Accounts Receivable

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Accounts Receivable: The term **receivable** refers to amounts due from individuals or companies'. Receivables are claims that are expected to be collected in cash. The management of receivables is a very important activity for any company that sells goods or services on credit.

Accounts receivable: are amounts customers owe on account. They result from the sale of goods and services on account. Companies generally expect to collect accounts receivable within 30 to 60 days. They are usually the most significant type of claim held by a company.

Notes receivable: represent claims for which formal instruments of credit are issued as evidence of the debt. The credit instrument normally requires the debtor to pay interest and extends for time periods of 60–90 days or longer.

Notes and accounts receivable that result from sales transactions are often called trade receivables.

Other receivables: include nontrade receivables such as interest receivable, loans to company officers, advances to employees, and income taxes refundable. These do not generally result from the operations of the business. Therefore, they are generally classified and reported as separate items in the balance sheet.

To review, assume that Baghdad Co. on July 1, 2012, sells merchandise on account to Basra Company for ID 1,000 terms 2/10, n/30. On July 5, Basra returns merchandise worth ID100 to Baghdad Co. On July 11, Baghdad receives payment from Basra Company for the balance due. The journal entries to record these transactions on the books of Baghdad Co. are as follows:

July 1

Accounts Receivable—Basra Company 1000

Sales Revenue 1000

(To record sales on account)

July 5

Sales Returns and Allowances 100

Accounts Receivable—Basra Company 100

(To record merchandise returned)

July 11

Cash (ID900 - ID18) 882

Sales Discounts (ID900 × .02) 18

Accounts Receivable—Basra Company 900

(To record collection of accounts receivable)

Valuing Accounts Receivables

Once company records receivables in the accounts, the next question is: how should they report accounts receivables in the financial statements?

Companies' report receivables in the balance sheet as an asset, but determine the amount to report is sometime is difficult because some receivable become uncollectible. Companies record credit losses as debits to Bad Debts Expenses or Uncollectible Accounts Expenses.

Two methods are used in accounting for uncollectible accounts:

1- The direct write- off method

2- The allowance method

1. Direct write–off method

When a company determines a particular account to be uncollectible, it charges the loss to bad debts expense. For example, assume that on December 12 Basra Co. write off amount of ID 200 as uncollectible, the entry is:

Bad debts expense	200	
Accounts receivable		200

2. Allowance method

The allowance method of accounting for bad debts involves estimating uncollectible accounts at the end of each period. This provides better matching on the income statement, it also ensure that companies state receivables on the balance sheet at their net receivable value. Therefore, the Company will report bad debts expense in income statement. In addition, Allowance for doubtful accounts shown in balance sheet deducted from Accounts receivables this method provides good disclosure for the users of financial reporting.

Example: Assume that Basra Furniture co. has credit sales of ID 1200000 in 2010. At December 31, the credit manager estimates that ID 120000 of the sales will be uncollectible. The adjusting entry to record the estimated uncollectible is:

Bad debts expense	120000	
Allowance for doubtful accounts		120000
To record estimate of uncollectible accounts		

Bases used for estimating Allowance

1- Percentage of Sales

2- 2- Percentage of receivables

1-Percentage of sales:

In the percentage of sales, management estimates what percentage of credit sales will be uncollectible.

Example: Assume that Baghdad Company elects to use the percentage of sales as a base for estimating uncollectible accounts receivables. It estimated that 1% of credit sales will become uncollectible. The company has net credit sales of ID 800 000 in 2017 year.

Required: Calculate and record the bad debts expense of Baghdad Co.

Solution:

Bad debt expense = 800000 * 1% = 8000

bad debts expense 8000

Allowance for doubtful accounts 8000

To record estimated bad debts for year

After adjusted entry is posted, assuming the allowance account already has a credit balance of ID 1723, the related accounts of Baghdad Co. show the following:

Bad debts expenses	
Dec. 31 8000	

Allowance for doubtful accounts	
	Jan.1 Bal. 1723
	Dec.31 8000
	Dec.31 bal. 9723

2- **Percentage of Receivables:**

Under the percentage of receivable basis, management estimated what percentage of receivables will result in losses from uncollectible accounts.

Example: Assume that the balance of accounts receivables for Basra Company at Dec.31, 2017 is 100000. The management estimates that the percentage of bad debts is 2% of accounts receivables. The balance of the allowance for bad debts at Dec. 31, 2017 is ID 500.

Required: Compute and record the bad debts expense for 2017.

Solution:

Bad debts expense = 100000 * 2% = ID 2000

2000 – 500 = ID 1500 allowance for doubtful accounts

bad debts expense	1500	
Allowance for doubtful accounts		1500
To record bad debts for the year		

Example: The following balances are extracted from Baghdad's company records in 1/1/2016; Accounts receivables ID 9000, allowance for doubtful accounts ID 1000, and the following transactions were happened during the year.

1- On 1/5/2016 sold goods of ID 2000 on credit.

2- On 1/7/2016 collection from customers of ID 3000.

3- On 31/12/2016 write-off uncollectible accounts receivable ID 1500?

4- On 31/12/2016 estimated bad-debts for ID 900.

Required: Record the journal entries and its posting to general ledger.

Solution: journal entries

1/5/2016

Accounts receivable 2000

Sales 2000

To record sales on account

1/7/2016

Cash 3000

Accounts receivable 3000

To record cash collection from accounts receivables

1/12/2016

Bad debt expense 900

Allowance for doubtful accounts 900

To record bad debts for the year

31/12/2009

Allowance for doubtful accounts 1500

Accounts receivable 1500

To record write off bad debts

General ledger **Accounts receivables**

Debit	**Credit**
1/1/2016 balance ID 9000	1/7/2016 cash ID 3000
1/5/2016 sales ID 2000	31/12/2016 Allowance for doubtful accounts ID 1500
	31/12/2016 balance ID 6500
ID 11000	ID 11000

Allowance for doubtful accounts

Debit	Credit
31/12/2016 Accounts receivable ID 1500	1/1/2016 balance ID 1000
31/12/2016 balance ID 400	1/10/2016 bad-debt ID 900
ID 1900	ID 1900

Q1: The following information is extracted from Basra Company.
1- Balances on 1/1/2007: balances of accounts receivables ID 13000, allowance for doubtful accounts ID 1000.

2- On 1/5/2007 sold goods for ID 6000 on account.

3- On 1/7/2007 collected ID 5000 from customers.

4- On 31/12/2007 write-off uncollectible accounts receivable for ID 2500.

5- On 1/10/2007 estimated that bad-debts of ID 2000

Required:
1- Record the journal entries for the above transaction.

2- Post the entries to the general ledger.

3- Show the details of accounts receivables at the end of period and the partial balance sheet.