

## Valuation of Accounts Receivable

### Methods of Accounting for Uncollectible Accounts

#### Direct Write-Off

Theoretically deficient:

- ◆ No matching.
- ◆ Receivable not stated at cash realizable value.
- ◆ Not GAAP when material in amount.

#### Allowance Method

Losses are estimated:

- ◆ Percentage-of-sales.
- ◆ Percentage-of-receivables.
- ◆ GAAP requires when material in amount.

## Accounts Receivable

- Issues with bad debts
- Two methods
  - Direct write-off
  - Allowance method
- Advantage of allowance method
  - Matches revenue with expense (adjusting entry is required)
  - More accurate balance on the balance sheet (cash realizable value)

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LO 5 Explain accounting issues related to valuation of accounts receivable.

## Allowance Method for Uncollectible Accounts

Allowance method follows a two-step process:

1. It records an estimated **bad debt expense** in the period when the related sales take place, by making an adjusting journal entry at the end of that period.
2. It removes (write off) **accounts receivable** in the period they are determined to be uncollectible.

## Percent of Sales

### Income Statement Approach

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- Adjust entry for Allowance of Uncollectible Accounts (U/A)
  - $\text{U/A Amount} = \text{Revenue} \times \% \text{ given}$
  - Allowance account has a normal balance of a credit, during a write-off it has to be debited.
  - Uncollectible Account Expense (debit), Allowance for U/A (credit)

## Aging of Receivables

### Balance Sheet Approach

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- Adjust entry for Allowance of Uncollectible Accounts (U/A)
  - Pay attention to dates!
  - Multiply Account Receivables by Percent Uncollectible, add up the total and that will be the new ending balance of the Allowance Account
  - Using the beginning balance and the new ending balance of Allowance, find the amount for the necessary adjustment
  - Adjust by: Allowance account has a normal balance of a credit, during a write-off it has to be debited.
  - Uncollectible Account Expense (debit), Allowance for U/A (credit)