



Navigating Accounting[®]

Receivables and Returns: How Do I Use the Numbers?

Industry Comparisons Exercises Series 01

Comparing doubtful account allowances and product returns across industries and time;
and analyzing ratios based on the adjusted numbers.

Background

- There is more emphasis on accounting entries and their financial-statement consequences in this assignment and less emphasis on comparing and contrasting reported numbers and related ratios. This does not mean these types of analyses are less important here. Rather, to keep your task manageable, we are going to focus less on analyses and more on understanding how the underlying accounting affects related reported numbers and ratios. The goal is to ultimately strengthen your future analyses considerably by helping you transfer what you have learned about entries and their financial-statement consequences to your analyses.
- You will be working with multiple companies in the same industry. For example, Apple, Dell, and Hewlett-Packard in computer manufacturing industry and Nordstrom, Saks, Gap, and J Crew in retail apparel industry.
- The Excel workbook for this assignment has multiple worksheets. You will see the tabs at the bottom of the Excel file for Parts 1(a), 1(b), 1(c), 2(a), 2(b), and 2(c). There is a Word file template for Parts 1(d) and 2(d).

Navigating Accounting Excerpt

- You will likely need to reference the *Excerpt: Revenue Recognition, Bad Debts, and Product Returns* repeatedly as you work your way through this assignment. This document is provided along with the Excel and Word exercise materials.
- Skim pages 1-8 of the Excerpt prior to starting the assignment to get a sense of where we are heading. The guidance for the various questions will direct you to specific pages in the Excerpt thereafter.

Part 1(a) Question

- Fill in the blank boxes (with red borders) in the “Part 1a” of the Excel worksheet.

Part 1(a) Guidance

- If you have not already done so, go to NavigatingAccounting.com and then click your way to the materials for this exercise:
 - Click “Analyzing Financial Statements Across Time and Industries”
 - Industry Comparisons Exercises: Series 01
 - Click “Exercise 5: Receivables, Product Returns, and Ratio Analyses”
- Download the reading Excerpt, Excel and Word files.
- Skim pages 9-17 of the Excerpt to get a sense for the entries that affect the allowance for bad debts, also called the allowance for doubtful accounts. You can return to this section when you record related entries in Part 1(b).
- Read pages 17-20 very carefully to learn how to locate and interpret numbers in the companies’ annual reports for Part 1(a).

Part 1(b) Question

A friend who follows Hewlett-Packard tells you he is concerned that HP’s allowance for doubtful accounts receivable might go back to the levels HP encountered when the high-tech bubble burst in 2001 (approximately 6% of gross receivables). Specifically, he would like you to determine how HP’s financial statements for 2009 would change if the allowance was 6% of gross accounts receivable (ignoring finance receivables and related allowances). You will determine these financial-statement consequences in Part 1(c). Here, in Part 1(b), you are to record entries that will help you determine these consequences.

Search



This exercise requires you to search for information.

Compute



This exercise requires you to compute information.

- Record the pretax entry HP would need to have recorded to get the allowance for doubtful accounts from the reported balance at the end of fiscal 2009 to 6% of gross accounts receivable on that date. You are to record this entry in the designated place in the “Part 1b” Excel worksheet using the chart of accounts in this worksheet.
- Record the tax entry of the tax effects of the above in the designated place further down the “Part 1b” Excel worksheet using the chart of accounts in this worksheet. This entry is explained in the Part 1(b) worksheet, immediately after the pretax entry. You do not need to understand the logic behind this entry. We essentially give it to you in the explanation in the Part 1(b) worksheet so you can assess its financial-statement consequences later.

Part 1(b) Guidance

- First determine how much the allowance would need to be increased from the reported amount at the end of fiscal 2009 to 6% of the gross receivables on that date.
- To record increases to the allowance, study the example on pages 14-16 in the Excerpt, paying particular attention to the entry at the top of page 16. Then read pages 18-19 to learn how to apply the concepts in this example to real companies.

Part 1(c) Question

This question builds on Part 1(b). Here you are to determine the financial-statement consequences of the hypothetical entries in Part 1(b) and fill in the related blank boxes with red borders in the “Part 1c” Excel worksheet.

Part 1(c) Guidance

- To learn about the financial-statement effects of the pretax entry in Part 1(b), see page 16 of the Excerpt.
- To determine the financial-statement consequences of the tax entry in Part 1(b), apply related concepts studied throughout the course and utilize two important assumptions: (1) HP classifies the related deferred tax asset as “other current assets” on its balance sheet and (2) HP reports the related statement of cash flow reconciliation adjustment in “deferred taxes on earnings.”

Part 1(d) Question: Analysis

- Compare and contrast how the six companies’ receivables were affected by significant economic events that occurred during the last ten years: the bursting of the internet bubble and accounting scandals that occurred in 2001 and the financial crisis of 2008-2010.

Part 1(d) Guidance

- Keep your analyses brief and to the point.
- Limit your analyses to:
 - The ratios in the Part 1 (a) Excel worksheet.
 - Your understanding of the companies’ businesses and the ways they were likely impacted by the bursting of the internet bubble and financial crisis. Your understanding of the companies’ businesses can be informed by related excerpts from the Management Discussion and Analysis (MD&A) section of the 10K. However, do not over invest in this question. Remember, our intent in this assignment is to focus less on analysis. Cite sources for your analysis as appropriate.
 - Download one of the Word files as a template for your analysis for Part 1(d) and Part 2 (d).

Usage



This exercise helps you learn how accounting reports are used by investors, creditors, and other stakeholders.

Judgement



This exercise helps you learn how to use judgement.

Part 2(a) Question

- Fill in the blank boxes (with red borders) in the “Part 2a” Excel worksheet. The assumptions regarding mark-ups and commissions are discussed in the guidance below.

Part 2(a) Guidance

- Skim pages 21-25 of the Excerpt to get a sense for the entries that affect the allowance for product returns. You can return to this section when you record related entries in Part 2(b).
- Read page 26 carefully to learn how to locate and interpret numbers for Part 2(a). As indicated therein, when cost of sales is combined with occupancy costs, as it is for the companies studied in this question, we need assumptions about mark-ups and commissions to estimate the revenues and costs of sales associated with the allowance numbers. Companies do not disclose this information. As indicated in the Part 2(a) Excel worksheet, we are assuming the markups are 2.5, meaning sales prices are 2.5 as large as the cost of the sold merchandise, and commissions are 10%. We doubt the assumptions are accurate for all four retailers and they may not be accurate for any one of them. For example, we expect Saks has higher markups than GAP because it is more upscale. Still, these assumptions will ensure you learn how to estimate the related measures, which is our primary purpose here.

Parts 2(b) & 2(c) Questions

Questions 2(b) and 2(c) ask you to record entries that summarize the entries related to product returns that Nordstrom recorded during fiscal 2008.

2(b) Record the entry to replenish the returns allowance. Use the chart of accounts in the Parts 2b&c Excel worksheet to record the costs and expenses Nordstrom recorded to the sales return allowance during fiscal 2008 to replenish the allowance.

2(c) Record the entry for product returns. Use the chart of accounts the Parts 2b&c Excel worksheet to record Nordstrom’s product returns during fiscal 2008, assuming: (1) 70% of the related revenues were cash refunds and 30% were forgiven receivables and (2) reversed commissions decreased accrued liabilities.

Parts 2(b) and 2(c) Guidance

- To learn how to record these entries, read pages 21-25 in the Excerpt, paying particular attention to the example entries and the discussions in the [sidebars](#) regarding how these entries must be adjusted when [commissions](#) are not earned on returned products (which is true for Nordstrom).
- Record the entries in the designated spaces in the Parts 2b&c Excel worksheet using the chart of accounts therein.

Part 2(d) Question: Analysis

- Compare and contrast the income statement consequences of product returns for Nordstrom, GAP, and Saks for the five years in the Part 2a Excel worksheet in terms of differences in their businesses and the ways product returns were affected by the financial crisis, if at all.

Part 2(d) Guidance

- Keep your analyses brief and to the point.
- Limit your analyses to the data in the Part 2a Excel worksheet and your understanding of the companies’ businesses, which can be informed by related excerpts from

the MD&A section of the 10K. However, do not over invest in this question. Cite sources for your analysis as appropriate.

- Answer the question in the Word file you used for Part 1(d).