Objectives

After careful study of this chapter, you will be able to:

1. Identify items of cash (and cash equivalents).
2. Understand the importance of cash management.
3. Discuss revenue recognition when the right of return exists.
4. Understand the credit policies related to accounts receivable.
5. Explain the gross and net methods to account for cash discounts.
6. Estimate and record bad debts using a percentage of sales.
7. Estimate and record bad debts using an aging analysis.
8. Explain pledging, assignment, and factoring of accounts receivable.
**SYNOPSIS**

**Cash**

1. Investors, long-term creditors, and short-term creditors are interested in the ability of a company to pay its operating expenses, dividends, interest, and to repay its current debts. The existence of cash and other liquid assets that may be quickly converted into cash to pay current debts is important to these users of financial statements.

2. In the current asset section of a company's balance sheet, "cash" is the resource on hand available to pay current obligations. "Cash" cannot be subject to any contractual restrictions that prevent using it to pay current debts. An example of a contractual restriction would be a "sinking fund" to repay bonds that the company issued. The company deposits cash into the sinking fund and uses the proceeds to pay off the bonds when they mature. Items properly included in the measurement of cash on hand are coins, currency, checking accounts, savings accounts, negotiable checks, and bank drafts. Items that should not be included are certificates of deposit, bank overdrafts, postdated checks, travel advances, and postage stamps. Certificates of deposit (CDs), which are normally classified as temporary investments, are short-term investments issued by banks that allow a company to invest idle cash for short periods.

3. Most companies use the title Cash and Cash Equivalents on their balance sheet in place of Cash. This category includes cash as well as securities, which are defined as "cash equivalents" because of their liquidity and low risk. Generally, only investments with maturity dates of less than three months can be considered a cash equivalent. Examples of cash equivalents are commercial paper, treasury bills, and money market funds.

4. Efficient cash management is very important to every company. Proper cash management requires the investment of idle funds. However, a company must estimate the timing of cash inflows and outflows to ensure the availability of cash to meet its needs prior to embarking on a short-term investment program.

5. **Cash planning systems** consist of those methods and procedures, such as cash budgets, adopted to ensure that a company has adequate cash available to meet maturing obligations and that it invests any unused or excess cash. **Cash control systems** are the methods and procedures adopted to ensure the safeguarding of the company's funds. Cash control systems can be subdivided into control over cash receipts and control over cash payments.

**Receivables**

6. **Receivables** consist of various claims against customers and others arising from the operations of a company. Most of a company's receivables are trade receivables that arise from selling products or rendering services to customers. Most trade receivables are recorded at their maturity value rather than present value because the short collection period (usually 60 days or less) makes the difference between the two values negligible. Most trade receivables are in the form of accounts receivable, which are nonwritten promises by customers to pay the amount due within a specified time period (typically 30 days).

7. **Nontrade receivables** are claims that are not related to selling products or rendering services. A company keeps these receivables separate from trade receivables both in the accounting records and in its financial statements. Examples of nontrade receivables are deposits with utilities, advances to subsidiary companies, deposits made to guarantee performance, declared dividends to be received and accrued interest on investments, and loans made by nonfinancial companies.
Revenue Recognition and Valuation of Trade Receivables

8. While sales on credit increase revenue, they also result in bad debt losses from nonpayment by some customers. A company recognizes revenue from credit sales when realization has occurred and the revenue is earned. When the right of return exists, as in book publishing, FASB Statement No. 48 identifies six criteria that must be satisfied to recognize revenue at the time of sale:

(a) the sales price is known at the date of sale
(b) the buyer has paid or will pay the seller and there is no contingency
(c) the buyer's obligation to the seller would not be changed by theft or damage to the product
(d) the buyer has an economic substance apart from the seller
(e) the seller does not have significant future obligations related to resale by the buyer, and
(f) the seller can reasonably estimate the amount of future returns.

If one or more of these criteria are not met, the seller would defer the recognition of revenue from the sales until all the criteria are met or when the return privilege expires, whichever occurs first.

Accounts Receivable

9. Sellers offer cash (sales) discounts on credit sales to induce buyers to pay more promptly and to reduce the risk of nonpayment by customers. Cash discounts are recognized for financial accounting purposes. They may be accounted for by one of two methods by the seller:

(a) **Gross Price Method**: The selling company records the receivable at the gross sales price with no accounting recognition of the available cash discount until it is actually taken. When the customer takes the discount, it is debited to the Sales Discounts Taken account. This account is deducted from sales on the income statement to determine net sales.

(b) **Net Price Method**: The selling company records the receivable at the sales price less the available cash discount (the net price). Subsequently, if the customer does not take the discount, the company credits the difference between the amount paid (the gross price) and the amount originally recorded (the net price) to the Sales Discounts Not Taken account. This account is reported as interest revenue in the Other Items section of the income statement.

10. While the gross price method lacks conceptual validity, most companies use it because the cash discount is usually immaterial and the recordkeeping less complicated. For a numerical example, refer to Example 7-1 of the text.

11. A sales allowance is a reduction in price to compensate the customer for defective goods that are retained by the customer. A sales return occurs when the customer returns defective or nondefective goods and receives credit. If sales returns and allowances are estimated at the time of sale, the amount is debited to Sales Returns and Allowances and credited to Allowance for Sales Returns and Allowances. This allowance account is a contra account to Accounts Receivable and decreases the carrying value of Accounts Receivable on the balance sheet. However, because sales returns and allowances are usually immaterial, a company normally records them at the time they occur and discloses them on the income statement as a deduction from sales revenue.
Valuation of Uncollectible Accounts Receivable

12. Companies that sell on credit must maintain a balance between maximizing revenue and minimizing bad debt risks. When a reasonable credit policy has been established, the seller will normally experience some degree of nonpayment by customers. A company may account for bad debt losses, which decrease the value of Accounts Receivable, by either of two procedures: (a) in the year of the sale based on an estimate of the amount of uncollectible accounts, the allowance method, or (b) when it determines that a specific customer account is uncollectible, the direct write-off method.

13. FASB Statement No. 5 requires bad debt losses that are material to be estimated and included in the current financial statements if (a) sufficient evidence exists at the balance sheet date that some receivables will not be collected, and (b) the amount can be reasonably estimated. The journal entry involves a debit to Bad Debt Expense and a credit to Allowance for Doubtful Accounts. Bad Debt Expense is usually classified as an operating expense on the income statement. Allowance for Doubtful Accounts is a contra account to Accounts Receivable and, as such, is disclosed on the balance sheet. The difference between Accounts Receivable and the Allowance account is the net realizable value of the receivables.

14. Under the allowance method, a company may estimate bad debts using techniques that emphasize either the income statement or the balance sheet. Under the income statement approach, a rate for estimating bad debt expense (percentage of sales) is established by determining the historical relationship between actual bad debts incurred and net credit sales (although total sales may be used). This relationship is expressed as a percentage that is then applied to net credit sales in the current year to determine Bad Debt Expense for the current period. The existing balance in the Allowance for Doubtful Accounts is disregarded in calculating and recording the bad debt expense. The focus is on correctly estimating the expense. This procedure is simple to apply and results in a matching of expenses with sales in the current period.

15. Under the balance sheet approach, a company may estimate bad debt expense as a percentage of outstanding accounts receivable or based on an aging of accounts receivable. When estimating bad debt expense as a percentage of outstanding accounts receivable, a rate determined from the historical relationship between accounts receivable and bad debts is applied to currently outstanding accounts receivable to determine the estimated uncollectible accounts. When using an aging schedule, accounts receivable are categorized according to the length of time outstanding (e.g., 60 days, 120 days, 240 days) and then historically determined bad debt percentages are applied to each category. These are summed to determine the total estimated uncollectible accounts. Under both balance sheet approaches, a company compares the amount of estimated uncollectible accounts receivable with the existing balance in the Allowance for Doubtful Accounts. The entry to record bad debt expense is the amount necessary to bring the Allowance account balance up to the required ending balance. The balance sheet approaches provide useful credit information and result in reporting the best estimate of the net realizable value of accounts receivable.

16. Under the allowance method, a company uses the valuation account, Allowance for Doubtful Accounts, because the actual accounts that will ultimately become uncollectible are not known at the time the estimate is made. Therefore, when the company determines that a specific account is uncollectible, it is written off by debiting the Allowance account and crediting Accounts Receivable. The write-off entry does not change either total current assets or the net realizable value of the accounts receivable. The income statement is also unaffected by this entry.
17. If a company later collects an account that had previously been written off, it reinstates the account in accounts receivable before recording the cash receipt. This process provides a better record of the customer's credit history. If the company is using either of the estimated bad debts methods, the reinstatement entry involves a debit to Accounts Receivable and a credit to Allowance for Doubtful Accounts for the amount of cash received. The cash collection is then recorded in the usual manner. If the company is using the direct write-off method (discussed in the next item), the reinstatement entry debits Accounts Receivable and credits Bad Debt Expense.

18. When using the direct write-off method, a company records bad debts as an expense during the period in which it determines that a specific receivable account is uncollectible. The journal entry debits Bad Debt Expense and credits Accounts Receivable. However, this method violates the matching principle and is not allowed under generally accepted accounting principles unless bad debt losses are immaterial.

Generating Immediate Cash from Accounts Receivable

19. Rather than waiting for customer payments in order to receive cash from accounts receivable, a company may speed up the cash flow by one of three processes:

(a) using the receivables as collateral for a loan (pledging). The company retains both risks and benefits of ownership and is responsible for routine collection and administration;

(b) contracting with a finance company to receive cash advances on specific customer accounts and to make repayment as the receivables are collected by the borrowing company (assigning). The company retains credit activities and because the accounts are assigned with recourse, the risk of ownership is retained; or

(c) selling the receivable (without recourse) to a bank or finance company, which assumes credit and collection activities, as well as risk of ownership (factoring).

20. FASB Statement No. 140 requires that a company (the transferor) record the transfer of accounts receivable in which it surrenders control over the receivables to another company (the transferee) as a sale when all three of the following conditions are met:

(a) the transferred assets (e.g. accounts receivable) have been isolated from the transferor (the company);

(b) the transferee (the other company) has the right to sell the accounts receivable; and

(c) the company has no agreement that entitles or obligates it to repurchase the receivables before maturity.

On completion of the transfer of accounts receivable, the transferor continues to report on its balance sheet any retained interest in the accounts receivable. If the transfer is a sale, the company records the proceeds, eliminates the receivables, and records a gain or loss. If the transfer is not deemed a sale, the company records the proceeds of the transfer as a secured borrowing with a pledge of collateral.

21. Credit card sales involving a national credit card company result in an account receivable in the name of the card-issuing company. The value of this account receivable is reduced by credit card fees owed by the seller to the credit card company for the use of its credit department. The seller reports Credit Card Expense as an operating expense on the income statement.
22. While factoring and assignment agreements are formally entered in the accounting records, pledge agreements are not. However, the assignor company should disclose the existence of factoring, pledging, or assignment agreements related to accounts receivable either parenthetically or in the notes to its financial statements. Such information is important in evaluating a company's liquidity and financial flexibility. The disclosure should include important conditions and terms related to the agreements. In addition, receivables that are assigned should be reported on the balance sheet separately from unassigned receivables.

Notes Receivable

23. A note receivable is an unconditional written agreement to collect a specified sum of money on a specified date. In addition, it is a negotiable instrument that may be sold by the holder to a third party, and usually involves an agreement to receive interest on the principal amount of the note.

24. There are generally two types of short-term notes receivable. The first, a short-term note with a stated interest rate (interest-bearing notes) is recorded at face value and subsequent interest revenue is recorded when received. The other type, short-term notes receivable without a stated interest rate (non-interest-bearing notes), are recorded at their maturity value unless the interest is readily determinable and the company wishes to recognize interest. However, recording a non-interest-bearing note at its present value and recognizing interest revenue as it is earned is conceptually better.

25. A company may wish to obtain cash from a customer's note prior to its maturity date by discounting the note at a bank. The bank deducts the amount of interest discount it wishes to earn on the transaction from the maturity value of the note and remits the net amount to the company. In order to account for a discounted note, each of the following items must be determined:

(a) face value of note  
(b) interest to maturity (face value × interest rate × interest period)  
(c) maturity value of note (face value + interest to maturity)  
(d) discount (maturity value of note × discount rate × discount period)  
(e) proceeds (maturity value − discount)  
(f) accrued interest revenue (face value × interest rate × period of time note is held by company)  
(g) book value of note (face value + accrued interest revenue)  
(h) gain or loss on sale of note (proceeds − book value).

On the date of the discount, the company makes journal entries to accrue interest revenue and to record the proceeds received, any gain or loss on the transfer of the note, and the contingent liability. Most discounting is done on a with recourse basis, which means that the company agrees to pay the bank the maturity value of the note at its maturity date if the maker of the note fails to do so.

26. When a note is discounted on a recourse basis, the company discounting the note is contingently liable on the note until the maker of the note pays it in full at its maturity date. FASB Statement No. 5 requires disclosure of this contingent liability in the financial statements if the contingency exists at the balance sheet date. The discounted note is recorded in a separate account, Notes Receivable Discounted. This may appear on the face of the balance sheet as a deduction from Notes Receivable. Alternatively, a company may report notes receivable net of the discounted note and disclose the contingent liability in a note to the financial statements.

27. When a note is discounted on a recourse basis, the company discounting the note is contingently liable on the note until the maker of the note pays it in full at its maturity date. FASB Statement No. 5 requires disclosure of this contingent liability in the financial statements if the contingency exists at the balance sheet date.
GAAP allows a company to elect to report many types of its financial assets (and financial liabilities) at their fair value. The types of financial assets that a company may report at their fair values include notes receivable and accounts receivable.

**SELF-EVALUATION EXERCISES**

**True-False Questions**

Determine whether each of the following statements is true or false.

1. Cash included in a sinking fund would ordinarily be classified under the cash heading on the balance sheet. **Answer: False**
   - Cash in a sinking fund is contractually restricted and is not considered cash on the balance sheet.

2. The measurement of cash on hand classified as a current asset includes postage stamps. **Answer: False**
   - Postage stamps are generally classified as a prepaid expense.

3. Proper cash management by a company requires the investment of idle funds on hand. **Answer: True**
   - Because idle cash is a nonproductive asset, most prudent companies seek to invest idle cash in short-term investments.

4. Cash control systems are employed to ensure the safeguarding of an organization's funds. **Answer: True**
   - Because cash is the most liquid asset, it is also the most susceptible to theft or misappropriation. This requires that a cash control system be in place to protect the organization's funds.

5. A cash budget would probably be an integral part of a company's cash planning system. **Answer: True**
   - A cash budget is the major component of a company's cash planning system.

6. The adjusting journal entry to record estimated bad debts under the allowance method involves a debit to Bad Debts Expense and credits to the accounts of customers whose balances are believed to be uncollectible. **Answer: False**
   - Because the initial adjusting entry to record bad debt expense is made before a determination regarding which specific accounts will be uncollectible, it is impossible to know which customers' accounts will be uncollectible. The credit is made to the Allowance for Bad Debts until a specific account is identified.

7. At the date of sale most trade accounts receivable are recorded at their maturity value. **Answer: True**
   - Because the maturity dates on most trade receivables are short, the difference between their present value and maturity value is usually not material. In addition, APB Opinion No. 21 specifically allows the recording of receivables of customers at maturity value instead of present value.
8. The collection period for most trade receivables is 60 days or less.  
Answer: True  
Most trade receivables are collected within 60 days.

9. If a credit sale is made with terms of 2/10, n/30, the customer is given a 10% discount if the bill is paid in less than 30 days.  
Answer: False  
The "n" in the term refers to the discount period, not the discount rate. The 2 represents the discount rate. Based on this, the customer in the question would be entitled to a 2% discount on any portion of the bill paid within the first 10 days. The 30 represents that the bill must be paid in full in 30 days.

10. If the seller grants a cash discount to credit customers, it is acceptable accounting practice to record both the sale and the receivable net of the available cash discount.  
Answer: True  
If the seller grants cash discounts, the sale and the receivable can be recorded using either the gross (no recording of the discount until it is actually taken) or the net (discount is assumed to be taken at initial recording of the sale and receivable) method.

11. When sales returns and allowances are not material to a company's financial statements, they are usually not accounted for in the statements on an estimated basis.  
Answer: True  
Unless material, it is acceptable and simpler to record sales returns and allowances as they occur instead of estimating the amount.

12. The direct write-off method of accounting for bad debts is widely used by companies that sell on credit.  
Answer: False  
The direct write-off method is not GAAP and can only be used if bad debt expense is not material in amount. Most companies that sell on credit have enough bad debt expense to prohibit the use of the direct write-off method.

13. If the proportion of credit sales to total sales varies from period to period, a company should base its bad debt loss estimate on total sales rather than credit sales.  
Answer: False  
Only credit sales can have bad debt expense associated with them, therefore if the proportion of credit to net sales is changing from period to period, a company should only use credit sales to estimate bad debt expense.

14. Basing a bad debt loss estimate on the relationship between actual losses and the accounts receivable total does not precisely match a company's current expenses with current revenues.  
Answer: True  
Using accounts receivable as a basis for bad debt expense is known as the balance sheet approach and it is not precisely matching expenses with revenue. It does, however, provide a better reporting of the net realizable value of accounts receivable.

15. A bad debt adjusting entry that is developed from an aging of accounts receivable must take into consideration the preadjustment balance in the allowance for doubtful accounts.  
Answer: True  
When using an aging of accounts system, the value in the allowance account is used to determine the appropriate amount of bad debt expense required during the period.
16. When accounts receivable are factored, ownership of the receivables is transferred to the party acting as the factor.  
Answer: True  
Factoring involves the sale and transfer of accounts receivable.

17. When a company pledges its accounts receivable to a bank, the bank takes title to the receivables at the time of the pledging.  
Answer: False  
When a company pledges their accounts receivable they are in essence using the receivables as collateral for a loan. The company, not the lender, retains the title to the receivables.

18. Assigned accounts receivable should be disclosed separately from unassigned accounts receivable on the borrowing company's balance sheet.  
Answer: True  
These receivables are reported separately because the collection of funds from these receivables are used for a specific purpose; the transfer of the funds to the assignee.

19. The term "non-interest-bearing note" is a misnomer because all notes do in fact contain an interest element.  
Answer: True  
All notes receivable involve interest, whether specifically stated or implied. In the case of a "non-interest bearing note," the interest is just included in the maturity value of the note.

20. Travel advances to sales personnel are properly classified as trade accounts receivable.  
Answer: False  
Travel advances to sales personnel are properly classified as a prepaid item.

Multiple Choice Questions
Select the one best answer for each of the following questions.

1. The measurement of cash on hand classified as a current asset would include each of the following, except:  
(a) bank drafts.  
(b) negotiable checks.  
(c) certificates of deposit.  
(d) unrestricted funds on deposit with a bank.  
Answer: (c) certificates of deposit.  
Certificates of deposit are often confused with cash but are more appropriately classified as short-term temporary investments.  
Choices (a), (b), and (d) are incorrect because each of these items is appropriately classified as cash on the balance sheet.
2. Use of the direct write-off method in accounting for bad debts would in most instances violate which of the following accounting principles?
   (a) objectivity
   (b) consistency
   (c) materiality
   (d) matching

   **Answer: (d) matching**

   Matching is not maintained with the use of the direct write-off method because the write-off of uncollectible accounts (bad debt expense) is usually not accomplished during the period in which the credit sales were made.

   Choice (a) is incorrect because there is no accounting principle called objectivity. Choice (b) is incorrect because consistency has to do with maintaining consistent policies from accounting period to accounting period. Choice (c) is incorrect because materiality has to do with the size of the bad debt expense relative to credit sales. While it is true that the direct write-off method can only be used when bad debt expense is not material in amount, its use does not constitute a violation of the principle.

3. The method of estimating bad debts that most closely matches current expenses with current revenues is one that obtains the estimate from:
   (a) a percentage of total sales.
   (b) a percentage of total credit sales.
   (c) a percentage of accounts receivable.
   (d) an aging of accounts receivable.

   **Answer: (b) a percentage of total credit sales.**

   The matching principle purports to match expenses to the period in which they contribute to revenue. To keep to the matching principle in the strictest sense, bad debt expense would need to be matched with the amount of credit sales made during a period.

   Choice (a) is incorrect because total sales consist of both cash and credit sales. With cash sales, there is no bad debt expense; therefore matching bad debt expense with total sales does not match the expense with the revenues that it helped generate. Choices (c) and (d) are incorrect because estimating bad debt expense from accounts receivable or an aging schedule disregards the credit sales and only considers the amount or types of current accounts receivable.
4. Wright Corporation had total sales in the current year of $700,000 and credit sales of $650,000. The Accounts Receivable balance was $400,000 at the balance sheet date and the Allowance for Doubtful Accounts had a credit balance of $2,800 before adjusting entries. Bad Debt Expense is estimated as 4% of credit sales. The adjusting entry to record estimated bad debt expense would include a:
(a) $28,800 debit to Bad Debt Expense.
(b) $28,800 credit to Bad Debt Expense.
(c) $26,000 debit to Bad Debt Expense.
(d) $26,000 credit to Bad Debt Expense.

Answer: (c) $26,000 debit to Bad Debt Expense;
Because credit sales are $650,000 and estimated bad debt is 4% of credit sales, we would estimate total bad debt expense to be $26,000. Because we are using the percentage of sales method, the amount already in the Allowance for Doubtful Accounts balance is disregarded. Therefore, the answer is what we calculated: $26,000.
Choice (a) is incorrect because to arrive at the $28,800 amount you would add the current balance in the Allowance for Doubtful Accounts to the calculated amount. This would be appropriate if we were using the percentage of receivables method, but is not appropriate when using the percentage of sales method. Choice (b) is incorrect for the reason mentioned earlier and because the appropriate entry to record bad debt expense is a credit, not a debit. Although the amount in choice (d) is correct, the appropriate entry to bad debt expense should be a debit, not a credit; therefore choice (d) is incorrect.

5. A company determined that $10,600 of existing accounts receivable may not be collected by aging its accounts receivable. At this date, the Allowance for Doubtful Accounts account had a credit balance of $1,200. Based on this information, an adjusting journal entry should involve a debit to Bad Debt Expense for:
(a) $11,800.
(b) $10,600.
(c) $9,400.
(d) $1,200.

Answer: (c) $9,400.
The adjusting entry to record Bad Debt Expense is composed of a debit to bad debt expense and a credit to Allowance for Doubtful Accounts. Using an aging schedule is an indication that bad debt expense will be estimated using the balance sheet method, which is more concerned about getting the net realizable value of accounts receivable correct. Because the aging schedule estimates that $10,600 will be uncollectible, that is the value that is needed as a credit in the Allowance for Doubtful Accounts after completion of the adjusting entry. Because the account already has $1,200 credit balance, only $9,400 ($10,600 - $1,200) is needed to bring the credit balance to the required $10,600.
Choice (a) is incorrect because a credit of $11,800 to the Allowance for Doubtful Accounts would be added to the existing credit balance of $1,200 to give a total of $13,000, which is more than the aging of accounts estimated would be required. If you got this answer you need to make sure you understand that a credit balance of $10,600 is required AFTER the adjusting entry. Choice (b) is incorrect because it does not reflect the amount that is already in the Allowance account. Choice (d) is incorrect because this is the amount already in the account and does not take into consideration the amount estimated through the use of the aging schedule.
The equity that a company has in trade accounts receivable that it has assigned should be disclosed in its financial statements as a:
(a) separate component of the stockholders' equity section of the balance sheet.
(b) contra asset account.
(c) current liability.
(d) current asset.

Answer: (d) current asset.

Accounts receivable that have been assigned are still recorded as accounts receivable on the assignor's balance sheet as a current asset. They are separated from other accounts receivable but they are still current assets.

Choice (a) is incorrect because the assigned accounts receivable are still assets and have not been collected; therefore, they are not stockholders' equity. Choice (b) is incorrect because assigned receivables are not a contra account; they are still accounts receivable. Choice (c) is incorrect because assigned receivables are not a liability; they are still an asset that has probable future economic benefits.

BRD Associates had credit sales of $500,000 in the current year, an ending accounts receivable balance of $350,000, and a $17,000 credit balance before adjustments in the Allowance for Doubtful Accounts account. Bad debts are estimated as 5% of outstanding accounts receivable. The adjusting entry to record bad debt expense for the year would include a:
(a) $500 debit to Bad Debt Expense.
(b) $500 credit to Bad Debt Expense.
(c) $500 debit to Allowance for Doubtful Accounts.
(d) $17,500 debit to Bad Debt Expense.

Answer: (a) $500 debit to Bad Debt Expense.

Based on the information given we estimate the ending balance in the Allowance account to be 5% of Accounts Receivable ($350,000 x 5%); therefore we estimate the ending balance should be $17,500. Because this question uses the percentage of receivables method, we must also consider the current credit balance of $17,000 in the Allowance for Doubtful Accounts account. After the adjusting entry we need a credit balance of $17,500 in the Allowance for Doubtful Accounts account. Because we already have a credit balance of $17,000, only an additional $500 is needed; therefore, we must credit $500 to Allowance for Doubtful Accounts and debit $500 to Bad Debt Expense.

Choice (b) is incorrect because a credit to Bad Debt Expense would reduce the credit balance of the Allowance for Doubtful Account balance to $16,500, which is not the $17,500 we need. Choice (c) is incorrect because a $500 debit to Allowance for Doubtful Accounts would also reduce the credit balance in that account to $16,500. Choice (d) is incorrect because the $17,500 debit to Bad Debt Expense does not take into consideration the current credit balance in the Allowance for Doubtful Accounts account, which is required when using the percentage of receivables method.
8. Jacobs Company follows the procedure of estimating its bad debts from credit sales. Recently, the company evaluated all of its trade accounts receivable balances and wrote off $16,000 worth of accounts that were considered to be uncollectible. Just prior to this write-off, the Allowance for Doubtful Accounts account had a credit balance of $82,000. The effect of this write-off on the financial statements was to:
   (a) increase company expenses by $16,000.
   (b) increase company expenses by $66,000.
   (c) decrease total current assets by $16,000.
   (d) leave the balance of total current assets unchanged.

Answer: (d) leave the balance of total current assets unchanged.

Because the Jacobs Company estimates bad debt expenses, they use an Allowance for Doubtful Accounts. The entry to write off the $16,000 worth of accounts would include a debit to Allowance for Doubtful Accounts and a credit to Accounts Receivable. A credit to Accounts Receivable would cause a decrease in current assets, but a debit to Allowance for Doubtful Accounts would cause an increase to current assets by the same amount. These two items would be cancelled out by each other and have no effect on the balance in Current Assets.

Choices (a) and (b) are incorrect because there was no entry that would affect expenses when the accounts were actually written off. The entry to expenses was made when the company originally estimated bad debt, not when the actual accounts were written off. Choice (c) is incorrect because the entry to write off the accounts both increased and decreased current assets by the same amount.

9. Kenneth Corporation received a note from a credit customer on June 15. The note, which had a face value of $10,000 at 8% interest and was due in 45 days, was discounted at a local bank 15 days after it was received. If the bank’s discount percentage was 9%, how much cash did Kenneth Corporation receive from the bank?

   (a) $9,887.50
   (b) $9,986.38
   (c) $10,024.25
   (d) $10,112.50

Answer: (c) $10,024.25

This problem requires multiple steps to complete, which are shown below:

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\begin{align*}
\text{Face Value of Note} & \quad $10,000 \\
\text{Interest to maturity} & \quad ($10,000 \times .08 \times 45/360) \quad 100 \\
\text{Maturity Value of Note} & \quad $10,100 \\
\text{Discount} & \quad ($10,100 \times .09 \times 30/360) \quad (75.75) \\
\text{Proceeds received} & \quad $10,024.25
\end{align*}
\]

Choice (a) is incorrect because it fails to calculate the original rate of 8% and only applies the discount to the original $10,000 value. Choice (b) is incorrect because it uses the entire period of the note (45 days) as the discount period for the bank. The bank only held the note for 30 days and is only entitled to earn 30 days of interest. Choice (d) is incorrect because it applies the discount of 9% to the total loan period of 45 days as if the rate of interest for the note was 9%.
10. To recognize revenue at the time of sale where the right of return exists, each of the following criteria must be satisfied except:
   (a) the conditions under which future damage to the goods affects the sales price are articulated at the date of sale.
   (b) the amount of future returns can be estimated.
   (c) the sales price is fixed or determinable at the date of sale.
   (d) there is no contingency on the sale.

   **Answer:** (a) the conditions under which future damage to the goods affects the sales price are articulated at the date of sale.

   To recognize revenue at the time of sale where a right of return exists, six conditions must be met. The one statement that does not satisfy one of the six criteria is (a) the conditions under which future damage to the goods affects the sales price are articulated at the date of sale. In order to meet this criteria there are no terms to be articulated at the date of sale, just the fact that there is no future obligation by the buyer with regard to damaged goods.

   Choices (b), (c), and (d) are three of the criteria for revenue recognition where the right of return exists and therefore they must be satisfied, which makes them incorrect choices for the correct answer to the question.

11. Accounts receivable are normally reported at:
   (a) present value.
   (b) fair market value.
   (c) historical cost.
   (d) net realizable value.

   **Answer:** (d) net realizable value.

   Accounts receivable are normally reported at the value we expect to receive, which is called the net realizable value. This value takes into consideration the fact that some of the accounts will be uncollectible.

   Choice (a) is incorrect because the present value uses a discount rate to calculate the value today of a payment in the future. Because the collection period for accounts receivable are typically very short, the present value and actual value are almost the same. Choice (b) is incorrect because there is no way to accurately measure the fair value of the accounts receivable. Choice (c) is incorrect because historical cost does not take into consideration that some of the accounts receivable will be uncollectible.
12. If a previously written-off account is later collected, the correct credit would be to:
(a) receivables gains.
(b) bad debt expense.
(c) allowance for doubtful accounts.
(d) sales returns.

Answer: (c) allowance for doubtful accounts.

If a previously written-off account is subsequently collected, the first step is to reverse the write-off. When the account was originally written off, there was a debit to allowance for doubtful accounts and a credit to accounts receivable. Therefore, to reverse this when the previously written-off account is repaid the account is reinstated by a debit to accounts receivable and a credit to allowance for doubtful accounts, which is answer (c). The next step would be to record the cash with a debit and then close the account receivable with a credit.

Choice (a) is incorrect because there is not an account called receivables gain. Choice (b) is incorrect because bad debt expense is only recorded when adjusting entries are made. Choice (d) is incorrect because this is not a sales return.

13. The Austin Company records sales on account using the gross method and offers terms of 3/15, n/45. How would Austin record the entry of a credit sale of $1,000?

a. Accounts receivable 1,000
   Sales 970
   Sales discounts 30

b. Accounts receivable 970
   Sales 970

c. Accounts receivable 1,000
   Sales 1,000

d. Accounts receivable 970
   Sales discounts 30
   Sales 1,000

Answer: (c)

In the gross method, sales are recorded at the selling price and are only adjusted if the sales discount is taken. Therefore, the accounts receivable and sales would be recorded at the nondiscounted price of $1,000.

Choice (a) is incorrect because sales discounts under the gross method are not recorded when the sale is made. In addition to this, sales discounts would be entered with a debit, not a credit entry. Choice (b) would be correct if the Austin Company recorded sales using the net method. Choice (d) is incorrect because sales discounts are not recorded at the sale under the gross method.
14. Using the information in question 13, assume that payment is made 5 days after the sale. What would be the correct entry?

a. Cash 1,000
   Accounts receivable 970
   Sales discounts 30

b. Cash 970
   Sales discounts 30
   Accounts receivable 1,000

c. Cash 1,000
   Accounts receivable 1,000

d. Accounts receivable 1,000
   Cash 970
   Sales discounts 30

Answer: b

Cash 970
Sales discounts 30
Accounts receivable 1,000

Using the gross method, if the discount is taken for the full invoice amount, cash will be recorded as a debit at the amount the buyer remits. The difference between the remitted amount and the balance in the accounts receivable is credited to the sales discount account. The accounts receivable account is credited for the full amount.

Choice (a) is incorrect because it overstates cash by recording the full amount when the buyer has only remitted the discounted amount. This choice also shows the sales discount as a credit when it should be a debit. This choice also leaves a portion ($1,000 - $970 = $30) of the account receivable on the books. Choice (c) is incorrect because the discount is not recorded even though the payment was submitted during the discount period. Choice (d) is incorrect because the entry is reversed. Cash and sales discounts should be debited and accounts receivable should be credited.
In order to encourage prompt payment on credit sales many companies offer cash discounts. The terms are usually expressed as a numerical abbreviation such as: 2/10, n/30. In this form the first set of numbers represents the amount of discount if the invoice is paid in the required number of days. In this example the discount would be 2% if paid within 10 days of the invoice date. The second set of numbers gives the due date of the invoice. In this example the invoice is due 30 days from the invoice date. This term is usually pronounced as “net 30.”

If a company offers cash (or sales) discounts, they have two methods they can record the sale and subsequent payment; the gross method and the net method.

To explain the two different methods we will use the following information:

River Chase Outfitters sells rafts and tubes on terms of 2/10, n/30. On January 2, 2011, they sell $800 worth of merchandise to Jerry’s Tube Rentals.

1. **Gross Method.** Using the gross method, the selling company records the initial sale for the full amount and does not assume the buyer will take the cash discount. Using the information above, the entry would look like this on River Chase’s books:

   \[
   \begin{align*}
   \text{Accounts receivable} & \quad 800 \\
   \text{Sales} & \quad 800 \\
   \end{align*}
   \]

   If the customer takes the discount, the cash received is debited and a sales discount account is also debited. The full amount of the accounts receivable is credited.

   \[
   \begin{align*}
   \text{Cash} & \quad 784 \\
   \text{Sales discounts} & \quad 16 \\
   \text{Accounts receivable} & \quad 800 \\
   \end{align*}
   \]

   If the customer does not pay the invoice within the discount period (10 days in our example), the entry would ignore sales discounts and look like this:

   \[
   \begin{align*}
   \text{Cash} & \quad 800 \\
   \text{Accounts receivable} & \quad 800 \\
   \end{align*}
   \]

2. **Net Method.** In the net method it is assumed at the time of sale that the customer will take the cash discount. River Chase will record the account receivable and sales as the amount of sale less the discount.

   \[
   \begin{align*}
   \text{Accounts receivable} \quad (800 \times .02 & \times 800) \\
   \text{Sales} & \quad 784 \\
   \end{align*}
   \]

   If the customer pays within the discount period the cash received is debited and accounts receivable is credited.

   \[
   \begin{align*}
   \text{Cash} & \quad 784 \\
   \text{Accounts receivable} & \quad 784 \\
   \end{align*}
   \]
If the customer does not pay the invoice within the discount period (10 days in our example), the total sales amount of $800 would be debited to cash. The amount of the accounts receivable initially entered ($784) would be credited and a new account for (sales discounts not taken) would be credited for the difference between the cash paid and the accounts receivable balance.

\[
\begin{array}{ccc}
\text{Cash} & \text{Accounts receivable} & \text{Sales discount not taken} \\
800 & 784 & 16
\end{array}
\]

**Strategy:** An easy way to remember which method is the gross method and which is the net method is to remember that the term "net" in accounting usually means that something is subtracted to arrive at the correct amount. In this instance the “net” that is subtracted is the assumed sales discount that the customer will take. Therefore the net method means that you will subtract the discount at the first entry.

### Allowance Method

When sales are made on credit there will be some accounts that will not be collected. There are two ways to handle these bad debt expenses. One is the direct write-off method, which creates bad debt expense once an account has been deemed uncollectible. The other, the allowance method, enables companies to match expenses with revenues in the current period and to properly value their receivables.

**Strategy:** The direct write-off method is not considered to follow generally accepted accounting principles if the amount of bad debt expense is material in amount. Of course, if the amount of bad debt expense is not material, then the use of the direct write-off method would be allowed.

Under the allowance method a company will utilize historical data about actual bad debts to estimate what current bad debt expense is likely to be. Once this estimate has been established, an amount is debited to bad debt expense and credited to an allowance for doubtful accounts. This allowance for doubtful accounts is a contra-asset account that is offset against accounts receivable to show the amount that the company expects to collect from their accounts receivable, which is called the net realizable value of the accounts receivable.

There are two ways that a company can estimate their bad debt expense: (1) as a percentage of sales, sometimes called the income statement approach, or (2) as a percentage of accounts receivables, sometimes called the balance sheet approach.

**Strategy:** It is easy to remember which method is called the income statement approach and which is called the balance sheet approach. Just remember that sales are found on the income statement and accounts receivables are on the balance sheet. Therefore, the method that uses sales is the income statement approach and the method that uses receivables is the balance sheet approach.
**Percentage of Sales Method**

If a company chooses to use sales as its estimate, it will generally use only credit sales because cash sales will never generate bad debts. However, if the percentage of credit sales to total sales is constant, total sales can be used. This method is based on matching the bad debt expense to the revenue (sales) in the period in which the expense helped to generate the revenue.

If the Kyle Corporation had net credit sales for the year of $275,000 and bad debts have historically amounted to 3.5% of credit sales, then bad debt expenses would be estimated to be $9,625 ($275,000 × .035). Kyle would make the following adjusting entry to record bad debt expenses:

```
Bad debt expense 9,625
Allowance for doubtful accounts 9,625
```

The advantage to this approach is that it is simple and provides a good theoretical application of the matching principle. Because this method focuses on an expense account, any existing balance in the allowance account is ignored when determining the amount of the adjusting entry and that is the disadvantage of this method; there is less emphasis on the net realizable value of the accounts receivable.

**Percentage of Receivables Method**

Instead of using sales as a basis for bad debt expense, a company may choose to focus on the accounts receivable that are outstanding. In this method, the goal is to determine the ending balance in the allowance for doubtful accounts and by extension the net realizable value of the accounts receivable.

For example, assume that the Kyle Corporation has determined that 4% of the $175,000 accounts receivable balance will be uncollectible. Based on this the company expects that $7,000 of the accounts receivable will be uncollectible therefore the net realizable value of the accounts receivable should be $168,000 ($175,000 – $7,000). Because the allowance for doubtful accounts is a contra account to accounts receivable, we need the allowance for doubtful accounts balance to be $7,000. Because we are concerned about the ending balance of the allowance account, we must use the existing balance in that account to determine the amount of the adjusting entry. If we assume that the allowance account has a credit balance of $1,000 before the adjusting entry, we can determine how much is needed in the adjusting entry to reach our desired balance of $7,000.

<table>
<thead>
<tr>
<th>Allowance for Doubtful Accounts</th>
<th>1,000 (current balance)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>7,000 (desired balance)</td>
</tr>
</tbody>
</table>

It is obvious from the above account that we need an adjusting entry with a credit of $6,000 to allowance for doubtful accounts. Based on this analysis the adjusting entry would be:

```
Bad debt expense 6,000
Allowance for doubtful accounts 6,000
```

This method can further be enhanced by analyzing the individual accounts. Looking at the actual accounts it may be possible to determine a better estimate of which accounts will become uncollectible. The best way to determine which accounts are more likely to become uncollectible is to look at how old the accounts are. An account that is only 10 days old is much more likely to be collected than an account that is 120 days old. Based on this knowledge, we can prepare an “aging” schedule that shows the various
amounts based on their ages. We can then apply a percentage to each age group and get a much more realistic estimate of the total amount of uncollectible accounts and the amount required in the allowance for doubtful accounts.

An example of an aging schedule is provided in Example 7-2 of the text.

**Writing Off Uncollectible Accounts**

When an account is determined to be uncollectible, we must remove it from our accounts receivable. To do that we just debit the allowance for doubtful accounts and credit accounts receivable. The entry for Kyle Corporation to write off a $500 account would look like this:

```
Allowance for doubtful accounts 500
Accounts receivable 500
```

If a customer whose account has previously been written off pays, it is best to reestablish the account and then record the payment. To reestablish the account, we would just reverse our previous entry to write the account off:

```
Accounts receivable 500
Allowance for doubtful accounts 500
```

Once the account has been reestablished we would record the payment as normal:

```
Cash 500
Accounts receivable 500
```

**Generating Immediate Cash from Accounts Receivable**

If a company has the need or desire to accelerate the receipt of cash from accounts receivable they have three options: (1) pledging, (2) assigning, or (3) factoring (sale) of the accounts receivable. FASB Statement 140 has very specific guidelines on when these accounts receivable have been transferred. The chart in Exhibit 7-2 of the text provides a graphic overview of how to determine which of the three options a company has used.

**Pledging of Accounts Receivables**

If a company pledges accounts receivables, they are essentially using the accounts receivable as collateral for a loan. The company would keep control and continue to collect the accounts receivable. They would record the loan as a liability and note the fact that the accounts receivable are pledged.

**Assigning of Accounts Receivables**

Assignment of accounts receivable is usually very similar to pledging, with the basic difference being that the company that is borrowing against the accounts receivable uses the amount they collect to pay off the amount borrowed. To protect the finance company against the threat of uncollectible accounts or sales returns and allowances, the amount advanced to the borrower is usually smaller than the total of the accounts receivables being assigned.
As an example, assume that the Jerry Moore Company assigns $100,000 of its accounts receivable to a finance company on March 1, 2011. The finance company advances Jerry Moore 85% of the receivables and charges a $1,000 service charge. In addition, the finance company charges a 10% rate of interest to any outstanding balance. The entry to record this:

\[
\begin{align*}
\text{Cash} & \quad [($100,000 \times 0.85) - $1,000] & \quad 84,000 \\
\text{Assignment service charge} & \quad 1,000 \\
\text{Note payable ($100,000 \times 0.85)} & \quad 85,000 \\
\text{Accounts receivable assigned} & \quad 100,000 \\
\text{Accounts receivable} & \quad 100,000
\end{align*}
\]

At the end of March, the Moore Company has collected $18,000 of the accounts receivable.

\[
\begin{align*}
\text{Cash} & \quad 18,000 \\
\text{Accounts receivable assigned} & \quad 18,000
\end{align*}
\]

It pays this amount as well as the interest payment to the finance company.

\[
\begin{align*}
\text{Note payable} & \quad 18,000 \\
\text{Interest expense ($85,000 \times 0.10 \times 1/12)} & \quad 708 \\
\text{Cash} & \quad 18,708
\end{align*}
\]

**Factoring of Accounts Receivables**

Factoring of accounts receivable is the same as selling the accounts receivables. When receivables are factored the company selling the accounts receivable removes them from their financial records and records the cash received as well as the fee paid to the factor (buyer). In addition, most factors will reserve 10% to 20% of the amount factored to protect against uncollectible accounts and sales returns and allowances. Once the accounts have been collected or written off, any of the reserve that has not been used is returned to the selling company. This reserve is usually recorded as a receivable on the books of the seller.

On June 1, 2011, Richie Williams Corporation factors $150,000 of receivables. The factor requires a 15% reserve and charges a 12% fee. The entry to record this would be as follows:

\[
\begin{align*}
\text{Cash} & \quad [($150,000 \times 0.85) - $18,000] & \quad 109,500 \\
\text{Receivable from factor ($150,000 \times 0.15)} & \quad 22,500 \\
\text{Factor expense ($150,000 \times 0.12)} & \quad 18,000 \\
\text{Accounts receivable} & \quad 150,000
\end{align*}
\]
Test Your Knowledge

1. The December 31, 2011, balance sheet of the Tampa Corporation included the following information pertaining to accounts receivable:

   Trade Accounts Receivable $420,000
   Less: Allowance for Doubtful Accounts (21,500) $398,500

   During 2012, the following transactions occurred:
   a. New sales on account $973,000
   b. Collections from past credit sales 847,000
   c. Accounts receivable written off as uncollectible 28,500
   d. Collections of accounts previously written off as uncollectible 900
   e. Recorded bad debt expense estimate using an aging analysis that indicates an Allowance for Doubtful Accounts balance of $24,900 is needed

   Required: (1) Prepare summary journal entries to record each of the above facts.

   (a)
   (b)
   (c)
   (d)
   (e)

   (2) Calculate the net realizable value of accounts receivable that will appear on Tampa’s December 31, 2012, balance sheet.
2. The records of Eric Elsner Corporation showed the following preadjustment information on December 31, 2011:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Net sales (80% on credit)</td>
<td>$350,000</td>
</tr>
<tr>
<td>Accounts receivable</td>
<td>$160,000</td>
</tr>
<tr>
<td>Allowance for doubtful accounts</td>
<td>$4,100</td>
</tr>
</tbody>
</table>

Prepare journal entries to record the estimates for bad debt expense assuming:

(a) Bad debts are estimated to be 4% of credit sales.

(b) Bad debts are estimated to be 3% of net sales.

(c) An aging schedule determines that uncollectible accounts should be $13,000.

3. In March 2011, the Forsyth Company had the following transactions:

<table>
<thead>
<tr>
<th>Date</th>
<th>Description</th>
</tr>
</thead>
<tbody>
<tr>
<td>March 4</td>
<td>Sales of $5,300 with terms on 3/15, n30</td>
</tr>
<tr>
<td>March 12</td>
<td>Received partial payment of $3,395 on March 4 sales</td>
</tr>
<tr>
<td>March 28</td>
<td>Received balance of payment for March 4 sales</td>
</tr>
</tbody>
</table>

(a) Prepare the journal entries assuming that Forsyth uses the gross method of recording sales.

(b) Prepare the journal entries assuming that Forsyth uses the net method of recording sales.
ANSWERS TO TEST YOUR KNOWLEDGE

1. (1) (a) Accounts receivable 973,000
Sales 973,000

(b) Cash 847,000
Accounts receivable 847,000

(c) Allowance for doubtful accounts 28,500
Accounts receivable 28,500

(d) Accounts receivable 900
Allowance for doubtful accounts 900
Cash 900
Accounts receivable 900

(e) Bad debts expense 31,000
Allowance for doubtful accounts 31,000

$24,900 needed as a credit balance in the allowance account plus the $6,100 debit balance in the allowance account prior to adjustment

(2) $420,000 Balance at December 31, 2011
973,000 Credit sales in 2012
(847,000) Collections of accounts receivable in 2012
(28,500) Accounts written off as uncollectible in 2012
$517,500 Receivables balance at December 31, 2012
(24,900) Allowance for Doubtful Accounts balance at December 31, 2012
$492,600 Net realizable value of receivables at December 31, 2012

2. (a) Credit sales = 80% of Net Sales: $350,000 × 0.80 = $280,000 credit sales
Bad debt is estimated to be 4% of credit sales: $280,000 × 0.04 = $11,200
Bad debt expense 11,200
Allowance for doubtful accounts 11,200

Note that because the percentage of sales method was used, the existing balance in the Allowance for Doubtful Accounts was ignored.

(b) Bad debt is estimated to be 3% of net sales: $350,000 × 0.03 = $10,500
Bad debt expense 10,500
Allowance for doubtful accounts 10,500

Note that because the percentage of sales method was used, the existing balance in the Allowance for Doubtful Accounts was ignored.
(c) Uncollectible accounts are estimated to be $13,000. The normal balance for the Allowance for Doubtful Accounts is a credit balance. Because the preadjusted balance is a $4,100 debit balance, in order to get a $13,000 credit balance we need to credit Allowance for Doubtful Accounts $17,100.

<table>
<thead>
<tr>
<th>Account</th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad debt expense</td>
<td>17,100</td>
<td></td>
</tr>
<tr>
<td>Allowance for doubtful accounts</td>
<td></td>
<td>17,100</td>
</tr>
</tbody>
</table>

3. (a) March 4

<table>
<thead>
<tr>
<th>March 4</th>
<th>Accounts receivable</th>
<th>5,300</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sales</td>
<td>5,300</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>March 12</th>
<th>Cash</th>
<th>3,395</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sales discounts</td>
<td>105</td>
</tr>
<tr>
<td></td>
<td>Accounts receivable</td>
<td>3,500</td>
</tr>
</tbody>
</table>

Sales Discount = $3,500 × 0.03 = $105

<table>
<thead>
<tr>
<th>March 4</th>
<th>Cash ($5,300 - $3,500)</th>
<th>1,800</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Accounts receivable</td>
<td>1,800</td>
</tr>
</tbody>
</table>

Remaining Accounts Receivable balance = $5,300 - $3,500 = $1,800

(b) March 4

<table>
<thead>
<tr>
<th>March 4</th>
<th>Accounts receivable</th>
<th>5,141</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Sales</td>
<td>5,141</td>
</tr>
</tbody>
</table>

Sales = [$5,300 - ($5,300 × 0.03)] = $159

<table>
<thead>
<tr>
<th>March 12</th>
<th>Cash</th>
<th>3,395</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Accounts receivable</td>
<td>3,395</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>March 4</th>
<th>Cash</th>
<th>1,800</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Accounts receivable</td>
<td>1,746</td>
</tr>
<tr>
<td></td>
<td>Sales discount forfeited</td>
<td>54</td>
</tr>
</tbody>
</table>

Remaining Accounts Receivable balance = $5,141 - $3,395 = $1,746

Cash Paid = $1,746 ÷ 0.97 = $1,800

Sales Discounts Forfeited = $1,800 - $1,746 = $54