

15.501/516

Problem Set 3

Revenue Recognition and Accounting for Account Receivables

1. Dove Company's balance sheet for Dec. 31, 2002 included the following information:

Accounts Receivable (net of allowance for doubtful accounts of \$25,200) \$462,700

The company had credit sales of \$870,000 during FY2003. Historically, the company's credit manager has estimated that 4% of credit sales will not be collected.

During FY2003, the company wrote off customer accounts with a face value of \$30,000. At the end of the year, a newly hired analyst presented the credit manager with the following breakdown of outstanding accounts receivable and the probability of customer default:

<u>Age of Accounts Receivable</u>	<u>Balance Receivable</u>	<u>Probability of not being Collected</u>
0 - 30 days	\$400,000	.005
31 - 60 days	90,000	.010
61 - 120 days	40,000	.100
More than 120 days	20,000	.700

Required:

- a. If Dove Company continues to use its historical percentage-of-credit-sales approach, how much bad debt expense will it recognize for FY2003? What will it report as the ending balance for the book value of accounts receivable?
 - b. If Dove Company applies the aging-of-accounts receivable method, using the credit analyst's estimates in the table above, how much bad debt expense will it recognize for FY2003? What will it report as the ending balance for the book value of accounts receivable?
 - c. What do the differences between the numbers you computed for parts a. and b. above suggest about the accuracy of Dove Company's past accruals for bad debt? Has the company tended to over-estimate or under-estimate uncollectible credit sales? Briefly explain.
2. The footnotes to Barnes & Noble's FY2000 financial statements include the following information:

Revenue Recognition

Revenue from sales of the Company's products is recognized at the time of sale. The Company sells memberships which entitle purchasers to additional discounts. The membership revenue is deferred and recognized as income over the 12-month membership period.

Suppose that B&N sold \$240 worth of memberships, for cash, on December 1, 1999.

Required:

- a. Show the effects on the Balance Sheet Equation (BSE) of the 12/1/99 transaction.
- b. Estimate how those memberships affected revenue for FY2000 (which ended on 1/29/2000) and show the BSE effects of the accounting entry B&N would have had to record on 1/29/2000.¹ Briefly explain how you derived your estimate.

¹ As a retailer, B&N has chosen to define its fiscal year as February through January; FY2000 ends on 1/29/2000.