	Cr
12/12	Bad Debt Expenses A/R XYZ Co, Writing off XYZ Co. Receivables	200	200

e3melbusiness.com

1- Direct Write – off method

What is wrong with the direct write off method?

- Under the direct write-off method, companies often record bad debt expense in a period different from the period in which they record the revenue.
- The method does not attempt to match bad debt expense to sales revenue in the income statement.
- Nor does the direct write-off method show accounts receivable in the balance sheet at the amount the company actually expects to receive.
- Consequently, unless bad debt losses are insignificant, the direct write-off method is not acceptable for financial reporting purposes.

2- The Allowance Method

- The allowance method of accounting for bad debts involves estimating uncollectible accounts at the end of each period.
- This provides better matching on the income statement.
- It also ensures that companies state receivables on the balance sheet at their Net Realizable value.
- The Net Realizable value is the net amount the company expects to receive in cash. It excludes amounts that the company estimates it will not collect.
- Thus, this method reduces receivables in the balance sheet by the amount of estimated uncollectible receivables.

2- The Allowance Method

How Does it work ?

1. Companies estimate uncollectible accounts receivable. In the same period they made the revenues.
2. Companies debit estimated uncollectibles to Bad Debt Expense and credit them to Allowance for Doubtful Accounts through an adjusting entry at the end of each period. Allowance for Doubtful Accounts is a contra account to Accounts Receivable.
3. When companies write off a specific account, they debit actual uncollectibles to Allowance for Doubtful Accounts and credit that amount to Accounts Receivable.

The Allowance Method

- Simply we make an estimate of the usually periodic uncollectible accounts as a percentage of sales or A/R, and given the following accounting treatment the A/R is not affected when an account is written off as the net effect of the entry on assets is zero.

Date	Description	Debit	Credit
31/12	Bad debts expense	Estimate	
	Allowance for bad debts		Estimate
	The adjusting entry to set up the allowance		
2/5	Allowance for bad debts	Actual	
	Accounts Receivables		Actual
	entry to write off bad debts		

Recording estimated Bad Debts

- ALI Furniture has credit sales of $1,200,000 in 2017. Of this amount, $200,000 remains uncollected at December 31. The credit manager estimates that $12,000 of these sales will be uncollectible.

Date	Item	Dr	Cr
31/12	Bad Debt Expenses	12,000	
	Allowance For Uncollectible accounts		12,000
	Estimating uncollectible acconts		

Recording estimated Bad Debts

- Allowance for Doubtful Accounts shows the estimated amount of claims on customers that the company expects will become uncollectible in the future. It is a contra account to Accounts Receivable because WE do not know which customers will not pay.

Balance Sheet (partial)		
Current assets		
Cash		$ 14,800
Accounts receivable	$200,000	
Less: Allowance for doubtful accounts	12,000	188,000
Inventory		310,000
Supplies		25,000
Total current assets		$537,800

Recording the Write off

- Assume that by Jan 15 2018 Ali company now know for sure that $ 500 of the uncollectible accounts recorded are actually for sure not going to be paid.

Date	Item	Dr	Cr
15/1	Allowance For Uncollectible accounts	500	
	A/R		500
	Writing Off Actual Bad Debts		

Recording the Write off

- Now the Accounts will look like the following

A/R

1/1	200,000	15/1	500
	199,500		

Allowance

15/1	500	1/1	12,000
			11,500

Write off effect

- A write-off affects only balance sheet accounts—not income statement accounts. The write-off of the account reduces both Accounts Receivable and Allowance for Doubtful Accounts.

	Before Write-Off	After Write-Off
Accounts receivable	$ 200,000	$ 199,500
Allowance for doubtful accounts	12,000	11,500
realizable value	$188,000	$188,000

Recovery of a written off acount

- On 201/2018 What if Ali furniture actually collect the amount of $ 500 previously written off on Jan 15 2018 .

Date	Item	Dr	Cr
20/1	A/R Allowance for uncollectible accounts Recording the recovery	500	500
20/1	Cash A/R Recording the collection	500	500

Receivables

Window dressing & spreading Issues

What ever you call it on your income statement the bad debt expense is a kind of expense that goes into the income statement.

Under what section?

Some companies classifies that expense as other losses to make the NET Operating profit look better but in fact it is a selling and marketing expense as the credit decision were to enhance sales.

Estimating Bad debts

- In "real life," companies must estimate that amount when they use the allowance method. Two bases are used to determine this amount:

  (1) percentage of sales and

  (2) percentage of receivables.

The choice is a management decision.

Estimating Bad debts

The allowance method for estimating Bad debts

Income Statement Approach

Uses Credit sales to make an estimate of the bad debts.

Balance Sheet Approach

Uses A/R Balance to make an estimate of the bad debts.

1- The Income Statement approach

- Management estimates what percentage of credit sales will be uncollectible. This percentage is based on past experience and anticipated credit policy.

The bad debts expense is a function of sales or credit sales

1- The Income Statement approach

- To illustrate, assume that ABC Company elects to use the percentage-of-sales basis. It concludes that 1% of net credit sales will become uncollectible.
- If net credit sales for 2017 are $800,000, the estimated bad debt expense is $8,000 (1% X $800,000). The adjusting entry is as follows.

Date	Item	Dr	Cr
31/12	Bad Debts Expense	8,000	
	Allowance For Uncollectible accounts		8,000
	Recording Estimated Bad Debts		

The Income Statement approach

Exercise: You have the following data

Opening balances:

A/R 100,000 Allowance account 2000

Current year transactions:

- Allowance for doubtful accounts was debited for $1600. (What does that mean ?)
- Sales on credit 500,000.
- The company have been experiencing 2% bad debts out of credit sales.

What should be recorded to treat the above info? (show ledgers)

1- The Income Statement approach

Date	Description	Debit	Credit
**	A/R Sales To record the Credit sales	500,000	 500,000
**	Allowance for Uncollectible Accounts Accounts Receivables Entry to write off bad debts	1600	 1600
Year End	Bad Debt Expenses Allowance for Uncollectible Accounts To increase the allowance with this year's estimate	10,000	 10,000

1- The Income Statement approach

A/R

Debit	Credit
100,000	1,600
500,000	
598,400	

Allowance

Debit	Credit
1,600	2000
	10,000
	10,400

Net 588,000

sales

Debit	Credit
	500,000
	500,000

Bad debt expenses

Debit	Credit
10,000	
10,000	

2- The Balance sheet approach

- The allowance is adjusted periodically to reflect a percentage of the A/R.

Step 1 : Age your A/R balances.

Step 2 : Apply uncollectible % to each balance at each age.

- The out come will be the amount that should appear in the allowance account.
- If you have any balance in the allowance account you should make your expense entry so that the ending balance in the allowance account reflects the newly calculated amount.

Example: You have the following data

Opening balances:

- Allowance for doubtful accounts 1250 (Cr)
- Accounts receivable 5000

Current year transactions:

- A/R 301,320
- And you have the following information for the age of the A/R

	Balance	31-60 days	61-90 days	91-120 days	121 - 360 days	Over 360 days
Ahmed	54,880	44,800	10,080			
Sherif	179,200	179,200				
Ali	30,800				25,800	5000
Hassan	41,440	33,600		7,840		
Total	$306,320	$ 257,600	$10,080	$7,840	$25,800	$5000

First we apply uncollectible percentage to the different categories.

Age	Balance	Estimated uncollectible%	Required balance in the allowance account
31-60	$257,600	5%	$ 12,880
61-90	10,080	15%	1,512
91-120	7,840	20%	1,568
121 - 360	25,800	25%	6,450
Over 360	5000	50%	2,500
Total	$ 306,320		$ 24,910

The required balance in the allowance account at the year end is $24,910 credit and we have a credit balance of 1,250 then the expense is $23,660.

2- The Balance sheet approach

A/R

306,320	
306,320	

Net 281,410

Allowance

	1,250
	23,660
	24,910

Bad debt expenses

23,660	
23,660	

Remember the entry to write off bad debts:

Allowance for bad debts	XXXX.	
AR		XXXX.

<u>If a client actually comes and pay the amount after it is written off:</u>

AR	XXXX.	
Allowance for bad debts		XXXX.

<u>To restore written off Accounts Receivables</u>:

Cash	XXXX.	
AR		XXXX.

- The amount restored into the allowance is used to absorb future uncollectible accounts.

Receivables Exercise 1

ABC Company had the following account balances at December 31, 2012:

• Accounts receivable	$900,000
• Allowance for doubtful accounts	16,000
(before any adjustments for 2012 doubtful accounts expense)	
• Credit sales for 2012	1,750,000

ABC is considering the following methods of estimating doubtful accounts expense for 2012:

- Based on credit sales at 2%
- Based on accounts receivable at 5%

Receivables Exercise 1

- What amount should Wren charge to doubtful accounts expense under each method?

	Percentage of Credit Sales	Percentage of Accounts Receivable
a.	$51,000	$45,000
b.	$51,000	$29,000
c.	$35,000	$45,000
d.	$35,000	$29,000

Receivables Exercise 1 income statement App

A/R

31/12	900,000		
	900,000		

Allowance

		31/12	16,000
		31/12	35,000
			51,000

Bad debts EXP

31/12	35,000		

Credit sales 1,750,000 X 2 % = 35,000 bad debt expenses

Receivables Exercise 1 B/S App

A/R

Debit		Credit
31/12	900,000	
	900,000	

Allowance

Debit	Credit	
	31/12	16,000
	31/12	29,000
		45,000

Bad debts EXP

Debit		Credit
31/12	29,000	

Gross receivables 900,000 X 5 % = 45,000 Allowance balance

Receivables Exercise

- What amount should Wren charge to doubtful accounts expense under each method?

	Percentage of Credit Sales	Percentage of Accounts Receivable
a.	$51,000	$45,000
b.	$51,000	$29,000
c.	$35,000	$45,000
d.	$35,000	$29,000

Receivables Exercise 2

Mill Co.'s allowance for uncollectible accounts was $100,000 at December 31, 2014, and $90,000 at the end of 2013. For the year ended December 31, 2014, Mill reported bad debt expense of $16,000. on its B/s. What amount did Mill debit to the appropriate account in 2014 to write off actual bad debts?

A. $6,000

B. $10,000

C. $16,000

D. $26,000

Receivables Exercise 2

Mill Co.'s allowance for uncollectible accounts was $100,000 at December 31, 2014, and $90,000 at the end of 2013. For the year ended December 31, 2014, Mill reported bad debt expense of $16,000.

Allowance 31/12/2014

Debit		Credit
6,000	1/1	90,000
	31/12	16,000
		100,000

106,000

Receivables Exercise 2

Mill Co.'s allowance for uncollectible accounts was $100,000 at December 31, 2014, and $90,000 at the end of 2013. For the year ended December 31, 2014, Mill reported bad debt expense of $16,000. on its B/s. What amount did Mill debit to the appropriate account in 2014 to write off actual bad debts?

A. $6,000

B. $10,000

C. $16,000

D. $26,000

Receivables Exercise 3

XYZ Co. estimates its uncollectible accounts expense to be 3% of total credit sales. XYZ credit sales for 2014 were $2,000,000. During 2014, XYZ wrote off $28,000 of uncollectible accounts. XYZ allowance for uncollectible accounts had a $20,000 balance on January 1, 2014. In its December 31, 2014 income statement, what amount should XYZ report as bad debt expense?

A. $68,000

B. $60,000

C. $52,000

D. $50,000

Receivables Exercise 4

When the allowance method of recognizing uncollectible accounts is used, the entries of recovery and collection of a small account previously written off:

A. Increase the allowance for uncollectible accounts.

B. Increase net income.

C. Decrease the allowance for uncollectible accounts

D. Have no effect on the allowance for uncollectible accounts

Receivables Exercise 5

At January 1, 2013, ABC CO, had a credit balance of $260,000 in its allowance for uncollectible accounts. Based on past experience, 2% of ABC CO's credit sales have been uncollectible. During 2013, ABC CO wrote off $325,000 of uncollectible accounts. Credit sales for 2013 were $9,000,000. In its December 31, 2013 balance sheet, what amount should ABC CO report as allowance for uncollectible accounts?

A. $115,000

B. $180,000

C. $245,000

D. $440,000

Exercise 6

The following accounts were abstracted from Roxy Company's unadjusted trial balance at December 31, 2014:

Accounts Receivable	$1,000,000	
Allowance for uncollectible accounts	8,000	
Net credit sales		$3,000,000

Roxy estimates that 3% of the gross accounts receivable will become uncollectible. After adjustment at December 31, 2014, the allowance for uncollectible accounts should have a credit balance of

A. $90,000

B. $82,000

C. $38,000

D. $30,000

Receivables Exercise 7

Larry. Co. determined that the net value of its Accounts receivable at December 31, 2014, based on an aging of the receivables, was $325,000. Additional information is as follows:

Allowance for uncollectible accounts 1/1/2014	$30,000
Uncollectible accounts written off during 2014	18,000
Uncollectible accounts recovered during 2014	2,000
Accounts Receivable at 31/12/2014	350,000

For 2014, what would be Larry's uncollectible accounts expense? 11000

Thank You