

CHAPTER 11: BAD DEBTS AND ALLOWANCE FOR DOUBTFUL DEBTS

Trade receivables;

Credit customers of a business.

Bad debts;

Trade receivables which are unable to pay their debts. Business records them as expenses in the income statement.

Provision For Doubtful Debt;

- Trade receivables who are expected to be bad but not confirmed.
- It is contra asset account.
- Increase in provision recorded as expenses in the income statement.
- Decrease in provision recorded as incomes in the income statement.
- Total provision for doubtful will also be subtracted from trade receivables in the statement of financial position.

What are the accounting concepts (or convention) involved in preparing a provision for doubtful debts account?

- **Matching concept** is used in preparing a provision for doubtful debts. This is because an expense can be recognized for probable bad debts as soon invoice issued to the trade receivables, rather than waiting for which outstanding debts is unlikely to be collected.
- The second accounting concept involved in preparing provision for doubtful debts is **prudence**. The function of prudence is not to overstate profits, revenues or assets and not to understate losses, expenses and liabilities. Prudence takes place in situation of uncertainty as part of ensuring the reliability information.

Bad debt journal entry:

		\$		\$																				
Bad Debts		XX																						
Trade receivables				XX																				
<table style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 40%;"></td> <td style="width: 10%;"></td> <td style="width: 10%; text-align: center;">\$</td> <td style="width: 10%;"></td> <td style="width: 10%; text-align: center;">\$</td> </tr> <tr> <td style="text-align: center;">Bad Debt</td> <td></td> <td></td> <td></td> <td></td> </tr> <tr> <td style="border-top: 1px solid black; border-right: 1px solid black; padding-right: 5px;"></td> <td style="border-top: 1px solid black; padding-right: 5px;"></td> <td style="border-top: 1px solid black; padding-right: 5px;"></td> <td style="border-top: 1px solid black; padding-right: 5px;"></td> <td style="border-top: 1px solid black; padding-right: 5px;"></td> </tr> <tr> <td style="border-right: 1px solid black; padding-right: 5px;">Trade receivables</td> <td style="padding-right: 5px;">XX</td> <td style="padding-right: 5px;"></td> <td style="padding-right: 5px;">Income statement (bal Fig)</td> <td style="padding-right: 5px;">XX</td> </tr> </table>							\$		\$	Bad Debt										Trade receivables	XX		Income statement (bal Fig)	XX
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Provision for Doubtful debt:**Journal entries**

Increase in provision	\$	\$	Decrease in provision	\$	\$
Income Statement	XX		Provision for doubtful debt	XX	
Provision for doubtful debt		XX	Income statement		XX

Provision Ledger Account:

Provision for Doubtful debt			
\$		\$	
Income statement	XX	Balance B/F	XX
(Decrease in provision)		Income statement	XX
Balance C/F	XX	(increase in provision)	

Practice questions:

Q1: The trade receivables' balances after the bad debts had been written off were:

	\$
At 31 December 2014	88,800
At 31 December 2015	78,300

The bad debts that had been written off during the two years were:

	\$
For the year ended 31 December 2014: Navera	3,600
For the year ended 31 December 2015: Miral	4,200

At the end of December 2014 and 2015, Dong maintained a provision for doubtful debts at 4% of trade receivables.

Required

Prepare the following for the years ended 31 December 2014 and 31 December 2015:

- (i) Bad Debts Account
- (ii) Provision for Doubtful Debts Account.

Q2: TOM LTD has trade receivable of worth \$50,000 as at 31 December 2010. JERRY LTD, a receivable owing \$10,000 to TOM LTD at the year end, has been recently been wound up. Consequently, TOM LTD does not expect to recover the amount due from JERRY LTD. Based on past experience, TOM LTD estimates that 5% of its receivables will default. Allowance for doubtful debts on 31 December 2009 was \$1500.

Required:

- a) Prepare bad debt account.
- b) Prepare allowance for bad debt account.
- c) Prepare income statement and statement of financial position extracts.

Q3: The following details of Esha's business are available for the four years ended 31 December 2015, 2016, 2017 and 2018.

<u>Year</u>	<u>Trade receivables</u>	<u>Bad debts</u>	<u>Provision for bad debt</u>
	\$	\$	%(Percentage)
<u>2015</u>	70 000	5 000	4
<u>2016</u>	86 000	6 700	5
<u>2017</u>	60 000	4 500	5
<u>2018</u>	95 000	8 450	6

Required:

- a) Prepare bad debt account for each of four years.
- b) Prepare allowance for bad debt account for each of four years.
- c) Prepare income statement and statement of financial position extracts for each of four years.

Q4: At December 31 of the current year, a company reported the following:

Trade receivable balance at Dec. 31, current year: \$190,000.

Bad debts written off during the current year: \$6,800.

Balance of Allowance for Doubtful Accounts at January 1, current year: \$8,300.

Required:

Prepare the bad debts expenses and provision for doubtful debt accounts assuming this company's provision for bad debt 5% of trade receivable.

Q5: Shanzay provided the following information about her trade receivables.

1 On 28 February 2016 Wade Designs, which owed Shanzay \$5100, was declared bankrupt.

A cheque for \$1800 was received. The balance of the debt was irrecoverable.

2 On 29 February 2016 the remaining trade receivables were:

Age of debt (Months)	Amount \$	Provision for doubtful debts percentage (%)
Up to 1 month	18000	2
1 to 3 months	12200	5
3 to 6 months	3300	10
Over 6 months	<u>2200</u>	20
	35700	

On 1 March 2015 the provision for doubtful debts account was \$2050.

REQUIRED

- Prepare the general journal to record the entries for Wade Designs on 28 February 2016.
- Prepare bad debt and provision for doubtful debt accounts on 28 February 2016.

Q6: Raja supplied the following information relating to her trade receivables before the preparation of the income statement for the year ended 31 May 2013.

1	31 May 2012 \$	31 May 2013 \$
Trade receivables	18800	19200
Provision for doubtful debts	940	?

2 The following accounts are to be written off as bad debts.

	\$
R B Brown	502
L Wong	90
P Singh	288

3 The provision for doubtful debts is maintained at 5% of trade receivables.

REQUIRED

- Prepare the bad debt and the provision for doubtful debts account for the year ended 31 May 2013. Balance the account and bring the balance down on 1 June 2013.
- Prepare income statement and statement of financial position.

Q7: Carson's Trade Receivables owed \$47 900 on 29 April 2007. The Trade Receivables included the following:

Trade Receivables	Balance
	\$
Iqbal	72
Johnston	148
Turner	880

- 1 Iqbal paid Carson \$72 in cash on 30 April.
- 2 Carson was told that Johnston had left the country and decided to write off the outstanding balance as a bad debt.
- 3 On 30 April Carson was informed that Turner was bankrupt. A cheque for \$240 was received in full and final settlement. Carson wrote off the remaining balance as a bad debt.
- 4 Carson decided to create a provision for doubtful debts at 2 % of the remaining Trade Receivables at 30 April 2007.

No other transactions occurred on 30 April 2007.

REQUIRED

- (a) Prepare the journal entries to record the bad debt write-offs and creation of the provision for doubtful debts.
- (b) Prepare Bad debt and provision for bad debt account.