The Revenue/Receivables/Cash Cycle

Overview

Chapter 7 returns us to a look at accounting transactions and their eventual reporting in the form of financial statements. This chapter looks at a cycle that is usually the most important for a company. For some companies, the transactions and record keeping that go on for the revenue, receivables, and cash cycle account for the vast majority of the company’s total bookkeeping responsibilities.

Along with the sale of merchandise and/or services (and the subsequent collection of cash on those sales) are a variety of transactions and/or journal entries that are a bit more complicated and rare. One of those is the reporting of bad debts, usually accounted for only once a period in the form of an adjusting entry. There are multiple methods to account for bad debts—some in accordance with GAAP and one that is not (but is still widely used for small, cash-basis businesses and for tax purposes). Other entries (that are slightly more complicated and somewhat rarer than the everyday sales entries) include discounts, warranties, and the accounting for sales returns and allowances.

The bank reconciliation is something introduced in this chapter, which you may not have encountered before. Bank reconciliation not only helps to control the handling of cash, but it is also required in order to get the correct balance of cash to show up on the statement of cash flows and balance sheet.

In the “Expanded Material” section of this chapter, various means of turning receivables into cash are discussed. (It’s not always as straightforward as you’ve been instructed thus far.) In addition, other kinds of receivables are gone over in detail so that you can understand some other important items that you are likely to see on a balance sheet. Finally, continuing the discussion from Chapter 5 on the statement of cash flows, a few items that are covered in this chapter that weren’t touched on yet back in Chapter 5 are explained in terms of their effect on the statement of cash flows using either the direct or indirect method.
Learning Objectives

Refer to the Review of Learning Objectives at the end of the chapter. It is crucial that this section of the chapter is second nature to you before you attempt the homework, a quiz, or exam. This important piece of the chapter serves as your CliffsNotes or "cheat sheet" to the basic concepts and principles that must be mastered.

If after reading this section of the chapter you still don't feel comfortable with all of the Learning Objectives covered, you will need to spend additional time and effort reviewing those concepts that you are struggling with.

The following “Tips, Hints, and Things to Remember” are organized according to the Learning Objectives (LOs) in the chapter and should be gone over after reading each of the LOs in the textbook.

Tips, Hints, and Things to Remember

LO1 – Explain the normal operating cycle of a business.

How? How is one to distinguish between the varying receivables in this learning objective? First of all, note that there is some degree of overlap between the definitions. For some transactions, two definitions hold up. For instance, your typical accounts receivables are also usually trade receivables. A trade receivable could also be a note receivable if it was extended to a one-time customer or a customer who couldn’t pay for a long period of time (and, hence, an interest-bearing note was issued in lieu of immediate payment or a payment typically due in a month or so without interest or a note attached to it).

LO2 – Prepare journal entries to record sales revenue, including the accounting for bad debts and warranties for service or replacement.

Why? Why would a company use the net method versus the gross method when accounting for cash (sales) discounts? The gross method is the method most commonly used, and it is the one that you’ve more than likely been exposed to. Why, then, may a company want to use the net method? Well, take a look at the difference in the journal entries. If you expect, or history indicates, that most of your customers pay within the discount period, then you have a simpler journal entry when payment is received if you use the net method (as there is no need to hit a Sales Discounts account like you do under the gross method).
Sales Discounts is a contra-revenue account which, when netted against sales, reduces the sales figure that will be reported on the income statement in arriving at net sales. The same is true for Sales Returns and Allowances.

Sales Discounts Not Taken (and some companies may in fact just credit the Sales account rather than an account with a different name like the example shows) increases the net sales figure that will be reported on the income statement.

**Why?** Why should a company choose to estimate bad debts based on an Accounts Receivable balance instead of as a percentage of sales? Think about the following scenario for a minute:

Acker Company has $5 million in sales and estimates bad debts to be 2 percent of sales. Accounts Receivable has a balance of $90,000 at year end since many customers pay with cash and those that don’t tend to pay off their balance in 15 days or less. Do you see anything wrong with this picture?

Two percent of $5 million is $100,000, which means that all of the receivables are expected to be bad under this estimation method (even though almost all of them were created in the past couple weeks of the year) and an extra $10,000 is being tossed in for good measure. Clearly, something is wrong here. A company with a long history may be able to use a percentage of sales to estimate bad debts somewhat accurately, but for most companies, it will be the least accurate estimating technique.

Performing the estimation based on the balance in Accounts Receivable is usually more accurate, and it also takes into consideration the current balance in the Allowance for Bad Debts account (leaving a company with a better estimated number in that account). The most accurate method takes it one step further and ages the receivables and then applies percentages to the various aging groups. After all, chances are that those accounts not yet due will be collected with a higher frequency than those that are, say, a year or more overdue.

LO3 – Analyze accounts receivable to measure how efficiently a firm is using this operating asset.
LO4 – Discuss the composition, management, and control of cash, including the use of a bank reconciliation.

**How?** Memorizing how the countless number of possible items that can be included in a bank reconciliation are to be treated seems daunting. The textbook only mentions a few of them. There are many others including numerous kinds of errors, electronic funds transfers, and collections made by the bank for the company. The problem is that if you try and memorize each of these items individually (i.e., Is the item added or subtracted to or from the books or to or from the bank statement?), you will get things confused. A better approach is to think about what a bank reconciliation is trying to accomplish and then take it from there.

So, in a nutshell, the following is a bank reconciliation from a conceptual standpoint:

- The bank knows about things the company doesn't yet know.
- The company knows about things the bank doesn't yet know.
- Add and subtract the other's knowledge to each, and you’ll come up with the true balance.

Now you can take any item and plug it into the above to do a bank reconciliation without getting things flip-flopped. For instance, let’s look at a common item like deposits in transit.

On the last day of the month, a deposit was taken to the bank (which closed at 5 P.M.) after the business closed at 9 P.M. and inserted into the night deposit box. The company, of course, knows about this deposit and has recorded it in their general ledger. The bank won’t process the transaction until the following weekday morning, so it won’t show up on the monthly bank statement. Therefore, this is something “the company knows about that the bank doesn’t yet know.” Hence, it should be added to the bank statement balance to “come up with the true balance.” It’s as simple as that.

**Why?** You will likely cover internal controls in much more detail in later courses (such as accounting information systems and auditing). However, it is never too early to understand some of the basic internal controls that are useful in companies.

There are four duties that should be kept separate if at all possible. In some smaller companies, it isn’t possible, but in most medium-size and large companies, keeping these functions in the hands of differing people can greatly reduce errors and fraud from occurring. The four areas consist of the following:

- asset custody
- record keeping
- authorization
- reconciliations
Why are these four the important ones to keep segregated? Because if an employee is responsible for two or more of these areas, this employee can cause errors that go undetected or, worse yet, commit fraud and cover up his/her own tracks.

There are several examples in the textbook of keeping the above duties separated although they aren’t laid out in the above terms. For instance, “separation of handling and recording cash receipts” is the same as keeping asset custody and record keeping separate.

When these four functions are kept segregated, it makes fraud difficult to perpetrate, without collusion between employees, and it also makes the discovery of everyday errors easier to detect. It is frequently easier to spot the errors of others than it is your own errors.

LO5 – Recognize appropriate disclosures for presenting sales and receivables in the financial statements.

LO6 – Explain how receivables may be used as a source of cash through secured borrowing or sale.

LO7 – Describe proper accounting and valuation of notes receivable.

LO8 – Understand the impact of uncollectible accounts on the statement of cash flows.
The following sections, featuring various multiple choice questions, matching exercises, and problems, along with solutions and approaches to arriving at the solutions, is intended to develop your problem-solving and critical-thinking abilities. While learning through trial and error can be effective for improving your quiz and exam scores, and it can be a more interesting way to study than merely re-reading a chapter, that is only a secondary objective in presenting this information in this format.

The main goal of the following sections is to get you thinking, “How can I best approach this problem to arrive at the correct solution—even if I don’t know enough at this point to easily come up with the proper results?” There is not one simple approach that can be applied to all questions to arrive at the right answer. Think of the following approaches as possibilities, as tools that you can place in your problem-solving toolkit—a toolkit that should be consistently added to. Some of the tools have yet to even be created or thought of. Through practice, creative thinking, and an ever expanding knowledge base, you will be the creator of the additional tools.

Multiple Choice

MC7-1 (LO2) Based on its past collection experience, Amanda Company provides for bad debts at the rate of 2 percent of sales. On January 1, 2011, the credit balance of Allowance for Bad Debts was $10,000. During 2011, Amanda wrote off $18,000 of uncollectible receivables and recovered $5,000 on accounts written off in prior years. If sales for 2011 totaled $1,000,000, the bad debt expense for 2011 should be
a. $17,000.
b. $20,000.
c. $23,000.
d. $35,000.

MC7-2 (LO2) Sanzberro Company sold $46,000 of pipe to Laughlin District 4 on April 12 of the current year with terms 1/15, net/60. Sanzberro uses the gross method of accounting for cash discounts. What entry would Sanzberro make on April 12?
a. Accounts Receivable
   Sales
   46,000
b. Accounts Receivable
   Sales
   46,000
   Sales Discounts
   45,540
   460
c. Accounts Receivable
   Sales
   45,540
d. Accounts Receivable
   Sales
   45,540
   Sales Discounts
   460
   46,000
MC7-3 (LO2) Based on the aging of its accounts receivables at December 31, Jimenez Company determined that the net realizable value of the receivables at that date is $760,000. Additional information is as follows:

Accounts Receivable at December 31 $880,000
Allowance for Bad Debts at January 1 128,000 (cr)
Accounts written off as uncollectible during the year 88,000

Jimenez Company’s bad debt expense for the year ended December 31 is
a. $80,000.
b. $96,000.
c. $120,000.
d. $160,000.

MC7-4 (LO2) Dahlman Appliance Center sells washing machines that carry a three-year warranty against manufacturer’s defects. Based on company experience, warranty costs are estimated at $30 per machine. During the year, Dahlman sold 40,000 washing machines and paid warranty costs of $200,000. In its income statement for the year ended December 31, Dahlman should report warranty expense of
a. $200,000.
b. $1,000,000.
c. $1,200,000.
d. $1,400,000.
MC7-5 (LO2) Deregla Company uses the allowance method of accounting for bad debts. The following summary schedule was prepared from an aging of accounts receivable outstanding on December 31 of the current year.

<table>
<thead>
<tr>
<th>Number of Days Outstanding</th>
<th>Amount</th>
<th>Probability of Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>0–30 days</td>
<td>$500,000</td>
<td>0.98</td>
</tr>
<tr>
<td>31–60 days</td>
<td>200,000</td>
<td>0.90</td>
</tr>
<tr>
<td>Over 60 days</td>
<td>100,000</td>
<td>0.80</td>
</tr>
</tbody>
</table>

The following additional information is available for the current year:

Net credit sales for the year $4,000,000
Allowance for Bad Debts:
  Balance, January 1 45,000 (cr)
  Balance before adjustment, December 31 2,000 (dr)

If Deregla bases its estimate of bad debts on the aging of accounts receivable, bad debt expense for the current year ending December 31 is
a. $47,000.
b. $48,000.
c. $50,000.
d. $52,000.

MC7-6 (LO2) Dollarhide Company sold merchandise on credit to Franklin Company for $2,000 on July 1, with terms of 2/10, net /30. On July 7, Franklin returned $400 worth of merchandise, claiming the materials were defective. On July 9, Dollarhide received a payment from Franklin and credited Accounts Receivable for $900. On July 28, Franklin Company paid the remaining balance on its account. What was the total cash received from Franklin during July, assuming that Dollarhide uses the gross method to record discounts?
a. $882
b. $900
c. $1,582
d. $1,600
MC7-7 (LO3) Ashland Corporation’s books disclosed the following information for the year ended December 31, 2011:

Net credit sales $3,000,000
Net cash sales 480,000
Accounts Receivable at beginning of year 400,000
Accounts Receivable at end of year 800,000

Ashland’s accounts receivable turnover is
a. 3.75 times.
b. 4.35 times.
c. 5.00 times.
d. 5.80 times.

MC7-8 (LO4) The amount reported as “Cash” on a company’s balance sheet normally should exclude
a. petty cash.
b. cash in a payroll account.
c. undelivered checks written and signed by the company.
d. NSF checks payable to the company.

MC7-9 (LO4) Which one of the following statements is NOT true?
a. The accounting function should be separated from the custodianship of a company’s assets.
b. The responsibility for receiving merchandise and authorizing the paying for it should usually be given to one person.
c. Someone outside the accounting function should perform the bank reconciliations.
d. A company’s personnel should be given well-defined responsibilities.

MC7-10 (LO4) Which of the following best describes a reconciling item in a bank reconciliation?
a. Subtract NSF checks to get the book balance to the corrected balance.
b. Subtract deposits outstanding to get the bank balance to the corrected balance.
c. Subtract interest earned at the bank to get the book balance to the corrected balance.
d. Add checks outstanding to get the bank balance to the corrected balance.
MC7-11 (LO4) Chalmers Company had the following cash balances at December 31, 2011:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Cash in banks</td>
<td>$375,000</td>
</tr>
<tr>
<td>Petty cash funds</td>
<td>5,000</td>
</tr>
</tbody>
</table>

Cash in banks includes $120,000 of compensating balances against long-term borrowing arrangements at December 31, 2011. The compensating balances are legally restricted as to withdrawal by Chalmers. In the Current Assets section of Chalmers’ December 31, 2011, balance sheet, what total amount should be reported as Cash?

a. $380,000  
b. $375,000  
c. $260,000  
d. $255,000

MC7-12 (LO4) Assume the following facts for Cordeiro Company: The month-end bank statement shows a balance of $50,000; outstanding checks total $2,000; a deposit of $8,000 is in transit at month-end; and a check for $400 was erroneously charged against the account by the bank. What is the correct cash balance at the end of the month?

a. $43,600  
b. $44,400  
c. $55,600  
d. $56,400
Matching

Matching 7-1 (LO1) Listed below are the terms and associated definitions from the chapter for LO1. Match the correct definition letter with each term number.

<table>
<thead>
<tr>
<th>Term Number</th>
<th>Term</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>___ 1.</td>
<td>accounts receivable</td>
<td>a. evidenced by a formal written promise to pay a certain sum of money at a specified date</td>
</tr>
<tr>
<td>___ 2.</td>
<td>nontrade receivable</td>
<td>b. inflow or other enhancement of assets of an entity or settlement of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations</td>
</tr>
<tr>
<td>___ 3.</td>
<td>notes receivable</td>
<td>c. not evidenced by a formal agreement; usually unsecured “open accounts” and represent an extension of short-term credit to customers</td>
</tr>
<tr>
<td>___ 4.</td>
<td>revenue</td>
<td>d. receivables associated with the normal operating activities of a business (e.g., credit sales of goods or services to customers)</td>
</tr>
<tr>
<td>___ 5.</td>
<td>trade receivables</td>
<td>e. receivables arising from transactions that are not directly associated with the normal operating activities of a business</td>
</tr>
</tbody>
</table>
Matching 7-2 (LO2, LO3) Listed below are the terms and associated definitions from the chapter for LO2 and LO3. Match the correct definition letter with each term number.

___ 1. aging receivables
___ 2. allowance method
___ 3. cash (sales) discount
___ 4. direct write-off method
___ 5. net realizable value
___ 6. present value
___ 7. trade discount
___ 8. warranties
___ 9. average collection period
___ 10. accounts receivable turnover

a. recognizing the estimated losses from uncollectible accounts as expenses during the period in which the sales occur
b. the typical number of days that lapse between the time that a sale is made and the time that cash is collected
c. discounted, at an appropriate rate of interest, net future cash inflows or outflows
d. obligations of a company to provide free service on units failing to perform satisfactorily or to replace defective goods
e. a reduction in sales price allowed if payment is received within a specified period, usually offered to customers to encourage prompt payment
f. an analytical measurement of how rapidly customers' accounts are being collected
g. the most commonly used method for establishing an Allowance for Bad Debts account based on outstanding receivables; this method involves analyzing individual accounts to determine those not yet due and those past due; past-due accounts are classified in terms of length of the period past due
h. recognizing the actual losses from uncollectible accounts as expenses during the period in which the receivables are determined to be uncollectible; this method is not in accordance with GAAP
i. the amount of cash expected to be received from the conversion of assets in the normal course of business; equals selling price less normal selling costs for inventory and equals gross receivables less the allowance for bad debts for accounts receivable
j. a reduction in the “list” sales price of an item to the “net” sales price actually charged to the customer; generally dependent on the volume of business or size of order from the customer
### Matching 7-3 (LO4, LO5)

Listed below are the terms and associated definitions from the chapter for LO4 and LO5. Match the correct definition letter with each term number.

<table>
<thead>
<tr>
<th>Term Number</th>
<th>Term Description</th>
<th>Definition</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>bank reconciliation</td>
<td>a. funds deposited in a bank that can be withdrawn at any time</td>
</tr>
<tr>
<td>2</td>
<td>bank service charge</td>
<td>b. coin, currency, and other items that are acceptable for deposit at face value; serves as a medium of exchange and provides a basis of measurement for accounting</td>
</tr>
<tr>
<td>3</td>
<td>cash</td>
<td>c. funds that legally require prior notification before they can be withdrawn</td>
</tr>
<tr>
<td>4</td>
<td>cash equivalents</td>
<td>d. not honored by a bank because there is not enough cash in the maker’s account</td>
</tr>
<tr>
<td>5</td>
<td>cash overdraft</td>
<td>e. a credit balance in the cash account; results from checks being written for more than the cash amount on deposit; should be reported as a current liability</td>
</tr>
<tr>
<td>6</td>
<td>compensating balances</td>
<td>f. the process that identifies differences between the cash balance on the depositor’s books and the balance reported on the bank statement; provides information needed to adjust the book balance to a corrected cash amount</td>
</tr>
<tr>
<td>7</td>
<td>demand deposits</td>
<td>g. made near the end of the month and recorded on the depositor’s books but is not received by the bank in time to be reflected on the bank statement</td>
</tr>
<tr>
<td>8</td>
<td>deposit in transit</td>
<td>h. written near the end of the month that have reduced the depositor’s cash balance but have not yet cleared the bank as of the bank statement date</td>
</tr>
<tr>
<td>9</td>
<td>not-sufficient-funds (NSF) check</td>
<td>i. the portion of a demand deposit that must be maintained as support for existing borrowing arrangements</td>
</tr>
<tr>
<td>10</td>
<td>outstanding checks</td>
<td>j. a monthly fee sometimes charged to service a depositor’s account</td>
</tr>
<tr>
<td>11</td>
<td>time deposits</td>
<td>k. short-term, highly liquid investments that can be converted easily to cash; generally, only investments that on the day of acquisition have less than three months remaining to maturity qualify</td>
</tr>
</tbody>
</table>
Matching 7-4 (LO6, LO7, LO8) Listed below are the terms and associated definitions from the chapter for LO6 through LO8. Match the correct definition letter with each term number.

___ 1. accounts receivable
___ 2. assignment of receivables
___ 3. implicit (effective) interest
___ 4. imputed interest rate
___ 5. interest-bearing note
___ 6. negotiable notes
___ 7. noninterest-bearing notes
___ 8. principal (face amount)
___ 9. promissory note
___ 10. selling receivables with recourse

a. the actual interest rate earned or paid on a note, bond, or similar instrument
b. the amount, excluding interest, that the maker of a note or the issuer of a bond agrees to pay at the maturity date
c. the borrowing of money with receivables pledged as security on the loan
d. a note written in a form in which the face amount includes an interest charge; in this form, the difference between the face amount and the present value of the note is the implicit or effective interest
e. the purchaser advances cash in return for receivables but retains the right to collect from the seller if debtors fail to make payments when due
f. a note written in a form in which the maker promises to pay the face amount plus interest at a specified rate
g. a formal written agreement to pay a certain amount of money at a specified future date
h. the sale of receivables without recourse for cash to a third party, usually a bank or other financial institution
i. notes that are legally transferable by endorsement and delivery
j. the rate of interest assigned to a note when there is no current market price for either the property, goods or services, or the note; the assigned rate of interest is used to discount future receipts or payments to the present in computing the present value of the note

Problems

Problem 7-1 (LO2) The following information was abstracted from the records of the Lifang Corporation:

Accounts Receivable, December 31, 2011 $  600,000
Allowance for Bad Debts before adjustment, December 31, 2011 10,000 (dr)
Sales—2011 2,100,000
Sales Discounts—2011 15,000
Sales Returns—2011 28,000
Prepare the adjusting entry for bad debt expense under each of the following assumptions:

1. Three percent of outstanding accounts receivable are uncollectible.
2. One-and-a-half percent of 2011 net sales are uncollectible.
3. An aging schedule of the accounts shows that $25,000 of the accounts are probably uncollectible.

**Problem 7-2 (LO4)** Lopez Company received its bank statement for the month ending July 31. The bank statement indicates a balance of $42,400. The Cash account as of the close of business on July 31 has a balance of $18,350. In reconciling the balances, the following items are discovered:

a. The bank collected a note for $1,500 less collection fees of $250.
b. Deposits in transit, $51,000
c. The bank charged the depositor $800 for overdrafts.
d. Outstanding checks on July 31, $79,100
e. A canceled check issued to Nelson Corporation for $4,500 was not recorded on Lopez Company’s books.

Prepare a bank reconciliation statement. (Use the format of reconciling both bank and book figures to corrected cash balances that equal each other.)

**Problem 7-3 (LO7)** Prout Incorporated sold merchandise that cost Prout $49,000 to produce to Renne Company on June 30, 2011. The normal selling price of the merchandise was $84,000, but Renne did not have enough money to pay cash. Prout accepted a note from Renne with a face amount of $92,000, no stated interest, and a maturity date of June 30, 2012, in exchange for the merchandise.

Assuming that Renne pays off the note on the maturity date, what are the journal entries that Prout should make on June 30, 2011, December 31, 2011, and June 30, 2012? Assume that Prout uses straight-line amortization for any discounts and the perpetual inventory method for recording inventory.

**Solutions, Approaches, and Explanations**

**MC7-1**
Answer: b

Approach and explanation: Sometimes you are given more information than needed. If you don’t recognize that fact, you can hang yourself with all the additional information; not only may you get the question wrong, but you may also waste precious quiz or test time performing calculations that need not be performed, thus shortening the amount of time available for other questions.
Upon reading the first sentence, you should remember that when bad debts are being estimated using anything other than Accounts Receivable, the Allowance for Bad Debts account is ignored. The amounts that were recovered and written off are also needless information.

The solution is as simple as the first sentence indicates—merely multiply the sales by 2 percent ($1,000,000 \times 0.02)$.

What if we changed the end of the question (the bad debt expense for 2011) to read:

What was the balance in the Allowance for Bad Debts account at the end of the year after the bad debt provision had been provided for?

<table>
<thead>
<tr>
<th>Allowance for Bad Debts</th>
</tr>
</thead>
<tbody>
<tr>
<td>18,000</td>
</tr>
<tr>
<td>10,000</td>
</tr>
<tr>
<td>5,000</td>
</tr>
<tr>
<td>20,000</td>
</tr>
<tr>
<td>17,000</td>
</tr>
</tbody>
</table>

You can see that the correct choice shifts from $b$ to $a$ with the new question.

**MC7-2**

Answer: $a$

Approach and explanation: There are three items not to be missed in the question. The first is the date. The pipe is sold on the 12th, and the question is asking for the entry on the 12th. If the entry was for collection on the 20th, you’d have a very different answer. The second item is the terms. The terms of 1/15, net/60 means that if paid within 15 days, a 1 percent discount can be taken, but that the amount is due in 60 days (without a discount). If Laughlin goes beyond 60 days, they probably won’t be allowed to purchase on credit in the future. The third item, and most important for this particular problem, is that the method being used is the gross method. Circle, or underline, those kinds of items as you are reading the problem.

Students will look at this question and think that choice $a$ looks too obvious and easy to possibly be correct, but it is.

Could choice $b$ ever be correct? No. Sales Discounts is rarely, if ever, credited. Remember that it is a contra-revenue account and, hence, should normally get a debit entry.

Could choice $c$ ever be correct? Yes. If the word “gross” was changed to “net” in the question, then choice $c$ would be the correct choice.
Choice \( d \) looks pretty good, but this entry would never be made under either method. The entry that gets recorded under the gross method when the full amount of cash is collected during the discount period is a debit to Cash (not Accounts Receivable) and a credit to Accounts Receivable (not Sales). The debit to Sales Discounts would be correct for that, different, transaction however.

**MC7-3**

Answer: a

Approach and explanation: The first thing you may want to do is create T-accounts for the applicable accounts like so:

<table>
<thead>
<tr>
<th>Bad Debt Expense</th>
<th>Accounts Receivable</th>
<th>Allowance for Bad Debts</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>not given</td>
<td>88,000</td>
</tr>
<tr>
<td>80,000</td>
<td></td>
<td>88,000</td>
</tr>
<tr>
<td>80,000</td>
<td>880,000</td>
<td></td>
</tr>
</tbody>
</table>

Then start filling them in until you “back into” the answer as follows:

<table>
<thead>
<tr>
<th>Bad Debt Expense</th>
<th>Accounts Receivable</th>
<th>Allowance for Bad Debts</th>
</tr>
</thead>
<tbody>
<tr>
<td>80,000</td>
<td>not given</td>
<td>88,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td>88,000</td>
</tr>
<tr>
<td>80,000</td>
<td>880,000</td>
<td></td>
</tr>
</tbody>
</table>

Were too many steps skipped for you? Well, let’s back up a bit and see where these numbers came from. The $880,000 was given as the ending Accounts Receivable balance so that is the first number entered. The next item entered was the $120,000 as the ending balance for Allowance for Bad Debts. This was computed as $880,000 – $760,000 with the $760,000 being the given amount for net ending receivables. Recall that the Allowance for Bad Debts account is a contra-Accounts Receivable account. The two combined are the net receivables that will be reported on the balance sheet.
No beginning balance or Accounts Receivable activity numbers were provided (or needed) so “not given” was written in just to make sure all bases were covered. The amount of $128,000 was given as the beginning balance for the Allowance for Bad Debts, so that was filled in as a credit. The final piece of important information is that specific customer accounts totaling $88,000 were written off during the year. The entry to record that is a debit to the Allowance account and a credit to Accounts Receivable. For this question, the credit to Accounts Receivable doesn’t affect things, but the debit to the Allowance account is key. Be sure to put that in before computing the bad debt expense.

Finally, we can see that nothing else affected the Allowance account except the Bad Debt Expense adjusting entry, and we are missing a credit of $80,000 in the Allowance account to arrive at the ending balance of $120,000. So the missing entry must have been a debit to Bad Debt Expense for $80,000 with a corresponding credit to Allowance for Bad Debts for the same amount.

Bad Debt Expense is only affected by that single, period-ending adjusting entry. It is not affected by accounts being written off, by subsequent collections, or by reinstatement of account balances.

**MC7-4**

Answer: c

**Approach and explanation:** Warranty expenses, like any other expenses, should be accounted for on the accrual basis. That means that when cash is paid for, the costs are irrelevant, and the balance in the liability account also doesn’t matter for this question. The matching process discussed back in Chapter 4 is the overriding criteria for warranty expense recognition.

What is matched you may ask? The matching isn’t the “paid costs” with the “expense” or “the time period in which the warranty covers” with the “expense.” The matching process matches expenses with revenues. So, in this case, the expense should be matched on the income statement with the revenue that will produce the eventual cost. Since Dahlman sold (and recognized the revenue on) 40,000 machines this year, the full amount of expected warranty costs should be recognized as an expense this year (40,000 × $30).

What if the question asked for the warranty liability (assuming this was the first year of business or the first year for a product with a warranty)? For that, it may be better to look at the journal entries or T-accounts. First, the journal entries:

```
Warranty Expense                  1,200,000
  Estimated Liability under Warranties  1,200,000

Estimated Liability under Warranties  200,000
  Cash                          200,000
```
And now, what it would look like if you used T-accounts:

<table>
<thead>
<tr>
<th>Warranty Expense</th>
<th>Estimated Liability under Warranties</th>
<th>Cash</th>
</tr>
</thead>
<tbody>
<tr>
<td>1,200,000</td>
<td>1,200,000</td>
<td>128,000</td>
</tr>
<tr>
<td></td>
<td>200,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>1,000,000</td>
<td></td>
</tr>
</tbody>
</table>

You can see that if the question was changed to ask for the balance in the liability account, the correct answer would change from choice c to choice b.

MC7-5
Answer: d
Approach and explanation: A few keys to this question…
1. Note that the balance before adjustment in the Allowance for Bad Debts account is a debit balance.
2. The beginning balance is meaningless (as is net credit sales) and can be ignored for this problem since the balance just prior to the adjustment is given.
3. When performing an estimate of bad debts using Accounts Receivable, the balance in the Allowance account cannot be ignored (unlike an estimate of bad debts using sales or credit sales as a basis in which the Allowance account can be ignored).

With that said, the first step is to figure out what the balance should be, after the adjusting entry, in the Allowance for Bad Debts account. The calculation is fairly simple and straightforward as follows:

<table>
<thead>
<tr>
<th>Amount</th>
<th>Probability of Non-Collection</th>
</tr>
</thead>
<tbody>
<tr>
<td>$500,000</td>
<td>$500,000 × (1 – 0.98) = $10,000</td>
</tr>
<tr>
<td>200,000</td>
<td>200,000 × (1 – 0.90) = 20,000</td>
</tr>
<tr>
<td>100,000</td>
<td>100,000 × (1 – 0.80) = 20,000</td>
</tr>
<tr>
<td>Total</td>
<td>$50,000</td>
</tr>
</tbody>
</table>

So there needs to be a credit balance in the Allowance for Bad Debts account of $50,000 as follows:

<table>
<thead>
<tr>
<th>Bad Debt Expense</th>
<th>Allowance for Bad Debts</th>
</tr>
</thead>
<tbody>
<tr>
<td>?</td>
<td>2,000</td>
</tr>
<tr>
<td></td>
<td>?</td>
</tr>
<tr>
<td></td>
<td>50,000</td>
</tr>
</tbody>
</table>
This means that the missing entry (in T-account format) to make the Allowance for Bad Debts account come up with the $50,000 ending balance is as follows:

<table>
<thead>
<tr>
<th>Bad Debt Expense</th>
<th>Allowance for Bad Debts</th>
</tr>
</thead>
<tbody>
<tr>
<td>52,000</td>
<td>2,000</td>
</tr>
<tr>
<td>52,000</td>
<td>52,000</td>
</tr>
<tr>
<td></td>
<td>50,000</td>
</tr>
</tbody>
</table>

Two final “what ifs” to note:

1. If the last line in the question read, “The balance for Allowance for Bad Debts at the end of current year ending December 31 is…,” then the correct answer would change to choice $c$.

2. If the “balance before adjustment, December 31” was changed from a debit to a credit, then the correct answer would change to choice $b$. 

MC7-6
Answer: c
Approach and explanation: At first glance, there appears to be a lot going on here. That being the case, don't try to do this in your head, or even on your calculator. Rather, break the paragraph down sentence by sentence. Prepare journal entries for each sentence and record what cash comes in from each sentence since the question ultimately is asking just that. (How much cash was received?)

Dollarhide Company sold merchandise on credit to Franklin Company for $2,000 on July 1, with terms of 2/10, net/30. (gross method)

<table>
<thead>
<tr>
<th>Cash Received?</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>2,000</td>
</tr>
</tbody>
</table>
| Sales             | 2,000   | $ 0

On July 7, Franklin returned $400 worth of merchandise, claiming the materials were defective.

<table>
<thead>
<tr>
<th>Sales Returns and Allowances</th>
<th>400</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts Receivable</td>
<td>400</td>
</tr>
</tbody>
</table>

On July 9, Dollarhide received a payment from Franklin and credited Accounts Receivable for $900. (gross method)

<table>
<thead>
<tr>
<th>Cash</th>
<th>882</th>
</tr>
</thead>
<tbody>
<tr>
<td>Sales Discounts</td>
<td>18</td>
</tr>
<tr>
<td>Accounts Receivable</td>
<td>900</td>
</tr>
</tbody>
</table>

On July 28, Franklin Company paid the remaining balance on its account.

<table>
<thead>
<tr>
<th>Cash</th>
<th>700</th>
</tr>
</thead>
</table>
| Accounts Receivable    | 700  | $700

Total cash received $1,582

You may be asking how one comes up with the final $700 as the remaining balance in Accounts Receivable. The answer is that the Accounts Receivable account balance (for Franklin anyway) went like the following:

<table>
<thead>
<tr>
<th>Accounts Receivable</th>
</tr>
</thead>
<tbody>
<tr>
<td>2,000</td>
</tr>
<tr>
<td>400</td>
</tr>
<tr>
<td>900</td>
</tr>
<tr>
<td>?</td>
</tr>
<tr>
<td>0</td>
</tr>
</tbody>
</table>
MC7-7
Answer: c
Approach and explanation: Just a few items to note on this one: The first is that when both credit and cash sales are known, the number is more accurate and meaningful when the cash sales are omitted since they never make it into Accounts Receivable and, hence, aren’t part of the turnover. If the company Ashland Company is being compared to has a similar amount of cash sales and their computation is based on total sales, then it would provide more comparability to include the cash sales (or better yet attempt to take them out of the other company’s calculation).

Another item to take notice of is that when you have multiple Accounts Receivable numbers from the period of the sales, you should average them. The more the better as your final figure will be more accurate. The computation with two Accounts Receivable numbers from the year is $3,000,000/($400,000 + $800,000)/2. If you were given the balance halfway through the year as being $600,000, then the calculation would be $3,000,000/($400,000 + $600,000 + $800,000)/3. If you were only given the ending balance, then choice a would be the correct answer.

As for memorizing these formulas, don’t bother. Check out the second How? on page 3-4 of this guide for tips on remembering what goes into financial ratios without having to memorize every single one of them.

MC7-8
Answer: d
Approach and explanation: Cash (and cash equivalents) are items that can be converted to currency on demand. Clearly choices a and b fall into that category. Other items that would fall under the “Cash” heading would be undeposited amounts, checks written to the company, and some very short-term (usually less than three months) securities.

Choice c is a bit tricky. The company has written and signed a check. Does the company still have that cash? The answer is yes, for the time being. The check could sit in a drawer for months or be voided before sending. So no cash has been given up just by writing and signing a check. Once the check becomes outstanding, then the cash has changed hands (even if the person the check is made out to has yet to cash it). So it is when the check is mailed or handed over to the payee that it should be a reduction in cash to the payer and not before.

Choice d, the correct choice, should not be included in cash. Before it is known that the check is NSF, it should be included in cash, but as soon as the NSF status is discovered, it should be taken out of cash and entered as a receivable. The money is still owed to the company at this point. The company can’t get cash out of a NSF check. The same can be said for an IOU or postdated check written to the company.

See Exhibit 7-5 in the textbook for more, specific classification items.
MC7-9
Answer: b
Approach and explanation: The question is asking for the statement that is not true. Be sure to read it correctly, or you may circle choice a and be done with it. In any case, be sure to always read all four choices so that your likelihood of misreading and subsequently answering a question incorrectly decreases (because if you know your stuff and see three correct answers, you'll know you have misread the question), and also be sure to highlight the fact that you are looking for the false statement.

Choices a and b are practically opposites. That should be a good indication that one of them is the correct answer. Custodianship and receiving merchandise are the same thing. Paying for it is also custodianship, whereas the accounting function is record keeping.

Choice c is a correct statement, although you frequently see bank reconciliations being performed in the accounting department in real life. This shouldn’t be happening. Many cases of fraud would be discovered if some other department, like the Internal Audit Department or a department without custody of the cash, performed the monthly bank reconciliations. In a small company, the owner or head manager should, at a minimum, review the bank reconciliation performed by the accountant or bookkeeper.

Choice d is certainly a correct statement and is the first one listed in the textbook as a basic characteristic in a system of cash control.

The reason why choice b is an incorrect statement is that there is insufficient segregation of duties when the person who has custody of the asset is also authorizing it (a function that should be separate). The person could be taking the asset home, and if the person doing the record keeping weren’t alert and checking up on the asset being recorded, no one would probably ever know.

MC7-10
Answer: a
Approach and explanation: At first glance, a student might see that one choice is for add and the other three choices are for subtract, so the different choice of add must be correct, right? Wrong! You need to work through each of these and find the one that is correct since items can be added or subtracted.

Let’s use the methodology (categories) discussed on page 7-4 and look at each choice individually.
What do you do with NSF checks? Before you can answer that, you need to know what one is. Assuming you know that they are checks written to the company that have bounced, you should also know that you won’t find out about them until you see them on the company’s bank statement or get a notice from the bank. In either case, they are already included in the bank’s balance (actually deducted from the bank’s balance if they were added when the deposit was made) and have yet to be accounted for in the general ledger. Therefore, they fall under category 1: “The bank knows about things the company doesn’t yet know.” Now that the company has been notified by the bank, the NSF checks are going to go into the reconciliation as a subtraction from cash on the books/general ledger to move the general ledger cash balance in the direction of the true balance.

Next up are deposits outstanding. These fall under category 2: “The company knows about things the bank doesn’t yet know.” So while it is true that the bank balance needs to be altered, these are deposits, so they should increase the bank balance, not decrease it with a subtraction.

Interest earned at the bank will be reflected in the bank’s balance but not the general ledger yet—category 1. The book balance does need to be adjusted, but like choice b, the item of interest earned should be added, not subtracted.

Finally, we come to outstanding checks. Outstanding checks are things that the company knows about (after seeing the bank statement), but the bank has no clue as to their existence. Therefore, we are dealing with category 2, and the bank’s balance needs to adjusted, just as the choice indicates. Once again, however, we have the effect going in the wrong direction, making choice d an incorrect choice. Checks, when cashed, will draw down the bank’s balance, so these should be subtracted to get the bank balance to the corrected balance.

Hopefully, working through these examples will help you to be able to solve any given item correctly and be able to perform a bank reconciliation even if you have never done so before or if you encounter specific items that aren’t listed in the textbook or as one of the four choices to this question.
MC7-11
Answer: c
Approach and explanation: Cash includes both cash in banks and petty cash funds. However, compensating balances are not always included in the Current Assets section as Cash. Here are the possibilities for compensating balances:

- Not legally restricted? The amounts and nature should be disclosed in the notes to the financial statements.
- Legally restricted and tied to short-term financing? Show amounts separately among the “cash items” in the Current Assets section.
- Legally restricted and tied to long-term financing? Show amounts separately as either investments or “other assets” but not in the Current Assets section.

In this case, Chalmers was in the third situation, so $120,000 should not be shown as Cash in the Current Assets section. Rather, it should be shown as a noncurrent asset. Hence, the calculation for the answer is $375,000 + $5,000 – $120,000 = $260,000 (choice c).

MC7-12
Answer: d
Approach and explanation: This question is pretty straightforward. Start with the bank statement and then adjust it to arrive at the correct cash balance.

Bank statement amount $50,000
Deduct outstanding checks (since they aren't accounted for in the $50,000 and shouldn't be included in the correct cash balance) – 2,000
Add deposit in transit (since it isn't accounted for in the $50,000 but should be included in the correct cash balance) + 8,000
Add erroneous charge (since it has been taken out of the $50,000 but shouldn't be excluded from the correct cash balance) + 400
Correct cash balance at the end of the month $56,400

Matching 7-1
1. c
2. e
3. a
4. b
5. d
Complete these terminology matching exercises without looking back at the textbook or on to the glossary. After all, you probably won’t have those as a reference at test time. Learning through trial and error causes the item to be learned better and to stick in your memory longer than if you just look at the textbook, glossary, or a dictionary and “cook book” the answers. Sure you may get the answer correct on your first attempt, but missing something is sometimes best for retention. Don’t be afraid of failure while studying and practicing.

Matching 7-2
1. g
2. a
3. e
4. h
5. i
6. c
7. j
8. d
9. b
10. f

Matching 7-3
1. f
2. j
3. b
4. k
5. e
6. i
7. a
8. g
9. d
10. h
11. c

Matching 7-4
1. h
2. c
3. a
4. j
5. f
6. i
7. d
8. b
9. g
10. e
Problem 7-1
1. Bad Debt Expense 28,000
   Allowance for Bad Debts 28,000
   \[ [0.3 \times \$600,000] + \$10,000 = \$28,000 \]

2. Bad Debt Expense 30,855
   Allowance for Bad Debts 30,855
   \[ [0.15 \times (\$2,100,000 - \$15,000 - \$28,000)] = \$30,855 \]

3. Bad Debt Expense 35,000
   Allowance for Bad Debts 35,000
   \[ \$25,000 + \$10,000 = \$35,000 \]

Problem 7-2

**Lopez Company**  
**Bank Reconciliation**  
**July 31**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance per bank statement at July 31</td>
<td>$42,400</td>
</tr>
<tr>
<td>Add: Deposits in transit</td>
<td>51,000</td>
</tr>
<tr>
<td>Deduct: Outstanding checks</td>
<td>79,100</td>
</tr>
<tr>
<td>Corrected bank balance</td>
<td>$14,300</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Balance per books at July 31</td>
<td>$18,350</td>
</tr>
<tr>
<td>Add: Notes receivable collected by bank (net)</td>
<td>1,250</td>
</tr>
<tr>
<td>Deduct:</td>
<td></td>
</tr>
<tr>
<td>Overdrafts</td>
<td>$ 800</td>
</tr>
<tr>
<td>Book error—unrecorded check</td>
<td>4,500</td>
</tr>
<tr>
<td>Corrected book balance</td>
<td>$14,300</td>
</tr>
</tbody>
</table>

Make sure that your corrected bank balance and corrected book balance equal ($14,300 each in this case). If they don't, check for items you may have missed, added when they should have been subtracted (or vice versa), included under the bank instead of under the books (or vice versa), or double counted. Also, look for any footing (adding/subtracting) errors and transposed numbers.
**Problem 7-3**

**June 30, 2011**
- Notes Receivable 92,000
- Cost of Goods Sold 49,000
  - Sales 84,000
  - Inventory 49,000
  - Discount on Notes Receivable 8,000

**December 31, 2011**
- Discount on Notes Receivable 4,000
- Interest Revenue 4,000
  
  ($8,000/12 \times 6 \text{ months})

**June 30, 2012**
- Cash 92,000
- Discount on Notes Receivable 4,000
  - Notes Receivable 92,000
  - Interest Revenue 4,000

Perhaps one of the most frequent errors with problems like the above is that the accounts that get established don’t get zeroed out by the time the transactions are completely finished. Check to make sure that your balances for any notes (bonds, plant assets, etc.) and associated discounts ( premiums, accumulated depreciation, etc.) go to zero when that particular asset (or liability as the case may be) is done away with. You shouldn’t have a $4,000 credit balance, or any debit or credit balance, sitting in a Discount on Notes Receivable account when the associated note no longer exists. Nor should you have an $8,000 balance, or any balance, in the Notes Receivable account after June 30, 2012.

If you notice these kinds of errors happening in your work, you may want to use T-accounts in your analysis of any of these types of problems to double check yourself and make sure these kinds of accounts go to zero. For example,:

<table>
<thead>
<tr>
<th>Notes Receivable</th>
<th>Discount on Notes Receivable</th>
</tr>
</thead>
<tbody>
<tr>
<td>92,000</td>
<td>8,000</td>
</tr>
<tr>
<td></td>
<td>4,000</td>
</tr>
<tr>
<td></td>
<td>0</td>
</tr>
<tr>
<td>92,000</td>
<td>4,000</td>
</tr>
<tr>
<td>0</td>
<td>0</td>
</tr>
</tbody>
</table>
Another thing students should consider on journal entry problems is to fill in what you know first and then work on the parts of the entry that you don’t. The parts that you don’t know right off the bat are easier to come by when other pieces are filled in. Sometimes you are missing a single debit or a single credit, and when you see the amount of the missing debit or credit, you can infer what the account must be. In addition, you may be given partial credit if you get 50 percent or 80 percent of the journal entry correct. If you leave it blank because you try and tackle the whole thing at once (and can’t), your chances of partial credit disappear.

Glossary

Note that Appendix C in the rear portion of the textbook contains a comprehensive glossary for all of the terms used in the textbook. That is the place to turn to if you need to look up a word but don’t know which chapter(s) it appeared in. The glossary below is identical with one major exception: It contains only those terms used in Chapter 7. This abbreviated glossary can prove quite useful when reviewing a chapter, when studying for a quiz for a particular chapter, or when studying for an exam which covers only a few chapters including this one. Use it in those instances instead of wading through the 19 pages of comprehensive glossary in the textbook trying to pick out just those words that were used in this chapter.

accounts receivable  Trade receivables that are not evidenced by a formal agreement or “note”; accounts receivable are usually unsecured "open accounts" and represent an extension of short-term credit to customers.

accounts receivable factoring  The sale of receivables without recourse for cash to a third party, usually a bank or other financial institution.

accounts receivable turnover  An analytical measurement of how rapidly customers’ accounts are being collected. The net accounts receivable turnover formula is net sales divided by average trade accounts receivable for a period.

aging receivables  The most commonly used method for establishing an Allowance for Bad Debts account based on outstanding receivables. This method involves analyzing individual accounts to determine those not yet due and those past due. Past-due accounts are classified in terms of length of the period past due.

allowance method  A method of recognizing the estimated losses from uncollectible accounts as expenses during the period in which the sales occur; this method is required by GAAP.

assignment of receivables  The borrowing of money with receivables pledged as security on the loan.

average collection period  Average number of days that lapse between the time that a sale is made and the time that cash is collected. Computed by dividing average receivables outstanding by average daily sales.
**bank reconciliation**  A process that identifies differences between the cash balance on the depositor’s books and the balance reported on the bank statement. The reconciliation provides information needed to adjust the book balance to a corrected cash amount.

**bank service charge**  Monthly fee sometimes charged by a bank to service the depositor’s account.

**cash**  Coin, currency, and other items that are acceptable for deposit at face value; serves as a medium of exchange and provides a basis of measurement for accounting.

**cash (sales) discount**  A reduction in sales price allowed if payment is received within a specified period, usually offered to customers to encourage prompt payment.

**cash equivalents**  Short-term, highly liquid investments that can be converted easily to cash. Generally, only investments that on the day of acquisition have less than three months remaining to maturity qualify as cash equivalents.

**cash overdraft**  A credit balance in the cash account; results from checks being written for more than the cash amount on deposit; should be reported as a current liability.

**compensating balances**  The portion of a demand deposit that must be maintained as support for existing borrowing arrangements.

**demand deposits**  Funds deposited in a bank that can be withdrawn upon demand.

**deposit in transit**  A deposit made near the end of the month and recorded on the depositor’s books but is not received by the bank in time to be reflected on the bank statement.

**direct write-off method**  A method of recognizing the actual losses from uncollectible accounts as expenses during the period in which the receivables are determined to be uncollectible; this method is not in accordance with GAAP.

**implicit (effective) interest**  The actual interest rate earned or paid on a note, bond, or similar instrument.

**imputed interest rate**  A rate of interest assigned to a note when there is no current market price for either the property, goods or services, or the note. The assigned rate of interest is used to discount future receipts or payments to the present in computing the present value of the note.

**interest-bearing note**  A note written in a form in which the maker promises to pay the face amount plus interest at a specified rate; in this form, the face amount is usually equal to the present value upon issuance of the note.

**negotiable notes**  Notes that are legally transferable by endorsement and delivery.

**net realizable value**  The amount of cash expected to be received from the conversion of assets in the normal course of business; net realizable value equals selling price less normal selling costs for inventory and equals gross receivables less the allowance for bad debts for accounts receivable.
noninterest-bearing note  A note written in a form in which the face amount includes an interest charge; in this form, the difference between the face amount and the present value of the note is the implicit or effective interest.

nontrade receivables  Any receivables arising from transactions that are not directly associated with the normal operating activities of a business.

notes receivable  Receivables that are evidenced by a formal written promise to pay a certain sum of money at a specified date.

not-sufficient-funds (NSF) check  A check that is not honored by a bank because of insufficient cash in the maker’s account.

outstanding checks  Checks written near the end of the month that have reduced the depositor’s cash balance but have not yet cleared the bank as of the bank statement date.

present value  The amount of net future cash inflows or outflows discounted to their present value at an appropriate rate of interest.

principal (face amount)  The amount, excluding interest, that the maker of a note or the issuer of a bond agrees to pay at the maturity date; this amount is printed on the note or bond contract.

promissory note  A formal written promise to pay a certain amount of money at a specified future date.

revenue  Inflow or other enhancement of assets of an entity or settlement of its liabilities (or a combination of both) from delivering or producing goods, rendering services, or other activities that constitute the entity’s ongoing major or central operations.

selling receivables with recourse  Purchaser advances cash in return for receivables but retains the right to collect from the seller if debtors fail to make payments when due.

time deposits  Funds deposited in a bank that legally require prior notification before they can be withdrawn.

trade discount  A reduction in the “list” sales price of an item to the “net” sales price actually charged to the customer; trade discounts are generally dependent on the volume of business or size of order from the customer.

trade receivables  Receivables associated with the normal operating activities of a business (e.g., credit sales of goods or services to customers).

warranties  Obligations of a company to provide free service on units failing to perform satisfactorily or to replace defective goods.