

# Financial Accounting Chapter 7

## Summary: Cheat Sheet

### VALUING RECEIVABLES

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**Accounts Receivable:** Amounts due from customers for credit sales.

**Credit sales and later collection:**

Accounts Receivable - CompStore	950	
Sales		950
Cash	720	
Accounts Receivable-RDA Electronics		720

**Sales using bank credit card:**

Cash	96	
Credit Card Expense	4	
Sales		100

### DIRECT WRITE-OFF METHOD

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**Direct write-off method:** Record bad debt expense when an account is determined to be uncollectible.

**Writing off a bad debt under *direct method*:**

Bad Debts Expense	520	
Accounts Receivable – J. Kent		520

**Bad debt later recovered under *direct method*:**

Accounts Receivable – J. Kent	520	
Bad Debts Expense		520
Cash	520	
Accounts Receivable – J. Kent		520

### ALLOWANCE METHOD

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**Allowance method:** Matches estimated loss from uncollectible accounts receivable against the sales they helped produce.

**Estimating bad debts:**

Bad Debts Expense	1,500	
Allowance for Doubtful Accounts		1,500

**Allowances for Doubtful Accounts:** A contra asset account that reduces accounts receivable. It has a normal credit balance.

**Writing off a bad debt under *allowance method*:**

Allowance for Doubtful Accounts	520	
Accounts Receivable – J. Kent		520

**Bad debt later recovered under *allowance method*:**

Accounts Receivable – J. Kent	520	
Allowance for Doubtful Accounts		520
Cash	520	
Accounts Receivable – J. Kent		520

**NOTES RECEIVABLE**

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**Note receivable:** A promise to pay a specified amount of money at a future date.

**Principal of a note:** Amount promised to be repaid.

**Maturity date:** Day the note must be repaid.

**Interest formula (year assumed to have 360 days):**

$\text{Principal of the note} \times \text{Annual interest rate} \times \text{Time expressed in fraction of year} = \text{Interest}$
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**Note receivable from sales:**

Notes Receivable	1,000	
Sales		1,000

**Note receivable and cash in exchange for accounts receivable:**

Cash	232	
Notes Receivable	600	
Accounts Receivable – J. Cook		832

**Note is *honored*; cash received in full (with interest):**

Cash	615	
Notes Receivable		600
Interest Revenue		15

**Note is *dishonored*; accounts receivable and interest recorded:**

Accounts Receivable – J. Cook	615	
Interest Revenue		15
Notes Receivable		600

**Accrue interest on note receivable:**

Interest Receivable	15	
Interest Revenue		15

**Note is *honored*; when note term runs over two periods:**

Cash	3,060	
Interest Revenue		45
Interest Receivable		15
Notes Receivable		3,000

**Factoring (selling) receivables:** Accounts receivable are sold to a bank and the seller is charged a *factoring fee*.

**Sale of receivables for cash with a charged factoring fee:**

Cash	19,200	
Factoring Fee Expense	800	
Accounts Receivable		20,000

**Pledging of receivables:** Borrowing money by *pledging* receivables as security for a loan. Borrower discloses pledging in notes to financial statement.

## ESTIMATING BAD DEBTS

When using the allowance method, we often use one of the following methods to estimate bad debts.

- **Percent of sales:** Uses a percent of credit sales for the period to estimate bad debts.
- **Percent of accounts receivable:** Uses a percent of total accounts receivable to estimate bad debts.
- **Aging of accounts receivable:** Applies increasing percentages to accounts receivable (classified by days past due) estimate bad debts.

