ACC1701X
SEMESTER 1   2022 /2022
POST LECTURE SUPPLEMENT 1

<u>LECTURE 06</u>

Important Reminder

Midterm Test is on 29th Sept (Tuesday)!

- **<u>80 minutes (1h 20 min)</u> on-site (@LT16)** digital test using **EXAMPLIFY.**
- **<u>Closed-book,</u>** you are **<u>NOT allowed</u>** any cheatsheet. Rough paper will be given.

Very Important, so take note of the following:

(1) Attend the midterm test during your official assigned lecture section!
- ❖ LX01 – 10 AM
- ❖ LX02 – 2 PM

(2) Midterm test will start at **<u>10AM (LX01) / 2PM (LX02) SHARP</u>!**
- ❖Please **come at least 10-15 minutes early** to set up your workstation.
- ❖Latecomers will not be given additional time.

Updated Lecture Slides:

Clarification on this slide: Assume the Loss Allowance account has a zero beginning balance.

Loss Allowance
Takashimaya Example

E.g. At the end of **2022**, Takashimaya estimates that 10% of its $500,000 Accounts Receivable may be uncollectable. (10% x 500,000 = $50,000)

1) Record ECL:

Dec 2022	Expected Credit Loss	$50,000	
	Loss Allowance*		$50,000

Stmt of Financial Position impact:

Accounts Receivable	500,000
Less Loss Allowance	<u>(50,000)</u>
Accounts Receivable (net)	<u>450,000</u>

Income Statement impact:

Revenues	XXX
Expenses:	
Expected Credit Loss	50,000

** Assuming the Loss Allowance account has zero beg balance.*

Clarification on this slide: Title update – this slide is for write off of AR.

Loss Allowance – Write off AR
Takashimaya Example

2) Write off: In February **2023**, Soft Towel Store has gone bankrupt and Takashimaya determines that Soft Towel's accounts receivable of $2,500 will be uncollectible.

Feb 2023	Loss Allowance	$2,500	
	Accounts Receivable – Soft Towel (A)		$2,500

- Note that writing off uncollectible accounts did not affect any income statement accounts, because impairment loss (ECL) has already been taken in the period of 2022 during the period of sale.
- **The write-off also does not affect the realizable value of accounts receivable.**

	Before Write-Off	After Write-Off
Accounts Receivable	500,000	497,500
Less Loss Allowance	50,000	47,500
Accounts Receivable (reported on SFP)	**450,000**	**450,000**

New slide: This slide illustrates the collection of a previously written off AR.

Loss Allowance – Collecting written off AR
Takashimaya Example

3) Collection on written off AR: In **2024,** Soft Towel Store revived from bankruptcy and paid Takashimaya the long overdue $2,500 that it owes.

Step 1: Takashimaya has to reinstate the previously written off account

Accounts Receivable – Soft Towel	$2,500	
Loss Allowance		$2,500

Step 2: Record collection of the AR

Cash	$2,500	
Accounts Receivable – Soft Towel		$2,500

- Again, note that collecting on a previously written off account receivable did not affect any income statement accounts.
- **The Loss Allowance account is used to "keep track" of write-offs and reinstatements of AR.**

Clarification on this slide: Assume the Loss Allowance account has a zero beginning balance.

Estimation of Allowance Example: Fab Co.
STEP 1 – Individual Assessment

- **Step 1: Individual assessment for specific accounts known to have credit problems.**

AR Customers	**Amount**	**Status**
Customer – Cool Co.	$100,000	Objective evidence that Cool Co. is in trouble and some amount would be uncollectible.
All other customers	$500,000	No obvious evidence that accounts will be uncollectible

- Suppose Fab Co. estimates that there is 90% chance that the entire amount owed by Cool Co. will be uncollectible: 90% x $100,00 = $90,000

Expected Credit Loss	90,000	
Loss Allowance* - Individual Assessment		90,000

** Assuming the Loss Allowance account for individual assessment has zero beg balance.*

Clarification on the next two slides: The aging analysis calculates the ***estimated uncollectible amount****, which is the target ending balance of your Loss Allowance account.*

Estimation of Allowance Example: Fab Co.
STEP 2 – Group Assessment (Aging Analysis)

- Aging Analysis for Fab Co. Accounts Receivables for group assessment:

Fab Co.
Schedule of Accounts Receivable by Age
31 December 2022

Customer	**Not Yet Due**	**1-30 Days**	**31-60 Days**	**61-90 Days**	**Over 90 Days**	**Total**
Company A	60,000	20,000	30,000	30,000	20,000	**160,000**
Company B	130,000	35,000	40,000	-	-	**205,000**
Company C	-	-	55,000	20,000	35,000	**110,000**
:	:	:	:	:	:	-
Company Z	-	-	-	-	25,000	**25,000**
Total	**190,000**	**55,000**	**125,000**	**50,000**	**80,000**	**500,000**
Estimated % Uncollectible	1%	5%	15%	25%	50%	
Estimated Uncollectible	1,900	2,750	18,750	12,500	40,000	**75,900**

Percentage uncollectible is estimated based on historical loss experience and assessment of current economic condition

Target balance of the Loss Allowance account under Group Assessment (i.e. the allowance account is to be adjusted to this target balance)

Estimation of Allowance Example: Fab Co.
STEP 2 – Group Assessment (Calculating ECL)

Estimated Uncollectible	1,900	2,750	18,750	12,500	40,000	**75,900**

- Based on our aging analysis, the **target balance** of the Loss Allowance account should be $75,900.
- We have to bring out Loss Allowance account to our target balance by adjusting the loss allowance account and recognizing ECL:
- ***Scenario 1:*** Suppose that the Loss Allowance had no existing balance
  ➔ adjustment needed: 75,900
- The adjusting journal entry is:

Expected Credit Loss	75,900	
Loss Allowance - Group Assessment		75,900

Loss Allowance

	Bal	0
	31-Dec	75,900
	End Bal	75,900

(Reminder: Loss Allowance is a contra-asset account, therefore it will have a normal credit balance)

In-class PollEV Quiz:

1) Credit sales are recorded by crediting an Accounts Receivable. FALSE

   Explanation:
   Credit sales are recorded with the following entry:
   Dr Accounts Receivable
   Cr Sales Revenue

2) The use of a loss allowance for accounts receivables requires an adjusting entry before financial statements are prepared. TRUE

3) The matching or revenue recognition principle requires that accrued interest on outstanding notes receivable be recorded at the end of each accounting period. TRUE

4) When using the allowance method of accounting for uncollectible accounts, the entry to write off Company Joe's uncollectible account is: Debit Loss Allowance, and Credit Accounts Receivable. TRUE

5) When using the allowance method of accounting for uncollectible accounts, the recovery of a bad debt would be recorded as: Debit Cash, and Credit Expected Credit Loss. FALSE

   Explanation:
   There are two entries involved in recoding the recovery of an account already previously written off:

Entry #1 to reinstate the accounts receivable account:
Dr Accounts Receivable
Cr Loss Allowance

Entry #2 to record collection and removal of the accounts receivable.
Dr Cash
Cr Accounts Receivable

6) The interest accrued on $6,500 at 6% for 2 months is: $65 ($6,500 x 0.06 x 2/12)

7) Chase Company concluded that a customer's accounts receivable of $2,000 was uncollectible this year and must be written off. Chase uses the allowance method. What effect will this write-off have on its net profit this year?

No effect on net profit.

Explanation:
The entry for writing off an account is:
Dr Loss Allowance
Cr Accounts Receivable
Both are Statement of Financial Position accounts that will NOT affect the income statement!

8) Chase Company's unadjusted trial balance on December 31, 2020 shows the following:

	Dr	**Cr**
Accounts Receivable	50,000	
Loss Allowance (Allowance for Doubtful Accounts)		800

Assuming 5% of outstanding accounts receivable at the end of the current year will be uncollectible, what is the amount of bad debt expense (ECL) recorded this year? $1,700

Explanation:
Step 1:
Calculate the target balance (i.e adjusted balance) of the Loss Allowance account as at Dec 31, 2020:

$50,000 x 5% = $2,500

➔ The target balance (credit balance) of Loss Allowance account is $2,500.

Step 2:
We need to bring the Loss Allowance account to its adjusted target balance (of $2,500 as calculated in Step 1) with an adjustment entry. Adjustment needed to bring current balance to desired balance:

$2,500 credit - $800 credit = $1,700 credit

Loss Allowance

	Unadj Bal	800
	Adjustment	1,700
	Adj Bal	2,500

Step 3:
Record the adjusting entry for Expected Credit Loss for the year:

Dr	Expected Credit Loss	$1,700	
	Loss Allowance		$1,700

In-class Illustration of Loss Allowance Account:

Please refer to separate file (Post Lecture Supplement 2) in Canvas for a summary of the illustration I performed during lecture of the Loss Allowance account across multiple periods.
