

## Chapter Nine

### Accounting Receivable

#### Recognition of Accounts Receivables:

- Accounts receivable generally arise as part of a revenue arrangement.
- The revenue recognition principle indicates that a company should recognize revenue when it satisfies its performance obligation by transferring the good or service to the customer.

**Accounts receivable: are amounts customers owe on account. They result from the sale of goods and services. Companies generally expect to collect accounts receivable within 30 to 60 days. They are usually the most significant type of claim held by a company.**

#### Accounts receivable classifications:

1. Accounts receivable are amounts customers owe on account. They result from the sale of goods and services.
2. Notes receivable represent claims for which formal instruments of credit are issued as evidence of the debt.
3. Other receivables include nontrade receivables such as interest receivable loans to company officers, advances to employees, and income taxes refundable.

**Example (1) :** Assume that AL-Iraqi Co. on July 1, 2012, sells merchandise on account to Baghdad Company for \$1,000, terms 2/10, n/30. On July 5, Baghdad returns merchandise worth \$100 to AL- Iraqi Co. On July 11, AL-Iraqi receives payment from Baghdad Company for the balance due. The journal entries to record these transactions on the books of AL-Iraqi Co. are as follows.(Cost of goods sold entries are omitted.)

#### Solution:

July 1/

Accounts Receivable- Baghdad Company	1000	
Sales Revenue		1000
(To record sales on account)		

July 5/

Sales Returns and Allowances	100	
Accounts Receivable- Baghdad Co.		100
(To record merchandise returned)		

July 11/

Cash	882	.....	(\$900 2 \$18)
Sales Discounts	18	.....	(\$900 ×0 .02)
Accounts Rec.- Baghdad Co.	900		

(To record collection of accounts receivable)

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### **Valuing Accounts Receivable:**

Once companies record receivables in the accounts, the next question is: How should they report receivables in the financial statements? Companies report accounts receivable on the balance sheet as an asset. But determining the amount to report is sometimes difficult because some receivables will become uncollectible.

Two methods are used in accounting for uncollectible accounts: (1) the direct write-off method and (2) the allowance method. The following sections explain these methods.

**1. Direct- method:** when a company determines a particular account to be uncollectible, it charges the loss to Bad Debts Expense.

Assume, for example, that Ali Co. writes off as uncollectible Ahmed \$200 balance on December 24. Warden's entry is:

Dec. 24/

Bad Debts Expense	200
Accounts Receivable Ahmed	200

(To record write-off of Ahmed account)

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**2. Allowance method:** The allowance method of accounting for bad debts involves estimating uncollectible accounts at the end of each period. This provides better matching on the income statement. It also ensures that companies state receivables on the balance sheet at their cash (net) realizable value.

**Recording Estimated Uncollectible:** Assume that Amer Furniture Co. has credit sales of \$1200000 in 2024. Of this amount, \$200000 remains uncollected at December 31. The credit manager estimates that \$12000 of these sales will be uncollectible. The adjusting entry to record the estimated uncollectible increases (debits) Bad Debts Expense and increases (credits) Allowance for Doubtful Accounts, as follows.

Dec. 31/

Bad Debts Expense	12000
Allowance for Doubtful Accounts	12000
(To record estimate of uncollectible accounts)	

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### Balance Sheet (partial)

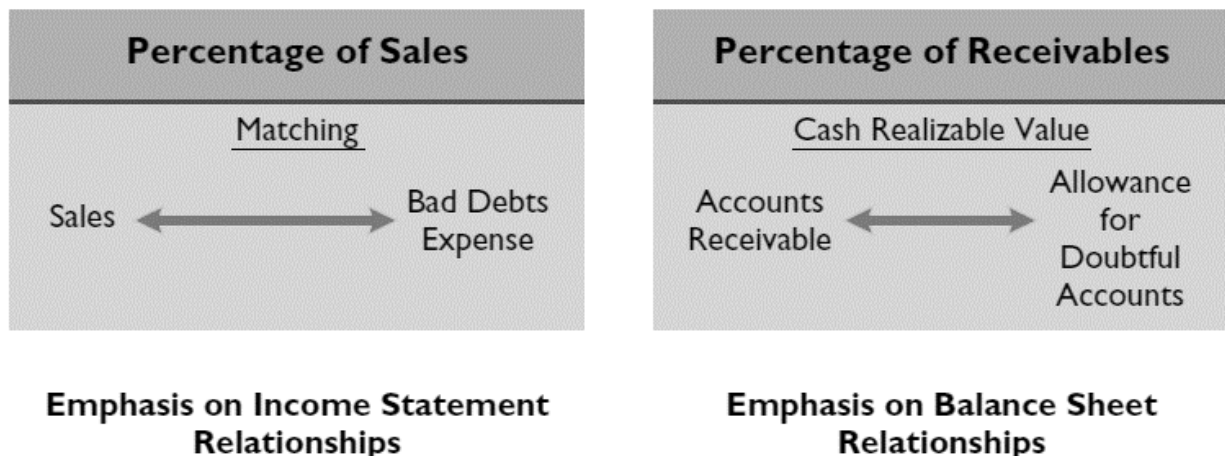
#### Current assets

Accounts receivable	\$200000	
Less: Allowance for doubtful accounts	12000	188000

#### **Estimating the Allowance:**

Two bases are used to determine this amount:

(1) Percentage of sales, and (2) percentage of receivables.



**1. Percentage of sales:** In the percentage-of-sales basis, management estimates what percentage of credit sales will be uncollectible. This percentage is based on past experience and anticipated credit policy

**Example (2):** Assume that Al-forat Co. To use the percentage-of-sales basis. It concludes that 1% of net credit sales will become uncollectible. If net credit sales for 2018 are \$800000.

#### **Instructions:**

Compute and prepare the journal entries for the transactions

#### **Solution:**

The estimated bad debts expense is  $(1\% \times \$800000) = \$8,000$

Dec. 31/

Bad Debts Expense	8000
Allowance for Doubtful Accounts	8000

(To record estimated bad debts for year)

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After the adjusting entry is posted, assuming the allowance account already has a credit balance of \$1750, the accounts of Gonzalez Company will show the following:

Bad Debts Expense		Allowance for Doubtful Accounts	
Dec. 31	8000		Jan. 1 Bal. 1750
			Dec. 31 8000
			Dec. 31 Bal. 9750

**2. Percentage of receivables:** Under the percentage-of-receivables basis, management estimates what percentage of receivables will result in losses from uncollectible accounts.

**Example (3):** Assume that the balance of A/R for Al-forat Co. at Des.31, 2018 IQD 200000, The estimated that percentage of bad debts 3% of accounts receivables. The balance off the allowance for bad debts at Des.31, 2018 IQD 2000.

**Instructions:**

Compute and prepare the journal entries for the transactions

Bad Debts Expense =  $200000 \times 0.03 = \text{IQD } 6000$ ....  $6000 - 2000 = 4000$

Dec. 31/

Bad Debts Expense	4000
Allowance for Doubtful Accounts	4000

(To record estimated bad debts for year)

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Bad Debts Expense

Dec. 31	4000
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Allowance for Doubtful Accounts

Jan. 1 Bal.	2000
Dec. 31	4000
Dec. 31 Bal.	6000