

BEFORE
You

READ

What You'll Learn

1. Explain methods used to write off uncollectible accounts.
2. Determine uncollectible accounts receivable.
3. Use the direct write-off method for uncollectible accounts.
4. Calculate bad debts expense.
5. Make an adjusting entry for uncollectible accounts.
6. Use the allowance method to record uncollectible accounts.
7. Record the collection of an account previously written off.
8. Describe two methods to estimate uncollectible accounts expense.
9. Define the accounting terms introduced in this chapter.

Why It's Important

- When a business extends credit, it assumes the risk of uncollectible accounts.



Predict

1. What does the chapter title tell you?
2. What do you already know about this subject from personal experience?
3. What have you learned about this in the earlier chapters?
4. What gaps exist in your knowledge of this subject?

Exploring the *Real World* of Business

ANALYZING CREDIT LOSSES

U.S. Government Accountability Office

Do you ever wonder who keeps watch on how your federal tax dollars are spent? The **Government Accountability Office (GAO)** has you covered. Independent and nonpartisan, the GAO recommends ways for government agencies to be more effective, audits federal expenditures, investigates fraudulent activities, and issues legal opinions.

You may hear news reports about budget deficits or social security shortfalls. Many Americans are worried about funding homeland security and health care. Business owners and farmers can secure government loans but may fail to repay them due to bad economic times. Elected officials express concern that the government is not collecting its outstanding loans and debts. In light of all these issues, the watchdog GAO is clearly the taxpayer's best friend.

What Do You Think?

Why is it important for the federal government to have good collection policies for the money it is owed?



Working in the *Real World*

APPLYING YOUR ACCOUNTING KNOWLEDGE

When people cannot pay their debts, businesses must decide what to do about these losses. Retailers and banks are examples of businesses that are likely to have customers who fail to pay what they owe. When a business cannot collect the amounts it is owed, it records them in the accounting records. In this chapter you will learn how to estimate and record uncollectible amounts.

Personal Connection

1. Does your workplace have customers who fail to pay what they owe?
2. How does the business handle amounts it cannot collect?

Online Connection

Go to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Working in the Real World** and select **Chapter 24**.





SECTION 1

BEFORE
You

READ

Main Idea

A business using the direct write-off method converts an account receivable to an expense when it becomes clear the customer will not pay the bill.

Read to Learn...

- how and why businesses extend credit. (p. 698)
- how to write off an uncollectible account using the direct method. (p. 698)

Key Terms

uncollectible account
direct write-off method

As
You

READ

Key Point

Uncollectible

Accounts Writing off an uncollectible account converts an asset to an expense.

The Direct Write-Off Method

In previous chapters you learned that many businesses sell goods or services on account. Some charge customers cannot or will not pay the amounts they owe.

Extending Credit

Why Do Businesses Extend Credit?

Selling goods and services on credit is a standard practice for businesses of all sizes and types. They offer credit because they expect to sell more than they would by accepting only cash.

Retail stores typically ask customers seeking to purchase on account to complete a credit application. Before a business extends credit, it should check each prospective customer's credit rating to help determine the customer's ability to pay the amounts charged on account. Businesses get these credit ratings from the national consumer-credit-reporting companies Equifax, Experian, and TransUnion. Wholesalers and manufacturers use reports from wholesale credit bureaus and national credit-rating organizations such as Dun & Bradstreet.

An **uncollectible account**, or *bad debt*, is an account receivable that the business cannot collect. The business eventually removes the account receivable from its records, and the amount becomes an expense to the business. Businesses account for bad debts by using the *direct write-off method* or the *allowance method*.

The Direct Write-Off Method

What Is the Direct Write-Off Method?

The *direct write-off method* is used primarily by small businesses and those with few charge customers. Under the **direct write-off method**, when the business determines that the amount owed is not going to be paid, the uncollectible account is removed from the accounting records. **Uncollectible Accounts Expense** is debited and **Accounts Receivable** (both controlling and subsidiary) is credited. The direct write-off method is the only method a business can use for income tax purposes.

Writing Off an Uncollectible Account

On June 4 On Your Mark Athletic Wear sold football equipment on account to Robert Galvin for \$250 plus \$15 sales tax. It recorded the transaction as a \$265 debit to **Accounts Receivable** (controlling) and the subsidiary account **Accounts Receivable—Robert Galvin** and as a credit to **Sales** for \$250 and **Sales Tax Payable** for \$15.

For over a year, On Your Mark tried to collect this account. The length of time is one consideration used to determine uncollectible accounts receivable. It is now apparent that Robert Galvin is not going to pay the \$265.

In effect, a business must decrease total assets and increase total expenses when a customer fails to pay a debt. On Your Mark must decrease its **Accounts Receivable** account and increase its expense related to uncollectible accounts.

Business Transaction

On August 25, 2011, On Your Mark wrote off as uncollectible Galvin's account for \$265, Memorandum 170.

ANALYSIS	Identify	1. The accounts affected are Uncollectible Accounts Expense , Accounts Receivable (controlling), and Accounts Receivable—Robert Galvin (subsidiary).
	Classify	2. Uncollectible Accounts Expense is an expense account. Accounts Receivable (controlling) and Accounts Receivable—Robert Galvin (subsidiary) are asset accounts.
	+/-	3. Uncollectible Accounts Expense is increased by \$265. Accounts Receivable (controlling) and Accounts Receivable—Robert Galvin (subsidiary) are decreased by \$265.

DEBIT-CREDIT RULE	4. Increases to expense accounts are recorded as debits. Debit Uncollectible Accounts Expense for \$265.
	5. Decreases to asset accounts are recorded as credits. Credit Accounts Receivable (controlling) and Accounts Receivable—Robert Galvin (subsidiary) for \$265.

T ACCOUNTS	6. Uncollectible Accounts Expense <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; text-align: center; padding: 5px;">Debit + 265</td> <td style="width: 50%; text-align: center; padding: 5px;">Credit —</td> </tr> </table>	Debit + 265	Credit —	Accounts Receivable <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; text-align: center; padding: 5px;">Debit + 265</td> <td style="width: 50%; text-align: center; padding: 5px;">Credit —</td> </tr> </table>	Debit + 265	Credit —	Accounts Receivable Subsidiary Ledger Robert Galvin <table border="1" style="width: 100%; border-collapse: collapse;"> <tr> <td style="width: 50%; text-align: center; padding: 5px;">Debit + 265</td> <td style="width: 50%; text-align: center; padding: 5px;">Credit —</td> </tr> </table>	Debit + 265	Credit —
Debit + 265	Credit —								
Debit + 265	Credit —								
Debit + 265	Credit —								

JOURNAL ENTRY	7. GENERAL JOURNAL <table border="1" style="width: 100%; border-collapse: collapse;"> <thead> <tr> <th style="width: 10%;"></th> <th style="width: 15%; text-align: center;">DATE</th> <th style="width: 45%; text-align: center;">DESCRIPTION</th> <th style="width: 10%; text-align: center;">POST. REF.</th> <th style="width: 10%; text-align: center;">DEBIT</th> <th style="width: 10%; text-align: center;">CREDIT</th> <th style="width: 10%;"></th> </tr> </thead> <tbody> <tr> <td>1</td> <td style="text-align: center;">2011</td> <td></td> <td></td> <td></td> <td></td> <td>1</td> </tr> <tr> <td>2</td> <td style="text-align: center;">Aug. 25</td> <td style="text-align: center;"><i>Uncollectible Accounts Expense</i></td> <td></td> <td style="text-align: right;">265 00</td> <td></td> <td>2</td> </tr> <tr> <td>3</td> <td></td> <td style="text-align: center;"><i>Accts. Rec./Robert Galvin</i></td> <td></td> <td></td> <td style="text-align: right;">265 00</td> <td>3</td> </tr> <tr> <td>4</td> <td></td> <td style="text-align: center;"><i>Memorandum 170</i></td> <td></td> <td></td> <td></td> <td>4</td> </tr> <tr> <td>5</td> <td></td> <td></td> <td></td> <td></td> <td></td> <td>5</td> </tr> </tbody> </table>		DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT		1	2011					1	2	Aug. 25	<i>Uncollectible Accounts Expense</i>		265 00		2	3		<i>Accts. Rec./Robert Galvin</i>			265 00	3	4		<i>Memorandum 170</i>				4	5						5
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT																																						
1	2011					1																																					
2	Aug. 25	<i>Uncollectible Accounts Expense</i>		265 00		2																																					
3		<i>Accts. Rec./Robert Galvin</i>			265 00	3																																					
4		<i>Memorandum 170</i>				4																																					
5						5																																					

ACCOUNT <u>Accounts Receivable</u>			ACCOUNT NO. <u>115</u>		
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE
					DEBIT
2011					
Aug. 1	Balance	✓			7 8 2 1 42
25	Write-off	G13		2 6 5 00	7 5 5 6 42

ACCOUNT <u>Uncollectible Accounts Expense</u>			ACCOUNT NO. <u>675</u>		
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE
					DEBIT
2011					
Aug. 25		G13	2 6 5 00		2 6 5 00

NAME Robert Galvin

ADDRESS 10223 Riggs Circle, Mesquite, TX 75181

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE
2010					
June 4		S14	2 6 5 00		2 6 5 00
2011					
Aug. 25	Written off as uncollectible	G13		2 6 5 00	—

Figure 24-1 Ledger Accounts After an Uncollectible Write-Off

Figure 24-1 shows how this transaction is posted to the general ledger and the accounts receivable subsidiary ledger.

Notice the explanation entered in Robert Galvin's account. When an account is written off as uncollectible, it is important to note on the subsidiary ledger that the account was not paid off but was written off.

Collecting a Written-Off Account

Occasionally, a charge customer whose account was written off as uncollectible later pays the amount owed. When this happens:

- First, reinstate the customer's account, or reenter it in the accounting records.
- Second, record the cash receipt.

Business Transaction

On September 5 On Your Mark received \$265 from Robert Galvin, whose account was written off as uncollectible on August 25, Memorandum 176 and Receipt 1109. First reinstate the account receivable.

ANALYSIS *Identify*

Classify

+/-

1. The accounts affected are **Accounts Receivable** (controlling), **Accounts Receivable—Robert Galvin** (subsidiary), and **Uncollectible Accounts Expense**.
2. **Accounts Receivable** (controlling) and **Accounts Receivable—Robert Galvin** (subsidiary) are asset accounts. **Uncollectible Accounts Expense** is an expense account.
3. **Accounts Receivable** (controlling) and **Accounts Receivable—Robert Galvin** (subsidiary) are increased by \$265. **Uncollectible Accounts Expense** is decreased by \$265.

DEBIT-CREDIT RULE

- Increases to asset accounts are recorded as debits. Debit **Accounts Receivable** (controlling) and **Accounts Receivable—Robert Galvin** (subsidiary) for \$265.
- Decreases to expense accounts are recorded as credits. Credit **Uncollectible Accounts Expense** for \$265.

T ACCOUNTS

6. Accounts Receivable		Uncollectible Accounts Expense	
Debit +	265	Credit -	
Accounts Receivable Subsidiary Ledger Robert Galvin			
Debit +	265	Credit -	

JOURNAL ENTRY

7. GENERAL JOURNAL						PAGE <u>14</u>
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	
1	2011					1
2	Sept. 5	Accts. Rec./Robert Galvin		265 00		2
3		Uncollectible Accts. Expense			265 00	3
4		Memorandum 176				4
5						5

After this transaction has been posted, the cash receipt is recorded as a debit to **Cash in Bank** for \$265 and a credit to **Accounts Receivable** (controlling) for \$265. Also, the subsidiary account **Accounts Receivable—Robert Galvin** is credited for \$265. Receipt 1109 is the source document for this entry.

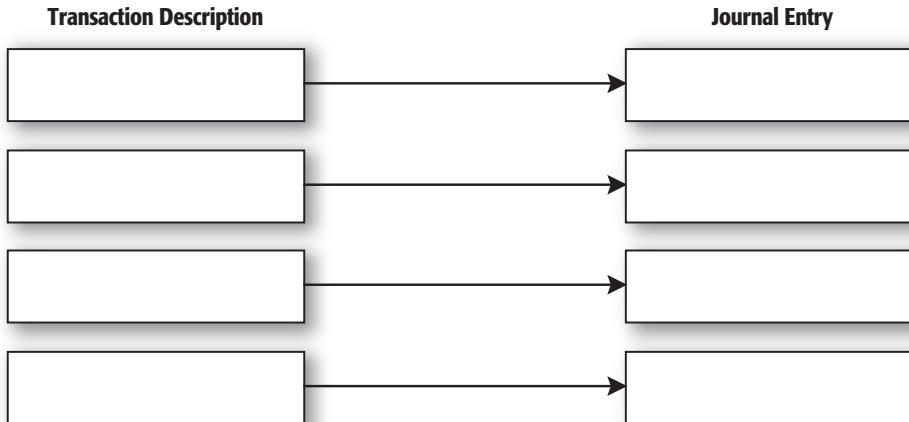
Robert Galvin's subsidiary ledger account in **Figure 24-2** contains data about the sale, write-off, reinstatement, and cash receipt.

NAME <u>Robert Galvin</u>					
ADDRESS <u>10223 Riggs Circle, Mesquite, TX 75181</u>					
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE
2010					
June 4		S14	265 00		265 00
2011					
Aug. 25	Written off as uncollectible	G13		265 00	
Sept. 5	Reinstated	G14	265 00		265 00
		G14		265 00	

Figure 24-2 Robert Galvin Account

Reinforce the Main Idea

Create a diagram similar to the one here to show four journal entries related to the direct write-off method of accounting for uncollectible accounts receivable.

**Do the Math**

You are the accounts receivable clerk for Fast and Friendly Shipping. The balance of the **Accounts Receivable** account is \$25,000. For six months you have been trying to collect the amounts owed by three companies: ABC Company, \$450; XYZ Company, \$500; and Nice Try Company, \$350. These accounts are still unpaid. Your supervisor asked you to write off these accounts using the direct write-off method. What is the balance of **Accounts Receivable** after you write off these accounts as uncollectible?

**Problem 24-1 Using the Direct Write-Off Method**

The Parker Supply Company uses the direct write-off method of accounting for uncollectible accounts.

Instructions In your working papers:

1. Record the following transactions on page 21 of the general journal.
2. Post the transactions to the appropriate accounts.

Parker Supply Company 

MEMORANDUM 78

TO: Accounting Clerk
FROM: Jon Herbert, Collection Manager
DATE: November 30, 20--
SUBJECT: Account write-off

It has been determined by the collection department that Account No. 4698214, Sonya Dickson, in the amount of \$630, is uncollectible. This memo is your authorization to write this amount off as uncollectible. Thank you.

Date	Transactions
Apr. 10	Sold merchandise on account to Sonya Dickson, \$600 plus \$30 sales tax, Sales Slip 928.
Nov. 30	Wrote off Sonya Dickson's account as uncollectible, \$630, Memorandum 78.
Dec. 30	Received \$630 from Sonya Dickson in full payment of her account. This account was written off on November 30, Memorandum 89 and Receipt 277.



SECTION 2

The Allowance Method



of accounting for uncollectible accounts. This method allows businesses to match revenue with the expenses incurred to earn that revenue. In this section you will learn about the allowance method and continue to journalize transactions involving uncollectible accounts.

Matching Uncollectible Accounts Expense with Revenue

Why Do Businesses Use the Matching Principle to Report Uncollectible Accounts?

When the direct write-off method of accounting for uncollectible accounts is used, an unpaid account is written off when the business determines that it will not be paid. Under the direct write-off method, it often happens that the sale is recorded in one period, and the uncollectible accounts expense is recorded in the following period. This violates the matching principle.

One of the fundamental principles of accounting is that *revenue should be matched with the expenses incurred in generating that revenue*. This means that expenses incurred to earn revenue should be deducted in the same period that the revenue is recorded. The uncollectible accounts expense should be reported in the year in which the sale takes place. However, the uncollectible account expense is usually not determined with certainty until some future period. That is, a credit sale in the year 2010 may not be determined to be uncollectible until some time in 2011. In order to conform to the matching principle, the credit sales are recorded in the year 2010 and an *estimate* of the uncollectible accounts expense is also recorded in 2010.

BEFORE
You

READ

Main Idea

A business using the allowance method estimates the bad debt expense and writes off that amount.

Read to Learn...

- why businesses apply the matching principle to accounts receivable. (p. 703)
- how businesses use the matching principle to recognize bad debt expense. (p. 704)

Key Terms

allowance method
book value of accounts receivable

The estimate of uncollectible accounts expense is recorded as an end-of-period adjustment. The adjusting entry meets two objectives:

1. **Accounts Receivable** is reduced to the amount the business can reasonably expect to receive.
2. The estimated uncollectible accounts expense is charged to the current period.

As You READ

Compare and Contrast

Reporting Uncollectible Accounts

Accounts How are the direct write-off method and the allowance method similar? How are they different?

The Allowance Method

How Do You Use the Allowance Method to Report Uncollectible Accounts Expense?

The **allowance method** of accounting for uncollectible accounts matches the estimated uncollectible accounts expense with sales made during the same period. At the end of the period, the accountant must calculate the uncollectible accounts expense that will result from the sales made during the period. The estimated uncollectible accounts expense is recorded as an adjustment on the work sheet. The two accounts affected by this adjustment are **Uncollectible Accounts Expense** and **Allowance for Uncollectible Accounts**.

When the adjustment is made, the business does not know exactly which charge customers will not pay the amounts they owe. Therefore, the estimated uncollectible amount cannot be credited to **Accounts Receivable** (neither the controlling nor the subsidiary). Since the **Accounts Receivable** account cannot be used to record the estimated uncollectible amount, another account is opened. This account is **Allowance for Uncollectible Accounts**.

Allowance for Uncollectible Accounts is used to summarize the *estimated* uncollectible accounts receivable of the business. It is classified as a contra asset account.

Allowance for Uncollectible Accounts	
Debit	Credit
–	+
Decrease Side	Increase Side
	Normal Balance

On Your Mark						
Work						
For the Year Ended						
ACCT. NO.	ACCOUNT NAME	TRIAL BALANCE		ADJUSTMENTS		
		DEBIT	CREDIT	DEBIT	CREDIT	
1 101	Cash in Bank	12 650 00				
2 115	Accounts Receivable	44 893 00				
3 117	Allowance for Uncollectible Accts.		125 00		(b) 1 350 00	
23 670	Supplies Expense	600 00				
24 675	Uncollectible Accounts Expense				(b) 1 350 00	
25						

Figure 24–3 Recording the Adjustment for Uncollectible Accounts on the Work Sheet

Business Transaction

On December 31 On Your Mark estimates its uncollectible accounts expense for the year ended December 31 to be \$1,350. (Various methods are used to estimate uncollectible accounts expense. You will learn about two of these methods later in this chapter.)

ANALYSIS	Identify Classify $+/-$	<ol style="list-style-type: none"> The accounts affected are Uncollectible Accounts Expense and Allowance for Uncollectible Accounts. Uncollectible Accounts Expense is an expense account. Allowance for Uncollectible Accounts is a contra asset account. Uncollectible Accounts Expense is increased by \$1,350. Allowance for Uncollectible Accounts is increased by \$1,350.
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DEBIT-CREDIT RULE

- 4. Increases to expense accounts are recorded as debits. Debit **Uncollectible Accounts Expense** for \$1,350.
- 5. Increases to contra asset accounts are recorded as credits. Credit **Allowance for Uncollectible Accounts** for \$1,350.

6. Uncollectible Accounts Expense		Allowance for Uncollectible Accounts	
Debit	Credit	Debit	Credit
+ 1,350	—	—	+ 1,350

GENERAL JOURNAL							PAGE <u>15</u>
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT		
1	20--	<i>Adjusting Entries</i>					1
2	Dec. 31	<i>Uncollectible Accts. Expense</i>		1 350 00			2
3		<i>Allow. for Uncollectible Accts.</i>				1 350 00	3
4							4
5							5

ADJUSTED TRIAL BALANCE		INCOME STATEMENT		BALANCE SHEET	
DEBIT	CREDIT	DEBIT	CREDIT	DEBIT	CREDIT
12 650 00				12 650 00	
44 893 00				44 893 00	
	1 475 00				1 475 00
60 000		60 000			
1 350 00		1 350 00			

Figure 24-3 Recording the Adjustment for Uncollectible Accounts on the Work Sheet (continued)

Instant Recall

Book Value Book value of a plant asset is the initial cost minus accumulated depreciation. Book value of accounts receivable is the controlling account balance minus the allowance for uncollectible accounts.

Allowance for Uncollectible Accounts appears on the balance sheet as a deduction from Accounts Receivable. By using Allowance for Uncollectible Accounts:

- The balance of Accounts Receivable still equals the total of the customer accounts in the subsidiary ledger.
- The balance of Allowance for Uncollectible Accounts represents the amount the business *estimates* to be uncollectible.
- The difference between Accounts Receivable and Allowance for Uncollectible Accounts represents the book value of accounts receivable.

The **book value of accounts receivable** is the amount the business can reasonably expect to collect from its accounts receivable. Figure 24–3 on pages 704 and 705 illustrates how this adjustment is recorded and extended on the work sheet.

Notice that Allowance for Uncollectible Accounts has a \$125 balance in the Trial Balance Credit column. This balance is carried over from previous years. If the previous years' uncollectible accounts exactly equaled the estimate, Allowance for Uncollectible Accounts would have a zero balance. This seldom happens.

Also notice that the new balance is extended first to the Adjusted Trial Balance Credit column and then to the Balance Sheet Credit column.

Reporting Estimated Uncollectible Amounts on the Financial Statements

The Uncollectible Accounts Expense account appears on On Your Mark's income statement as an expense. See Figure 24–4 for the placement of the Uncollectible Accounts Expense account in its partial income statement.

Figure 24–4 Reporting Uncollectible Accounts on the Income Statement

On Your Mark Athletic Wear						
Income Statement						
For the Year Ended December 31, 20--						
<i>Operating Expenses</i>						
Supplies Expense					6 0 0 0 0	
Uncollectible Accounts Expense					1 3 5 0 0 0	
<i>Total Operating Expenses</i>					38 3 4 5 0 0	
<i>Operating Income</i>					24 6 9 8 0 0	

Figure 24–5 Reporting Allowance for Uncollectible Accounts on the Balance Sheet

On Your Mark Athletic Wear						
Balance Sheet						
December 31, 20--						
<i>Assets</i>						
<i>Cash in Bank</i>						12 6 5 0 0 0
<i>Accounts Receivable</i>				44 8 9 3 0 0		
Less: Allowance for				1 4 7 5 0 0	43	4 1 8 0 0
<i>Uncollectible Accounts</i>						

Instant Recall

Adjusting Entry An adjusting entry affects one *temporary* account and one *permanent* account.

On the balance sheet, **Allowance for Uncollectible Accounts** is listed immediately below **Accounts Receivable** in the Assets section. See On Your Mark's partial balance sheet in **Figure 24–5**.

Notice that the balances of **Accounts Receivable** and **Allowance for Uncollectible Accounts** are entered in the first amount column. The difference between the two balances—the book value of accounts receivable—is entered in the second amount column.

Journalizing the Adjusting Entry for Uncollectible Accounts

After the work sheet has been completed and the financial statements have been prepared, the adjusting entries are journalized. The information for the adjusting entries is found in the Adjustments section of the work sheet as shown in **Figure 24–3** on pages 704 and 705.

GENERAL JOURNAL							PAGE <u>14</u>
	DATE	DESCRIPTION		POST. REF.	DEBIT	CREDIT	
1	20--	<i>Adjusting Entries</i>					1
2	Dec. 31	<i>Uncollectible Accounts Expense</i>		675	1 350 00		2
3		<i>Allowance for Uncollectible Accounts</i>		117		1 350 00	3
4							4

ACCOUNT <u>Allowance for Uncollectible Accounts</u>			ACCOUNT NO. <u>117</u>				
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	DEBIT	CREDIT
20--							
Dec. 1	<i>Balance</i>	✓					1 250 00
31	<i>Adjusting Entry</i>	G14		1 350 00			1 475 00

ACCOUNT <u>Uncollectible Accounts Expense</u>			ACCOUNT NO. <u>675</u>				
DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE	DEBIT	CREDIT
20--							
Dec. 31	<i>Adjusting Entry</i>	G14	1 350 00		1 350 00		

See **Figure 24–6** for the way the adjusting entry for the estimated uncollectible accounts expense is recorded in the general journal and posted to the appropriate general ledger accounts.

At the end of the period, the balance of the **Uncollectible Accounts Expense** account is closed, along with the balances of the other expense accounts, to **Income Summary**. **Uncollectible Accounts Expense** has a zero balance at the beginning of the next period. The balance of **Allowance for Uncollectible Accounts** is not affected by the closing entries. It is a permanent account, and its balance at the beginning of the next period remains \$1,475.

Figure 24–6 Journalizing and Posting the Adjusting Entry for Uncollectible Accounts



Writing Off Uncollectible Accounts Receivable

When it becomes clear that a charge customer is not going to pay the amount owed, the accountant removes the uncollectible account from the accounting records.

Allowance for Uncollectible Accounts acts as a reservoir; that is, at the end of the period, the adjusting entry “fills it up.” The account balance is saved until it is needed some time in the future. When a charge customer’s account finally proves uncollectible, the business dips into that reservoir to write off the account. In other words **Allowance for Uncollectible Accounts** is reduced when a specific account is written off. Let’s look at an example.

Business Transaction

On April 18, after many attempts to collect the amount owed, On Your Mark decides to write off the account of Megan Sullivan for \$150, Memorandum 236.

ANALYSIS *Identify*

Classify

+/-

1. The accounts affected are **Allowance for Uncollectible Accounts**, **Accounts Receivable** (controlling), and **Accounts Receivable—Megan Sullivan** (subsidiary).
2. **Allowance for Uncollectible Accounts** is a contra asset account. **Accounts Receivable** (controlling) and **Accounts Receivable—Megan Sullivan** (subsidiary) are asset accounts.
3. **Allowance for Uncollectible Accounts** is decreased by \$150. **Accounts Receivable** (controlling) and **Accounts Receivable—Megan Sullivan** (subsidiary) are decreased by \$150.

DEBIT-CREDIT RULE

4. Decreases to contra asset accounts are recorded as debits. Debit **Allowance for Uncollectible Accounts** for \$150.
5. Decreases to asset accounts are recorded as credits. Credit **Accounts Receivable** (controlling) and **Accounts Receivable—Megan Sullivan** (subsidiary) for \$150.

T ACCOUNTS

6.		Allowance for Uncollectible Accounts		Accounts Receivable	
		Debit	Credit	Debit	Credit
		—	+		—
150					
Accounts Receivable Subsidiary Ledger Megan Sullivan					
		Debit	Credit		
		+	—		
				150	

JOURNAL ENTRY

7.

GENERAL JOURNAL					PAGE <u>16</u>
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
1	20--				1
2	Apr. 18	Allow. for Uncollectible Accts.		150 00	2
3		Accts. Rec./Megan Sullivan			150 00
4		Memorandum 236			4
5					5

Under the allowance method, the write-off of a specific account does not affect an expense account. Recall that the expense was already recorded as an adjusting entry.

The adjusting entry recorded the entire estimated expense for the period, not just this one customer's bad debt.

Collecting an Account Written Off by the Allowance Method

A charge customer whose account was written off as uncollectible might later pay the amount owed. When this happens:

- First, reinstate the customer's account.
- Second, record the cash receipt.

READ
In Your Own Words

Reinstatement What does it mean to *reinstate* an account receivable?

Business Transaction

On November 19 On Your Mark received a check for \$150 from Megan Sullivan, whose account was written off April 18, Memorandum 294 and Receipt 2243.

ANALYSIS *Identify*

1. The accounts affected are **Accounts Receivable** (controlling), **Accounts Receivable—Megan Sullivan** (subsidiary), and **Allowance for Uncollectible Accounts**.
2. **Accounts Receivable** (controlling) and **Accounts Receivable—Megan Sullivan** (subsidiary) are asset accounts. **Allowance for Uncollectible Accounts** is a contra asset account.
3. **Accounts Receivable** (controlling) and **Accounts Receivable—Megan Sullivan** (subsidiary) are increased by \$150. **Allowance for Uncollectible Accounts** is increased by \$150.

Classify
+/−
DEBIT-CREDIT RULE

4. Increases to asset accounts are recorded as debits. Debit **Accounts Receivable** (controlling) and **Accounts Receivable—Megan Sullivan** (subsidiary) for \$150.
5. Increases to contra asset accounts are recorded as credits. Credit **Allowance for Uncollectible Accounts** for \$150.

T ACCOUNTS

6.

Accounts Receivable		Allowance for Uncollectible Accounts	
Debit	Credit	Debit	Credit
+ 150	-	-	+ 150
Accounts Receivable Subsidiary Ledger Megan Sullivan			
Debit		Credit	
+ 150	-		

JOURNAL ENTRY



7.

GENERAL JOURNAL					PAGE <u>18</u>
	DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT
1	20--				1
2	Nov. 19	Accts. Rec./Megan Sullivan		150 00	2
3		Allow. for Uncollectible Accts.			3
4		Memorandum 294			4
5					5

After this transaction to reinstate the customer's account is posted, the cash receipt transaction is journalized and posted. **Figure 24–7** shows Megan Sullivan's account after the cash receipt transaction is posted. The account shows that:

1. The account had been declared uncollectible and was written off.
2. The account was reinstated.
3. The account was collected in full.

NAME Megan Sullivan

ADDRESS 883 Bisbee Drive, Dallas, TX 75211

DATE	DESCRIPTION	POST. REF.	DEBIT	CREDIT	BALANCE
20--					
Jan. 1	Balance	✓			150 00
Apr. 18	Written off as uncollectible	G16		150 00	
Nov. 19	Reinstated	G18	150 00		150 00
19		G18		150 00	

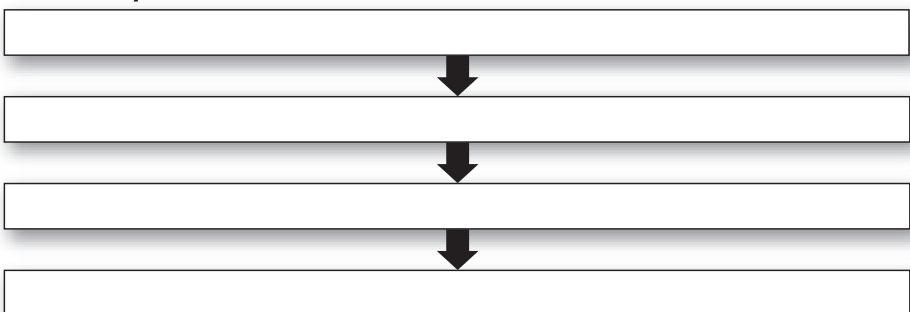
Figure 24–7 Megan Sullivan Account

AFTER You READ

Reinforce the Main Idea

Use a diagram like the one shown here to describe what happens when payment is received for an account receivable that had been written off.

When Payment is Received for an Account Receivable That Was Written Off



Do the Math

A review of the accounting records for Mary Sawyer's business, Secret Garden, revealed a disturbing trend. Her uncollectible accounts continue to increase. You suspect that Mary is far too nice about extending "in store" credit. You strongly recommend that she change her credit policies and collect on the outstanding accounts for this year. However Mary does not seem to understand the big picture, and she requested an illustration. Use a line graph to chart the uncollectibles for the past five years using the following figures.

Year 1	\$1,500	Year 4	\$2,422
Year 2	\$1,875	Year 5	\$2,800
Year 3	\$2,300		



Problem 24-2 Writing Off Accounts Using the Allowance Method

Taylor Furniture Company Inc. uses the allowance method to account for uncollectible accounts.

Instructions In your working papers:

1. Record the following transactions in the general journal on page 24.
2. Post the transactions to the appropriate accounts.
3. Prepare the Assets section of the balance sheet for Taylor Furniture Company Inc. using the partial general ledger in your working papers. The balance of other asset accounts are **Merchandise Inventory**, \$42,000; **Supplies**, \$1,500; and **Prepaid Insurance**, \$1,200.

Date	Transactions
May 4	Using the allowance method, wrote off the account of Jack Bowers for \$1,050 as uncollectible, Memorandum 241.
Nov. 18	Received \$1,050 from Jack Bowers in full payment of his account, which was written off May 4, Memorandum 321 and Receipt 1078.
Dec. 31	The adjusting entry for the estimated uncollectible accounts expense for the year ended December 31 was \$1,850.



SECTION 3

BEFORE
YOU

READ

Main Idea

Different methods can be used to estimate the allowance for uncollectible accounts. Two methods are *percentage of net sales* and *aging of accounts receivable*.

Read to Learn...

- how to use the percentage of net sales method. (p. 712)
- how to use the aging of accounts receivable method. (p. 713)

Key Terms

percentage of net sales method
aging of accounts receivable method

Estimating Uncollectible Accounts Receivable

As you learned in the previous section, businesses estimate the uncollectible accounts expense at the end of the period using the allowance method. In this section you will learn about the percentage of net sales and the aging of accounts receivable methods. These two ways to estimate uncollectible accounts expenses are based on judgment and past experience.

Percentage of Net Sales Method

How Do You Use Net Sales to Compute Uncollectible Amounts?

When using the **percentage of net sales method** for estimating uncollectible accounts expense, the business assumes that a certain percentage of each year's net sales will be uncollectible. To find the adjustment for uncollectible accounts expense:

1. Determine the percentage.
2. Calculate net sales.
3. Multiply net sales by the percentage.
4. Enter the amount calculated above on the work sheet.

Let's see how this method works. First, the percentage is determined. As you can see, in recent years On Your Mark's actual uncollectible accounts have been approximately 2 percent of net sales. On this basis, On Your Mark's accountant believes that the 2 percent figure should be used to estimate uncollectible accounts expense.

Year	Net Sales	Uncollectible Accounts	Percentage
2008	\$ 59,000	\$1,062	(1.8%)
2009	65,000	1,430	(2.2%)
2010	67,000	1,273	(1.9%)
Totals	\$191,000	\$3,765	(2.0%)

Second, the amount of net sales is calculated. Remember that net sales equals sales minus sales discounts and sales returns and allowances.

As shown, net sales for On Your Mark is \$67,500.

Sales	\$74,500
Less: Sales Discounts	\$3,000
Sales Returns and Allowances	<u>4,000</u>
Net Sales	<u>— 7,000</u> \$67,500

Third, the uncollectible accounts expense for the current year is determined by multiplying net sales by the percentage. On Your Mark's

uncollectible accounts expense for the period is estimated to be \$1,350 ($\$67,500 \times .02$).

Under this method the amount calculated is recorded as the adjustment on the work sheet and later is entered into the accounting records by journalizing the adjusting entry. At the beginning of the next period, **Allowance for Uncollectible Accounts** will have a credit balance of \$1,475 (\$1,350 adjustment plus \$125 existing balance in the account).

Aging of Accounts Receivable Method

How Do You Use Accounts Receivable to Compute Uncollectible Amounts?

The **aging of accounts receivable method** classifies the accounts receivables according to the number of days each account is past due. This method assumes that the longer an account is overdue, the less likely it is to be collected. Use these steps to find the adjustment for uncollectible accounts expense:

1. Age, or classify and group, each account according to the number of days it is past due.
2. Use past experience to determine the percentage of each group that will be uncollectible.
3. Multiply the uncollectible amount for each group by the percentage for that group.
4. Add the results for all groups.
5. Enter on the work sheet the total estimated uncollectible amount (calculated above) adjusted by any balance in **Allowance for Uncollectible Accounts**.

Let's look at an example. First, each customer account is *aged*, or classified and grouped according to the number of days it is overdue. The computer printout in **Figure 24–8** is a schedule of On Your Mark's aged accounts receivable that has grouped each customer account.

On Your Mark Athletic Wear ANALYSIS OF ACCOUNTS RECEIVABLE December 31, 20--							
Account ID	Customer's Name	Total Amount Owed	Not Yet Due	Days Past Due			
				1-30	31-60	61-90	Over 90
DIM	Joe Dimaio	\$ 300.00	\$ 300.00				
GAL	Robert Galvin	50.00			\$ 50.00		
KLE	Casey Klein	800.00					\$ 800.00
MON	Anita Montero	200.00	200.00				
RAH	Shashi Rahim	175.00				\$ 175.00	
RAM	Gabriel Ramos	1,000.00	1,000.00				
SUL	Megan Sullivan	40.00					\$ 40.00
TAM	Tammy's Fitness	225.00	225.00				
WON	Kim Wong	306.50		306.50			
YOU	Lara Young	750.00	750.00				
TOTALS		\$ 3,846.50	\$ 2,475.00	\$ 356.50	\$ 175.00	\$ 40.00	\$ 800.00

CULTURAL Diversity 
Mealtime When you host a business meal, be aware that your guests' eating and drinking choices may be tied to their religion or culture. Several religions prohibit pork. The Islamic religion outlaws both pork and alcohol. Hindus do not eat beef. Some cultures and religions are vegetarian.

Figure 24–8 Computer-Generated Analysis of Accounts Receivable

On Your Mark Athletic Wear AGING OF ACCOUNTS RECEIVABLE Estimated Uncollectible Amount December 31, 20--			
Age Group	Amount	Estimated Percentage Uncollectible	Estimated Uncollectible Amount
Not yet due	\$ 2,475.00	2%	\$ 49.50
1–30 days past due	356.50	4%	14.26
31–60 days past due	175.00	10%	17.50
61–90 days past due	40.00	20%	8.00
Over 90 days past due	800.00	80%	640.00
Total	\$ 3,846.50		\$ 729.26

Figure 24–9 Accounts Receivable Aging Schedule

Next, On Your Mark's accountant estimates what percentage of each group will be uncollectible based on past experience. The percentages range from 2 to 80 percent.

Third, the total uncollectible amount for each group is multiplied by the percentage for that group. The resulting amounts are the estimated uncollectible amounts for each group. The computer printout in **Figure 24–9** illustrates how the estimated uncollectible amount is determined from the accounts receivable analysis in **Figure 24–8**. As you can see, On Your Mark estimates that a total of \$729.26 of its accounts will be uncollectible. This total represents the end-of-period balance of **Allowance for Uncollectible Accounts**.

Finally, an adjustment is entered on the work sheet. This adjustment will bring the balance of **Allowance for Uncollectible Accounts** to \$729.26, the estimated amount.

Suppose the balance of **Allowance for Uncollectible Accounts** reported in the Trial Balance Credit column is \$49.80. To determine the adjustment, subtract the balance of **Allowance for Uncollectible Accounts** from the total estimated uncollectible amount. The adjustment amount is \$679.46 ($\$729.26 - \49.80).

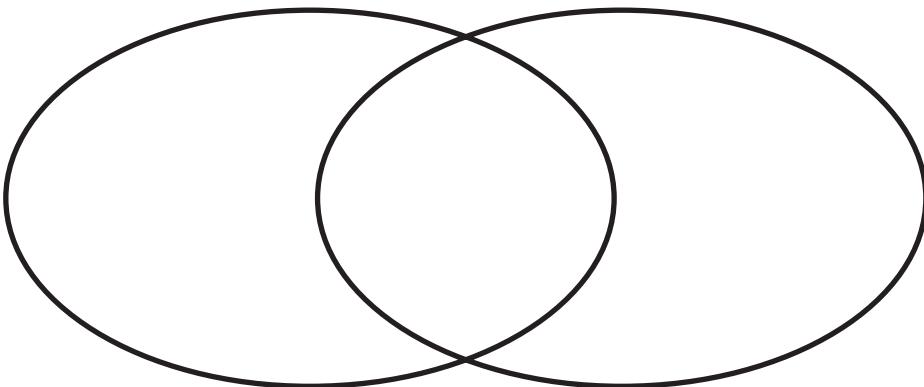
After the adjusting entry has been journalized and posted, the balance of **Allowance for Uncollectible Accounts** is \$729.26 (the balance as determined by the aging schedule).



Uncollectible Accounts Expense	Allowance for Uncollectible Accounts
Debit + Adj. 679.46	Credit - Debit - Bal. 49.80 Adj. 679.46 Bal. 729.26

Reinforce the Main Idea

Use a diagram like this one to compare and contrast the two methods for estimating uncollectible accounts discussed in Section 3.

**Do the Math**

Hernando's Card Shop is planning to expand. Before it expands, the owner wants to review the uncollectible accounts. Hernando asks you to calculate the percentage of uncollectible accounts per year.

	Net Sales	Uncollectible Accounts
Year 1	\$23,000	\$ 800
Year 2	28,750	1,200
Year 3	46,000	1,345
Year 4	52,000	1,150

**Problem 24-3 Estimating Uncollectible Accounts Expense Using the Percentage of Net Sales Method**

Following are the end-of-period account balances for several stationery and office supply companies. Each company uses the percentage of net sales method to estimate its uncollectible accounts expense. The percentage used by each company is also listed.

Instructions Using the form provided in your working papers:

1. Calculate the amount of the adjustment for uncollectible accounts expense using the percentage of net sales method.
2. Record the adjusting entry for the estimated uncollectible accounts expense for Davis Inc.

	Sales	Sales Discounts	Sales Returns and Allowances	Percentage of Net Sales Uncollectible
Andrews Co.	\$142,360	\$1,423	\$ 936	2
The Book Nook	209,100	3,180	1,139	1
Cable Inc.	173,270	1,730	1,540	1½
Davis Inc.	65,460	650	690	2
Ever-Sharp Co.	95,085	900	1,035	1¼

Key Concepts

- Customer accounts that are uncollectible are expenses to the business. When it is apparent that a customer account is uncollectible, it is written off using either the *direct write-off method* or the *allowance method*. The allowance method enables the business to match sales revenue and uncollectible accounts expense in the same period.
- An *uncollectible account*, or *bad debt*, is created when a customer fails to pay the amount due on account. **Allowance for Uncollectible Accounts** is used to summarize the *estimated* uncollectible accounts receivable of a business. The estimate is based on judgment and past experience.
- Write off a specific uncollectible account using the direct write-off method:

Allowance for Uncollectible Accounts	
Debit	Credit
—	+
Decrease Side	Increase Side
	Normal Balance

Uncollectible Accounts Expense	Accounts Receivable (controlling/subsidiary)
Debit + xxx	Credit —

- At the end of the fiscal period, the accountant calculates the amount of *bad debt expense* that will result from sales during the period. This estimated uncollectible account expense appears as an adjustment on the work sheet.
- Record the adjusting entry using the allowance method:

Uncollectible Accounts Expense	Allowance for Uncollectible Accounts
Debit + xxx	Credit —

- Write off a specific account using the allowance method:

Allowance for Uncollectible Accounts	Accounts Receivable (controlling/subsidiary)
Debit — xxx	Credit +

- When a charge customer whose account was previously written off pays the amount owed,
 - reinstate the customer's account, and
 - record the cash receipt.

Collection of an account that was written off using the direct write-off method.

- Reinstate the customer's account.

Accounts Receivable (controlling/subsidiary)	Uncollectible Accounts Expense
Debit + xxx	Credit — xxx

b. Record the cash receipt by debiting **Cash in Bank** and crediting **Accounts Receivable** (controlling and subsidiary).

Collection of an account that was written off using the allowance method.

a. Reinstate the customer's account.

Accounts Receivable (controlling/subsidiary)		Allowance for Uncollectible Accounts	
Debit	Credit	Debit	Credit
+ xxx	-	-	+ xxx

b. Record the cash receipt by debiting **Cash in Bank** and crediting **Accounts Receivable** (controlling and subsidiary).

8. Two common methods used to estimate uncollectible Accounts Receivable are the *percentage of net sales method* and the *aging of accounts receivable method*.

Percentage of net sales method:

$$\text{Net Sales} \times \text{Percentage of Net Sales Estimated Uncollectible} = \text{Uncollectible Accounts Expense}$$

Aging of accounts receivable method:

Age Group	Amount	×	Estimated Percentage Uncollectible	=	Estimated Uncollectible Amount
Not yet due	xxxxx		xx		xxxx
1–30 days past due	xxxxx		xx		xxxx
31–60 days past due	xxxxx		xx		xxxx
61–90 days past due	xxxxx		xx		xxxx
91–180 days past due	xxxxx		xx		xxxx
Over 180 days past due	xxxxx		xx		xxxx
Total					xxxx
Allowance for Uncollectible Accounts, end of period					→ xxxx

Key Terms

aging of accounts receivable method	(p. 713)	direct write-off method	(p. 698)
allowance method	(p. 704)	percentage of net sales method	(p. 712)
book value of accounts receivable	(p. 706)	uncollectible account	(p. 698)

AFTER
YOU

READ

Check Your Understanding

1. **Accounting for Uncollectible Accounts**
 - a. Explain the difference between the direct write-off method and the allowance method.
 - b. Which method is likely to be used by a business with many charge customers? Which is likely to be used by a business that sells mainly on a cash basis?
2. **Determining Uncollectible Accounts Receivable**
 - a. How does the direct write-off method identify the uncollectible accounts expense amount?
 - b. What factors does the allowance method consider in determining bad debt expense?
3. **Direct Write-Off Method**
 - a. Which accounting principle does the direct write-off method violate?
 - b. In the direct write-off method of recording an uncollectible account receivable, which accounts are debited and credited?
4. **Bad Debts Expense**
 - a. What is another term for *bad debts expense*?
 - b. What can businesses do to prevent bad debts?
5. **Adjusting Entry**
 - a. What accounts are debited and credited in the adjusting entry to record uncollectible accounts using the allowance method?
 - b. What is the account classification of **Allowance for Uncollectible Accounts**?
6. **Allowance Method**
 - a. When does the allowance method recognize the bad debt expense for a year's sales?
 - b. When a specific account receivable is written off using the allowance method, which accounts are debited and credited?
7. **Collecting a Written-Off Account**
 - a. What is the first journal entry made when a customer pays an amount that was previously written off? Name the accounts debited and credited for both methods.
 - b. In the second journal entry, which accounts are debited and credited?
8. **Estimating Uncollectible Accounts Expense**
 - a. Describe the percentage of net sales method.
 - b. Describe the aging of accounts receivable method.

Apply Key Terms

As a quick review of uncollectible accounts, define each of the following key terms and explain its relationship to **Accounts Receivable**.

aging of accounts
receivable method
allowance method

book value of accounts
receivable
direct write-off method

percentage of net sales
method
uncollectible account

Writing Off Uncollectible Accounts Receivable

Making the Transition from a Manual to a Computerized System

Task	Manual Methods	Computerized Methods
Preparing an aged accounts receivable report	<ul style="list-style-type: none"> Examine each customer account and organize it based on its due date. Using accounting stationery, list each customer's account in the appropriate past due columns. 	<ul style="list-style-type: none"> A preformatted report feature allows the accountant to generate an aging schedule. The software pulls data from information stored in the accounts receivable ledgers.
Writing off an uncollectible account	<ul style="list-style-type: none"> Determine the method to be used to write off uncollectible accounts. Record a general journal entry to record the write-off and post it to the general ledger and subsidiary ledger. Calculate new balances. 	<ul style="list-style-type: none"> Determine the method to be used to write off uncollectible accounts. Outstanding invoices due are tied to the customer's ID and assigned to the account, Allowance for Uncollectible Accounts.



Peachtree® Q & A

Peachtree Question	Answer
How do I set up defaults for the aging of Accounts Receivable ledgers in Peachtree?	<ol style="list-style-type: none"> From the Maintain menu, select Default Information. Select Customers to set or to change default information. (In Peachtree, Accounts Receivable ledgers are referred to as <i>customer accounts</i>.) Click on the Account Aging tab, and set the account defaults.
How do I write off an uncollectible account in Peachtree?	<ol style="list-style-type: none"> From the Tasks menu, select Receipts and enter the Customer ID. In the Cash Account field, select Allowance for Uncollectible Accounts. Click the Apply to Invoices tab. Select the Pay box next to the invoices you wish to write off.



QuickBooks Q & A

QuickBooks Question	Answer
How do I set up defaults for the aging of Accounts Receivable ledgers in QuickBooks?	<ol style="list-style-type: none"> From the Edit menu, select Preferences and click on Reports & Graphs. Click the Company Preferences tab. Choose either the Age from due date or Age from transaction radio button to set how Accounts Receivable are aged.
How do I write off an uncollectible account in QuickBooks?	<ol style="list-style-type: none"> From the Company menu, select Make General Journal Entries. Enter the date and reference, the debit amount, the description, and Uncollectible Accounts Expense as the account to be debited. Enter the credit amount, the description, the customer name, and Accounts Receivable as the account to be credited.

For detailed instructions, see your Glencoe Accounting Chapter Study Guides and Working Papers.

Complete problems using:

Manual Glencoe
Working Papers OR Peachtree Complete
Accounting Software OR QuickBooks
Templates**Peachtree®****SMART GUIDE****Step-by-Step Instructions:**
Problem 24-4

1. Select the problem set for Sunset Surfwear.
2. Rename the company and set the system date.
3. Record the transactions to write off bad debts and reinstate Alex Hamilton's account.
4. Print a Cash Receipts Journal, Sales Journal, Customer Ledgers, and General Ledger.
5. Complete the Analyze activity.
6. End the session.

Step-by-Step Instructions:
Problem 24-5

1. Select the problem set for InBeat CD Shop.
2. Rename the company and set the system date.
3. Record the uncollectible accounts adjustment.
4. Print the General Journal and General Ledger.
5. Complete the Analyze activity.
6. End the session.

QuickBooks**PROBLEM GUIDE****Step-by-Step Instructions:**
Problem 24-4

1. Restore the Problem 24-4.QBB file.
2. Record the transactions to write off bad debts and reinstate Alex Hamilton's account.
3. Print a Journal, General Ledger report, and Customer Balance Summary report.
4. Complete the Analyze activity.
5. Back up your work.

Problem 24-4 Using the Direct Write-Off Method

Sunset Surfwear uses the direct write-off method of accounting for uncollectible accounts.

Instructions

1. In your working papers, record the following transactions on page 14 in the general journal.
2. Post the transactions to the appropriate accounts.

Date	Transactions
June 1	Wrote off the \$288.75 account of Alex Hamilton as uncollectible, Memorandum 223.
4	Wrote off the \$243.60 account of Helen Jun as uncollectible, Memorandum 249.
14	Wrote off the \$57.75 account of Nate Moulder as uncollectible, Memorandum 255.
22	Received \$288.75 from Alex Hamilton in full payment of his account, Memorandum 298 and Receipt 944.
29	Wrote off the \$100.80 account of Martha Adams as uncollectible, Memorandum 329.

Analyze

Describe the impact on Accounts Receivable and Uncollectible Accounts Expense when an account is written off.

Problem 24-5 Calculating and Recording Estimated Uncollectible Accounts Expense

InBeat CD Shop uses the percentage of net sales method of accounting for uncollectible accounts. At the end of the period, the following account balances appeared on InBeat's trial balance:

Accts. Rec.	\$110,000	Allow. for Uncoll. Accts.	\$ 4,000
Sales	900,000	Sales Ret. and Allow.	50,000
Sales Disc.	10,000	Uncoll. Accts. Expense	—

Instructions

1. In your working papers, calculate the amount of the adjustment for uncollectible accounts for the period ended June 30. Management estimates that uncollectible accounts will be 1 percent of net sales.
2. Journalize the adjusting entry on page 8 in the general journal.
3. Post the adjusting entry to the general ledger accounts.

Analyze

Determine the book value of accounts receivable.

Problem 24–6 Writing Off Accounts Under the Allowance Method

Shutterbug Cameras uses the allowance method of accounting for uncollectible accounts.

Instructions

1. In your working papers, record the following transactions on page 9 in the general journal.
2. Post the transactions to the appropriate accounts.
3. Prepare the Assets section of the balance sheet for Shutterbug Cameras using the partial general ledger in the working papers. The balances of other asset accounts are **Merchandise Inventory**, \$33,000; **Supplies**, \$2,000; and **Prepaid Insurance**, \$1,200.

Date	Transactions
June 2	Wrote off the \$593.25 account of Kalla Booth as uncollectible, Memorandum 329.
9	Wrote off the \$840 account of Click Studios as uncollectible, Memorandum 343.
10	Received \$131.25 from Jimmy Thompson in full payment of his account, which was written off on November 10, Memorandum 349 and Receipt 210.
12	Wrote off the \$945 account of FastForward Productions as uncollectible, Memorandum 474.
30	Recorded the adjusting entry for estimated uncollectible accounts for the period. The uncollectible accounts expense estimate is based on 2 percent of the net sales of \$150,000.
30	Recorded the closing entry for Uncollectible Accounts Expense .

Analyze

Calculate the book value of the accounts receivable after the closing entries have been posted.

SOURCE DOCUMENT PROBLEM

Problem 24–6

Use the source documents in your working papers to record the transactions for this problem.

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SMART GUIDE

Step-by-Step Instructions: Problem 24–6

1. Select the problem set for Shutterbug Cameras.
2. Rename the company and set the system date.
3. Record the transactions.
4. Record the uncollectible accounts adjustment.
5. Record the closing entry for **Uncollectible Accounts Expense**.
6. Print Cash Receipts and Sales Journals, Customer Ledgers, General Journal, General Ledger, and Balance Sheet.
7. Complete the Analyze activity.
8. End the session.

QuickBooks

PROBLEM GUIDE

Step-by-Step Instructions: Problem 24–6

1. Restore the Problem 24–6.QBB file.
2. Record the transactions.
3. Record the adjustment for estimated uncollectible accounts.
4. Record the closing entry for **Uncollectible Accounts Expense**.
5. Print a Journal, Balance Sheet, General Ledger, and Customer Balance Summary.
6. Complete the Analyze activity.
7. Back up your work.

Problem 24–7 Estimating Uncollectible Accounts Expense

Cycle Tech Bicycles uses the allowance method of accounting for uncollectible accounts. The company estimates the uncollectible amount by aging its accounts receivable accounts.

Instructions

1. Complete the analysis of accounts receivable that is included in your working papers.
2. Calculate the estimated uncollectible amount. Use the form provided in your working papers.

CONTINUE

CHAPTER 24

Problems

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SMART GUIDE

Step-by-Step Instructions: Problem 24-7

1. Select the problem set for Cycle Tech Bicycles.
2. Rename the company and set the system date.
3. Complete the analysis of the accounts receivable in your workbook.
4. Record the uncollectible accounts adjustment.
5. Print a General Journal and General Ledger.
6. Complete the Analyze activity.
7. End the session.

Step-by-Step Instructions: Problem 24-8

1. Select the problem set for River's Edge Canoe.
2. Rename the company and set the system date.
3. Record the uncollectible accounts adjustment.
4. Print a General Journal.
5. Print a Balance Sheet, a Statement of Retained Earnings, and an Income Statement.
6. Click the **Save Pre-closing Balances** button.
7. Close the fiscal year.
8. Print a post-closing Trial Balance.
9. Complete the Analyze activity.
10. End the session.

Step-by-Step Instructions: Problem 24-9

1. Select the problem set for Buzz Newsstand.
2. Rename the company and set the system date.
3. Record the uncollectible accounts transactions.
4. Print a Cash Receipts Journal, Sales Journal, and Customer Ledgers.
5. Complete the Analyze activity.
6. End the session.

3. Journalize the June 30 adjusting entry for uncollectible accounts expense on page 11 of the general journal. Before the adjusting entry, Allowance for Uncollectible Accounts had a credit balance of \$142.
4. Post the adjusting entry to the general ledger accounts.

Analyze

Calculate the book value of accounts receivable.

Problem 24-8 Reporting Uncollectible Amounts on the Financial Statements

The work sheet for River's Edge Canoe & Kayak is included in your working papers. The trial balance is complete, and all of the adjustments except the one required for uncollectible accounts have been entered.

Instructions

1. Record the adjustment for uncollectible accounts expense in the Adjustments section of the work sheet. Uncollectible accounts are estimated to be 1.5 percent of net sales. Label the adjustment (a).
2. Complete the work sheet.
3. Prepare an income statement, a statement of retained earnings, and a balance sheet.
4. Record the adjusting entries on page 18 of the general journal.
5. Post the adjusting entries. Record and post the closing entries.

Analyze

Compute the balance of Allowance for Uncollectible Accounts before and after the adjusting entry.



Problem 24-9 Using the Allowance Method for Write-Offs

Buzz Newsstand uses the allowance method for uncollectible accounts.

Instructions

In your working papers, journalize the following transactions on page 13 in the general journal. Post the transactions to the account of Lee Adkins.

Date	Transactions
Jan. 14	Wrote off the \$194.50 account of Lee Adkins as uncollectible, Memorandum 498.
June 25	Received a check for \$30 from Lee Adkins on account, Memorandum 767 and Receipt 98.
Dec. 10	Received notice that Lee Adkins declared bankruptcy. Received 40 percent of the balance not paid, Receipt 288 and Memorandum 941.

Analyze

Conclude which account you would debit when writing off an account using the direct write-off method instead of the allowance method.

Practice your test-taking skills! The questions on this page are reprinted with permission from national organizations:

- Future Business Leaders of America
- Business Professionals of America

Use a separate sheet of paper to record your answers.



Future Business Leaders of America

MULTIPLE CHOICE

1. The _____ of accounting for uncollectible accounts matches potential bad debts expense with the sales from the same period.
 - direct write-off method
 - matching principle
 - aging of accounts receivable method
 - allowance method
2. Under the allowance method, the entry to record the estimated bad debts expense
 - has no effect on net income.
 - increases net income.
 - has no effect on total assets.
 - reduces total assets.
3. Cameron Corporation ages accounts receivable to estimate uncollectibles. The aging schedule estimates \$2,340 of uncollectible accounts. Prior to adjustment, allowance for uncollectible accounts has a debit balance of \$300. The expense reported on the income statement for uncollectibles will be
 - \$2,640.
 - \$2,040.
 - \$2,340.
 - \$300.
4. Vasquez Construction uses the percentage of sales method to estimate uncollectibles. Net credit sales for the current year amount to \$500,000 and management estimates 2% will be uncollectible. Allowance for doubtful accounts prior to adjustment has a debit balance of \$890. The amount of expense reported on the income statement will be
 - \$10,000.
 - \$10,890.
 - \$9,110.
 - \$890.



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MULTIPLE CHOICE

5. SPH, Inc. uses the direct write-off method for uncollectible accounts. The entry to record the \$64 invoice that Dave Case did not pay is
 - debit Accounts Receivable/Dave Case, credit Uncollectible Accounts Expense.
 - debit Allowance for Uncollectible Accounts, credit Accounts Receivable/Dave Case.
 - debit Uncollectible Accounts Expense, credit Accounts Receivable/Dave Case.
 - debit Uncollectible Accounts Expense, credit Cash.

Need More Help?

Go to glencoeaccounting.glencoe.com and click on Student Center. Click on Winning Competitive Events and select Chapter 24.

- Practice Questions and Test-Taking Tips
- Concept Capsules and Terminology



CRITICAL Thinking**CASE STUDY*****a matter of* ETHICS****Uncollectible Accounts Receivable**

1. Before a business extends credit, it should determine whether potential credit customers are likely to pay their bills. Explain why this is important.
2. Contrast the direct write-off method and the allowance method.
3. Prepare the journal entry to write off an uncollectible account using (a) the direct write-off method and (b) the allowance method.
4. Compare the journal entries to reinstate a customer account that had been written off using (a) the direct write-off method and (b) the allowance method.
5. To determine the amount of the adjustment for uncollectible accounts expense, develop (a) a formula for the percentage of net sales method and (b) a step-by-step procedure for the aging of accounts receivable method.
6. Evaluate (a) the direct write-off method and (b) the allowance method.

Merchandising Business: Formal Wear

The Black Tie rents formal attire. It accepts cash, debit cards, credit cards, and personal checks. To reserve an outfit requires a down payment. The balance, due 10 days after the return, is recorded as an account receivable. Lately the store has had problems collecting accounts receivable. Customers say they do not receive an invoice for the balance until it is past due.

INSTRUCTIONS

1. Develop a plan for quality that will reduce uncollectible accounts. Your plan must be attainable and measurable.
2. Determine how to implement your plan. Will you need to change procedures, modify the accounts receivable system, hire another clerk, or retrain personnel?

Early Write-Off

Suppose you are an accounts receivable clerk for an advertising agency. Your friend, Hector, owns a deli and has hired your agency to create an ad for a local magazine. Hector's business is having financial difficulties, and he asks you to write off his account although it should not be considered uncollectible yet.

ETHICAL DECISION MAKING

1. What are the ethical issues?
2. What are the alternatives?
3. Who are the affected parties?
4. How do the alternatives affect the parties?
5. What would you do?

Collecting an Outstanding Account

At The Music Connection, you handle accounts receivable and uncollectible accounts. Six months ago a new dance club bought an expensive, state-of-the-art music system on account. It is still unpaid. Write the customer a letter requesting payment. State that if payment is not received within 30 days, you will turn the account over to a collection agency.



Communicating Information

The Clothes Horse, a well-known retailer of men's apparel, is closing. Before it does it wants to collect all its accounts receivable.

INSTRUCTIONS Write a collection letter to send to all customers with outstanding balances now and a second letter to send in four weeks.

Transaction Risks

International companies strive to collect accounts receivable as quickly as possible. A firm that expects to receive payment in a foreign currency faces a *transaction risk* that currency values will change to its disadvantage between the time the contract is entered and the time payment is made.

INSTRUCTIONS Assume that British Airways purchases airplanes from Boeing, a U.S. manufacturer. Boeing agrees to accept British pounds for the purchase. British Airways takes three months to pay. Describe the transaction risk involved.

Credit Check

To obtain credit, you must complete a credit application. The business will check your income, banking record, current debt amount, debt payment record, age, employment history, current employer, address, and so on.

PERSONAL FINANCE ACTIVITY Imagine that you just graduated from high school, have a part-time job, and plan to work your way through college. What are some steps you can take to establish a good credit rating?

PERSONAL FINANCE ONLINE Log on to glencoeaccounting.glencoe.com and click on **Student Center**. Click on **Making It Personal** and select **Chapter 24**.

Horizontal Analysis

Horizontal analysis compares the same items on a financial statement for two or more accounting periods. For example you might compare the change in accounts receivable from one year to the next. Look at PETsMART's balance sheet in Appendix F on page A-46. To complete a horizontal analysis, subtract the item's base year amount (2003) from the current year amount (2004). Then calculate the result as a percentage of the base year amount.

The result is the increase or decrease over the base year.

INSTRUCTIONS Use PETsMART's balance sheet in Appendix F to complete the following.

1. Calculate the amount and percentage that total assets and total stockholders' equity changed from 2003 to 2004.
2. How does horizontal analysis provide useful information to a reader of a financial statement?



Write It Off

All types of companies can experience uncollectible accounts receivable. Visit glencoeaccounting.glencoe.com and click on **Student Center**. Click on **WebQuest** and select **Unit 5** to continue your Internet project.

