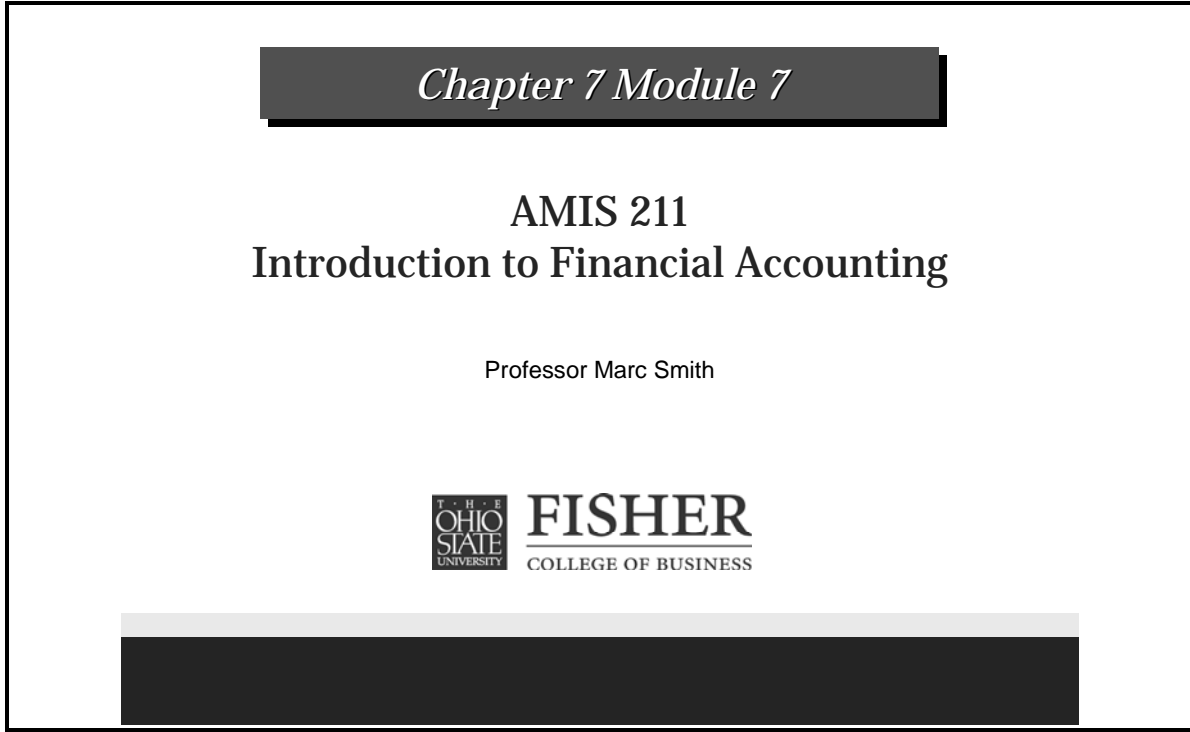


**Chapter 7, Module 7**

**Slide 1**



The slide content is enclosed in a black rectangular border. At the top, there is a dark grey horizontal bar with the text *Chapter 7 Module 7* in white, italicized font. Below this bar, the text **AMIS 211** and **Introduction to Financial Accounting** is centered. Underneath, the name **Professor Marc Smith** is centered. In the center of the slide is the logo for Fisher College of Business at Ohio State University, which includes the text "T · H · E OHIO STATE UNIVERSITY" in a small box and "FISHER COLLEGE OF BUSINESS" in a larger font. At the bottom of the slide, there is a light grey horizontal bar above a dark grey horizontal bar.

Hi everyone. Welcome back.

Let's go ahead and let's get a little bit more practice with this bad debt estimation.

And, let's look at Example #4 from the Web site problems.

And, this one is going to be a little bit more involved. Notice the name of the problem: Comprehensive Bad Debt Problem.

We are going to basically take all that we have learned so far about bad debts and Accounts Receivable and let's lump them into this one example. And, let's see if we can work our way through it.

Let's look at the example together.

Here is what it says:

“Grandma Veazy’s House of Fun has compiled the following information to help in determining its year-end estimate of bad debt expense.”

Here is the information they tell us:

Our Credit Sales for the year. They tell us the Sales Returns and Allowances for the year. They tell us what Accounts Receivables were at the end of the year. They tell us the Allowance for Doubtful Accounts at January 1<sup>st</sup>—the beginning of the year—had a credit side balance. And then, they tell us about write-offs and recoveries that happened during the year.

Part A says:

“Let’s assume Grandma Veazy’s House of Fun is using the Net Credit Sales Method and estimates her bad debt expense to be 4% of Net Credit Sales.”

“Calculate the bad debt expense estimate and the Net Realizable Value (NRV).”

Let’s go ahead to the next slide and let’s jump right into it.

## Slide 2

**Chapter 7 Module 7: Example #4, Part A****Part A: Net Credit Sales Method**

$$1. \text{ Bad debt expense} = \text{Net credit sales} \times \%$$

$$500,000 \times .04 \quad \leftarrow \text{NOT CORRECT}$$

$$\text{Bad debt expense} = (500,000 - 18,000) \times .04$$

$$\text{Bad debt expense} = \$19,280$$

Now, we know under the Net Credit Sales Method, our bad debt expense is equal to (=) the Net Credit Sales times (x) the percentage (%) expected to be uncollectible.

So, here is what we would probably want to do as we are working through this problem.

Take the Credit Sales of \$500,000 times (x) 4%.

And, BOOM! The estimated bad debt expense is \$20,000.

Except: guess what?

That is NOT CORRECT! That is not right. There is something that we are not accounting for.

Take a look at the problem.

What are we missing here? What do we not have in this formula?

The formula is Net Credit Sales.

We know how to calculate our Net Sales as our Sales minus (-) Sales Returns and Sales Discounts.

There are no Sales Discounts in the problem. But, they do tell us about Sales Returns.

Thus, to get our Net Credit Sales, you take the \$500,000 minus (-) \$18,000.

It looks like Net Credit Sales of \$482,000.

You multiply (x) that by the 4% expected to be uncollectible.

Our bad debt expense is estimated as \$19,280.”

Watch for that! That is one place it is sort-of easy to trip up a little bit.

Now, if you would go to the next slide...

## Slide 3

*Chapter 7 Module 7: Allowance T-account*

| <u><i>Allowance for Doubtful Accounts</i></u> |                              |
|---|------------------------------|
| <i>Beginning</i>                              | <i>Balance</i>               |
| <i>Write-offs</i>                             | <i>Recoveries</i>            |
|   | <i>Bad debt expense</i>      |
|   | <u><i>Ending Balance</i></u> |

One thing we should never do when we are working these problems is not use T-Accounts. We should always have T-Accounts.

And, I have repeated the Allowance for Doubtful Accounts T-Account here (on Slide 3) with all of the different items that go into that T-Account.

This is something that you just need to know. You need to know what causes that account to go up and down. So, you need to know what to put where in the T-Account.

And, you can see the recoveries and the bad debt expense on the credit side; write-offs on the debit side, Ending Balance at the bottom right (credit); Beginning Balance can either be debit or credit. The problem will always tell you.

Now, go to the next slide with me.

## Slide 4

**Chapter 7 Module 7: Example #4, Part A****Allowance for Doubtful Accounts**

|        |        |
|--------|--------|
|        | 18,500 |
| 12,200 | 7,800  |
|        | 19,280 |
|        | 33,380 |

|   |                       |
|---|-----------------------|
| <b>Accounts Receivable</b>                      | <b>420,000</b>        |
| <b>- <u>Allowance for Doubtful Accounts</u></b> | <b>&lt;33,380&gt;</b> |
| <b>Net Realizable Value</b>                     | <b>\$386,620</b>      |

Let's go back to our problem and let's calculate the Net Realizable Value (NRV) here in Part A.

Let's fill in what we know.

What we know:

The Beginning Balance is given: \$18,500 on the credit side.

What else we know is:

Recoveries during the year on the credit side as well: \$7,800.

We also know that there were write-offs during the year that are recorded on the debit side of the T-Account: \$12,200.

We just calculated the bad debt expense estimate: \$19,280 on the credit side.

This allows us to figure out the Ending Balance in the Account: \$33,380.

And, once we know that, we can go ahead and figure out the NRV: the Accounts Receivable minus (-) the Allowance.

At the end of the year, Accounts Receivable is given: \$420,000.

You have just calculated the Ending Balance in the Allowance account as \$33,380.

This gives us a Net Realizable Value (NRV) of \$386,620.

Those T-Accounts just make your life a lot easier in dealing with these bad debts.

Please go to the next slide.

## Slide 5

**Chapter 7 Module 7: Example #4, Part B****Part B: Aging Method** **$\Sigma$  (Amount of receivables x %)**

| <u>Age</u>         | <u>Balance</u> | <u>Percentage<br/>Estimated to be<br/>Uncollectible</u> | <u>Amount</u> |
|--------------------|----------------|---|---------------|
| Current. ....      | \$320,000      | 6%  | \$19,200      |
| 1-30 days. ....    | 50,000         | 9   | 4,500         |
| 31-90 days. ....   | 30,000         | 15  | 4,500         |
| Over 90 days. .... | <u>20,000</u>  | 40  | <u>8,000</u>  |
|                    | \$420,000      |   | \$36,200      |

**The \$36,200 represents the required ending credit balance in the allowance for doubtful accounts.**

And, let's go ahead and do Part B—the Aging Method.

Let's say: "Forget about what we just did. Let's assume Grandma Veazy's House of Fun employs the Aging Method to estimate bad debt expense."

And, there is the Aging Schedule—given in the problem and repeated on this slide (Slide 5).

And what we need to do: for each age category, take the amount of the Receivables times (x) the percentage (%) given, and then, add (+) those products.

The number from the Aging Schedule when we do that is: \$36,200.

Note: what is very important!

The \$36,200 IS NOT your bad debt expense. But, rather: it is the Ending Balance in the Allowance for Doubtful Accounts.

Go to the next slide.

## Slide 6

**Chapter 7 Module 7: Example #4, Part B****Allowance for Doubtful Accounts**

|        |        |
|--------|--------|
|        | 18,500 |
| 12,200 | 7,800  |
|        | X      |
|        | 36,200 |

$$18,500 + 7,800 + X - 12,200 = 36,200$$

$$X = \$22,100 = \text{bad debt expense}$$

And, let's work our T-Account.

The Beginning Balance is given: \$18,500 on the credit side.

Recoveries are given: \$7,800 on the credit side of the T-Account.

Write-offs are given: \$12,200 on the debit side of the T-Account.

When using the Aging Method, you are always going to end up with that Ending Balance from the Aging Schedule. That is the \$36,200 from the Aging Schedule that we just worked with.

This allows us to then solve for "x"—"x" being our bad debt expense.

Set up the Algebra equation. Solve for "x."

Your bad debt expense estimate is \$22,100.

Aging can be a little bit more involved. So, you will want to be comfortable with how it is done.

And, you have to remember the key point:

That number you get from the Aging Schedule—multiplying the amount of Receivables in each category times (x) the percentage (%) is the Ending Credit side balance in the Allowance for Doubtful Accounts.

Please go to the next slide.

**Slide 7**

| <i>Chapter 7 Module 7: Example #4, Part B</i>   |                       |
|---|-----------------------|
| <b><u>Part B: Aging Method</u></b>              |                       |
| <b>Accounts Receivable</b>                      | <b>420,000</b>        |
| <b>- <u>Allowance for Doubtful Accounts</u></b> | <b>&lt;36,200&gt;</b> |
| <b>Net Realizable Value</b>                     | <b>\$383,800</b>      |

We can calculate our NRV—Net Realizable Value—as our Accounts Receivable of \$420,000 minus (-)...what number?

It is minus (-) that Ending Balance in the Allowance. We just got it from the Aging Schedule: \$36,200.

That gives us a Net Realizable Value (NRV) of \$383,800.