

## Estimating Bad Debt Using the Allowance Method - Part 2

At the end of the period we take care of adjusting entries. When adjusting for bad debt estimates we use two accounts: bad debts expense and the allowance for doubtful accounts. This adjusting entry can be calculated one of three ways: the percent of sales method, percent of account receivables, and aging of account receivables.

### Percent of Sales Method

The percent of sales method determines bad debts by assuming a percent of total credit sales\* for the current period will be uncollectible.

\*Total Sales may be used instead - familiarize yourself with what the company uses!!!

**Fig. 4**

Total Credit Sales	Bad Debt Estimate
\$ 400,000	0.6%

-	+
Allowance for Doubtful Accounts	

**"Allowance" T-Account Cheat Sheet**

Beginning Balance: Starting point  
 Unadjusted Balance: Beginning Balance - Write-Offs  
 Adjusting Entry: Difference between Unadj. & Ending Bal.  
 Ending Balance: (Carries Over to the next Period/What goes on the Balance Sheet with A/R)

\$400,000 x 0.6% = \$2,400

	750	←	Unadjusted Bal.
	2,400	←	Adj. Entry= What's Given
	3,150	←	Ending Bal.

**Adjusting Journal Entry**

Dec. 31	Bad Debts Expense	2,400
	Allowance for Doubtful Accounts	2,400

### Percent of Receivables Method

The percent of receivables method estimates bad debts by assuming a percent of account receivable's ending balance is going to be uncollectible. This method gives us allowance for doubtful account's ending balance.

**Fig. 5**

Ending A/R Balance	Bad Debt Estimate
\$ 50,000	5%

\$50,000 X5% = \$2,500

-	+
Allowance for Doubtful Accounts	

An unadjusted debit balance results when write-offs total more than the account's beginning balance. When figuring out the adjusting entry think, "Right now I'm at -800 (debit balance). How much will I have to increase (credit) the account to get to a positive (credit balance) 2,500?" Test your answer out.

Write-Offs →

Unadjusted Bal.: →

Beginning Bal. - Write-Offs →

	3,000	←	Beginning Bal.
	800	←	
	3,300	←	Adj. Entry
	2,500	←	Ending Bal.= What's Given

800 + 2,500 = 3,300  
!Test Run!: -800 + 3,300 = 2,500

**Adjusting Journal Entry**

Dec. 31	Bad Debts Expense	3,300
	Allowance for Doubtful Accounts	3,300

### Aging of Receivables Method

With this method we estimate bad debt based accounts receivable. Yet instead of just looking at the ending balance, we group each customer on account into categories based on how far past due their debts are. A percentage of each category is deemed uncollectible (each group has their own rate).

**Fig. 6**

Accounts Receivable Aging Schedule  
December 31, 20X6

Customer	Balance	Current	Days Past Due			
			1 to 30	31 to 60	61 to 90	Over 90
C. Aaron	\$ 2,000	\$ 2,000				
B. Ambroz	1,900	1,100	\$ 800			
J. Baker	1,300			\$ 1,100	\$ 200	
W. Bruce	1,500	800	700			
H. Bunica	2,000	2,000				
K. Carter	600					\$ 600
E. Cline	2,700	2,700				
All Others	88,000	71,400	12,500	1,900	800	1,400
<b>Totals</b>	<b>\$100,000</b>	<b>\$80,000</b>	<b>\$14,000</b>	<b>\$3,000</b>	<b>\$1,000</b>	<b>\$2,000</b>
Percentage		1%	10%	30%	50%	70%
Estimated Bad Debts	\$ 5,000	\$ 800	\$ 1,400	\$ 900	\$ 500	\$ 1,400

-	+
Allowance for Doubtful Accounts	

**Allowance for Doubtful Accounts**

	1,400	←	Unadjusted Bal.
	3,600	←	Adj. Entry
	5,000	←	Ending Bal.= What's Given

After each category has been calculated the total amount likely to remain uncollected from each group is added together. The results give us the ending balance to the allowance for doubtful accounts.