What is the Allowance for Doubtful Accounts?

Worksheet

The allowance for doubtful accounts is a contra-asset that reduces accounts receivable to its net realizable value. It is estimated as a percentage of receivables (or sales) and recorded before specific customers actually default, following the matching principle.

Questions

1. The allowance for doubtful accounts is classified as a:
A) Liability
B) Contra-asset
C) Revenue
D) Expense

2. AR is $200,000 and 3% is estimated uncollectible. What is the allowance?
A) $600
B) $6,000
C) $60,000
D) $3,000

3. Writing off a specific customer account against the allowance affects:
A) Total assets, decreasing them
B) Net income, decreasing it
C) Total assets, no net change
D) Revenue, decreasing it

4. Which accounting principle justifies estimating bad debt in advance?
A) Conservatism only
B) Matching principle
C) Cost principle
D) Going concern

5. A company has $150,000 in accounts receivable and estimates 4% will be uncollectible. What is the allowance for doubtful accounts?

6. Using the aging method, a company classifies $80,000 as current (2% uncollectible) and $20,000 as over 90 days (25% uncollectible). Find the total allowance.

7. The allowance account has an existing credit balance of $1,000. The company estimates it now needs a $6,000 allowance. What adjusting entry is recorded?

8. Define: What is the allowance for doubtful accounts?

9. Define: Why use an estimate instead of waiting for defaults?

10. Define: What is net realizable value of receivables?

Answer Key

1. B) Contra-asset - It reduces Accounts Receivable on the balance sheet, making it a contra-asset.

2. B) $6,000 - 200,000 0.03 = $6,000.

3. C) Total assets, no net change - AR decreases and the allowance decreases by the same amount, so net receivables - and total assets - stay the same.

4. B) Matching principle - The matching principle requires expenses to be recorded in the period of the related revenue.

5. Allowance = AR % = 150,000 0.04 Allowance = $6,000

6. Current: 80,000 0.02 = $1,600 Over 90 days: 20,000 0.25 = $5,000 Total allowance = 1,600 + 5,000 = $6,600

7. Required balance = $6,000 Existing credit balance = $1,000 Adjustment needed = 6,000 1,000 = $5,000 Entry: Debit Bad Debt Expense $5,000, Credit Allowance for Doubtful Accounts $5,000

8. A contra-asset account estimating the portion of receivables a company expects will never be collected.

9. The matching principle requires bad debt expense to be recognized in the same period as the related credit sales.

10. Accounts Receivable minus the Allowance for Doubtful Accounts - the amount expected to actually be collected.