

ACC 1701X - Post Lecture 06 Supplement

In-class Illustration of the Loss Allowance Account across multiple periods

I did an illustration in class using my digital notepad to show the recalibration that is done on the Loss Allowance account across mutiple periods. Below is a summary of the illustration for your reference.
At the end of each period, we always figure out first what is the target desired ending balance of the Loss Allowance through an aging analysis (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) 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
- ECL Expected Credit Loss - this is an expense account
- WO Writeoff of AR
- AR Accounts Receivable
- AJE Adjusting Journal Entry

<div><div>YEAR 1:</div><div>Target LA End Bal =10 k</div><div>ECL = 10 k</div></div> <div><div>LA</div><table><tr><td>Beg</td><td>0</td></tr><tr><td>ECL</td><td>10 k</td></tr><tr><td>End</td><td>10 k</td></tr></table><div>ECL</div><div>10 k</div><div><div>AJE:</div><div>Dr ECL</div><div>Cr LA</div><div>10 k</div><div>10 k</div></div></div>	Beg	0	ECL	10 k	End	10 k	<div><div>YEAR 2:</div><div>Target LA End Bal =15 k</div><div>ECL = 5 k</div></div> <div><div>LA</div><table><tr><td>Beg</td><td>10 k</td></tr><tr><td>ECL</td><td>5 k</td></tr><tr><td>End</td><td>15 k</td></tr></table><div>ECL</div><div>5 k</div><div><div>AJE:</div><div>Dr ECL</div><div>Cr LA</div><div>5 k</div><div>5 k</div></div></div>	Beg	10 k	ECL	5 k	End	15 k	<div><div>YEAR 3:</div><div>Target LA End Bal =15 k</div><div>WO = 3 k</div><div>ECL = 3 k</div></div> <div><div>LA</div><table><tr><td>Beg</td><td>15 k</td></tr><tr><td>ECL</td><td>3k</td></tr><tr><td>End</td><td>15 k</td></tr></table><div>WO</div><div>3 k</div><div><div>AR</div><div>WO</div><div>3 k</div></div><div><div>Writeoff Entry:</div><div>Dr LA</div><div>Cr AR</div><div>3 k</div><div>3 k</div></div><div><div>ECL</div><div>3 k</div></div><div><div>AJE:</div><div>Dr ECL</div><div>Cr LA</div><div>3 k</div><div>3 k</div></div></div>	Beg	15 k	ECL	3k	End	15 k	<div><div>YEAR 4:</div><div>Target LA End Bal =25 k</div><div>WO = 20 k</div><div>ECL = 30 k</div></div> <div><div>LA</div><table><tr><td>Beg</td><td>15 k</td></tr><tr><td>ECL</td><td>30 k</td></tr><tr><td>End</td><td>25 k</td></tr></table><div>WO</div><div>20 k</div><div><div>AR</div><div>WO</div><div>20 k</div></div><div><div>Writeoff Entry:</div><div>Dr LA</div><div>Cr AR</div><div>20 k</div><div>20 k</div></div><div><div>ECL</div><div>30 k</div></div><div><div>AJE:</div><div>Dr ECL</div><div>Cr LA</div><div>30 k</div><div>30 k</div></div><div><div>(a) The beg bal 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. Thus 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.</div></div></div>	Beg	15 k	ECL	30 k	End	25 k	<div><div>YEAR 5:</div><div>Target LA End Bal =20 k</div><div>ECL = (5 k)</div></div> <div><div>LA</div><table><tr><td>Beg</td><td>25 k</td></tr><tr><td>ECL</td><td>5 k</td></tr><tr><td>End</td><td>20 k</td></tr></table><div>ECL</div><div>5 k</div><div><div>AJE:</div><div>Dr LA</div><div>Cr ECL</div><div>5 k</div><div>5 k</div></div><div><div>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 an "addition" in the Income Statement instead of a deduction. Such a scenario may happen in practice but it is not common.</div></div></div>	Beg	25 k	ECL	5 k	End	20 k
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