

## Review from Peter's Slides

### Incentives

- Bonuses – Managerial bonuses are often linked to net income (“Pay for Performance”). May have incentives to make net income look higher or lower.
- Taxes – Taxes reduce net income. If managers want the company to pay less in taxes, they may have incentives to make net income look lower.

### Net Sales

#### Credit Card discount:

- Credit cards allow customers to make purchases, but pay later.
- The credit card company charges a fee for the service they provide.
- Contra account “Credit card discount” is used.

#### Trade discounts:

- Represent a reduction in the listed price of a product or service.
- Enter into the calculation of GROSS sales.
- Typically noted, but they do NOT require an adjusting journal entry.
- No contra account is used.

#### Sales discount:

- represents a reduction in the amount a credit customer has to pay if the customer pays by a specific date.
- E.g. 2/10, n/30
- Contra account “Sales Discount” is used.

#### Sales returns & allowances:

- Returns are products returned by customers
- Allowances are post-sale adjustments to the original price
- Contra account “Sales Returns” is used

### Net Receivables

#### Accounts receivable:

- We report accounts receivable at its “net realizable value,” which is the amount of cash the firm expects to collect.
- Two methods for dealing with uncollectible accounts:
  - a. Specific write-off method (rare)
  - b. Allowance method (common)

#### Allowance for bad debts (allowance method):

- Two methods used to estimate uncollectible accounts:
  - a. Percent of (credit) sales
  - b. Aging of accounts receivable
- Contra A/R account used to reduce A/R to its net realizable value
- Value of uncollectible accounts debited to Bad Debt Expense
- Journal entries associated with the allowance method:
  - a. Recording the period's estimate of uncollectible accounts.
  - b. Writing off specific accounts when they go bad.
  - c. Collecting a previously written off account (Recovery).

## SALES RETURNS

Data Recovery Services (DRS) specializes in data recovery from crashed hard drives. The price charged varies on the extent of damage and the amount of data being recovered. DRS offers a 20% discount to students and faculty at educational institutions. Consider the following transactions during the month of June.

- June 10 Rashid's hard drive crashes and he sends it to DRS.  
June 12 After initial evaluation, DRS e-mails Rashid to let him know that full data recovery will cost \$2,000.  
June 13 Rashid informs DRS that he would like them to recover the data that he is a student at UCLA, qualifying him for a 20% educational discount and reducing the cost by \$400 (= \$2,000 X 20%).  
June 16 DRS performs the work and claims to be successful in recovering all the data. DRS asks Rashid to pay within 30 days of today's date, offering a 3% discount for payment within 10 days.  
June 19 What Rashid receives the hard drive, he notices that DRS did not successfully recover all data. Approximately 25% of the data has not been recovered and he informs DRS.  
June 20 DRS reduces the amount Rashid owes by 25%.  
June 30 Rashid pays the amount owed.

Required:

1. Record the necessary transactions for DRS on each date.
2. Calculate the net sales.
3. Show how net sales would be presented in the income statement.
4. Calculate net sales if Rashid had paid his bill on June 25.

## ALLOWANCE FOR BAD DEBTS

Facial cosmetics provides plastic surgery primarily to hide the appearance of the appearance of unwanted scars and other blemishes. During 2010, the company provides services of \$400,000 on account. Of this amount, \$50,000 remains uncollected at the end of the year. An aging schedule as of December 31, 2010, is provided below.

| Age Group                  | Amount Receivable | Estimated % Uncollectible |
|----------------------------|-------------------|---------------------------|
| Not yet due                | 30,000            | 2%                        |
| 0-30 days past due         | 10,000            | 5%                        |
| 31-60 days past due        | 7,000             | 10%                       |
| More than 60 days past due | 3,000             | 20%                       |
| Total                      | 50,000            |                           |

Required:

1. Calculate the allowance for uncollectible accounts.
2. Record the December 31, 2010, adjusting entry, assuming the balances of the allowance account before adjusting entries is \$300 (debit).
3. On April 3, 2011, a customer's account balance of \$400 is written off as uncollectible. Record the write-off.
4. On July 17, 2011, the customer, whose account was written off in Requirement 3, unexpectedly pays \$100 of the amount but does not expect to pay any additional amounts. Record the cash collection.