LECTURE 06

In-class Illustration of Loss Allowance Account:

I did an illustration in class to show the recalibration that is done on the Loss Allowance account across multiple periods. Below is a summary of the illustration for your reference.

Remember: At the end of each period, we always figure out first what is the **target desired ending balance of the Loss Allowance** account through an **aging analysis** of the accounts receivable (not shown in the illustration below), and then using the beginning balance, ending balance and the movements in the Loss Allowance account during the period (e.g. writeoffs & recovery) to figure out what is the ECL amount to be taken for the period.

Shorthand used in the illustration below:
LA = Loss Allowance - this is the contra-asset account to your AR   *AR = Accounts Receivable*
ECL = Expected Credit Loss - this is an expense account (Also known as Bad Debt Expense)   *AJE = Adjusting Journal Entry*

YEAR 1: Beg LA Bal 0
         Target LA Bal 10

AJE:
Dr ECL   10
    Cr LA   10

Loss Allowance Account	Dr	Cr	Balance
Beg			0
31-Dec		10	10

ECL	Dr	Cr	Balance
Beg			0
31-Dec	10		10

YEAR 2: Beg LA Bal 10
         Target LA Bal 15

AJE:
Dr ECL   5
    Cr LA   5

Loss Allowance Account	Dr	Cr	Balance
Beg			10
31-Dec		5	15

ECL	Dr	Cr	Balance
Beg			0
31-Dec	5		5

YEAR 3: Beg LA Bal 15
         Target LA Bal 15
         Writeoff 3

Writeoff Entry:
Dr LA   3
    Cr AR   3

AJE:
Dr ECL   3
    Cr LA   3

Loss Allowance Account	Dr	Cr	Balance
Beg			15
Writeoff	3		12
31-Dec		3	15

ECL	Dr	Cr	Balance
Beg			0
31-Dec	3		3

YEAR 4: Beg LA Bal 15
         Target LA Bal 25
         Writeoff 20

Writeoff Entry:
Dr LA   20
    Cr AR   20

AJE:
Dr ECL   30
    Cr LA   30

Loss Allowance Account	Dr	Cr	Balance
Beg			15
Writeoff	20		-5
31-Dec		30	25

Refer Note (a) below

ECL	Dr	Cr	Balance
Beg			0
31-Dec	30		30

(a) The beginning balance of the LA account is 15k and the writeoff during the year of 20k will eventually result in the LA account to have an abnormal balance of 5k (i.e. debit balance of 5k) before our adjustment of ECL. Therefore, to get the LA account back into the normal credit balance, a larger ECL was taken this year to "compensate" for last year's under-provisioning of the LA account.

YEAR 5: Beg LA Bal 25
         Target LA Bal 20

AJE:
Dr LA   5
    Cr ECL   5

Loss Allowance Account	Dr	Cr	Balance
Beg			25
31-Dec	5		20

ECL	Dr	Cr	Balance
Beg			0
31-Dec		5	-5

In this scenario, the company's target ending balance of its loss allowance account is 20 k, which is lower than the existing balance of 25k. Assuming no other movements in the loss allowance account, the loss allowance is thus reduced through the debit entry. The ECL expense account will now have a credit balance, and this will instead become a writeback, which is an "addition" in the Income Statement instead of a deduction. Such a scenario may happen in practice, though it is not too common.

As an example, you may refer to Samsung FS Note 7, you will see that in 2023, it had reported an ECL writeback (i.e. reversal) for its non-trade receivables.