

STEP #1 ESTIMATING UNCOLLECTIBLE ACCOUNTS

- Two methods:
 - Percentage of sales method
 - Based on the relationship between the amount of credit sales and the amount of uncollectible accounts
 - Percentage of receivables method
 - Based on the relationship between the amount of accounts receivable and the amount of uncollectible accounts

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PERCENTAGE OF SALES METHOD

Step #1 Determine the % of credit sales expected to become uncollectible

This can be done by looking at the company's prior credit experience, industry averages, or percentages for similar companies.

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PERCENTAGE OF SALES METHOD

EXAMPLE: Chris Co. had total credit sales of \$200,000, and \$2,000 of those credit sales had become uncollectible.

$$\frac{\text{Uncollectible Accounts}}{\text{Credit Sales}} = \frac{\$2,000}{\$200,000} = 1\%$$

This is used in future periods to estimate uncollectible accounts.

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PERCENTAGE OF SALES METHOD

EXAMPLE: During the next year, Chris Co. has credit sales of \$120,000. What amount should be recorded as "Bad Debt Expense" for this year?

Credit Sales	×	Est. % Uncollectible	=	Estimated Uncollectible Accounts
\$120,000	×	1%	=	\$1,200

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GENERAL JOURNAL

	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1		Adjusting Entries			
2	20--				
3	Dec. 31	Bad Debt Expense		1,200	
4		Allowance for Bad Debts			1,200
5					
6					
7					
8					
9					
10					
11					

The income statement will show...
Revenues (Sales) of \$120,000
and Bad Debt Expense of \$1,200.

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PERCENTAGE OF SALES METHOD

Subsequent write-offs

Let's look at how write-offs are recorded under the allowance method.

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PERCENTAGE OF SALES METHOD

Subsequent write-offs

Under the allowance method, write-offs affect the balance sheet only!

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GENERAL JOURNAL

DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	Allowance for Bad Debts		1,100	
2	Accts. Rec./Cust. Names			1,100
3				
4				
5				
6				
7				
8				
9				
10				
11				

The allowance account, accounts receivable account, and subsidiary ledger account are all reduced.

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GENERAL JOURNAL

DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	Allowance for Bad Debts		1,100	
2	Accts. Rec./Cust. Names			1,100
3				
4				
5				
6				
7				
8				
9				
10				
11				

The bad debt expense account is not affected. The expense of this uncollectible account was recognized in the adjusting entry in the period of the related sale.

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PERCENTAGE OF RECEIVABLES METHOD

Simplest form: Apply an estimated percentage of uncollectible accounts to the Accounts Receivable balance, to determine "Estimated Uncollectible Accounts"

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PERCENTAGE OF RECEIVABLES METHOD

EXAMPLE: Craft Co. had an average Accounts Receivable balance at the end of the past two years of \$110,000, and average uncollectible accounts of \$4,400.

$$\frac{\text{Avg. Uncollectible Accts.}}{\text{Average Accounts Receivable}} = \frac{\$4,400}{\$110,000} = 4\%$$

This is used in future periods to estimate uncollectible accounts.

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PERCENTAGE OF RECEIVABLES METHOD

EXAMPLE: At the end of the current year the Accounts Receivable balance was \$120,000. What amount should be recorded as "Bad Debt Expense" for this year?

$$\begin{array}{rcl} \text{Accts. Rec.} & \times & \text{Est. \% Uncollectible} & = & \text{Estimated Uncollectible Accounts} \\ \$120,000 & \times & 4\% & = & \$4,800 \end{array}$$

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GENERAL JOURNAL

	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1		Adjusting Entries			
2	20-- Dec. 31	Bad Debt Expense		4,800	
3		Allowance for Bad Debts			4,800
4					
5					
6					
7					
8					
9					
10					
11					

Assuming the allowance account has a zero balance prior to this adjustment.

AGING THE RECEIVABLES

- An aging schedule is prepared, which details:
 - Each customer's account balance and how long it has been outstanding
 - Estimated percentage uncollectible based on the "age" of the account
- This computes a more precise estimate of uncollectible accounts

AGING SCHEDULE OF ACCOUNTS RECEIVABLE—Dec 31, 20-1

Customer	Total	Not Yet Due
W. Billiard	\$ 3,000	\$ 2,500
K. Campbell	950	
J. Farley	4,325	3,800
L. Gilbert	1,900	1,500
E. Rome	3,950	3,170
B. Zimmerman	200	

Customers and balances are listed.

AGING SCHEDULE OF ACCOUNTS RECEIVABLE—Dec 31, 20-1

1-30	31-60	61-90	91-180	181-365	Over 365
\$ 500					
	\$ 650		\$ 300		
	400	\$ 525			
				\$ 780	
			200		

The balances are separated and classified by how long they have been outstanding.

AGING SCHEDULE OF ACCOUNTS RECEIVABLE—Dec 31, 20-1

Customer	Total	Not Yet Due
W. Billiard	\$ 3,000	\$ 2,500
K. Campbell	950	
J. Farley	4,325	3,800
L. Gilbert	1,900	1,500
E. Rome	3,950	3,170
B. Zimmerman	200	
Total	\$100,500	\$65,000

Each category is totaled.

AGING SCHEDULE OF ACCOUNTS RECEIVABLE—Dec 31, 20-1

Customer	Total	Not Yet Due
W. Billiard	\$ 3,000	\$ 2,500
K. Campbell	950	
J. Farley	4,325	3,800
L. Gilbert	1,900	1,500
E. Rome	3,950	3,170
B. Zimmerman	200	
Total	\$100,500	\$65,000
Estimated percent uncollectibles		2%
Total est. uncollectible accounts		\$1,300

Percentages, based on past experience are applied to each category.

AGING SCHEDULE OF ACCOUNTS RECEIVABLE—Dec 31, 20-1					
1-30	31-60	61-90	91-180	181-365	Over 365
\$ 500			\$ 300		
	\$ 650				
		\$ 525			
\$18,000	\$8,250	\$6,310	\$1,810	\$780	\$350
5%	10%	20%	30%	50%	80%
\$ 900	\$ 825	\$1,262	\$ 543	\$390	\$280

The percentage increases as the accounts become older and less likely to be collected.

AGING SCHEDULE OF ACCOUNTS RECEIVABLE—Dec 31, 20-1		
Customer	Total	Not Yet Due
W. Billiard	\$ 3,000	\$ 2,500
K. Campbell	950	
J. Farley	4,325	3,800
L. Gilbert	1,900	1,500
E. Rome	2,050	3,170
B. Zimmer		
Total		000
Estimated percent uncollectibles		2%
Total est. uncollectible accounts	\$ 5,500	\$ 1,300

All the categories' estimated uncollectible accounts are totaled.

GENERAL JOURNAL					
DATE	DESCRIPTION	PR	DEBIT	CREDIT	
1	Adjusting Entries				
2	20--				
3	Dec. 31	Bad Debt Expense	5,500		
4		Allowance for Bad Debts		5,500	
5					
6					
7					
8					
9					
10					
11					

Assuming the allowance account has a zero balance prior to this adjustment.

GENERAL JOURNAL					
DATE	DESCRIPTION	PR	DEBIT	CREDIT	
1	Allowance for Bad Debts				
2			5,200		
3		Accts. Rec./Cust. Names		5,200	
4					
5					
6					
7					
8					
9					
10					
11					

During the year, accounts totaling \$5,200 are written off.

AGING THE RECEIVABLES			
Allowance for Bad Debts			
Write-offs during 20-2	5,200	5,500	12/31-1 Adj.
		300	12/31-2 Bal.

After write-offs, the allowance account is left with a \$300 credit balance.

AGING THE RECEIVABLES	
EXAMPLE: At the end of 20-2, another aging schedule is prepared, and it shows estimated uncollectible accounts of \$5,700.	
The \$5,700 is the balance needed in the allowance account.	

AGING THE RECEIVABLES

Allowance for Bad Debts			
Write-offs during 20-2	5,200	5,500	12/31/-1 Adj.
		300	12/31/-2 Bal.
		5,700	Desired 12/31/-2 Bal.

Need a balance of \$5,700, but the balance is only \$300.

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AGING THE RECEIVABLES

Allowance for Bad Debts			
Write-offs during 20-2	5,200	5,500	12/31/-1 Adj.
		300	12/31/-2 Bal.
		5,400	Adj.
		5,700	Desired 12/31/-2 Bal.

An adjustment of \$5,400 is needed.

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COMPARISON OF ALLOWANCE METHODS

FEATURE	PERCENTAGE OF SALES	PERCENTAGE OF RECEIVABLES
Basis for estimate	% of credit sales	Aging (%) of accounts receivable
Amount of year-end adjustment	Amount calculated above	Amount calculated above plus debit balance in allowance account before adjustment or minus credit balance in allowance account before adjustment

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COMPARISON OF ALLOWANCE METHODS


FEATURE	PERCENTAGE OF SALES	PERCENTAGE OF RECEIVABLES
Balance after adjustment	Amount calculated above plus debit balance in allowance account before adjustment or minus credit balance in allowance account before adjustment	Amount calculated above

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- ### EFFECT OF WRITE-OFFS
- On the income statement
 - No effect
 - The expense was already recognized during the adjusting entry
 - On the balance sheet
 - No effect overall
 - The write-off decreases both the asset (Accounts Receivable) and the contra-asset (Allowance for Bad Debts)
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RECOVERY OF A PREVIOUSLY WRITTEN-OFF ACCOUNT

EXAMPLE: A check for \$500 was received on February 1 from Bill McDonald, whose account was written off on January 15.



This requires two entries!

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GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20-- Feb.	1 Accts. Rec./B. McDonald		500	
2		Allowance for Bad Debts			500
3		Reinstated acct. receivable			
4					
5					
6					
7					
8					
9					
10					
11					

Step #1
Reinstate the account
(reverse the write-off).

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20-- Feb.	1 Accts. Rec./B. McDonald		500	
2		Allowance for Bad Debts			500
3		Reinstated acct. receivable			
4					
5		1 Cash		500	
6		Accts. Rec./B. McDonald			500
7		Collection on account			
8					
9					
10					
11					

Step #2
Record the collection.

Learning Objective 3

Apply the direct write-off method of accounting for uncollectible accounts.

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DIRECT WRITE-OFF METHOD

- Bad Debt Expense is not recognized until it has been determined that an account is uncollectible
- Advantage:
 - It's simple
- Disadvantages:
 - Violates the matching principle
 - The amount of the expense can be manipulated
 - The balance sheet does not reflect the amount of Accounts Receivable actually expected to be received

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GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20X1 Aug.	15 Bad Debt Expense		500	
2		Accts. Rec./J. Lafollette			500
3					
4					
5					
6					
7					
8					
9					
10					
11					

J. Lafollette's account is written off under the direct write-off method.

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20X1 Aug.	15 Bad Debt Expense		500	
2		Accts. Rec./J. Lafollette			500
3					
4					
5					
6					
7					
8					
9					
10					
11					

If he subsequently pays the \$500 IN THE SAME ACCOUNTING PERIOD, two entries are needed.

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20X1 Aug. 15	Bad Debt Expense		500	
2		Accts. Rec./J. Lafollette			500
3					
4	Dec. 20	Accts. Rec./J. Lafollette		500	
5		Bad Debt Expense			500
6					
7					
8					
9					
10					
11					

Step #1
 Reinstate the account
 (reverse the write-off).

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20X1 Aug. 15	Bad Debt Expense		500	
2		Accts. Rec./J. Lafollette			500
3					
4	Dec. 20	Accts. Rec./J. Lafollette		500	
5		Bad Debt Expense			500
6					
7	20	Cash		500	
8		Accts. Rec./J. Lafollette			500
9					
10					
11					

Step #2 Record the collection.

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20X1 Aug. 15	Bad Debt Expense		500	
2		Accts. Rec./J. Lafollette			500
3					
4					
5					
6					
7					
8					
9					
10					
11					

Now let's see how the entries would be
 different if he subsequently pays the \$500,
 IN A DIFFERENT ACCOUNTING PERIOD.

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20X1 Aug. 15	Bad Debt Expense		500	
2		Accts. Rec./J. Lafollette			500
3					
4	20X2 Jan. 20	Accts. Rec./J. Lafollette		500	
5		Uncol. Accts. Recovered			500
6					
7					
8					
9					
10					
11					

Step #1
 Reinstate the account
 crediting a REVENUE account
 instead of subtracting from
 Bad Debt Expense.

GENERAL JOURNAL					
	DATE	DESCRIPTION	PR	DEBIT	CREDIT
1	20X1 Aug. 15	Bad Debts Expense		500	
2		Accts. Rec./J. Lafollette			500
3					
4	20X2 Jan. 20	Accts. Rec./J. Lafollette		500	
5		Uncol. Accts. Recovered			500
6					
7	20	Cash		500	
8		Accts. Rec./J. Lafollette			500
9					
10					
11					

Step #2
 Record the collection.