Q7-1 Trade receivables collectible within one year (one operating cycle if it is longer than one year) are shown as current assets on the balance sheet. In this case, the operating cycle of the company becomes 16 months if that is the normal collection period for the trade receivables.

Q7-2 The general concept of valuing trade receivables is to determine their net realizable value. To do so, the accountant must also make provision for certain income statement items such as estimated losses on uncollectible accounts, estimated discounts to be taken, estimated sales returns, and any probable collection fees and expenses. The matching principle would require that these items be determined in the period of sale and that they be deducted from sales in the determination of net income.

Q7-3 a. Allowance for Doubtful Accounts is a contra account to Accounts Receivable. It shows the estimated losses that may result through failure to collect some of the receivables. By deducting the balance in Allowance for Doubtful Accounts from Accounts Receivable, the latter is shown at its net realizable value.

b. The two methods that may be used to determine the estimated allowance for doubtful accounts are known as (1) the income statement approach and (2) the balance sheet approach.

c. Allowance for Doubtful Accounts is shown as a contra account Accounts Receivable in the current assets section.

Q7-4 Under the income statement approach, the bad debts expense is based on a percentage of sales less sales returns and allowances (either total or preferably credit sales). Under the balance sheet approach, Accounts Receivable rather than sales volume is used as a base for the adjustment. The income statement approach determines bad debts expense directly; the balance sheet approach determines the adjusted amount needed in Allowance for Doubtful Accounts.
Q7-5 Three possible contra accounts to Accounts Receivable other than Allowance for Doubtful Accounts are (1) Allowance for Sales Returns and Allowances (2) Allowance for Sales Discounts, and (3) Allowance for Transportation Out. These accounts should be used when the three items materially affect net realizable value of trade receivable and the calculation of accrual-basis net income.

Q7-6 Allowance for Doubtful Accounts is a contra (valuation) account to Accounts Receivable, its normal balance is a credit. The account may often have a debit balance during a period and the regular end-of-period adjusting entry will remove the negative balance. The reason for a debit balance is the company has written off more accounts than it provided for.

Q7-7 a. The total current assets of Rockwood Company immediately after the write-off will not be affected because the write-off decreases the receivable and the contra account to the receivable.
b. The write-off will have no effect on 2011 net income. Since the sale to Mark Slater was made prior to 2011, Bad Debts Expense was recorded in the year of the sale using either the income statement approach or the balance sheet approach.

Q7-8 One explanation for a disproportionately large balance in Allowance for Doubtful Accounts is that since any existing balance in the account is ignored, a small error in the same direction each year could accumulate to a large error in five years. Another reason for an unusually large amount might be that the company could have recovered a sizable account receivable that had been written off five or six years ago.

Q7-9 When a company takes a percentage of its accounts receivable to estimate uncollectible accounts, it does not estimate the bad debts expense in relation to sales for that year. Therefore, a company could have abnormally low sales for one year but still have a sizable bad debts expense, since the total of accounts receivable, which includes receivables from previous years when sales were larger, is used as the guide. Also, a recovery in the current year of a large receivable written off in a previous year could cause the bad debts expense in the current year to decrease significantly.

Q7-10 In a transaction involving a nonbank credit card, the retailer sends the credit card slips to the credit card company for payment. Therefore, we debit a receivable from the credit card company.

Q7-11 A credit card company will charge a fee of 2-6% for accepting and collecting a receivable. Therefore, these companies know the exact amount added on to cover various types of expenses ranging from cash discounts to bad debts expenses and accounting expenses. A receivable should be recorded for the net amount to be received and an expense debited for the amount of the credit card fee. On the other hand, with trade receivables, a predetermined amount to cover bad debt expenses, collection expenses, and other business expenses is not specifically
added on to the purchase once of the goods. Instead, the company must set the price of its product so that it will cover these expenses. Therefore, it is necessary to establish the contra account, Allowance for Doubtful Accounts, to remove bad debt expense from the trade receivables.

Q7-12  a. The reasons for credit balances occurring in Accounts Receivable accounts are (1) a customer's overpayment, (2) a sales return after original payment has been received, (3) a sales allowance after original payment has been received, and (4) a customer advance payment. Any of these may convert the account into a credit balance.

b. Credit balances in accounts receivable accounts should be shown as current liabilities on the balance sheet.

Q7-13  The most important principle of internal control applicable to receivables is separation of duties. Separation of duties allows each employees work to be verified by the work of the next employee in the accounts receivable processing procedure.

Examples of sound accounts receivable control procedures are:

1. The employees who maintain the accounts receivable records should not have access to cash.
2. Recording of returns and allowances, discounts, and bad debts write-offs should be authorized by an officer and should be separated from the cash receipt and cash disbursement functions.
3. An independent check should be established to see that the statements sent to customers are in agreement with the accounts receivable records.

Q7-14  The bad debts expense occurs at the point of sale. If a totally adequate credit and character check were made, there would be few or no bad debts losses. The expense is incurred at the point when a failure is made in the credit investigation of the customer, i.e., the point of sale.

Q7-15  A debit balance in Allowance for Doubtful Accounts could be the result of an error, but there could be a debit balance in the account without an error being made. The adjusting entry for bad debts expense is made at the end of a period, often a year. Some accounts receivable arising out of sales of the current period are written off prior to the time the adjusting entry is made; hence, a debit balance could arise prior to the making of the adjustment.
E7-16 Balance Sheet Classification of Receivables
LG 1

1. **VERO COMPANY**
   Partial Balance Sheet
   December 31, 2011

   **Assets**

   **Current assets**
   - Accounts receivable: $80,000
   - Deduct: Allowance for doubtful accounts: 1,500
   - Accounts receivable, American Express: 10,000
   - Interest receivable: 1,450
   
   **Long-term investments**
   - Notes receivable: $52,000
   - Notes receivable, officers: 18,500

2. 
   a. Accounts receivable are listed as current if they are collectible within a year or an operating cycle, whichever is longer.
   b. Allowance for Doubtful Accounts is a contra account to Accounts Receivable.
   c. Accounts receivable from American Express are collectible as soon as the sales slips are sent in. Thus, they are current assets.
   d. Accrued interest on notes receivable is collected at the end of each interest period of six months. Thus, it is a current asset.
   e. Notes receivable are due on October 1, 2014. These are noncurrent and are usually classified as long-term investments.
   f. Notes receivable for officers are not due within a year or the current operating cycle and therefore are not current. They are shown as long term investments or other assets on the balance sheet. The expectation of not collecting the notes receivable from officers in the near future makes them unlikely be classified as current. Therefore, the best classification is long-term investments.
E7-17 Journalizing Entries under the Allowance Method
LG 3

GENERAL JOURNAL

2011
Dec. 31  Bad Debts Expense  6,000
        Allowance for Doubtful Accounts  6,000
        To record estimated bad debts expense for the year.

2012
Jun. 12  Allowance for Doubtful Accounts  1,320
        Accounts Receivable, Jen Sweeney  1,320
        To write off receivable from Jen Sweeney as uncollectible.

Aug. 1   Accounts Receivable, Jen Sweeney  1,320
        Allowance for Doubtful Accounts  1,320
        To reinstate the account of Jen Sweeney previously written off.

1       Cash  1,320
        Accounts Receivable, Jen Sweeney  1,320
        To record payment received from Jen Sweeney.

E7-18  Recording Bad Debts Expense by Use of the Allowance Method
LG 3, 4

GENERAL JOURNAL

2011
Dec. 31  a. Bad Debts Expense  12,100*
        Allowance for Doubtful Accounts  12,100
        *0.05 x $250,000 = $12,500 desired balance of allowance.
        $12,500 - $400 = $12,100 bad debts expense.

b. Bad Debts Expense  9,000*
        Allowance for Doubtful Accounts  9,000
        *0.01 x $900,000 = $9,000.

c. Bad Debts Expense  8,100*
        Allowance for Doubtful Accounts  8,100
        *8,500 - $400 = $8,100.
E7-19 Recording Bad Debts Expense by Use of the Allowance Method
LG 3, 4

GENERAL JOURNAL

2011
Dec. 31 a. Bad Debts Expense 4,000*
   Allowance for Doubtful Accounts 4,000
   *0.04 x $80,000 = $3,200
   desired balance of allowance.
   $3,200 + $800 = $4,000
   bad debts expense.

   b. Bad Debts Expense 5,400*
      Allowance for Doubtful Accounts 5,400
      *0.006 x $900,000 = $5,400.

   c. Bad Debts Expense 7,500*
      Allowance for Doubtful Accounts 7,500
      *$6,700 + $800 = $7,500.

E7-20 Recording Bad Debts Expense, Write-off, and Balance Sheet
LG 3,4 Presentation under the Allowance Method

1. GENERAL JOURNAL

2011
Jun. 30 Bad Debts Expense 11,400
   Allowance for Doubtful Accounts 11,400
   To record bad debts expense for year.
   0.06% x $200,000 = $12,000
   desired balance of allowance.
   $12,000 - $600 = $11,400 bad debts.

2. JONI COMPANY
   Partial Balance Sheet
   June 30, 2011

   Assets

   Current assets
   Accounts receivable $200,000
   Deduct: Allowance for doubtful accounts 12,000
   Net realizable value $188,000
3. GENERAL JOURNAL

2011
Jul. 3 Allowance for Doubtful Accounts 1,300
Accounts Receivable, Carley Simon 1,300
To write off receivable from Carley Simon as uncollectible.

4. JONI COMPANY
Partial Balance Sheet
July 3, 2011

Assets

Current assets
Accounts receivable $198,700
Deduct: Allowance for doubtful accounts 10,700
Net realizable value $188,000

E7-21 Aging Accounts Receivable and Recording Bad Debts Expense under the Allowance Method

STEEL PIER DISTRIBUTING COMPANY
Analysis of Accounts Receivable by Age
December 31, 2011

<table>
<thead>
<tr>
<th>Customer's Name</th>
<th>Total Balance</th>
<th>Not Yet Due</th>
<th>1-30 Days</th>
<th>31-60 Days</th>
<th>61-90 Days</th>
<th>91-120 Days</th>
<th>121-365 Days</th>
</tr>
</thead>
<tbody>
<tr>
<td>Atlantic Co.</td>
<td>$ 1,000</td>
<td></td>
<td></td>
<td>$ 1,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Margate Co.</td>
<td>650</td>
<td>$ 400</td>
<td></td>
<td>$ 650</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Ventnor Co.</td>
<td>1,100</td>
<td></td>
<td></td>
<td>$ 700</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cape May Co.</td>
<td>600</td>
<td>$ 775</td>
<td></td>
<td></td>
<td>$ 600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Avalon Co.</td>
<td>775</td>
<td>$ 775</td>
<td></td>
<td></td>
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<td></td>
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</tr>
<tr>
<td>LBI Co.</td>
<td>1,725</td>
<td>325</td>
<td></td>
<td>$ 500</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Others</td>
<td>41,000</td>
<td>41,000</td>
<td></td>
<td>$ 650</td>
<td>$ 2,500</td>
<td>$ 2,500</td>
<td></td>
</tr>
<tr>
<td></td>
<td>$ 46,850</td>
<td>$ 41,400</td>
<td>$ 1,100</td>
<td>$ 700</td>
<td>$ 500</td>
<td>$ 650</td>
<td>$ 2,500</td>
</tr>
</tbody>
</table>
E7-21 (continued)

2. Calculation of uncollectibles:

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
<th>Rate</th>
<th>Amount Uncollectible</th>
</tr>
</thead>
<tbody>
<tr>
<td>Not yet due</td>
<td>$41,400</td>
<td>2%</td>
<td>$828</td>
</tr>
<tr>
<td>1-30 days past due</td>
<td>1,100</td>
<td>6</td>
<td>66</td>
</tr>
<tr>
<td>31-60 days past due</td>
<td>700</td>
<td>15</td>
<td>105</td>
</tr>
<tr>
<td>61-90 days past due</td>
<td>500</td>
<td>30</td>
<td>150</td>
</tr>
<tr>
<td>91-120 days past due</td>
<td>650</td>
<td>40</td>
<td>260</td>
</tr>
<tr>
<td>121-365 days past due</td>
<td>2,500</td>
<td>70</td>
<td>1,750</td>
</tr>
<tr>
<td>Totals</td>
<td>$46,850</td>
<td></td>
<td>$3,159</td>
</tr>
</tbody>
</table>

3. GENERAL JOURNAL

2011
Dec. 31 Bad Debts Expense 3,359
       Allowance for Doubtful Accounts 3,359
       To increase the allowance account to
       the desired balance.
       ($3,159 + $200 previous debit balance).

E7-22 Journalizing Entries under the Direct Write-off Method
LG 5

GENERAL JOURNAL

2011
Apr. 18 Bad Debts Expense 1,000
       Accounts Receivable, Tom Petty 1,000
       To write off receivable from Tom Petty
       as uncollectible.

Nov. 28 Accounts Receivable, Tom Petty 650
       Bad Debts Recovered 650
       To reinstate the recoverable amount of the
       Tom Petty account previously written off.

28 Cash 650
       Accounts Receivable, Tom Petty 650
       To record payment received from Tom
       Petty.
1. Direct Write-off Method:
   a. Net sales ($520,000 – $10,000) $ 510,000
   b. Bad debts expense (accounts written off) $ 5,000
   c. Net sales $ 510,000
      Deduct:
      Expenses $ 420,000
      Bad debts expense 5,000
      Add: Bad debts recovered 1,000
      Net income 86,000
   d. Accounts receivable ($100,000 + $520,000 – $10,000
      – $510,000 – $5,000 = $95,000) $ 95,000

2. Allowance Method:
   a. Net sales ($520,000 – $10,000) $510,000
   b. Bad debts expense:
      Accounts receivable 1/1/11 $100,000
      Add: Sales on account 520,000
      Deduct: Returns (10,000)
      Cash collections (510,000)
      Writeoffs (5,000)
      Accounts receivable, 12/31/11 $ 95,000
      x 0.06
      Desired allowance balance $ 5,700
      Deduct: Balance in Allowance for Doubtful Accounts, 12/31/11 3,000
      Bad debts expense $ 2,700
   c. Net sales $510,000
      Deduct:
      Expenses $420,000
      Bad debts expense 2,700
      Net income 87,300
   d. Accounts receivable $ 95,000
      Deduct: Allowance for doubtful accounts 5,700
      Net realizable value $ 89,300
E7-24 Accounting for Credit Card Sales
LG 7

GENERAL JOURNAL

2011
Dec. 12 Cash 28,800
Accounts Receivable, Marksman Card Company 13,440
Credit Card Fees Expense Sales 1,760 44,000

To record sales on credit cards as follows:
Bankco, $30,000 less fee of $1,200.
Marksman, $14,000 less fee of $560.

E7-25 Balance Sheet Disclosure of Receivables with Credit Balances
LG 1

MUSTAFKA COMPANY
Partial Balance Sheet
December 31, 2011

Assets

Current assets
Accounts receivable $ 57,200
Notes receivable, trade 12,400
Total trade receivables $ 69,600
Deduct: Allowance for doubtful accounts 4,800* $ 64,800

Long-term investments
Accounts receivable, officers (due June 30, 2014) 7,000

Liabilities and Owners’ Equity

Current liabilities
Credit balances in customer’s accounts $ 600

*This could have been deducted from accounts receivable alone.
E7-26 Internal Control Of Accounts Receivable
LG 8

1. a. Persons who maintain accounts receivable records should not have access to cash by being responsible for counting and depositing cash receipts.
   b. Employees should be required to use up vacation time both for their own physical and mental benefit and also to have other employees involved in the operations of the company.

2. a. O'Brien should have a responsible person in charge of all cash refunds instead of having all employees authorized to issue cash refunds.
   b. O'Brien should centralize cash refunds in one location instead of using all cash registers.
   c. Customers requesting a cash refund should be required to fill out a form that indicates their name and address and the reason for return.

3. a. O'Brien should establish an allowance for doubtful accounts.
   b. O'Brien should resolve the $5,000 account receivable by taking steps to either collect the account or write it off.

E7-27 Real-Life Interpretation of Accounts Receivable
LG 9 Customers

1. Net sales for Fast Computer are decreasing each year from 2009 to 2011. Net sales have decreased 9.4% from 2009 to 2011.

2. Accounts receivable have grown each year from 2009 to 2011. Net accounts receivable have increased 40.0% from 2009 to 2011. The increase in receivables and the decrease in net sales are very unfavorable. It may indicate that Fast Computer is selling to less credit-worthy customers in an attempt to maintain sales.

3. For bad debts, Fast Computer uses the allowance method as seen from the existence of a allowance account.

4. As of the end of fiscal 2011, gross amount of accounts receivable are $2,190,000,000 ($2,100,000,000 + $90,000,000).

5. As of the end of fiscal 2011, the net realizable value for accounts receivable is $2,100,000,000.

6. Bad Debts Expense
   Allowance for Doubtful Accounts 25,000,000 25,000,000

7. Allowances for Doubtful Accounts
   Accounts Receivable 12,000,000 12,000,000


Interpretation of Accounts Receivable (continued)

10. A concern about the trend in amounts for bad debts expense and write-offs of receivables from 2009 to 2011 is that both the "charged to expense" and the "amounts written off" have decreased each year. This is of great concern in the light of increasing amounts for accounts receivable each year. It looks like management may be attempting to maintain an increasing allowance balance by reducing both Bad Debts Expense and Accounts Written Off each year.

11. In 2011, if Fast Computer used the direct write-off method the Bad Debts Expense would be the accounts receivable written off.

| Bad Debts Expense | 12,000,000 |
| Accounts Receivable | 12,000,000 |

12. At the end of 2011, if Fast Computer used the direct write-off method, there would be no allowance account and the net accounts receivable on the balance sheet would be the gross accounts receivable of $2,190,000,000.
SOLUTIONS TO PROBLEMS

P7-28 Journalizing Entries under the Allowance Method
LG3

GENERAL JOURNAL

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>Dec. 31 Bad Debts Expense</td>
<td>Allowance for Doubtful Accounts</td>
<td>3,600</td>
<td>3,600</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To record estimated bad debts expense for year.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>Apr. 16 Allowance for Doubtful Accounts</td>
<td>Accounts Receivable, Sam's Diner</td>
<td>800</td>
<td>800</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To write off receivable from Sam's Diner as uncollectible.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Jun. 10 Accounts Receivable, Mary's Lunch</td>
<td>Allowance of Doubtful Accounts</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To reinstate the account of Mary's Lunch previously written off.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>10 Cash</td>
<td>Accounts Receivable, Mary's Lunch</td>
<td>500</td>
<td>500</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To record payment received from Mary's Lunch.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Nov. 4 Allowance for Doubtful Accounts</td>
<td>Accounts Receivable, Adam's Eatery</td>
<td>400</td>
<td>200</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Accounts Receivable, Sally's Coffee</td>
<td>80</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Accounts Receivable, Jenny's Deli</td>
<td>120</td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>To write off receivables from Adam's Eatery, Sally's Coffee, and Jenny's Deli as uncollectible.</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>Dec. 2 Cash</td>
<td>Allowance for Doubtful Accounts</td>
<td>180</td>
<td>120</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Accounts Receivable, Donny's Bar</td>
<td>120</td>
<td>300</td>
</tr>
<tr>
<td></td>
<td></td>
<td>To record partial payment received from Donny's Bar and to write off remaining receivable as uncollectible.</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
### Journalizing Entries under the Allowance Method: Using Estimates Based on Both Sales and Receivables

#### Requirement 1

**GENERAL JOURNAL**

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td><strong>Dec. 31</strong> Bad Debts Expense</td>
<td>18,000</td>
<td>18,000</td>
</tr>
<tr>
<td></td>
<td>Allowance for Doubtful Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To record estimated bad debts expense for year ($900,000 x .02).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td><strong>May 12</strong> Allowance for Doubtful Accounts</td>
<td>4,200</td>
<td>4,200</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable, Frank Ford</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To write off receivable from Frank Ford as uncollectible.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td><strong>Sep. 28</strong> Allowance for Doubtful Accounts</td>
<td>3,500</td>
<td>3,500</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable, Mary Nissan</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To write off receivable from Mary Nissan as uncollectible.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td><strong>Oct. 29</strong> Accounts Receivable, Frank Ford</td>
<td>1,700</td>
<td>1,700</td>
</tr>
<tr>
<td></td>
<td>Allowance for Doubtful Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To reinstate partial account of Frank Ford previously written off as uncollectible.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td><strong>Dec. 29</strong> Cash</td>
<td>1,700</td>
<td>1,700</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable, Frank Ford</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To record payment received from Frank Ford</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td><strong>Dec. 31</strong> Bad Debts Expense</td>
<td>4,000</td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>Allowance for Doubtful Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To increase allowance account to the desired balance ($19,000 - $15,000 previous credit balance).</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td><strong>Aug. 21</strong> Allowance for Doubtful Accounts</td>
<td>9,000</td>
<td>9,000</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable, Sue Toyota</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To write off receivable from Sue Toyota as uncollectible.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td><strong>Dec. 31</strong> Bad Debts Expense</td>
<td>8,500</td>
<td>8,500</td>
</tr>
<tr>
<td></td>
<td>Allowance for Doubtful Accounts</td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td>To increase allowance account to the desired balance ($18,500 - $10,000 previous credit balance).</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
P7-29 (continued)

Requirement 2.

GENERAL LEDGER

Allowance for Doubtful Accounts

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010 Dec.</td>
<td>Balance</td>
<td></td>
<td></td>
<td>18,000</td>
<td>3,000</td>
</tr>
<tr>
<td>2011 May</td>
<td></td>
<td>4,200</td>
<td></td>
<td></td>
<td>16,800</td>
</tr>
<tr>
<td>Sep.</td>
<td></td>
<td>3,500</td>
<td></td>
<td></td>
<td>13,300</td>
</tr>
<tr>
<td>Oct.</td>
<td></td>
<td></td>
<td>1,700</td>
<td></td>
<td>15,000</td>
</tr>
<tr>
<td>Dec.</td>
<td></td>
<td></td>
<td>4,000</td>
<td></td>
<td>19,000</td>
</tr>
<tr>
<td>2012 Aug.</td>
<td></td>
<td>9,000</td>
<td></td>
<td></td>
<td>10,000</td>
</tr>
<tr>
<td>Dec.</td>
<td></td>
<td></td>
<td>8,500</td>
<td></td>
<td>18,500</td>
</tr>
</tbody>
</table>

P7-30 Recording Various Accounts Receivable Transactions Using the Allowance Method
LG 3, 4, 7

Requirement 1.

GENERAL JOURNAL

Page 151

2011
Nov. 1 Accounts Receivable, Bat Eason Sales 111 2,660.00
To record sales on account; invoice no. 1001 to Bat Eason.

2 Accounts Receivable, C. Faison Sales
111 9,400.00
To record sales on account; invoice no. 1002 to C. Faison.
Nov. 7 Sales Returns and Allowances
   Accounts Receivable, C. Faison 111 1,400.00
   To record a sales return from C. Faison.

9 Cash
   Sales Discounts
   Accounts Receivable, Bat Eason
   To record payment received from Bat Eason.

10 Accounts Receivable, Verree Company
    Company 111 3,200.00
    Sales
    To record sales on account; invoice 1003 to Verree Company.

13 Cash
   Sales Discounts
   Accounts Receivable, Verree Company
   To record partial payment received from Verree Company.

14 Cash
   Accounts Receivable, C. Faison
   To record payment received from C. Faison.

15 Accounts Receivable, Dick Bracey Company
    Company 111 18,000.00
    Sales
    To record sales on account; invoice no. 1004 to Dick Bracey Co.

23 Cash
   Sales Discounts
   Accounts Receivable, Dick Bracey Co.
   To record payment received from Dick Bracey Company.

7-16
<table>
<thead>
<tr>
<th>Date</th>
<th>Account Description</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov. 30</td>
<td>Accounts Receivable, Annie Leigh Company Sales To record sales on account; invoice no 1005 to Annie Leigh Company.</td>
<td>111</td>
<td>12,600.00</td>
</tr>
<tr>
<td></td>
<td>Accounts Receivable, Three Company Sales To record sales on account; invoice no. 1006 to Three Company.</td>
<td>111</td>
<td>15,000.00</td>
</tr>
<tr>
<td></td>
<td>Cash Accounts Receivable, American Express Credit Card Fees Expense Sales To record sales on credit cards, less a 6% credit card expense.</td>
<td>113</td>
<td>12,032.00</td>
</tr>
<tr>
<td></td>
<td>Bad Debts Expense Allowance for Doubtful Accounts To record bad debts expense for month (3.6% x $59,460). ($59,460 = $2,660 + $9,400 + $1,400 + $3,200 + $18,000 + $12,500 + $15,000)</td>
<td></td>
<td>2,140.56</td>
</tr>
<tr>
<td>Dec. 8</td>
<td>Allowance for Doubtful Accounts Accounts Receivable, Verree Company To write off receivable from Verree Company as uncollectible.</td>
<td>111</td>
<td>2,320.00</td>
</tr>
</tbody>
</table>

7-17
P7-30 (continued)

Requirement 2.

**GENERAL LEDGER**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1</td>
<td></td>
<td>2,660</td>
<td></td>
<td>2,660</td>
</tr>
<tr>
<td>2</td>
<td></td>
<td>9,400</td>
<td></td>
<td>12,060</td>
</tr>
<tr>
<td>7</td>
<td></td>
<td>1,400</td>
<td></td>
<td>10,660</td>
</tr>
<tr>
<td>9</td>
<td></td>
<td>2,660</td>
<td></td>
<td>8,000</td>
</tr>
<tr>
<td>10</td>
<td></td>
<td>3,200</td>
<td></td>
<td>11,200</td>
</tr>
<tr>
<td>13</td>
<td></td>
<td>880</td>
<td></td>
<td>10,320</td>
</tr>
<tr>
<td>14</td>
<td></td>
<td>8,000</td>
<td></td>
<td>2,320</td>
</tr>
<tr>
<td>15</td>
<td></td>
<td>18,000</td>
<td></td>
<td>20,320</td>
</tr>
<tr>
<td>23</td>
<td></td>
<td>18,000</td>
<td></td>
<td>2,320</td>
</tr>
<tr>
<td>30</td>
<td></td>
<td>12,600</td>
<td></td>
<td>14,920</td>
</tr>
<tr>
<td>30</td>
<td></td>
<td>15,000</td>
<td></td>
<td>29,920</td>
</tr>
<tr>
<td>Dec.</td>
<td></td>
<td>2,320</td>
<td></td>
<td>27,600</td>
</tr>
</tbody>
</table>

**Accounts Receivable, American Express**  
Acct. No. 113

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>30</td>
<td></td>
<td>13,348</td>
<td></td>
<td>13,348</td>
</tr>
</tbody>
</table>

**ACCOUNTS RECEivable SUBSIDIARY LEDGER**

**Dick Bracev Company**

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>15</td>
<td></td>
<td>18,000</td>
<td></td>
<td>18,000</td>
</tr>
<tr>
<td>23</td>
<td></td>
<td>18,000</td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>
**P7-30 Requirement 2 (continued)**

### Bat Eason

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>1</td>
<td>2,660</td>
<td>2,660</td>
<td>2,660</td>
</tr>
<tr>
<td></td>
<td>9</td>
<td></td>
<td></td>
<td>0</td>
</tr>
</tbody>
</table>

### C. Faison

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>2</td>
<td>9,400</td>
<td></td>
<td>9,400</td>
</tr>
<tr>
<td></td>
<td>7</td>
<td></td>
<td>1,400</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td>14</td>
<td></td>
<td>8,000</td>
<td>0</td>
</tr>
</tbody>
</table>

### Annie Leigh Company

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>30</td>
<td>12,600</td>
<td></td>
<td>12,600</td>
</tr>
</tbody>
</table>

### Verree Company

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>10</td>
<td>3,200</td>
<td></td>
<td>3,200</td>
</tr>
<tr>
<td></td>
<td>13</td>
<td></td>
<td>880</td>
<td>2,320</td>
</tr>
<tr>
<td>Dec.</td>
<td>8</td>
<td></td>
<td>2,320</td>
<td>0</td>
</tr>
</tbody>
</table>

### Three Company

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Nov.</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>30</td>
<td>15,000</td>
<td></td>
<td>15,000</td>
</tr>
</tbody>
</table>
P7-30 (continued)

Requirement 3.

BIGGS COMPANY
Schedule of Accounts Receivable
December 8, 2011

Annie Leigh Company $ 12,600
Three Company 15,000
Total accounts receivable $ 27,600

P7-31 Journalizing Entries and Preparing an Income Statement under the Direct
LG 5 Write-off Method

Requirement 1.

GENERAL JOURNAL

2011
Dec. 31  a. Bad Debts Expense
         Accounts Receivable, Gramling
         To write off account receivable from
         Gramling’s Service as uncollectible. 6,000 6,000

31  b. Accounts Receivable, H. Wyman
    Bad Debts Recovered
    To reinstate the account of
    Hal Wyman previously written off. 2,500 2,500

31  Cash
    Accounts Receivable, H. Wyman
    To record payment received from
    Hal Wyman. 2,500 2,500

31  c. No entry made under the direct write-off
    method.
P7-31 (continued)

Requirement 2.

ELLINGTON AUTO PARTS
Income Statement
For the Year Ended December 31, 2011

Sales $740,000
Sales returns 22,000
Net sales revenue $718,000
Cost of goods sold 520,000
Gross margin $198,000

Operating expenses:
Operating expenses $130,000
Bad debts expense 6,000
Deduct: Bad debts recovered 2,500 3,500
Total operating expenses 133,500

Net income $64,500

Requirement 3.

Accounts receivable ($76,000 - $6,000) $70,000

P7-32 Comparing the Allowance Method with the Direct Write-off Method
LG 6

Requirement 1.

GENERAL LEDGER

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Debit</td>
</tr>
<tr>
<td>2011</td>
<td></td>
<td>40,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dec.</td>
<td>Balance</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>(a) Sales</td>
<td>165,200</td>
<td></td>
<td>205,200</td>
</tr>
<tr>
<td></td>
<td>(b) Accounts written off</td>
<td></td>
<td>1,800</td>
<td>203,400</td>
</tr>
<tr>
<td></td>
<td>(c) Collections</td>
<td></td>
<td>150,000</td>
<td>53,400</td>
</tr>
<tr>
<td></td>
<td>(d) Accounts written off then collected: To reinstate</td>
<td>100</td>
<td></td>
<td>53,500</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>To collect</td>
<td>100</td>
</tr>
</tbody>
</table>
P7-32 Requirement 1 (continued)

<table>
<thead>
<tr>
<th>Date</th>
<th>Explanation</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Acct. No. 112</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2011</td>
<td>Balance</td>
<td></td>
<td></td>
<td></td>
<td>200</td>
</tr>
<tr>
<td>Dec.</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>31</td>
<td>Bad debts expense</td>
<td></td>
<td>1,240</td>
<td>1,440</td>
<td></td>
</tr>
<tr>
<td>2012</td>
<td>(b)</td>
<td>1,800</td>
<td>360</td>
<td>260</td>
<td></td>
</tr>
<tr>
<td>(d)</td>
<td></td>
<td>100</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Dec.</td>
<td>Bad debts expense</td>
<td>2,160</td>
<td></td>
<td>1,900</td>
<td></td>
</tr>
</tbody>
</table>

Requirement 2.

- Bad debts expense by direct write-off method is $1,800 because the bad debts recovered ($100) are considered to be revenue.
- The bad debts expense by the allowance method is $2,160.*

*$1,900 desired balance + $260 previous debit balance = $2,160 in Bad Debts Expense.

P7-33 Comprehensive Analysis of Accounts Receivable for Manpower, Inc.

LG 9

1. Net sales have increased by 5.1% ($1,052.5 ÷ 20,500.3) from 2007 to 2008. Manpower is growing at a modest rate from 2007 to 2008.

2. While net sales have increased by 5.1% from 2007 to 2008, net accounts receivable have decreased by 19.0% ($849.1 ÷ $4,478.8). The decrease in accounts receivable means the company is selling more and is collecting at a faster rate. This is favorable because Manpower is turning more receivables into cash.

3. Since an allowance account exists, Manpower uses the allowance method.

4. Gross receivables at the end of fiscal 2008 are $3,748,200,000 ($3,629,700,000 + $118,500,000).

5. The net realizable value of the accounts receivable is $3,629,700,000 (the net amount shown on the balance sheet). This is the amount the company expects to collect.

6. Bad Debts Expense
   Allowance for Doubtful Accounts
   23,400,000
   23,400,000
P7-33 (continued)

7. Allowance for Doubtful Account
   Accounts Receivable

   28,000,000*                        28,000,000*

   ($123,100,000 + 23,400,000 - accounts written off* = $118,500,000)

8. 2008 ($23,400,000)

9. 2008: 0.11% ($23.4 ÷ $21,552.8)
   2007: 0.11% ($21.8 ÷ $20,500.3)

   From 2007 to 2008, Manpower is maintaining the same percent of estimated bad
   debts expense to net sales. Considering the size of the net sales and large amount
   of receivables at year end, the percent of bad debts to net sales seems low. We would
   want to question management about this.

10. 2008: 3.2% ($118.5 ÷ $3,748.2)
    2007: 2.7% ($123.1 ÷ $4,601.9)

    From 2007 to 2008, Manpower is increasing the percent of the allowance for doubtful
    accounts to gross accounts receivable. We would ask management if the allowance
    balance is high enough considering the large amount of receivables at the end of
    2008. We would also ask why write-offs of $28 million during 2008 seem relatively
    small considering the large receivables ($3,748.2 million) and allowance balance of
    $118.5 million at December 31, 2008.

11. $28,000,000 (the amounts written off, see part 7).

12. $3,748,200,000 (the gross amount of accounts receivable).
Effect of Alternative Methods for Bad Debts on Financial Statements
LG 6

Following is a typical student response to this communications problem; actual responses may vary in content and style but should contain as much of this basic information as possible.

TO: Linda Petrofsky, President
    Linda’s Dolls
FROM: Student

In response to your request, I have prepared the following comparison of the allowance and direct write-off methods for Linda’s Dolls.

1. Income Statement Effects

Under the allowance method, the comparative income statement below shows a net loss of $(10,000) for 2011. This compares to a net income of $140,000 using the direct write-off method. The allowance method provides for estimated bad debts and results in a better matching of revenues and expenses. The estimate for bad debts assumes that you will not collect 30% of the accounts receivable. The direct write-off method recognizes the expense in the period the account proves uncollectible. Since no accounts were written off during the first year of business, bad debt expense is zero.

LINDA’S DOLLS
Comparative Income Statements
Allowance and Direct Write-off Methods
For the Year Ended December 31, 2011

<table>
<thead>
<tr>
<th></th>
<th>Allowance Method</th>
<th>Direct Write-off Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales</td>
<td>$ 900,000</td>
<td>$ 900,000</td>
</tr>
<tr>
<td>Cost of goods sold</td>
<td>600,000</td>
<td>600,000</td>
</tr>
<tr>
<td>Gross margin</td>
<td>$ 300,000</td>
<td>$ 300,000</td>
</tr>
<tr>
<td>Operating expenses</td>
<td>$ 160,000</td>
<td>$ 160,000</td>
</tr>
<tr>
<td>Bad debts expense ($500,000 x 0.30)</td>
<td>150,000</td>
<td>0</td>
</tr>
<tr>
<td>Total operating expenses</td>
<td>$ 310,000</td>
<td>$ 160,000</td>
</tr>
<tr>
<td>Net income (loss)</td>
<td>$(10,000)</td>
<td>$ 140,000</td>
</tr>
</tbody>
</table>
Business Decision and Communication Problem (continued)

2. Balance Sheet Presentation of Accounts Receivable

Under the allowance method, you adjust the gross accounts receivable by an allowance account to determine the net amount the company expects to collect. After deducting an allowance for doubtful accounts balance of $150,000, the net realizable value of the accounts receivable is $350,000. Use of the allowance method results in a balance sheet presentation of accounts receivable that is more realistic. Under the direct write-off method, you show the accounts at the gross amount of $500,000.

LINDA’S DOLLS
Comparative Balance Sheet Information for Accounts Receivable
Allowance and Direct Write-off Methods
December 31, 2011

<table>
<thead>
<tr>
<th></th>
<th>Allowance Method</th>
<th>Direct Write-off Method</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>$500,000</td>
<td>$500,000</td>
</tr>
<tr>
<td>Deduct: Allowance for doubtful accounts</td>
<td>$150,000</td>
<td>0</td>
</tr>
<tr>
<td>Net realizable value</td>
<td>$350,000</td>
<td>$500,000</td>
</tr>
</tbody>
</table>

3. Concerns and Recommendations

An overall concern is the high proportion of accounts receivable that remain uncollected as of December 31, 2011. The $500,000 balance in accounts receivable represents 56% of sales for 2011. You should re-examine the decision to sell to high-credit-risk customers to determine if this represents a good business decision.

For financial reporting purposes, the allowance method provides a more correct determination of net income and a presentation of the net realizable value of accounts receivable. In view of the high level of accounts receivable for Linda’s Dolls, I recommend that you use the allowance method.
**SOLUTION TO ETHICAL DILEMMA**

**Disclose to Casino Customers that Some Gambling Debts will not be Collected?**

**LG 3**

Individual responses to ethical dilemmas will vary. The technical and ethical issues raised in the following response are central to this dilemma; look for them in students' answers and be prepared to discuss them with students in class.

Accounting for business transactions and reporting the results to users should be based on objective evidence. The central goal of the accrual basis of accounting is to match revenues and expenses for a period of time. If bad debts from casino activities can be reasonably estimated, they should be recognized as an expense in the same period the revenues are recognized. Ethically, management has a responsibility to financial statement users to fully disclose all significant economic events concerning the company. The estimated losses from not collecting gambling debts should be accrued and disclosed.

**SOLUTION TO COMPREHENSIVE ANALYSIS CASE**

**SUN MICROSYSTEMS**

**Income Statement Responses:**

1. Total revenues in 2008 ($13,880,000,000) are higher than the total for 2006 ($13,068,000,000).

2. The percent increase in total revenues from 2006 to 2008 is:

   \[
   6.2\% = 100 \times \frac{812,000,000}{13,068,000,000} = \frac{812,000,000}{13,068,000,000} \times 100
   \]

   Total revenues increased 6.2% from 2006 to 2008.

3. The cost of goods sold percent decreased from 56.9% in 2006 to 53.5% in 2008. As a result, the gross margin percent increased from 43.1% in 2006 to 46.5% in 2008. This is a *favorable* trend.

4. The percentage of total operating expenses to total revenues decreased from 49.7% in 2006 to 43.8% in 2008. This is *favorable*. The operating income percent increased from (6.7)% in 2006 to 2.7% in 2008. This is a *favorable* trend.

5. The percent of net income to total revenues increased from (6.6)% in 2006 to 2.9% in 2008. This is a *favorable* trend.
Solution to Comprehensive Analysis Case (continued)

Balance Sheet Responses:
6. Total assets at June 30, 2008 ($14,340,000,000) are lower than the total at June 30, 2006 ($15,082,000,000).

7. The percent decrease to total assets from June 20, 2006 to June 30, 2008 is:

\[
(4.9\%) = 100 \times \frac{\$(742,000,000)^*}{\$15,082,000,000} \quad \text{\$14,340,000,000 - \$15,082,000,000}
\]

Total Revenues increased while total assets have decreased over the three-year period. This is a favorable trend.

8. The largest asset investment for the company is intangibles and goodwill. This item makes up 26.4% of the company’s assets at the end of the most recent year.

9. The largest asset investment increase between 2006 and 2008 is:

\[
6.8\% = 100 \times \frac{\$241,000,000^*}{\$3,539,000,000} \quad \text{\$3,780,000,000 - \$3,539,000,000}
\]

Intangibles and goodwill increased by 6.8% compared to an increase in total revenues of 6.2%. This is unfavorable.

10. On the balance sheet, refer to the common-size percent for total liabilities each year. The percent of liabilities has increased from 57.9% of total assets in 2006 to 61.0% in 2008. This is unfavorable.

Integrative Income Statement and Balance Sheet:
11. This company is operating more efficiently in 2008 than in 2007. We conclude this by comparing the total asset turnover for the two years which increased from 0.90 times in 2007 to 0.92 times in 2008. Each dollar of investment in assets generated a higher amount of revenues in 2008 than in 2007. This is favorable.

Ratio Analysis Responses:
12. The current ratio is higher in 2008 than in 2006.


14. For the year ended June 30, 2008, the accounts receivable turnover ratio 1 is worse this year compared to the previous year. In 2008, the accounts receivable turnover ratio 1 is 3.85 times. This is an decrease from 4.25 times in 2007. This is unfavorable.

15. For the year ended June 30, 2008, the accounts receivable turnover ratio 2 (based on year-end receivables) is better at 3.87 times compared to the 2008 accounts receivable turnover ratio 1 (based on average receivables) at 3.85 times.
Solution to Comprehensive Analysis Case (continued)

16. For the year ended June 30, 2008, the inventory turnover ratio 1 is worse this year compared to the previous year. In 2008, the inventory turnover ratio 1 is 12.33 times. This is a decrease from 14.30 times in 2007. This is unfavorable.

17. For the year ended June 30, 2008, the inventory turnover ratio 2 (based on year-end inventory) at 10.92 is worse than the 2008 inventory ratio 1 (based on average inventory) at 12.33. This is unfavorable.

18. The return on total assets (ROA) ratio is worse in 2008 than in 2007. In 2008, the ROA is 2.67%. This is a decrease from 3.06% in 2007. This is unfavorable.

Accounts Receivable and Bad Debts Questions:

19. Selling on account is important to Sun Microsystems. Accounts receivable comprises approximately 25% of their total assets.

20. We compute the gross value of accounts receivable at the end of 2008 as follows (in millions):

   Accounts receivable, net $3,586.0
   Allowance balance 64.0
   Accounts receivable, gross $3,650.0

21. They would have made the following journal entry at the end of 2008 to provide for estimated bad debts (in millions):

   Bad Debts Expense 10.0
   Allowance for doubtful accounts 10.0

22. They would have made the following journal entry in 2008 to write-off uncollectible accounts receivable (in millions):

   Allowance for doubtful accounts 27.0
   Accounts receivable 27.0

23. In 2007 the bad debts expense is $12 million. In 2008, the bad debts expense is only $10 million. In 2007, the bad debts expense was 0.09% of revenues. In 2008, the bad debts expense was 0.07% of revenues. We would want to determine why there is a decrease in the bad debts expense in 2008. Is management adequately providing for estimated bad debts?

24. The Allowance for Doubtful Accounts is 1.8% of gross accounts receivable in 2008. In 2007, the Allowance for Doubtful Accounts was 2.2% of gross accounts receivable. This is a decrease in the allowance in relationship to the accounts receivable in 2008. Once again, we would ask if management is adequately providing for estimated bad debts.