Writing off Bad Debts

A company might not be able to recover a debt that is owed to them. This is called a bad debt. This account is used in anticipation that a debt may not be collected sometime in the future. This can occur for any number of reasons, such as a bad credit history or possible bankruptcy.

If it is likely that you will not receive the debt that is owed to you, it must be written off as a debit to the account "bad debt expense" and is shown on the income statement. When the anticipated amount is identified as uncollectible, the accounts receivable account is credited.

Example:

Company A sells $500 worth of products to Company B on credit (the transaction is recorded in the general journal as follows):

Accounts receivable	*500*
Revenue	*500*

Company A estimates that due to its past history in doing business with Company B, Company A estimates that they will not receive 20% of Company B's debt that is owed to them (the transaction is recorded in the general journal as follows):

Bad debt expense	*100*
Allowance for doubtful accounts	*100*

*The allowance for doubtful accounts is a contra-asset account. This means that it is shown as a credit balance on the balance sheet, associated with accounts receivable. It would be shown as follows:

Accounts receivable	*500*
Allowance for doubtful accounts	*100*
Accounts receivable (net)	*400*

Company A determines with certainty that the estimate of 20% of Company B's debt is uncollectible (the transaction is recorded in the general journal as follows):

Allowance for doubtful accounts	*100*
Accounts receivable	*100*