

BAD DEBTS

Accounting for bad debt

Debts :The amount which is receivable from a person or a concern for supplying goods or services is called Debt. Debts may be classified into :

- a) Bad debts;
- b) Doubtful debts and
- c) Good debts

a) Bad Debts :

Bad debts are uncollectable or irrecoverable debt or debts which are impossible to collect is called Bad Debts. If it is definitely known that amount recoverable from a customer can not be realized at all, it should be treated as a business loss and should be adjusted against profit.

b) Doubtful Debts :

The debts which will be receivable or cannot be ascertainable at the date of preparing the final accounts (i.e., the debts which are doubtful to realise) is known as doubtful debts. Practically it cannot be treated as a loss on that particular date, as such, it cannot be written off. But, it should be charged against Profit and Loss Account on the basis of past experience of the firm.

c) Good Debts :

The debts which are not bad i.e., there is neither any possibility of bad debts nor any doubts about its realization, is called good debts. As such, no provision is necessary for it.

The debtors becoming bad are deleted from the list of debtors and the amount is deducted for the amount of gross debtors. On the balance amount provision for doubtful debt is created. Such provision is shown in the balance sheet by way of deduction from the net debtors. But in the ledgers, it is kept separately.

Accounting Steps

The 1st year

(a) For Bad Debts

| | | | |
|-----------------------|-----|--|--|
| Bad Debts A/c | Dr. | | |
| To Sundry Debtors A/c | | | |

(b) For creating provision for Doubtful Debts

| | | | |
|-------------------------------------|-----|--|--|
| Profit and Loss A/c | Dr. | | |
| To Provision for Doubtful Debts A/c | | | |

(c) For Transferring Bad Debts

| | | | |
|---------------------|-----|--|--|
| Profit and Loss A/c | Dr. | | |
| To Bad Debts A/c | | | |

The Second/ subsequent year

FIRST METHOD**(a) (i) For Bad Debts**

| | | | |
|-----------------------|-----|--|--|
| Bad Debts A/c | Dr. | | |
| To Sundry Debtors A/c | | | |

| | | | |
|--------------------------|-----|--|--|
| (ii) Profit and Loss A/c | Dr. | | |
| To Bad Debts A/c | | | |

(b) For provision of Doubtful Debts**(i) If closing provision is more than the opening provision-**

| | | | |
|-------------------------------------|-----|--|--|
| Profit and Loss A/c | Dr. | | |
| To Provision for Doubtful debts A/c | | | |

(ii) If Closing Balance is less than opening provision -

| | | | |
|----------------------------------|-----|--|--|
| Provision for Doubtful Debts A/c | Dr. | | |
| To Profit and Loss A/c | | | |

SECOND METHOD**(i) For Bad Debts**

| | | | |
|-----------------------|-----|--|--|
| Bad Debts A/c | Dr. | | |
| To Sundry Debtors A/c | | | |

| | | | |
|---------------------------------|-----|--|--|
| (ii) Provision for Bad Debt A/c | Dr. | | |
| To Bad Debts A/c | | | |

(iii) Compare the balance in the PBDD with the closing provision required and the provision is either created or reversed.**Provision for Discount On Debtors:**

We know that Cash discount is allowed by the suppliers to customer for prompt settlement of cash. Naturally a provision is created for this purpose. Thus, the provision which is created on Sundry Debtors for allowing discount on receipt of Cash in that accounting period is called Provision for Discount on Debtors.

Discount should be calculated at a specified rate on of debtors (i.e. after deducting bad debts and provision for bad debts). The accounting steps are same as discussed above.

Recovery of Bad Debts

We know that bad debt is a loss and as much, transferred to current year's Profit and Loss Account. Now, if the amount of bad dent is received in any succeeding year the same will be credited to Profit and Loss of that year as an income that is, recovery of bad debt is as income i.e., clear profit.

Accounting Steps**(a) When bad debts are recovered**

| | | | |
|---------------------------|-----|--|--|
| Cash/Bank A/c | Dr. | | |
| To Bad Debts Recovery A/c | | | |

(b) When the same is transferred

| | | | |
|------------------------|-----|--|--|
| Bad Debts Recovery A/c | Dr. | | |
| To Profit & Loss A/c | | | |

ASSIGNMENTS FOR CLASS

1).

The provision for Doubtful Debt A/c shows a balance of ₹5,000 on Jan 01, 2014. The bad debt during the year 2014 amounted to ₹3,000. The sundry debtors on Dec 31 2014 were ₹50,000. On Dec 31 2014 there was an additional bad debt of ₹3000. Create a new provision @ 10 % on debtors. Bad debt recovered ` 500.

You are required to show necessary ledger accounts and balance sheet.

2).

Prepare Bad Debts Accounts, Provision for Bad Debts Accounts under each of the above methods from the following information and also the Profit and Loss Account and Balance sheet:-

| | | |
|------------|-------------------------|-----------|
| 01.01.2012 | Provision for Bad Debts | ₹5,000 |
| 31.12.2012 | Bad Debts written off | ₹3,000 |
| | Sundry Debtors | ₹1,25,000 |
| 31.12.2013 | Bad Debts written off | ₹2,500 |
| | Sundry Debtors | ₹1,00,000 |

Provision for Doubtful debts to be provided for @ 5% for 2012 and 2.5% for 2013.

3).

On 01.01.2013 the balance of Provision for doubtful debts was ₹5,000. The Bad Debts during the year were ₹900. The Sundry Debtors as on 31.12.2013 stood at ₹40,400 out of these debtors of ₹400 are bad and cannot be realized. The Provision for Doubtful Debts is to be raised to 5% on Sundry Debtors. Show the necessary ledger accounts and the balance sheet.

4).

On 01.04.2012, M/s Singh Bros. had a provision for bad debts of ₹6,500 against their book debts. During 2012-13,

₹4,200 proved irrecoverable and it was desired to maintain the provision for bad debts @4% on debtors which stood at ₹1,95,000 before writing off Bad Debts. They also decided to maintain a provision for discount on debtors @2%. Show Provision for Bad Debt Account and Provision for Discount on Debtors Account as would appear in the books of the firm in 2012-13.

5).

A company maintains its reserve for bad debts @ 5% and a reserve for discount on debtors @ 2%. You are given the following details :

| | 2012(₹) | 2013(₹) |
|------------------|---------|---------|
| Bad debts | 800 | 1,500 |
| Discount allowed | 1,200 | 500 |

Sundry debtors (before providing all bad debts and discounts) amounted to ₹60,000 on 31.12.2012 and ₹42,000 on 31.12.2013.

On 1.1.2012, Reserve for bad debts and Reserve of discount on debtors had balance of ₹4,550 and ₹800 respectively.

Show Reserve for Bad Debts and Reserve for Discount on Debtors Account.

6).

On 31.12.2012, Sundry Debtors and Provision for Doubtful Debts are ₹50,000 and ₹5,000 respectively. During the year 2013, ₹3,000 are bad and written off on 30.9.2013, an amount of ₹400 was received on account of a debt which was written off as bad last year on 31.12.2013, the debtors left was verified and it was found that sundry debtors stood in the books were ₹40,000 out of which a customer Mr. X who owed ₹800 was to be written off as bad.

Prepare Bad Debt A/c. Provision for Doubtful A/c. assuming that some percentage should be maintained for provision for Doubtful debt as it was on 31.12.2012.

Show also how the illustration appear in Profit & Loss A/c. and Balance Sheet.

