LEARNING THE ACCOUNTING FOR ACCOUNTS RECEIVABLE AND BAD DEBTS:
AN INTERACTIVE APPROACH

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INTRODUCTION

Students are often confused by the impact and timing of recording transactions and events that affect the net realizable value of accounts receivable and bad debts. This instructional resource uses a comprehensive problem to illustrate an interactive approach of teaching/learning concepts related to accounting for accounts receivable and bad debts in a principles of financial accounting course.

The problem contains background information about a company followed by a set of transactions/events over two accounting periods. Students are asked to record them on a spreadsheet that accompanies the problem by preparing all accounting entries in T-account format for a complete accounting cycle. This process helps students learn and develop critical-thinking skills by addressing the issues of uncollectible accounts on credit sales, explaining the concept of net realizable value of accounts receivable, identifying the reasons that bad debts are estimated, analyzing the appropriateness of the bad debt estimation in a changing economy, and examining the differences between the income statement and balance sheet approaches in estimating bad debts.

A downloadable spreadsheet is provided for use in conjunction with class discussion of the problem, helping to facilitate an interactive and engaging presentation. A video clip for instructors is included to demonstrate the use of the interactive spreadsheet to show/hide the numbers (with built-in formula) for class discussion. A clip for students is also available as a tutorial or for after-class review. Click the links below for the teaching aids:

Worksheet/Solution   https://www.dropbox.com/s/ik8w5tul912jde7/AR_Worksheet.xlsx
Instructor video   http://www.youtube.com/watch?v=_lSVcULwUQg
Solution video   http://www.youtube.com/watch?v=it5OMnKr8gg

BACKGROUND

ABC Fashion Company (ABC hereafter) is a retailer that sells a wide variety of different articles of clothing, from shirts to shoes. ABC is owned by Andrew and Betty Carlton, whose passions are in clothing design and retail, but not accounting. ABC currently generates all of its revenue through credit sales. Also, the allowance method is applied to account for bad debts by using credit sales to estimate the amount of accounts receivable that likely will be uncollectible.

On March 1, you are hired to manage the accounts receivable. On your first day, Andrew Carlton greets you at the door and takes you to your office. He tells you that it is your responsibility to enter all of the transactions/events affecting accounts receivable, including adjusting and closing entries. As he is leaving, he starts mumbling additional information, and you barely have time to write it all down. Once he is gone you read your note, which contains the following information:

- $346,000 of retained earnings for ABC
- $300,000 in cash
- Total amount of $50,000 owed to them for prior sales
- The balance in their allowance for bad debts is $4,000

You look down at your desk and are pleasantly surprised to find that you have been given a spreadsheet with all the necessary accounts. During March, the following transactions and events occurred.

March Transactions/Events

3/5   ABC sells $120,000 worth of t-shirts to customers on credit.[1]
3/19   ABC receives $138,000 in cash from customers in payment for prior purchases.
3/22   You determine that the $7,000 balance owed by MC Jammer is uncollectible.
3/26   ABC sells $40,000 worth of hats to customers. No cash was received at the time the sales took place.
3/31   The end-of-period bad debt adjustment is made; based on the company's policy, the adjustment is estimated to be 5% of sales for the period.

Requirements (March): The ABC owners approach you at the end of the month with a list of questions they want answered.

1. How are the journal entries recorded in the spreadsheet for March?
2. What is both the gross amount and the net realizable value of accounts receivable (NRV) for ABC at the end of the month? Which of these two amounts is likely to be received in cash, and why?
3. Why is an estimated amount recorded for bad debt expense instead of an actual amount?
4. For the transactions that you recorded in March, which accounts would be closed at the end of the month? Why are those accounts closed and the other accounts are not? What are the necessary closing entries?
5. Does ABC use the balance sheet approach or the income statement approach in estimating bad debt expense, and what is the difference between these methods?

April Transactions/Events:

4/3   You conclude that $4,000 owed by David Walker is uncollectible.
4/5   ABC sells $110,000 worth of clothes to customers on credit.
4/21   ABC receives $90,000 from customers for previous sales made on credit.
4/23   The XYZ Co. account was previously written-off as uncollectible, but ABC unexpectedly receives a full payment of $3,000 from XYZ Co.
4/27   ABC sells $10,000 of shirts to Big Ben Clothing on credit.
4/28   You conclude that $21,000 owed by R. Logan is uncollectible.
4/30   The end-of-period bad debt adjustment is made, based again on 5% of sales for the period.

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[1] To focus on transactions that affect accounts receivable, the entry to record cost of sales and inventory is omitted.

Requirements (April): To understand the effects on the financial statements, ABC's owners ask even more questions of you at the end of April.

1. What is the beginning balance for each account on April 1st? Why do some accounts have a balance and others do not?
2. What are the required journal entries for April, and what are the ending balances in each account?
3. Based on the NRV of accounts receivable immediately before and after the transaction on April 3rd, how is the NRV affected by the write-off?
4. What are both the purpose and the effects of the entries for the April 23rd transaction?
5. What is the NRV of accounts receivable on April 30th (after adjustments)? Is this likely to occur?
6. What does the debit balance in the allowance for bad debts account indicate?
7. Does the percentage of sales rate being used to estimate bad debts appear appropriate? If you believe it is not appropriate, propose a new rate and justify your suggestion.
8. If a new rate is implemented, what effect will this change have on prior financial statements?
9. The income statement approach was used to estimate bad debts, and it resulted in a debit balance for the allowance account in the month of April. If the balance sheet approach was used for the bad debt adjustment, could that method have resulted in a debit balance for the allowance account at the end of the period?

LEARNING OBJECTIVES AND IMPLEMENTATION GUIDANCE

Overview

There has been much discussion in recent years about the need for instructors to move beyond sole reliance on the traditional lecture-based approach to accounting education and to employ pedagogical strategies so students become active and engaged learners (see Albrecht and Sack, 2000 and AAHE, 1998 for examples). We agree with that refrain, and have thus attempted to enhance student engagement and understanding related to the accounts receivable cycle, an area identified by the authors as one causing significant challenges and difficulties for students in an introductory financial accounting course. To meet this end, we created this instructional material, which is presented in the form of a comprehensive problem related to accounts receivable.

An interactive spreadsheet is designed as a tool to aid in the learning for introductory accounting students. Each row corresponds to a specific transaction, ordered chronologically as presented in the problem. The first column provides the details for each event/transaction that occurs, and the next column provides the specific amount for the transaction. This reference column allows instructors to customize the transactions, as all entries are linked with formulas to the proper reference column amount so dollar amounts can be easily changed by the instructor for illustrative purposes. Also, all the calculations throughout the spreadsheet (for net realizable value and the ending account balances) are built in with formulas that will auto-fill upon changing numbers in the reference column as shown in Exhibit 2. The rest of the columns are T-accounts for each respective account affected in the events that occur throughout the problem. This design allows students to utilize T-accounts and also visually see the specific debit and credit entries that correspond to each transaction.

After recording the transactions in the T-accounts, students are asked to complete a list of requirements that will involve quantitative and qualitative analyses of that month's transactions. Specifically, students are required to perform calculations and provide written explanations to questions related to accounting for accounts receivable and bad debts. These requirements expound upon the learning objectives identified in this problem, as described below.

Learning Objectives

Although this problem was developed for use in introductory level financial accounting courses, it can be utilized as a study tool for any level of accounting student. The overall objective of the problem is to enhance student learning related to accounting for accounts receivable through use of a comprehensive example of the entire accounts receivable cycle. This is done by providing students with a scenario that involves several accounts receivable transactions and a related spreadsheet to assist with their analyses. To support this overall objective, the following additional objectives of the problem are described below.

First, the problem can be used to teach concepts related to Net Realizable Value (NRV) on accounts receivable, which tend to be difficult for students just beginning in accounting. Students are required to determine NRV and analyze the effect different transactions have on it. Also, they can visually see on the spreadsheet how the transactions/events impact NRV.

Second, the problem allows students to critically analyze various issues related to the allowance for bad debts account. Several transactions impact the allowance account throughout this problem, and students are required to analyze the balance in that account, and interpret how it relates to accounts receivable and NRV.

Third, as a result of looking at two months of transactions, students can benefit by reviewing multiple steps in the accounting cycle since they are required to prepare adjusting entries for bad debts and related closing entries at the end of the period.[2] Thus, the problem also reinforces the difference between accounts on the balance sheet (i.e., permanent accounts) and the income statement (i.e., temporary accounts).

Fourth, the requirements at the end of each month are designed to reinforce each of the learning objectives mentioned previously, and they are intended to allow students to critically analyze the transactions and the related concepts. For example, students are asked to examine the differences between the income statement and balance sheet approaches for estimating bad debts. Also, they are required to evaluate the appropriateness of the percentage used in the bad debt estimate and propose a new rate, if appropriate. These requirements challenge students to think beyond simple identification of the correct debit and credit entries for a transaction.

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[2] Evaluating two months of data is particularly important in the area of bad debts to allow students critically examine the relationship between the previous period's bad debt estimate and the subsequent period's write-off, and the resultant balance in the allowance for bad debts account. In many principles of financial accounting textbooks, end-of-chapter problems related to this subject oftentimes provide data over one period only. We believe that examining two periods provides students with a better understanding of the entire accounts receivable cycle. Furthermore, the instructor can work with students on the first period, and then let students work on the second period on their own to evaluate the students' understanding of the concepts.

Implementation Guidance

Differences between March and April Transactions

The problem contains transactions that occur over a period of two months. The set of transactions for March are relatively easier than April. Depending on where each class is as a whole, the suggested method is to review the March transactions together as a class, engaging students in discussion over each transaction and the requirements. The instructor can then let the students attempt April's requirements on their own (either individually or in small groups). The March transactions will serve as a tool to guide them through the requirements for April. After the students have attempted the April transactions, the instructor can discuss the answers with them as a class.

Use during a Classroom Lecture

An appealing attribute of this exercise is that it allows the instructor to engage the students to critically think about each different event/transaction and evaluate how each account would be impacted. This approach should prove helpful for instructors in diagnosing areas or concepts about which students are struggling. When the instructor is satisfied with the discussion regarding that transaction, he/she can reveal the solution. This process can then be repeated throughout all of the transactions. The spreadsheet that accompanies the problem contains two worksheets – one for students to complete the problem and the other, which contains the transactions' solutions, for instructors. The interactive spreadsheets allow the instructor to customize them, and thus the problem, for their specific class needs.[3]

Use as a Self-study Aid

The problem can also be given to students as an individual assignment that can be completed on their own. After allowing students to work through it themselves, the instructor can provide them with the solutions to the transactions or direct students to watch the demo video. They can utilize this as a self-study aid that could serve as a valuable reference in preparing for an examination.

Classroom Experience

This problem has been used by two instructors in multiple sections of principles of financial accounting courses (both undergraduate and graduate) over the last two years. Since its use in the classroom, the instructors have observed apparent increased understanding of the related concepts by their students. These outcomes have been anecdotally perceived in both increased student participation and engagement during course lectures on the topic and improved performance on related examination questions. As stated above, it appears that the use of the spreadsheet provided with the problem materials enhances the classroom discussion and student understanding of the material.

The problem is relatively easy to implement and offers flexibility for the instructor to use in class as an illustrative problem to supplement a related lecture, as a stand-alone assignment, or

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[3] The authors use the spreadsheet to reveal the transactions' solution in class. We initially conceal the answer for each requirement/transaction (row) by having the answers in white font so they are not visible to the students. After class discussion related to the transaction, we change the font color for the row in question so the correct answer is revealed. We have found that this interactive approach to revealing the solutions appears to improve both class discussion and student engagement, thus enhancing the case's effectiveness as a teaching tool.

a combination of these two. The authors are able to cover this problem in its entirety in about thirty minutes of class time. However, instructors who assign this to students as a stand-alone assignment should anticipate it taking approximately one hour for students to complete on their own.

REFERENCES

Albrecht, W. S., and R. J. Sack. 2000. *Accounting Education: Charting the Course through a Perilous Future*. Accounting Education Series, Vol. 16. Sarasota, FL: American Accounting Association.

American Association for Higher Education. 1998. *Learning by Doing: Concepts and Models for Service-Learning in Accounting*. Washington, D.C.: AAHE.

TEACHING NOTES

Requirements (March):

1. This requirement is designed as a review of journalizing in the accounts receivable cycle. Students should be able to identify the proper debit and credit accounts for each event. See Exhibit 2 for the solution.

2. This requirement is designed to teach the students the concept and definition of Net Realizable Value (NRV) on accounts receivable. Students should note that NRV is the amount of accounts receivable that is likely to be realized (received) in cash. As indicated in the spreadsheet solution, students should compute a NRV for accounts receivable as of March 31st of $60,000, computed as follows:

NRV	=	Gross A/R (Debit balance)	–	Allowance (Credit balance)
$60,000	=	$65,000	–	$5,000

3. This requirement requires students to analyze why bad debts are estimated under the allowance method. The instructor can emphasize that the allowance method requires recognition of bad debt expense to apply the matching principle that underlies the preparation of the income statement. Specifically, if the sales revenue was recorded in one period, all related expenses, including bad debt expense, should be recorded in the same accounting period. The instructor could further elaborate about the importance of evaluating credit worthiness of customers and emphasize that companies are oftentimes willing to assume some level of risk of not getting paid (credit risk) because losses from bad debts could be more than offset by increased sales and profits on other credit sales that ultimately are realized in cash.

4. The objective of this requirement is to illustrate the difference between accounts on the income statement (temporary accounts) and accounts on the balance sheet (permanent accounts). The instructor could emphasize that since both sales and bad debt expense are found on the income statement, they both would be closed so the company can begin the following period with $0 balances for those accounts. The spreadsheet that accompanies this problem provides the closing entries in T-account form.

5. This requirement is designed to help students identify and understand the differences between the balance sheet and income statement approaches in accounting for bad debts under an allowance method. Since ABC estimates their bad debts expense using a percentage of credit sales, they use the income statement approach (i.e., they use one income statement account, sales, to estimate another income statement account, bad debt expense). If the balance sheet method was used, the company would use a percentage of accounts receivable to estimate the ending balance for the allowance for bad debts account (i.e., one balance sheet account, accounts receivable, is used to estimate the ending balance of another balance sheet account, allowance for bad debts). The instructor could also explain that companies using this approach oftentimes use different percentages for individual accounts receivable balances based on the age of those balances.

Requirements (April):

1. This requirement is designed to illustrate the effect of the previous period's closing entries on the current period's beginning account balances. It should be noted to students that only balance sheet accounts (i.e., permanent accounts) have opening balances, and that temporary accounts begin each period with $0 balances since they were closed at the end of the previous accounting period. See Exhibit 2 for the solution.

2. See Exhibit 2.

3. This requirement again addresses the concept of NRV and how it is impacted by the write-off of an account under the allowance method. The instructor can explain that writing off an account as uncollectible occurs after efforts to collect have failed. Under the allowance method, bad debt expense is **never** affected when an account is written off. In the related journal entry, the individual account receivable is taken off of the books through a credit entry, and the allowance account is debited. When thinking in terms of NRV, the amount likely to be received will not be affected by the April 3rd transaction since the debits and credits simply negate each other. The calculations are provided below, and the supporting numbers can be found in the spreadsheet that accompanies this problem.

	NRV	=	Gross A/R (Debit balance)	–	Allowance (Credit balance)
Before the April 3rd entry	$60,000	=	$65,000	–	$5,000
After the April 3rd entry	$60,000	=	$61,000	–	$1,000

4. There will be circumstances in which cash is collected on an account that was previously deemed to be uncollectible. In order to properly account for this situation, two entries typically are made. The first entry reverses the entry that was recorded when the account was previously written off, essentially re-instating the account back on the books as shown below.

Accounts receivable	XXX	
Allowance for bad debts		XXX

The second entry is accounted for the same way as any other receipt of cash on account. There are no income effects from this situation, as all affected accounts are assets or a contra asset. Also, total assets remain unchanged as a result of these entries.

Cash	XXX	
Accounts receivable		XXX

5. The supporting numbers in the spreadsheet indicate that the NRV of accounts receivable on April 30th is $81,000, computed as follows:

NRV	=	Gross A/R (Debit balance)	+	Allowance *(Debit balance)*
$81,000	=	$70,000	+	$11,000

8

This requirement is crucial to the learning objectives in this problem. It was developed to allow students to critically think about the concept of NRV, and if the NRV on April 30th makes practical sense. It is important to point out to students that the NRV is greater than the total balance of accounts receivable. This DOES NOT MAKE LOGICAL SENSE!!! It is illogical to believe that ABC will collect more than the current balance of accounts receivable. Another way of expressing this is that ABC will receive more than they expect to collect. This situation indicates that a new rate should be proposed. Determining an appropriate new rate is the objective of requirement #8.

6. Since it is a contra asset, one would expect the allowance for bad debts account to have a credit balance to offset accounts receivable. When there is a debit balance in the allowance account, it indicates that the <u>actual</u> amount of write-offs for uncollectible accounts was greater than the previous <u>estimate</u> for uncollectible accounts. This implies that both the allowance account and bad debt expense were <u>understated</u>, leading to an <u>overstated</u> NRV and net income, respectively.

7. This question relates to requirements #5 through #7 and builds on them by reinforcing the concept that the recorded amount for bad debt expense is based on an ESTIMATE. This question is designed to allow students to critically analyze if the current rate for estimating bad debts needs to be adjusted. Since the amount of write-offs in April exceeded the existing balance in the allowance for bad debts account, it would appear that ABC needs to increase their current estimated rate. In order to demonstrate to students how a new proposed rate can be determined, the instructor can propose that they take the amount written off as uncollectible in April, and divide it by the previous month's sales amount, as shown below.

> Proposed rate calculation:
>
> $\dfrac{\text{Amount written off in April}}{\text{Total credit sales in March}} \quad \dfrac{\$25,000}{\$160,000} = 16\%$

8. This question is designed to reinforce the fact that any change in an estimate (which would occur if a new rate is used) is treated <u>prospectively</u> and would not require any restatement of financial statements in prior periods. However, if the change in rate results in a material effect on the financial statements, disclosure of the change should be provided in the footnotes to the financial statements.

9. This question is designed for students to consider further the differences between the balance sheet and the income statement approaches. It requires them to think critically about the journal entry for bad debt expense and how it impacts the allowance for bad debts account. In the adjusting entry for bad debt expense, the accounts debited and credited would be the same under both the balance sheet and income statement methods, as shown below.

> Bad debt expense   XXX
>   Allowance for bad debts   XXX

The difference in the journal entries between the balance sheet and income statement approaches is simply the dollar amount in the adjusting entry and how that dollar amount is

determined. Students should note that under the balance sheet approach, it is the ending balance of the allowance for bad debts account that is determined, and that ending balance appears on the credit side of that account. Thus, it is impossible for that account to end the period with a debit balance using that approach. Unlike the balance sheet approach, the income statement approach does not take into account the existing balance in the allowance for bad debts account, thus making it possible for that account to end a period with a debit balance.

Exhibit 1: Worksheet

	AMOUNT	Cash dr	Cash cr	Accounts Receivable dr	Accounts Receivable cr	Allowance for Doubtful Accounts dr	Allowance for Doubtful Accounts cr	Sales dr	Sales cr	Bad Debts Expense dr	Bad Debts Expense cr	Retained Earnings dr	Retained Earnings cr
3/1 Beginning Balances		300,000		50,000			4,000		-0-	-0-			346,000
3/5 Credit sales ($X)	120,000												
3/19 Cash collections on A/R ($X)	138,000												
3/22 Customer account deemed uncollectible ($X)	7,000												
3/26 Credit sales ($X)	40,000												
3/31 Trial balances BEFORE adjustments													
3/31 AJE for bad debt expense (X% on credit sales)	5%												
3/31 Ending balances AFTER adjustment													
3/31 CLOSE Sales to Retained Earnings													
3/31 CLOSE Bad debts expense to Retained Earnings													
3/31 Ending balances after closing entries													

Net Realizable Value of A/R

	AMOUNT	Cash dr	Cash cr	Accounts Receivable dr	Accounts Receivable cr	Allowance for Doubtful Accounts dr	Allowance for Doubtful Accounts cr	Sales dr	Sales cr	Bad Debts Expense dr	Bad Debts Expense cr	Retained Earnings dr	Retained Earnings cr
4/1 Beginning Balances													
4/3 Customer account deemed uncollectible ($X)	4,000												
4/3 Balances AFTER A/R write-off													
Net Realizable Value or Accounts Receivable													
4/5 Credit sales ($X)	110,000												
4/21 Cash collections on A/R ($X)	90,000												
4/23 Cash received in payment of an account that was written off as worthless in a previous period ($X)													
4/27 Credit sales ($X)	10,000												
4/28 Customer account deemed uncollectible ($X)	21,000												
4/30 Trial balances BEFORE adjustments													
4/30 AJE for bad debt expense (X% on credit sales)	5%												
4/30 Ending balances AFTER adjustment													
Net Realizable Value of Accounts Receivable													

Exhibit 2: Solution

	AMOUNT	Cash dr	Cash cr	Accounts Receivable dr	Accounts Receivable cr	Allowance for Doubtful Accounts dr	Allowance for Doubtful Accounts cr	Sales dr	Sales cr	Bad Debts Expense dr	Bad Debts Expense cr	Retained Earnings dr	Retained Earnings cr
3/1 Beginning Balances		300,000		50,000			4,000		-0-	-0-			346,000
3/5 Credit sales ($X)	120,000			120,000					120,000				
3/19 Cash collections on A/R ($X)	138,000	138,000			138,000								
3/22 Customer account deemed uncollectible ($X)	7,000				7,000	7,000							
3/26 Credit sales ($X)	40,000			40,000					40,000				
3/31 Trial balances BEFORE adjustments		**438,000**		**65,000**		**3,000**			**160,000**	**-0-**			**346,000**
3/31 AJE for bad debt expense (X% on credit sales)	5%						8,000			8,000			
3/31 Ending balances AFTER adjustment		**438,000**		**65,000**			**5,000**		**160,000**	**8,000**			**346,000**
3/31 CLOSE Sales to Retained Earnings								160,000					160,000
3/31 CLOSE Bad debts expense to Retained Earnings											8,000	8,000	
3/31 Ending balances after closing entries		438,000		65,000			5,000		-0-	-0-			498,000

Net Realizable Value of A/R **60,000**

	AMOUNT	Cash dr	Cash cr	Accounts Receivable dr	Accounts Receivable cr	Allowance for Doubtful Accounts dr	Allowance for Doubtful Accounts cr	Sales dr	Sales cr	Bad Debts Expense dr	Bad Debts Expense cr	Retained Earnings dr	Retained Earnings cr
4/1 Beginning Balances		438,000		65,000			5,000		-0-	-0-			498,000
4/3 Customer account deemed uncollectible ($X)	4,000				4,000	4,000							
4/3 Balances AFTER A/R write-off				61,000			1,000						
Net Realizable Value or Accounts Receivable							**60,000**						
4/5 Credit sales ($X)	110,000			110,000					110,000				
4/21 Cash collections on A/R ($X)	90,000	90,000			90,000								
4/23 Cash received in payment of an account that was		3,000			3,000								
written off as worthless in a previous period ($X)	3,000	3,000		3,000			3,000						
4/27 Credit sales ($X)	10,000			10,000					10,000				
4/28 Customer account deemed uncollectible ($X)	21,000				21,000	21,000							
4/30 Trial balances BEFORE adjustments		**531,000**		**70,000**		**17,000**			**120,000**	**-0-**			**498,000**
4/30 AJE for bad debt expense (X% on credit sales)	5%						6,000			6,000			
4/30 Ending balances AFTER adjustment		**531,000**		**70,000**			**11,000**		**120,000**	**6,000**			**498,000**
Net Realizable Value of Accounts Receivable							**81,000**						

Exhibit 2: Solution

	AMOUNT	Cash dr	Cash cr	Accounts Receivable dr	Accounts Receivable cr	Allowance for Doubtful Accounts dr	Allowance for Doubtful Accounts cr	Sales dr	Sales cr	Bad Debts Expense dr	Bad Debts Expense cr	Retained Earnings dr	Retained Earnings cr
3/1 Beginning Balances		300,000		50,000			4,000		-0-	-0-			346,000
3/5 Credit sales ($X)	120,000			120,000					120,000				
3/19 Cash collections on A/R ($X)	138,000	138,000			138,000								
3/22 Customer account deemed uncollectible ($X)	7,000				7,000	7,000							
3/26 Credit sales ($X)	40,000			40,000					40,000				
3/31 Trial balances BEFORE adjustments		*438,000*		*65,000*			*3,000*		*160,000*	*-0-*			*346,000*
3/31 AJE for bad debt expense (X% on credit sales)	5%						8,000			8,000			
3/31 Ending balances AFTER adjustment		*438,000*		*65,000*			*5,000*		*160,000*	*8,000*			*346,000*
3/31 CLOSE Sales to Retained Earnings								160,000					160,000
3/31 CLOSE Bad debts expense to Retained Earnings											8,000	8,000	
3/31 Ending balances after closing entries		438,000		65,000			5,000		-0-	-0-			498,000

Net Realizable Value of A/R 60,000

	AMOUNT	Cash dr	Cash cr	Accounts Receivable dr	Accounts Receivable cr	Allowance for Doubtful Accounts dr	Allowance for Doubtful Accounts cr	Sales dr	Sales cr	Bad Debts Expense dr	Bad Debts Expense cr	Retained Earnings dr	Retained Earnings cr
4/1 Beginning Balances		438,000		65,000			5,000		-0-	-0-			498,000
4/3 Customer account deemed uncollectible ($X)	4,000				4,000	4,000							
4/3 Balances AFTER A/R write-off				61,000			1,000						
Net Realizable Value or Accounts Receivable							60,000						
4/5 Credit sales ($X)	110,000			110,000					110,000				
4/21 Cash collections on A/R ($X)	90,000	90,000			90,000								
4/23 Cash received in payment of an account that was written off as worthless in a previous period ($X)	3,000	3,000		3,000	3,000		3,000						
4/27 Credit sales ($X)	10,000			10,000					10,000				
4/28 Customer account deemed uncollectible ($X)	21,000				21,000	21,000							
4/30 Trial balances BEFORE adjustments		*531,000*		*70,000*			*17,000*		*120,000*	*-0-*			*498,000*
4/30 AJE for bad debt expense (X% on credit sales)	5%						6,000			6,000			
4/30 Ending balances AFTER adjustment		*531,000*		*70,000*			*11,000*		*120,000*	*6,000*			*498,000*
Net Realizable Value of Accounts Receivable							81,000						

Learning Objectives:

1. Life cycle of AR
a. Credit sales
b. Cash collection from AR
c. Uncollectable

2. Complete accounting cycles
2a. Journal entry cycle
Bad debt expense end-of-period adjustment

2b. Adjusting cycle
2c. Closing cycle

3a. Meaning of NRV: The likely amount to receive cash from AR

2d. Balance Sheet accounts

3b. NRV remains the same before/after the actual uncollectibles

4. Debit balance in allowance
a. Why?
b. Meaning of a debit balance?
c. Is the historical bad debt % reasonable?
d. Propose a new rate
e. Change in accounting policy? Temporary or permanent change?
f. Can a BS approach create a debit balance on allowance?