Lesson 8.2 - Accounting for Current Assets – Trade Receivables

Table of Contents

8.2.1 Trade Receivables

Trade receivables are amounts billed by a business to its customers when it delivers goods or services to them in the ordinary course of business.

These billings are typically documented on formal invoices, which are summarized in an accounts receivable aging report.

This report is commonly used by the collections staff to collect overdue payments from customers.

In the general ledger, trade receivables are recorded in a control account and individually recorded in Sub Ledger.

Trade receivable classified as current assets on the balance sheet because you expect to receive payment from customers within one year of the billing date.

8.2.2 Trade Receivables Aging Report

Accounts receivable aging is the process of distinguishing open accounts receivables based on the length of time an invoice has been outstanding.

Open accounts represent those account owing by your customer still not pay.

Accounts receivable aging is useful in determining the allowance for doubtful accounts.

The aged receivables report tabulates those invoices owed by length, often in 30-day segments, for quick reference.

Sample of Aging as below.

Accounts Receivable Aging

	Current	1-30 days	31-60 days	61-90 days	Over 90 days	**Total**
Company ABC	$200	$400	$0	$0	$0	$600
XYZ LLC	$0	$500	$100	$0	$0	$600
UVW Inc.	$0	$0	$1,000	$5,000	$2,500	$8,500
Total	$200	$900	$1,100	$5,000	$2,500	$9,700

8.2.3 Bad Debts

Bad debt refers to loans or outstanding balances owed that cannot be collected and must be written off.

This expense is a cost of doing business with customers on credit, as there is always some default risk inherent with extending credit.

When a company confirmed that the debts from a customer cannot be collected, the account shall be written off to profit & loss based on the following double entries.

Dr Bad Debts Written Off (P&L)

Cr Trade Receivables – ABC Company (Balance Sheet)

Loan to Other Receivables shall be written off as bad debts if confirmed such debts cannot be collected.

8.2.4 Bad Debts Recovered

Bad debt recovery is a payment received for a debt that was previously written off and considered uncollectible.

The receivable may come in the form of a loan, credit line, or any other accounts receivable.

Because it generally generates a loss when it is written off, bad debt recovery usually produces income.

When a previous debts had been written off now become recovered, the account shall account such recovery as other income and recorded as follows:

Dr Bank (amount being received and bank into company bank)

Cr Bad Debts Write Back

You may classify the bad debts recovery under Other Income by created a new chart of account name Bad Debts Write Back. Some account may directly credit into Bad Debts Written Off which classify under expenses. Both way are practically accepted.

8.2.5 Provision for Doubtful Debts

Provision for bad debts is the estimated percentage of total doubtful debt that needs to be account for.

It is nothing but a loss to the company which needs to be charged to the profit and loss account in the form of provision. This is to comply with the prudence concept because Financial Statement shall not overstate the assets value.

Therefore, the company shall carefully take into consideration of its credit risk and provide an acceptable level of doubtful debts. This is to report what if there is a default debt, what will be the company's value.

Generally, Provision of Doubtful Debts can be classified into:

a) Specific Provision
b) General Provision

8.2.6 Specific Provision for Doubtful Debts

A specific provision is one created in respect of identified receivables which have serious financial problems or have a dispute with the company.

For example , ABC Sdn Bhd owing the company RM120,000 and the company found that ABC Sdn Bhd might not be able to pay the debts as they go into cash flow problem. Therefore, the company specifically provide a doubtful Debts for ABC Sdn Bhd.

Account may enter as follow:

Dr Provision for Doubtful Debts – P&L

Cr Provision for Doubtful Debts - Balance Sheet

The company still not write off the debts therefore we cannot credit Trade Receivables – ABC Sdn Bhd.

8.2.7 General Provision for Doubtful Debts

There are two main ways to generally estimate an allowance for bad debts, this is called General Provision

a) the percentage sales method or

The company will be based on company estimation policy to provide certain percentage on sales to estimate for doubtful debts.

For example, 2% on this year sales

b) the percentage of the accounts receivable aging method.

The company will be based on company estimation policy to provide certain percentage on year end trade receivables balances after specific provision to estimate for doubtful debts.

For example, 5% on closing trade receivables after deducted specific provision and bad debts that had been written off.

Account may enter as per follow:

Dr Provision for Doubtful Debts – P&L

    Cr Provision for Doubtful Debts - Balance Sheet

8.2.8 Increased/Decreased in Provision of Doubtful Debts

The Doubtful debts shall be reviewed on a yearly basis to reflect the true value of the company. Any difference arises upon the reviewed can be categorized as:

a) Increase in provision of Doubtful Debts

Increase in provision means the company's sales or trade receivables value increase and this indirectly will increase the probably of default risk. Therefore, there will caused an increased in Doubtful Debts.

The increase in provision for doubtful debts will reduce the profit and reduce the value of the trade receivables in the balance sheet.

The different of this year Provision and Last Year provision shall charged to account as follow

Dr Provision for Doubtful Debts – P&L
Cr Provision for Doubtful Dents – Balance Sheet

For example, last year the debtors were $2,000 and Provision for Doubtful Debts calculated as $2,000 x 5% = $100

This year, the debtors are $3,000 and Provision for Doubtful Debts calculated as $3000 x 5% = $150

Now, compare this $150 with previous year of $100. There is an increase in provision for doubtful debts of $50.

Because the amounts of debts have increased, more bad debts will be expected in the future.

b) Decrease in provision of Doubtful Debts

Decrease in provision means the company's sales or trade receivables value reduce and this indirectly will decrease the probably of default risk. Therefore, there will caused a decreased in Doubtful Debts.

The decrease in provision for doubtful debts will increase the profit and increase the value of the trade receivables in the balance sheet.

The different of this year Provision and Last Year provision shall charged to account as follow

Dr Provision for Doubtful Debts – Balance Sheet
Cr Provision for Doubtful Dents – P&L

For example, last year the debtors were $4,000 and Provision for Doubtful Debts calculated as $4,000 x 5% = $200

This year, the debtors are $3,000 and Provision for Doubtful Debts calculated as $3000 x 5% = $150

Now, compare this $150 with previous year of $200. There is a decrease in provision for doubtful debts of $50.

Because the amounts of debts have decreased, less bad debts will be expected in the future.

8.2.9 Specific Provision Write Off / Write Back

It is like Increase or decreased in Doubtful Debts the only different is we are aware which debtors to write off / write back.

a) Specific Provision Write Off

Meaning the debtor that had been provided as Doubtful Debts now confirmed cannot be collected therefore, we need to write it off the receivables and write back the Provision for Doubtful Debts.

Account shall be entered as follows:

Dr Bad Debts Writ Off – P&L
    Cr Trade Receivables - BS

Dr Provision for Doubtful Debts – BS
    Cr Provision for Doubtful Debts – P&L

b) Specific Provision Write Back

Meaning the debtor that had been provided as doubtful debts now become collectible

Account shall be entered as follows:

Dr Bank
    Cr Trade Receivables

Dr Provision for Doubtful Debts – BS
    Cr Provision for Doubtful Debts – P&L

8.2.10 Summary

We should apply prudence concept when we prepare Finance Statement. Meaning we cannot overstate our assets and understated our liabilities.

For a company which carry on business may have a certain level of credit risk meaning customers might not be able to pay their debts. Therefore the company shall estimate a certain percentage to inform the user of Financial Statement that based on estimate or historical data the company might have a doubtful debts of certain amount.

Provision of Doubtful Debts is normally classified:

- Specific Provision
- General Provision

Specific provision is provided from a known customer. Whereas general provision is provide based on a certain percentage of company's sales value or closing trade receivables value.

Any Increased in provision will decreased the company's profit and assets' value. Whereas any decreased will increased the company's profit and assets' value.

Any Bad Debts that cannot be recovered shall be written off and charged to P&L. The company may credited its Other Income for Bad Debts which had been written off and later become recovered.