Chapter 7: Cash and Receivables

Intermediate Accounting, 10th Edition
Kieso, Weygandt, and Warfield

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Part 1: Cash and Cash Equivalents

Items Considered Cash

- U.S. currency and coins
- Foreign currency, if freely convertible into U.S. currency
- Demand deposits (checking accounts)
- Bank drafts
- Petty cash
- Personal checks
- Money orders
- Most savings deposits

Items Excluded From Cash

- Restricted deposits
- Postdated checks
- IOUs
- Postage stamps
- Certificates of deposit
- Money market accounts
- Prepaid expenses

Cash and Cash Equivalents: Issues

- Definition of “cash”
- Management and control of cash
- Reporting of cash in the balance sheet

Items comprising “Cash”

- Cash must be readily available and be free of restrictions
- Various items that comprise cash:
  - U.S. currency and coins
  - Foreign currency, if freely convertible into U.S. currency
  - Demand deposits (checking accounts)
  - Bank drafts
  - Petty cash
  - Personal checks
  - Money orders
  - Most savings deposits

Management and control of cash

- Since cash is the most liquid asset, internal control of cash is imperative.
- Controls must prevent unauthorized use of cash
- Management must have necessary information for proper use of cash

Control of Cash Disbursements

- Separate responsibilities for:
  - Cash disbursement documents
  - Check writing
  - Check signing
  - Check mailing and record keeping
- All disbursements, except petty cash, made by check.
Cash Management

Control Over Payments

- Make all payments by check (except petty cash items) so that a record exists for every company expenditure.
- Authorize and sign all checks only after an expenditure is verified and approved.
- Periodically reconcile the cash balance in the bank statements with the company’s accounting records.

Imprest funds

- Established for set amounts
- Replenished periodically
- Examples:

  Petty cash funds
  Cash register drawers

Petty Cash

Imprest fund providing limited cash for routine disbursements.

Intended for payment of:
- Minor transportation costs.
- Postage.
- Office supplies.
- Delivery charges.

Petty Cash Funds

• Set up to disburse small amounts
• Control procedures
  2 Require documentation for disbursements
  2 Record cash short & over when fund is replenished

Imprest Petty Cash System

• The Petty Cash account is debited or credited only when the fund is first established or is changed in size.
• Cash Over and Short (現金短溢) is shown on the income statement as an other expense or revenue.
• The petty cash custodian is responsible at all times for the amount of the petty cash fund on hand either as cash or in the form of signed receipts.
• Reimbursements of the petty cash fund are recorded by debiting the expenses, assets, or liabilities and crediting the Cash account.

Petty Cash

Imprest system—an advance of money for a designated purpose

Action
(What people are doing)
1. A person is chosen to be the petty cash custodian.
   
   A check is written, cashed, and the money given to the petty cash custodian.

Accounting
(Making—or charging—entries)
1. Petty Cash Fund + Cash

   Petty Cash 300
   To record check no. xx and to set up petty cash account

   Petty Cash 300
   Office Supplies 42
   Entertainment Expense 76
   Cash Over and Short 173

Petty Cash

3. When the cash fund is low
   The cash is counted = $127
   The receipts are totaled = $298
   The total is compared to the original amount = $300
   The difference represents the cash (shortage) or
   Vouched receipts
   + Cash remaining in the fund
   = Petty cash account balance

   $298 - $127 = $171

   Petty Cash 171
   To record the petty cash receipts and cash shortage.

   Petty Cash 171
   Office Supplies Expense 42
   Entertainment Expense 76
   Cash Over and Short 173

   Petty Cash 171
   The check is canceled and the money given to the petty cash custodian.
Exercise 7-20

1. April 1 Petty Cash ................................ 200
   Cash ........................................... 200
2. April 10 Cash Over and Short ........... 2
   Transportation-In ......................... 60
   Supplies Expense ......................... 25
   Postage Expense ......................... 33
   Receivables—Employees ............... 17
   Miscellaneous Expense .............. 36
   Cash ........................................... 173
3. April 20 Petty Cash ................................ 100
   Cash ........................................... 100

Accounting for Petty Cash

• Debit Petty Cash to establish fund
• When fund is replenished:
  - Debit expenses, etc
  - Debit or credit cash short & over
• Debit Petty Cash to increase the petty cash fund
• Credit Petty Cash to decrease or eliminate the petty cash fund

Bank Reconciliation

Bank Reconciliation is prepared periodically to:
- Explain the difference between cash reported on bank statement and cash balance on company’s books.
- Arrive at the adjusted (correct) cash balance.
- Provide information for reconciling journal entries.

Bank Reconciliation

Balance per Bank
Deposit in Transit
Outstanding Checks
Service Charge
NSF Checks
Bank Errors
Book Errors
Adjusted Balance

Bank Reconciliation

All reconciling items in book balance section require an adjusting entry to the cash account.

Bank Reconciliation

Balance per Book
Deposit by Bank (credit memos)
Service Charge
NSF Checks
Make Journal Entries
Adjusted Balance

All reconciling items on the book side require an adjusting entry to the cash account.
Two Forms of Bank Reconciliation

- Reconciliation from the bank statement balance to the book balance or vice versa.
- Reconciliation of bank and book balances to a correct cash balance.
  - This form consists of two separate sections:
    - “Balance per bank statement” section
    - “Balance per books” section
  - This form facilitates computation of the correct cash balance, which is the amount that should be reported on the balance sheet.

Two Forms of Bank Reconciliation

- Two-section bank reconciliation:
  - “Balance per bank statement” section.
    - The “balance per bank statement” is the amount shown on the most recent bank statement as of the bank’s closing date for the month.
    - Add deposits recorded in the company’s books but not yet credited by the bank (e.g., deposits in transit).
    - Deduct charges recorded in the company’s books but not yet recorded by the bank (e.g., outstanding checks).
  - “Balance per books” section.
    - The “balance per books” is the amount shown in the company’s Cash Account as of the desired reconciliation date.
    - Add deposits credited by the bank but not yet recorded by the company (e.g., interest earned, collection of notes).
    - Deduct charges recorded by the bank but not yet recorded by the company (e.g., service charges, NSF checks).

Exercise 7-23

(a) Logan Bruno Company
Bank Reconciliation, August 31, 2001
County National Bank

Balance per bank statement, August 31, 2001
$8,089
Add: Cash on hand $310
Deposits in transit 3,800
$4,110
Deduct: Outstanding checks 1,050
Correct cash balance $11,149

Balance per books, August 31, 2001
($10,050 + $35,000 – $34,903)
$10,147
Add: Note ($1,000) and interest ($40) collected 1,040
11,187
Deduct: Bank service charges $20
Understated check for supplies 18
Correct cash balance $11,149

(b) Cash ................................................................. 1,040
  (To record collection of note and interest)
Interests Receivable ........................................ 1,000
  (To record collection of note and interest)
Office Expenses—Bank Service Charges 20
  (To record August bank charges)
Supplies Expense ........................................... 18
  (To record error in recording check for supplies)

(c) The corrected cash balance of $11,149 would be reported in the August 31, 2001, balance sheet.

Two forms of bank reconciliation

- Both sections end with the correct cash balance, which is the amount the should be reported on the balance sheet.
- Every reconciling item that appears in the “balance per books” section requires an adjusting entry to bring the books to the correct balance.
Reporting of Cash

- The reporting of cash depends upon whether it is:
  1. restricted cash
  2. a bank overdraft or
  3. a cash equivalent

Restricted Cash

- Compensating balances:
  1. are amounts maintained by a corporation with a bank in support of existing borrowing arrangements
  2. give bank use of the restricted balance
  3. are identified as current assets separate from cash, if they relate to short-term loans.
  4. are identified as non-current assets separate from cash, if they relate to long-term loans.
  5. Required disclosure for SEC reporting firms.

Cash in the balance sheet

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  1. are amounts maintained by a corporation with a bank in support of existing borrowing arrangements
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  3. are identified as current assets separate from cash, if they relate to short-term loans.
  4. are identified as non-current assets separate from cash, if they relate to long-term loans.
  5. Required disclosure for SEC reporting firms.

Cash Equivalents

- Must be readily convertible to cash
- Must be close to maturity

Typical Cash Equivalents

- Treasury bills
- Commercial paper
- Certificates of deposit (within 90 days of maturity)

Bank Overdrafts

- Overdrafts represent checks written in excess of cash account (negative cash balances). 銀行存款帳戶支用金額超過存款餘額之金額
- Overdrafts may be offset against available cash in another account in the same bank. 同一銀行不同帳戶之存款與透支可互抵
- Otherwise, such offsetting is not allowed (classified as a current liability). 通常列為流動負債。若金額小可併於應付帳款中，
  金額大則自列一項

Restricted Cash

(1) Compensating balances (Compensating Balance):

- 銀行要求客戶必須將借款之特定比例流於活存不能動用
- 借款回存使實質利率提高
- 短期借款回存列於現金
- 長期借款之補償性餘額列為非現金資產
- 非依法所作之借款回存仍可包含於現金中，但應
  註明

Cash Equivalents

- 與現金等值之投資物
- 約當現金

- Must be readily convertible to cash
- Must be close to maturity

Typical Cash Equivalents

- Treasury bills
- Commercial paper
- Certificates of deposit (within 90 days of maturity)

Bank Overdrafts

- Overdrafts represent checks written in excess of cash account (negative cash balances). 銀行存款帳戶支用金額超過存款餘額之金額
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  金額大則自列一項

Restricted Cash

(2) Other specific restricted cash:

- 約當現金
- Must be readily convertible to cash
- Must be close to maturity

Typical Cash Equivalents

- Treasury bills
- Commercial paper
- Certificates of deposit (within 90 days of maturity)

Bank Overdrafts

- Overdrafts represent checks written in excess of cash account (negative cash balances). 銀行存款帳戶支用金額超過存款餘額之金額
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  金額大則自列一項
Part 2: Accounts Receivable

Accounts Receivable - Issues

- Types of accounts receivable
  - current and non-current
  - trade and non-trade
- Recognition of accounts receivable in the financial statements - cash discounts / interest
- Valuation of accounts receivable: estimated bad debts and net realizable value
- Disposition of receivable - transfers / sale

Classifications

- Current vs. noncurrent:
  - Current receivables are expected to be collected within a year or during the current operating cycle whichever is longer
- Trade vs. nontrade:
  - Trade receivables are amounts owed by customers for goods sold and services rendered as part of normal business operations.
  - Nontrade receivables are receivables that do not arise from major operating activities
- Accounts receivable vs. notes receivable
  - Accounts receivable are oral promises of the purchaser to pay for goods and services sold.
  - Notes receivable are written promises to pay a certain sum of money on a specified future date.

When to Record A/R

Recognition of accounts receivable is directly related to when the revenue is recognized.

- Earnings process is complete or virtually complete - revenue has been earned
- Amount and timing of the revenue can be reasonably estimated - revenue has been realized or is realizable

Credit Sale and Collection

Assume that John purchased $1,000 of equipment on account. What entries are made?

When the inventory is sold on account:

<table>
<thead>
<tr>
<th>Accounts Receivable</th>
<th>1,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>1,000</td>
</tr>
</tbody>
</table>

Sold equipment to John on account.

When the collection takes place:

<table>
<thead>
<tr>
<th>Cash</th>
<th>1,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>1,000</td>
</tr>
</tbody>
</table>

Payment from John for equipment purchased.

Credit Cards -- Submission

The ABC Company has American Express receipts of $500 at the end of the day. What journal entry is needed?

| Accounts Receivable--Amex | 500 |
| Sales                     | 500 |

To record Amex sales for 1/1/x5.

American Express charges a 5% credit card fee. When ABC Company receives payment from American Express, what journal entry is needed?

<table>
<thead>
<tr>
<th>Cash</th>
<th>475</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Card Expense</td>
<td>25</td>
</tr>
<tr>
<td>Accounts Receivable--Amex</td>
<td>500</td>
</tr>
</tbody>
</table>

Received payment for 1/1/x5 Amex drafts.

Credit Cards -- Deposit

The ABC Company has bank card drafts of $1,500 at the end of the day. Assuming the bank card charges a 5% credit card fee, what journal entry is made?

<table>
<thead>
<tr>
<th>Cash</th>
<th>1,425</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit Card Service Charge</td>
<td>75</td>
</tr>
<tr>
<td>Sales</td>
<td>1,500</td>
</tr>
</tbody>
</table>

To record bank card sales for 1/1/x5.
Accounts Receivable

- Recognition Issues

- The amount to be recognized is the exchange price, which is the amount due from the debtor. 入帳金額除成交價格外尚需考慮下列因素:
- Two factors to be considered
  - The availability of discount
    - Trade discount (商業折扣)
    - Cash discount (現金折扣)
  - The interest element

Interest Element

- Theoretically, receivables should be measured at their present value. 應收帳款應以按公平利率折算之現值入帳
- But accountants have chosen to ignore the implicit interest element in normal account receivables which are due within one year. 但若到期日不遠 (短於一年) 則可忽略利息因素，直接以到期值入帳

Accounts Receivable: Recognition

- Trade or quantity discounts are not recorded in books of account. 商業折扣不入帳，即應以定價減除商業折扣後之淨額為應收帳款及銷貨收入入帳之依據
  - reductions from the list price
  - customers are billed net of trade discounts
- Cash (sales) discounts are inducements to customers for prompt payment of amounts billed.
  - Cash discounts are recorded in books as reductions of sales revenue. 總額法、淨額法

Cash Discounts

- 2/10, n/30

<table>
<thead>
<tr>
<th>Discount Percent</th>
<th>Number of Days Discount is Available</th>
<th>Otherwise, Net (or All) is Due</th>
<th>Credit Period</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash Discounts</td>
<td>2/10, n/30: 2% discount if paid within 10 days, gross amount due in 30 days. （隱含利率=2/98×365/20=37.25%）</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable: Recording Cash Discounts</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

- There are two methods: Gross and Net
  - Gross method records discounts when taken by customers.
  - Net method records discounts not taken by customers.

Accounts Receivable: Recording Cash Discounts

- 2/10, E.O.M.: 2% discount if paid within 10 days following the end of the month.

<table>
<thead>
<tr>
<th>Gross Method</th>
<th>NET method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Record revenue at gross amount of sales</td>
<td>Record revenue at gross amount of sales less cash discount</td>
</tr>
<tr>
<td>When customer takes the discount, record cash discounts</td>
<td>When customer forfeits discount, record discounts not taken.</td>
</tr>
<tr>
<td>Cash discounts reduce gross sales revenue</td>
<td>Report discounts forfeited as other revenue</td>
</tr>
</tbody>
</table>

Accounts Receivable: Recognition

- Cash Discounts are used to . . .
  - Increase sales.
  - Encourage early payment by customers.
  - Increase the likelihood of collections of accounts receivable.

Gross Method

- Record sales at the gross amount
- Record sales discounts when taken
- Make year end estimate of amount of discounts expected to be taken

Adjusting entry:
Sales discounts
Allowance for sales discounts
### Recording sales discounts

**The gross method**

- Assume a $100 sale, terms 2/10, n/30
- The sale is recorded:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>100</td>
</tr>
<tr>
<td>Sales</td>
<td>100</td>
</tr>
</tbody>
</table>

**If paid within 10 days:**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>98</td>
</tr>
<tr>
<td>Sales Discounts</td>
<td>2</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>100</td>
</tr>
</tbody>
</table>

A contra-account to Sales Revenue

- Will not disclose that discount was taken

**If paid after 10 days:**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>100</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>100</td>
</tr>
</tbody>
</table>

**Net Method**

- Record sales net of cash discounts
- Record discounts not taken (similar to interest income)
- Make year end adjustment for accounts that are past the discount period

Adjusting entry:

ACCOUNTS RECEIVABLE
SALES

**The net method**

- Assume a $100 sale, terms 2/10, n/30
- The sale is recorded:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>98</td>
</tr>
<tr>
<td>Sales</td>
<td>98</td>
</tr>
</tbody>
</table>

**If paid within 10 days:**

<table>
<thead>
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<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>98</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>98</td>
</tr>
</tbody>
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Will not disclose that discount was taken

**If paid after 10 days:**

<table>
<thead>
<tr>
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<th>Credit</th>
</tr>
</thead>
<tbody>
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<td>Cash</td>
<td>100</td>
</tr>
<tr>
<td>Sales Discounts</td>
<td>2</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>98</td>
</tr>
</tbody>
</table>

Report as miscellaneous revenue
Recording sales discounts
The allowance method

• Assume a $100 sale, terms 2/10, n/30
• The sale is recorded:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>100</td>
</tr>
<tr>
<td>Sales</td>
<td>98</td>
</tr>
<tr>
<td>Allowance for Sales</td>
<td>2</td>
</tr>
<tr>
<td>Discounts</td>
<td></td>
</tr>
</tbody>
</table>

02/11/25
Wei-heng Lin at Department of Accounting, CYCU

Recording sales discounts
The allowance method

If paid within 10 days:

<table>
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<th>Credit</th>
</tr>
</thead>
<tbody>
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<td>Cash</td>
<td>98</td>
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<tr>
<td>Allowance for Sales</td>
<td>2</td>
</tr>
<tr>
<td>Discounts</td>
<td></td>
</tr>
<tr>
<td>Accounts Receivable</td>
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Will not disclose that discount was taken

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Recording sales discounts
The allowance method

If paid after 10 days:

<table>
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<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash</td>
<td>100</td>
</tr>
<tr>
<td>Allowance for Sales</td>
<td>2</td>
</tr>
<tr>
<td>Discounts</td>
<td></td>
</tr>
<tr>
<td>Sales Discounts</td>
<td></td>
</tr>
<tr>
<td>Forfeited</td>
<td>2</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>100</td>
</tr>
</tbody>
</table>

Report as miscellaneous revenue

02/11/25
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Sales Returns and Allowances

• The right of return is frequently given as part of a company’s overall marketing plan.
• An allowance may be given for damaged merchandise.
• Returned and damaged merchandise is tracked separately in an account called “Sales Returns and Allowances.”

Sales Returns and Allowances

Sales Returns
Sales Allowance

Merchandise returned by a customer to a supplier.
A reduction in the cost of defective merchandise.

On June 1, a customer of LarCo returns $750 of merchandise that was damaged. LarCo uses the periodic method to account for inventory.

Record the journal entry for the return of merchandise.

Sales Returns and Allowances

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Post. Ref.</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Jun 1</td>
<td>Sales Returns and Allowances</td>
<td>750</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable</td>
<td></td>
<td>750</td>
<td></td>
</tr>
</tbody>
</table>

Sales Returns and Allowances is a contra account that reduces Sales Revenue in the current accounting period.

Theory

• Discount are more like interest
• If so, the Gross Method
  a. Overstates Sales
  b. Understates Interest Income
• Defense for use of the Gross Method
  a. Materiality
Valuation of Accounts Receivable

- Short term receivables are reported at their net realizable value (NRV)
- The NRV is the net amount expected to be collected
- The NRV is gross accounts receivable less estimated uncollectible accounts.

Bad Debts

If you do business on credit, the question is not “whether” but “how much”

Some people cannot or will not pay their bills

You know that they are out there

You just don’t know who they are

Allowance Method

<table>
<thead>
<tr>
<th>Year end</th>
<th>Actual bad debts are</th>
<th>Uncollectible accounts are estimated</th>
<th>adjusting entry</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales occur</td>
<td>are written-off</td>
<td>Estimated -</td>
<td>adjustment</td>
</tr>
</tbody>
</table>

Uncollectible Accounts Receivable

Most businesses record an estimate of the bad debt expense by an adjusting entry at the end of the accounting period.

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 31</td>
<td>Bad Debt Expense</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Allowance for Uncollectible Accounts</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Estimating uncollectible receivables

Methods

- Direct Write-Off
- Allowance

1. Not based on the matching principle
2. Based on the matching principle
3. Accounts are written off when determined uncollectible
4. Estimated bad debts are matched against revenue
5. Must be followed if amounts are material

Methods of estimating the year-end adjusting entry for bad debts

(A) Percentage of Sales (Income Statement Approach)

Year-end adjusting entry = Year-end Sales x Percentage x Credit sales

(B) Percentage of Receivables (Balance Sheet Approach)

First Step: | Balance in Allowance Accounts | = | Percentage x Credit sales |

Second Step: | Beginning balance in Allowance Accounts | = | Estimated bad debts |

Uncollectible Accounts Receivable

<table>
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<th>Date</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 31</td>
<td>Allowance for Uncollectible Accounts</td>
<td>-</td>
<td></td>
</tr>
</tbody>
</table>

Comparison of Methods for Estimating Uncollectibles

- Percentage-of-Sales Method
- Percentage-of-Receivables Method
- Balance Sheet Approach
Allowance for Uncollectible Accounts

\[ \text{Net Realizable Value} = \frac{\text{Accounts Receivable}}{1 + \text{Estimated % of accounts not collectible}} \]

The net realizable value is the amount of the accounts receivable that the business expects to collect.

Uncollectible Accounts

As accounts become uncollectible, the following entry is made:

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<tr>
<td></td>
<td>Allowance for Doubtful Accounts</td>
<td>Accounts Receivable</td>
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So what happens if someone pays after a write-off of the accounts receivable?

Direct Write-Off Method

If uncollectible accounts are immaterial, bad debts are simply recorded as they occur (without the use of an allowance account).

Estimating uncollectible accounts: the Allowance method

- The estimate of uncollectible accounts may be based on:
  1. either sales (or net sales) or
  2. accounts receivable balance end of year
- These approaches are referred to as Income statement and Balance sheet approaches

Allowance Method

- Reflects probable cost of uncollectible accounts
- Approaches
  - Income Statement Approach
    - % of credit sales
  - Balance Sheet Approach
    - % of accounts receivable
    - Aging accounts receivable

Collection of Previously Written-Off Accounts

When a customer makes a payment after an account has been written off, two journal entries are required.

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<td>Accounts Receivable</td>
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**Income Statement Approach**
- Consistent with Matching Concept
  † Emphasis on matching credit sales with associated bad debts
- Bad Debt Expense = % of net credit sales
- Expense measured directly
- Balance sheet (Allowance Account) is adjusted to accommodate income statement measurement
- Does not necessarily result in NRV in balance sheet

**Balance Sheet Approaches**
- Determine the balance in the Allowance account directly as
  † % of accounts receivable or by aging
- Income statement is adjusted to accommodate balance sheet adjustment
- Emphasis is not on matching bad debt expense with sales

**Aging of Accounts Receivable**
- Instead of using a single composite rate, we can develop different rates depending upon the length of time the account is past due.
- The more days past due, the higher the rate of uncollectible receivable.

**Marshall Co Reported**
- Sales 500,000 (70% = credit sales)
- A/R 80,000 (beginning balance)
- Allowance 2,400 (beginning balance)
- Wrote Off 2,700
- Collections 320,000

**Assumption 1**
- Uncollectible accounts are typically 3% of net credit sales
  - Credit Sales (70% x 500,000) 350,000
  - Expected Uncollectible Sales 10,500
  - Expense 10,500

**Assumption 2**
- Uncollectible accounts are typically 3% of accounts receivable
- A/R ending balance?
  - Accounts Receivable
    - Beg Balance 80,000
    - Credit Sales 350,000
    - Written off 2,700
    - Collections 320,000
    - NRV 107,300

**Assumption 2**
- Uncollectible accounts are typically 3% of accounts receivable
  - A/R Ending Balance 107,300
  - Expected Uncollectible Accts 3,219
  - NRV 104,081
**Assumption 2**

- Uncollectible accounts are typically 3% of accounts receivable
- Allowance Balance?

<table>
<thead>
<tr>
<th>Allowance - Bad Debts</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Written off</td>
<td></td>
</tr>
<tr>
<td>2,700</td>
<td></td>
</tr>
<tr>
<td>2,400 Beg Balance</td>
<td></td>
</tr>
<tr>
<td>300</td>
<td></td>
</tr>
</tbody>
</table>

Desired Balance 3,219

**Assumption 3**

- Uncollectible accounts are typically 3% of net credit sales
- Expense = 3,519

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<tr>
<td>Written off</td>
<td></td>
</tr>
<tr>
<td>2,700</td>
<td>2,400 Beg Bal</td>
</tr>
<tr>
<td>300</td>
<td>3,519 Adjustment</td>
</tr>
</tbody>
</table>

Desired Balance 3,219

**Account write-offs do not reduce total assets!**

- Assume $10,000 of Accts. Receivable and a $1,000 Allowance for Bad Debts
- Net collectible receivables are $9,000

| Accounts Receivable | 10,000 |
| Less: Allow - Bad Debts | 1,000 |
| Net receivables | 9,000 |

**Assumption 3**

- Uncollectible accounts are typically 3% of A/R over 30 days & 1% all others
- $14,000 is over 30 days

<table>
<thead>
<tr>
<th>A/ R Ending Bal</th>
<th>&gt; 30 days</th>
<th>all others</th>
</tr>
</thead>
<tbody>
<tr>
<td>% uncollectible</td>
<td>3%</td>
<td>1%</td>
</tr>
<tr>
<td>$ Uncollectible</td>
<td>420</td>
<td>933</td>
</tr>
<tr>
<td></td>
<td>= 1,353</td>
<td></td>
</tr>
</tbody>
</table>

**Account for Bad Debts**

- Assume we write off a $100 account
- The entry to write off the account is

| Allowance for Bad Debts | 100 |
| Account Receivable | 100 |
| Accts. Rec. | 10,000 |
| Allow - Bad Debts | 1,000 |
Now assume we write off a $100 account
The entry to write off the account is

\[
\begin{align*}
\text{Allowance for Bad Debts} & \quad 100 \\
\text{Account Receivable} & \quad 100
\end{align*}
\]

Posting the entry has this result

\[
\begin{array}{c|c|c}
\text{Accts. Rec.} & \text{Allow - Bad Debts} & \\
10,000 & 100 & 9,900 \\
9,900 & 1,000 & 900
\end{array}
\]

Note that net collectible receivables are

\[
\begin{align*}
\text{Accounts receivable} & \quad \$ 9,900 \\
\text{Less: Allow - Bad Debts} & \quad 900 \\
\text{Net receivables} & \quad \$ 9,000
\end{align*}
\]

BEFORE = $9,000
AFTER = $9,000

A tempting simpler approach is the direct write off method

Assume that we have $10,000 of accounts receivable--$9,000 of good accounts and $1,000 from Skip Towne

\[
\begin{align*}
\text{Bad Debt Expense} & \quad 1,000 \\
\text{A/R - Skip Towne} & \quad 1,000
\end{align*}
\]

Unfortunately, this often leads to a mismatch between costs and revenues.

We must wait until we know the account is uncollectible before we take action

Defects with the Direct Write-off Method

The potential mismatch of costs and revenues
Tendency to overstate assets and income by waiting until customers have already failed to pay in order to "bite the bullet"
For these reasons, the direct write-off method is not considered GAAP

Balance Sheet Representation

Short term accounts receivable are shown at their net realizable value as follows:

\[
\begin{align*}
\text{Accounts Receivable (gross)} & \quad \text{\$ XXX} \\
\text{less: Allowance} & \quad \text{\$ (XX)} \\
\text{Net Realizable Value} & \quad \text{\$ XX}
\end{align*}
\]

Net Realizable Value

Amount expected to be realized (collected)
Gross Accounts Receivable, net of

\[
\begin{align*}
\text{á Expected returns & allowances} \\
\text{á Cash discounts expected to be taken} \\
\text{á Expected uncollectible amounts}
\end{align*}
\]

Special Allowance Account

Sales returns and allowances

\[
\begin{align*}
\text{Sales Returns and Allowances} & \quad \text{\$ \ldots xxx} \\
\text{Allowance for Sales Returns} & \quad \text{\ldots \ldots xxx}
\end{align*}
\]

Sales returns and allowances are reported as an offset to Sales Revenue in the income statement.

Allowance for sales returns and allowances is an asset valuation account and is deducted from total Accounts Receivable.

Sales returns and allowances

\[
\begin{align*}
\text{Sales Returns and Allowances} & \quad \text{\$ \ldots xxx} \\
\text{Allowance for Sales Returns} & \quad \text{\ldots \ldots xxx}
\end{align*}
\]

Special Allowance Account

Collecting Expense

\[
\begin{align*}
\text{Collecting Expense} & \quad \text{\$ \ldots xxx} \\
\text{Allowance for Collecting Expense} & \quad \text{\ldots \ldots xxx}
\end{align*}
\]

Collecting Expense

\[
\begin{align*}
\text{Collecting Expense} & \quad \text{\$ \ldots xxx} \\
\text{Allowance for Collecting Expense} & \quad \text{\ldots \ldots xxx}
\end{align*}
\]
Part 3: Notes Receivable

Notes Receivable

- Formal, unconditional written promises to pay a definite amount of money...
- To pay the bearer or stated payee. (Negotiable)
- Provide legal evidence of debt
- Usually interest bearing, but may be noninterest bearing
- Should be valued at present value of future cash inflows

Notes Receivable: Issues

- Plus a stated interest rate...
  - The note does not have to include a stated interest rate. If there is not a stated rate, there is an implicit or imputed rate.
- On the maturity date...
  - On demand, a specific date, or at the end of a stated period.

Notes Receivable—Recognition Issues

- Termination:
  - maker (發票人) vs. payee (受款人)
  - face value/face amount (面額)
  - interest-bearing notes (附息票據) vs. zero-interest-bearing notes (未附息票據)
  - stated interest rate/face rate/coupon rate (票面利率) vs. effective interest rate/market rate/effective yield (有效利率/市場利率)
Simple Interest Note

Example: Issues at par

On November 1, 19X8, Winn, Inc. loans $25,000 to Westward, Co. The note bears interest at 12% and is due on November 1, 19X9.

Prepare the journal entry on November 1, 19X8, December 31, 19X8 (year-end) and November 1, 19X9.

Date | Description | Debit | Credit
--- | --- | --- | ---
Nov 1 | Notes Receivable | 25,000 | Cash 25,000
Dec 31 | Interest Receivable | 500 | Interest Revenue 500

Post.

Ref.

Discount on Notes Receivable is reported on the balance sheet as a contra-asset account to Notes Receivable. Assume interest is paid in advance.

Date | Description | Debit | Credit
--- | --- | --- | ---
Nov 1 | Cash | 25,000 | Note Receivable 25,000

$25,000 x 12% = $3,000 - $500 = $2,500

Notes Receivable

Example: Issues not at par

Different Market and Stated Rates

- Requires present value computations.
- Use the stated rate of interest to determine the annuity cash flow.
- Use the market rate of interest to determine the present value of the face amount and interest annuity of the note.

Cash 25,000

Notes Receivable

Example: Issues not at par

Different Market and Stated Rates

- Requires present value computations.
- Use the stated rate of interest to determine the annuity cash flow.
- Use the market rate of interest to determine the present value of the face amount and interest annuity of the note.

Cash 25,000
Recognition of Notes Receivable

**Issues NOT at face value**

**Non interest bearing**
1. Determine discount on notes receivable at the implicit rate of interest.
2. The discount is amortized to interest revenue by the effective interest method.

**Interest bearing**
1. Determine discount on notes receivable at the effective rate of interest.
2. The discount is amortized to interest revenue by the effective interest method.

Different Rates

Example: Issues not at par

On December 1, WayCo, Inc. sold a specialized piece of equipment receiving $5,000 cash and a $50,000 note receivable due in three years. The note has a stated interest rate of 4% and the market rate of interest for a similar note is 10%. Interest payments are made annually.

Prepare the entries to record the sale on December 1, and the adjusting entry required on December 31.

Annual interest receipt (4% x $50,000) = $2,000
Present value of annuity, n = 3, i = 10% = 2.48685, $4,974
Face amount of note = $50,000
Present value of $1, n = 3, i = 10% = 0.75131, $37,566
Present value of note = $42,540
Cash received = $5,000
Amount of the sale = $47,540

**Note Amortization Schedule**

<table>
<thead>
<tr>
<th>Payment</th>
<th>Interest</th>
<th>Interest Amortization</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>$2,000</td>
<td>$4,254</td>
</tr>
<tr>
<td>2</td>
<td>$2,000</td>
<td>$4,749</td>
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票據認列之特殊問題

1. 給付現金取得票據與權利
   u 給付之現金與票據現值之差額為取得權利之價值
   u 票據面額與現值之差額為票據之折溢價
   u 票據之折溢價於票據存在期間按利息法攤銷
   u 權利之價值按受益期間（或按已享受權利之比例）攤銷

2. 因移轉非現金資產、商品或勞務而取得票據
   u 以所移轉之物的現金價值或所收到票據之現值二者中較易客觀決定者為入帳之依據。
   u 若公平利率已知，則依票據之現值決定移轉之物之價值（並確認損益）。
   u 若移轉之物之價值已知，則依其值決定票據之現值，並據以推算公平利率。

3. 若公平利率與所移轉之物之價值均不可得
   u 應於收到票據時，依票據之限制、支付條件、有無抵押品及當時之prime rate（基本放款利率），決定票據之隱含利率（Imputed Interest Rate）。
   u 依隱含利率計算票據之現值，據以入帳

Note receivable with interest rates lower than current market rate

- Effective interest rate is assigned to note
- Determine whether fair market value (FMV) of assets surrendered is known or unknown
- If FMV is known, use as present value of note
- If FMV not known, use current rate for borrower or rate on other similar loans

Note with low interest rate assumptions--FMV known

- Three-year, noninterest bearing note dated 12-31-95
- Face value $10,000
- Exchanged for land which originally cost $5,000 with a fair market value of $7,120
- Discount rate for note is 12 percent ($7,120 is the present value of $10,000 to be received in 3 years at 12 percent)
- Discount must be amortized over life of note

Note with low interest rate entries--FMV known

- On 12-31-95
  Note Receivable 10,000
  Discount on Note Rec. 2,880
  Land 5,000
  Gain on Sale of Land 2,120
- On 12-31-96 (rounded to nearest dollar)
  Discount on Note Rec. 854
  Interest Revenue 854

Note with low interest rate entries--FMV unknown

- On 12-31-97
  Discount on Note Rec. 957
  Interest Revenue 957
- On 12-31-98 (maturity)
  Discount on Note Rec. 1,069
  Interest Revenue 1,069
  Cash 10,000
  Note Receivable 10,000

Note with low interest rate assumptions--FMV unknown

- Three-year note dated 12-31-95
- Face value $5,000
- Stated interest rate 12 percent
- Exchanged for land which cost $2,000 with unknown fair market value
- Incremental interest rate for borrower is 15 percent
- Present value of note at 15 percent is $4,658 (based on PV of principal and interest)
Note with low interest rate entries-
-FMV unknown

- On 12-31-95
  Note Receivable 5,000
  Land 2,000
  Discount on Note Rec. 342
  Gain on Sale of Land 2,658

- "Discount" based on difference between PV of note and $5,000 face amount
- "Gain" based on difference between PV of note and cost of Land

Notes Receivable-Valuation Issues

- Short-term notes receivable are reported at their net realizable value, i.e., face amount less all allowances.
- Long-term notes receivable are reported at face amount adjusted for unamortized discount or premium.

Factoring

FASB Statement No. 125 states that a company records transfer of financial assets (e.g., accounts receivable) in which it surrenders control over the financial assets to another company as a sale when all the following conditions are met:
1. The transferred assets have been isolated from the transferor.
2. The transferee obtains the right to exchange.
3. The transferor does not maintain effective control over the transferred assets through an agreement that entitles and obliges the transferor to repurchase the transferred assets before their maturity.

FAS 125

1. 应收帐款（或其他金融资产）從企業隔離出來，企業無法再接觸該應收帳款，即使企業破產清算，其債權人亦無法對該應收帳款主張任何權利。
2. 受讓之銀行或金融公司有權將該應收帳款再出售或質押。
3. 企業無權再買回該應收帳款。

Accounts Receivables Financing Agreements

Part 4:
Disposition of Accounts and Notes Receivable
Receivables can be used as an immediate source of cash

- **Assigning** accounts receivable means using them as collateral for a loan
- **Factoring** accounts receivable means selling them
  - Factoring can be with recourse or without recourse
  - Recourse refers to ultimate responsibility for payment
  - Factoring with recourse -- to be recognized as a loan...
  - If the transaction fails to meet the three conditions necessary to be classified as a sale, the agreement will be treated as a loan.

Using A/R as collateral for a Loan

| C Pledging A/R | No effect on A/R accounting |
| Assigning A/R | A/R Assigned replaces A/R |
|               | Assignor typically collects A/R |
|               | Factoring with recourse |
|               | Liability - offset to A/R |
|               | Factor typically collects A/R |

Secured Borrowing (highlights)

- Transferor records a finance charge.
- Transferor collects accounts receivable.
- Transferor records sales returns and sales discounts.
- Transferor absorbs bad debts expense.
- Transferor records interest expense on notes payable.
- Transferor pays on the note periodically from collections.

Assigning Accounts Receivable

- Merely a promise by the borrower (owner of receivables) that any failure to repay debt will result in proceeds from accounts receivable collections being used to repay the debt.
- Reclassify Accounts Receivable as Accounts Receivable Assigned: 債款人將特定應收款項重分類為設定期担保後應收帳款 (或以附註說明 A/R Assigned之部分)
  - 設定期擔保後應收帳款中剩餘之權益 Equity in Assigned Accounts Receivable 應予揭露 (以附註說明於流動資產項目下以 Assigned A/R減列示其淨額)

Assignment of receivables assumptions

- $100,000 of accounts assigned
- Used as collateral for an $80,000 loan
- Fee of $1,200 paid at initiation

Assignment of receivables entries

| Cash              | 78,800 |
| Financing Expense | 1,200  |
| Note Payable      | 80,000 |
| Accts. Receivable | 100,000|

Assignment of receivables entries

1. Assume $60,000 of assigned accts. collected in April, half subject to a 2% sales discount
2. Sales returns are $1,000
3. $58,400 remitted to lender

Cash 58,400
Sales Returns & Allow. 1,000
Sales Discounts 600
Accts. Rec. Assigned 60,000
Interest Expense 789
Note Payable 57,611

Cash 58,400

Assignment of receivables entries

1. Assume $30,000 of assigned accts. collected in May
2. No discounts or returns
3. Note repaid at end of month

Cash 30,000
Accts. Rec. Assigned 30,000
Interest Expense 228
Note Payable 22,389
Cash 22,617

Accounts Receivable 10,000
Accts. Rec. Assigned 10,000
Factoring Accounts Receivable

1. Merchandise
2. Accounts Receivable
3. Accounts Receivable
4. Cash
5. Cash

Transferor (Supplier)→ Factoring (Transferee)→ Retailer (Transferor)

Sale of Receivables

- Transferor transfers ownership of receivables to factor.
- Factor records the (transferred) accounts as assets in its books.
- Transferor records any amount retained by transferee as "due from factor"
- Transferor records loss on sale of receivables
- Transferor records any component liability (when appropriate)

Factoring without recourse

- An ordinary sale of receivables to the factor.
- Control of receivable passes to the factor.
- Receivables are removed from our books, cash is received and a financing expense or loss is recognized.

Factoring without recourse assumptions

- $100,000 of accounts factored by Olin (seller) to Financo (factor)
- Without recourse
- Finance charge is 15 %
- An additional 10 % withheld for returns, etc.

Olin (seller) books

<table>
<thead>
<tr>
<th>Cash</th>
<th>75,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Loss on Sale of Rec.</td>
<td>15,000</td>
</tr>
<tr>
<td>Receivable from Factor</td>
<td>10,000</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>100,000</td>
</tr>
</tbody>
</table>

Financo (factor) books

| Accounts Receivable   | 100,000|
| Payable to Olin       | 10,000 |
| Factoring Revenue     | 15,000 |
| Cash                  | 75,000 |

Additional factoring assumptions

- Accounts collected except for
  - $3,000 uncollectible
  - and $1,000 sales discounts taken
- Sales returns & allowances on factored accounts are $2,000

Selling Accounts Receivable

- Sell without recourse to an investor
- Factor without recourse
- Accounting Approach:
  - Record cash receipt
  - Remove BV of receivables
  - Recognize Gain (Loss) on sale
Factoring Accounts Receivable

- Factoring with recourse
  - An ordinary sale of receivables to the factor. (financial components approach)
  - Control of receivable passes to the factor.
  - Receivables are removed from our books, cash is received and a financing expense or loss is recognized.

Financial Components Approach

- 适用时机：
  移转出售金融资产时，若移转人同时获得其他资产（例如应收权益资产）及发生其他负债（例如追索权负债及收账损失负债）
- 方法：
  移转出售之金融资产、获得之其他资产及发生之负债均按公平价值入账，并确认移转出售资产之损益。

Exercise

• YOUR Co has A/R of $10,000
• YOUR Co accepts N/R for $10,500 due in 6 months
• After 3 months, you sell the note.
• When the Market rate of interest = 12%

Interest earned so far?

500*3/6 = 250
• YOUR Co has A/R of $10,000
• YOUR Co accepts N/R for $10,500 due in 6 months
• After 3 months, you sell the note.
• When the Market rate of interest = 12%

**Book value of note?**

| Face Value | 10,500 |
| Unamort Disc | (250) |
| Book Value | 10,250 |

**Fair value of note?**

\[
10,500 \times PV_{.12,3} = 10,500 \times 0.9709 = 10,194.45
\]

**Gain or loss on sale?**

| Book Value | 10,250.00 |
| Fair Value | 10,194.45 |
| Loss on Sale | 55.55 |

**Record interest earned**

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Discount on N/R</td>
<td>250</td>
</tr>
<tr>
<td>Interest Revenue</td>
<td>250</td>
</tr>
</tbody>
</table>

**Discounting N/R**

• Selling note (usually to Bank) @ a discount
• Discount = Interest earned by purchaser
• Typically with recourse
  a Seller has contingent liability

**Discounting note receivable assumptions**

• $1,000, six month note dated 3-1-95
• Face interest rate 10 percent
• Discounted on 7-1-95
• Discount rate 12 percent
• Time to maturity (discount period) is two months
• Discounted without recourse

**Discount calculations**

| Interest = $1,000 \times .10 \times 6/12 = $50 |
| Maturity Value = $1,000 + $50 = $1,050 |
| Discount = $1,050 \times .12 \times 2/12 = $21 |
| Proceeds = $1,050 - $21 = $1,029 |

Note value at discount date
| Interest = $1,000 \times .10 \times 4/12 = $33 |
| Value = $1,000 + $33 = $1,033 |
Entry to record discounting of note

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1, 1995</td>
<td>Cash</td>
<td>1,029</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Loss on Sale of Note Rec.</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Note Receivable</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest Revenue</td>
<td>33</td>
<td></td>
</tr>
</tbody>
</table>

Interest Revenue is interest earned to date. Loss on Sale is difference between Proceeds and value of note at date of sale.

Same note discounted with recourse

• The bad news here is that if the original maker of the note defaults when the note is due...

• The bank or finance company will hold the party discounting the note responsible for payment.

Entry to record discounting of note with recourse

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>July 1, 1995</td>
<td>Cash</td>
<td>1,029</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest Expense</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Note Receivable Discounted</td>
<td>1,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Interest Revenue</td>
<td>33</td>
<td></td>
</tr>
</tbody>
</table>

"Note Receivable Discounted" is a contra-account to "Note Receivable". "Interest Expense" debited instead of "Loss on Sale of Note".

Discounter entries at note maturity

Original maker pays

Note Receivable Discounted 1,000
Note Receivable 1,000
Entry removes the two accounts no longer needed from the books.

Discounter entries at note maturity

Original maker defaults

Bank charges $20 protest fee

Note Receivable Discounted 1,000
Note Receivable 1,000
Rec. from Dishonored Note 1,070
Cash 1,070

"Receivable from Dishonored Note" reflects effort to collect from original maker. Payment is maturity value of $1,050 plus $20 protest fee.

Discounting Notes Receivable

• Note is sold to a financial institution.

• Discount fee is the discount rate times the maturity value of the note for the time remaining to maturity.

• Maker of the note pays the financial institution at maturity.

Discounting Notes Example

On May 30, Apex discounts a customer's $25,000 note at the bank. The note was dated May 1 and matures in 90 days. The note bears interest at 12% and the bank charges a discount of 15% on the maturity value of the note.

Prepare the journal entry to record the discounting of the note.

Discounting Notes Example

<table>
<thead>
<tr>
<th>Principal amount of note</th>
<th>$25,000.00</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest to maturity, i = 12% n = 90 days</td>
<td>750.00</td>
</tr>
<tr>
<td>Maturity value of the note</td>
<td>25,750.00</td>
</tr>
<tr>
<td>Discount fee, i = 15% n = 60 days</td>
<td>(643.75)</td>
</tr>
<tr>
<td>Proceeds from sale</td>
<td>$25,106.25</td>
</tr>
</tbody>
</table>

GENERAL JOURNAL

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Date Description Post. Ref. Debit Credit
May 30 Cash 25,106.25
Notes Receivable 25,000.00
Interest Revenue 106.25
Discount Expense 643.75
Exercise

• YOUR Co has A/R of $10,000
• YOUR Co accepts N/R for $10,500 due in 6 months
• After 3 months, you discount the note at the bank.
• The discount rate is 11%

How much will the bank receive when the note matures?

$10,500

Discount Period?

3 months

Term of Note: 6 months

Amount of Discount

10,500*11%*3/12 = 28875

Rate the bank is earning?

10,211.25*R*3/12 = 28875

Debit

Discount on N/R 250

Interest Revenue 250

Credit

Cash 10,211

Discount on N/R 250

Loss on Discounting N/R 39

N/R 10,500

Does YOUR Company have a Liability?

• Yes
• Bank has recourse
• But, not probable that your customer will default on the note.  * Contingent Liability
• Treat as Sale
• Report contingent liability in footnotes
Dishonored Notes

- A note that is not renewed or collected at maturity is dishonored.
- Interest continues to accrue on the maturity value of the note.
- If the note cannot be collected, the amount of the loss depends upon whether it has already been considered in the bad debt estimation.

What do you do when the customer pays the bank?

- Nothing

Assume the customer defaults
The bank charges $20 fee

How much do you pay bank? 10,520

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>10,520</td>
<td></td>
</tr>
<tr>
<td>Cash</td>
<td></td>
<td>10,520</td>
</tr>
</tbody>
</table>

End of Chapter 7