

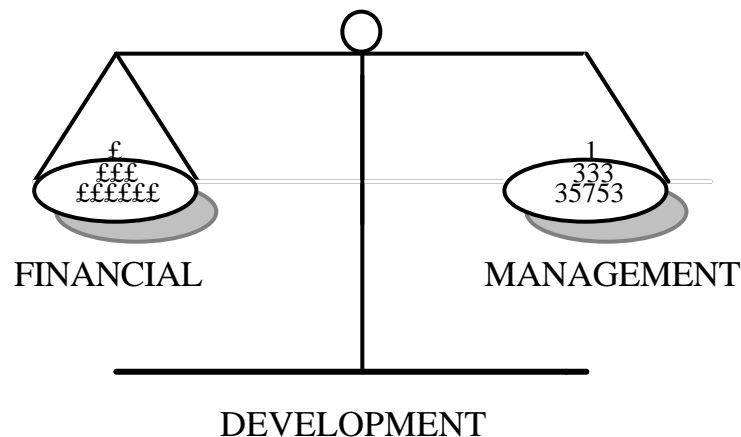
FINANCIAL MANAGEMENT DEVELOPMENT

Financial Accounting

Common Problem Areas

NO 141

ACCOUNTING FOR BAD DEBT AND DOUBTFUL DEBTS



ONE OF A SERIES OF GUIDES FOR
FINANCIAL MANAGEMENT DEVELOPMENT

FROM

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

ACCOUNTING FOR BAD DEBT AND DOUBTFUL DEBTS

OVERVIEW

It is a feature of commercial life that some sales on credit terms are never paid for. Most organisations recognise this and provide for it in their results. This note sets out how provisions and write offs are treated for accounting purposes.

EXAMPLE

A company sells 10 items at £1,000 each to 10 different customers. All amounts are payable after one month. Two months from the date of sale five customers have not paid. The company policy is to provide 5% on all debts over two months old and 30% on those over three months old. Provisions are retained until the customer goes into liquidation or until formal write off is approved.

Chronologically

Month 1	Sales of £10,000 are recorded
Month 3	A provision of 5% of £5,000 is made by charging £250 against profits
In Month 4	One customer pays £1,000
Month 4	An additional provision is made to bring the balance to 30% of £4,000, i.e. a further £950 is charged against profits
In Month 5	One customer goes into liquidation and another two customers pay their £2,000
Month 5	The £1,200 provision brought forward is reduced by the write off of £1,000 on the liquidation and an additional £100 is charged against profits to bring the balance to £300 i.e. 30% of the remaining £1,000 debt.

The debt and the provision are retained in the books until a decision is taken to provide more, to write the debt off, to accept partial payment or the debt is received.

In some countries there may be taxation benefits from certain treatment e.g.

1. General provisions may not be allowable as a cost for tax purposes but those specifically identified against named debtors may be allowed.
2. Sales taxes paid on debts later found to be bad may be recovered under certain circumstances.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development.

He has worked as a Financial Controller and Company Secretary in the Finance Industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over thirty major organisations including Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, The Post Office, Rothmans and Zeneca. International training experience includes work in Denmark, Kenya and the Czech Republic for Unilever, in Dubai for Al Atheer, in Holland and the U.S. for Avecia and Zeneca and in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. A key output from the training is demonstrable use of the knowledge and skills acquired to enhance corporate profitability. In addition he has run courses in acquisition evaluation (The Economist, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). He has also developed material for delivery by in house personnel (Royal Mail, Lloyds Bowmaker and Conoco) and computer based training packages (The Post Office, Unilever and BP).

He is a prolific writer of case studies, role plays and course material, he has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants and the need for taxation awareness training for general managers.

He is married with one grown up daughter and his outside interests include being The Treasurer of the Hospice of St. Francis (Berkhamsted), and a member of the Catholic Alpha Training Team (Promoting the Alpha course on Basic Christianity). He was a Governor of Luton University for nine years and a school Governor for four years.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).