

# ACCOUNTING FOR RECEIVABLES

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## I. ACCOUNTING FOR BAD DEBTS

Credit Sales are an integral part of a competitive business environment. The benefit is increased sales and the cost is some credit sales will be defaulted upon. The cost, bad debt expense, should be recorded in the year of sale. Since time will pass before a particular defaulting account is known, an estimate of total bad debts is made with an Allowance for Bad Debts account charged in place of the unknown accounts receivable. As specific defaults become known, both their accounts receivable and the allowance account are lowered. The allowance account should approach zero as the

Darin's Music Emporium allowed local businesses to charge and pay monthly. To estimate bad debts, they could have used a percentage of total receivable sales, a percentage of current receivables, or aged current receivables. Being a new business, no historical data

operating cycle comes to an end. If a credit balance begins to accumulate over a number of accounting cycles in the allowance account, bad debt estimates have been too high and should be lowered. If a debit balance begins to accumulate, bad debt expense has been understated and should be increased. An alternative method, waiting until specific defaulters are known before recording an expense, is called Direct Write Off and is sometimes used when amounts are immaterial.

existed and the latter method was chosen. As of December 31, \$2,000 of Receivables were over 90 days, and it was estimated that 25% would not be paid. Relevant entries would be as follows:

		DR.	CR.
Dec. 31	Bad Debt Expense Allowance for Bad Debts	500	
<b>READ FIRST</b>	--> To record bad debt expense.		500
March 23	Allowance For Bad Debts Accounts Receivable, X Co. To write off X Co.	40	40
April 20	Allowance For Bad Debts Accounts Receivables, Y Co. To write off Y Co.	120	120
May 14	Allowance For Bad Debts Accounts Receivable To write off Z Company.	420	420
Nov. 20	Accounts Receivable, Y Co. Allowance For Bad Debts Y Co., previously written off, made good on their debt.	120	120
Nov. 20	Cash Accounts Receivable, Y Co. Cash received from Y Co.	120	120
Dec. 31 1996	Bad Debt Expense Allowance For Bad Debts To record 1996 bad debt expenses estimated at \$600.	560	560

Note: When bad debts are estimated based upon a percentage of total yearly credit sales, the adjustment is for this percentage. When a percentage or aging of the December 31 accounts receivable balance is used, the allowance account is made equal to this current estimate of total bad debts.

Allowance For Bad Debts	
40	500
120	120
<u>420</u>	<u>620</u>
580	580
	40 Bal.
	<u>600</u>
	640

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Note: Allowance For Bad Debts (a Contra Asset) would be subtracted from Accounts Receivable in the Current Assets Section of the Balance Sheet with the balance called Net Receivables.

## II. CREDIT CARD SALES

Darin's Music Emporium dealt with two types of credit card companies: one electronically tied to the company's 286 Computer/cash register and paid immediately, the other delayed payment until receipts were received and processed. Both charged 4%. Relevant entries for a \$50 sale would have been:

CASH RECEIVED IMMEDIATELY			
		DR.	CR.
Jan. 5	Cash	48	
	Credit Card Expense	2	
	Sales		50
CREDIT CARD COMPANY BILLED			
Jan. 5	Accounts Receivable, Card Co.	50	
	Sales		50
Jan. 25	Cash	48	
	Credit Card Expense	2	
	Accounts Receivable, Card Co.		50

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