

# Topic 4



## Irrecoverable debts and Provision for Doubtful debts

# BAD AND DOUBTFUL DEBTS

Bad debts: The credit customers who are unable to settle their debts are called bad debts.

## 1. To write off bad debt

bad debt expense	dr		
		trade receivables	cr

## 2. To close the bad debt A/c

income statement	dr		
		bad debt expense	cr

Note: Since there are no accruals or prepayments in bad debts there will be no opening or closing balance on bad debt expense account.

## Example 1

A business experienced the following during the year ended 31<sup>st</sup> December 2021.

✓ 18<sup>th</sup> April: The balance on David's account of \$200 was written off as bad debt.

✓ 31<sup>st</sup> Aug: A credit customer Amit with outstanding balance of \$600 went into liquidation and paid 25 cents for every \$1. The remaining balance on his account was written off as bad debt.

✓ 31<sup>st</sup> Dec: Wrote off various trade receivables as bad debt \$420.

Required:

- Prepare a bad debt account.
- Prepare Amit's account.

## Bad Debt Expense

2021	2021
\$	\$
18 <sup>th</sup> Apr David	
200	
31 <sup>st</sup> Aug Amit	
450	
31 <sup>st</sup> Dec Trade Receivables (various)	31 <sup>st</sup> Dec <b>Income Statement</b>
<u>420</u>	<u>1070</u>
<u>1070</u>	<u>1070</u>

## Amit

2021	2021
\$	\$
1 Jan balance b/d	31 Aug bank (receipts)
600	150
<u>600</u>	31 Aug bad debt
	<u>450</u>
	<u>600</u>

$$\begin{array}{l} \text{Amit } \$600 \times ? \\ \$1 \times \$0.25 \end{array}$$

$$\text{Receipt} = \$600 \times \$0.25 = \$150$$

$$\text{Bad debt} = 600 - 150 = \$450$$

Bad Debts Recovered :- The credit customers who were written off as bad debt in previous years, if pay the amount are referred as bad debt recovered.

1. Trade Receivables dr  
Bad debt Recovered cr

[To reopen the trade receivables a/c who were written off as bad debt]

2. Bank / cash dr  
Trade receivables cr

[To record the collections from these customers]

### 3. To close bad debt recovered account

Bad Debt recovered                      dr  
Income Statement                                      cr

Note: Bad debts are shown as an expense in income statement whereas bad debts recovered are part of other income and gains.

#### Example ::

Hamidullah, a credit customer whose outstanding balance of \$900 was written off as bad debt in 2019 paid the amount in full on 15<sup>th</sup> July 2021.

#### Required ::

Prepare ::

a. Hamidullah's account

b. Bad Debt Recovered Account

#### Hamidullah

2021	\$	2021	\$
15 <sup>th</sup> July bad debt recovered	<u>900</u>	15 <sup>th</sup> July cash/bank	<u>900</u>
	<u>900</u>		<u>900</u>

#### Bad Debt Recovered

2021	\$	2021	\$
31 <sup>st</sup> Dec Income Statement	<u>900</u>	15 <sup>th</sup> July Hamidullah	<u>900</u>
	<u>900</u>		<u>900</u>

Provision for Doubtful Debts: It is the estimated amount of bad debts that can arise from credit customers from whom the amount has not yet been received

Factors that are taken into account when deciding the amount to be provided as doubtful debts:

- i. Past experience
- ii. Credit worthiness of customers
- iii. Financial and liquidity position of credit customers
- iv. Ageing of trade receivables
- v. Efficiency of credit control department
- vi. Average collection period of trade receivables =  $\frac{\text{Trade receivables} \times 365}{\text{Credit Sales}}$  days

Accounting Entries:

1. When the provision is created for the first time:

Income Statement	dr		
		provision for doubtful debts	cr

Note: When provision is created for the first time the full amount of provision is recorded as an expense in income statement.

2. Subsequent years/maintenance of provision:

i. Increase in provision - [expense]

Income Statement	dr		
		provision for doubtful debts	cr

Note: If the current year's provision is higher than the previous year, then it is recorded as an expense in I/s with the amount of **increase**.

ii. Decrease in provision - [other income]

Provision for doubtful debts	dr		
		income statement	cr

Note: If the current year's provision is less than the previous year, then it is recorded as an income in I/s with the amount of **decrease**.

Example: The following details are available

	2018	2019	2020
Trade receivables	\$ 20,000	\$24,000	\$21,000
Rate of provision for doubtful debt	x 5%	x 5%	5%
Provision	\$1,000	\$ 1,200	\$1,050

Required

Prepare Provision for doubtful debts account.

### Provision for Doubtful Debts

2018	\$	2018	\$
31 Dec. balance c/d	<u>1000</u>	31 Dec. Income Statement (increase)	1000
	<u>1000</u>		<u>1000</u>
2019		2019	
31 Dec balance c/d	<u>1200</u>	1 Jan balance b/d	1000
	<u>1200</u>	31 Dec Income Statement (Increase)	200
2020			<u>1200</u>
31 Dec Income Statement (Decrease)	150	2020	
31 Dec balance c/d	<u>1050</u>	1 Jan balance b/d	1200
	<u>1200</u>		<u>1200</u>
2021		2021	
		1 Jan balance b/d	1050

Note: When preparing the statement of financial position always the current year's provision is deducted from trade receivables figure to get the net outstanding trade receivables.

Example - Balance Sheet Extract 2020

	\$	\$
Current Assets		
Trade receivables	gross outstanding trade receivables 20000	
(-) Provision for doubtful debts	(1050)	18950 ⇒ net outstanding trade receivables

# INTRODUCTION TO COST AND MANAGEMENT ACCOUNTING

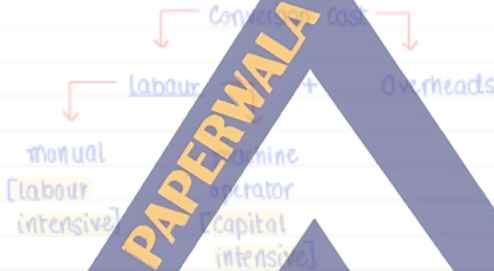
Cost/Expense: Outflow of resources.

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Stages of Manufacturing

1. Input [raw material] → 2. Process → 3. Output [finished goods]



Labour intensive business: Business organisations dependant on manual labour rather than technology or machinery.

Capital intensive business: Business organisations which are more dependant on machines rather than manual labour.