

SOLUTIONS

Learning Goal 26

Multiple Choice

1. c Remember that any entry to the Accounts Receivable account also requires an entry to a subsidiary account.
2. b
3. d Only the direct write-off method debits an expense at the time a receivable is written off.
4. b $\$44,700 - \$1,500 = \$43,200$
5. a Assets are overstated because the credit to the allowance has not been recorded, so net accounts receivable is too high. Expenses are understated because the debit to uncollectible accounts expense has not been recorded.
6. b When a receivable is written off, there is no expense recorded, so there is no effect on net income. There is also no change in net accounts receivable because the Accounts Receivable and allowance accounts are reduced by the same amount.
7. c With a \$350 previous debit balance, a \$2,350 credit is needed to end with a \$2,000 credit balance.
8. d *Net realizable value* means the amount collectible.
9. b Both Accounts Receivable and the Allowance for Uncollectible Accounts are reduced by \$450.
10. d
11. a $(\$120,000 \times .01) + (\$45,000 \times .03) + (\$30,000 \times .1) + (\$10,000 \times .6) = \$11,550$
12. a $\$11,550 - \$900 = \$10,650$. The amount of the adjustment compensates for the existing allowance balance.
13. d
14. c $(\$120,000 \times .09 \times 60)/360 = \$1,800$
15. a Use T accounts to visualize:

Accounts Receivable	Allowance for Uncollectible Accounts
<div style="text-align: right; border-bottom: 1px solid black; margin-bottom: 5px;">bal. 62,300</div>	<div style="text-align: right; border-bottom: 1px solid black; margin-bottom: 5px;">bal. 1,000</div> <div style="text-align: right; margin-bottom: 5px;">3,300</div> <div style="text-align: right; border-top: 1px solid black; border-bottom: 1px solid black;">3,000</div> <div style="text-align: right; border-bottom: 1px solid black; margin-top: 5px;">1,300</div>

The net realizable value is $\$62,300 - \$1,300 = \$61,000$. The \$3,300 expense (period-end adjustment) creates a \$3,300 credit entry into the allowance account. The write-offs during the year are debits to the allowance account.

16. b The collectible value is called the *net realizable value*.
17. c
18. c

SOLUTIONS

Learning Goal 26, continued

Discussion Questions and Brief Exercises

1. $\$9,100 - \$2,300 = \$6,800$
2. $\$9,100$
3. $\$9,100 + \$2,300 = \$11,400$
4. $\$9,100$
5. $\$11,500 + \$44,000 - \$39,800 - \$1,000 = \$14,700$. The uncollectible accounts expense adjusting entry does not affect the balance in Accounts Receivable—only an expense and an allowance account are affected. You can also use a T account to visualize the answer to the problem:

Accounts Receivable	
bal. 11,500	39,800
44,000	1,000
bal. 14,700	

6. The net realizable value is the difference between the balance in Accounts Receivable and the adjusted balance in Allowance for Uncollectible Accounts. Using the percent of sales method, the adjusted balance in Allowance for Uncollectible Accounts is $\$200 + (\$44,000 \times .01) = \$640$. Therefore, $\$14,700 - \$640 = \$14,060$.
7. Because both the accounts receivable account and the allowance account, which is an offset, are reduced by the same amount. For example, assume that a \$200 receivable is written off. The table below shows account balances before and after the write-off. The net realizable amount is unchanged.

Account	Balance Before	Balance After
Accounts Receivable	\$20,000	\$19,800
Less: Allowance for Uncollectible Accts.	1,500	1,300
Net realizable amount	\$18,500	\$18,500

8. Maturity value is the amount of principal and interest owing at the maturity date. The interest for the 90 days is $(\$4,500 \times .06 \times 90)/360 = \67.50 . The maturity value is $\$4,500 + \$67.50 = \$4,567.50$.
9. August 5. (24 days in May + 30 days in June + 31 days in July + 5 days in August = 90 days)
10. An account receivable usually is created by a sale of products or services and is typically due in 30–60 days. It does not accumulate interest except as a penalty for late payment. No formal promise to pay (a note) is signed. A note receivable arises for various reasons, including loaning money or making a sale. The note is a formal written promise to repay principal plus interest in a specified way by a specified date.
11. The allowance method is used to satisfy the GAAP requirement of showing accounts receivable at their net realizable value. This prevents overstating the value of accounts receivable on the balance sheet and also results in better matching of uncollectible accounts expense to the revenue that created the receivables. With this method, uncollectible receivables are estimated and an uncollectible accounts expense is recorded in the same period as the sales that created the bad receivables. The realizable amount of accounts receivable is reduced by use of an offsetting allowance account. In contrast, the direct write-off method simply records an uncollectible accounts expense in the period that a receivable is written off, and no effort is made to estimate bad receivables. This method overstates the accounts receivable value on the balance sheet and mismatches expenses to revenues.

SOLUTIONS**Learning Goal 26, continued**

12. A debit balance in the Allowance for Uncollectible Accounts means that the total of the debits to the account exceeded the credit balance created by the previous period-end estimate. This means that more receivables were written off than expected (bad debts were underestimated). A credit balance in the account means that the total debits were less than the credit balance created by the previous period estimate, so fewer receivables were written off than expected (bad debts were overestimated). The amount of the debit or credit balance is the amount of error in the previous estimate.
13. Yes, if the aging procedure is being used. No, if the percentage-of-sales procedure is being used, which targets a calculated balance for the Uncollectible Accounts Expense.
14. On the balance sheet, total assets would be overstated because net accounts receivable would be overstated. Also, on the balance sheet, owner's equity would be overstated because net income is overstated. On the income statement, net income is overstated because uncollectible accounts expense is understated.
15. If sales returns and allowances are relatively stable every period, then they can simply be recorded as they occur. However, if returns and allowances are unpredictable or it is likely that there may be significant merchandise returns from certain customers, sales returns and allowances should be estimated and recorded as a period-end adjustment in the same period in which the related sales were recorded.
16. This fraud was accomplished by debiting the Allowance for Uncollectible Accounts and crediting a revenue or an expense account. Greater revenue or less expense resulted in higher net income.

Reinforcement Problems**LG 26-1.**

	Total	Not Yet Due	Number of Days Past Due			
			1-30	31-60	61-90	Over 90
	\$ 47,650	\$ 32,000	\$ 7,050	\$ 3,900	\$ 3,150	\$ 1,550
Estimated % Uncollectible		1%	4%	10%	30%	60%
Total Estimated Uncollectible	\$ 2,867	\$ 320	\$ 282	\$ 390	\$ 945	\$ 930

a. $\$2,867 = (\$320 + \$282 + \$390 + \$945 + \$930)$; rounded to \$2,900

b.

June 30	Uncollectible Accounts Expense	2,530	
	Allowance for Uncollectible Accounts		2,530

SOLUTIONS**Learning Goal 26, continued****LG 26-2.**

- a. $\$320,000 \times .01 = \$3,200$
 b.

June 30	Uncollectible Accounts Expense	3,200	
	Allowance for Uncollectible Accounts		3,200

LG 26-3.

	Total Accounts Receivable	Allowance for Uncollectible Accounts	Net Realizable Value	Uncollectible Accounts Expense
Using the aging method, 2% of total accounts receivable are estimated to be uncollectible.	NE	+	-	+
Using the percent of sales method, uncollectible accounts expense is estimated to be 1.25% of net sales.	NE	+	-	+
An account receivable is written off.	-	-	NE	NE
An account receivable that was previously written off is now reinstated.	+	+	NE	NE
Using the direct write-off method, an account receivable is written off.	-	Account not used	-	+

LG 26-4.

a.

June 30	Uncollectible Accounts Expense	4,250	
	Allowance for Uncollectible Accounts		4,250

b.

June 30	Uncollectible Accounts Expense	5,750	
	Allowance for Uncollectible Accounts		5,750

SOLUTIONS

Learning Goal 26, continued

LG 26-4, *continued*

c.

June 30	Uncollectible Accounts Expense	1,800	
	Allowance for Uncollectible Accounts		1,800

d.

June 30	Uncollectible Accounts Expense	1,800	
	Allowance for Uncollectible Accounts		1,800

Comment: The percentage of sales method does not compensate for an existing balance in the allowance account.

LG 26-5.

a.

	Allowance for Uncollectible Accounts
Beginning balance:	750
Adjustment:	4,250
Ending balance:	5,000

b.

	Allowance for Uncollectible Accounts
Beginning balance:	750
Adjustment:	5,750
Ending balance:	5,000

Comment: Notice that with the aging method, the allowance account balance *must* have an ending balance that is the same as the estimated amount of uncollectible accounts.

c.

	Allowance for Uncollectible Accounts
Beginning balance:	500
Adjustment:	1,800
Ending balance:	2,300

d.

	Allowance for Uncollectible Accounts
Beginning balance:	500
Adjustment:	1,800
Ending balance:	1,300

SOLUTIONS

Learning Goal 26, continued

LG 26-6.

a.

2008				
Dec. 31	Uncollectible Accounts Expense		41,240	
	Allowance for Uncollectible Accounts			41,240

	Allowance for Uncollectible Accounts	
Beginning balance:		2,700
Adjustment:		41,240
December 31, 2008, balance:		43,940

b.

2009				
Feb. 15	Allowance for Uncollectible Accounts		15,000	
	Accounts Receivable—Shankar			15,000

	Allowance for Uncollectible Accounts	
Beginning balance:		2,700
Adjustment:		41,240
December 31, 2008, balance:		43,940
Shankar write-off:	15,000	

c.

2009				
Sept. 3	Accounts Receivable—Shankar		10,000	
	Allowance for Uncollectible Accounts			10,000
	Cash		10,000	
	Accounts Receivable—Shankar			10,000

	Allowance for Uncollectible Accounts	
Beginning balance:		2,700
Adjustment:		41,240
December 31, 2008, balance:		43,940
Shankar write-off:	15,000	
Shankar partial payment:		10,000

SOLUTIONS

Learning Goal 26, continued

LG 26-6, continued

d.

2009				
Dec. 31	Uncollectible Accounts Expense		39,060	
	Allowance for Uncollectible Accounts			39,060

	Allowance for Uncollectible Accounts
Beginning balance:	2,700
Adjustment:	41,240
December 31, 2008, balance:	43,940
Shankar write-off: 15,000	10,000
Shankar partial payment:	48,200
Other write-offs:	39,060
Adjustment:	29,800
December 31, 2009, balance:	29,800

December 31, 2009 calculation: $43,940 + 10,000 - 15,000 - 48,200 = (9,260)$ which is a debit balance before the adjustment. To obtain a final credit account balance of 29,800, a credit entry of 39,060 is required.

- e. The direct write-off method does not use an allowance account. Therefore, no year-end adjustments are prepared, and the only entries recorded are those that involve events related to the write-off of receivables.

2009				
Feb. 15	Uncollectible Accounts Expense		15,000	
	Accounts Receivable—Shankar			15,000
Sept. 3	Accounts Receivable—Shankar		10,000	
	Uncollectible Accounts Expense			10,000
	Cash		10,000	
	Accounts Receivable—Shankar			10,000
	Uncollectible Accounts Expense		48,200	
	Accounts Receivable—(various accounts)			48,200

The allowance method is better because it better matches the expense of bad receivables against the sales revenue that created the receivables. This is done by estimating bad receivables at the end of each accounting period. By not making an estimate and waiting until a receivable is judged to be uncollectible, the direct write-off method also overstates the collectible value of the accounts receivable showing on the balance sheet. The allowance method is required by GAAP.

SOLUTIONS

Learning Goal 26, continued

LG 26-7.

a. Bellarmine Associates

Date	Account/Explanation	Post. Ref.	Dr.	Cr.
Jan. 17	Allowance for Uncollectible Accounts		500	
	Accounts Receivable—Tyler			500
March 11	Notes Receivable		7,000	
	Sales			7,000
	Cost of Goods Sold		5,000	
	Merchandise Inventory			5,000
15	Accounts Receivable—Tyler		500	
	Allowance for Uncollectible Accounts			500
	Cash		250	
	Accounts Receivable—Tyler			250
31	Uncollectible Accounts Expense		1,250	
	Allowance for Uncollectible Accounts			1,250
	Interest Receivable		39	
	Interest Revenue			39
April 20	Allowance for Uncollectible Accounts		4,725	
	Accounts Receivable—Burrus			1,775
	Accounts Receivable—Chen			2,950
May 23	Cash		250	
	Accounts Receivable Tyler			250
June 9	Accounts Receivable—Dinville		7,175	
	Interest Receivable			39
	Interest Revenue			136
	Notes Receivable			7,000
30	Uncollectible Accounts Expense		1,650	
	Allowance for Uncollectible Accounts			1,650

SOLUTIONS

Learning Goal 26, continued

LG 26-7, continued

Date	Account/Explanation	Post. Ref.	Dr.	Cr.
August 2	Allowance for Uncollectible Accounts		3,170	
	Accounts Receivable—Cramer			1,400
	Accounts Receivable—Seinfeld			850
	Accounts Receivable—Costanza			920
Sept. 30	Uncollectible Accounts Expense		1,800	
	Allowance for Uncollectible Accounts			1,800
Nov. 16	Notes Receivable		20,000	
	Sales			20,000
	Cost of Goods Sold		12,000	
	Merchandise Inventory			12,000
18	Accounts Receivable—Burrus		150	
	Allowance for Uncollectible Accounts			150
	Cash		150	
	Accounts Receivable—Burrus			150
Dec. 4	Allowance for Uncollectible Accounts		1,390	
	Accounts Receivable—Bennis			1,390
31	Uncollectible Accounts Expense		4,235	
	Allowance for Uncollectible Accounts			4,235
	Interest Receivable		609	
	Interest Revenue			609

Calculation notes:

- March 31 (end of quarter) interest accrual on Dinville note: $(\$7,000 \times .1 \times 20)/360 = \38.88 , rounded to \$39.
- December 31 interest accruals:
Dinville: $\$7,175 \times .1 \times (205/360) = \408.58 , rounded to \$409.
Kessler: $\$20,000 \times .08 \times (45/360) = \200 .

SOLUTIONS

Learning Goal 26, continued

LG 26-7, continued

- December 31 uncollectible accounts adjustment: Because this is the aging procedure, before making the adjusting entry, it is necessary to know the balance in the allowance account. Calculate the balance by using a T account:

	Allow. for Uncoll. Accts.	
Beginning balance:		4,700
Jan. 17, write off Tyler:	500	
Mar. 15, reinstate Tyler:		500
Mar. 31, first quarter adjustment:		1,250
April 20, write off Burrus, Chen:	4,725	
June 30, second quarter adjustment:		1,650
August 2, write off Cramer, Seinfeld, Costanza:	3,170	
September 30, third quarter adjustment:		1,800
November 18, reinstate Burrus:		150
December 4, write off Bennis:	1,390	
Balance prior to adjustment:		265
Dec. 31 adjustment:		4,235
Dec. 31 balance:		4,500

The December 31 adjusting entry is the difference between the required balance of \$4,500 and the credit balance of \$265.

- b. The December 31 balance in Accounts Receivable is \$67,390:

	Accounts Receivable	
Beginning balance:	152,000	
Jan. 17, write off Tyler:		500
Mar. 15, reinstate Tyler:	500	
Sales first quarter:	125,000	
March 15, Tyler collection:		250
April 20, Write off Burrus, Chen:		4,725
May 23, Tyler collection:		250
June 10, Dinville note dishonored:	7,175	
Sales second quarter:	165,000	
Aug. 2, write off Cramer, Seinfeld, Costanza:		3,170
Sales third quarter:	180,000	
Nov. 18, reinstate Burrus:	150	
Nov. 18, Burrus collection:		150
Dec. 4, write off Bennis:		1,390
Sales fourth quarter:	190,000	
Collections for the year:		742,000
Ending balance, Dec. 31:	67,390	

Note: Remember that in actual practice there would also be subsidiary accounts for each of the individual customers. Each subsidiary account would record all the activity including write-offs and reinstatements, and would maintain a balance for each customer.

SOLUTIONS

Learning Goal 26, continued

LG 26-7, continued

b, continued

The December 31 balance in Notes Receivable (short term) is \$0:

	Notes Receivable	
Beginning balance:	-0-	
Mar. 11, Dinville note:	7,000	
June 10, Dinville note dishonored:		7,000
Nov. 16, Kessler note	20,000	
Ending balance, December 31:	20,000	

Balance sheet presentation of accounts receivable:

Accounts and notes receivable	\$87,390	
Less: Allowance for uncollectible accounts	4,500	
Net realizable value		\$82,890

Or:

Accounts and notes receivable, less allowance for uncollectible accounts of \$4,500	\$82,890
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LG 26-8.

a. St. Cloud Company

Date	Account/Explanation	Post. Ref.	Dr.	Cr.
Jan. 14	Allowance for Uncollectible Accounts		1,400	
	Accounts Receivable—Donnelly			1,400
Feb. 9	Accounts Receivable—Donnelly		1,400	
	Allowance for Uncollectible Accounts			1,400
	Cash		1,000	
	Accounts Receivable—Donnelly			1,000
March 31	Uncollectible Accounts Expense		3,150	
	Allowance for Uncollectible Accounts			3,150
April 18	Allowance for Uncollectible Accounts		4,100	
	Accounts Receivable—Nordquist			1,400
	Accounts Receivable—Carlson			2,700

SOLUTIONS

Learning Goal 26, continued

LG 26-8, *continued*

Date	Account/Explanation	Post. Ref.	Dr.	Cr.
May 4	Cash		400	
	Accounts Receivable—Donnelly			400
June 30	Uncollectible Accounts Expense		3,375	
	Allowance for Uncollectible Accounts			3,375
July 19	Notes Receivable		15,000	
	Sales			15,000
	Cost of Goods Sold		10,000	
	Merchandise Inventory			10,000
Aug. 22	Allowance for Uncollectible Accounts		5,850	
	Accounts Receivable—Kirk			1,800
	Accounts Receivable—Spock			1,500
	Accounts Receivable—McCoy			2,550
Sept. 30	Uncollectible Accounts Expense		3,450	
	Allowance for Uncollectible Accounts			3,450
	Interest Receivable		304	
	Interest Revenue			304
Oct. 17	Cash		10,000	
	Notes Receivable		5,375	
	Interest Receivable			304
	Interest Revenue			71
	Notes Receivable			15,000
Nov. 30	Accounts Receivable—Carlson		150	
	Allowance for Uncollectible Accounts			150
	Cash		150	
	Accounts Receivable—Carlson			150

SOLUTIONS

Learning Goal 26, continued

LG 26-8, *continued*

Date	Account/Explanation	Post. Ref.	Dr.	Cr.
Dec. 8	Allowance for Uncollectible Accounts		2,900	
	Accounts Receivable—Scott			2,900
Dec. 31	Uncollectible Accounts Expense		6,875	
	Allowance for Uncollectible Accounts			6,875
	Interest Receivable		112	
	Interest Revenue			112

Calculation notes:

- Sept. 30 (end of quarter) interest accrual on Johnson note: $(\$15,000 \times .1 \times 73)/360 = \304.17 rounded to \$304.
- Oct. 17 partial payment and renewal of Johnson note: Partial payments are normally applied first to interest and then to principal. The interest due for the remaining 17 days is $(\$15,000 \times .1 \times 17)/360 = \70.83 rounded to \$71. Therefore, the total interest due on the note is \$375 ($\$304 + \71). To verify this, calculate the interest for the full 90 days: $(\$15,000 \times .1 \times 90)/360 = \375 . After interest, the balance of the payment applied to principal is \$9,625: $\$10,000 - \$375 = \$9,625$. The new net balance is: $\$15,000 - \$9,625 = \$5,375$.
- December 31 uncollectible accounts adjustment: Because this is the aging procedure, before making the adjusting entry it is necessary to know the balance in the allowance account. Calculate the balance by using a T account:

	Allow. for Uncoll. Accts.
Beginning balance:	950
Jan. 14, write off Donnelly:	1,400
Feb. 9, reinstate Donnelly:	1,400
March 31, first quarter estimate:	3,150
April 18, write off Nordquist, Carlson:	4,100
June 30, second quarter estimate:	3,375
Aug. 22, write off Kirk, Spock, McCoy:	5,850
Sept. 30, third quarter estimate:	3,450
Nov. 30, reinstate Carlson:	150
Dec. 8, write off Scott:	2,900
Balance prior to adjustment:	1,775
Dec. 31 adjustment:	6,875
Dec. 31 balance:	<u>5,100</u>

The December 31 adjusting entry is the sum of the required balance of \$5,100 and the debit balance of \$1,775.

- December 31 interest accrual on Johnson note: $(\$5,375 \times .1 \times 75)/360 = \111.98 , rounded to \$112. Notice that the note principal was reduced to \$5,375 because of the October 17 partial payment before the renewal.

SOLUTIONS

Learning Goal 26, continued

LG 26-8, continued

- b. The December 31 balance in Accounts Receivable is \$94,100:

	Accounts Receivable	
Beginning balance:	47,300	
Write off Donnelly:		1,400
Reinstate Donnelly:	1,400	
Sales first quarter:	210,000	
Write off Nordquist and Carlson:		4,100
Sales second quarter:	225,000	
Write off Kirk, Spock, McCoy:		5,850
Sales third quarter:	230,000	
Reinstate Carlson:	150	
Write off Scott:		2,900
Sales fourth quarter:	310,000	
Collections for the year:		915,500
Ending balance, December 31:	94,100	

Note: Remember that in actual practice there would also be subsidiary accounts for each of the individual customers. Each subsidiary account would record all the activity for a customer, including write-offs and reinstatements, and would maintain a balance for the customer.)

The December 31 balance in Notes Receivable (short term) is \$5,375:

	Notes Receivable	
July 19:	15,000	
October 17:		15,000
October 17:	5,375	
	5,375	

Balance sheet presentation as part of current assets:

Accounts and notes receivable	\$99,475	
Less: Allowance for uncollectible accounts	<u>5,100</u>	
Net realizable value		\$94,375

Or:

Accounts and notes receivable, less allowance for uncollectible accounts of \$5,100:	\$94,375
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LG 26-9.

Maker	Maturity Date	Maturity Value	Interest Due Calculation
O'Meara	May 4, 2008	\$10,000 + \$2,000 = \$12,000	\$10,000 × .1 × 2 = \$2,000
Choi	September 12	\$50,000 + \$750 = \$50,750	(\$50,000 × .06) × 3/12 = \$750
Cook	December 18	\$80,000 + \$2,400 = \$82,400	(\$80,000 × .12) × 90/360 = \$2,400
Agami	January 26	\$45,000 + \$900 = \$45,900	(\$45,000 × .08) × 90/360 = \$900
Natenberg	January 2, 2008	\$20,000 + \$3,000 = \$23,000	(\$20,000 × .1) × 18/12 = \$3,000

SOLUTIONS

Learning Goal 26, continued

LG 26-10.

Date	Account/Explanation	Post. Ref.	Dr.	Cr.
Mar. 5	Cash		10,000	
	Notes Receivable—Kapalua Corp.		30,000	
	Equipment			40,000
April 8	Notes Receivable—Wailea Company		10,000	
	Accounts Receivable—Wailea Company			10,000
June 12	Notes Receivable—Supplies, Inc.		7,500	
	Cash			7,500
July 7	Cash		5,000	
	Notes Receivable—Wailea Company		5,250	
	Interest Revenue			250
	Notes Receivable—Wailea Company			10,000
	$(10,000 \times .1 \times 90)/360 = 250$			
Aug. 20	Notes Receivable—Kahalui Bay Company		16,000	
	Equipment			16,000
Nov. 1	Accounts Receivable—Supplies, Inc.		7,737	
	Notes Receivable—Supplies, Inc.			7,500
	Interest Revenue			237
	$(7,500 \times .08 \times 142)/360 = 237$			
Nov. 18	Cash		16,360	
	Notes Receivable—Kahalui Bay Company			16,000
	Interest Revenue			360
Dec. 31	Interest Receivable—Kapalua Corporation		2,190	
	Interest Receivable—Wailea Company		310	
	Interest Receivable—Supplies, Inc.		103	
	Interest Revenue			2,603
	$(30,000 \times .09 \times 292)/360 = 2,190$			
	$(5,250 \times .12 \times 177)/360 = 310$ (rounded)			
	$(7,737 \times .08 \times 60)/360 = 103$ (rounded)			

SOLUTIONS

Learning Goal 26, continued

LG 26-11.

Multiple-step income statement for periodic format showing cost of goods sold calculation:

Zhang Trading Company			
Income Statement			
For the Year Ended January 31, 2008			
Sales revenue			\$561,090
Less: Sales returns and allowances		\$2,500	
Sales discounts		3,250	<u>5,750</u>
Net sales revenue			555,340
Cost of goods sold			
Inventory, February 1		47,300	
Purchases	\$284,800		
Less: Purchase returns and allowances	\$900		
Purchase discounts	800	<u>1,700</u>	
Net purchases		<u>283,100</u>	
Cost of goods available for sale		330,400	
Inventory, January 31		<u>39,700</u>	
Cost of goods sold			<u>290,700</u>
Gross profit			264,640
Operating expenses			
Selling expenses			
Salaries and wages expense	15,100		
Depreciation expense	5,500		
Uncollectible accounts expense	2,100		
Freight-out expense	1,100		
Supplies expense	<u>350</u>		
Total selling expenses		24,150	
Administrative expenses			
Salaries & wages	60,400		
Rent expense	21,900		
Insurance expense	4,300		
Utilities expense	1,740		
Depreciation expense	500		
Supplies expense	<u>350</u>		
Total administrative expenses		<u>89,190</u>	
Total operating expenses			<u>113,340</u>
Operating income			151,300
Other revenue			
Interest revenue			<u>3,740</u>
Net income			<u><u>\$155,040</u></u>

SOLUTIONS

Learning Goal 26, continued

LG 26-11, *continued*

Zhang Trading Company			
Balance Sheet			
January 31, 2008			
Assets			
Current assets			
Cash		\$98,390	
Accounts receivable	\$55,750		
Less: Allowance of uncollectible accounts	<u>2,500</u>		
Net realizable accounts receivable		53,250	
Current portion of note receivable		6,000	
Merchandise inventory		39,700	
Store supplies		5,750	
Prepaid insurance		<u>950</u>	
Total current assets			\$204,040
Non-current notes receivable			24,000
Property, plant, and equipment			
Office equipment	\$15,500		
Less: Accumulated Depreciation	<u>10,750</u>	4,750	
Store equipment	<u>125,300</u>		
Less: Accumulated Depreciation	<u>101,100</u>	24,200	
Total Property, plant, and equipment			<u>28,950</u>
Total assets			<u>\$256,990</u>
Liabilities and Owner's Equity			
Current Liabilities			
Accounts payable		\$51,300	
Unearned revenue		<u>750</u>	
Total current liabilities			\$52,050
Owner's equity			
M. Zhang, capital			<u>204,940</u>
Total liabilities and owner's equity			<u>\$256,990</u>

The current portion of the long-term receivable is $\$500/\text{month} \times 12 = \$6,000$. This must be shown as a current asset. This is for receipts of principal only and does not include interest receipts.

Depreciation on store equipment is usually considered part of selling expenses. Uncollectible accounts expense is usually classified as part of selling expenses because it results from decisions to approve credit sales. Some accountants might consider it to be an administrative expense.

Also notice that merchandise inventory is the item that appears on both the balance sheet and income statement. Merchandise inventory is a major asset that appears on the balance sheet. When a detailed multiple-step income statement is prepared, merchandise inventory is also shown as part of the calculation of cost of goods sold on the income statement.

SOLUTIONS

Learning Goal 26, continued

LG 26-12. Multiple-step income statement for perpetual inventory system format:

Zhang Trading Company		
Income Statement		
For the Year Ended January 31, 2008		
Sales revenue		\$561,090
Less: Sales returns and allowances	\$2,500	
Sales discounts	3,250	<u>5,750</u>
Net sales revenue		555,340
Cost of goods sold		<u>290,700</u>
Gross Profit		264,640
Operating expenses		
Selling expenses		
Salaries and wages expense	15,100	
Depreciation expense	5,500	
Uncollectible accounts expense	2,100	
Freight-out expense	1,100	
Supplies expense	<u>350</u>	
Total selling expenses		24,150
Administrative expenses		
Salaries & wages	60,400	
Rent expense	21,900	
Insurance expense	4,300	
Utilities expense	1,740	
Depreciation expense	500	
Supplies expense	<u>350</u>	
Total administrative expenses		<u>89,190</u>
Total operating expenses		<u>113,340</u>
Operating income		151,300
Other revenue		
Interest revenue		<u>3,740</u>
Net income		<u>\$155,040</u>

SOLUTIONS

Learning Goal 26, continued

LG 26-12, *continued*

Zhang Trading Company			
Balance Sheet			
January 31, 2008			
Assets			
Current assets			
Cash		\$98,390	
Accounts receivable	\$55,750		
Less: Allowance of uncollectible accounts	<u>2,500</u>		
Net realizable accounts receivable		53,250	
Current portion of note receivable		6,000	
Merchandise inventory		39,700	
Store supplies		5,750	
Prepaid insurance		<u>950</u>	
Total current assets			\$204,040
Non-current notes receivable			24,000
Property, plant, and equipment			
Office equipment	\$15,500		
Less: Accumulated Depreciation	<u>10,750</u>	4,750	
Store equipment	125,300		
Less: Accumulated Depreciation	<u>101,100</u>	24,200	
Total property, plant, and equipment			<u>28,950</u>
Total assets			<u>\$256,990</u>
Liabilities and Owner's Equity			
Current liabilities			
Accounts payable		\$51,300	
Unearned revenue		<u>750</u>	
Total current liabilities			\$52,050
Owner's equity			
M. Zhang, capital			<u>204,940</u>
Total liabilities and owner's equity			<u>\$103,580</u>

The current portion of the long-term receivable is $\$500/\text{month} \times 12 = \$6,000$. This must be shown as a current asset. This is for receipts of principal only and does not include interest receipts.