

Uncollectible Accounts

A business sells on account to encourage sales. Customers can buy merchandise even though they will not have the cash needed to pay the account until days or months later. A business that sells on account expects full payment within the terms of the sale. Before selling to a customer on account, management should perform a thorough credit check on a customer. A credit customer's financial condition may decline over time. Business customers may experience increased competition or a catastrophic event, such as a weather disaster. Individual customers may lose their employment. Regardless of the reason, creditworthy customers may later be unable to pay their accounts. Accounts receivable that cannot be collected are known as uncollectible accounts.

Estimating and Recording Uncollectible Accounts Expense

Allowing customers to buy now and pay later is an effective method for increasing sales. Unfortunately, some customers may later become unable or unwilling to pay their account. These uncollectible accounts must be recorded as an expense.

The allowance method of recording losses from uncollectible accounts attempts to match the expense of uncollectible accounts in the same fiscal year the related sales are recorded. At the end of the fiscal year, the business does not know which specific accounts will become uncollectible. Therefore, an estimate of the uncollectible accounts is recorded to the contra asset account "Allowance for Uncollectible Accounts" and the expense account "Uncollectible Accounts Expense".

As we discussed the other day, the percentage of total sales on account method of estimating uncollectible accounts expense assumes that a portion of every sale on account dollar will become uncollectible.

Example: Restaurant Supply

Restaurant Supply has estimated that 1% of its \$1,287,330.00 sales on account, or \$12,873.30, will eventually become uncollectible. At the end of the fiscal period, an adjustment for uncollectible accounts expense is planned on a worksheet. The Allowance for Uncollectible Accounts balance in the trial balance credit column, \$280.00, is the allowance estimate from the previous fiscal period that has not yet been identified as uncollectible.

TRIAL BALANCE

ACCOUNT TITLE	UNADJUSTED		Adjustments		ADJUSTED	
	Debit	Credit	Debit	Credit	Debit	Credit
<i>Accounts Receivable</i>	142,624.50				142,624.50	
<i>Allowance for Uncollectible Accounts</i>		280.00	12,873.30			13,153.30
<i>Uncollectible Accounts Expense</i>			12,873.30		12,873.30	

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2016 Date	Account Title	Doc. No.	Post. Ref.	Debit		Credit	
December 31	<i>Uncollectible Accounts Expense</i>			12	873.30		
	<i>Allowance for Uncollectible Accounts</i>					12	873.30

The adjustment for uncollectible accounts expense planned on the worksheet is recorded as an adjusting entry in the general journal and then posted to the general ledger. Note that the adjusting entry will not affect the balance of Accounts Receivable.

The book value of accounts receivable on December 31, 2016 is \$129,471.20, calculated by taking the balance of accounts receivable, \$142,624.50, and subtracting the adjusted balance of allowance for uncollectible accounts, \$13,153.30.

Writing Off Accounts Receivable

When a specific customer account is determined to be uncollectible, a journal entry is made to cancel the uncollectible account. The entry cancels the uncollectible amount from the general ledger account Accounts Receivable as well as the customer account in the accounts receivable subsidiary ledger. Canceling the balance of a customer account balance because the customer does not pay is called **writing off an account**.

Example: Restaurant Supply

After months of unsuccessful collection efforts, Restaurant Supply decides that the past-due account of Metro Food Court is uncollectible.

January 4 Wrote off Metro Food Court's past-due account as uncollectible, \$1,621.00. M3.

Because the account of Metro Food Court has been determined to be uncollectible, the \$1,621.00 is now an actual uncollectible amount. Therefore, the amount of the uncollectible account is deducted from the allowance account. Accounts receivable is credited to reduce the balance due from customers. Metro Food Court's account is also credited to cancel the debit balance of the account. Metro Food Court's account is written off.

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2018 Date	Account Title	Doc. No.	Post. Ref.	Debit					Credit					
January 4	Allowance for Uncollectible Accounts	M3	1140	1	6	2	1	00						
	Accounts Receivable - Metro Food Court		1130 110						1	6	2	1	00	

GENERAL LEDGER

Account: ACCOUNTS RECEIVABLE			Account No: 1130																								
2018 Date	Item	Post. Ref.	Debit					Credit					Balance														
													Debit					Credit									
January 1	Balance	✓											78	3	4	0	30										
	4	GI						1	6	2	1	00						76	7	1	9	30					

Account: ALLOWANCE FOR UNCOLLECTIBLE ACCOUNTS			Account No: 1140																								
2018 Date	Item	Post. Ref.	Debit					Credit					Balance														
													Debit					Credit									
January 1	Balance	✓																13	1	5	3	30					
	4	GI	1	6	2	1	00																				

ACCOUNTS RECEIVABLE SUBSIDIARY LEDGER

Customer: METRO FOOD COURT			Customer No: 110																								
2018 Date	Item	Post. Ref.	Debit					Credit					Debit Balance														
													Debit Balance														
January 1	Balance	✓											1	6	2	1	00										
	4	GI						1	6	2	1	00											0	00			

