

ACCOUNTING FOR UNCOLLECTIBLE ACCOUNTS

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BEFORE WE GET STARTED...



Everyone should
remain muted



Submit
questions
through chat



Attendance for
CPE credit

ACCOUNTING FOR UNCOLLECTIBLE ACCOUNTS

L A V E R N E F U N D E R B U R K , C P A

U I L A C C O U N T I N G S T A T E C O N T E S T D I R E C T O R



FIRST LET'S REVIEW

Basis of Accounting

Revenue Recognition

Matching Principle

Basis of Accounting

CASH BASIS—an accounting system that records revenue when cash is received and records expenses in the period the cash is paid.

ACCRUAL BASIS—an accounting system that records revenue when it is earned regardless of when the cash is received **AND** records expenses when they are incurred regardless of when cash is paid out.

Revenue Recognition

The GAAP principle that revenue is RECORDED on the date it is earned, even if the cash has not yet been received.

Matching Principle

Revenue and the expenses associated with earning that revenue are recorded in the SAME accounting period.

CASH SALE

Account Name	Debit	Credit
Cash	500	
Sales		500

SALE ON ACCOUNT

- The customer does NOT give us any form of cash at the point of sale.
- The business owner allows the customer to “charge on account.”
- Therefore, the business owner carries the risk of loss.
- This type of sale is also referred to as a “charge sale.”

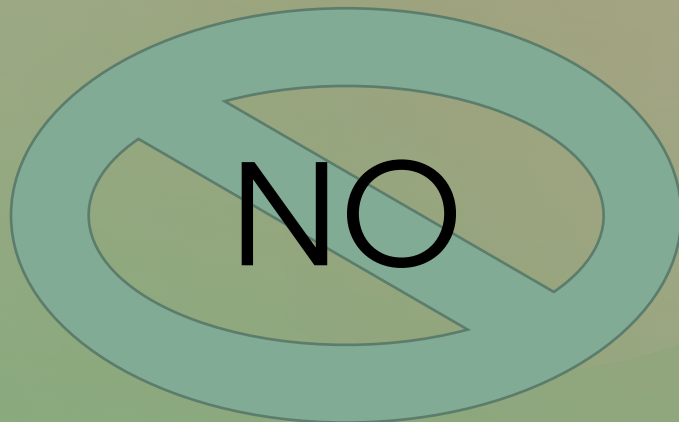
SALE ON ACCOUNT

Account Name	Debit	Credit
Accounts Receivable	500	
Sales		500

CASH RECEIVED ON ACCOUNT

Account Name	Debit	Credit
Cash	500	
Accounts Receivable		500

**WILL EVERY
CUSTOMER WHO
CHARGES ON
ACCOUNT ALWAYS
PAY WHAT THEY OWE?**



WRITE OFF AN ACCOUNT RECEIVABLE

Account Name	Debit	Credit
????	500	
Accounts Receivable		500

The account debited depends on our Basis of Accounting

Cash
Basis

Direct Write
Off Method

Accrual
Basis

Allowance
Method

Cash Basis

Direct
Write
Off
Method

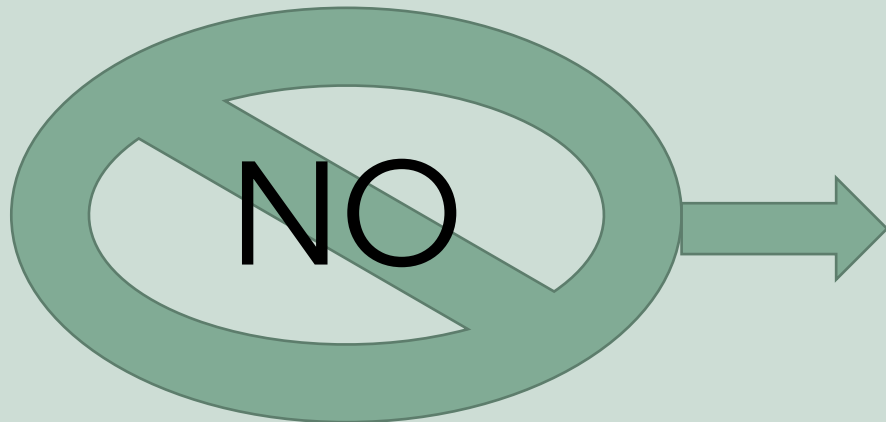
Account Name	Debit	Credit
Bad Debt Expense**	500	
Accounts Receivable		500

** could also use an account called Uncollectible Accounts Expense

Assume the Following:

1. The business uses the Cash Basis
2. The business prepares adjusting and closing entries only at the end of the fiscal year, which is December 31
3. The \$500 charge sale was made in December 2019
4. The customer's account is considered uncollectible in July 2020, at which time the account is written off.

Has this business complied with the Matching Principle?



Because the revenue is reported on the 2019 Income Statement; but the matching expense is reported on the 2020 Income Statement.

Cash Basis

Collection
After
Write-Off

Step One: Reinstate Customer's Account

Account Name	Debit	Credit
Accounts Receivable	500	
Bad Debt Expense		500

Cash Basis

Collection
After
Write-Off

Step Two: Record Payment Received

Account Name	Debit	Credit
Cash	500	
Accounts Receivable		500



Are We All Clear about:
Cash Basis Accounting?
and the
Direct Write-Off Method?

Accrual
Basis

Allowance
Method

We want to comply with the Matching Principle. At the end of a fiscal period, since we have no crystal ball to determine which specific accounts will become uncollectible in the future, we must ESTIMATE the Bad Debt Expense using the Allowance Method.

ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS

- THIS IS AN ACCOUNT IN THE GENERAL LEDGER.
- IT IS SOMETIMES CALLED ALLOWANCE FOR BAD DEBTS.
- IT IS CLASSIFIED AS A CONTRA-ASSET ACCOUNT.
- IT IS A CONTRA-ASSET TO THE ACCOUNTS RECEIVABLE ACCOUNT.
- IT IS A PERMANENT ACCOUNT.
- THE NORMAL BALANCE SIDE IS THE CREDIT SIDE.
- IT SELDOM HAS A ZERO BALANCE.
- IT IS FOUND ON THE BALANCE SHEET.
- IT IMMEDIATELY FOLLOWS THE ACCOUNTS RECEIVABLE ACCOUNT.

Accrual Basis

Estimate using
the Allowance
Method

Account Name	Debit	Credit
Bad Debts Expense	?	
Allowance for Bad Debts		?

NET REALIZABLE VALUE OF ACCOUNTS RECEIVABLE

ACCOUNTS RECEIVABLE

MINUS ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS

IS EQUAL TO NET REALIZABLE VALUE

(TRANSLATION: WHAT IS THE AMOUNT OF RECEIVABLES
YOU ESTIMATE TO BE COLLECTIBLE.)

HOW DO WE CALCULATE THE AMOUNT OF BAD DEBT EXPENSE?

It depends on which Allowance Method the company has selected to use (and use consistently).

The Number One Point of Confusion:

When do I use the existing balance in the Allowance Account and when do I ignore it?

When you learn to associate the "APPROACH," your days of confusion on this topic will hopefully end forever.

Estimating
Uncollectible
Accounts

Two Allowance
Methods

CALCULATION

Balance Sheet
Approach

Income
Statement
Approach



Two Allowance
Methods

Income Statement
Approach

Percentage of (??)
Sales

Calculate
Percentage and
that's your AJE
amount

ALLOWANCE METHOD PERCENTAGE OF (??) SALES

- THE GIVEN INFORMATION MUST GIVE YOU THE COMPANY POLICY.
 - % OF GROSS SALES?
 - % OF NET SALES?
 - % OF CHARGE SALES?
- THE GIVEN INFORMATION MAY CONTAIN "GARBAGE"
 - UNNECESSARY INFORMATION LIKE CASH SALES

ALLOWANCE METHOD PERCENTAGE OF (??) SALES

EXAMPLE:

GIVEN: THE COMPANY ESTIMATES UNCOLLECTIBLE ACCOUNTS BASED ON
2% OF CHARGE SALES.

CHARGE SALES OF \$90,000 X .02 = \$1,800

Account Name	Debit	Credit
Bad Debts Expense	1,800	
Allowance for Bad Debts		1,800

On December 31 BEFORE the AJE for Bad Debts

<u>Bad Debts Expense</u>

<u>Allowance for Bad Debts</u>
200

With the Income Statement Approach, we are focused on the "sales" calculation, so it does not matter what the balance is in the Allowance account before adjustment. Just make the entry.

Bad Debts Expense	
1,800	AJE

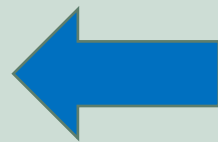
Allowance for Bad Debts	
	200 Dec 31 before AJE
AJE	1,800
	2,000 Dec 31 after AJE

UIL State 2019-S Group 5

Company policy is 2.5% of "Total Sales on Account"

The amounts given are:

1. Net Sales
2. Total Charge Sales



Which sales amount should you use?

UIL State 2018-S Group 3

The given information includes the amount of:

1. charge sales
2. net sales

Logical choice?

However, the company policy of Copper Company (the second case) is to use the Percentage of Net Sales Method.

Read the instructions carefully!



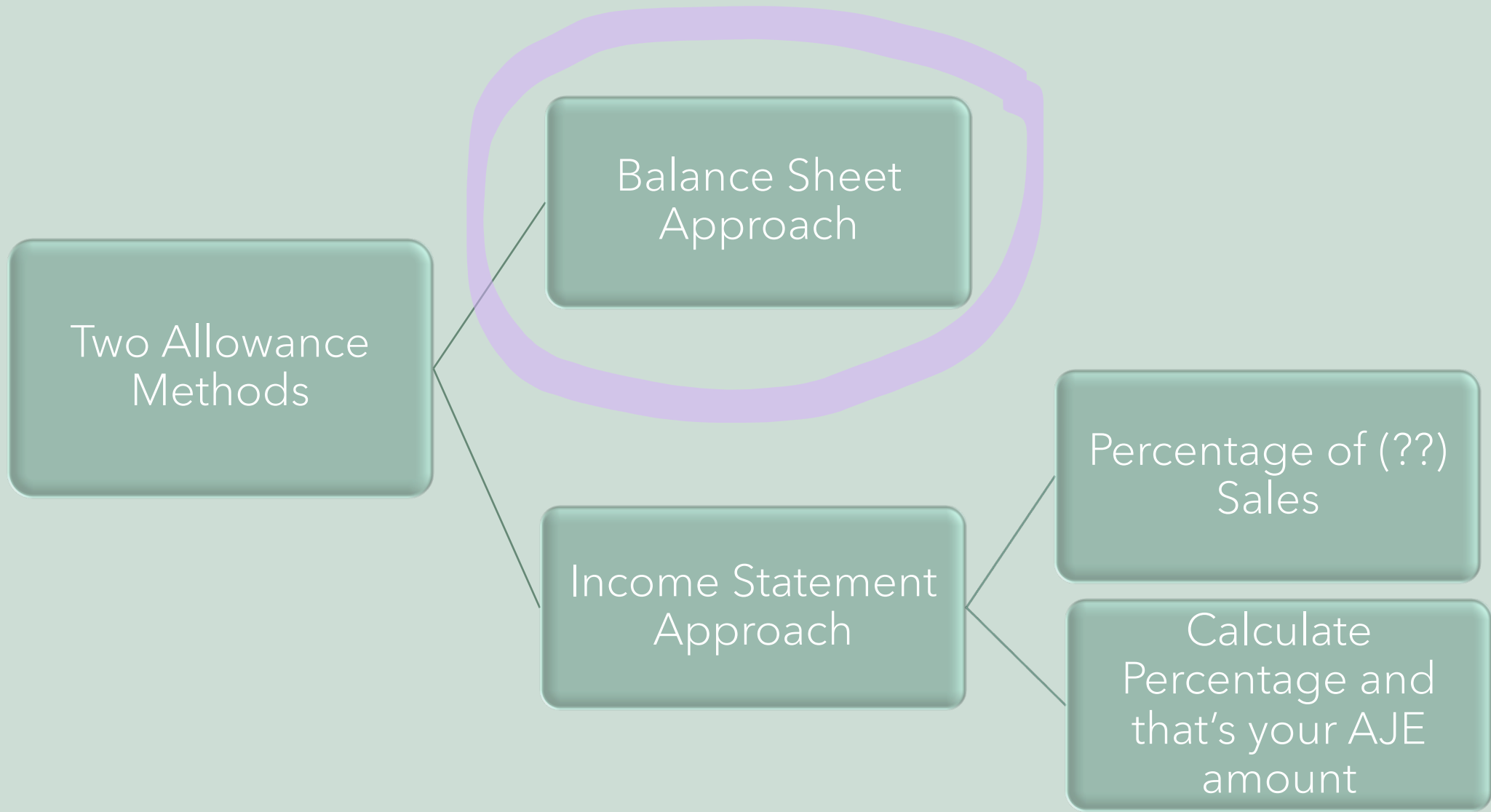


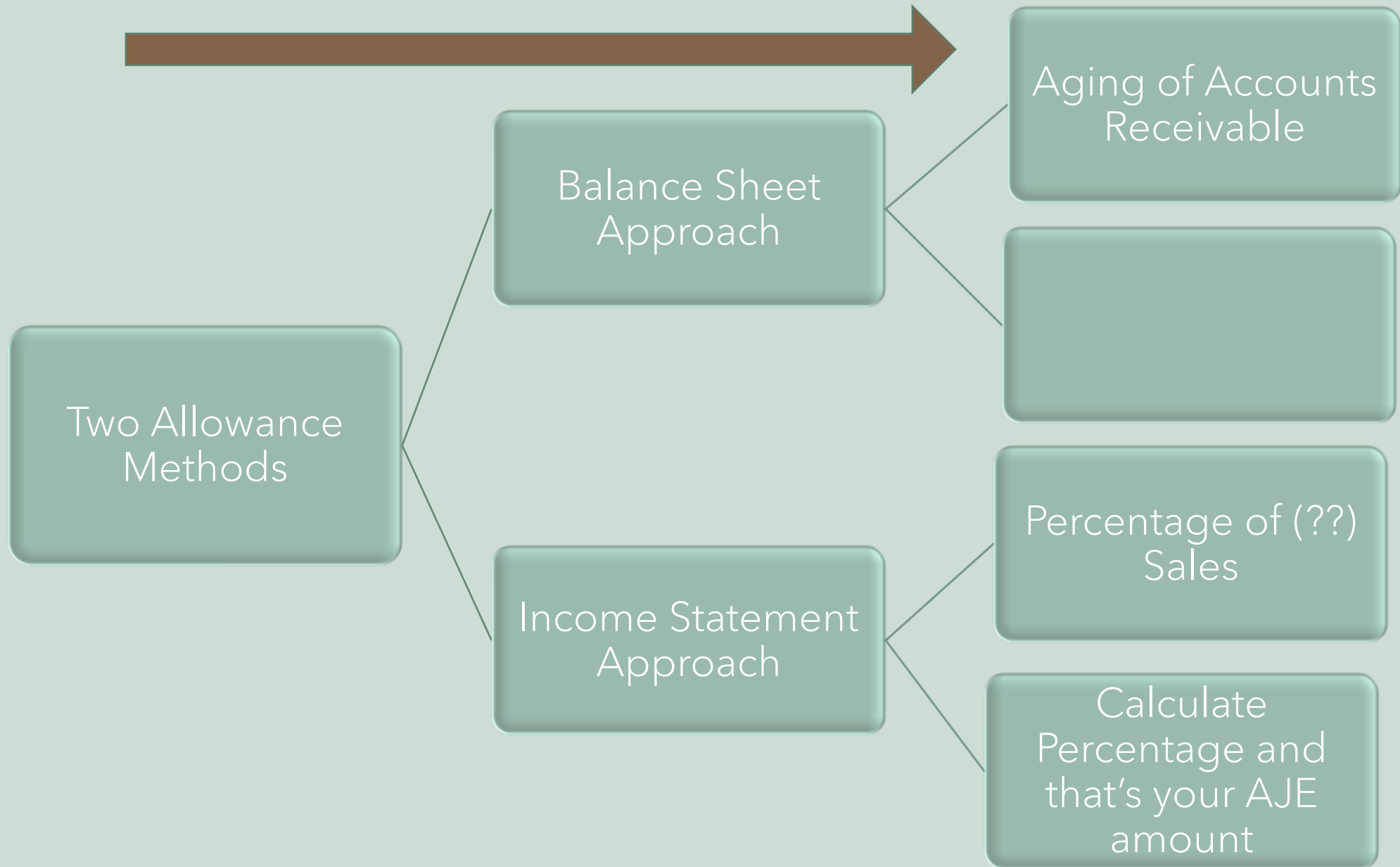
Before We Move On to the Other Calculation Method,
Are We All Clear about:

Accrual Basis Accounting?

Allowance Method of Estimating Bad Debts?

Calculating using the Income Statement Approach (Sales Method)?



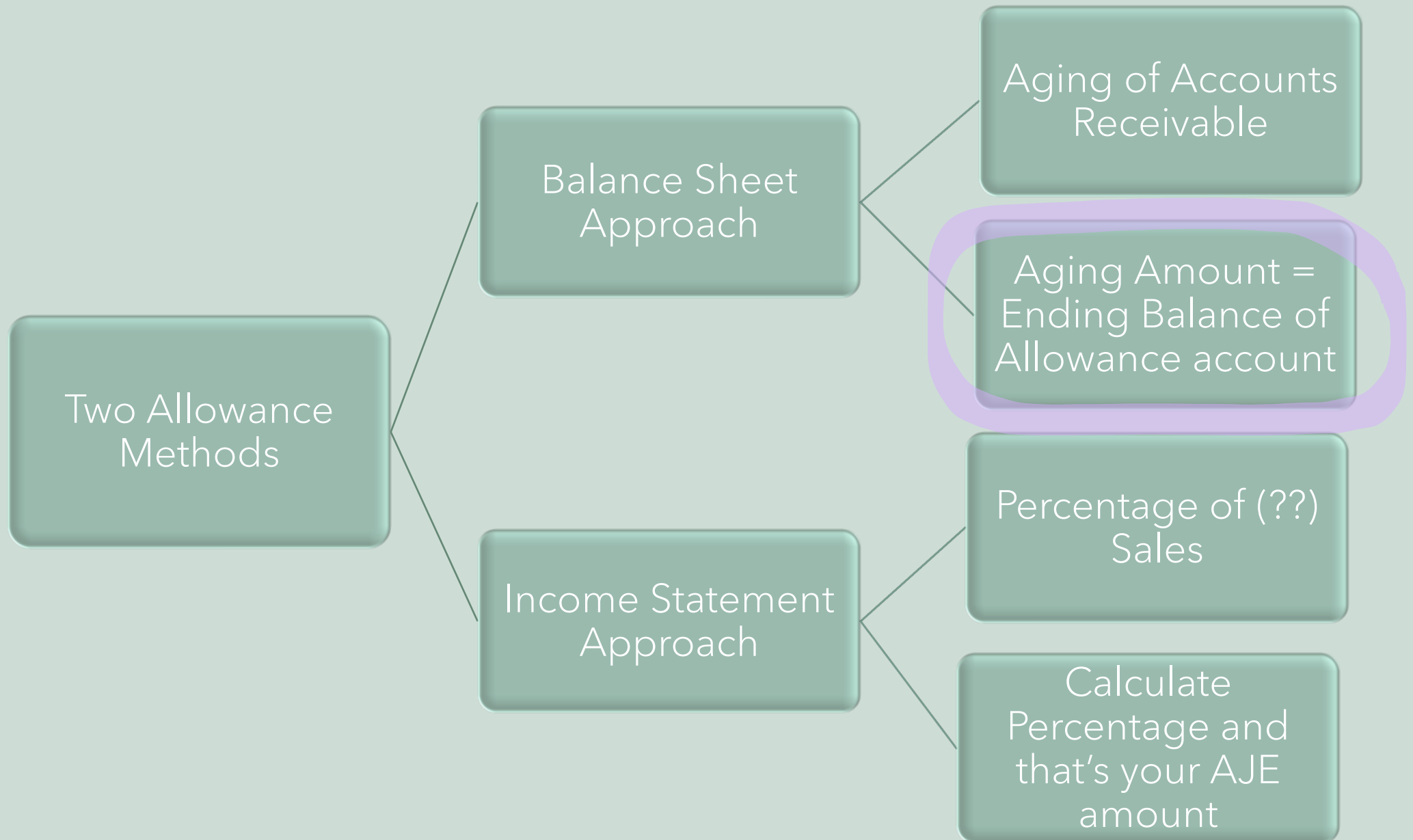


ACCOUNTS RECEIVABLE AGING REPORT FORMAT

Customer	Number of Days Unpaid				Total
	0-30	31-60	61-90	Over 90	
Fitness Mania					
Health for Life					
Holistic Health Options					
Image Reimaging					
Today's Gym World					
Whole Life Fitness Center					
Workouts Unlimited					
Total Accounts Receivable					
Estimated Uncollectible(%)	2%	10%	20%	40%	
Estimated Uncollectible (\$)					

GIVEN: The Aging Report calculation of uncollectible accounts is \$1,500





With the Balance Sheet Approach, we are focused on the Aging analysis of Accounts Receivable. So the goal is for the ENDING balance of the Allowance account to BE the Aging amount.

Bad Debts Expense		Allowance for Bad Debts	
			200 Dec 31 before AJE
AJE		??	
			1,500 Dec 31 after AJE

The Aging Report calculation of estimated uncollectible accounts = \$1,500

ALLOWANCE METHOD AGING OF ACCOUNTS RECEIVABLE

Allowance Account Ending Balance Desired (the Aging amount) \$1,500

Minus the balance already in the Allowance account <200>

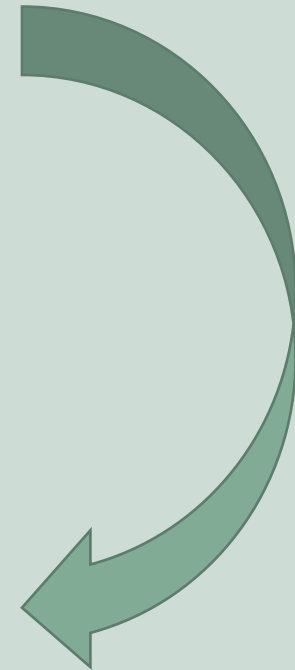
Equals the AJE amount of \$1,300

Account Name	Debit	Credit
Bad Debts Expense	1,300	
Allowance for Bad Debts		1,300

**Davy's Sporting Goods
Balance Sheet
December 31, 2019**

Assets		
Cash in Bank		10,330
Accounts Receivable	40,000	
Allowance for Uncollectible Accounts	1,500	38,500
Merchandise Inventory		16,200
Supplies		3,750
Prepaid Insurance		1,900
Equipment	26,180	

Book Value of A/Rec: $40,000 - 1500 = 38,500$





Are We All Clear about:

Allowance Method of Estimating Bad Debts
Calculating using the Balance Sheet Approach (Aging Method)?

Allowance Method

How to Write Off a Customer Account

Account Name	Debit	Credit
Allowance for Bad Debts	400	
Accounts Receivable		400

Allowance Method

Write-Off of Customer Account

Account Name	Debit	Credit
Allowance for Bad Debts	400	
Accounts Receivable		400

Accounts Receivable		Allowance for Bad Debts	
40,000			1,500 January 1
	400	400	May 2
38,500			1,100

NET REALIZABLE VALUE OF
ACCOUNTS RECEIVABLE
BEFORE AND AFTER
WRITE-OFF
WILL ALWAYS BE THE SAME
AMOUNT!

CALCULATION OF NET REALIZABLE VALUE BEFORE AND AFTER WRITE-OFF

Accounts Receivable	
40,000	
	400
<hr/>	
39,600	

Allowance for Bad Debts		
	1,500	$40,000 - 1,500 = 38,500$
400		Write-Off
<hr/>		
	1,100	$39,600 - 1,100 = 38,500$

Net Realizable Value is \$38,500 both before and after the Write-Off

Will the Allowance for Bad Debts account ALWAYS have a credit balance?

NO

Allowance for Bad Debts

	200	12-31-19 Unadjusted Trial Balance
	1,300	AJE on 12-31-19
	1,500	12-31-19 Adjusted Trial Balance
2,000		5-1-20 Customer Acct Written Off
500		12-31-20 Unadjusted Trial Balance

Accrual
Basis

Collection
After
Write-Off

Step One: Reinstate Customer's Account

Account Name	Debit	Credit
Accounts Receivable	400	
Allowance for Bad Debts		400

Accrual
Basis

Collection
After
Write-Off

Step Two: Record Payment Received

Account Name	Debit	Credit
Cash	400	
Accounts Receivable		400



Are We All Clear about:

How to Write-Off an Account when Allowance Method is used?
Why the Allowance Account COULD have a debit balance?



The information for 2011 related to Thompson Co. before adjusting entries is summarized below:

Net Cash Sales	64,347
Net Charge Sales	61,200
Accounts Receivable on 12-31-11	38,437
Customer accounts written off in 2011	1,895

Assume that Thompson Co. uses the allowance method of accounting for uncollectible accounts. The company estimates that uncollectible accounts will be 2.75% of net charge sales. What amount of bad debts expense will Thompson Co. record if Allowance for Bad Debts has a credit balance of \$508 before the adjusting entry?

$$\text{Net charge sales } 61,200 \times .0275 = \$1,683$$

Allowance for Bad Debts

	508	12-31-11 before AJE
	1,683	AJE
	2,191	12-31-11 after AJE

Account Name	Debit	Credit
Bad Debts Expense	1,683	
Allowance for Bad Debts		1,683

Remember, with the Income Statement Approach, you don't CARE what the balance was in the Allowance account before the AJE

UI Regional
2012-R, Group 8

Net Cash Sales	64,347
Net Charge Sales	61,200
Accounts Receivable on 12-31-11	38,437
Customer accounts written off in 2011	1,895

Assume that Thompson Co. uses the allowance method of accounting for uncollectible accounts. The company prepares an aging of accounts receivable on 12-31-11 and determines that \$3,450 of its Accounts Receivable will be uncollectible. What amount of bad debts expense will Thompson Co. record for 2011 if Allowance for Bad Debts has a credit balance of \$508 before the adjusting entry?

Allowance for Bad Debts

	508	12-31-11 before AJE
	??	AJE
	3,450	12-31-11 after AJE

Desired Balance 3,450
Less Existing Balance 508
Equals Expense Entry of \$2,942

Account Name	Debit	Credit
Bad Debts Expense	2,942	
Allowance for Bad Debts		2,942

UI Regional
2012-R, Group 8

Net Cash Sales	64,347
Net Charge Sales	61,200
Accounts Receivable on 12-31-11	38,437
Customer accounts written off in 2011	1,895

Assume the same facts as in the previous question, except that there is a \$149 debit balance in Allowance for Bad Debts before the adjusting entry because more accounts were written off in 2011 than had been estimated the previous year. What amount of bad debts expense will Thompson Co. record?

Allowance for Bad Debts

149	12-31-11 before AJE
??	AJE
3,450	12-31-11 after AJE

Desired CR Balance 3,450
PLUS Existing DR Balance 149
Equals Expense Entry of \$3,599

Account Name	Debit	Credit
Bad Debts Expense	3,599	
Allowance for Bad Debts		3,599

To All UIL Accounting Coaches:

If you would like to be added to the
UIL Accounting State Contest Director's Coaches Contacts,
please email LaVerne Funderburk

laverne@funderburkcpa.com

UIL Accounting Website:
www.funderburkcpa.com/UIL

SOME of the Various Formats Found on
Prior Year UIL Exams on the topic of
Uncollectible Accounts

Regional 2015-R Group 5

Regional 2012-R Group 8

Regional 2013-R Group 2

Regional 2019-R Group 10

Regional 2013-R Group 7

Regional 2017-R Group 14

State 2019-S Group 5

the MORE
YOU PRACTICE
THE PRACTICE
BETTER
YOU GET

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Thank you for watching
this presentation!

Accountants, Stay Balanced!