Allowance for Uncollectible Accounts and Bad Debt Expense

The two most common methods of measuring bad debt expense and the allowance for uncollectible accounts are the percentage-of-sales method (an income statement approach) and the percentage-of-receivables method (a balance sheet approach).

Income Statement Approach (Percentage of Sales)

The **income statement approach** calculates bad debt expense as a percentage of credit sales reported on the income statement.

EXAMPLE 2-2 Income Statement Approval

A company's year-end unadjusted trial balance reports the following amounts:

Gross accounts receivable	$100,000	Dr
Allowance for uncollectible accounts (year-beginning balance)	1,000	Cr
Sales on credit	250,000	Cr

According to past experience, 1% of the company's credit sales have been uncollectible. The company uses the income statement approach to calculate bad debt expense. The bad debt expense recognized for the year is $2,500 ($250,000 × 1%). The company records the following adjusting journal entry:

Bad debt expense	$2,500	
Allowance for uncollectible accounts		$2,500

The total adjusted balances of allowance for uncollectible accounts and bad debt expense are $3,500 ($1,000 + $2,500) and $2,500, respectively. The company reports **net accounts receivable** of **$96,500** ($100,000 – $3,500) in its balance sheet and **bad debt expense** of **$2,500** in its statement of income.

<u>Balance sheet presentation:</u>
Accounts receivable, net of allowance for uncollectible accounts of $3,500 **$96,500**

Balance Sheet Approach (Percentage of Receivables)

The **balance sheet approach** estimates the balance that should be recorded in the allowance based on the collectability of ending gross accounts receivable. Bad debt expense is the amount necessary to adjust the allowance.

Using the data from Example 2-2, assume that the company uses the balance sheet approach and that based on the company's experience, 6% of accounts receivable are determined to be uncollectible.

Thus, the ending balance of the allowance for uncollectible accounts is $6,000 ($100,000 × 6%). Because the allowance currently has a balance of $1,000, the following journal entry is required:

Bad debt expense ($6,000 – $1,000)	$5,000	
Allowance for uncollectible accounts		$5,000

<u>Balance sheet presentation:</u>
Accounts receivable, net of allowance for uncollectible accounts of $6,000 **$94,000**

An entity rarely has a single rate of uncollectibility for all accounts. Thus, an entity using the balance sheet approach generally prepares an **aging schedule** for accounts receivable

EXAMPLE 2-4 Balance Sheet Approach (Aging Schedule)

Using the data from the Example 2-3, assume that the company uses the following aging schedule to determine the ending balance of the allowance for uncollectible accounts:

Aging Interval	Balance	Estimated Uncollectible	Ending Allowance
Less than 30 days	$ 70,000	2%	$1,400
30-60 days	18,000	5%	900
61-90 days	10,000	13%	1,300
Over 90 days	2,000	20%	400
Total	**$100,000**		**$4,000**

Thus, the ending balance of the allowance for uncollectible accounts is $4,000. Because the allowance currently has a balance of $1,000, the following journal entry is required:

Bad debt expense ($4,000 – $1,000)	$3,000	
Allowance for uncollectible accounts		$3,000

Balance sheet presentation:

Accounts receivable, net of allowance for uncollectible accounts of $4,000 **$96,000**

Write-Off of Accounts Receivable

Some customers are unwilling or unable to satisfy their debts. A write-off of a specific debt is recorded as follows:

Allowance for uncollectible accounts	$XXX	
Accounts receivable		$XXX

Occasionally, a customer pays on an account previously written off.

Cash	$XXX	
Allowance for uncollectible accounts		$XXX

The following equation illustrates the reconciliation of the beginning and ending balances of gross accounts receivable (accounts receivable before adjustment for allowance for uncollectible accounts):

Beginning accounts receivable
Plus: Credit sales during the period
Minus: Cash collected on credit sales during the period
Minus: Accounts receivable written-off during the period

Ending accounts receivable

The following equation illustrates the reconciliation of the beginning and ending balances of the allowance for uncollectible accounts:

Beginning allowance for uncollectible accounts
Plus: Bad debt expense recognized for the period
Minus: Accounts receivable written off
Plus: Collection of accounts receivable previously written off

Ending allowance for uncollectible accounts

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Example

The Crowe Company offers 30 days of credit to its customers. At the end of the year, bad debts expense is estimated and the allowance for uncollectible accounts is adjusted based on an aging of accounts receivable. The company began 2019 with the following balances in its accounts:

Accounts receivable	$350,000
Allowance for uncollectible accounts	(32,000)
Net accounts receivable	$318,000

During 2019, sales on credit were $1,300,000, cash collections from customers were $1,253,000, and actual write-offs of accounts were $25,000.

Crowe Company Accounts Receivable Aging
December 31, 2019

		Summary
Age Group	**Amount**	**Estimated Percent Uncollectible**
0–60 days	$250,000	6%
61–90 days	80,000	15%
91–120 days	32,000	25%
Over 121 days	10,000	50%
Total	$372,000	

Required:

1. Determine the balances in accounts receivable and allowance for uncollectible accounts at the end of 2019.
2. Determine bad debt expense for 2019.
3. Prepare journal entries to write off receivables and to recognize bad debt expense for 2019.

Determine the balances in accounts receivable and allowance for uncollectible accounts at the end of 2019.

Accounts Receivable

	Debit	Credit
12/31/2018	350,000	
Sales	1,300,000	
Collections		1,253,000
Write-offs		25,000
12/31/2019	372,000	

Allowance for Uncollectible Accounts

	Debit	Credit
		32,000
Write-offs	25,000	
Bad debt expense (12/31/2019) adjustment		30,000
		37,000

Prepare journal entries to write off receivables and to recognize bad debt expense for 2019

Allowance for uncollectible accounts	25,000	
Accounts receivable		25,000
Write-off of accounts receivable as they are determined uncollectible.		
Bad debt expense	30,000	
Allowance for uncollectible accounts		30,000
Year-end adjusting entry for bad debts		

BE5–1 The Giles Agency offers a 12% trade discount when providing advertising services of $1,000 or more to its customers. Audrey's Antiques decides to purchase advertising services of $3,500 (not including the trade discount), while Michael's Motors purchases only $700 of advertising. Both services are provided on account. Record both transactions for The Giles Agency, accounting for any trade discounts.

BE5–2 Kelly's Jewelry has the following transactions during the year: total jewelry sales = $750,000; sales discounts = $20,000; sales returns = $50,000; sales allowances = $30,000. In addition, at the end of the year the company estimates the following transactions associated with jewelry sales in the current year will occur next year: sales discounts = $2,000; sales returns = $6,000; sales allowances = $4,000. Compute net sales.

BE5–3 At the end of the first year of operations, Mayberry Advertising had accounts receivable of $20,000. Management of the company estimates that 10% of the accounts will not be collected. What adjustment would Mayberry Advertising record to establish Allowance for Uncollectible Accounts?

BE5–4 At the beginning of the year, Mitchum Enterprises allows for estimated uncollectible accounts of $15,000. By the end of the year, actual bad debts total $17,000. Record the write-off to uncollectible accounts. Following the write-off, what is the balance of Allowance for Uncollectible Accounts?

BE5–5 Barnes Books allows for possible bad debts. On May 7, Barnes writes off a customer account of $7,000. On September 9, the customer unexpectedly pays the $7,000 balance. Record the cash collection on September 9.

BE5–6 At the end of the year, Mercy Cosmetics' balance of Allowance for Uncollectible Accounts is $600 (*credit*) before adjustment. The balance of Accounts Receivable is $25,000. The company estimates that 12% of accounts will not be collected over the next year. What adjustment would Mercy Cosmetics record for Allowance for Uncollectible Accounts?

BE5–7 Refer to the information in BE5–6, but now assume that the balance of Allowance for Uncollectible Accounts before adjustment is $600 (*debit*). The company still estimates future uncollectible accounts to be 12% of Accounts Receivable. What is the adjustment Mercy Cosmetics would record for Allowance for Uncollectible Accounts? Does the amount of the adjustment differ from BE5–6? If so, why?

BE5–8 At the end of the year, Dahir Incorporated's balance of Allowance for Uncollectible Accounts is $3,000 (*credit*) before adjustment. The company estimates future uncollectible accounts to be $15,000. What adjustment would Dahir record for Allowance for Uncollectible Accounts?

BE5–9 Refer to the information in BE5–8, but now assume that the balance of Allowance for Uncollectible Accounts before adjustment is $3,000 (*debit*). The company still estimates future uncollectible accounts to be $15,000. What is the adjustment Dahir would record for Allowance for Uncollectible Accounts? Does the amount of the adjustment differ from BE5–8? If so, why?

BE5–10 Williamson Distributors separates its accounts receivable into three age groups for purposes of estimating the percentage of uncollectible accounts.

1. Accounts not yet due = $40,000; estimated uncollectible = 5%.
2. Accounts 1–30 days past due = $11,000; estimated uncollectible = 20%.
3. Accounts more than 30 days past due = $5,000; estimated uncollectible = 30%.

Compute the total estimated uncollectible accounts.

BE5–11 Spade Agency separates its accounts receivable into three age groups for purposes of estimating the percentage of uncollectible accounts.

1. Accounts not yet due = \$25,000; estimated uncollectible = 4%.
2. Accounts 1–60 days past due = \$10,000; estimated uncollectible = 25%.
3. Accounts more than 60 days past due = \$5,000; estimated uncollectible = 50%.

In addition, the balance of Allowance for Uncollectible Accounts before adjustment is \$1,000 (*credit*). Compute the total estimated uncollectible accounts and record the year-end adjustment.

BE5–12 At the end of 2021, Worthy Co.'s balance for Accounts Receivable is \$20,000, while the company's total assets equal \$1,500,000. In addition, the company expects to collect all of its receivables in 2022. In 2022, however, one customer owing \$2,000 becomes a bad debt on March 14. Record the write off of this customer's account in 2022 using the direct write-off method.

BE5–13 Sanders Inc. is a small brick manufacturer that uses the direct write-off method to account for uncollectible accounts. At the end of 2021, its balance for Accounts Receivable is \$35,000. The company estimates that of this amount, \$4,000 is not likely to be collected in 2022. In 2022, the actual amount of bad debts is \$3,000. Record, if necessary, an adjustment for estimated uncollectible accounts at the end of 2021 and the actual bad debts in 2022.

BE5–14 Brady is hired in 2021 to be the accountant for Anderson Manufacturing, a private company. At the end of 2021, the balance of Accounts Receivable is \$29,000. In the past, Anderson has used only the direct write-off method to account for bad debts. Based on a detailed analysis of amounts owed, Brady believes the best estimate of future bad debts is \$9,000. If Anderson continues to use the direct write-off method to account for uncollectible accounts, what adjustment, if any, would Brady record at the end of 2021? What adjustment, if any, would Brady record if Anderson instead uses the allowance method to account for uncollectible accounts?

BE5–15 Calculate the missing amount for each of the following notes receivable.

Face Value	Annual Interest Rate	Fraction of the Year	Interest
\$11,000	6%	4 months	(a)
\$30,000	5%	(b)	\$1,500
\$35,000	(c)	6 months	\$1,225
(d)	8%	6 months	\$ 700

BE5–16 On October 1, 2021, Oberley Corporation loans one of its employees \$40,000 and accepts a 12-month, 9% note receivable. Calculate the amount of interest revenue Oberley will recognize in 2021 and 2022.

BE5–17 At the end of the year, Brinkley Incorporated's balance of Allowance for Uncollectible Accounts is \$4,000 (*credit*) before adjustment. The company estimates future uncollectible accounts to be 3% of credit sales for the year. Credit sales for the year total \$135,000. What is the adjustment Brinkley would record for Allowance for Uncollectible Accounts using the percentage-of-credit-sales method?

BE5–18 Refer to the information in BE5–17, but now assume that the balance of Allowance for Uncollectible Accounts before adjustment is \$4,000 (*debit*). The company still estimates future uncollectible accounts to be 3% of credit sales for the year. What adjustment would Brinkley record for Allowance for Uncollectible Accounts using the percentage-of-credit-sales method?

BE5–19 Match each of the following terms with its definition.

Terms	Definitions
_____ 1. Accounts receivable	a. Reductions in amount owed by customers because of deficiency in products or services.
_____ 2. Credit sales	b. Formal credit arrangements evidenced by a written debt instrument.
_____ 3. Sales allowances	c. Amount of cash owed to the company by customers from the sale of products or services on account.
_____ 4. Allowance method	d. Recording bad debt expense at the time the account is known to be uncollectible.
_____ 5. Notes receivable	e. Sales on account to customers.
_____ 6. Direct write-off method	f. Reductions in amount owed by customers if payment on account is made within a specified period of time.
_____ 7. Net revenues	g. Total revenues less returns, allowances, and discounts.
_____ 8. Sales discounts	h. Recording an adjustment at the end of each period for the estimate of future uncollectible accounts.
_____ 9. Aging method	i. Estimated percentage of uncollectible accounts is greater for "old" accounts than for "new" accounts.