Account Receivable

lecture 4

Al-Mustaqbal University
College of Administrative Sciences
Department of Accounting

Assistant.lect Hussein Ali Hussein

Accounts Receivable

Receivables are also financial assets. Receivables (often referred to as loans and receivables) are claims held against customers and others for money, goods, or services.

Trade receivables usually the most significant item it possesses, into accounts receivable and notes receivable

Accounts receivable: Are oral promises of the purchaser to pay for goods and services sold. They represent “open accounts” resulting from short-term extensions of credit. A company normally collects them within 30 to 60 days.

Notes receivable : are written promises to pay a certain sum of money on a specified future date. They may arise from sales, financing, or other transactions. Notes may be short-term or long-term .

Example1: Assume that Baghdad Co. on July 1, 2012, sells merchandise on account to Basra Company for 1,000 ID terms 2/10, n/30. On July 5, Basra returns merchandise worth 100 ID 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)		

Valuation of Accounts Receivable

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 mount 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 ensures that companies state receivables on the balance sheet at their net realizable value.

Example 2 : Assume that Basra Furniture co. has credit sales of 1,200,000 ID in 2010. At December 31, the credit manager estimates that 120,000 ID 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		

Determining the allowance account :

1- **Percentage of Sales**
2- **Percentage of receivables**

1-Percentage of sales :

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

Example 3 : 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 800, 000 ID 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 4 : Assume that the balance of accounts receivables for Basra Company at Dec.31, 2017 is 100,000. 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 = 100,000 * 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 5 : The following balances are extracted from Baghdad's company records in 1/1/2016; Accounts receivables 9000 ID , allowance for doubtful accounts 1000 ID , And the following transactions were happened during the year.

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

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

3- On 1/12/2016 estimated bad-debts for 900 ID .

4- On 31/12/2016 write-off uncollectible accounts receivable 1500 ID .

Required: Record the journal entries .

Solution: journal entries

1/5/2016

Accounts receivable 2000

Sales 2000

<u>To record sales on account</u>

1/7/2016

Cash 3000

Accounts receivable 3000

<u>To record cash collection from accounts receivables</u>

1/12/2016

Bad debt expense 900

Allowance for doubtful accounts 900

<u>To record bad debts for the year</u>

31/12/2009

Allowance for doubtful accounts 1500

Accounts receivable 1500

<u>To record write off bad debts</u>