Chapter 6
Reporting and Interpreting Sales Revenue, Receivables, and Cash

ANSWERS TO QUESTIONS

1. The difference between sales revenue and net sales is the amount of goods returned by customers because the goods were either unsatisfactory or not desired and also includes sales allowances given to customers (also refer to the answers given below to questions 3, 4 and 5).

2. Gross profit or gross margin on sales is the difference between net sales and cost of goods sold. It represents the average gross markup realized on the goods sold during the period. The gross profit ratio is computed by dividing the amount of gross profit by the amount of net sales. For example, assuming sales of $100,000, and cost of goods sold of $60,000, the gross profit on sales would be $40,000. The gross profit ratio would be $40,000/$100,000 =.40. This ratio may be interpreted to mean that out of each $100 of sales, $40 was realized above the amount expended to purchase the goods that were sold.

3. A credit card discount is the fee charged by the credit card company for services. When a company deposits its credit card receipts in the bank, it only receives credit for the sales amount less the discount. The credit card discount account either decreases net sales (it is a contra revenue) or increases selling expense.

4. A sales discount is a discount given to customers for payment of accounts within a specified short period of time. Sales discounts arise only when goods are sold on credit and the seller extends credit terms that provide for a cash discount. For example, the credit terms may be 1/10, n/30. These terms mean that if the customer pays within 10 days, 1% can be deducted from the invoice price of the goods. Alternatively, if payment is not made within the 10-day period, no discount is permitted and the total invoice amount is due within 30 days from the purchase, after which the debt is past due. To illustrate, assume a $1,000 sale with these terms. If the customer paid within 10 days, $990 would have been paid. Thus, a sales discount of $10 was granted for early payment.

5. A sales allowance is an amount allowed to a customer for unsatisfactory merchandise or for an overcharge in the sales price. A sales allowance reduces the amount the customer must pay, or if already paid, a cash refund is required. Sales allowances may occur whether the sale was for cash or credit. In contrast, a sales discount is a cash discount given to a customer who has bought on credit, with payment made within the specified period of time. (Refer to explanation of sales discount in Question 4, above.)

6. An account receivable is an amount owed to the business on open account by a trade customer for merchandise or services purchased. In contrast, a note receivable is a short-term obligation owed to the company based on a formal written document.

7. In conformity with the matching principle, the allowance method records bad debt expense in the same period in which the credit was granted and the sale was made.

8. Using the allowance method, bad debt expense is recognized in the period in which the sale related to the uncollectible account was recorded.

9. The write-off of bad debts using the allowance method decreases the asset accounts receivable and the contra-asset allowance for doubtful accounts by the same amount. As a consequence, (a) net income is unaffected and (b) accounts receivable, net, is unaffected.

10. An increase in the receivables turnover ratio generally indicates faster collection of receivables. A higher receivables turnover ratio reflects an increase in the number of times average trade receivables were recorded and collected during the period.

11. Cash includes money and any instrument, such as a check, money order, or bank draft, which banks normally will accept for deposit and immediate credit to the depositor’s account. Cash equivalents are short-term investments with original maturities of three months or less that are readily convertible to cash, and whose value is unlikely to change (e.g., bank certificates of deposit and treasury bills).

12. The primary characteristics of an internal control system for cash are: (a) separation of the functions of cash receiving from cash payments, (b) separation of accounting for cash receiving and cash paying, (c) separation of the physical handling of cash from the accounting function, (d) deposit all cash receipts daily and make all cash payments by check, (e) require separate approval of all checks and electronic funds transfers, and (f) require monthly reconciliation of bank accounts.

13. Cash-handling and cash-recording activities should be separated to remove the opportunity for theft of cash and a cover-up by altering the records. This separation is accomplished best by assigning the responsibility for cash handling to individuals other than those who have the responsibility for record-keeping. In fact, it usually is desirable that these two functions be performed in different departments of the business.

14. The purposes of a bank reconciliation are (a) to determine the “true” cash balance and (b) to provide data to adjust the Cash account to that balance. A bank reconciliation involves reconciling the balance in the Cash account at the end of the period with the balance shown on the bank statement (which is not the “true” cash balance) at the end of that same period. Seldom will these two balances be identical because of such items as deposits in transit; that is, deposits that have been made by the company but not yet entered on the bank statement. Another cause of the difference is outstanding checks, that is, checks that have been written and recorded in the accounts of the company that have not cleared the bank (and thus have not been deducted from the bank's balance). Usually the reconciliation of the two balances, per books against per bank, requires recording of one or more items that are reflected on the bank statement but have not been recorded in the accounting records of the company. An example is the usual bank service charge.

15. The **total** amount of cash that should be reported on the balance sheet is the sum of (a) the true cash balances in all checking accounts (verified by a bank reconciliation of each checking account), (b) cash held in all “cash on hand” (or “petty cash”) funds, and (c) any cash physically on hand (any cash not transferred to a bank for deposit—usually cash held for change purposes).

16. (Based on Supplement A) Under the gross method of recording sales discounts, the amount of sales discount taken is recorded at the time the collection of the account is recorded.

ANSWERS TO MULTIPLE CHOICE

1. b)	2. b)	3. b)	4. d)	5. c)
6. c)	7. d)	8. b)	9. d)	10. c)

Authors' Recommended Solution Time

(Time in minutes)

Mini-exercises		*Exercises*		*Problems*		*Alternate Problems*		*Cases and Projects*	
No.	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*	*No.*	*Time*
1	5	1	15	1	25	1	35	1	25
2	5	2	15	2	35	2	35	2	30
3	10	3	15	3	20	3	50	3	35
4	10	4	20	4	35	4	40	4	20
5	10	5	20	5	50	5	45	5	35
6	10	6	30	6	40			6	45
7	10	7	30	7	45			7	*
8	5	8	15	8	45				
9	10	9	15	9	45				
		10	15						
		11	15						
		12	15						
		13	20						
		14	20						
		15	20						
		16	20						
		17	30						
		18	30						
		19	15						
		20	15						
		21	20						
		22	20						
		23	20						
		24	30						
		25	30						

* Due to the nature of these cases and projects, it is very difficult to estimate the amount of time students will need to complete the assignment. As with any open-ended project, it is possible for students to devote a large amount of time to these assignments. While students often benefit from the extra effort, we find that some become frustrated by the perceived difficulty of the task. You can reduce student frustration and anxiety by making your expectations clear. For example, when our goal is to sharpen research skills, we devote class time to discussing research strategies. When we want the students to focus on a real accounting issue, we offer suggestions about possible companies or industries.

MINI-EXERCISES

M6–1.

Transaction	Point A		Point B	
(a) Airline tickets sold by an airline on a credit card		Point of sale	x	Completion of flight
(b) Computer sold by mail order company on a credit card	x	Shipment		Delivery
(c) Sale of inventory to a business customer on open account	x	Shipment		Collection of account

M6–2.

If the buyer pays within the discount period, the income statement will report $9,405 as net sales ($9,500 x 0.99).

M6–3.

Credit card sales (R)	$8,400
Less: Credit card discount (XR)	252
Net credit card sales	$8,148
Sales on account (R)	$10,500
Less: Sales returns (XR)	500
	10,000
Less: Sales discounts (1/2 x 10,000 x 1%) (XR)	50
Net sales on account	9,950
Net sales (reported on income statement)	$18,098

M6–4.

$$\text{Gross Profit Percentage} = \frac{\text{Gross Profit}}{\text{Net Sales}} = \frac{\$49{,}000 - \$28{,}000}{\$49{,}000} = \frac{\$21{,}000}{\$49{,}000} = 0.429$$

The gross profit percentage is 42.9%. This ratio measures the excess of sales prices over the costs to purchase or produce the goods or services sold as a percentage. It indicates a company's ability to charge premium prices and produce goods and services at lower cost.

M6–5.

(a)	Allowance for doubtful accounts (–XA, +A)	22,000	
	Accounts receivable (–A)		22,000
	To write off specific bad debts.		
(b)	Bad debt expense (+E, –SE)	13,000	
	Allowance for doubtful accounts (+XA, –A)		13,000
	To record estimated bad debt expense.		

M6–6.

	Assets		Liabilities	Stockholders' Equity	
(a)	Allowance for doubtful accounts	–17,000		Bad debt expense	–17,000
(b)	Allowance for doubtful accounts	+7,000			
	Accounts receivable	–7,000			

M6–7.

__+__ (*a*) Granted credit with shorter payment deadlines.
__+__ (*b*) Increased effectiveness of collection methods.
__–__ (*c*) Granted credit to less creditworthy customers.

M6–8.

Reconciling Item	Company's Books	Bank Statement
(a) Outstanding checks		–
(b) Bank service charge	–	
(c) Deposit in transit		+

M6–9. (Based on Supplement A)

A $8,000 credit sale with terms, 1/10, n/30, should be recorded as follows:

Accounts receivable (+A)..	8,000	
Sales revenue (+R, +SE)		8,000

This entry records the sale at the gross amount. If the customer does pay within the discount period, only $7,920 must be paid, in which case the entry for payment would be as follows:

Cash (+A)	7,920	
Sales discounts (+XR, –SE)	80	
Accounts receivable (–A)		8,000

EXERCISES

E6–1.

Sales revenue ($950 + $600 + $450)	$2,000
Less: Sales discount ($950 collected from S. Green x 2%)	19
Net sales	$1,981

E6–2.

Sales revenue ($2,000 + $7,000 +$5,000)	$14,000
Less: Sales discounts ($7,000 collected from S x 3%)	210
Less: Credit card discounts ($2,000 from R x 2%)	40
Net sales	$13,750

E6–3.

Sales revenue ($350 + $4,500 + $9,000)	$13,850
Less: Sales returns and allowances ($^{1}/_{10}$ x $9,000 from D)	900
Less: Sales discounts ($^{9}/_{10}$ x $9,000 from D x 3%)	243
Less: Credit card discounts ($350 from B x 2%)	7
Net sales	$12,700

E6–4.

Transaction	Net Sales	Cost of Goods Sold	Gross Profit
July 12	+ 396	+ 250	+ 146
July 15	+ 4,000	+ 2,000	+ 2,000
July 20	– 120	NE	– 120
July 21	– 1,000	– 600	– 400

E6–5.

Req. 1 (Amount saved ÷ Amount paid) = Interest rate for 50 days.
(4% ÷ 96%) = 4.17% for 50 days.

Interest rate for 50 days x (365 days ÷ 50 days) = Annual interest rate
4.17% x (365 ÷ 50 days) = 30.44%

Req. 2 Yes, because the 15% rate charged by the bank is less than the 30.44% rate implicit in the discount. The company will earn 15.44% by doing so (30.44% – 15%).

E6–6.

Req. 1

WOLVERINE WORLD WIDE INC.
Income Statement
For the Year Ended

	Amount	Percentage
Sales of merchandise	$1,141,887	100.0%
Cost of products sold	700,349	61.3%
Gross profit	441,538	38.7%
Selling and administrative expense	318,243	27.9%
Income from operations	123,295	10.8%
Other income (expense)		
Interest expense	(2,973)	0.3%
Other income	1,970	0.2%
Pretax income	122,292	10.7%
Income taxes	38,645	3.4%
Net Income	$ 83,647	7.3%

Earnings per share ($83,647 ÷ 55,030 shares) $1.52

Req. 2

Gross profit margin: $1,141,887 – $700,349 = $441,538.

Gross profit percentage ratio: $441,538 ÷ $1,141,887 = .387 (or 38.7%).

Gross margin or gross profit in dollars is the difference between the sales prices and the costs of purchasing or manufacturing all goods that were sold during the period (sometimes called the markup); that is, net revenue minus only one of the expenses-- cost of goods sold. The gross profit ratio is the amount of each net sales dollar that was gross profit during the period. For this company, the rate was 38.7%, which means that $.387 of each net sales dollar was gross profit (alternatively, 38.7% of each sales dollar was gross profit for the period).

Wolverine World Wide's gross profit percentage was below Deckers' current (2006) percentage of 46.4%. Deckers' shoes have a reputation as a rugged product as well as a premium "high fashion" product. This has allowed it to maintain higher prices and higher gross margins. In marketing this is called the value of brand equity. Wolverine World Wide has been investing in its own brand development program, and has increased its gross profit percentage by about 2% in the last three years.

E6–7.

Req. 1

SLATE, INCORPORATED
Income Statement
For the Year Ended December 31, 2010

		Amount	Percentage
Gross sales ($223,000 + $40,000)		$263,000	
Less sales returns and allowances		8,000	
Net sales revenue		255,000	100%
Cost of goods sold		143,000	56%
Gross profit		112,000	44%
Operating expenses:			
Administrative expense	$20,000		
Selling expense	45,200		
Bad debt expense ($40,000 x 3%)	1,200	66,400	26%
Income from operations		45,600	18%
Income tax expense ($45,600 x 30%)		13,680	5%
Net income		$ 31,920	13%

Earnings per share ($31,920 ÷ 4,000 shares) $7.98

Req. 2

Gross profit margin: $255,000 – $143,000 = $112,000.

Gross profit percentage ratio: $112,000 ÷ $255,000 = .44 (or 44%).

Gross margin or gross profit in dollars is the difference between the sales prices and the costs of purchasing or manufacturing all goods that were sold during the period (sometimes called the markup); that is, net revenue minus only one of the expenses--cost of goods sold. The gross profit ratio is the amount of each net sales dollar that was gross profit during the period. For this company, the rate was 44%, which means that $.44 of each net sales dollar was gross profit (alternatively, 44% of each sales dollar was gross profit for the period).

E6–8.

(a) Bad debt expense (+E, –SE) ($700,000 x 0.01)........ 7,000
  Allowance for doubtful accounts (+XA, –A)....... 7,000
To record estimated bad debt expense.

(b) Allowance for doubtful accounts (–XA, +A) 2,000
  Accounts receivable (–A) 2,000
To write off a specific bad debt.

E6–9.

(a) Bad debt expense (+E, –SE) ($790,000 x 0.03)........ 23,700
  Allowance for doubtful accounts (+XA, –A)....... 23,700
To record estimated bad debt expense.

(b) Allowance for doubtful accounts (–XA, +A) 240
  Accounts receivable (–A) 240
To write off a specific bad debt.

E6–10.

	Assets		Liabilities	Stockholders' Equity	
(a)	Allowance for doubtful accounts	–23,700		Bad debt expense	–23,700
(b)	Allowance for doubtful accounts	+240			
	Accounts receivable	–240			

E6–11.

Req. 1

(a) Bad debt expense (+E, –SE) ($640,000 x 0.035)...... 22,400
  Allowance for doubtful accounts (+XA, –A)....... 22,400
To record estimated bad debt expense.

(b) Allowance for doubtful accounts (–XA, +A) 1,800
  Accounts receivable (–A) 1,800
To write off a specific bad debt.

Req. 2

Transaction	Net Sales	Gross Profit	Income from Operations
a.	NE	NE	– 22,400
b.	NE	NE	NE

E6–12.

Aged accounts receivable			Estimated percentage uncollectible		Estimated amount uncollectible
Not yet due	$14,000	x	2%	=	$ 280
Up to 120 days past due	4,500	x	12%	=	540
Over 120 days past due	2,500	x	30%	=	750
Estimated balance in Allowance for Doubtful Accounts					1,570
Current balance in Allowance for Doubtful Accounts					800
Bad Debt Expense for the year					$770

E6–13.

Req. 1

December 31, 2011-Adjusting entry:

Bad debt expense (+E, –SE)	4,800	
Allowance for doubtful accounts (+XA, –A)		4,800

To adjust for estimated bad debt expense for 2011 computed as follows:

Aged accounts receivable			Estimated percentage uncollectible		Estimated amount uncollectible
Not yet due	$60,000	x	3%	=	$ 1,800
Up to 180 days past due	12,000	x	15%	=	1,800
Over 180 days past due	4,000	x	35%	=	1,400
Estimated balance in Allowance for Doubtful Accounts					5,000
Current balance in Allowance for Doubtful Accounts					200
Bad Debt Expense for the year					$4,800

Req. 2

Balance sheet:

Accounts receivable ($60,000 + $12,000 + $4,000)	$76,000	
Less allowance for doubtful accounts	5,000	
Accounts receivable, net of allowance for doubtful accounts		$71,000

E6–14.

Req. 1

December 31, 2010-Adjusting entry:

Bad debt expense (+E, –SE)	22,350	
Allowance for doubtful accounts (+XA, –A)		22,350

To adjust for estimated bad debt expense for 2010 computed as follows:

Aged accounts receivable			Estimated percentage uncollectible		Estimated amount uncollectible
Not yet due	$250,000	x	3.5%	=	$8,750
Up to 120 days past due	50,000	x	10%	=	5,000
Over 120 days past due	30,000	x	30%	=	9,000
Estimated balance in Allowance for Doubtful Accounts					22,750
Current balance in Allowance for Doubtful Accounts					400
Bad Debt Expense for the year					$22,350

Req. 2

Balance sheet:

Accounts receivable ($250,000 + $50,000 + $30,000)	$330,000	
Less allowance for doubtful accounts	22,750	
Accounts receivable, net of allowance for doubtful accounts		$307,250

E6–15.

1.

Bad debt expense (+E, –SE)	207	
Allowance for doubtful accounts (+XA, –A)		207

To record estimated bad debt expense.

Allowance for doubtful accounts (–XA, +A)	450	
Accounts receivable (–A)		450

To write off specific bad debts.

2. It would have no effect because the asset “Accounts receivable” and contra-asset “Allowance for doubtful accounts” would both decline by Euro 10 million. Neither “Receivables, net” nor “Net income” would be affected.

E6–16.

Req. 1

Allowance for doubtful accounts

		142	Beg. Balance
Write-offs	$\boxed{89}$	64	Bad debt exp.
		117	End. balance

Beg. Balance + Bad debt exp. – Write-offs = End. Balance
Beg. Balance + Bad debt exp. – End. Balance = Write-offs
142 + 64 – 117 = 89

Bad debt expense increases (is credited to) the allowance. Since we are given the beginning and ending balances in the allowance, we can solve for write-offs, which decrease (are debited to) the allowance.

Req. 2

Accounts Receivable (Gross)

Beg. balance*	9,458	89	Write-offs
Net sales	51,122	$\boxed{49{,}036}$	Cash collections
End. balance **	11,455		

* 9,316 + 142
** 11,338 + 117
Beg. balance + Net sales – Write-offs – Cash collections = End. Balance
Beg. balance + Net sales – Write-offs – End. Balance = Cash collections
9,458 + 51,122 – 89 – 11,455 = 49,036

Accounts receivable gross is increased by recording credit sales and decreased by recording cash collections and write-offs of bad debts. Thus, we can solve for cash collections as the missing value.

E6–17.

Req. 1

The allowance for doubtful accounts is increased (credited) when bad debt expense is recorded and decreased (debited) when uncollectible accounts are written off. This case gives the beginning and ending balances of the allowance account and the amount of uncollectible accounts that were written off. Therefore, the amount of bad debt expense (in thousands) can be computed as follows:

Allowance for doubtful accounts

		399,000	Beg. balance
Write-offs	512,000	$\boxed{532{,}000}$	Bad debt exp.
		419,000	End. balance

Beg. Balance + Bad debt exp. – Write-offs = End. Balance
End. Balance – Beg. Balance + Write-offs = Bad debt exp.
419,000 – 399,000 + 512,000 = 532,000

Req. 2

Working capital is unaffected by the write-off of an uncollectible account when the allowance method is used. The asset account (accounts receivable) and the contra-asset account (allowance for doubtful accounts) are both reduced by the same amount; therefore, the book value of net accounts receivable is unchanged.

Working capital is decreased when bad debt expense is recorded because the contra-asset account (allowance for doubtful accounts) is increased. From requirement (1), we know that net accounts receivable was reduced by $532,000 when bad debt expense was recorded in year 2, reducing working capital by $532,000.

Note that income before taxes was reduced by the amount of bad debt expense that was recorded, therefore tax expense and tax payable will decrease. The decrease in tax payable caused working capital to increase; therefore, the net decrease was $532,000 – ($532,000 x 30%) = $372,400.

Req. 3

The entry to record the write-off of an uncollectible account did not affect any income statement accounts; therefore, net income is unaffected by the $512,000 write-off in year 2.

The recording of bad debt expense reduced income before taxes in year 2 by $532,000 and reduced tax expense by $159,600 (i.e., $532,000 x 30%). Therefore, year 2 net income was reduced by $372,400 (as computed in Req. 2).

E6–18.

Req. 1

Dec. 31, 2011		
Allowance for doubtful accounts (–XA, +A)	1,700	
Accounts receivable (J. Doe) (–A)		1,700
To write off an account receivable determined to be uncollectible.		

Dec. 31, 2011		
Bad debt expense (+E, –SE)	1,125	
Allowance for doubtful accounts (+XA, –A).....		1,125
Adjusting entry--estimated loss on uncollectible accounts; based on credit sales ($75,000 x 1.5% = $1,125).		

Req. 2

Income statement:		
Operating expenses:		
Bad debt expense		$1,125
Balance sheet:		
Current assets		
Accounts receivable ($13,000 + $75,000 - $60,000 - $1,700)	$26,300	
Less: Allowance for doubtful accounts ($800 - $1,700 + $1,125)	225	$26,075

Req. 3

The 1.5% rate on credit sales appears reasonable because it approximates the amount of receivables written off ($1,700) during the year. However, if the uncollectible account receivable written off during 2011 is not indicative of average uncollectibles written off over a period of time, the 1.5% rate may not be appropriate. There is not sufficient historical data to make a definitive decision.

E6–19.

Req. 1

$$\text{Receivables turnover} = \frac{\text{Net Sales}}{\text{Average Net Trade Accounts Receivable}} = \frac{\$24{,}710{,}000}{\$2{,}827{,}000^*} = 8.74 \text{ times}$$

$$\text{Average days sales in receivables} = \frac{365}{\text{Receivables Turnover}} = \frac{365}{8.74} = 41.8 \text{ days}$$

* ($3,027,000 + $2,627,000) ÷ 2

Req. 2

The receivables turnover ratio reflects how many times average trade receivables were recorded and collected during the period. The average days sales in receivables indicates the average time it takes a customer to pay its account.

E6–20.

Req. 1

$$\text{Receivables turnover} = \frac{\text{Net Sales}}{\text{Average Net Trade Accounts Receivable}} = \frac{\$57{,}420{,}000}{\$4{,}352{,}000^*} = 13.19 \text{ times}$$

$$\text{Average days sales in receivables} = \frac{365}{\text{Receivables Turnover}} = \frac{365}{13.19} = 27.7 \text{ days}$$

* ($4,622,000 + $4,082,000) ÷ 2

Req. 2

The receivables turnover ratio reflects how many times average trade receivables were recorded and collected during the period. The average days sales in receivables indicates the average time it takes a customer to pay its account.

E6–21.

Req. 1

The change in the accounts receivable balance ($48,066 – 63,403 = –$15,337) would increase cash flow from operations by $15,337 thousand. This happens because the Company is collecting cash faster than it is recording credit sales revenue.

Req. 2

(a) Declining sales revenue leads to lower accounts receivable because fewer new credit sales are available to replace the receivables that are being collected.

(b) Cash collections from the prior period's higher credit sales are greater than the new credit sales revenue. Note that in the next period, cash collections will also decline.

E6–22.

Req. 1

The change in the accounts receivable balance would decrease cash flow from operations by $173,000 thousand. This happens because the Company is recording credit sales revenue faster than it is collecting cash.

Req. 2

(a) Increasing sales revenue leads to higher accounts receivable balances because credit sales are creating new receivables faster than receivables can be collected.

(b) Cash collections from the prior period's lower credit sales are lower than the new credit sales revenue. Note that in the next period, cash collections will also rise.

E6–23.

Req. 1

JONES COMPANY
Bank Reconciliation, June 30, 2010

Company's Books		*Bank Statement*	
Ending balance per Cash account…………………….	$8,000	Ending balance per bank statement…………….	$6,060
Additions:		**Additions:**	
None		Deposit in transit………..	2,900*
			8,960
Deductions:		**Deductions:**	
Bank service charge……	40	Outstanding checks…	1,000
Correct cash balance………	$7,960	Correct cash balance……	$7,960

*$19,100 – $16,200 = $2,900.

Req. 2

Bank service charge expense (+E, –SE).................................	40	
Cash (–A)..		40
To record deduction from bank account for service charges.		

Req. 3

The correct cash balance per the bank reconciliation ($8,000 – $40), $7,960

Req. 4

Balance sheet (June 30, 2010):
Current assets:
Cash $7,960

E6–24.

Req. 1

RUSSELL COMPANY
Bank Reconciliation, September 30, 2011

Company's Books			***Bank Statement***		
Ending balance per Cash account...........................		$5,700	Ending balance per bank statement........................		$4,770
Additions:			**Additions:**		
None			Deposit in transit*.........		1,200*
					5,970
Deductions:			**Deductions:**		
Bank service charges ...	$ 60				
NSF check – Betty Brown	170	230	Outstanding checks ($28,900 – $28,400)		500
Correct cash balance		$5,470	Correct cash balance		$5,470

*$28,600 - $27,400 = $1,200.

Req. 2

(1)	Bank service charge expense (+E, –SE)...............................	60	
	Cash (–A)..		60
	To record bank service charges deducted from bank balance.		
(2)	Accounts receivable (Betty Brown) (+A)...............................	170	
	Cash (–A)..		170
	To record customer check returned due to insufficient funds.		

Req. 3

Same as the correct balance on the reconciliation, $5,470.

Req. 4

Balance Sheet (September 30, 2011):
Current Assets:
Cash $5,470

E6–25 (Based on Supplement A)

November 20, 2010		
Cash (+A)	441	
Credit card discount (+XR, –R, –SE)	9	
Sales revenue (+R, +SE)		450
To record credit card sale.		
November 25, 2010:		
Accounts receivable (Customer C) (+A)	2,800	
Sales revenue (+R, +SE)		2,800
To record a credit sale.		
November 28, 2010:		
Accounts receivable (Customer D) (+A)	7,200	
Sales revenue (+R, +SE)		7,200
To record a credit sale.		
November 30, 2010:		
Sales returns and allowances (+XR, –R, –SE)	600	
Accounts receivable (Customer D) (–A)		600
To record return of defective goods, $7,200 x 1/12 = $600.		
December 6, 2010:		
Cash (+A)	6,468	
Sales discounts (+XR, –R, –SE)	132	
Accounts receivable (Customer D) (–A)		6,600
To record collection within the discount period, 98% × ($7,200 – $600) = $6,468		
December 30, 2010:		
Cash (+A)	2,800	
Accounts receivable (Customer C) (–A)		2,800
To record collection after the discount period.		

PROBLEMS

P6–1.

Case A

Because McDonald's collects cash when the coupon books are sold, cash collection is not an issue in this case. In order to determine if the revenue has been earned, the student must be careful in analyzing what McDonald's actually sold. Students who focus on the sale of the coupon book often conclude that the earning process is complete with the delivery of the book to the customer. In reality, McDonald's has a significant additional service to perform; it has to serve a meal. The correct point for revenue recognition in this case is when the customer uses the coupon or when the coupon expires and McDonald's has no further obligation.

Case B

In this case there is an extremely low down payment and some reason to believe that Quality Builders may default on the contract because of prior actions. If students believe that Howard Land Development could sue and collect on the contract, they will probably argue for revenue recognition. Given the risk of cash collection, most students will argue that revenue should be recognized as cash is collected. The text does not discuss FASB #66, but the instructor may want to mention during the discussion that there is authoritative guidance concerning minimum down payments before revenue can be recorded on a land sale.

Case C

While warranty work on refrigerators can involve significant amounts of effort and money, companies are permitted to record revenue at the point of sale. The text does not discuss this specific issue but the matching concept is mentioned in the context of revenue recognition. This is an excellent opportunity to mention the need to accrue estimated warranty expense at the time that sales revenue is recorded. Some students are surprised to see that costs that will be incurred in the future can be recorded as an expense in the current accounting period.

P6–2.

Req. 1

	Sales Revenue	Sales Discounts (taken)	Sales Returns and Allowances	Bad Debt Expense
(a)	+234,000	NE	NE	NE
(b)	+13,000	NE	NE	NE
(c)	+25,000	NE	NE	NE
(d)	NE	NE	+500	NE
(e)	+24,500	NE	NE	NE
(f)	NE	+250	NE	NE
(g)	NE	+2,000	NE	NE
(h)	NE	+500	NE	NE
(i)	+17,500	NE	NE	NE
(j)	NE	–70	+3,500	NE
(k)	NE	NE	NE	NE
(l)	NE	NE	NE	NE
(m)	NE	NE	NE	+1,140*
Total	+$314,000	+$2,680	+$4,000	+$1,140

* Credit sales ($13,000 + $25,000 + $24,500 + $17,500) .	$80,000
Less: Sales returns ($500 + $3,500)	4,000
Net sales revenue..	76,000
Estimated bad debt rate	x 1.5%
Bad debt expense..	$1,140

Req. 2

Income statement:

Sales revenue	$314,000	
Less: Sales returns and allowances	4,000	
Sales discounts...................................	2,680	
Net sales revenue		$307,320
Bad debt expense		1,140

P6–3.

Income Statement Items		Case A		Case B
Gross sales revenue		$239,000		$165,000
Sales returns and allowances		20,000	i.	40,500
Net sales revenue	a.	219,000	g.	124,500
Cost of goods sold	c.	153,300	h.	(70%) 87,150
Gross profit	b.	(30%) 65,700	f.	37,350
Operating expenses	d.	43,700		18,600
Pretax income		22,000	d.	18,750
Income tax expense (20%)	e.	4,400	e.	3,750
Income before extraordinary items	f.	17,600	c.	15,000
Extraordinary gain (loss)		(2,000)		10,000
Less: Income tax (20%)	g.	400	b.	(2,000)
Net income	h.	$16,000	a.	$23,000
EPS (10,000 shares)	i.	$1.60		$2.30

Note = Computations in order

CASE A

a. $239,000 – $20,000 = $219,000
b. $219,000 x .30 = $65,700
c. $219,000 – $65,700 = $153,300
d. $65,700 – $22,000 = $43,700
e. $22,000 x .20 = $4,400
f. $22,000 – $4,400 = $17,600
g. $2,000 x .20 = $400
h. $17,600 - $2,000 + $400 = $16,000
i. $16,000 ÷ 10,000 = $1.60

CASE B

a. $2.30 x 10,000 shares = $23,000
b. $10,000 x .20 = $2,000
c. $23,000 - $10,000 + $2,000 = $15,000
d. $15,000 ÷ .80 = $18,750
e. $18,750 - $15,000 = $3,750
f. $18,750 + $18,600 = $37,350
g. $37,350 ÷ (1 - .70) = $124,500
h. $124,500 - $37,350 = $87,150
i. $165,000 - $124,500 = $40,500

P6–4.

1. Bad debt expense (+E, –SE) 162
   Allowance for doubtful accounts (+XA, –A) 162
   End-of-period bad debt expense estimate.

   Allowance for doubtful accounts (–XA, +A) 145
   Accounts receivable (–A) 145
   Write-off of bad debts.

2.

Year 2	\$69	+ \$30	– $\boxed{\$41}$	= \$58
Year 1	\$61	+ $\boxed{\$23}$	– \$15	= \$69

Allowance for DA Year 2

		69	Beg. bal.
Write-offs	$\boxed{41}$	30	Bad debt exp.
		58	End. bal.

Allowance for DA Year 1

		61	Beg. bal
Write-offs	15	$\boxed{23}$	Bad debt exp.
		69	Ending Bal.

The solution involves solving for the missing value in the T-account.

P6–5.

Req. 1

Aging Analysis of Accounts Receivable

Customer	Total Receivables	(a) Not Yet Due	(b) Up to One Year Past Due	(c) More Than One Year Past Due
B. Brown…………..	$ 5,200			$5,200
D. Donalds………..	8,000		$ 8,000	
N. Napier………….	7,000	$ 7,000		
S. Strothers………	22,500	2,000	20,500	
T. Thomas………...	4,000	4,000		
Totals……………	$46,700	$13,000	$28,500	$5,200
Percent………….	100%	28%	61%	11%

Req. 2

Aging Schedule--Estimated Amounts Uncollectible

	Age	Amount of Receivables	Estimated Uncollectible Percentage	Estimated Amount Uncollectible
a.	Not yet due……………………	$13,000	2%	$ 260
b.	Up to one year past due…….	28,500	7%	1,995
c.	Over one year past due……..	5,200	30%	1,560
	Estimated ending balance in Allowance for Doubtful Accounts			3,815
	Balance before adjustment			920
	Bad Debt Expense for the year			$2,895

Req. 3

Bad debt expense (+E, –SE)...	2,895	
Allowance for doubtful accounts (+XA, –A)...........		2,895

Req. 4

Income statement:

Bad debt expense		$2,895

Balance sheet:
Current Assets:

Accounts receivable	$46,700	
Less: Allowance for doubtful accounts	3,815	
Accounts receivable (net)		$42,885

P6–6.

Req. 1

BUILDERS COMPANY, INC.
Income Statement
For the Year Ended December 31, 2009

Net sales revenue ($145,600 – $5,600 – $6,400)		$133,600
Cost of goods sold..		78,400
Gross profit on sales		55,200
Operating expenses:		
Selling expense..	$13,600	
Administrative expense	14,400	
Bad debt expense	1,600	29,600
Income from operations...		25,600
Income tax expense		7,680
Net income		$ 17,920

Earnings per share on capital stock outstanding
($17,920 ÷ 10,000 shares) $1.79

Req. 2

$$\text{Gross Profit Percentage} = \frac{\text{Gross Profit}}{\text{Net Sales}} = \frac{\$55,200}{\$133,600} = 0.413 \quad (41.3\%)$$

The gross profit percentage measures the excess of sales prices over the costs to purchase or produce the goods or services sold as a percentage.

$$\text{Receivables Turnover} = \frac{\text{Net Sales}}{\text{Average Net Trade Accounts Receivable}} = \frac{\$133,600}{\$15,200^*} = 8.79$$

* ($16,000 + $14,400) ÷ 2

The receivables turnover ratio measures the effectiveness of credit-granting and collection activities.

P6–7.

Req. 1

HOPKINS COMPANY
Bank Reconciliation, April 30, 2010

Company's Books			Bank Statement	
Ending balance per Cash account		$23,900	Ending balance per bank statement	$23,550
Additions:			**Additions:**	
Interest collected		1,180	Deposits in transit*	5,400
		25,080		28,950
Deductions:			**Deductions:**	
NSF—A.B. Wright	160		Outstanding checks	4,100
Bank charges	70	230		
Correct cash balance		$24,850	Correct cash balance	$24,850

*$41,500 - $36,100 = $5,400.

Req. 2

(1)	Cash (+A)	1,180	
	Interest revenue (+R, +SE)		1,180
	Interest collected.		
(2)	Accounts receivable (A. B. Wright) (+A)	160	
	Cash (–A)		160
	Customer's check returned, insufficient funds.		
(3)	Bank service charge expense (+E, –SE)	70	
	Cash (–A)		70
	Bank service charges deducted from bank statement.		

These entries are necessary because of the changes to the regular Cash account that have not yet been recorded by the company. The bank already has recorded them in its accounts. The Cash account (and the other accounts in the entries) must be brought up to date for financial statement purposes.

Req. 3

Balance in regular Cash account $24,850

Req. 4

Balance Sheet (April 30, 2010):
Current Assets:
Cash $24,850

P6–8.

Req. 1
Comparison of deposits listed in the Cash account with deposits listed on the bank statement reveals a $5,200 deposit in transit on August 31.

Req. 2
Comparison of the checks cleared on the bank statement with (a) outstanding checks from July, and (b) checks written in August reveals two outstanding checks at the end of August ($280 + $510 = $790).

Req. 3

HIRST COMPANY
Bank Reconciliation, August 31, 2011

Company's Books		**Bank Statement**	
Ending balance per Cash account	$20,370	Ending balance per bank statement	$17,990
Additions:		**Additions:**	
Interest collected	2,150	Deposits in transit	5,200
	22,520		23,190
Deductions:		**Deductions:**	
Bank service charges	120	Outstanding checks	790
Correct cash balance	$22,400	Correct cash balance	$22,400

Req. 4

(1)	Cash (+A)	2,150	
	Interest revenue (+R, +SE)		2,150
	Interest collected.		
(2)	Bank service charge expense (+E, –SE)	120	
	Cash (–A)		120
	Service charges deducted from bank balance.		

These entries are necessary because of the changes in the regular Cash account that have not yet been recorded by the company. The bank already has recorded them in its accounts. The Cash account (and the other accounts in the entries) must be brought up to date for financial statement purposes.

Req. 5
Current Assets:
Cash $22,400

P6–9. (Based on Supplement A)

Req. 1

(a)	Cash (+A)	234,000	
	Sales revenue (+R, +SE)		234,000
	Cash sales for 2010.		
(b)	Accounts receivable (R. Jones) (+A)	13,000	
	Sales revenue (+R, +SE)		13,000
	Credit sale, $13,000.		
(c)	Accounts receivable (K. Black) (+A)	25,000	
	Sales revenue (+R, +SE)		25,000
	Credit sale, $25,000.		
(d)	Sales returns and allowances (+XR, –R, –SE)	500	
	Accounts receivable (R. Jones) (–A)		500
	Sale return, 1 unit @ $500.		
(e)	Accounts receivable (B. Sears) (+A)	24,500	
	Sales revenue (+R, +SE)		24,500
	Credit sale, $24,500.		
(f)	Cash (+A)	12,250	
	Sales discounts (+XR, –R, –SE)	250	
	Accounts receivable (R. Jones) (–A)		12,500
	Paid account in full within discount period, ($13,000 - $500) x (1 - .02) = $12,250.		
(g)	Cash (+A)	98,000	
	Sales discounts (+XR, –R, –SE)	2,000	
	Accounts receivable (prior year) (–A)		100,000
	Collected receivables of prior year, all within discount periods $98,000 ÷ .98 = $100,000.		
(h)	Cash (+A)	24,500	
	Sales discounts (+XR, –R, –SE)	500	
	Accounts receivable (K. Black) (–A)		25,000
	Collected receivable within the discount period $25,000 x .98 = $24,500.		
(i)	Accounts receivable (R. Roy) (+A)	17,500	
	Sales revenue (+R, +SE)		17,500
	Credit sale.		

P6–9. *(continued)*

(j)	Sales returns and allowances (+XR, –R, –SE)	3,500	
	Cash (–A)		3,430
	Sales discounts (–XR, +R, +SE)		70
	Sales return, 7 units @ $500 less sales discounts taken = $3,500 x .98.		

(k)	Cash (+A)	6,000	
	Accounts receivable (–A)		6,000
	Collected receivable of prior year, after the discount period.		

(l)	Allowance for doubtful accounts (–XA, +A)	3,000	
	Accounts receivable (2009 account) (–A)		3,000
	Wrote off uncollectible account from 2009.		

(m)	Bad debt expense (+E, –SE)	1,140	
	Allowance for doubtful accounts (+XA, –A).....		1,140
	To adjust for estimated bad debt expense		

Credit sales ($13,000 + $25,000 + $24,500 + $17,500) ..	$80,000
Less: Sales returns ($500 + $3,500)	4,000
Net sales revenue	76,000
Estimated bad debt rate x	1.5%
Bad debt expense	$1,140

.

Req. 2

Income statement:

Sales revenue ($234,000 + $13,000 + $25,000 + $24,500 + $17,500)	$314,000	
Less: Sales returns and allowances ($3,500 + $500)	4,000	
Sales discounts ($250 + $2,000 + $500 – $70)	2,680	
Net sales revenue		$307,320
Bad debt expense		1,140

ALTERNATE PROBLEMS

AP6–1.

Req. 1

	Sales Revenue	Sales Discounts (taken)	Sales Returns and Allowances	Bad Debt Expense
(a)	+227,000	NE	NE	NE
(b)	+12,000	NE	NE	NE
(c)	+23,500	NE	NE	NE
(d)	NE	+240	NE	NE
(e)	+26,000	NE	NE	NE
(f)	NE	-10	+500	NE
(g)	NE	+1,600*	NE	NE
(h)	NE	NE	+3,500	NE
(i)	NE	+400	NE	NE
(j)	+18,500	NE	NE	NE
(k)	NE	NE	NE	NE
(l)	NE	NE	NE	NE
(m)	NE	NE	NE	+2,280**
Total	+$307,000	+$2,240	+$4,000	+$2,280

* [($78,400/.98) x .02] = $1,600

**Credit sales ($12,000 + $23,500 + $26,000 + $18,500) .	$80,000
Less: Sales returns ($500 + $3,500)	4,000
Net sales revenue...	$76,000
Estimated bad debt rate	x 3%
Bad debt expense..	$2,280

Req. 2

Income statement:

Sales revenue	$307,000	
Less: Sales returns and allowances.............	4,000	
Sales discounts..................................	2,240	
Net sales revenue		$300,760
Bad debt expense		$2,280

AP6–2.

1. Bad debt expense (+E, –SE) 4,908
   Allowance for doubtful accounts (+XA, –A) 4,908
   End of period bad debt expense estimate.

   Allowance for doubtful accounts (–XA, +A) 5,060
   Accounts receivable (–A) 5,060
   Write-off of bad debts.

2.

Allowances for Doubtful Accounts	Balance at Beginning of Year	Additions Charged to Costs and Expenses	Deductions from Reserve	Balance at End of Year
Year 3	$2,032	$4,908	$5,060	$\boxed{\$1,880}$
Year 2	1,234	$\boxed{5,475}$	4,677	2,032
Year 1	940	5,269	$\boxed{4,975}$	1,234

Year 3

Allowance for Doubtful Accounts

		2,032	Beg. bal.
Write-offs	5,060	4,908	Bad debt exp.
		$\boxed{1,880}$	End. bal.

Year 2

Allowance for Doubtful Accounts

		1,234	Beg. bal.
Write-offs	4,677	$\boxed{5,475}$	Bad debt exp.
		2,032	End. bal.

Year 1

Allowance for Doubtful Accounts

		940	Beg. bal
Write-offs	$\boxed{4,975}$	5,269	Bad debt exp.
		1,234	Ending bal.

The solution involves solving for the missing value in the T-account.

AP6–3.

Req. 1

Aging Analysis of Accounts Receivable

Customer	Total Receivable	(a) Not Yet Due	(b) Up to 6 Mo. Past Due	(c) 6 to 12 Mo. Past Due	(d) More Than 12 Mo. Past Due
R. Devens ………..	$ 2,000			$2,000	
C. Howard ………..	6,000				$6,000
D. McClain ……….	4,000		$ 4,000		
T. Skibinski ………	14,500	$ 4,500	10,000		
H. Wu ……….…...	13,000	13,000			
Totals……………	$39,500	$17,500	$14,000	$2,000	$6,000
Percent…………	100%	44.3%	35.4%	5.1%	15.2%

Req. 2

Estimated Amounts Uncollectible

	Age	Amount of Receivable	Estimated Loss Rate	Estimated Uncollectible
a.	Not yet due……………………	$17,500	1%	$ 175
b.	Up to 6 months past due....…	14,000	5%	700
c.	6 to 12 months past due.….	2,000	20%	400
d.	Over 12 months past due…...	6,000	50%	3,000
	Total………………………..	$39,500		$4,275

To adjust for estimated bad debt loss:

Balance needed in the allowance account	$4,275
Balance currently in the account	1,550
Adjustment needed (increase)	$2,725

Req. 3

Bad debt expense (+E, –SE)	2,725	
Allowance for doubtful accounts (+XA, –A)		2,725

Req. 4

Income statement:

Bad debt expense	$2,725

Balance sheet:

Current Assets:

Accounts receivable	$39,500	
Less: Allowance for doubtful accounts	4,275	
Accounts receivable, net		$35,225

AP6–4.

Req. 1

RANG CORPORATION
Income Statement
For the Year Ended December 31, 2012

Net sales revenue ($182,000 - $7,000)		$175,000
Cost of goods sold		98,000
Gross profit		77,000
Operating expenses:		
Selling expense	$17,000	
Administrative and general expense	18,000	
Sales discounts	8,000	
Bad debt expense	2,000	
Total operating expenses		45,000
Income from operations		32,000
Income tax expense		9,600
Net income		$ 22,400

Earnings per share on common stock outstanding
($22,400 ÷ 10,000 shares) $2.24

Req. 2

$$\text{Gross Profit Percentage} = \frac{\text{Gross Profit}}{\text{Net Sales}} = \frac{\$77{,}000}{\$175{,}000} = 0.440 \quad (44.0\%)$$

The gross profit percentage measures the excess of sales prices over the costs to purchase or produce the goods or services sold as a percentage.

$$\text{Receivables Turnover} = \frac{\text{Net Sales}}{\text{Average Net Trade Accounts Receivable}} = \frac{\$175{,}000}{\$17{,}000^*} = 10.29$$

* ($16,000 + $18,000) ÷ 2

The receivables turnover ratio measures the effectiveness of credit-granting and collection activities.

AP6–5.

Req. 1

Comparison of (a) the unrecorded deposit carried over from November and (b) the deposits listed on the bank statement reveals that the $13,000 deposit for December 31 is in transit.

Req. 2

Comparison of the checks cleared on the bank statement with (a) outstanding checks from November and (b) checks written in December reveals that the outstanding checks at the end of December are $5,000 + $3,300 + $500 = $8,800.

Req. 3

PACKER COMPANY
Bank Reconciliation, December 31, 2011

Company's Books			Bank Statement	
Ending balance per Cash account		$61,260	Ending balance per bank statement	$61,860
Additions:			**Additions:**	
Interest collected		5,250	Deposits in transit	13,000
		66,510		74,860
Deductions:			**Deductions:**	
NSF check—J. Left............	$300			
Bank service charges.........	150	450	Outstanding checks............	8,800
Correct cash balance		$66,060	Correct cash balance	$66,060

AP6–5. ***(continued)***

Req. 4

(1)	Accounts receivable (J. Left) (+A)	300	
	Cash (–A)		300
	To record NSF check.		
(2)	Cash (+A)	5,250	
	Interest revenue (+R, +SE)		5,250
	Interest collected.		
(3)	Bank service charge expense (+E, –SE)	150	
	Cash (–A)		150
	Service charges deducted from bank balance.		

These entries are necessary because of the changes in the regular Cash account that have not yet been recorded by the company. The bank already has recorded them in its accounts. The Cash account (and the other accounts in the entries) must be brought up to date for financial statement purposes.

Req. 5

Balance Sheet (2011):
Current Assets:
Cash $66,060

CASES AND PROJECTS

ANNUAL REPORT CASES

CP6–1.

1. The company includes liquid financial instruments with original maturities of three months or less to be cash and cash equivalents. This information is from note 2 of the financial statements. The amount disclosed is likely to be close to the fair market value of the securities, given the short maturity date of the securities.

2. In addition to Cost of Goods Sold, American Eagle Outfitters subtracts buying, occupancy and warehousing costs from Net Sales in its computation of Gross Profit. This follows standard practice among retailers. No such additional expenses are subtracted in Deckers' (a footwear manufacturer) computation of Gross Profit. This makes the interpretation of gross profit percentages across different industries difficult.

3.

$$\text{Receivables turnover} = \frac{\text{Net Sales}}{\text{Average Net Trade Accounts Receivable}} = \frac{\$2,794,409}{27,595.5} = 101.3 \text{ times}$$

* ($26,045 + 29,146) ÷ 2

This question is designed to focus student attention on the mechanics of the computation of the receivables turnover ratio and the effect of industry differences. The receivables turnover is so high because of the nature of the company's business. Retail sales are likely to be made with cash or credit card. As a consequence, most retailers would not have accounts receivable related to sales unless they had private store credit card accounts. The accounts receivable on American Eagle's balance sheet relate primarily to amounts owed from landlords for construction allowances for building new stores in malls.

4. No, the company does not report an allowance for doubtful accounts on the balance sheet or in the notes. As a retailer, its trade receivables from customers are immaterial—the company's receivables consist of non-trade receivables and notes receivable.

CP6–2.

1. The company held $27,267 thousand of cash and cash equivalents at the end of the current year. This is disclosed on the balance sheet and the statement of cash flows.

2. Accounts receivable increased by $6,547 thousand, decreasing Net Cash Provided by Operating Activities for the current year. This is included in the operating section of the statement of cash flows in the line item relating to changes in receivables. You may wish to note to students that this amount does not agree with the amount on the statement of cash flows which indicates a $6,547 increase. This difference is the result of the translation of foreign currency receivables.

3.

	2007	**2006**
Gross Profit Percentage = $\frac{\text{Gross Profit}}{\text{Net Sales}}$	$\frac{\$451,921}{1,224,717} = 0.369$	$\frac{\$448,606}{1,092,107} = 0.411$

The gross profit percentage decreased from 2006 to 2007. The decrease implies that the company has reduced its ability to charge premium prices or to purchase goods for resale at lower cost.

4. It discloses its revenue recognition policies in note 2 which summarizes significant accounting policies. The company recognizes revenue from selling gift cards when customers redeem a gift card for merchandise rather than when the gift card is sold. When gift cards are sold, a current liability (deferred revenue) is recorded.

CP6–3.

1.

Current year		American Eagle Outfitters	Urban Outfitters
Gross Profit Percentage	= Gross Profit / Net Sales	$1,340,429 / 2,794,409 = 0.480	$451,921 / 1,224,717 = 0.369

Prior year		American Eagle Outfitters	Urban Outfitters
Gross Profit Percentage	= Gross Profit / Net Sales	$1,077,749 / 2,321,962 = 0.464	$448,606 / 1,092,107 = 0.411

The improved gross profit percentage for American Eagle suggests higher sales prices and/or lower costs of merchandise. Because other costs (occupancy, etc.) are included along with cost of goods sold, the improved ratios may also result from improved comparable store sales and better cost controls. The declining gross profit percentage for Urban Outfitters suggests the opposite scenarios.

2. Companies with unique items for sale or valuable brand images often produce higher gross profit margins. Because American Eagle Outfitters and Urban Outfitters have unique items for sale as well as valuable brand images in certain markets, their margins are predicted to be in the mid to upper range of their industry.

3.

	Industry Average	American Eagle Outfitters	Urban Outfitters
Gross Profit Percentage =	40.23%	48.0%	36.9%

Urban Outfitters' gross profit percentage is below and American Eagle Outfitters' is above the industry average. The higher gross profit percentage for American Eagle Outfitters was anticipated in Requirement 2, but Urban Outfitters is not above the industry average (although it is close, and *was* above average in the prior year).

FINANCIAL REPORTING AND ANALYSIS CASES

CP6–4.

1. No, because the service is completed over a short time period and the difference in sales for that period from year to year is not large.

2. $365,000,000 under each. If the current fiscal year is 2009, UPS recognizes revenues from December 31, 2008 to December 30, 2009 pickups (365 days). Federal Express recognizes revenues from January 1, 2009 through December 30 pickups plus *half* of December 31, 2008 and December 31, 2009 pickups. Airborne recognizes revenues from January 1 through December 31, 2009 pickups.

3. If there was a significant increase or decrease in pickups from year to year, the different methods could cause different amounts of revenue to be recognized in each period, though the total revenues over the life of the company would still remain the same.

4. Either the UPS or Federal Express rule is more correct conceptually (follow the revenue recognition rules). However, since the choice does not materially affect the financial statements, we have no preference among the three.

CRITICAL THINKING CASES

CP6–5.

1. Recording sales for goods or services that had not been delivered as of year-end violates the revenue principle. Recording revenue for sales that were subject to cancellation, without estimating returns properly, is also a violation.

2. It should establish a sales returns and allowances account (a contra revenue) for potential cancellations. An estimate of future cancellations should be made and the amount should reduce net sales in the period the revenue is recognized.

3. Profiting from sales of stock they owned at an inflated stock price and perhaps receiving bonuses determined on the basis of growth in net income probably motivated management. Management was very focused on reporting increased growth because the growth fueled the run-up in the stock price.

CP6–5. *(continued)*

4. The other investors who paid inflated amounts for the stock, customers who were poorly served during the period, and employees of the company who were drawn into the fraud and suffered damage to their reputations were all hurt by management's conduct.

5. Sales transactions booked near the end of the quarter and sales with special terms, e.g. right of return or cancellation, should receive special attention from auditors. Channel stuffing often lowers the receivables turnover ratio. To cover up this change, management improperly reclassified some accounts receivable as notes receivable.

CP6–6.

Req. 1

(a)	$50 x 12 months	=	$ 600
(b)	$12 x (52 weeks x 5 days per week)	=	3,120
(c,d)	Accounts receivable collections ($300 + $800)	=	1,100
	Total approximate amount stolen		$4,820

Req. 2
Basic recommendations:

(1) Install a tight system of internal control, including the following:
  a. Separate cash handling from recordkeeping.
  b. Deposit all cash daily.
  c. Make all payments by check. Consider a separate cash on hand system for small expense payments.
  d. Reconcile bank statement monthly.
  e. Institute a system of spot checks.
  f. Establish cash and paperwork flows.

(2) a. Arrange for an annual independent audit on a continuing basis.
  b. Carefully plan and assign definite responsibilities for all employees. Focus on attaining internal control. Isolate the once trusted employee from all cash handling and accounting activities and consider dismissing and bringing charges against the employee.

FINANCIAL REPORTING AND ANALYSIS PROJECTS

CP6–7.

The solutions to this case will depend on the company and/or accounting period selected for analysis.