

Adjustment to Financial Statements

Irrecoverable debts and PFDD

2 Zak owns a wholesale business. He makes sales on credit.

REQUIRED

(a) Explain why it may be important for a business to maintain a provision for doubtful debts.

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..... [2]

Additional information

Zak has prepared an aged schedule of trade receivables at 31 December 2020.

Period outstanding	Amount \$	Estimated irrecoverable debts
Less than 1 month	34 200	1%
Between 1 month and 3 months	6 680	5%
Between 4 and 6 months	2 130	10%

In addition, two accounts had been outstanding for over 6 months.

	\$
P Limited	340
Q Limited	510

Zak’s policy is to write off as irrecoverable any amounts outstanding for more than 6 months. Zak updates the provision for doubtful debts at each financial year end based on the estimated percentage of irrecoverable debts.

REQUIRED

(b) Prepare a journal entry to write off the irrecoverable debts. A narrative is **not** required.

Journal

	Dr	Cr
	\$	\$

[2]

(c) State **two** ways in which the risk of irrecoverable debts may be reduced.

1

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[2]

Additional information

At 1 January 2020 the business had a provision for doubtful debts of \$980.

REQUIRED

(d) Calculate the adjustment required to the provision for doubtful debts at 31 December 2020.

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[4]

(e) Prepare the provision for doubtful debts account for the year ended 31 December 2020.

Provision for doubtful debts account

	\$		\$

[3]

(f) State **two** factors that should be taken into account when setting a provision for doubtful debts.

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[2]

[Total: 15]



Additional information

Daniel had created a provision for doubtful debts of \$672 on 31 December 2018. At this date trade receivables appeared on the statement on financial position with a net value of \$16 128.

At 31 December 2019 Daniel decided to maintain the provision for doubtful debts at the same rate as in the previous year. Total trade receivables at 31 December 2019 were \$15 300 before making any adjustment for provision for doubtful debts.

REQUIRED

(d) Calculate the increase or decrease in the provision for doubtful debts at 31 December 2019.

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(e) State **two** accounting concepts which are applied when creating a provision for doubtful debts.

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2 [2]

(f) State **two** factors that a business could consider when setting a rate for provision for doubtful debts.

1
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2
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[Total: 15]

2 Sofia has provided the following information relating to her trade receivables at 31 December 2018:

	Analysis of trade receivables		
	0-60 days	61-90 days	Over 90 days
Percentage of total trade receivables	68%	20%	12%

- 1 At 31 December 2018 total trade receivables were \$54 500.
- 2 Dixie, who had been declared bankrupt, owed \$1500. This debt was 110 days old at 31 December 2018 and was to be written off.
- 3 Sofia's policy is to make a provision for doubtful debts as follows:
 - 5% for debts aged between 61 and 90 days old
 - 7.5% for debts aged over 90 days old.

The balance on the provision for doubtful debts at 1 January 2018 was \$1100.

REQUIRED

(a) State the journal entry to write off an irrecoverable debt.

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(b) Calculate the amount of provision for doubtful debts at 31 December 2018.

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(c) Prepare the provision for doubtful debts account for the year ended 31 December 2018. Dates are required.

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(d) Explain **one** accounting concept which is applied when making a provision for doubtful debts.

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Additional information

Sofia is considering changing the basis of the provision for doubtful debts to a general provision of 2.5% on all trade receivables.

She has calculated her profit for the year ended 31 December 2018 as \$4300 after writing off Dixie's debt but before making any adjustment for the provision for doubtful debts.

REQUIRED

(e) Describe how this change will affect Sofia's profit. Support your answer with relevant calculations.

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[Total: 15]

2 Sturgess has provided the following information:

- 1 The provision for doubtful debts at 1 August 2015 was \$1940.
- 2 Trade receivables at 31 July 2016 were \$48 500.
- 3 A customer owing \$2100 has been declared bankrupt. This amount is to be written off.
- 4 A customer owing \$900 did not pay within the agreed credit terms. There are concerns about the recovery of this debt.
- 5 The business policy is to make a 5% provision for doubtful debts on remaining trade receivables.

REQUIRED

(a) (i) State **one** reason why a business may make a provision for doubtful debts.

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(ii) State **one** accounting concept applied while making the provision for doubtful debts.

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(iii) Prepare the provision for doubtful debts account for the year ended 31 July 2016.

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(b) Explain how a provision for doubtful debts is treated in:

(i) the statement of financial position

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(ii) the income statement

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