Chapter 7 Alternate Demonstration Problem

**At the end of the year, the M. I. Wright Company showed the following selected account balances:**

**Sales (all on credit) $300,000**

**Accounts Receivable 800,000**

**Allowance for Doubtful Accounts 38,000**

**Required:**

**1. Assume the company estimates that 1% of all credit sales will not be collected.   
 a. Prepare the proper journal entry to recognize the expense involved.  
 b. Present the balances in Accounts Receivable and Allowance for Doubtful Accounts as they would appear on the balance sheet. Also show the net realizable Accounts Receivable.**

**2. Assume the company estimates that 5% of its accounts receivable will never be collected.   
 a. Prepare the proper journal entry to recognize the expense involved.  
 b. Present the balances in Accounts Receivable and Allowance for Doubtful Accounts as they would appear on the balance sheet. Also show the net realizable Accounts Receivable.**

**3. Under assumptions 1 and 2 above, give the proper journal entries for the following events.**

**June 3 John Shifty, who owes us $500, informs us that he is broke and cannot pay. We believe him.**

**Nov. 9 We learned that John Shifty has won the lottery and is willing to pay off all his old debts.**

Chapter 7 Solution: Alternate Demonstration Problem

**1a. Bad Debts Expense 3,000  
 Allowance for Doubtful Accounts 3,000  
 ($ 300,000 X 1 %)**

**1b. Accounts Receivable $800,000  
 Less: Allowance for Doubtful Accounts 41,000  
 Estimated Realizable A/R $759,000**

**2a. Bad Debts Expense 2,000  
 Allowance for Doubtful Accounts 2,000  
 ($ 800,000 X 5 % less $38,000)**

**2b. Accounts Receivable $800,000  
 Less: Allowance for Doubtful Accounts 40,000  
 Estimated Realizable A/R $760,000**

1. **Both assumptions 1 and 2 above represent the allowance method of accounting for uncollectibles. The only difference is in the approach to estimating uncollectibles. Therefore the entries to write off and show subsequent reinstatement would be the same in 1 and 2.   
     
     
   June 3 Allowance for Doubtful Accounts 500  
    Accounts Receivable, John Shifty 500  
     
     
   Nov. 9 Accounts Receivable, John Shifty 500  
    Allowance for Doubtful Accounts 500  
     
     
   Note: There would be a closing entry for the Bad Debts Expense since it is an expense account just like any other expense account. There would be no closing entry for the Allowance for Doubtful Accounts since it is not a temporary account. It is a contra-asset account, contra to Accounts Receivable.**