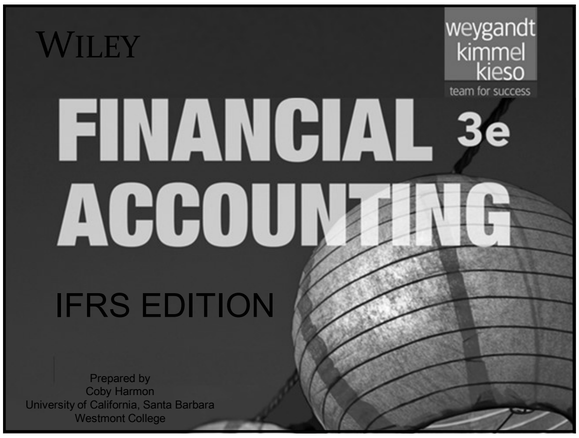


PREVIEW OF CHAPTER 8

ACCOUNTING FOR RECEIVABLES

Types of Receivables	Accounts Receivable	Notes Receivable	Statement Presentation and Analysis
• Accounts receivable • Notes receivable • Other receivables	• Recognizing accounts receivable • Valuing accounts receivable • Disposing of accounts receivable	• Determining the maturity date • Computing interest • Recognizing notes receivable • Valuing notes receivable • Disposing of notes receivable	• Presentation • Analysis

Financial Accounting
IFRS 3rd Edition
Weygandt ● Kimmel ● Kieso

CHAPTER
8 Accounting for Receivables

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Identify the different types of receivables.
2. Explain how companies recognize accounts receivable.
3. Distinguish between the methods and bases companies use to value accounts receivable.
4. Describe the entries to record the disposition of accounts receivable.
5. Compute the maturity date of and interest on notes receivable.
6. Explain how companies recognize notes receivable.
7. Describe how companies value notes receivable.
8. Describe the entries to record the disposition of notes receivable.
9. Explain the statement presentation and analysis of receivables.

Types of Receivables

Learning Objective 1
Identify the different types of receivables.

Amounts due from individuals and companies that are expected to be collected in cash.

- **Accounts Receivable** — Amounts customers owe on account that result from the sale of goods and services.
- **Notes Receivable** — Written promise (formal instrument) for amount to be received. Also called **trade receivables**.
- **Other Receivables** — Nontrade receivables such as interest, loans to officers, advances to employees, and income taxes refundable.

TYPES OF RECEIVABLES

Amounts due from individuals and companies that are expected to be collected in cash.

Company	Receivables as a Percentage of Total Assets
adidas (DEU)	16%
Hyundai (KOR)	5
Samsung (KOR)	13
Nestlé (CHE)	41
China Mobile Limited (HKG)	2

Illustration 8-1
Receivables as a percentage of assets

TYPES OF RECEIVABLES

Question

Receivables are frequently classified as:

a. accounts receivable, company receivables, and other receivables.

b. accounts receivable, notes receivable, and employee receivables.

c. accounts receivable and general receivables.

d. accounts receivable, notes receivable, and other receivables.

Accounts Receivable

Recognizing Accounts Receivable

Learning Objective 2
Explain how companies recognize accounts receivable.

- **Service organization** records a receivable when it performs service on account.
- **Merchandiser** records accounts receivable at the point of sale of merchandise on account.
- Seller may offer a **discount** to encourage early payment.
- Buyer might **return goods** found to be unacceptable.
  - Sales returns reduce receivables.

Recognizing Accounts Receivable

Illustration: Assume that **Hennes & Mauritz** (SWE) Co. on July 1, 2017, sells merchandise on account to Polo Company for $1,000 terms 2/10, n/30. Prepare the journal entry to record this transaction on the books of Hennes & Mauritz.

Jul. 1	Accounts Receivable	1,000	
	Sales Revenue		1,000

Recognizing Accounts Receivable

Illustration: On July 5, Polo returns merchandise worth $100 to Hennes & Mauritz.

Jul. 5	Sales Returns and Allowances	100	
	Accounts Receivable		100

Illustration: On July 11, Hennes & Mauritz receives payment from Polo Company for the balance due.

Jul. 11	Cash ($900 - $18)	882	
	Sales Discounts ($900 x .02)	18	
	Accounts Receivable		900

Recognizing Accounts Receivable

Illustration: Some retailers issue their own credit cards. Assume that you use your JCPenney Company credit card to purchase clothing with a sales price of $300.

Accounts Receivable	300	
Sales Revenue		300

Assume that you owe $300 at the end of the month, and JCPenney charges 1.5% per month on the balance due.

Accounts Receivable	4.50	
Interest Revenue		4.50

LO 2

ANATOMY OF A FRAUD

Tasanee was the accounts receivable clerk for a large non-profit foundation that provided performance and exhibition space for the performing and visual arts. Her responsibilities included activities normally assigned to an accounts receivable clerk, such as recording revenues from various sources that included donations, facility rental fees, ticket revenue, and bar receipts. However, she was also responsible for handling all cash and checks from the time they were received until the time she deposited them, as well as preparing the bank reconciliation. Tasanee took advantage of her situation by falsifying bank deposits and bank reconciliations so that she could steal cash from the bar receipts. Since nobody else logged the donations or matched the donation receipts to pledges prior to Tasanee receiving them, she was able to offset the cash that was stolen against donations that she received but didn't record. Her crime was made easier by the fact that her boss, the company's controller, only did a very superficial review of the bank reconciliation and thus didn't notice that some numbers had been cut out from other documents and taped onto the bank reconciliation.

Total take: $1.5 million

The Missing Controls

LO 2

> DO IT!

On May 1, Wilton sold merchandise on account to Bates for €50,000 terms 3/15, net 45. On May 4, Bates returns merchandise with a sales price of €2,000. On May 16, Wilton receives payment from Bates for the balance due. Prepare journal entries to record the May transactions on Wilton's books. (Ignore cost of goods sold entries.)

May 1	Accounts Receivable—Bates	50,000	
	Sales Revenue		50,000
4	Sales Returns and Allowances	2,000	
	Accounts Receivable—Bates		2,000
16	Cash (€48,000 - €1,440)	46,560	
	Sales Discounts (€48,000 x .03)	1,440	
	Accounts Receivable—Bates		48,000

LO 2

Valuing Accounts Receivable

Learning Objective 3
Distinguish between the methods and bases companies use to value accounts receivable.

- Current asset.
- Valuation (net realizable value).

Uncollectible Accounts Receivable

- Sales on account raise the possibility of accounts not being collected.
- Seller records losses that result from extending credit as **Bad Debt Expense**.

Valuing Accounts Receivable

Methods of Accounting for Uncollectible Accounts

Direct Write-Off	Allowance Method
Theoretically undesirable:	**Losses are estimated:**
◆ No matching.	◆ Better matching.
◆ Receivable not stated at amount expect to be received.	◆ Receivable stated at cash (net) realizable value.
◆ Not acceptable for financial reporting.	◆ Required by IFRS.

Accounts Receivable

How are these accounts presented on the Statement of Financial Position?

	Accounts Receivable			Allowance for Doubtful Accounts	
Beg.	500			25	Beg.
End.	500			25	End.

Accounts Receivable

ABC Corporation
Statement of Financial Position (partial)

Current Assets:		
Supplies		**€ 40**
Inventory		**812**
Accounts receivable	500	
Less: Allowance for doubtful accounts	(25)	475
Cash		**330**
Total current assets		**1,657**

LO 3

Accounts Receivable

Alternate Presentation

ABC Corporation
Statement of Financial Position (partial)

Current Assets:	
Supplies	**€ 40**
Inventory	**812**
Accounts receivable, net of €25 allowance	475
Cash	**330**
Total current assets	**1,657**

LO 3

Accounts Receivable

Journal entry for credit sale of €100.

Accounts Receivable	100	
Sales		100

Accounts Receivable

Beg.	500	
End.	500	

Allowance for Doubtful Accounts

	25	Beg.
	25	End.

LO 3

Accounts Receivable

Journal entry for credit sale of €100.

Accounts Receivable	100	
Sales		100

Accounts Receivable				Allowance for Doubtful Accounts			
Beg.	500					25	Beg.
Sale	100						
End.	600					25	End.

 LO 3

Accounts Receivable

Collected €333 on account.

Cash	333	
Accounts Receivable		333

Accounts Receivable				Allowance for Doubtful Accounts			
Beg.	500					25	Beg.
Sale	100						
End.	600					25	End.

 LO 3

Accounts Receivable

Collected €333 on account.

Cash	333	
Accounts Receivable		333

Accounts Receivable				Allowance for Doubtful Accounts			
Beg.	500					25	Beg.
Sale	100	333	Coll.				
End.	267					25	End.

 LO 3

Accounts Receivable

Adjustment of €15 for estimated bad debts.

Bad Debt Expense	15	
Allowance for Doubtful Accounts		15

Accounts Receivable

Beg.	500		
Sale	100	333	Coll.
End.	267		

Allowance for Doubtful Accounts

		25	Beg.
		25	End.

Accounts Receivable

Adjustment of €15 for estimated bad debts.

Bad Debt Expense	15	
Allowance for Doubtful Accounts		15

Accounts Receivable

Beg.	500		
Sale	100	333	Coll.
End.	267		

Allowance for Doubtful Accounts

		25	Beg.
		15	Est.
		40	End.

Accounts Receivable

Write-off of uncollectible accounts for €10.

Allowance for Doubtful Accounts	10	
Accounts Receivable		10

Accounts Receivable

Beg.	500		
Sale	100	333	Coll.
End.	267		

Allowance for Doubtful Accounts

		25	Beg.
		15	Est.
		40	End.

Accounts Receivable

Write-off of uncollectible accounts for €10.

Allowance for Doubtful Accounts	10	
Accounts Receivable		10

Accounts Receivable

Beg.	500		
Sale	100	333	Coll.
		10	W/O
End.	257		

Allowance for Doubtful Accounts

		25	Beg.
		15	Est.
W/O	10		
		30	End.

LO 3

Accounts Receivable

ABC Corporation
Statement of Financial Position (partial)

Current Assets:		
Supplies		€ 40
Inventory		812
Accounts receivable	257	
Less: Allowance for doubtful accounts	(30)	227
Cash		330
Total current assets		1,409

LO 3

DIRECT WRITE-OFF METHOD FOR UNCOLLECTIBLE ACCOUNTS

Illustration: Assume that Warden Ltd. writes off M. E. Doran's HK$1,600 balance as uncollectible on December 12. Warden's entry is:

Bad Debt Expense	1,600	
Accounts Receivable—M. E. Doran		1,600

Theoretically undesirable:

- No matching.
- Receivable not stated at cash realizable value.
- Not acceptable for financial reporting.

LO 3

ALLOWANCE METHOD FOR UNCOLLECTIBLE ACCOUNTS

1. Companies **estimate** uncollectible accounts receivable.
2. Debit **Bad Debt Expense** and credit **Allowance for Doubtful Accounts** (a contra-asset account).
3. Companies debit **Allowance for Doubtful Accounts** and credit **Accounts Receivable** at the time the specific account is **written off** as uncollectible.

ALLOWANCE METHOD

RECORDING ESTIMATED UNCOLLECTIBLES

Illustration: Hampson Furniture has credit sales of €1,200,000 in 2017, of which €200,000 remains uncollected at December 31. The credit manager estimates that €12,000 of these sales will prove uncollectible.

Dec. 31	Bad Debt Expense	12,000	
	Allowance for Doubtful Accounts		12,000

Allowance Method for Uncollectibles

HAMPSON FURNITURE Statement of Financial Position (partial)		
Current assets		
Supplies		€ 25,000
Inventory		310,000
Accounts receivable	**€200,000**	
Less: Allowance for doubtful accounts	**12,000**	**188,000**
Cash		14,800
Total current assets		€537,800

Illustration 8-3
Presentation of allowance for doubtful accounts

Allowance Method for Uncollectibles

WRITE-OFF OF AN UNCOLLECTIBLE ACCOUNT

Illustration: The vice-president of finance of Hampson Furniture on March 1, 2018, authorizes a write-off of the €500 balance owed by R. A. Ware. The entry to record the write-off is:

Mar. 1	Allowance for Doubtful Accounts	500	
	Accounts Receivable—R. A. Ware		500

Accounts Receivable		Allowance for Doubtful Accounts	
Jan. 1 Bal. 200,000	Mar. 1 **500**	Mar. 1 **500**	Jan. 1 Bal. 12,000
Mar. 1 Bal. 199,500			Mar. 1 Bal. 11,500

Illustration 8-4
General ledger balances after write-off

LO 3

Allowance Method for Uncollectibles

WRITE-OFF OF AN UNCOLLECTIBLE ACCOUNT

Illustration: The vice-president of finance of Hampson Furniture on March 1, 2018, authorizes a write-off of the €500 balance owed by R. A. Ware. The entry to record the write-off is:

Mar. 1	Allowance for Doubtful Accounts	500	
	Accounts Receivable—R. A. Ware		500

	Before Write-Off	After Write-Off
Accounts receivable	€ 200,000	€ 199,500
Less: Allowance for doubtful accounts	12,000	11,500
Cash realizable value	**€188,000**	**€188,000**

Illustration 8-5
Cash realizable value comparison

LO 3

Allowance Method for Uncollectibles

RECOVERY OF AN UNCOLLECTIBLE ACCOUNT

Illustration: On July 1, R. A. Ware pays the €500 amount that Hampson Furniture had written off on March 1. Hampson makes these entries:

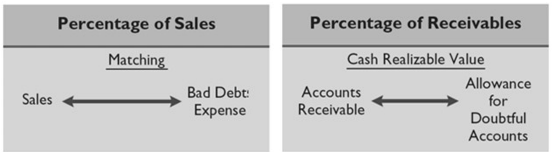
July 1	Accounts Receivable—R. A. Ware	500	
	Allowance for Doubtful Accounts		500
1	Cash	500	
	Accounts Receivable—R. A. Ware		500

LO 3

Allowance Method for Uncollectibles

ESTIMATING THE ALLOWANCE

Illustration 8-6
Comparison of bases for estimating uncollectibles



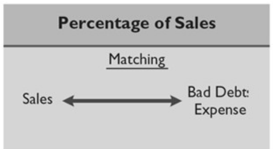
Emphasis on Income Statement Relationships

Emphasis on Statement of Financial Position Relationships

Allowance Method for Uncollectibles

ESTIMATING THE ALLOWANCE

Illustration 8-6



Emphasis on Income Statement Relationships

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

Allowance Method for Uncollectibles

Percentage-of-Sales

Illustration: Assume that Gonzalez SA 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 adjusting entry is:

Dec. 31	Bad Debt Expense	8,000 *	
	Allowance for Doubtful Accounts		8,000

* €800,000 x 1%

Allowance Method for Uncollectibles

Percentage-of-Sales

- Emphasizes matching of expenses with revenues.
- Adjusting entry to record bad debts **disregards** the existing balance in Allowance for Doubtful Accounts.

Bad Debt Expense		Allowance for Doubtful Accounts	
Dec. 31 Adj. 8,000			Jan. 1 Bal. 1,723
			Dec. 31 Adj. 8,000
			Dec. 31 Bal. 9,723

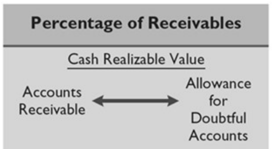
Illustration 8-7
Bad debt accounts after posting

LO 3

Allowance Method for Uncollectibles

ESTIMATING THE ALLOWANCE

Illustration 8-6



Management establishes a percentage relationship between the amount of receivables and expected losses from uncollectible accounts.

Emphasis on Statement of Financial Position Relationships

LO 3

Allowance Method for Uncollectibles

Aging the accounts receivable - customer balances are classified by the length of time they have been unpaid.

Illustration 8-8
Aging schedule

(₩ in thousands)			Number of Days Past Due			
Customer	Total	Not Yet Due	1–30	31–60	61–90	Over 90
T. E. Song	₩ 600		₩ 300		₩ 200	₩ 100
R. C. Han	300	₩ 300				
B. A. Yoon	450		200	₩ 250		
O. L. Choi	700	500			200	
T. O. Bae	600			300		300
Others	36,950	26,200	5,200	2,450	1,600	1,500
	₩39,600	₩27,000	₩5,700	₩3,000	₩2,000	₩1,900
Estimated Percentage Uncollectible		2%	4%	10%	20%	40%
Total Estimated Bad Debts	₩ 2,228	₩ 540	₩ 228	₩ 300	₩ 400	₩ 760

Allowance Method for Uncollectibles

Percentage-of-Receivables (₩ in thousands)

Illustration: Assume the unadjusted trial balance shows Allowance for Doubtful Accounts with a credit balance of ₩528. Prepare the adjusting entry assuming ₩2,228 is the estimate of uncollectible receivables from the aging schedule.

Dec. 31	Bad Debt Expense	1,700	
	Allowance for Doubtful Accounts		1,700

Illustration 8-9 Bad debt accounts after posting

Bad Debt Expense		Allowance for Doubtful Accounts	
Dec. 31 Adj. 1,700			Bal. 528
			Dec. 31 Adj. 1,700
			Bal. 2,228

LO 3

> DO IT!

Brule Co. has been in business five years. The ledger at the end of the current year shows:

Accounts Receivable	$30,000	Dr.
Sales Revenue	$180,000	Cr.
Allowance for Doubtful Accounts	$2,000	Dr.

Bad debts are estimated to be 10% of receivables. Prepare the entry to adjust Allowance for Doubtful Accounts.

Solution:

Bad Debt Expense	5,000 *	
Allowance for Doubtful Accounts		5,000

* [(0.1 x $30,000) + $2,000]

LO 3

Allowance Method for Uncollectibles

Question

Which of the following approaches for bad debts is best described as a statement of financial position method?

a. Percentage-of-receivables basis.

b. Direct write-off method.

c. Percentage-of-sales basis.

d. Both percentage-of-receivables basis and direct write-off method.

LO 3

Disposing of Accounts Receivables

Learning Objective 4
Describe the entries to record the disposition of accounts receivable.

SALE OF RECEIVABLES

- Finance company or bank.
- Buys receivables from businesses and then collects the payments directly from the customers.
- Typically charges a commission to the company that is selling the receivables.
- Fee ranges from 1% to 3% of the receivables purchased.

SALE OF RECEIVABLES

Illustration: Assume that Tsai Furniture factors NT$600,000 of receivables to Federal Factors. Federal Factors assesses a service charge of 2% of the amount of receivables sold. The journal entry to record the sale by Tsai Furniture is as follows.

(NT$600,000 x 2% = NT$12,000)

Cash	588,000	
Service Charge Expense	12,000	
Accounts Receivable		600,000

Disposing of Accounts Receivables

CREDIT CARD SALES

- Retailer pays card issuer a fee of 2 to 6% of the invoice price for its services.
- Recorded the same as cash sales.
- Advantages to retailer:
  - Issuer does credit investigation of customer.
  - Issuer maintains customer accounts.
  - Issuer undertakes collection and absorbs losses.
  - Receives cash more quickly.

CREDIT CARD SALES

Illustration: Lee Co. purchases NT$6,000 of music downloads for its restaurant from Yang Music Co., using a Visa First Bank Card. First Bank charges a service fee of 3%. The entry to record this transaction by Yang Music is as follows.

Cash	5,820	
Service Charge Expense	180	
Sales Revenue		6,000

ACCOUNTING ACROSS THE ORGANIZATION

How Does a Credit Card Work?

Suppose that you use a **Visa** card to purchase some new ties at **PPR** (FRA). The salesperson swipes your card, which allows the information on the magnetic strip on the back of the card to be read. The salesperson then enters in the amount of the purchase. The machine contacts the Visa computer, which routes the call back to the bank that issued your Visa card. The issuing bank verifies that the account exists, that the card is not stolen, and that you have not exceeded your credit limit. At this point, the slip is printed, which you sign. Visa acts as the clearing agent for the transaction. It transfers funds from the issuing bank to PPR's bank account. Generally this transfer of funds, from sale to the receipt of funds in the merchant's account, takes two to three days. In the meantime, Visa puts a pending charge on your account for the amount of the tie purchase; that amount counts immediately against your available credit limit. At the end of the billing period, Visa sends you an invoice (your credit card bill) which shows the various charges you made, and the amounts that Visa expended on your behalf, for the month. You then must "pay the piper" for your stylish new ties.

> DO IT!

Mehl Wholesalers NV needs to raise €120,000 in cash to safely cover next Friday's employee payroll. Mehl has reached its debt ceiling. Mehl's balance of outstanding receivables totals €750,000. Mehl decides to factor €125,000 of its receivables on September 7, 2017, to alleviate this cash crunch. Record the entry that Mehl would make when it raises the needed cash. (Assume a 1% service charge.)

Solution

Cash	123,750	
Service Charge Expense	1,250 *	
Accounts Receivable		125,000

* (1% x €125,000)

Notes Receivable

Learning Objective 5
Compute the maturity date of and interest on notes receivable.

Companies may grant credit in exchange for a promissory note. A **promissory note** is a written promise to pay a specified amount of money on demand or at a definite time.

Promissory notes may be used

1. when individuals and companies lend or borrow money,
2. when amount of transaction and credit period exceed normal limits, or
3. in settlement of accounts receivable.

Notes Receivable

To the **payee**, the promissory note is a **note receivable**.
To the **maker**, the promissory note is a **note payable**.

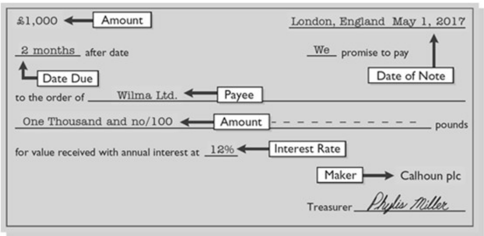


Illustration 8-11
Promissory note

Determining the Maturity Date

Maturity date of a promissory note may be stated in one of three ways:

1. On demand.
2. On a stated date.
3. At the end of a stated period of time.

Note terms are expressed in:

- Months
- Days

Computing Interest

Face Value of Note	×	Annual Interest Rate	×	Time in Terms of One Year	=	Interest

Illustration 8-14
Formula for computing interest

When counting days, **omit** the date the note is issued, but **include** the due date.

Terms of Note	Face	×	Rate	×	Time	=	Interest
\$ 730, 12%, 120 days	\$ 730	×	12%	×	120/360	=	\$ 29.20
\$1,000, 9%, 6 months	\$1,000	×	9%	×	6/12	=	\$ 45.00
\$2,000, 6%, 1 year	\$2,000	×	6%	×	1/1	=	\$120.00

Illustration 8-15
Computation of interest

LO 5

Notes Receivable

Question

One of the following statements about promissory notes is **incorrect**. The incorrect statement is:

a. The party making the promise to pay is called the maker.

b. The party to whom payment is to be made is called the payee.

c. A promissory note is not a negotiable instrument.

d. A promissory note is often required from high-risk customers.

LO 5

Recognizing Notes Receivable

Learning Objective 6
Explain how companies recognize notes receivable.

Illustration: Calhoun Company wrote a £1,000, two-month, 12% promissory note dated May 1, to settle an open account. Prepare entry would Wilma Company makes for the receipt of the note.

May 1	Notes Receivable	1,000	
	Accounts Receivable—Calhoun plc		1,000

LO 6

Valuing Notes Receivable

Learning Objective 7
Describe how companies value notes receivable.

- Report short-term notes receivable at their **cash (net) realizable value**.
- Estimation of cash realizable value and recording bad debt expense and related allowance are similar to accounts receivable.
- Allowance for Doubtful Accounts is used.

Global Insight

Can Fair Value Be Unfair?

The IASB and the Financial Accounting Standards Board (FASB) are considering proposals for how to account for financial instruments. The FASB has proposed that loans and receivables be accounted for at their fair value (the amount they could currently be sold for), as are most investments. The FASB believes that this would provide a more accurate view of a company's financial position. It might be especially useful as an early warning when a bank is in trouble because of poor-quality loans. But, banks argue that fair values are difficult to estimate accurately. They are also concerned that volatile fair values could cause large swings in a bank's reported net income. As a result, the IASB issued a standard that instead accounts for loans at amortized cost.

Source: David Reilly, "Banks Face a Mark-to-Market Challenge," *Wall Street Journal Online* (March 15, 2010).

Disposing of Notes Receivable

Learning Objective 8
Describe the entries to record the disposition of notes receivable.

1. Notes may be held to their maturity date.
2. Maker may default and payee must make an adjustment to the account.
3. Holder speeds up conversion to cash by selling the note receivable.

Disposing of Notes Receivable

HONOR OF NOTES RECEIVABLE

A note is **honored** when its maker pays it in full at its maturity date.

DISHONOR OF NOTES RECEIVABLE

A **dishonored note** is not paid in full at maturity. Dishonored note receivable is no longer negotiable.

HONOR OF NOTES RECEIVABLE

Illustration: Wolder Co. lends Higley Inc. €10,000 on June 1, accepting a five-month, 9% interest note. If Wolder presents the note to Higley Inc. on November 1, the maturity date, Wolder's entry to record the collection is:

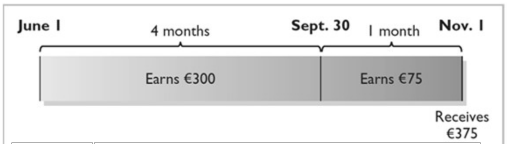
Nov. 1	Cash	10,375	
	Notes Receivable		10,000
	Interest Revenue		375

(€10,000 x 9% x 5/12 = €375)

ACCRUAL OF INTEREST RECEIVABLE

Illustration: Suppose instead that Wolder Co. prepares financial statements as of September 30. The adjusting entry by Wolder is for four months ending Sept. 30.

Illustration 8-16
Timeline of interest earned



Sept. 30	Interest Receivable	300	
	Interest Revenue		300

(€10,000 x 9% x 4/12 = € 300)

ACCRUAL OF INTEREST RECEIVABLE

Illustration: Prepare the entry Wolder's would make to record the honoring of the Higley note on November 1.

Nov. 1	Cash	10,375	
	Notes Receivable		10,000
	Interest Receivable		300
	Interest Revenue (€10,000 × 9% × 1/12)		75

DISHONOR OF NOTES RECEIVABLE

Illustration: Assume that Higley Co. on November 1 indicates that it cannot pay at the present time. If Wolder Co. does expect eventual collection, it would make the following entry at the time the note is dishonored (assuming no previous accrual of interest).

Nov. 1	Accounts Receivable	10,375	
	Notes Receivable		10,000
	Interest Revenue		375

ACCOUNTING ACROSS THE ORGANIZATION

Filling a Lending Void

After the global financial crisis, many banks were slow to extend business loans. Companies that needed financing were forced to look to alternative sources. For example, those with significant receivables were sometimes able to use those as a mechanism to get funding. One company, **Trafalgar Capital Advisors** (GBR), has an investment fund that extends financing supported by receivables, especially on long-term contracts. Examples have included, "suppliers with a large order from a large supermarket chain such as Walmart or Carrefour, which may account for 30 percent of their annual revenue, companies supplying systems to Thomson Reuters on 'non-cancellable' contracts, contractors selling to the UK's Ministry of Defence ('they never get paid on time'), and an organiser of international golf tournaments with long-term contracts but lumpy revenue streams." The company does not like to lend on "intangible" collateral, such as that of biotech or software companies.

Source: Steve Johnson, "Few Fund Managers Filling Bank Lending Void," *Financial Times Online (FT.com)* (January 9, 2011).

> DO IT!

Gambit Stores accepts from Leonard SpA a €3,400, 90-day, 6% note dated May 10 in settlement of Leonard's overdue open account. The note matures on August 8. What entry does Gambit make at the maturity date, assuming Leonard pays the note and interest in full at that time?

Solution

Interest payable at maturity date = €3,400 × 6% × 90/360 = **€51**

Cash	3,451	
Notes Receivable		3,400
Interest Revenue		51

LO 8

Statement Presentation and Analysis

Learning Objective 9
Explain the statement presentation and analysis of receivables.

Presentation

SFP
- Identify in the statement of financial position or in the notes each major type of receivable.
- Report short-term receivables as current assets.
- Report both gross amount of receivables and allowance for doubtful account.

IS
- Report bad debt expense and service charge expense as selling expenses.
- Report interest revenue under "Other income and expense."

LO 9

Statement Presentation and Analysis

Analysis

Illustration: In a recent year **Lenovo Group** (CHN) (which reported in U.S. dollars) had net sales of $38,707 million for the year. It had a beginning accounts receivable (net) balance of $2,885 million and an ending accounts receivable (net) balance of $3,171 million. Assuming that Lenovo's sales were all on credit, its accounts receivable turnover is computed as follows.

Net Credit Sales	÷	Average Net Accounts Receivable	=	Accounts Receivable Turnover
$38,707	÷	$\frac{\$2,885 + \$3,171}{2}$	=	12.8 times

Illustration 8-17
Accounts receivable turnover and computation

LO 9

Statement Presentation and Analysis

Analysis

Illustration: Variant of the accounts receivable turnover ratio is average collection period in terms of days.

Illustration 8-17

Net Credit Sales	÷	Average Net Accounts Receivable	=	Accounts Receivable Turnover
$38,707	÷	$\frac{\$2,885 + \$3,171}{2}$	=	12.8 times

Illustration 8-18

Days in Year	÷	Accounts Receivable Turnover	=	Average Collection Period in Days
365 days	÷	12.8 times	=	28.5 days

LO 9

> DO IT!

In 2017, Rafael Nadal SA had net credit sales of €923,795 for the year. It had a beginning accounts receivable (net) balance of €38,275 and an ending accounts receivable (net) balance of €35,988. Compute Rafael Nadal SA's **accounts receivable turnover** and **average collection period in days**.

Net credit sales	÷	Average net accounts receivable	=	Accounts receivable turnover
	÷		=	

Days in year	÷	Accounts receivable turnover	=	Average collection period in days
	÷		=	

LO 9

Statement Presentation and Analysis

Question

Accounts and notes receivable are reported in the current assets section of the statement of financial position at:

a. cash (net) realizable value.

b. net book value.

c. lower-of-cost-or-net realizable value.

d. invoice cost.

LO 9

A Look at U.S. GAAP

Learning Objective 10
Compare the accounting for receivables under IFRS and U.S. GAAP.

Key Points

Similarities

- GAAP and IFRS account for bad debts in a similar fashion. Both account for short-term receivables at amortized cost, adjusted for allowances for doubtful accounts.

Differences

- IFRS and GAAP differ in the criteria used to derecognize (generally through a sale or factoring) a receivable. IFRS uses a combination approach focused on risks and rewards and loss of control. GAAP uses loss of control as the primary criterion. In addition, IFRS permits partial derecognition; GAAP does not.
- IFRS specifies a two-step process for determining the impairment of receivables for a period. This process starts by identifying individual impairments of specific receivables and then estimating impairments of groups of receivables. GAAP does not specify a similar approach.

A Look at U.S. GAAP

Looking to the Future

It appears likely that the question of recording fair values for financial instruments will continue to be an important issue to resolve as the Boards work toward convergence. Both the IASB and the FASB have indicated that they believe that financial statements would be more transparent and understandable if companies recorded and reported all financial instruments at fair value. That said, in IFRS 9, which was issued in 2009, the IASB created a split model, where some financial instruments are recorded at fair value, but other financial assets, such as loans and receivables, can be accounted for at amortized cost if certain criteria are met. Critics say that this can result in two companies with identical securities accounting for those securities in different ways. A proposal by the FASB would require that practically all equity instruments be reported at fair value and that debt instruments may or may not be reported at fair value, depending on whether certain criteria are met. It has been suggested that IFRS 9 will likely be changed or replaced as the FASB and IASB continue to deliberate the best treatment for financial instruments.

A Look at U.S. GAAP

GAAP Self-Test Questions

Under GAAP, receivables are reported on the balance sheet at:

a) amortized cost.

b) amortized cost less allowance for doubtful accounts.

c) historical cost.

d) replacement cost.

A Look at U.S. GAAP

GAAP Self-Test Questions

Which of the following statements is false?

a) Receivables include equity securities purchased by the company.

b) Receivables include credit card receivables.

c) Receivables include amounts owed by employees as a result of company loans to employees.

d) Receivables include amounts resulting from transactions with customers.

LO 10

A Look at U.S. GAAP

GAAP Self-Test Questions

In recording a factoring transaction:

a) IFRS focuses on loss of control.

b) GAAP focuses on loss of control and risks and rewards.

c) IFRS and GAAP allow partial derecognition.

d) IFRS allows partial derecognition.

LO 10

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