Allowance for Uncollectible Accounts Receivables

Concept

Not all revenue generated from goods and services sold on "credit" or "account" will be collected. Therefore, balances of open accounts must have a provision for uncollectibility to estimate how much of those balances will actually be received. Under generally accepted accounting principles, this is accomplished by establishing an allowance for uncollectible accounts receivables (an offsetting, "contra-asset" account) that creates an allowance "reserve" which nets against total accounts receivable. The net of total accounts receivable less the allowance reserve balance results in a more realistic value of the asset.

Accounting

When an allowance for uncollectible accounts receivables is established or increased based on revised estimates, bad debt expense is charged (debited) in the operating ledger and the balance of the allowance for uncollectible accounts is increased (credited) in the general ledger.

Reductions of the allowance for uncollectible accounts receivables based on revised estimates result in a decrease (debit) of the allowance balance and decrease (credit) of bad debt expense.

When a specific account becomes uncollectible, it is written off by charging the allowance for uncollectible accounts and crediting accounts receivable. Writing off an account is only permitted after all reasonable collection efforts (e.g., in-house, outside agency, state offset) have failed and proper approvals are obtained.

Specific Banner account codes used to track balances of allowances for uncollectible accounts receivables in the general ledger and bad debt expense in the operating ledger are:

- 53090 – Allowance for Uncollectible Accounts – Non-Banner System AR
- 53099 – Allowance for Uncollectible Accounts – Banner System AR
- 186100 – Bad Debt Expense

The effectiveness of collections and adequate provision for the allowance for uncollectible accounts receivables must be reviewed, analyzed and calculated at least annually at fiscal yearend. For all receivables recorded in Banner AR, University Bursar performs this review, analysis and calculation at the detail code level. Units using an approved non-Banner AR system are required to maintain and record a reasonable estimate of an allowance for uncollectible accounts receivable in the general ledger.

Calculation

The allowance for uncollectible accounts is calculated by multiplying the receivable balance in the various aging categories (see table below) by a reserve rate. A higher reserve rate is applied to older receivables because those receivables are less likely to be collected.

As the dollar amount of receivables increases or decreases each year, the corresponding allowance for uncollectible accounts and bad debt expense are adjusted accordingly. In addition, the rates used in the allowance calculation are reviewed annually and adjusted as necessary.

Reserve rates are developed and refined based on the actual collection history of a particular operation.

<u>Example</u>

For example, at the end of June a department has a balance in Allowance for Uncollectible Accounts of **$900**. The department's aging categories along with its reserve rates, month end balances, and reserve amounts for each aging category are as follows:

	Not Yet Due	0-30 Days	31-90 Days	91-180 Days	181-365 Days	>365 Days	Total
Reserve Rate	**1.35%**	**1.80%**	**12%**	**18%**	**35%**	**95%**	
Receivable Balance	**20,000**	**7,000**	**2,000**	**1,000**	**500**	**125**	**30,625**
Reserve Amount	**270**	**126**	**240**	**180**	**175**	**119**	**1,110**

At the end of June, then, the recorded reserve balance is $210 lower than the computed reserve. Therefore $210 is credited to the allowance account (53099) in the general ledger. The offsetting entry is a $210 charge to bad debt expense account (186100) in the operating ledger.

<u>Questions</u>

Questions regarding this information may be directed to Bursar Business Operations at bursarbusinessops@uillinois.edu.