

## Chapter 4 Bad debts and allowance for doubtful accounts

### 4.2 Bad debts (壞帳)

**Bad debts** refer to the **accounts receivable** (應收帳款) that have been proved to be **uncollectible** (無法收回). Once a bad debt **arises** (出現時), it should be immediately **written off** (註銷) from the affected **debtor's account** (債務人的帳戶). If there is no **specific debtor's account** (特定的債務人的帳戶), we usually use **account receivable account** or **debtor account**. Due to bad debts would reduce the profits (利潤減少), it is regarded as one of the operating expenses (營運開支). Hence, the total of bad debts would be transferred to the **profit and loss account** as an **expense** (開支) at the end of an **accounting period** (在會計期末).

1. Write off a bad debt (記錄壞帳)

Dr Bad debt account  
Cr Debtor's account

2. Transferring the total of bad debts to the profit and loss account (把壞帳總額轉到損益帳戶)

Dr Profit and loss account  
Cr Bad debts account

#### Class work 1

1. Suppose Firm A sold goods on credit to the following debtors during the year ended 31 December 2009:

Jan 5 K Lau \$5,000 Feb 16 T Yeung \$2,400

On 17 May 2009, it was found that K Lau gone bankrupt and could only pay \$200 cash. On 20 August 2009, T Yeung also went bankrupt and could not pay anything back. Show how these matters would be recorded in S Lee's ledgers and journal for the year ended 31 December 2009.

#### K Lau

2009			\$	2009			\$
Jan	5	Sales	5,000	May	17	Cash	200
				"	17	Bad Debts	4,800
			5,000				5,000

#### T Yeung

2009			\$	2009			\$
Feb	16	Sales	2,400	Aug	20	Bad Debts	2,400

#### Bad Debts

2009			\$	2009			\$
May	17	K Lau	4,800	Dec	31	Profit and loss	7,200
Aug	20	T Yeung	2,400				
			7,200				7,200

#### Profit and Loss

2009			\$				
Dec	31	Bad Debts	7,200				

#### Journal

Date		Details	Dr	Cr
2009			\$	\$
May	17	Bad Debts	4,800	
		K Lau (debtor)		4,800
Aug	20	Bad Debts	2,400	
		T Yeung (debtor)		2,400
Dec	31	Profit and loss	7,200	
		Bad Debts		7,200

### 4.3 Bad debts recovered (壞帳收回)

Bad debts recovered (壞帳收回) refer to the debtor (債仔) to pay back (償還) the written off bad debt subsequently.

— The bad debt was recovered in the same accounting period (在同一會計期內收回)

1. Deducting the written off bad debts in the debtors and bad debts account (扣回在壞帳帳戶及債仔已註銷的壞帳款項)

Dr Debtor's account

Cr Bad debts account

2. Recording the receipt of payment (記錄收取債仔款項)

Dr Cash book (or Bank/Cash account)

Cr Debtor's account

#### Class work 2

1. The following is the accounts of K Lau and his bad debts.

##### K Lau

2009			\$	2009			\$
Jan	5	Sales	5,000	May	17	Cash	200
				"	17	Bad debts	4,800

##### Bad Debts

2009			\$				
May	17	K Lau	4,800				

If K Lau paid back by cheque in full on 10 December 2009, show the entries in the account.

##### K Lau

2009			\$	2009			\$
Jan	5	Sales	5,000	May	17	Cash	200
Dec	10	Bad Debts	4,800	"	17	Bad Debts	4,800
				Dec	10	Bank	4,800
			9,800				9,800

##### Bad Debts

2009			\$	2009			\$
May	17	K Lau	4,800	Dec	10	K Lau	4,800

##### Journal

Date		Details	Dr	Cr
2009			\$	\$
Dec	10	K Lau (debtor)	4,800	
		Bad debts		4,800
		Bank	4,800	
		K Lau (debtor)		4,800

— **The bad debt was recovered in a later accounting period (在其後的會計期收回)**

Because the bad debts accounts has been closed off (關閉) in the previous accounting period (在上一會計期間), we need to open a separate account (獨立賬戶), **bad debts recovered** to record the bad debts recovered. Due to bad debts recovered would increase the profits (利潤增加), it is regarded as one of the **other revenue (其他收益)**. At the end of an accounting period, the total of bad debts recovered would be **transferred to the profit and loss account (轉到損益帳戶)** as **other revenue (其他收益)**.

- Restating the debt in the debtor's account (把壞帳收回重列在壞帳收回及債仔帳戶內)  
 Dr Debtor's account  
 Cr Bad debts recovered account
- Recording the receipt of payment (記錄收取債仔款項)  
 Dr Cash book (or Bank/Cash account)  
 Cr Debtor's account
- Transferring the **total of bad debts recovered** to the profit and loss account at the end of an accounting period (在會計期末，把壞帳收回總額轉到損益帳戶)  
 Dr Bad debts recovered account  
 Cr Profit and loss account

**Class work 3**

- Mr Robinson, whose debt of \$500 had been written off in the previous financial year, paid back by cheque in full on 31 January 2009. Show the entries in **debtors** and **bad debts recovered** account if the accounting year ended on 31 March 2009.

**Robinson**

2009			\$	2009			\$
Jan	31	Bad debts recovered	500	Jan	31	Bank	500

**Bad Debts Recovered**

2009			\$	2009			\$
Mar	31	Profit and loss	500	Jan	31	Robinson	500

**Journal**

Date		Details	Dr	Cr
2009			\$	\$
Jan	31	Robinson (debtor)	500	
		Bad Debts Recovered		500
"	31	Bank	500	
		Robinson (debtor)		500
Mar	31	Bad Debts Recovered	500	
		Profit and loss		500

## 4.4 Allowance for doubtful accounts (呆帳準備)

An allowance for doubtful account should be made at the end of an accounting period for those **accounts receivable** (收帳款) that are likely to become **uncollectible** (無法收回). We need to open a separate account (allowance for doubtful accounts, allowance for bad debts, allowance for doubtful debts, or allowance for bad and doubtful debts) to record the likely uncollectible debts. Allowance for doubtful accounts is actually a **contra-asset account** (資產對銷帳戶). This is used together with the **account receivable** in order to determine the **net realizable value** (變現淨值) of accounts receivable.

There are two cases for recording allowance for doubtful account (呆帳準備的入帳，有下列兩種情況)

- **When the allowance is made for the first time** (首次作呆帳準備)
- **When the allowance is made in subsequent periods** (其後的會計期所作的呆帳準備)

### When the allowance is made for the first time (首次作呆帳準備)

the profit of accounts receivable must be decreased, they were seen as an expense. (應收帳利潤一定減少，所以被視為一項開支)

Dr Profit and loss account

Cr 'Allowance for doubtful accounts' account

### When the allowance is made in subsequent periods (其後的會計期所作的呆帳準備)

The allowance may increase or decrease to compare with the previous year. (對比上一年度呆帳準備，呆帳準備會有所增加或減少)

- (a) An **increase** in the allowance should be recorded as an **expense** (把增加了的準備視為費用)

Dr Profit and loss account (增加了的呆帳準備)

Cr 'Allowance for doubtful accounts' account (增加了的呆帳準備)

- (b) A **decrease** in the allowance should be recorded as **other revenue** (把減少了的準備視為其他收益)

Dr 'Allowance for doubtful accounts' account (減少了的呆帳準備)

Cr Profit and loss account (減少了的呆帳準備)

### Class work 4

1. A business started on 1 January 2004 and its financial year ends on 31 December each year. The following table shows the accounts receivable balance and bad debts written off during the years 2005-2008. In addition to the writing-off of bad debts, the business makes an allowance for doubtful accounts of 5% on the remaining accounts receivable. Complete the following table:

Year ended 31 Dec	Accounts receivable at the end of the year (before writing off bad debts)	Bad debts written off at year end	Net Accounts receivable	Allowance for doubtful	Increase/Decrease in allowance
2004	\$70,000	\$10,000	\$60,000	\$3,000	\$3,000
2005	\$80,000	\$5,000	\$75,000	\$3,750	\$750
2006	\$60,000	\$0	\$60,000	\$3,000	(\$750)
2007	\$70,000	\$6,000	\$64,000	\$3,200	\$200

Show the entities in the relevant accounts for 2007.

#### Bad Debts

2007			\$	2007			\$
Dec	31	Accounts receivable	6,000	Dec	31	Profit and loss	6,000

#### Allowance for Doubtful Accounts

2007			\$	2007			\$
Dec	31	Balance c/f	3,200	Jan	1	Balance b/f	3,000
				Dec	31	Profit and loss – Increase in allowance	200
			3,200				3,200

2. The allowance for doubtful accounts had a balance of \$1,500 as at 1 January 2010. On 31 December 2010, Bruce decided to increase the allowance for doubtful accounts to 8% of accounts receivable. Accounts receivable as at that date amounted to \$70,000. Draw up the journal entries of provision of doubtful debts for the year ended 31 December 2010.

Journal				
Date		Details	Dr	Cr
2010			\$	\$
Dec	31	Profit and loss – Increase in allowance $[(\$70,000 \times 8\%) - \$1,500]$	4,100	
		Allowance for Doubtful Accounts		4,100

**HKDSE (2018, 8)**

**(Correction of errors/Limited Company)**

- (A) Bright Company Limited had the following trade receivables balances:

Trade receivables, net \$  
294,000

- (i) Bad debts of \$9,700 had not been recorded in the books.
- (ii) The allowance for doubtful accounts, which had been provided at 2% on trade receivables, would be increased to 3% after a review of the economic environment.

REQUIRED: (a) Calculate the allowance for doubtful accounts of previous year and this year.

(b) Prepare the necessary journal entries to correct the above. Narrations are not required.

(a) The allowance for doubtful accounts of previous year =  $\$294,000/98\% \times 2\% = \$6,000$

The allowance for doubtful accounts of this year =  $(\$294,000/98\% - 9,700) \times 3\% = \$8,709$

(b)

Journal				
2017			Dr	Cr
December 31			\$	\$
(i)	Bad debts		9,700	
	Trade receivables			9,700
(ii)	Increase in allowance for doubtful accounts		2,709	
	Allowance for doubtful accounts $(\$8,760 - 6,000)$			2,709

## 4.5 Preparation of financial statements included Bad debts and allowance (編製包含壞帳及呆帳準備的財務報表)

When bad debts, bad debts recovered and allowance once occur in the accounting records, the financial statements should make the adjustments. (當壞帳，壞帳收回及呆帳準備一旦出現在會計賬目內，財務報表內相關項目就要作出調整)

### Adjustments summary (調整摘要)

項目	在損益表內	在資產負債表內
壞帳 (Bad debts)	須列示壞帳費用	不須列示
壞帳收回 (Bad debts recovered)	須列示壞帳收回收入	不須列示
呆帳準備 (allowance for doubtful debts)	不須列示	須列示在流動資產債務人內
增加呆帳準備 (allowance increase)	須列示呆帳準備增加費用	不須列示
減少呆帳準備 (allowance decrease)	須列示呆帳準備減少收入	不須列示

The increase/decrease in allowance for doubtful accounts and the bad debts written off would be shown in the income statement at the end of each year:

### Income Statement for the year ended 31 December (extract)

	2006	2007	2008	2009
	\$	\$	\$	\$
<i>Other revenues:</i>				
Decrease in allowance for doubtful accounts	---	---	---	250
<i>Expenses:</i>				
Bad debts	4,230	5,100	6,040	6,100
Increase in allowance for doubtful accounts	1,200	200	150	---

The net realizable value of accounts receivable would be shown in the balance sheet at the end of each year.

### Balance Sheets as at 31 December (extract)

	2006	2007	2008	2009
	\$	\$	\$	\$
<i>Current assets</i>				
Accounts receivable	60,000	70,000	77,500	65,000
Less Allowance for doubtful accounts	(1,200)	(1,400)	(1,550)	(1,300)
	<u>58,800</u>	<u>68,600</u>	<u>75,950</u>	<u>63,700</u>

The bad debts written off have already been deducted from the total of accounts receivable shown in the balance sheet

### Class work 4

3. Prepare an income statement and a balance sheet after adjusting for accruals, prepayments, bad debts and the allowance for doubtful accounts.

#### Trial Balance as at 31 March 2010

	Dr	Cr
	\$	\$
Sales		114,000
Purchases	85,000	
Returns	3,500	
Inventory	28,000	
Discounts		870
<b>Bad debts recovered</b>		<b>360</b>
Wages and salaries	10,600	
Rent	12,000	
Sundry expenses	680	
Office equipment	14,000	
Furniture and fittings	13,000	
Accounts receivable and payable	6,520	5,710
Allowance for doubtful accounts, 31 March 2009		260
Capital		55,000
Bank	2,900	
	<b>176,200</b>	<b>176,200</b>

Additional information:

- (i) Inventory as at 31 December 2010 was valued at \$22,000
- (ii) Accrued expenses include: wages \$1,000, sundry expenses \$200.
- (iii) Prepaid rent amounted to \$3,000.
- (iv) A bad debt of \$480 was to be written off.
- (v) A specific allowance of \$100 was to be made for a doubtful debtor's account, while a general allowance of 5% was to be made for the remaining accounts.

#### Required:

Prepare an income statement for the year ended 31 March 2010 and a balance sheet as at that date.

#### Income Statement for the year ended 31 March 2010

	\$	\$
<b>Sales</b>	<b>114,000</b>	
<b>Less Returns inwards</b>	<b>(3,500)</b>	<b>110,500</b>
<b>Less Cost of goods sold:</b>		
<b>Opening inventory</b>	<b>28,000</b>	
<b>Add Purchases</b>	<b>85,000</b>	
	<b>113,000</b>	
<b>Less Closing inventory (i)</b>	<b>(22,000)</b>	<b>(91,000)</b>
<b>Gross profit</b>		<b>19,500</b>
<b>Add Other revenues:</b>		
<b>Discount received</b>	<b>870</b>	
<b>Bad debts recovered</b>	<b>360</b>	<b>1,230</b>
		<b>20,730</b>
<b>Less Expenses:</b>		
<b>Wages and salaries (\$10,600 + \$1,000) (ii)</b>	<b>11,600</b>	
<b>Rent (\$12,000 – \$3,000) (iii)</b>	<b>9,000</b>	
<b>Sundry expenses (\$680 + \$200) (ii)</b>	<b>880</b>	
<b>Bad debts (iii)</b>	<b>480</b>	
<b>Increase in allowance for doubtful accounts {[\$100 + (\$6,520 – \$480 – \$100) x 5%] – \$260} (v)</b>	<b>137</b>	<b>(22,097)</b>
<b>Net loss</b>		<b>(1,367)</b>

**Balance sheet as at 31 March 2010**

	\$		\$	\$
<i>Non-current assets</i>				
Office equipment				14,000
Furniture and fittings				13,000
				27,000
<i>Current assets</i>				
Inventory (i)			22,000	
Accounts receivable (\$6,520 – \$480) (iv)	6,040			
Less Allowance for doubtful accounts (\$260 + \$137) (v)	(397)		5,643	
Prepaid expenses (iii)			3,000	
Bank			2,900	
			33,543	
Less <i>Current liabilities</i>				
Accounts payable	5,710			
Accrued expenses (\$1,000 + \$200) (ii)	1,200		(6,910)	
Net current assets				26,633
				53,633
<i>Capital</i>				
Balance as at 1 April 2009				55,000
Less Net loss for the year				(1,367)
				53,633