Bad Debts

Bad debts

If a firm finds that it is impossible to collect a debt then that debt should be written off as a *bad debt*. This would happen if the firm was almost certain the debtor could not pay the debt.

Example
We sold \$50 of goods to K Lin on the 5th of January 20X8, but he became bankrupt. On the 16th of February 20X8 we sold \$240 of goods to T. Jung. He managed to pay \$200 on the 17th of May, but it became obvious that he would never be able to pay the final \$40. The accounts would appear as follows:

K Lin a/c

Dr					Cr
		\$			\$
1.1.X8	Sales	50	5.1.X8	Bad Debts	50
		50			**50**

T Jung a/c

Dr					Cr
		\$			\$
16.2.X8	Sales	240	17.5.X8	Bank	200
			17.5.X8	Bad Debts	40
		240			**240**

Bad Debts a/c

Dr					Cr
		\$			\$
5.1.X8	K Lin	50		Income or Profit & Loss	90
17.5.X8	T Jung	40			
		90			**90**

Dr **Trading and Profit and Loss Account for the year ended the 31.12.X8** Cr

	$		$
Opening Stock	XXX	Sales	XXX
		Closing Stock	XXX
Gross Profit bal. c/d	XXX		XXX
Wages	XXX	Gross Profit bal. b/d	XXX
Lighting and heating	XXX		
Provision for Depreciation	XXX		
Rent	XXX		
Bad Debts	**90**		
General expenses	XXX		
Carriage inwards	XXX		
Net Profit bal. c/d	XXX		
	XXX		**XXX**
Capital	XXX	Net Profit bal. b/d	XXX

A debt that is not going to be repaid must be deducted as an expense from the profit of the firm. This is because we would have counted the debtor in our sales figure (realisation) and in order to cancel the effect out then a debit entry for the amount owing from the debtor is necessary.