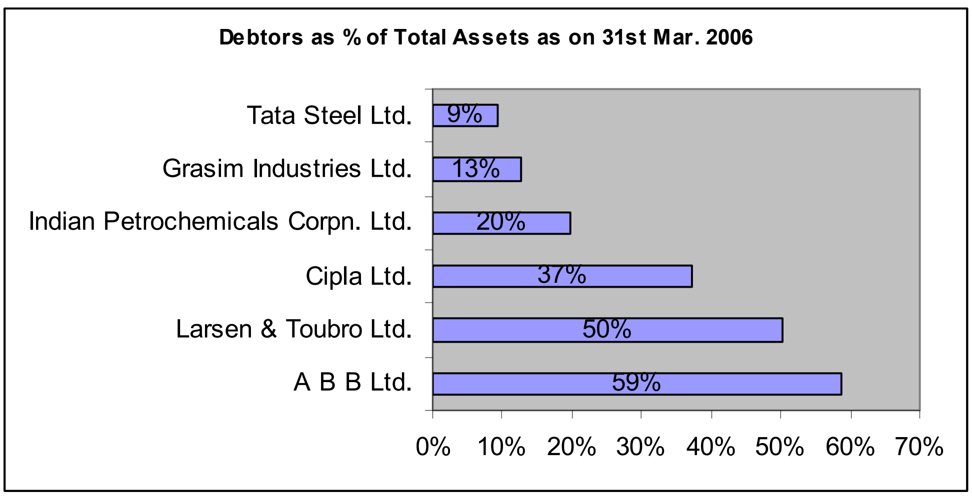
ACCOUNTING OF DEBTORS OR RECEIVABLES

The "accrual concept" is one of the fundamental accounting assumptions. According to the Accounting Standard (AS-1), revenues and costs are recognised as they are earned or incurred (and not as money is received or paid) and recorded in the financial statements of the periods to which they relate. According to this standard, even if a company sells goods on credit, it has to record the transaction and recognise the revenue in the period of sale irrespective of cash inflow happening or not happening.

The person to whom the goods are sold on credit is called a debtor. A group of debtors is generally shown as sundry debtors in the financial statements. Following exhibit shows the debtors as % of total assets as on 31st March 2006



Credit Sales and Accounting Equation

When goods are sold on credit, debtors in the balance sheet are increased to that extent and sales is shown as an income in the income statement. The company should maintain a separate account for each customer to keep a track of actual payment and money receivable.

Example12.8

Table 12.32 shows the assets and sources of ABC ltd at the beginning of the year:

Table 12.32

Accounting Equation as on 30 April xx

Capital +	Profit +	Loan=	Stock +	Cash
2000	1500	4000	2000	5500

Company sells the entire stock for Rs. 5000 on credit. Accounting equation after the sales is shown by table 12.33

Table 12.33

Accounting Equation as on 30 April xx

Capital +	Profit +	Loan=	Stock +	Cash +	Debtors
2,000	4,500	4,000	0	5,500	5,000

Credit Sales and Financial Statements

Goods sold on credit will affect the income statement and the balance sheet.

Example: 12.9

Table 12.34 shows the assets and sources of ABC ltd as on 1st April 2005:

Table 12.34

Balance Sheet as on 1st April 2005

Sources		Assets	
Capital	50,000	Plant	50,000
10% loan	50,000	Stock	25,000
Creditors	50,000	Cash	75,000
	150,000		150,000

During the year 2005, company sold entire goods for Rs.50,000 (60% on credit). Paid interest and charged depreciation of 10%. Tables 12.35 to 12.27 show the financial statements at the end of the year.

Table 12.35

Income Statement

Sales	50,000
Less	
COGS	25,000
Depreciation	5,000
Interest	5,000
	35,000
Profit	**15,000**

Table 12.36

Cash Flow Statement

Opening Cash	75,000
Sales	20,000
	95,000
Payment	
Interest	5,000
CIH	**90,000**

Table 12.37

Balance Sheet as on 31st March 2006

Capital	50,000
10% loan	50,000
Creditors	50,000
Profit	**15,000**
	165,000
Debtors	30,000
Plant	45,000
Cash	**90,000**
	165,000

When the debtors pay the money, debtors are cancelled and cash is increased in the balance sheet.

Income statement is not affect when the company collects the money from the debtors. let us see the impact on the financial statements, If the company collects Rs. 20,000 from the customers

Table 12.38

Cash Flow Statement	
Opening Cash	90,000
Collection	20,000
Closing Cash	110,000

Table 12.39

Balance Sheet as on 31st March 2006	
Capital	50,000
10% loan	50,000
Creditors	50,000
Profit	15,000
	165,000
Plant	45,000
Cash	110,000
Debtors	10,000
	155,000

Table 12.40

Debtors	
Opening Debtors	30,000
Add	
Credit Sales	0
Less	
Collections	20,000
Bad Debts	
Closing Debtors	10,000

Bad Debts and Accounting Equation

Bad debt is the loss due to the insolvency of the debtors. Bad Debt is shown in the income statement during the year in which the debtors become insolvent. The process of reducing debtors is *called writing-off of bad debts.* When the debtors become bad, debtors are reduced and a corresponding loss is recorded in the income statement. Let us see the impact on the accounting equation.

Example:12.10

Table 12.41 shows the assets and sources of ABC ltd:

Table 12.41

Accounting Equation					
Loan+	Profit+	Capital =	Cash+	Debtors+	Stock
20,000	50,000	50,000	50000	30000	40000

Mr.X, one of the debtors, declared insolvent. Rs. 5,000 due from Mr. X was written off as bad debt. Table 12.42 shows the accounting equation after writing off the bad debts will be as follows:

Table 12.42					
Accounting Equation					
Loan+	Profit+	Capital =	Cash+	Debtors+	Stock
20000	45000	50000	50000	25000	40000

Reduced due to bad debts

Bad Debts and Financial Statements:

As mentioned in the previous section, bad debt is the loss due to the insolvency of the debtors. So the impact of bad debts on financial statements can be summarized as follows:

- Cash Flow Statement: No effect
- Income Statement: Shown as a loss called Bad Debt
- Balance Sheet: Reduced from the Debtors or Provisions for Bad and Doubtful Debts

Example12.11

Table 12.43 shows the assets and sources of ABC ltd as on 1st April 2006

Table 12.43			
Balance Sheet as on 1st April 2006			
Capital	50,000	Debtors	50,000
12% loan	50,000	Plant	45,000
Creditors	6,000	Cash	50,000
Profit	39,000		
	145,000		145,000

Transactions during the first quarter are follows:

- One of the debtors Mr .X owing Rs. 10,000 becomes insolvent. Entire money due from him becomes bad.
- Paid interest for the quarter.
- Depreciation on the plant = 1250.
- No other transactions.

If the company collects 80% money from the customers and the balance becomes irrecoverable**:**

Cash is increased to the extent of actual collection from the customers and the balance not receivable is transferred to the income statement as loss and is called ***bad debt***. Table 12.44 shows the financial statements.

Income Statement:

- No sales
- Expenses
    - Depreciation for the period: 1250
    - Bad Debt = 10,000
    - Interest for the period = 1500
- Loss = 12,750

Cash Flow Statement

- Opening balance = 50,000
- Receipts
    - Collections = 40,000
- Payments
    - Interest =1,500
- Cash in hand = 88.500

Balance Sheet

- Capital/ 12% loan/ Creditors = no change
- Profit = Opening balance – Current Loss = 39,000 -12,750 = 26,250
- Debtors = Opening balance - Collection – Bad Debt = 50,000 -40,000 -10,000 = 0

Table 12.44

Income Statement		Cash Flow Statement		Balance Sheet as on 31st March 2006		Debtors	
						Opening Debtors	50,000
Sales	0	Opening Cash	50,000	Capital	50,000	Add	
Less				12% loan	50,000	Credit Sales	0
COGS	0	Collection	40,000	Creditors	6,000	Less	
Depreciation	1,250			Profit	26,250		
Bad Debt	**10,000**	Payment			132,250	Collections	40,000
Interest	1,500			Debtors	0	Bad Debts	10,000
		Interest	1,500	Plant	43,750		
				Cash	88,500		
Loss	12,750	CIH	88,500		132,250	Closing Debtors	0

Provisions for Bad Debts

Some times companies keep aside a profit as provision to meet future bad debts. Such provisions are called *Provisions for Bad and Doubtful Debts*. Such a practice is also backed by the conservative principle of accounting. According to the conservative principle, a company can create provisions for future losses and expenses.

First time creation of Provision

When a company creates provision for the first time, it is charged to the income statement and the same amount is shown in the balance sheet as provision for bad and doubtful debts.

Example:12.12

Table 12.45 shows the assets and sources of ABC ltd as on 1st April 2006.

Table 12.45

Balance Sheet as on 1st April 2005			
Sources		Assets	
Capital	50,000	Debtors	0
10% loan	50,000	Plant	45,000
Creditors	50,000	Cash	114,000
Profit	9,000		
	159,000		159,000

Transactions during the year:

- During the year 2005, company purchases goods costingRs.80,000 for cash. Sold entire stock on credit for Rs. 100,000.
- Paid all expenses on time. Depreciation for year was 5,000.
- In anticipation of bad debts, the company creates a provision of 5% of debtors.

Table 12.46 shows the financial statements.

Table 12.46

Income Statement		Cash Flow Statement		Balance Sheet as on 31st March 2006	
Sales	100,000	Opening Cash	114,000	Capital	50,000
Less				10% loan	50,000
COGS	80,000	Payment		Creditors	50,000
Depreciation	5,000	Stock purchase	80,000	Profit (9000+5000)	14,000
Provision for Bad Debts	**5,000**				164,000
Interest	5,000	Interest	5,000	Debtors	100,000
Total Expenses	95,000	Total payments	85,000	**Provision for Bad Debts**	**-5,000**
				Plant	40,000
				Cash	29,000
Profit	**5,000**	CIH	29,000		164,000

Note:

- The company created a provision for bad-doubtful debts = 5% of 100,000 = 5,000
- Provision for bad and doubtful debts is shown as a charge against the income for the period
- Debtors are reduced to the extent of the provisions for bad and doubtful debts.

When provisions are created, debtors are shown at the full amount and the provision for the bad debt are shown as separate item. So at this juncture, the company is expecting some debtors to become bad, therefore debtors are reduced in the balance sheet.

Subsequent Adjustments to the Provisions

In the subsequent years, when the debtors become bad, they are reduced from the provisions and not charged to the income statement again.

Example 12.13

Refer to example 12.12. Transactions during the first quarter of 2006

- A customers owing Rs. 3000 becomes insolvent.

Impact on the financial statements will be as follows and shown in table no.12.47

- Bad debt of Rs, 3000;
- Bad debt charged (reduced) against the available provisions
- No impact on the cash flow statement,
- No impact on the income statement, :

Table 12.47

Balance Sheet	
Capital	50,000
10% loan	50,000
Creditors	50,000
Profit	14,000
	164,000
Debtors	97,000
Less Provision for Bad Debts	2,000
Plant	40,000
Cash	29,000
	164,000

Provisions for Bad and Doubtful Debts	
Opening Provisions	5,000
Add	
Further Provisions	0
Less	
Bad Debt	3,000
Closing Provisions	2,000

- No change in the profit. Bad debt has been adjusted against the provisions.
- Debtors = Opening debtors – Bad Debts = 100,000 -3000
- Provisions for Bad Debts = Opening Balance – Bad Debts
- Provision has been reduced to the extent of the bad debt (5000 – 3000) and provision account will appear as follows:

Subsequent Adjustments and Creation of Further Provisions

If the provisions already exist on the balance sheet and the company is interested in creating further provisions, the necessary adjustments will be as follows:

- Cash Flow Statement: No change
- Income Statement: Amount equal to the additional provisions charged to the incomes
- Balance sheet: Provisions increased to that extent

Example: 12.14

Let us continue with the above example number 12.13 to understand the process of creation of further provisions. Transactions during the year:

- Sold entire stock on credit for Rs. 50,000
- Collection from old customers: 45000
- Bad Debts = 1500 (out of old amount)
- Company policy to maintain 10% of credit sales a provision for bad and doubtful debts.

Show the financial statements at the end of the year.

Income Statement:

- Sales of Rs.50,000 shown as an income,
- COGS: 29,000
- Other Expenses:
    - Depreciation: 5000
    - Interest: 5000
    - Provisions to be created: 4500

Cash Flow Statement

- Collection from old customer is a receipt: Rs 45,000
- Payment of interest: 5000

Balance Sheet

- Reduction in the old debtors to the extent of 45000 (collection) and 1500 (bad debts)
- Provision for the next year: 5000

Table 12.48

Income Statement			Cash Flow Statement			Balance Sheet as on 1st April 2005	
						Capital	50,000
Sales	50,000		Opening Cash	0		10% loan	50,000
Less			Receipts			Creditors	50,000
COGS	29,000		Collection	45,000		Profit	20,500
Depreciation	5,000						170,500
Provision for Bad Debts	4,500		Payments			Debtors	100,500
Interest	5,000		Interest	5,000		**Less Provisions for Bad Debts**	-5,000
	43,500					Plant	35,000
						CIH	40,000
Profit	**6,500**		CIH	40,000			170,500

Working note for Provisions for bad and doubtful debts

Provisions for Bad and Doubtful Debts	
Closing Provisions (5% of the Credit Sales)	5000
Add Bad Debt	1500
Total	6500
Less Existing Provisions	2000
Provision to be created	4500

Excess Provisions

Sometimes, the existing provisions may be much higher than the bad debts written off and provisions required for the next accounting year. In such a situation provisions are written back to the income statement. Profit for that year increases to that extent.

Example12.15

Let us continue with the above example 12.14. Transactions during 2005-06 were as follows:

- Purchased goods for 40,000 for cash
- Sold entire stock on credit: 75,000
- Collection from customer (old): 50,000
- No bad debts during the year
- The company maintains a provision of 5% of the credit sales

Table 12.49

Income Statement			Cash Flow Statement			Balance Sheet	
Sales	75,000		Opening Cash	40,000		Capital	50,000
Less			Collection	50,000		10% loan	50,000
COGS	40,000			90,000		Creditors	50,000
Depreciation	5,000					Profit	46,750
Provision for Bad Debts	-1,250		Payment			**Provision for Bad Debts**	3,750
Interest	5,000		Stock purchase	40,000			200,500
						Debtors	125,500
Total Expenses	48,750		Interest	5,000		Plant	30,000
						CIH	45,000
Profit	**26,250**		CIH	45,000			200,500

Working Note for Provisions for Bad and Doubtful Debts

Provisions for Bad and Doubtful Debts	
Closing Provisions (5% of the Credit Sales)	3750
Bad Debt	0
Total	3750
Less Existing Provisions	5000
Excess Provision	-1250

Presentation of Debtors in the Balance Sheet

Debtors are shown in the financial statements as per the Schedule VI of the Companies Act 1956.

- The provisions for bad debts to be shown under this head should not exceed the amounts of debts stated to be considered doubtful or bad and any surplus of such provision if already created, should be shown at every closing under "Reserves and Surplus" (in the liabilities side) under a separate sub-head "Reserve for Doubtful or Bad Debts".
- In regard to Sundry Debtors particulars to be given separately of- (a) debts considered good and in respect of which the company is fully secured; and (b) debts considered good for which the company holds no security other than the debtor's personal security; and (c) debts considered doubtful or bad.
- Debts due by directors or other officers of the company or any of them either severally or jointly with any other person or debts due by firms or private companies respectively in which any director is a partner or a director or a members to be separately stated.
- Debtors should be shown in the balance sheet as follows:
  - Debts outstanding for a period exceeding six months.
  - Other debts
  - Less: Provisions for bad and doubtful debts

Following exhibit shows the schedule showing the details of debtors of NALCO as on 31 March 2006 and the previous year.

				Rs in crores		
Sundry Debtors :						
(Unsecured)						
Debts over six months						
Considered good	0.14			14.69		
Considered doubtful	40.63			40.62		
	40.77			55.31		
Less: Provision for doubtful debts	40.63			40.62		
		0.14			14.69	
Other debts, Considered good		29.28			78.12	
			29.42			92.81