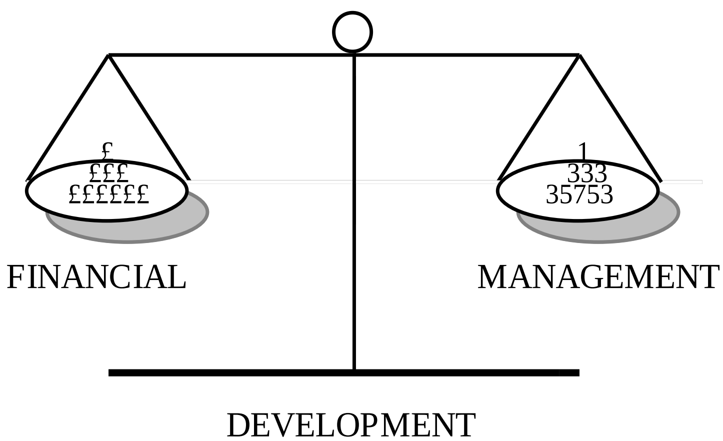
FINANCIAL MANAGEMENT DEVELOPMENT

Financial Accounting

Common Problem Areas

NO 141

ACCOUNTING FOR BAD DEBT AND DOUBTFUL DEBTS



ONE OF A SERIES OF GUIDES FOR

FINANCIAL MANAGEMENT DEVELOPMENT

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This is one of a series of documents produced by David A Palmer as a guide for managers on specific financial topics to assist informed discussion. Readers should take appropriate advice before acting upon any of the issues raised.

ACCOUNTING FOR BAD DEBT AND DOUBTFUL DEBTS

OVERVIEW

It is a feature of commercial life that some sales on credit terms are never paid for. Most organisations recognise this and provide for it in their results. This note sets out how provisions and write offs are treated for accounting purposes.

EXAMPLE

A company sells 10 items at £1,000 each to 10 different customers. All amounts are payable after one month. Two months from the date of sale five customers have not paid. The company policy is to provide 5% on all debts over two months old and 30% on those over three months old. Provisions are retained until the customer goes into liquidation or until formal write off is approved.

Chronologically

Month 1	Sales of £10,000 are recorded
Month 3	A provision of 5% of £5,000 is made by charging £250 against profits
In Month 4	One customer pays £1,000
Month 4	An additional provision is made to bring the balance to 30% of £4,000, i.e. a further £950 is charged against profits
In Month 5	One customer goes into liquidation and another two customers pay their £2,000
Month 5	The £1,200 provision brought forward is reduced by the write off of £1,000 on the liquidation and an additional £100 is charged against profits to bring the balance to £300 i.e. 30% of the remaining £1,000 debt.

The debt and the provision are retained in the books until a decision is taken to provide more, to write the debt off, to accept partial payment or the debt is received.

In some countries there may be taxation benefits from certain treatment e.g.

1. General provisions may not be allowable as a cost for tax purposes but those specifically identified against named debtors may be allowed.

2. Sales taxes (VAT) paid on debts later found to be bad may be recovered under certain circumstances.

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David is an experienced financial professional who has devoted his skills to management training in practical understanding and utilisation of financial information. A Graduate, Chartered Accountant, and Associate of the Institute of Taxation, he is also a Member of the Chartered Institute of Personnel and Development and has been an Ordained as a Deacon in the Catholic Church.

He has worked as a Financial Controller and Company Secretary in the Finance industry and as a Director of Finance and Administration in the Computer Services industry. Since 1990 he has conducted management development programmes for over forty major organisations including Arla Foods, Blue Circle, BP, CSC Computer Sciences, Conoco, Ernst & Young, Lloyds Bowmaker, Royal Mail, Unilever and Zeneca. He also runs programmes for the Leadership Foundation and the management teams at a number of Universities. International training experience includes work in Belgium and Holland for CSC, in Denmark, Kenya and the Czech Republic for Unilever, in Holland and the US for Zeneca, in Dubai for Al Atheer, in Bahrain and Saudi Arabia for Cable & Wireless.

He specialises in programmes in financial management for both tactical and strategic decision making. In addition he has run courses in acquisition evaluation (The Economist, Eversheds, Blue Circle and Hays Chemicals) and in post-acquisition management (Unilever). All training is specifically tailored to the needs of the organisation with the emphasis on practical applications to enhance profitability and cashflow. He has developed material for delivery by in-house personnel (Royal Mail, Lloyds Bowmaker and Conoco), computer based training packages (The Post Office, Unilever and BP), and post course reinforcement self-study workbooks (CSC and Zeneca). He has also produced a training video on Cashflow Management.

He is a prolific writer of case studies, role plays and course material. He has also published articles on the financial justification of training, financial evaluation of IT investment proposals, the use of Activity Based Costing and Customer Profitability statements, commercial considerations for consultants, the need for taxation awareness training for general managers, evangelisation and Christian business ethics.

Many of his generic documents are freely available on his website: **FinancialManagementDevelopment.com** including papers on Charity Management.

In addition to his Diaconal work in the Church, he has held a number of voluntary positions including University, College and School Governor, Hospice Treasurer and Trustee of various charitable institutions. He continues to provide ad hoc commercial advice to several other charitable organisations. He has been married for over 35 years and has one daughter and three granddaughters.

This series of papers is designed to help managers by providing a basic understanding of key financial concepts to assist them in their work. It is provided at no cost since this knowledge is a Gift from God and thus to be shared (Matthew 10:8).

