



ACCOUNTING FOR UNCOLLECTIBLE ACCOUNTS

Chapter
7

OBJECTIVES

- ❖ Define accounting terms related to uncollectible accounts.
- ❖ Identify accounting concepts and practices related to uncollectible accounts.
- ❖ Calculate and record estimated uncollectible accounts expense using the direct write off method.
- ❖ Calculate and record estimated uncollectible accounts expense using the allowance method.
- ❖ Calculate and analyze accounts receivable turnover ratios.

TERMS

1. Uncollectible accounts
2. Writing off an account
3. Direct write-off method of recording losses from uncollectible accounts.
4. Allowance method of recording losses from uncollectible accounts.
5. Aging accounts receivable
6. Accounts receivable turnover ratio
7. Book value of accounts receivable

DIRECT WRITE OFF METHOD OF RECORDING UNCOLLECTIBLE ACCOUNTS

Why do businesses offer credit terms?

1. Attract new customers
2. Increase sales to current customers
3. Encourage customer loyalty

What should a business do before selling merchandise on account?

Answer: Investigate a customers credit rating. Why?

CREDIT RATINGS

Most credit scores – including the FICO score and VantageScore 3.0 – operate within the range of 300 to 850, and a good credit score is typically one that is 700 or above. Within that range, there are different categories, from bad to excellent.

Excellent Credit: 750+

Good Credit: 700–749

Fair Credit: 650–699

Poor Credit: 600–649

Bad Credit: below 600

FICO stands for Fair, Isaac and Company. It is used by Equifax, Experian and TransUnion to secure a credit score.

DIRECT WRITE OFF METHOD OF RECORDING UNCOLLECTIBLE ACCOUNTS

Just because a person has a high credit score, is it a guarantee that they will pay according to terms?

Answer: No. Why not?

1. I forgot.
2. I don't have the money right now.
3. I have no idea where my bill is.
4. Dissatisfaction with service or product.

DIRECT WRITE OFF METHOD OF RECORDING UNCOLLECTIBLE ACCOUNTS

Accounts that cannot be collected are called_____.

Answer: Uncollectible accounts

When we make an initial sale on account, what accounts are used?

Answer: Accounts receivable and Sales

The amount originally charged to Accounts Receivable will remain there until it is either paid or determined to be uncollectible.

DIRECT WRITE OFF METHOD OF RECORDING UNCOLLECTIBLE ACCOUNTS

At what point is a customer account no longer an asset?

Answer: When it is determined to be uncollectible.

When an account is determined to be uncollectible, what must we do?

Answer: We have to write off the account

Writing off an account is canceling the balance of the customer account because the customer is not expected to pay.

DIRECT WRITE OFF METHOD OF RECORDING UNCOLLECTIBLE ACCOUNTS

Occasionally, an account that has been written off is collected.

This is referred to as a “Recovery of Bad Debt.”

RECORDING UNCOLLECTIBLE ACCOUNTS EXPENSE

An amount owed by a customer will remain part of the accounts receivable until when?

1. It is paid off
2. Written off as uncollectible

How is an uncollectible account closed?

Answer: By transferring the balance to a general ledger account title Uncollectible Account Expense.

RECORDING UNCOLLECTIBLE ACCOUNTS EXPENSE

Northwest Cleaners - what do we know?

1. Dry cleaner
2. Most of their business is cash or credit card
3. Do a few sales on accounts

Because they have a small number of sale on accounts, they will write off the specific account when it is actually known to be uncollectible. This is known as *direct write off method of recording losses from uncollectible accounts.*

Page 201 Remember:

Uncollectible accounts are also referred to
as _____.

Answer: Bad Debts

What are two account titles that could be used?

1. Bad Debt Expense
2. Collection of Bad Debt



RECORDING UNCOLLECTIBLE ACCOUNTS EXPENSE

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November 15. Wrote off James Nordquist's past due account as uncollectible, \$50. Memorandum No. 21.

General Ledger

Accounts Receivable Ledger

Uncollectible Accounts Expense

James Nordquist

Bal. \$50.00

Accounts Recievable

Bal. \$54,789.05

JOURNAL ENTRIES

GENERAL JOURNAL

	DATE	ACCOUNT TITLE	DOC.	POST	GENERAL	
			NO.	REF.	DEBIT	CREDIT
1	2019 Nov. 15	Uncollectible Accounts Expense	M21		\$ 50.00	
2		Accounts Rec. / James Nordquist				\$ 50.00
3						

COLLECTING A WRITTEN-OFF ACCOUNT – DIRECT METHOD

When an account is written off, the balance is recorded as an *expense*.

When the account is later collected, the amount is recorded as *other revenue*.

Northwest Cleaners needs a complete history of each customer's credit activities. Therefore, two journal entries are recorded for the collection of a written-off account receivable.

1. General journal entry to reopen the account
2. Cash receipts journal entry to record the cash received on account.

General Ledger

Accounts Receivable Ledger

Cash

Accounts Recievable

Bal. \$54,789.05

Write off \$50.00

James Nordquist

Bal. \$50.00

Write off \$50.00

Collection of Uncollectible Account

AUDITS

Why should the amount of uncollectible account be removed from the assets of a business?

Answer:

When a customer's account is believed to be uncollectible, it should be written off because *it is no longer an asset of the business.*

AUDITS

In the direct write off method, how is an uncollectible account closed?

Answer:

Uncollectible accounts expense – debit
Accounts receivable – credit

The customer's account is also credited in the AR Ledger.

AUDITS

Why is the customer account reopened when cash is received for an account previously written off as uncollectible?

Answer:

To provide a complete history of a customer's credit activities.