

# Toward Business Literacy: Accounting Outlines



## Accounts Receivable

Claims held against customers and others for money, goods or services

### Accounts Receivable- discounts

- **Trade discount:** list or catalog price can include a trade discount in the basis of the bargain to reflect quantity discounts or special pricing
- **Sales discount:** this induces customers to pay promptly; terms such as 2/10, net/30 mean that there is a 2% discount for those who pay within 10 days, and the total is due in 30 days regardless.
  - There are two ways to account for the sales discount
    - **Gross method:** discounts are recognized when payment is received
    - **Net method:** record sale with discount embedded; debit a revenue account (discounts forfeited) if discount is not taken by customer.

### Accounts Receivable-valuation

Accounts receivable are valued at Net Realizable Value (total less an allowance for doubtful accounts)

- Direct write-off (not GAAP)

JE:	Bad debt expense	xxx
	Accounts Receivable	xxx

  - If written off account is collected later, Dr. cash Cr. Uncollectible amount recovered
- Allowance method (GAAP)
  - *Income statement* approach takes a percentage of net sales as bad debt expense and adds this to the beginning balance in the Allowance account
  - *Balance sheet* approach finds a balance in the Allowance account first, subtracts the beginning balance in the Allowance account to arrive at the bad debt expense for the period.
- Uncollectible accounts: uses the “cushion” of the Allowance account to offset write-offs

JE:	Allowance for Doubtful Accounts	xxx
	Accounts Receivable	xxx
- If written-off account is later collected, reverse the above entry, and debit cash and credit A/R

### Account Receivable-factoring

Factoring or selling receivables to a professional collector can provide cash immediately from receivables outstanding. A couple of arrangements exist:

1. With recourse: the seller (original holder) is liable, and a contingent liability is credited when cash is received (debited).
2. Without recourse: the factor (one taking on the receivables) bears the loss.

### Sales Returns

A certain percentage of sales is normally returned; an allowance is set up for this.

Balance Sheet:      Sales Returns and Allowances (*Contra sales revenue*)  
                         -      Allowance for Sales R&A (*Contra-asset account*)

=    *Net Sales*

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## Notes Receivable

### Promissory Note

- Written promise to pay a certain sum on a certain date to a payee
- Negotiable (can be sold or transferred from one holder to another)
- Must be signed by maker with a stated interest rate and date for payment
- A “zero interest” bearing note has the interest as part of the face amount

### Uses of notes

- Can extend the time necessary to pay for goods or services
- Is wise for high credit risk or new, unknown customers
- Can secure loans for employees
- Facilitates and expedites sales of property, plant and equipment

### Valuation

- Short term notes (3 months or less) are at face value (original amount)
- Long term notes are carried at present value
  - There are two interest rates: stated (on the note) and market
  - When the stated rate on the note varies from the market rate:
    - A discount (lowers value of note) results (stated < market)
    - A premium (raises value of note) results (stated > market).
  - Carrying value = face amount plus premium or less discount
- An **imputed interest rate** is used when a borrower and a lender are both independent and need to negotiate (agree on) a rate equal to similar instruments of issuers with same credit ratings.
- Allowances are used in a manner similar to accounts receivable.
- If it is probable the creditor will be unable to collect, this is **impairment**
  - The note should be written off

### Disposition: Transfer or Sale

- The new holder of the receivable is the legal owner
- Holder’s rights are protected vs. secured creditor (see Law handout)

### Factoring

Factors are finance companies or banks that buy receivables from businesses for a fee and are skilled in collecting from debtors. Arrangements can be:

- With recourse: seller guarantees payment to purchaser
- Without recourse: purchaser assumes risk of collection and absorbs any credit losses

JE: Cash	xxx	
Due from factor	xxx	(to cover discounts, returns, etc)
Accounts Receivable	xxx	