Name: _____ (   ) Class: _____ Date: _____

Ch 10 Trade Receivables III – Interpretation of ledger accounts

At the end of this chapter, you will be able to:

Interpret the following ledger accounts:
- Trade receivables
- Allowance for impairment of trade receivables
- Impairment loss on trade receivables

1. <u>**TRADE RECEIVABLE account**</u> – *you are required to know both: how to* <u>prepare</u> *the TR a/c* <u>*and interpret*</u> *the TR ac*

   RECALL: Balance in trade receivable, an asset a/c represents the amount owed by the customer for the goods sold or services provided to her on credit previously.

   Common transactions that concern trade receivable and the effect on TR are:
   (Debit TR when debtor owes biz MORE money; Credit TR when debtor owes biz LESS money)

TRANSACTION	Account to be DEBITED	Account to be CREDITED
1 Credit sale of goods or services	Dr Trade receivable, xx (+ asset)	
2 Returns of goods sold on credit previously		Cr Trade receivable, xx (-asset)
3 Cash discount given to debtor		Cr Trade receivable, xx (-asset)
4 Receipt of money from debtor		Cr Trade receivable, xx (-asset)
5 Withdrawal of cash discount given to debtor	Dr Trade receivable, xx (+ asset)	
6 Dishonour of cheque received from debtor	Dr Trade receivable, xx (+ asset)	
7 Charge debtor interest on overdue account	Dr Trade receivable, xx (+ asset)	
8 Write off amount owed by debtor		Cr Trade receivable, xx (-asset)

Trade discount is <u>*NOT*</u> *recorded in TR a/c. Only the invoiced price i.e. List price – Trade discount is recorded in the TR a/c. Increases or decreases in allowance for impairment of TR is* <u>*NOT*</u> *recorded in TR a/c. Only the TR written off is credited to TR a/c*

EXAMPLE:

Trade Receivable, XYZ Account (an asset)

Date	Particulars	Dr (+) $	Cr (-) $	Balance ($)
2023				
SOP	Balance b/d			47 300 Dr
E2	Sales revenue (credit only) *list pr – trade discount*	55 700		103 000 Dr
E3	Sales returns (credit only) *list pr – trade discount*		6 300	96 700 Dr
E4	Discount allowed		1 700	95 000 Dr
E4	Cash at Bank		30 700	64 300 Dr
E5	Discount allowed (withdrawn)	1 700		66 000 Dr
E5	Cash at bank (dishonoured cheque)	30 700		96 700 Dr
E6	Interest income	1 000		97 700 Dr
E7	Allowance for impairment of TR		64 300	33 400 Dr
E7	Cash at bank		33 400	0

NOTES:

i. If the **list price and trade discount** of the goods sold and goods returned by customers are given, find the invoice price of the goods sold and goods returned (i.e. invoice price = list price – trade discount) to record in the trade receivable account for E2 and E3 above.

ii. **Interpret the entries in the above trade receivable account:**

SOP (start of period): On this date, credit customer, XYZ owed $47,300 to the business.

E2: The business sold goods <u>worth</u> $55,700 on credit to XYZ on this date.

(note: This is <u>not</u> the cost of the goods sold. This is the invoiced price (selling price) of the goods sold. The cost of the goods sold is debited to inventory & credited to cost of sales accounts)

E3: Credit customer, XYZ returned $6,300 worth of goods to the business. The goods were sold on credit to XYZ previously.

(note: This is <u>not</u> the cost of the goods returned. This is the invoiced/sales value of the goods returned. The cost of the goods returned is debited to inventory and credited to cost of sales account.)

E4: The business received a cheque of $30,700 from credit customer, XYZ and gave her a cash discount of $1,700 for early payment.

E5: The cheque of $30,700 received from credit customer, XYZ was rejected by the bank. The cash discount of $1,700 given previously was withdrawn.

E6: The business charged credit customer, XYZ $1,000 interest on her overdue account.

E7: The business received a cheque of $33 400 from credit customer, XYZ and the remaining outstanding amount owing of $64 300 was written off as uncollectible.

PRACTICE Workbook pg 122 Ex 1 Q3 and Q4

2. <u>IMPAIRMENT LOSS on TRADE RECEIVABLE and ALLOWANCE for IMPAIRMENT of TRADE RECEIVABLES accounts</u> – *you are required to how to <u>interpret</u> these accounts only*

Allowance for impairment of trade receivable (AfIOTR) account is a contra-asset account which shows the estimated amount of debts owed by credit customers that may **not** be collectible in the future.

NOTE: *Debit AfIOTR a/c when the business decreases the allowance and write off TR.*
Credit AfIOTR ac/ when the business create or increases the allowance

Transaction	Account to be debited	Account to be credited
1. Create or Increase AfIOTR	Dr Impairment loss on TR (+expense)	Cr AfIOTR (+ allowance)
	(for the create amount – for the first time OR the INCREASE in the allowance amount)	
2 Decrease AfIOTR	Dr AfIOTR (- allowance)	Cr Impairment loss on TR (- expense)
	(for the DECREASE in the allowance amount)	
3 Write off a trade receivable as irrecoverable as the credit customer is unable to pay (eg declared bankrupt).	Dr AfIOTR (- allowance)	Cr Trade receivable, xxx (- asset)

- The **ending balance** in the **AfIOTR b/d** to the following period and is **shown as** a deduction from the trade receivables in the SOFPO.

- **Only the create or increase or decrease in AfIOTR amount is shown as** an expense called ILOTR or (reversal of ILOTR) respectively in the SOFPE

- **Impairment loss on trade receivable account (ILOTR)** is an expense account that records the increases or decreases in the allowance for impairment of trade receivables for the period.
  - Debit ILOTR for increases in allowance
  - Credit ILOTR for decreases in allowance AND transfer to the Income Summary at the end of every financial period.
  - ILOTR a/c is closed (zero balance) to the Income Summary at the end of every accounting period.

EXAMPLE 1 The accountant of Derrick Jewellery extracted the following allowance for impairment of trade receivables account for the years ended 31 December 2019 and 2020.

Allowance for impairment of trade receivables account

Date	Particulars	Debit (-) $	Credit (+) $	Balance $
2019				
Jan 1	Balance b/d			4 850 Cr
Jul 9	Trade receivable – Shashwat	2 130		2 720 Cr
Dec 31	Impairment loss on trade receivables	410		2 310 Cr
2020				
Jan 1	Balance b/d			2 310 Cr
May 7	Trade receivable - Jared	1 620		690 Cr
Dec 31	Impairment loss on trade receivables		2 790	? Cr
2021				
Jan 1	Balance b/d			? Cr

REQUIRED

(a) Calculate the balance of allowance for impairment of trade receivables account as at 31 December 2020.   *$3,480 Cr (690+2790 OR 2,310 -1,620 + 2790)*

(b) Interpret the entries on the following dates in the allowance for impairment of trade receivables account.

(i) Jan 1 2019 *Derrick Jewellery estimated trade receivables balance of $4,850 to be uncollectible as at 31 December 2018, brought down to 1 Jan 2019.*

(ii) 9 July 2019 *Derrick Jewellery wrote off $2,130 owed by credit customer, Shashwat as uncollectible.*

(iii) 31 December 2019 *At 31 December 2019, Derrick Jewellery reviewed its trade receivables and decreased its allowance for impairment of trade receivables by $410 to $2,310.*

(iv) 31 December 2020 *At 31 December 2020, Derrick Jewellery reviewed its trade receivables and increased its allowance for impairment of trade receivables by $2,790 to $3,480.*

(c) Prepare the journal entry to adjust the balance of allowance for impairment of trade receivables for the year ended 31 December 2020. A narration **not** is required.

Journal

Date	Particulars	Debit ($)	Credit ($)
2020			
Dec 31	*Impairment loss on trade receivables*	*2,790*	
	Allowance for impairment of trade receivables		*2,790*

(d) State the effect of adjusting allowance for impairment of trade receivables on profit and assets for the following years ended.

    (i) 31 December 2019 *Both profit and current assets will increase by $410 due to a decrease in AfIOTR of $410*.

    (ii) 31 December 2020 *Both profit and current assets will decrease by $2,790 due to an increase in AfIOTR of $2,790*

(e) Given that the balance of the trade receivables account as at 31 December 2020 is $43 500 **after** the write-off of debts

    (i) prepare an extract of statement of financial performance for the year ended 31 December 2020

Extract of statement of financial performance for the year ended 31 December 2020

Less Other expenses	$
Impairment loss of trade receivables	*2,790*

    (ii) prepare an extract of statement of financial position as at 31 December 2020.

Extract of statement of financial position as at 31 December 2020

Current assets	$
Trade receivables	*43,500*
Less Allowance for impairment of trade receivables	*3,480*
	40,020

EXAMPLE 2 The accountant of Derrick Jewellery extracted the following impairment loss on trade receivables for the years ended 31 December 2019 and 2020.

Impairment loss on trade receivables account (expense)

Date	Particulars	Debit (+) $	Credit $	Balance $
2019				
Dec 31	Allowance for Impairment of trade receivables		410	410 Cr
31	Income summary (ii)	410		0
2020				
Dec 31	Allowance for Impairment of trade receivables	2,790		2,790 Dr
Dec 31	Income summary (iv)		2,790	0

REQUIRED

Interpret the entries on the following dates in the impairment loss on trade receivables a/c

(i) 31 December 2019

   (i) Derrick Jewellery reviewed its trade receivables and reduced the allowance for impairment of trade receivables by $410.

   (ii) Reversal of impairment loss on trade receivables of $410 transferred (closed) to Income Summary at end of the financial year.

(ii) 31 December 2020

   (i) Derrick Jewellery reviewed its trade receivables and increased the allowance for impairment of trade receivables by $2,790.

   (ii) Impairment loss on trade receivables of $2,790 transferred (closed) to Income Summary at end of the financial year.

(iii) State the effect on profit for the year ended 31 December 2019. *Increases profit by $410*

(iv) State the effect on profit for the year ended 31 December 2020. *Decreases profit by $2,790*

READ Textbook pg 183-184 Example 10.7 (Interpret AflOTR)
PRACTICE Workbook pg 126 Ex 2 Q10 and Q11 and pg 129 Ex 3 Q3 (Interpret)

MUST PRACTICE & KNOW HOW TO DO Workbook pg 125 Ex 2 Q8, pg 127 Ex 3 Q1
(prepare journal entries & extracts of FS – Adjustment for AflOTR and TR written off – learnt in Ch 10 (Part II)

Name: _____ ( ) Class: _____ Date: _____

Ch 10 Trade Receivables IV – Scenario Based Question
(Will be tested in Paper 2 as part of one of the questions)

At the end of this chapter, you will be able to:

Analyse, evaluate and make decisions about the credit worthiness of existing and new customers by considering both accounting and non-accounting information

MARKS ALLOCATION
Total : 7 marks, comprising:

- 1 decision statement [1m] AND
- 3 reasons [6m] to support your decision. For GCE 'N' (7086/2), only 2 reasons [4m]
  - Each reason 2 marks, comprising one basic statement (evidence) and one matching development (relevant explanation)

NOTES:

- **Must paraphrase** the basic statement (evidence given). **No** marks will not be awarded if the evidence supporting your answer is **copied word for word** from the question.
- Each reason must have one <u>matching</u> development / one <u>relevant</u> explanation. No additional marks will be given for more than 1 development/explantion on the same reason. No mark if the reason given contradicts the decision.
- No decision, no marks for reasons.

POSSIBLE SCENARIOS

Decide whether to
1. Sell on credit to customer A (to grant credit to its customer) **OR** to customer A <u>or</u> B
2. To grant longer credit (repayment) period to existing customer A **OR** to customer A <u>or</u> B

INFORMATION TO CONSIDER
when a business grants credit to its customers

ACCOUNTING INFORMATION	NON-ACCOUNTING INFORMATION
- Trade receivables balance - Credit terms and cash discount - Number of days trade receivables are overdue - Existing customers' history of repayment - Rate of trade receivable turnover [O level] - Trade receivable collection period [O level]	- Specific industry outlook - Economic outlook - Reputation of customers - New customers' history of repayment

KEY POINT - assess the credit customers' ability to pay (credit worthiness of customers).
Customer that is able to pay / pay early means lesser risk of impairment loss on trade receivables, less expense thus more profit and more cash available for the business to pay for its daily operations.

Accounting / Non-accounting information to look out for	Explanation / development point
High annual sales made to customer or customer is a major customer of the business (high trade receivable balance)	Higher annual sales revenue contributes to higher business profit. So, if the major customer stops buying or reduce the amount bought from the business, the business will suffer lower income, thus lower profit.
Good history of repayment NB: Shorter trade receivables collection period means business can collect the debts earlier.	Business will have more cash flow/able to have the cash earlier to pay for its day-to-day operations when a customer pays earlier. Also, less risk of impairment loss on trade receivables if customer has the history of paying promptly or early, thus reducing expenses and higher profit for the business.
Nature of business of customer – eg local or overseas	If customer's business operates overseas, it may mean possible delay in receiving payment from the customer, more risk due to currency exchanges and also possible language problems and delay in collecting the debts.
Good reputation of customer, established or has been in the business for a longer period	A business that is more established, longer in the business and is well-respected or has positive reviews means it is more stable, enjoys stronger customer loyalty and better relationships with its customers, able to provide good quality goods or services, has a strong stable customer base, makes good sales revenue and is thus more likely to be able to pay its debts. Nonetheless, a new business that has outstanding reviews and popularity, or has achieved any award will likely to attract more customers to its business and great potential for growth, thus able to pay its debts.
Promising/good industry outlook	A business that is experiencing growing demand for its goods or services will earn good revenue and profit and thus more likely to be able to pay its debts.
Booming/growing economic outlook	A business that is based in a country that enjoys booming economy means the business will be doing well and their customers will also be more likely to be able to pay their debts.

Example 1 – Whether to extend credit to customer A (local) or customer B (overseas)

Brazor Trading is a supplier of durians in Singapore. Two of its existing customers are negotiating for an extension of their credit days from 30 to 45 days. The business only intends to extend credit to one of the two customers.

The details of the two customers are as follows.

	Customer A	Customer B
Nature of business of customer	Sell durians to local customers	Sell durians to China
History of repayment	Within 35 days, late 4 times	Within 60 days, late 6 times
Reputation of customer	In business for 20 years. Provides good variety of durians that is popular among local older generation	In business for 3 years. Provides good variety of durians that is popular among China's younger generation
Annual sales revenue made to customer	$100 000	$300 000
Industry outlook	Demand is stagnating as local younger generations don't like the taste	Demand is increasing as durian is considered an exotic fruit in China
Economic outlook	Singapore's economy is booming due to increase in trade with emerging markets in Africa and South America	China's economy is slowing down due to trade war with USA

REQUIRED

If you are the accounts manager of Brazor Trading, which customer will you grant the extension of credit days? Explain your answer.

Answer (Customer A)

Decision	I will grant extension of credit to customer A.
Evidence 1 (Basic statement 1) History of repayment	Customer A takes a shorter time to pay back his debts, 35 days as compared to B, 60 days and is late in payment 4 times only while customer B was late in payment for 6 times. OR *The business is able to collect payment earlier and more promptly from customer A (quote statistics)*
Explanation 1 (Development 1)	The business more assured of payment from customer A as compared to customer B. This allows the business to receive cash earlier for its daily operations.
Evidence 2 (Basic statement 2) Reputation of customer	Customer A has been in business (or has been operating) for 20 years, which is 17 years more than customer B. OR *Customer A has been in business for a much longer period, 17 years more than customer B. OR Customer A is more established in the years as it has been operating for 20 years, which is 17 years more than customer B. OR Customer A has more experience in running the business (i.e 17 more years) than customer B*
Explanation 2 (Development 2)	Customer A should be more stable (or has a stable large customers base) and less likely to close down. Hence, the business will be more assured of receiving payment from her (or customer A is more likely to be able to pay its debts on time/promptly).
Evidence 3 (Basic statement 3) Economic outlook	Customer A sells durians to the locals in Singapore while customer B's customers are from China. The economy in Singapore is booming while that in China is slowing down. OR *Singapore economic outlook is soaring/prospering whereas China's economy is withering.*
Explanation 3 (Development 3)	When the economy is doing well, customer A's sales (or business) is likely to be well too as its customers will be more willing to spend on durians. Hence, customer A will be more likely to be able to pay its debts. On the other hand, customer B's business may be adversely affected by the slowing down economy and would be less likely to be able to repay his debts. OR *Since Company A sells durians in Singapore, its sales revenue is likely to increase as its customers will be more willing / more able to spend on durians. Hence customer A will be more likely to be able to pay its debts.*
Evidence 4 (Basic statement 4) Nature of business (local vs overseas)	Customer A's business operates locally while customer B's business operates overseas.
Explanation 4 (Development 4)	This may mean possible further delay in receiving payments from customer B, more risk due to currency exchanges and possible language problems in the debt collection process.

Alternative Answer :(Customer B)

Decision	I will grant extension of credit to customer B.
Evidence 1 (Basic statement 1) *Annual sales*	The business sold 3 times more durians to customer B than that to customer A in a year ($300,000 versus $100,000). OR *Annual sales to customer B is $200,000 more than that of customer A. (customer B is a "bigger" customer")*
Explanation 1 (Development 1)	The higher sales revenue to customer B will result in higher profit for Brazor Trading. Thus, it will be good to extend the credit to customer B as the business may lose a big customer B if the extended credit is not given to B
Evidence 2 (Basic statement 2) *Reputation of customer*	Although Customer B is in business for 3 years, there is good demand for the durians among the younger people in China.
Explanation 2 (Development 2)	This means customer B business is good and thus is able to repay its debts.
Evidence 3 (Basic statement 3) *Industry outlook*	Customer B's industry outlook is promising as there is a growing demand for durians because the younger generation find the fruit unique.
Explanation 3 (Development 3)	This means customer B's business is growing and will likely to earn better revenue and profit and thus likely to be able to pay its debts.

Example 2 Whether to sell on credit to a new customer

Dylan Sports allows its customers a credit period of 30 days to repay any amount outstanding. The business usually takes 32 days on average to collect money owed by its trade receivables.

Famous is a prospective new customer. Dylan Sports gathered the following information about Famous' business.

1. Famous operates his business locally.

2. Famous opened his business selling sports equipment one year ago. His business also provides physical training to individuals and companies. As a successful business, he expects his business sales revenue and coaching fee revenue to double within one year.

3. Famous' business pays its suppliers on average within 37 days.

4. Famous has a good credit rating. He can provide details of two of his current suppliers who are willing to provide evidence of his payment history and reliability.

5. The economic outlook is uncertain due to the current Covid-19 situation.

REQUIRED

Advise whether Dylan Sports should agree to make sales on credit to Famous' business. Justify your decision with **three** reasons.

ANSWER

The business should <u>grant credit</u> to Famous' business. [1]

Reasons (comprising 1 basic statement (evidence) and 1 development statement (explanation)

Nature of business (local vs overseas)
1. Famous' business is located locally. **(1 basic statement)** [1]
Thus, it will be easier to collect debts from Famous' business and there is no currency exchange risk nor language problem in the debt collection process. **(1 development)** [1]

Reputation of customer
2. Famous' business is very new (started one year ago). **(1 basic statement)** [1]
However, he expects to double his sales revenue and coaching fee revenue within a year. **This indicates** the business has good potential to grow and is able to pay its debts. **(1 development)** [1]

History of repayment
3. Famous is creditworthy. His suppliers rated him favourably for his ability to pay. **OR** Famous can provide references from current suppliers. This means it may be possible to have evidence of his payment history, reliability and reputation from third parties. **(1 basic statement)** [1]
Famous good credit rating **means he is able to** pay the amount owing to suppliers within reasonable time. **Although** he takes 5 days longer (37 days vs 32 days) to pay than Dylan Sports average time to collect money from its trade receivables, Dylan Sports may agree to sell goods on credit to Famous and insist on strict credit terms with Famous. **(1 development)** [1]

ALTERNATIVE ANSWER

The business should <u>not</u> grant credit to Famous' business.
[1]

Reasons (comprising 1 basic statement (evidence) and 1 development statement (explanation)

History of repayment

1. Famous takes longer to pay his suppliers than both Dylan's standard credit terms to its customers and its average trade receivables collection period. **(1 basic statement)** [1]

This may indicate that Famous' may not be able to pay promptly/on time. **It may affect** Dylan Sports' cash flow and hinders its operations. **(1 development)** [1]

Reputation of customer

2. Famous can provide references from current suppliers. This means it may be possible to have evidence of his payment history, reliability and reputation from third parties. **(1 basic statement)** [1]

However, the current suppliers have been in business with Famous for only 1 year or less, and Famous could have chosen to provide details of suppliers whom he pays promptly. **(1 development)** [1]

Economic outlook

3. The economic outlook is unpredictable depending on how the Covid-19 situation evolves. **(1 basic statement)** [1]

Famous' business may be adversely affected if the Covid-19 situation worsens. This may affect his ability to repay his debts, thus affecting Dylan Sports' cash flow and operations.[1] **(1 development)**

READ Textbook pg 167-172
PRACTICE Workbook Page 236-237 Exercise 3 Q1,2