

Lets do a complete a/r allowance activity project! Prepare a balance sheet and income statement for the following as of and for the three month period ending March 31:

Make sales to customers in January, February and March totaling \$4,850,000. Terms 2/10 net 30.

Allowance for doubtful accounts at BOY is \$575,000.

Inventory at the beginning of the period is \$5,000,000, purchases were \$2,000,000 and ending inventory is \$4,000,000.

Loss incurrence rate over trailing twelve months (ttm) is 1%.

Management writes off \$100,000 of receivables in the ordinary course.

Management reviews the accounts receivable at the end of March and notes that an old receivable from prior year sales in the amount of \$1,000,000 is from a customer which is no longer in existence. Management concludes that the allowance against current period sales still appears appropriate and that an additional \$500,000 of expense is justified for this item (b/c there was already \$500,000 in the reserve account at the beginning of the year). The old customer balance should be written-off.

Collected \$2,500,000 of accounts receivable during the three month period, all of which was received within 10 days. Gross method employed.

BOY retained earnings was \$4,425,000.

Record sales activity:

Accounts receivable	\$4,850,000	
Sales		\$4,850,000

Record % of Sales A/R Reserve

Bad debt expense	\$48,500	
Allowance for doubtful accounts		\$48,500

Record Ordinary Write-Offs

Allowance for DA's	\$100,000	
Accounts receivable		\$100,000

Direct Write-Off of Large Balance (per management analysis)

Bad debt expense	\$500,000	
Accounts receivable		\$500,000
Allowance for doubtful accounts	\$500,000	
Accounts receivable		\$500,000

Compute A/R Paid on Discount

Cash received	\$2,500,000	
Divided by Discount (1-.02)	<u> .98</u>	
A/R		<u>\$2,552,020</u>

Record Cash Collections

Cash	\$2,500,000	
Trade discounts (sales)	\$51,020	
Accounts receivable		\$2,551,020

Compute COS:

Inventory at BOY	\$5,000,000
Purchases	\$2,000,000
<u>Ending balance</u>	<u>(\$4,000,000)</u>
COS	\$3,000,000

Record Inventory activity:

COS	\$3,000,000	
Inventory		\$3,000,000
Inventory	\$2,000,000	
Cash		\$2,000,000

Analyze adequacy (valuation) of A/R allowance:

Balance at beginning of year	\$575,000
Additions during year	\$48,500
Ordinary write-off's	(\$100,000)
Direct w-off	<u>(no impact)</u>
Ending balance	\$523,500
Amount estimated for 90 days sales	<u>(\$48,500)</u>
"Cushion"	\$475,000

Is this adequate? Depends on many factors such as: What is the balance of the >90 days aging component, what is the quality of the past 3 months sales, etc.

ROLLFORWARDS FOR STATEMENT PREPARATION(CAN USE T-ACCOUNTS OR WHATEVER WORKS FOR YOU!)

NOTE: CREDITS IN BRACKETS IN THIS PRESENTATION

A/R

BOY	0
Debits	\$4,850,000
Credits	<u>(\$3,651,020)</u>
EOY	<u>\$1,198,980</u>

Allowance

BOY	(575,000)
Debits	\$600,000
Credits	<u>(48,500)</u>
EOY	<u>(\$23,500)</u>

Bad Debt Expense

BOY	0
Debits	\$548,500
Credits	<u>(none)</u>
EOY	<u>\$548,500</u>

INVENTORY

BOY	5,000,000
Debits	2,000,000
Credits	<u>-3,000,000</u>
EOY	<u>4,000,000</u>

SALES

BOY	0
Debits	\$51,020
Credits	<u>(4,850,000)</u>
EOY	<u>(4,798,980)</u>

CASH

BOY	0
Debits	\$2,500,000
Credits	<u>(2,000,000)</u>
EOY	<u>\$500,000</u>

COS

BOY	0
Debits	\$3,000,000
Credits	<u>(none)</u>
EOY	<u>\$3,000,000</u>

RETAINED EARNINGS

BOY	(4,425,000)
Debits	\$0
Credits (Net income)	<u>(1,250,480)</u>
EOY	<u>(\$5,675,480)</u>

**XYZ INC
BALANCE SHEET
3/31/XX**

ASSETS	
Cash	500,000
Accounts Receivable, net of \$23,500 allowance	1,175,480
Inventory	<u>4,000,000</u>
Total current assets	<u>5,675,480</u>
 Total Assets	 <u>5,675,480</u>

LIABILITIES & EQUITY	
Current liabilities	none in example

EQUITY	
Retained Earnings	<u>5,675,480</u>
 Liabilities & Equity	 <u>5,675,480</u>

**XYZ INC
INCOME STATEMENT
3 MONTHS ENDED MARH 31, XX**

Revenue	4,798,980
COS	<u>3,000,000</u>
Gross profit	1,798,980
 Bad debt expense	 <u>548,500</u>
Provision for income taxes	nothing in example
 Net income	 <u>1,250,480</u>