Name: KEY

Chapter 7 Notes
Accounting for Uncollectible Accounts

7.1: DIRECT WRITE-OFF METHOD OF RECORDING UNCOLLECTIBLE ACCOUNTS

- **Uncollectible Accounts** - accounts receivable that cannot be collected
- **Writing Off an Account** - canceling the balance of a customer account because the customer is not expected to pay

Recording Uncollectible Accounts Expense

- An uncollectible account is closed by transferring the balance to a general ledger account titled Uncollectible Accounts Exp..
- **Direct Write-Off Method of Recording Losses from Uncollectible Accounts** - recording uncollectible accounts expense only when an amount is actually known to be uncollectible

Practice Problem

Cracker, Inc. uses the direct write-off method of recording uncollectible accounts expense. A general journal is provided below. Source document is abbreviated as follows: memorandum, M.

1. Journalize the following transactions completed during the current year.
   - Jan. 10 Wrote off Melinda Sanford's past due account as uncollectible, $261.54. M13.
   - Mar. 12 Wrote off Mark Polk's past due account as uncollectible, $45.00. M24.

GENERAL JOURNAL PAGE 2

	DATE		ACCOUNT TITLE	DOC. NO.	POST. REF.	1 DEBIT	2 CREDIT	
1	2015 Jan.	10	Uncollectible Accts. Exp.	M13		261.54		1
2			AR/Melinda Sanford				261.54	2
3	Mar.	12	Uncollectible Accts. Exp.	M24		45		3
4			AR/Mark Polk				45	4
5								5

Collecting a Written-Off Account – Direct Method

- Sometimes a customer's written-off account is later collected. When the account is written off, the balance is recorded as an expense. When the account is later collected, the amount is recorded as other revenue.
- Therefore, two journal entries are recorded for the collection of a written-off account receivable:
  1. A general journal entry to reopen the customer account.
  2. A cash receipts journal entry to record the cash received on account.
- The account Collection of Uncollectible Accounts is used for recording collection of previously written-off accounts.

Practice Problem

Cracker, Inc. uses the direct write-off method of recording uncollectible accounts expense. A general journal and cash receipts journal are provided below. Source documents are abbreviated as follows: memorandum, M; receipt, R.

1. Journalize the following transactions completed during the current year.

Apr. 13 Received cash in full payment of Andrew Leslie's account, previously written off as uncollectible, $67.42. M31 and R158.

Nov. 15 Received cash in full payment of Melinda Sanford's account, previously written off as uncollectible, $261.54. M84 and R313.

GENERAL JOURNAL PAGE 2

	DATE		ACCOUNT TITLE	DOC. NO.	POST. REF.	1 DEBIT	2 CREDIT	
	2015							
1	Apr	13	AR/Andrew Leslie	M31		67.42		1
2			Collection of Uncoll. Accts.				67.42	2
3	Nov	15	AR/Melinda Sanford	M84		261.54		3
4			Collection of Uncoll. Accts.				261.54	4
5								5

CASH RECEIPTS JOURNAL PAGE 3

	DATE		ACCOUNT TITLE	DOC. NO.	POST. REF.	1 GENERAL DEBIT	2 GENERAL CREDIT	3 ACCOUNTS RECEIVABLE CREDIT	4 SALES CREDIT	5 SALES TAX PAYABLE CREDIT	6 SALES DISCOUNT DEBIT	7 CASH DEBIT	
	2015												
1	Apr	13	Andrew Leslie	R158				67.42				67.42	1
2	Nov	15	Melinda Sanford	R313				261.54				261.54	2
3													3

7.2: ALLOWANCE METHOD OF RECORDING UNCOLLECTIBLE ACCOUNTS EXPENSE

Estimating Uncollectible Accounts Expense

- When the direct write-off method is used, the expense may be recorded in a fiscal period different from the fiscal period of the sale. Uncollectible accounts expense should be recorded in the same fiscal period in which the sales revenue is received (concept: Matching Expenses with Revenue)
- At the time sales on account are made, a business has no way to know for sure which customer will not pay an amount due. Therefore, the business makes an estimate based on its past history of uncollectible accounts.
- **Allowance Method of Recording Losses from Uncollectible Accounts** - crediting the estimated value of uncollectible accounts to a contra account
  - Two methods are used to estimate uncollectible accounts expense:
    1. Percentage of sales method
    2. Percentage of accounts receivable method

Adjustment Using the Percentage of Sales Method

Steps to Estimate Uncollectible Accounts Expense Using the Percentage of Sales Method:

1. Compute the estimated uncollectible accounts expense by multiplying net sales by the percentage estimate:

   Net Sales x Percentage = Estimated Uncollectible Accounts Expense

2. Record an adjustment on the worksheet:
   - Debit: Uncollectible Accounts Exp.
   - Credit: Allow. for Uncoll. Accounts

Practice Problem

A general journal page has been provided below.

1. Lynum, Inc. had net sales of $245,321.09 during the current year. It estimates that the amount of uncollectible accounts expense is equal to 0.5% of net sales. Journalize the adjusting entry for uncollectible accounts expense on December 31 of the current year.

GENERAL JOURNAL PAGE 12

	DATE		ACCOUNT TITLE	DOC. NO.	POST. REF.	DEBIT (1)	CREDIT (2)	
1	2019		Adjusting Entries					1
2	Dec	31	Uncoll. Accts. Exp.			1226.61		2
3			Allow. for Uncoll. Accts.				1226.61	3
4								4

Adjustment Using Aging of Accounts Receivable

- The percentage of accounts receivable method assumes that a percentage of the accounts receivable balance is uncollectible. Therefore, emphasis is placed on estimating a percentage of accounts receivable that will not be collected.
- **Aging Accounts Receivable** - analyzing accounts receivable according to when they are due
  - For example, Rosedale sells on the terms of 2/10, n/30 and expects customers to pay in full within 30 days. If Rosedale has not received cash within 30 days, it mails reminders to the customers. If it has not received cash after 60 days, the company makes special attempts to collect the amount due. If the business has not collected after 90 days, it may stop selling on account to that customer until collection has been made.

Adjustment Using Percentage of Accounts Receivable

- Based on past records, a business determines that a percentage of each accounts receivable age group (30 days, 60 days, and 90 days) will become uncollectible in the future. Using these percentages, the business calculates the total amount of estimated uncollectible accounts receivable.

Practice Problem

A general journal page has been provided below.

1. The aging of accounts receivable for Kersten, Inc., as of December 31 of the current year and estimated percentages of uncollectible accounts by age group are given below. Calculate the estimated balance of Allowance for Uncollectible Accounts. Then journalize the adjusting entry for uncollectible accounts expense. The balance of Allowance for Uncollectible Accounts on December 31 before adjusting entries are recorded is $63.24.

Age Group	Amount	Percentage	Uncollectible
Not yet due	$8,619.18	0.1%	$8.62
1-30 days	2,254.83	0.2%	4.51
31-60 days	862.57	0.3%	2.59
61-90 days	2,574.57	0.8%	20.60
Over 90 days	350.90	50.0%	175.45
Totals	$14,662.05	------	$211.77
Current Balance of Allowance for Uncollectible Accounts			63.24
Estimated Addition to Allowance for Uncollectible Accounts			$148.53

GENERAL JOURNAL PAGE 14

	DATE		ACCOUNT TITLE	DOC. NO.	POST. REF.	1 DEBIT	2 CREDIT	
1	2015		Adjusting Entries					1
2	Dec.	31	Uncoll. Accts. Exp.			148.53		2
3			Allow. for Uncoll. Accts.				148.53	3
4								4

Writing Off an Uncollectible Account – Allowance Method

- The procedures for writing off an account are the same regardless of the allowance method used to calculate the estimated uncollectible accounts expense.
- This transaction is recorded in the general journal and looks like this:
  - Debit: Allow. for Uncoll. Accts.
  - Credit: Accts. Rec. and (Customer Name)

Collecting a Written-Off Account – Allowance Method

- The two parts of the transaction to record the collection of a previously written-off account are as follows:
  - In the General journal:
    - Debit: Accts. Rec. and (Customer Name)
    - Credit: Allow. for Uncoll. Accts.
  - In the Cash Receipts journal
    - Debit: Cash
    - Credit: Accts. Rec. / Cust. Name

7.3: ACCOUNTS RECEIVABLE TURNOVER RATIO

Calculating the Accounts Receivable Turnover Ratio

- If a business does not collect amounts due from customers promptly, too large a share of the assets of the business will be in accounts receivable and not immediately usable.
- One way to analyze the collection efficiency of a business is to calculate the accounts receivable turnover ratio.
- **Accounts Receivable Turnover Ratio** - number of times the average amount of accounts receivable is collected during a specified period
  - It is calculated by dividing net sales on account by the average book value of accounts receivable.
  - **Book Value of Accounts Receivable** - difference between the balance of AR & its contra, Allow. for Uncoll. Accts.
  - Example: An accounts receivable turnover ratio of 7.1 times means that a business turns over (or collects) its average accounts receivable about seven times a year.
  - The number of days in a year divided by the accounts receivable turnover ratio yields the average number of days required to pay.

Analyzing Accounts Receivable Turnover Ratios

- A business hopes to see a steady increase in the turnover ratio, which shows a decrease in the number of days it takes a customer to pay on account.
- A business might take several steps to create a more favorable accounts receivable turnover ratio:
  1. Send statements of account to customers more often, including a request for prompt payment.
  2. Not sell on account to a customer who has an account for which payment is overdue more than 30 days.
  3. Encourage more cash sales and fewer sales on account.
  4. Conduct a more rigorous credit check on new customers before extending credit to them.

Practice Problem

Stokes Building Supply offers its customers n/45 credit terms. The turnover ratio for the prior year was 5.8. The following account balances were obtained from the records of Stokes Building Supply for the current year.

Account	**January 1**	**December 31**
Accounts Receivable	$163,874.05	$186,383.48
Allowance for Uncollectible Accounts	$6,544.83	$7,745.86
Net Sales on Account		$872,895.94

1. Calculate the accounts receivable turnover ratio for the current year.

Accounts Receivable Turnover Ratio:

	Accounts Receivable	-	*Allow. for Uncoll. Accounts*	=	*Book Value of Accounts Receivable*
Beginning	163,874.05	-	6,544.83	=	157,329.22
Ending	186,383.48	-	7,745.86	=	178,637.62

Beginning Book Value of Accounts Receivable	+	*Ending Book Value of Accounts Receivable*	÷	2	=	*Average Book Value of Accounts Receivable*
157,329.22	+	178,637.62	÷	2	=	167,983.42

Net Sales on Account	÷	*Average Book Value of Accts. Receivable*	=	*Accounts Receivable Turnover Ratio*
872,895.94	÷	167,983.42	=	5.20

2. Calculate the average number of days for payment.

Average Number of Days for Payment:

Days in a Year	÷	*Accounts Receivable Turnover Ratio*	=	*Average Number of Days for Payment*
365	÷	5.20	=	70

3. Is Stokes Building effective in collecting its accounts receivable?

Stokes Building Supply is effective/not effective (circle one) in collecting its accounts receivable. With n/45 credit terms, Stokes should be able to collect its accounts quicker than 70 days. Because Stokes was more/less (circle one) effective collecting its accounts last year, it should reexamine any changes in its collection methods.