AUDIT OF RECEIVABLES

PROBLEM NO. 1

Your audit disclosed that on December 31, 2006, the accounts receivable control account of Alilem Company had a balance of P2,865,000. An analysis of the accounts receivable account showed the following:

- Accounts known to be worthless: P37,500
- Advance payments to creditors on purchase orders: 150,000
- Advances to affiliated companies: 375,000
- Customers’ accounts reporting credit balances arising from sales return: (225,000)
- Interest receivable on bonds: 150,000
- Other trade accounts receivable – unassigned: 750,000
- Subscriptions receivable for common stock due in 30 days: 825,000
- Trade accounts receivable - assigned (Finance company’s equity in assigned accounts is P150,000): 375,000
- Trade installment receivable due 1 – 18 months, including unearned finance charges of P30,000: 330,000
- Trade receivables from officers due currently: 22,500
- Trade accounts on which post-dated checks are held (no entries were made on receipts of checks): 75,000

P2,865,000

Questions:

Based on the above and the result of your audit, determine the adjusted balance of following:

1. The trade accounts receivable as of December 31, 2006 is
   a. P1,147,500
   b. P1,522,500
   c. P1,485,000
   d. P1,447,500

2. The current trade and other receivables net as of December 31, 2006 is
   a. P2,647,500
   b. P2,610,000
   c. P2,272,500
   d. P1,822,500

3. How much of the foregoing will be presented under noncurrent assets as of December 31, 2006?
   a. P1,200,000
   b. P375,000
   c. P525,000
   d. P0

Suggested Solution:

Question No. 1

Other trade accounts receivable – unassigned: P750,000
Trade accounts receivable - assigned: 375,000
Trade installment receivable due 1 – 18 months, net of unearned finance charges of P30,000: 300,000
Trade receivables from officers due currently: 22,500
Trade accounts on which post-dated checks are held: 75,000
Trade accounts receivable: P1,522,500

Question No. 2

Trade accounts receivable (see no. 1): P1,522,500
Advance payments to creditors on purchase orders: 150,000
Interest receivable on bonds: 150,000
Subscriptions receivable, due in 30 days: 825,000
Current trade and other receivables: P2,647,500

Question No. 3

Advances to affiliated companies: P375,000

Note: Advances to affiliated companies are normally presented under noncurrent assets.

Answers: 1) B; 2) A; 3) B
PROBLEM NO. 2

Your audit of Banayoyo Corporation for the year ended December 31, 2006 revealed that the Accounts Receivable account consists of the following:

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade accounts receivable (current)</td>
<td>P3,440,000</td>
</tr>
<tr>
<td>Past due trade accounts</td>
<td>640,000</td>
</tr>
<tr>
<td>Uncollectible accounts</td>
<td>128,000</td>
</tr>
<tr>
<td>Credit balances in customers’ accounts</td>
<td>(80,000)</td>
</tr>
<tr>
<td>Notes receivable dishonored</td>
<td>240,000</td>
</tr>
<tr>
<td>Consignment shipments – at cost</td>
<td></td>
</tr>
<tr>
<td>The consignee sold goods costing P96,000 for P160,000. A 10% commission was charged by the consignee and remitted the balance to Banayoyo. The cash was received in January, 2007.</td>
<td></td>
</tr>
<tr>
<td>Total</td>
<td>P4,688,000</td>
</tr>
</tbody>
</table>

The balance of the allowance for doubtful accounts before audit adjustment is a credit of P80,000. It is estimated that an allowance should be maintained to equal 5% of trade receivables, net of amount due from the consignee who is bonded. The company has not provided yet for the 2006 bad debt expense.

Questions:

Based on the above and the result of your audit, determine the adjusted balance of following:

1. Trade accounts receivable
   a. P4,080,000
   b. P3,440,000
   c. P4,464,000
   d. P3,584,000

2. Allowance for doubtful accounts
   a. P204,000
   b. P216,000
   c. P172,000
   d. P179,200

3. Doubtful accounts expense
   a. P264,000
   b. P220,000
   c. P252,000
   d. P227,200

Suggested Solution:

**Question No. 1**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Trade receivables (current)</td>
<td>P3,440,000</td>
</tr>
<tr>
<td>Past due trade accounts</td>
<td>640,000</td>
</tr>
<tr>
<td>Notes receivable dishonored</td>
<td>240,000</td>
</tr>
<tr>
<td>Consignment goods already sold (P160,000 x 90%)</td>
<td>144,000</td>
</tr>
<tr>
<td>Adjusted trade receivables</td>
<td>P4,464,000</td>
</tr>
</tbody>
</table>

**Question No. 2**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Adjusted trade receivables</td>
<td>P4,464,000</td>
</tr>
<tr>
<td>Less due from consignee</td>
<td>144,000</td>
</tr>
<tr>
<td>Basis of allowance for doubtful accounts</td>
<td>4,320,000</td>
</tr>
<tr>
<td>Bad debt rate</td>
<td>5%</td>
</tr>
<tr>
<td>Required allowance for doubtful accounts</td>
<td>P216,000</td>
</tr>
</tbody>
</table>

**Question No. 3**

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Required allowance for doubtful accounts</td>
<td>P216,000</td>
</tr>
<tr>
<td>Add write-off of uncollectible accounts</td>
<td>128,000</td>
</tr>
<tr>
<td>Total</td>
<td>344,000</td>
</tr>
<tr>
<td>Less allowance account before adjustment</td>
<td>80,000</td>
</tr>
<tr>
<td>Doubtful accounts expense</td>
<td>P264,000</td>
</tr>
</tbody>
</table>

Answers: 1) C; 2) B; 3) A

PROBLEM NO. 3

Presented below are a series of unrelated situations. Answer the following questions relating to each of the independent situations as requested.

1. Bantay Company’s unadjusted trial balance at December 31, 2006, included the following accounts:

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>P1,000,000</td>
</tr>
<tr>
<td>Allowance for doubtful accounts</td>
<td>40,000</td>
</tr>
<tr>
<td>Sales</td>
<td>P15,000,000</td>
</tr>
<tr>
<td>Sales returns and allowances</td>
<td>700,000</td>
</tr>
</tbody>
</table>
Bantay Company estimates its bad debt expense to be 1 1/2% of net sales. Determine its bad debt expense for 2006.

- P225,000
- P254,500
- P55,000
- P14,500

2. An analysis and aging of Burgos Corp. accounts receivable at December 31, 2006, disclosed the following:
   - Amounts estimated to be uncollectible: P1,800,000
   - Accounts receivable: 17,500,000
   - Allowance for doubtful accounts (per books): 1,250,000

   What is the net realizable value of Burgos’ receivables at December 31, 2006?
   - P15,700,000
   - P16,250,000
   - P14,500,000
   - P17,500,000

3. Cabugao Company provides for doubtful accounts based 3% of credit sales. The following data are available for 2006.
   - Credit sales during 2006: P21,000,000
   - Allowance for doubtful accounts 1/1/06: 170,000
   - Collection of accounts written off in prior years (Customer credit was reestablished): 80,000
   - Customer accounts written off as uncollectible during 2006: 300,000

   What is the balance in allowance for doubtful accounts at December 31, 2006?
   - P630,000
   - P500,000
   - P420,000
   - P580,000

4. At the end of its first year of operations, December 31, 2006, Caoayan, Inc. reported the following information:
   - Accounts receivable, net of allowance for doubtful accounts: P9,500,000
   - Customer accounts written off as uncollectible during 2006: 240,000
   - Bad debts expense for 2006: 840,000

   What should be the balance in accounts receivable at December 31, 2006, before subtracting the allowance for doubtful accounts?
   - P10,100,000
   - P9,740,000
   - P10,340,000
   - P10,580,000

5. The following accounts were taken from Cervantes Inc.’s balance sheet at December 31, 2006.

<table>
<thead>
<tr>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>P4,100,000</td>
</tr>
<tr>
<td>Allowance for doubtful accounts</td>
<td>100,000</td>
</tr>
<tr>
<td>Net credit sales</td>
<td>P7,500,000</td>
</tr>
</tbody>
</table>

If doubtful accounts are 3% of accounts receivable, determine the bad debt expense to be reported for 2006.

- P123,000
- P23,000
- P223,000
- P225,000

Suggested Solution:

**Question No. 1**

- Sales: P15,000,000
- Less sales returns and allowances: 700,000
- Net sales: 14,300,000
- Multiply by bad debt rate: 1 1/2%
- Bad debt expense: P214,500

**Question No. 2**

- Accounts receivable: P17,500,000
- Amount estimated to be uncollectible: (P1,800,000)
- Net realizable value: P15,700,000

**Question No. 3**

- Allowance for doubtful accounts 1/1/06: P170,000
- Establishment of accounts written off in prior years: 80,000
- Customer accounts written off in 2006: (300,000)
- Bad debt expense for 2006 (P21,000,000 X 3%): 630,000
- Allowance for doubtful accounts 12/31/06: P580,000
**Question No. 4**

Bad debt expense for 2006 \[ P840,000 \]
Customer accounts written off as uncollectible during 2006 \[ (240,000) \]
Allowance for doubtful accounts, 12/31/06 \[ P600,000 \]

Accounts receivable, net of allowance for doubtful accounts \[ P 9,500,000 \]
Allowance for doubtful accounts, 12/31/06 \[ 600,000 \]
Accounts receivable, before deducting allowance for doubtful accounts \[ P10,100,000 \]

**Question No. 5**

Accounts receivable \[ P4,100,000 \]
Percentage 3%
Bad debt expense, before adjustment \[ 123,000 \]
Allowance for doubtful accounts (debit balance) \[ 100,000 \]
Bad debt expense for 2006 \[ P 223,000 \]

Answers: 1) C; 2) A; 3) D; 4) A, 5) C

**PROBLEM NO. 4**

The adjusted trial balance of Galimuyod Company as of December 31, 2005 shows the following:

<table>
<thead>
<tr>
<th></th>
<th>Debit</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable</td>
<td>P1,000,000</td>
<td>P40,000</td>
</tr>
<tr>
<td>Allowance for bad debts</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Additional information:

- Cash sales of the company represents 10% of gross sales.
- 90% of the credit sales customers do not take advantage of the 2/10, n/30 terms.
- It is expected that cash discount of P6,000 will be taken on accounts receivable outstanding at December 31, 2006.
- Sales returns in 2006 amounted to P400,000. All returns were from charge sales.
- During 2006, accounts totaling to P44,000 were written off as uncollectible; bad debt recoveries during the year amounted to P3,000.
- The allowance for bad debts is adjusted so that it represents certain percentage of the outstanding accounts receivable at year end. The required percentage at December 31, 2006 is 150% of the rate used on December 31, 2005.

**Questions:**

Based on the above and the result of your audit, answer the following:

1. The accounts receivable as of December 31, 2006 is
   a. P3,000,000  
   b. P 300,000  
   c. P 333,333  
   d. P2,444,000

2. The allowance for doubtful accounts as of December 31, 2006 is
   a. P 20,000  
   b. P120,000  
   c. P180,000  
   d. P146,640

3. The net realizable value of accounts receivable as of December 31, 2006 is
   a. P 307,340  
   b. P2,814,000  
   c. P2,874,000  
   d. P2,291,360

4. The doubtful account expense for the year 2006 is
   a. P181,000  
   b. P212,000  
   c. P 21,000  
   d. P147,640

**Suggested Solution:**

**Question No. 1**

Expected cash discounts \[ P 6,000 \]
Divide by percentage of cash discount \[ 0.02 \]
Portion of AR that will be granted cash discounts \[ 300,000 \]
Divide by percentage of total AR estimated to take advantage of the discount \[ 0.10 \]
Accounts receivable, 12/31/06 \[ P3,000,000 \]
Question No. 2

Accounts receivable, 12/31/06 P3,000,000

Multiply by bad debt rate
\[ \left( \frac{P40,000}{P1,000,000} \times 1.5 \right) \]
0.06

Allowance for doubtful accounts, 12/31/06 P180,000

Question No. 3

Accounts receivable, 12/31/06 P3,000,000

Less: Allowance for doubtful accounts P180,000

Allowance for sales discounts 6,000

Net realizable value, 12/31/06 P2,814,000

Question No. 4

Allow. for doubtful accounts, 12/31/06 P180,000

Add accounts written off 44,000

Total 224,000

Less: Allow. for doubtful accounts, 12/31/05 P40,000

Bad debt recoveries 3,000

43,000

Doubtful accounts expense for 2006 P181,000

Answers: 1) A; 2) C; 3) B; 4) A

PROBLEM NO. 5

In your audit of Lidlidda Plastic Products Co., you noted that the company’s balance sheet shows the accounts receivable balance at December 31, 2005 as follows:

<table>
<thead>
<tr>
<th>Accounts receivable</th>
<th>P3,600,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance for doubtful accounts</td>
<td>72,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td>P3,528,000</td>
</tr>
</tbody>
</table>

During 2006, transactions relating to the accounts were as follows:

- Sales on account, P38,400,000.
- Cash received from collection of current receivable totaled P31,360,000, after discount of P640,000 were allowed for prompt payment.
- Customers’ accounts of P160,000 were ascertained to be worthless and were written off.
- Bad accounts previously written off prior to 2005 amounting to P40,000 were recovered.
- The company decided to provide P184,000 for doubtful accounts by journal entry at the end of the year.
- Accounts receivable of P5,600,000 have been pledged to a local bank on a loan of P3,200,000. Collections of P1,200,000 were made on these receivables (not included in the collections previously given) and applied as partial payment to the loan.

Questions:

Based on the above and the result of your audit, answer the following:

1. The accounts receivable as of December 31, 2006 is
   a. P8,680,000  
   c. P4,240,000  
   b. P9,840,000  
   d. P8,640,000

2. The allowance for doubtful accounts as of December 31, 2006 is
   a. P8,000  
   c. P184,000  
   b. P136,000  
   d. P176,000

3. The net realizable value of accounts receivable as of December 31, 2006 is
   a. P8,544,000  
   c. P8,504,000  
   b. P8,456,000  
   d. P4,104,000

4. If receivables are hypothecated against borrowings, the amount of receivables involved should be
   a. Disclosed in the statements or notes  
   b. Excluded from the total receivables, with disclosure  
   c. Excluded from the total receivables, with no disclosure  
   d. Excluded from the total receivables and a gain or loss is recognized between the face value and the amount of borrowings
Suggested Solution:

Question No. 1

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable, 12/31/05</td>
<td>P 3,600,000</td>
</tr>
<tr>
<td>Add: Sales on account</td>
<td>38,400,000</td>
</tr>
<tr>
<td>Bad debt recoveries</td>
<td>40,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>42,040,000</strong></td>
</tr>
<tr>
<td>Less: Current receivables collected, before cash discounts</td>
<td>(P31,360,000 + P640,000) = P32,000,000</td>
</tr>
<tr>
<td>Accounts written off</td>
<td>160,000</td>
</tr>
<tr>
<td>Bad debt recoveries</td>
<td>40,000</td>
</tr>
<tr>
<td>Collections made on AR pledged as collateral</td>
<td>1,200,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>33,400,000</strong></td>
</tr>
</tbody>
</table>

Accounts receivable, 12/31/06: P 8,640,000

Question No. 2

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Allowance for doubtful accounts, 12/31/05</td>
<td>P 72,000</td>
</tr>
<tr>
<td>Add: Bad debt recoveries</td>
<td>40,000</td>
</tr>
<tr>
<td>Provision for doubtful accounts</td>
<td>184,000</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>296,000</strong></td>
</tr>
<tr>
<td>Less: Accounts written off</td>
<td>160,000</td>
</tr>
<tr>
<td>Allowance for doubtful accounts, 12/31/06</td>
<td>P 136,000</td>
</tr>
</tbody>
</table>

Question No. 3

<table>
<thead>
<tr>
<th>Description</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Accounts receivable, 12/31/06</td>
<td>P 8,640,000</td>
</tr>
<tr>
<td>Less allowance for doubtful accounts, 12/31/06</td>
<td>136,000</td>
</tr>
<tr>
<td><strong>Net realizable value, 12/31/06</strong></td>
<td><strong>P 8,504,000</strong></td>
</tr>
</tbody>
</table>

Question No. 4

Receivables hypothecated or pledged against borrowings should be disclosed.

Answers: 1) D; 2) B; 3) C; 4) A

PROBLEM NO. 6

You were able to obtain the following information from your audit of Magsingal Corporation’s Accounts Receivable and Allowance for Doubtful Accounts:

- From the general ledger you noted that the Accounts Receivable has a balance of P848,000 as of December 31, 2006. Below is a transcript of the Allowance for Doubtful Accounts:

<table>
<thead>
<tr>
<th>Description</th>
<th>Debit</th>
<th>Credit</th>
<th>Balance</th>
</tr>
</thead>
<tbody>
<tr>
<td>January 1 – Balance</td>
<td></td>
<td></td>
<td>P20,000</td>
</tr>
<tr>
<td>July 31 – Write-off</td>
<td>P16,000</td>
<td></td>
<td>4,000</td>
</tr>
<tr>
<td>December 31- Provision</td>
<td>P48,000</td>
<td></td>
<td>P52,000</td>
</tr>
</tbody>
</table>

- The summary of the subsidiary ledger as of December 31, 2006 was totaled as follows:

  **Debit balances:**
  - Under one month: P360,000
  - One to six months: 368,000
  - Over six months: 152,000
  **Total:** P880,000

  **Credit balances:**
  - Alien: P 8,000 - OK; additional billing in January, 2006
  - T. Twister: 14,000 - Should have been credited to Apol*
  - Dee Lah: 18,000 - Advances on sales contract
  **Total:** P40,000

  *Account is one to six months classification

The customers’ ledger is not in agreement with the accounts receivable control. The client requested you to adjust the control account to the subsidiary ledger after corrections are made.

- It is agreed that 1 percent is adequate for accounts under one month. Accounts one to six months are expected to require a reserve of 2 percent. Accounts over six months are analyzed as follows:
Definitely bad P 48,000
Doubtful (estimated to be 50% collectible) 24,000
Apparently good, but slow (estimated to be 90% collectible) 80,000
Total P152,000

QUESTIONS:

Based on the above and the result of your audit, answer the following:

1. How much is the adjusted balance of Accounts Receivable as of December 31, 2006?
   a. P818,000  c. P832,000
   b. P846,000  d. P826,000

2. How much is the adjusted balance of the Allowance for Doubtful Accounts as of December 31, 2006?
   a. P30,680  c. P30,960
   b. P31,240  d. P30,760

3. How much is the Doubtful Accounts expense for the year 2006?
   a. P74,680  c. P74,960
   b. P75,240  d. P74,760

Suggested Solution:

Question No. 1

<table>
<thead>
<tr>
<th>Classification</th>
<th>GL</th>
<th>Debit</th>
<th>SL</th>
<th>Credit</th>
<th>0 to 1</th>
<th>1 to 6</th>
<th>Over 6</th>
</tr>
</thead>
<tbody>
<tr>
<td>Unadjusted balances</td>
<td>P848,000</td>
<td></td>
<td>P880,000</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Add (deduct):</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts w/ credit balances</td>
<td>26,000</td>
<td></td>
<td>(14,000)</td>
<td>(40,000)</td>
<td></td>
<td>(14,000)</td>
<td></td>
</tr>
<tr>
<td>Definitely uncollectible accounts</td>
<td>(48,000)</td>
<td>(48,000)</td>
<td>(48,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unlocated difference</td>
<td>(8,000)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted balances</td>
<td>P818,000</td>
<td></td>
<td>P818,000</td>
<td>0</td>
<td>360,000</td>
<td>354,000</td>
<td>104,000</td>
</tr>
</tbody>
</table>

Question No. 2

<table>
<thead>
<tr>
<th>Account classification</th>
<th>Adjusted balance</th>
<th>Required Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 1 month</td>
<td>P360,000</td>
<td>1%</td>
</tr>
<tr>
<td>1 to 6 months</td>
<td>354,000</td>
<td>2%</td>
</tr>
<tr>
<td>Over 6 months</td>
<td>104,000</td>
<td>P24,000 – 50%</td>
</tr>
<tr>
<td></td>
<td></td>
<td>P80,000 – 10%</td>
</tr>
</tbody>
</table>

P30,680

Question No. 3

Doubtful account expense, per books P48,000
Add adjustment to allowance:
Required allowance P30,680
Less balance before required allowance (P52,000 – P48,000) 4,000
Doubtful Accounts expense for 2006 P74,680

Answers: 1) A; 2) A; 3) A

PROBLEM NO. 7

In connection with your examination of the financial statements of Nagbukel, Inc. for the year ended December 31, 2006, you were able to obtain certain information during your audit of the accounts receivable and related accounts.

The December 31, 2006 balance in the Accounts Receivable control accounts is P788,000.

The only entries in the Doubtful Accounts Expense account were:

- A credit for P1,296 on December 2, 2006 because Company A remitted in full for the accounts charged off on October 31, 2006; and
- A debit on December 31 for the amount of the credit to the Allowance for Doubtful Accounts.

The Allowance for Doubtful Accounts schedule is follows:
January 1, 2006  
October 31, 2006  
Uncollectible accounts:  
Company A – P1,296  
Company B – P3,280  
Company C – P2,256  
December 31, 2006  
8,600

An aging schedule of the accounts receivable as of December 31, 2006 is presented below:

<table>
<thead>
<tr>
<th>Age</th>
<th>Net debit balance</th>
<th>Amount to which the Allowance is to be adjusted after adjustments and corrections have been made</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 1 month</td>
<td>P372,960</td>
<td>1 percent</td>
</tr>
<tr>
<td>1 to 3 months</td>
<td>307,280</td>
<td>2 percent</td>
</tr>
<tr>
<td>3 to 6 months</td>
<td>88,720</td>
<td>3 percent</td>
</tr>
<tr>
<td>Over 6 months</td>
<td>24,000</td>
<td>Definitely uncollectible, P4,000; P8,000 is considered 50% uncollectible; the remainder is estimated to be 80% collectible.</td>
</tr>
</tbody>
</table>

There is a credit balance in one account receivable (0 to 1 month) of P8,000; it represents an advance on a sales contract. Also, there is a credit balance in one of the 1 to 3 months account receivable of P2,000 for which merchandise will be accepted by the customer.

The ledger accounts have not been closed as of December 31, 2006. The Accounts Receivable control account is not in agreement with the subsidiary ledger. The difference cannot be located, and you decided to adjust the control account to the sum of the subsidiaries after corrections are made.

QUESTIONS:

Based on the above and the result of your audit, answer the following:

1. How much is the adjusted balance of Accounts Receivable as of December 31, 2006?
   a. P794,000
   b. P793,200
   c. P798,960
   d. P802,960

2. How much is the adjusted balance of the Allowance for Doubtful Accounts as of December 31, 2006?
   a. P63,552
   b. P23,057
   c. P18,937
   d. P19,057

3. How much is the net adjustment to the Allowance for Doubtful Accounts?
   a. P24,493 debit
   b. P15,552 credit
   c. P28,943 debit
   d. P29,063 debit

4. How much is the Doubtful Accounts expense for the year 2006?
   a. P13,961
   b. P18,411
   c. P58,456
   d. P13,841

5. How much is the net adjustment to the Doubtful Accounts expense account?
   a. P20,352 debit
   b. P24,263 credit
   c. P24,143 credit
   d. P19,693 credit

Suggested Solution:

Question No. 1

<table>
<thead>
<tr>
<th>Unadjusted balances</th>
<th>GL</th>
<th>SL</th>
<th>0 to 1</th>
<th>1 to 3</th>
<th>3 to 6</th>
<th>Over 6</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>788,000</td>
<td>792,960</td>
<td>372,960</td>
<td>307,280</td>
<td>88,720</td>
<td>24,000</td>
</tr>
<tr>
<td>Add (deduct):</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Understatement of</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>accounts written off</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>(P6,832-P6,032)</td>
<td>(800)</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Definitely uncollectible accounts</td>
<td>(4,000)</td>
<td>(4,000)</td>
<td>(4,000)</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Advances from</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>customers</td>
<td>8,000</td>
<td>8,000</td>
<td>8,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Accounts w/ credit</td>
<td>2,000</td>
<td>2,000</td>
<td>2,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>balances</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Unlocated difference</td>
<td>5,760</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Adjusted balances</td>
<td>798,960</td>
<td>798,960</td>
<td>380,960</td>
<td>309,280</td>
<td>88,720</td>
<td>20,000</td>
</tr>
</tbody>
</table>
Question No. 2

<table>
<thead>
<tr>
<th>Account classification</th>
<th>Adjusted balance</th>
<th>Rate</th>
<th>Required Allowance</th>
</tr>
</thead>
<tbody>
<tr>
<td>0 to 1 month</td>
<td>P380,960</td>
<td>1%</td>
<td>P3,809.60</td>
</tr>
<tr>
<td>1 to 3 months</td>
<td>309,280</td>
<td>2%</td>
<td>6,185.60</td>
</tr>
<tr>
<td>3 to 6 months</td>
<td>88,720</td>
<td>3%</td>
<td>2,661.60</td>
</tr>
<tr>
<td>Over 6 months</td>
<td>20,000</td>
<td>50%</td>
<td>10,000</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>P20,000</td>
</tr>
</tbody>
</table>

Question No. 3

Balance per books: P48,000

Add (deduct) adjustments:

- AJE No. 1: P1,296
- AJE No. 2: (800)
- AJE No. 3: (4,000)
- AJE No. 4: (25,439)

Required allowance (Sec No. 2): P19,057

Adjusting entries affecting Allowance for Doubtful Accounts and Doubtful Accounts Expense

1) Doubtful account expense: P1,296
   - Allowance for doubtful accounts: P1,296
   - To correct entry made in recording recovery of account written off

2) Allowance for doubtful accounts: P800
   - Accounts receivable: P800
   - To correct understatement of accounts written off

3) Allowance for doubtful accounts: P4,000
   - Accounts receivable: P4,000
   - To write off definitely uncollectible accounts

4) Allowance for doubtful accounts: P25,439
   - Doubtful account expense: P25,439
   - To adjust allowance to required balance

Questions No. 4 & 5

Balance per books (P39,400 - P1,296): P38,104

Add (deduct) adjustments:

- AJE No. 1: P1,296
- AJE No. 4: (25,439) (24,143)

Doubtful accounts expense per audit: P13,961 (4)

Answers: 1) C; 2) D; 3) C; 4) A, 5) C

PROBLEM NO. 8

During your examination of the 2006 financial statements of the Narvacan Company you find that the company does not provide allowance for doubtful accounts ever since it started operations in 2002. The company's practice is to directly write-off as expense doubtful accounts and credit recoveries to income. The company's contracts are generally for two years.

Upon your recommendation, the company agreed to change its accounts for 2006 to give effect to doubtful treatment on the allowance basis. The allowance is to be based on a percentage of sales which is derived from the experience of prior years. Statistics for 2002 to 2006 are shown as follows:

<table>
<thead>
<tr>
<th>Year of Sale</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Charge Sales Accounts Written off</td>
<td>P2,460,000</td>
<td>P6,000,000</td>
<td>P7,200,000</td>
<td>P7,800,000</td>
<td>P6,600,000</td>
</tr>
<tr>
<td>&amp; Year of Sale</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>13,200</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>36,000</td>
<td>24,000</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>12,000</td>
<td>96,000</td>
<td>31,200</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>28,800</td>
<td>108,000</td>
<td>36,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2006</td>
<td>64,800</td>
<td>120,000</td>
<td>33,600</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Recoveries &amp; Year of Sale</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>2,400</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
Accounts receivable at December 31, 2006 were as follows:

From 2005 sales  P 360,000
From 2006 sales  3,240,000
Total  P3,600,000

QUESTIONS:

Based on the above and the result of your audit, you are to provide the answers to the following:

1. The average percentage of net doubtful accounts to charge sales that should be used in setting up the 2006 allowance is
   a. 2.50%
   b. 1.90%
   c. 2.05%
   d. 1.77%

2. How much is the doubtful accounts expense for 2006?
   a. P131,400
   b. P218,400
   c. P165,000
   d. P175,200

3. The doubtful accounts expense for 2006 is over(under) stated by
   a. P223,800
   b. P53,400
   c. (P131,400)
   d. (P165,000)

4. The net realizable value of accounts receivable as of December 31, 2006 balance sheet is
   a. P3,415,200
   b. P3,474,600
   c. P3,326,400
   d. P3,240,000

5. The adjusting journal entry necessary to set up the allowance for doubtful accounts as of December 31, 2006 will include a debit to Retained Earnings of
   a. P223,800
   b. P184,800
   c. P165,000
   d. P0

Suggested Solution:

**Question No. 1**

<table>
<thead>
<tr>
<th>Year</th>
<th>Charge sales</th>
<th>AR written-off</th>
<th>Recoveries</th>
<th>Net AR written-off</th>
</tr>
</thead>
<tbody>
<tr>
<td>2002</td>
<td>P2,400,000</td>
<td>P61,200</td>
<td>P2,400</td>
<td>P15,600</td>
</tr>
<tr>
<td>2003</td>
<td>6,000,000</td>
<td>148,800</td>
<td>9,600</td>
<td>139,200</td>
</tr>
<tr>
<td>2004</td>
<td>7,200,000</td>
<td>204,000</td>
<td>12,000</td>
<td>192,000</td>
</tr>
<tr>
<td></td>
<td>P15,600,000</td>
<td>P414,000</td>
<td>P24,000</td>
<td>P390,000</td>
</tr>
</tbody>
</table>

Net AR written off  P 390,000
Divide by charge sales  P15,600,000
Percentage  2.50%

**Question No. 2**

Doubtful accounts expense for 2006 (P6,600,000 x 2.5%)  P165,000

**Question No. 3**

Recorded doubtful accounts expense  (P64,800 + P120,000 + P33,600)  P214,800
Should be doubtful accounts expense for 2006  165,000
Overstatement of doubtful accounts expense  P53,400

**Question No. 4**

Accounts receivable, 12/31/06  P3,600,000
Required allowance for doubtful accounts
(see computation below)  184,800
Net realizable value, 12/31/06  P3,415,200

<table>
<thead>
<tr>
<th>(A)</th>
<th>(B)</th>
<th>(C)</th>
<th>(D)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Year</td>
<td>Charge sales</td>
<td>(A) x 2.5%</td>
<td>AR written-off</td>
</tr>
<tr>
<td>2005</td>
<td>P7,800,000</td>
<td>P195,000</td>
<td>P156,000</td>
</tr>
<tr>
<td>2006</td>
<td>6,600,000</td>
<td>165,000</td>
<td>33,600</td>
</tr>
<tr>
<td></td>
<td>P14,400,000</td>
<td>P360,000</td>
<td>P189,600</td>
</tr>
</tbody>
</table>
Question No. 5

Adjusting journal entry necessary to set up the allowance for doubtful accounts as of December 31, 2006:

<table>
<thead>
<tr>
<th></th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bad debt recovery</td>
<td>P 14,400</td>
</tr>
<tr>
<td>Retained earnings (see below)</td>
<td>223,800</td>
</tr>
<tr>
<td>Doubtful account expense</td>
<td>P53,400</td>
</tr>
<tr>
<td>Allowance for doubtful accounts</td>
<td>184,800</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>D/A exp provided</td>
<td>P 13,200</td>
<td>P 60,000</td>
<td>P139,200</td>
<td>P172,800</td>
<td>P 385,200</td>
</tr>
<tr>
<td>Less recoveries</td>
<td>-</td>
<td>2,400</td>
<td>9,600</td>
<td>12,000</td>
<td>24,000</td>
</tr>
<tr>
<td>Net</td>
<td>13,200</td>
<td>57,600</td>
<td>129,600</td>
<td>160,800</td>
<td>361,200</td>
</tr>
<tr>
<td>Should be D/A exp (Sales x 2.5%)</td>
<td>60,000</td>
<td>150,000</td>
<td>180,000</td>
<td>195,000</td>
<td>585,000</td>
</tr>
</tbody>
</table>

Answers: 1) A; 2) C; 3) B; 4) A; 5) A

PROBLEM NO. 9

Unless otherwise identified, the notes receivable of the Quirino Company on December 31, 2006, were trade notes receivable. On this date the balance of the account, P3,036,915, consisted of the following notes all received during the calendar year under audit:

<table>
<thead>
<tr>
<th>Maker</th>
<th>Date</th>
<th>Term</th>
<th>Rate</th>
<th>Amount</th>
<th>Remarks</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Co.</td>
<td>Oct. 1</td>
<td>6 mos.</td>
<td>18%</td>
<td>P 57,416</td>
<td>Four notes to settle past due account.</td>
</tr>
<tr>
<td></td>
<td>Oct. 1</td>
<td>12 mos.</td>
<td>18%</td>
<td>100,000</td>
<td>Current billings are on a 10 – day credit basis.</td>
</tr>
<tr>
<td></td>
<td>Oct. 1</td>
<td>18 mos.</td>
<td>18%</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Oct. 1</td>
<td>24 mos.</td>
<td>18%</td>
<td>100,000</td>
<td></td>
</tr>
<tr>
<td>B Co.</td>
<td>July 1</td>
<td>36 mos.</td>
<td>18%</td>
<td>500,000</td>
<td>This note is for a cash loan made to this customer. No interest has been collected to date.</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>All interest collected on Oct. 1.</td>
</tr>
<tr>
<td>C Co.</td>
<td>Oct. 1</td>
<td>4 mos.</td>
<td>15%</td>
<td>251,636</td>
<td>Loan approved in minutes book, Jan. 20. On Aug. 1 this note was pledged as collateral for a bank loan P500,000.</td>
</tr>
<tr>
<td>Mr. Pogi(Company President)</td>
<td>Feb. 1</td>
<td>Demand</td>
<td>18%</td>
<td>1,000,000</td>
<td>Interest payable at maturity</td>
</tr>
<tr>
<td>D Co.</td>
<td>Nov. 1</td>
<td>12 mos.</td>
<td>15%</td>
<td>546,387</td>
<td>Interest payable at maturity</td>
</tr>
<tr>
<td>E, Inc.</td>
<td>Dec. 10</td>
<td>90 days</td>
<td>18%</td>
<td>381,476</td>
<td></td>
</tr>
</tbody>
</table>

All of the above notes are considered good except that of A Company which is somewhat doubtful. An allowance of 25% should be established against the notes receivable of this company.

QUESTIONS:

Based on the above and the result of your audit, compute the following:

1. Adjusted balance of Trade Notes Receivable as of December 31, 2006
   a. P1,179,499  
   b. P 927,863  
   c. P2,036,915  
   d. P1,536,915

2. Net realizable value of Trade Notes Receivable as of December 31, 2006
   a. P1,447,561  
   b. P1,947,561  
   c. P1,090,145  
   d. P 838,509

3. Interest income for the year ended December 31, 2006
   a. P243,749  
   b. P208,185  
   c. P208,185  
   d. P 43,185

4. Accrued interest income as of December 31, 2006
   a. P253,185  
   b. P 78,749  
   c. P243,749  
   d. P198,749

11
Suggested Solution:

Question No. 1

Unadjusted Trade Notes Receivable: P3,036,915

Less Non-Trade Notes Receivable:

- B Company (Cash Loan): P 500,000
- Mr. Pogi (Loan to officer): P 1,000,000

Adjusted Trade Notes Receivable: P1,536,915

Question No. 2

Adjusted Trade Notes Receivable: P1,536,915

Less allowance for doubtful accounts (P357,416 x 25%): 89,354

Net realizable value: P1,447,561

Questions No. 3 & 4

<table>
<thead>
<tr>
<th>Maker</th>
<th>Date</th>
<th>Amount</th>
<th>Rate</th>
<th>Interest Income</th>
<th>AIR</th>
</tr>
</thead>
<tbody>
<tr>
<td>A Co.</td>
<td>Oct. 1</td>
<td>57,416</td>
<td>18%</td>
<td>P 2,584</td>
<td>P 2,584</td>
</tr>
<tr>
<td></td>
<td>Oct. 1</td>
<td>100,000</td>
<td>18%</td>
<td>4,500</td>
<td>4,500</td>
</tr>
<tr>
<td></td>
<td>Oct. 1</td>
<td>100,000</td>
<td>18%</td>
<td>4,500</td>
<td>4,500</td>
</tr>
<tr>
<td></td>
<td>Oct. 1</td>
<td>100,000</td>
<td>18%</td>
<td>4,500</td>
<td>4,500</td>
</tr>
<tr>
<td>B Co.</td>
<td>Jul. 1</td>
<td>500,000</td>
<td>18%</td>
<td>45,000</td>
<td>45,000</td>
</tr>
<tr>
<td>C Co.</td>
<td>Oct. 1</td>
<td>251,636</td>
<td>15%</td>
<td>9,436</td>
<td>-</td>
</tr>
<tr>
<td>Mr. Pogi</td>
<td>Feb. 1</td>
<td>1,000,000</td>
<td>18%</td>
<td>165,000</td>
<td>165,000</td>
</tr>
<tr>
<td>D Co.</td>
<td>Nov. 1</td>
<td>546,387</td>
<td>15%</td>
<td>13,660</td>
<td>13,660</td>
</tr>
<tr>
<td>E, Inc.</td>
<td>Dec. 10</td>
<td>381,476</td>
<td>18%</td>
<td>4,005</td>
<td>4,005</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td>P253,185</td>
<td>P243,749</td>
</tr>
</tbody>
</table>

Answers: 1) D; 2) A; 3) B; 4) C

PROBLEM NO. 10

In connection with your audit of the Salcedo Corporation, you noted that the company’s Notes Receivable consists of the following:

a. A 4-month note dated November 30, 2006, from AA Company, P200,000; interest rate, 16%; discounted on November 30, 2006 at 16%.

b. A draft drawn payable 30 days after for P900,000 by the BB Company on the Charlie Company in favor of the Delta Company, endorsed to Salcedo Corp. on December 2, 2006 and accepted on December 4, 2006.

c. A 90-day note dated November 1, 2006 from E. Dy, P500,000; interest at 16%; the note is for subscription to 5,000 shares of the preferred stock of Salcedo Corp. at P100 per share.

d. A 60-day note dated May 3, 2006, from CC Company, P600,000; interest rate, 16%; dishonored at maturity; judgment obtained on October 10, 2006. Collection within the next twelve months is doubtful.

e. A 90-day note dated January 4, 2006, from Apol Bobads, president of Salcedo, P160,000; no interest; note not renewed; president confirmed.

f. A 120-day note dated September 14, 2006, from DD Company, P120,000; interest rate, 16%; note is held by bank as collateral.

QUESTIONS:

Based on the above and the result of your audit, you are to provide the answers to the following:

1. The adjusted balance of Notes Receivable as of December 31, 2006 is
   a. P2,480,000  c. P1,020,000
   b. P1,220,000  d. P 900,000

2. How much of foregoing notes receivable will be reported in the current assets section of the balance sheet?
   a. P1,220,000  c. P1,680,000
   b. P2,480,000  d. P1,520,000

3. How much is the net interest income from the foregoing notes receivable for 2006?
   a. P19,093  c. P166,613
   b. P70,613  d. P 35,093

4. The adjusted balance of Interest Receivable as of December 31, 2006 is
   a. P19,093  c. P70,613
   b. P 5,760  d. P 0
Suggested Solution:

Question No. 1

<table>
<thead>
<tr>
<th>Company</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>AA Company</td>
<td>P 200,000</td>
</tr>
<tr>
<td>BB Company</td>
<td>900,000</td>
</tr>
<tr>
<td>DD Company</td>
<td>120,000</td>
</tr>
<tr>
<td><strong>Adjusted balance of Notes Receivable</strong></td>
<td><strong>P1,220,000</strong></td>
</tr>
</tbody>
</table>

Notes:
1) **AA Company will still be included in the balance of “Notes Receivable” since “Notes Receivable-Discounted” account will be credited upon discounting. If the question is Notes Receivable that will be reported in the balance sheet, the Notes Receivable – Discounted will be excluded from the total Notes Receivable with disclosure of contingent liability.**
2) E. Dy note was excluded since that will be reclassified to Subscriptions Receivable.
3) **CC Company note was excluded because the note was dishonored. It will be reclassified to Accounts Receivable, including the accrued interest.**
4) Apol Bobads note was excluded due to the fact that it will be reclassified to Advances to Officers.
5) The fact that DD Company note is held by bank as collateral should be disclosed but the note will still be included in the Notes Receivable.

Question No. 2

| Notes receivable – trade (excluding note discounted amounting to P200,000) | P1,020,000 |
| Subscriptions receivable | 500,000 |
| Advances to officers | 160,000 |
| **Amount that will be reported in the current assets section of the balance sheet** | **P1,680,000** |

Questions No. 3 & 4

<table>
<thead>
<tr>
<th>Maker</th>
<th>Date</th>
<th>Amount</th>
<th>Rate</th>
<th>Interest</th>
</tr>
</thead>
<tbody>
<tr>
<td>E. Dy</td>
<td>Nov. 1</td>
<td>P500,000</td>
<td>16%</td>
<td>P 13,333</td>
</tr>
<tr>
<td>CC Com.</td>
<td>May 3</td>
<td>600,000</td>
<td>16%</td>
<td>16,000</td>
</tr>
<tr>
<td>DD Co.</td>
<td>Sep. 14</td>
<td>120,000</td>
<td>16%</td>
<td>5,760</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td></td>
<td><strong>P35,093</strong></td>
</tr>
</tbody>
</table>

Answers: 1) **B**; 2) **C**; 3) **D**; 4) **A**

PROBLEM NO. 11

The balance sheet of Santiago Corporation reported the following long-term receivables as of December 31, 2005:

| Note receivable from sale of plant | P9,000,000 |
| Note receivable from officer      | 2,400,000  |

In connection with your audit, you were able to gather the following transactions during 2006 and other information pertaining to the company's long-term receivables:

a. The note receivable from sale of plant bears interest at 12% per annum. The note is payable in 3 annual installments of P3,000,000 plus interest on the unpaid balance every April 1. The initial principal and interest payment was made on April 1, 2006.

b. The note receivable from officer is dated December 31, 2005, earns interest at 10% per annum, and is due on December 31, 2008. The 2006 interest was received on December 31, 2006.

c. The corporation sold a piece of equipment to Yes, Inc. on April 1, 2006, in exchange for an P1,200,000 non-interest bearing note due on April 1, 2008. The note had no ready market, and there was no established exchange price for the equipment. The prevailing interest rate for a note of this type at April 1, 2006, was 12%. The present value factor of 1 for two periods at 12% is 0.797 while the present value factor of ordinary annuity of 1 for two periods at 12% is 1.690.

d. A tract of land was sold by the corporation to No Co. on July 1, 2006, for P6,000,000 under an installment sale contract. No Co. signed a 4-year 11% note for P4,200,000 on July 1, 2006, in addition to the down payment of P1,800,000. The equal annual payments of principal and interest on the note will be P1,353,750 payable on July 1, 2007, 2008, 2009, and 2010. The land had an established cash price of P6,000,000, and its cost to the corporation was P4,500,000. The collection of the installments on this note is reasonably assured.
QUESTIONS:

Based on the above and the result of your audit, determine the following:

1. Noncurrent notes receivable as of December 31, 2006
   a. P13,556,400  
   b. P 9,664,650  
   c. P10,556,400  
   d. P 9,750,726

2. Current portion of long-term notes receivable as of December 31, 2006
   a. P3,891,750  
   b. P4,353,750  
   c. P3,000,000  
   d. P 0

3. Accrued interest receivable as of December 31, 2006
   a. P771,000  
   b. P857,076  
   c. P540,000  
   d. P1,011,000

4. Interest income for the year 2006
   a. P1,281,000  
   b. P1,637,076  
   c. P1,367,076  
   d. P1,512,000

Suggested Solution:

Question No. 1

<table>
<thead>
<tr>
<th>NR from sale of plant</th>
<th>Balance, 12/31/06</th>
<th>(P9,000,000 - P3,000,000)</th>
<th>P6,000,000</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less inst. due on 4/1/07</td>
<td>3,000,000</td>
<td>P3,000,000</td>
<td></td>
</tr>
<tr>
<td>NR from officer, due 12/31/08</td>
<td>2,400,000</td>
<td></td>
<td></td>
</tr>
<tr>
<td>NR from sale of equipment</td>
<td>Present value of note, 4/1/06</td>
<td>(P1,200,000 x 0.797)</td>
<td>956,400</td>
</tr>
<tr>
<td>Add interest earned for 2006</td>
<td>(P956,400 x 12% x 9/12)</td>
<td>86,076</td>
<td>1,042,476</td>
</tr>
<tr>
<td>NR from sale of land</td>
<td>Balance, 12/31/06</td>
<td>4,200,000</td>
<td></td>
</tr>
<tr>
<td>Less principal installment due on 7/1/07</td>
<td>Total amount to be received</td>
<td>P1,353,750</td>
<td></td>
</tr>
<tr>
<td>Less interest</td>
<td>(P4,200,000 x 11%)</td>
<td>462,000</td>
<td>891,750</td>
</tr>
<tr>
<td>Total</td>
<td>P9,750,726</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

Question No. 2

Note receivable from sale of plant due, 4/1/07 P3,000,000 
Note receivable from sale of land (see no. 1) 891,750 
Current portion of long-term notes receivable P3,891,750

Question No. 3

NR from sale of plant (P6,000,000 x 12% x 9/12) P540,000 
NR from sale of land (P4,200,000 x 11% x 6/12) 231,000 
Accrued interest receivable, 12/31/06 P771,000

Question No. 4

NR from sale of plant: 1/1 to 3/31 - P9,000,000 x 12% x 3/12 P 270,000 
4/1 to 12/31 - P6,000,000 x 12% x 9/12 540,000 
810,000 
NR from officer (P2,400,000 x 10%) 240,000 
NR from sale of equipment (P956,400 x 12% x 9/12) 86,076 
NR from sale of land (P4,200,000 x 11% x 6/12) 231,000 
Interest income for 2006 P1,367,076

Answers: 1) D; 2) A; 3) A; 4) C

PROBLEM NO. 12

Sigay Company has been using the cash method to account for income since its first year of operation in 2005. All sales are made on credit with notes receivable given by the customers. The income statements for 2005 and 2006 included the following amounts:

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Revenues – collection on principal</td>
<td>P1,600,000</td>
<td>P2,500,000</td>
</tr>
<tr>
<td>Revenues – interest</td>
<td>180,000</td>
<td>275,000</td>
</tr>
<tr>
<td>Cost of goods purchased*</td>
<td>2,260,000</td>
<td>2,601,000</td>
</tr>
</tbody>
</table>
The balances due on the notes at the end of each year were as follows:

<table>
<thead>
<tr>
<th></th>
<th>2005</th>
<th>2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Notes receivable (gross)</td>
<td>P3,100,000</td>
<td>P1,800,000</td>
</tr>
<tr>
<td>Notes receivable (gross)</td>
<td></td>
<td>- 3,000,000</td>
</tr>
<tr>
<td>Unearned interest income</td>
<td>358,350</td>
<td>278,950</td>
</tr>
<tr>
<td>Unearned interest income</td>
<td></td>
<td>- 402,150</td>
</tr>
</tbody>
</table>

**QUESTIONS:**

Your client requested you to compute for the following using the installment sales method:

1. Installment sales for the year 2005
   a. P4,700,000  
   b. P4,341,650  
   c. P4,521,650  
   d. P4,062,700  

2. Realized gross profit in 2005
   a. P804,000    
   b. P864,640    
   c. P835,680    
   d. P749,280    

3. Installment sales for the year 2006
   a. P4,200,000  
   b. P3,797,850  
   c. P3,877,250  
   d. P4,152,250  

4. Realized gross profit in 2006 on 2005 installment sales
   a. P504,600    
   b. P3,797,850  
   c. P637,519    
   d. P613,352    

5. Realized gross profit in 2006 on 2006 installment sales
   a. P504,600    
   b. P3,797,850  
   c. P637,519    
   d. P613,352    

**Suggested Solution:**

**Question No. 1**

Principal amount collected on 2005 note  
Add uncollected 2005 note, net – 12/31/05  
(P3,100,000 - P358,350)  
Installment sales for 2005  
P4,341,650  

*Note: Installment sales is equal to the original amount of notes receivable, net of unearned interest income.*

**Question No. 2**

Principal amount collected on 2005 note  
Multiply by gross profit rate in 2005  
Realized gross profit in 2005 on 2005 inst. sales  
P 804,000

**Computation of gross profit rate in 2005:**

Installment sales for 2005  
Less cost of installment sales (P2,260,000 - P100,000)  
Gross profit for 2005  
Divide by installment sales for 2005  
Gross profit rate in 2005  
50.25%

**Question No. 3**

Total principal amount collected in 2006  
Principal amount collected in 2006 on 2005 note:  
Uncollected 2005 note, net - 12/31/05  
Less uncollected 2005 note, net - 12/31/06 (P1,800,000 - P278,950)  
Prinicipal amount collected on 2006 note  
Uncollected 2006 note, net – 12/31/06 (P3,000,000 - P402,150)  
Installment sales for 2006  
P3,877,250

**Question No. 4**

Principal amount collected in 2006 on 2005 note  
Multiply by gross profit rate in 2005  
Realized gross profit in 2006 on 2005 inst. sales  
P 613,352
Question No. 5

Principal amount collected in 2006 on 2006 note $1,279,400
Multiply by gross profit rate in 2006 43.23%
Realized gross profit in 2006 on 2006 inst. sales $553,085

**Computation of gross profit rate in 2006:**

- Installment sales for 2006 $3,877,250
- Less cost of installment sales ($2,601,000 - $400,000) $2,201,000
- Gross profit for 2006 $1,676,250
- Divide by installment sales for 2006 3,877,250
- Gross profit rate in 2006 43.23%

**Answers:** 1) B; 2) A; 3) C; 4) D, 5) D

**PROBLEM NO. 13**

On January 1, 2004, Sinait Company loaned $3,000,000 to Ilocos Company. The terms of the loan were payment in full on January 1, 2009, plus annual interest payments at 11%. The interest payment was made as scheduled on January 1, 2005; however, due to financial setbacks, Ilocos was unable to make its 2006 interest payment. Sinait considers the loan impaired and projects the following cash flows from the loan as of December 31, 2006 and 2007. Assume that Sinait accrued the interest at December 31, 2005, but did not continue to accrue interest due to the impairment of the loan.

<table>
<thead>
<tr>
<th>Date of Flow</th>
<th>Amount projected as of</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 31, 2007</td>
<td>P 200,000</td>
</tr>
<tr>
<td>Dec. 31, 2008</td>
<td>400,000</td>
</tr>
<tr>
<td>Dec. 31, 2009</td>
<td>800,000</td>
</tr>
<tr>
<td>Dec. 31, 2010</td>
<td>1,200,000</td>
</tr>
<tr>
<td>Dec. 31, 2011</td>
<td>400,000</td>
</tr>
</tbody>
</table>

**QUESTIONS:**

Your client requested you to determine the following: *(Round-off present value factors to four decimal places)*

1. Loan impairment (bad debt expense) for the year 2006
   a. P 882,380
   b. P 1,549,500
   c. P 1,212,380
   d. P 1,542,380

2. Interest income for 2007 assuming the P200,000 was collected on December 31, 2007 as scheduled
   a. P 195,855
   b. P 232,938
   c. P 200,000
   d. P 66,000

3. Allowance for loan impairment as of December 31, 2007
   a. P 554,340
   b. P 752,640
   c. P 649,442
   d. P 776,900

4. Interest income for 2008 assuming the P600,000 was collected on December 31, 2008 as scheduled
   a. P 225,210
   b. P 247,023
   c. P 236,561
   d. P 222,541

5. Carrying amount of loan receivable as of December 31, 2008
   a. P 1,672,570
   b. P 2,150,558
   c. P 1,645,641
   d. P 1,892,683

**Suggested Solution:**

**Question No. 1**

<table>
<thead>
<tr>
<th>Date</th>
<th>Collection</th>
<th>Period</th>
<th>PVF at 11%</th>
<th>Present value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 31, 2007</td>
<td>P 200,000</td>
<td>1 year</td>
<td>0.9009</td>
<td>P 180,180</td>
</tr>
<tr>
<td>Dec. 31, 2008</td>
<td>400,000</td>
<td>2 years</td>
<td>0.8116</td>
<td>324,640</td>
</tr>
<tr>
<td>Dec. 31, 2009</td>
<td>800,000</td>
<td>3 years</td>
<td>0.7312</td>
<td>584,960</td>
</tr>
<tr>
<td>Dec. 31, 2010</td>
<td>1,200,000</td>
<td>4 years</td>
<td>0.6587</td>
<td>790,440</td>
</tr>
<tr>
<td>Dec. 31, 2011</td>
<td>400,000</td>
<td>5 years</td>
<td>0.5935</td>
<td>237,400</td>
</tr>
</tbody>
</table>

**Loan impairment (bad debt expense) P1,212,380**

**Suggested Solution:**
Journal entry to record the loan impairment:
Bad debt expense P1,212,380
Interest receivable P330,000
Allowance for loan impairment 882,380

Note: PAS 39 par. 63 states that the carrying amount of the asset shall be reduced either directly or through the use of an allowance account. The use of allowance account is preferable since this will inform the users of the gross amount of the impaired loan receivable.

Question No. 2
Interest income for 2007 (P2,117,620 x 11%) P232,938

Incidentally, the following are the journal entries to record the collection:
Cash P200,000
Loan receivable P200,000
Allowance for loan impairment P232,938
Interest income P232,938

Question No. 3
Principal, 12/31/07 (P3,000,000 - P200,000) P2,800,000
Less PV of projected cash flows (see below) 2,245,660
Allowance for loan impairment, 12/31/07 P554,340

<table>
<thead>
<tr>
<th>Date</th>
<th>Collection</th>
<th>Period</th>
<th>PVF at 11%</th>
<th>Present value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Dec. 31, 2008</td>
<td>600,000</td>
<td>1 year</td>
<td>0.9009</td>
<td>P540,540</td>
</tr>
<tr>
<td>Dec. 31, 2009</td>
<td>1,200,000</td>
<td>2 years</td>
<td>0.8116</td>
<td>973,920</td>
</tr>
<tr>
<td>Dec. 31, 2010</td>
<td>1,000,000</td>
<td>3 years</td>
<td>0.7312</td>
<td>731,200</td>
</tr>
<tr>
<td></td>
<td>P2,800,000</td>
<td></td>
<td></td>
<td>P2,245,660</td>
</tr>
</tbody>
</table>

Journal entry to adjust net loan receivable to present value of new cash flow projections.
Allowance for loan impairment (P882,380 - P232,938 - P554,340) P95,102
Bad debt expense P95,102

Question No. 4
Interest income for 2008 (P2,245,660 x 11%) P247,023

Question No. 5
Principal, 12/31/08 (P2,800,000 - P600,000) P2,200,000
Less allowance for loan impairment, 12/31/08 (P554,340 - P247,023) 307,317
Carrying value, 12/31/08 P1,892,683

Answers: 1) C; 2) B; 3) A; 4) B, 5) D

PROBLEM NO. 14
Tagudin Co. required additional cash for its operation and used accounts receivable to raise such needed cash, as follows:
• On December 1, 2006 Tagudin Company assigned on a nonnotification basis accounts receivable of P5,000,000 to a bank in consideration for a loan of 90% of the receivables less a 5% service fee on the accounts assigned. Tagudin signed a note for the bank loan. On December 31, 2006, Tagudin collected assigned accounts of P3,000,000 less discount of P200,000. Tagudin remitted the collections to the bank in partial payment for the loan. The agreed interest is 1% per month on the loan balance.
• Tagudin Co. sold P1,550,000 of accounts receivable for P1,340,000. The receivables had a carrying amount of P1,470,000 and were sold outright on a nonrecourse basis.
• Tagudin Co. received an advance of P300,000 from Union Bank by pledging P360,000 of accounts receivable.
• On June 30, 2006, Tagudin Co. discounted at a bank a customer’s P600,000, 6-month, 10% note receivable dated April 30, 2006. The bank discounted the note at 12% on the same date.
QUESTIONS:

1. In its December 31, 2006 balance sheet, Tagudin should report note payable as a current liability at
   a. P1,745,000  
   b. P2,250,000  
   c. P1,545,000  
   d. P1,700,000

2. Tagudin Company’s equity in the assigned accounts receivable as of December 31, 2006 is
   a. P255,000  
   b. P300,000  
   c. P455,000  
   d. P0

3. The entry to record the sale of accounts receivable would include
   a. A debit to Finance Charge of P210,000.  
   b. A debit to Allowance for Doubtful Accounts of P80,000.  
   c. A credit to Accounts Receivable of P1,470,000.  
   d. A credit to Notes Payable of P1,550,000.

4. Accounts receivable pledged against borrowings, should be
   a. Included in total receivables with disclosure.  
   b. Included in total receivables without disclosure.  
   c. Excluded from total receivables with disclosure.  
   d. Excluded from total receivables without disclosure.

5. The proceeds from the note receivable discounted on June 30, 2006 is
   a. P564,000  
   b. P617,400  
   c. P604,800  
   d. P576,000

Suggested Solution:

**Question No. 1**

Original note payable (P5,000,000 x 90%)  
P4,500,000

Less payment applied to principal:  
Total payment (P3,000,000 - P200,000)  
P2,800,000

Less payment applied to interest  
(P4,500,000 x 1%)  
45,000  
2,755,000

Note payable, 12/31/06  
P1,745,000

**Question No. 2**

Total accounts receivable assigned  
P5,000,000

Less collections  
3,000,000

Accounts receivable assigned, 12/31/06  
2,000,000

Note payable, 12/31/06  
1,745,000

Equity in accounts receivable assigned  
P255,000

**Question No. 3**

*Journal entry to record the sale (factoring) of accounts receivable:*

Cash  
P1,340,000

Allowance for doubtful accounts  
P(1,550,000-1,470,000)  
80,000

Profit on factoring (Finance Charge)  
130,000

Accounts receivable  
P1,550,000

**Question No. 4**

Accounts receivable pledged against borrowings, should be included in total receivables with disclosure.

**Question No. 5**

Face value  
P600,000

Add interest up to maturity (P600,000 x 10% x 6/12)  
30,000

Maturity value  
630,000

Less discount (P630,000 x 12% x 4/12)  
25,200

Proceeds from note receivable discounting  
P604,800

Answers: 1) A; 2) A; 3) B; 4) A; 5) C
PROBLEM NO. 15

Select the best answer for each of the following:

1. An auditor is testing sales transactions. One step is to trace a sample of debit entries from the accounts receivable subsidiary ledger back to the supporting sales invoices. What would the auditor intend to establish by this step?
   a. Sales invoices represent bona fide sales.
   b. Debit entries in the accounts receivable subsidiary ledger are properly supported by sales invoices.
   c. All sales invoices have been recorded.
   d. All sales invoices have been properly posted to customer accounts.

2. Tracing bills of lading to sales invoices provides evidence that
   a. Shipments to customers were recorded as sales.
   b. Shipments to customers were invoiced.
   c. Recorded sales were shipped.
   d. Invoiced sales were shipped.

3. Proper authorization procedures in the revenue/receipt cycle usually provide for approval of write-offs by an employee in which of the following departments?
   a. Accounts receivable
   b. Treasurer
   c. Billing
   d. Sales

4. To gather audit evidence about the proper credit approval of sales, the auditor would select a sample of documents from the population represented by the
   a. Subsidiary customers' accounts ledger.
   b. Sales invoice file.
   c. Customer order file.
   d. Bill of lading file.

5. In determining validity of accounts receivable, which of the following would the auditor consider most reliable?
   a. Direct telephone communication between auditor and debtor.
   b. Documentary evidence that supports the accounts receivable balance.
   c. Confirmation replies received directly from customers.
   d. Credits to accounts receivable from the cash receipts book after the close of business at year end.

6. When the objective of the auditor is to evaluate the appropriateness of adjustments to sales, the best available evidence would normally be
   a. Documentary evidence obtained by inspecting documents supporting entries to adjustment accounts.
   b. Oral evidence obtained by discussing adjustment-related procedures with controller personnel.
   c. Analytical evidence obtained by comparing sales adjustments to gross sales for a period of time.
   d. Physical evidence obtained by inspection of goods returned for credit.

7. Which source document should an auditor use to verify the correct sales date for an item sold FOB shipping point?
   a. Sales invoice.
   b. Carrier’s bill of lading.
   c. Customer’s payment document.
   d. Customer’s purchase order.

8. Which of the following procedures would an auditor most likely rely on to verify management’s assertion of completeness?
   a. Confirm a sample of recorded receivables by direct communication with the debtors.
   b. Observe the client’s distribution of payroll checks.
   c. Compare a sample of shipping documents to related sales invoices.
   d. Review standard bank confirmations for indications of kiting.

9. The negative form of accounts receivable confirmation request is particularly useful except when
   a. Individual account balances are relatively large.
   b. Internal control surrounding accounts receivable is considered to be effective.
   c. A large number of small balances are involved.
   d. The auditor has reason to believe the persons receiving the request are likely to give them consideration.

10. An auditor who wishes to substantiate the gross balance of the account "Trade Notes Receivable" is considering the advisability of performing the four procedures listed below. Which pair of procedures is best suited to this objective?
    I. Age the receivables.
    II. Confirm the notes with the makers.
    III. Inspect the notes.
    IV. Trace a sample of postings from the sales journal to the notes receivable ledger.
    a. I and III.  b. II and III  c. I and IV.  d. I and IV