

How are bad debts accounted for under the direct write-off method?

What are the disadvantages of this method?

Under the direct write-off method, bad debts are accounted as an debit to bad debts expense and a credit to accounts receivable. At my current employer we see several write-offs each and every month the process has some similarities from the reading. For example after 90 days of account inactivity at my place of employment the account is considered a write-off and our company then sells these account to a corporate collection agency to make up the loss that has already been taken. The most noticeable disadvantage is that it can make the income statement and the balance sheet less useful for users of this information. In my opinion I feel that this provides an extremem disadvantage because if a company has to sell its accounts for a price, then it would hint to me that maybe somewhere down the road that the company may not be able to generate enough accounts receiveable to stay afloat. Contrary to this previous statement is that AT&T had a decline in accounts receivable from 2009 to 2010.

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Bad debts are a very common issue with the company I work for in that lawn care is a luxury and when money gets tight the low item on the priority list is lawn treatments. The result of this reality is that people decide not to pay there bills and they ultimately cannot be collected. Here in lies the bad debt. My branch alone posts thousands of dollars a month in bad debts and this is a costly account.

The bad debts are accounted for as an expense. The bad debt expense is debited and the credit is shown as an Accounts receivable as shown in the text. If I understand correctly the disadvantage is that the direct write off method reduces the usefulness of the both the income statement and the balance sheet. This is true because the year of a large credit would look great on either of the two sheets, but defaulting on loans would case a huge loss on the next year's statement.

In my company we sell a ton a revenue a year, in the billions, but the net revenue is dramatically lower because of bad debts. We write off a ton of bad debt expense and it is being managed tightly, however it always happens. I know that when we put sales budgets and P&L projections together for a year we always account for bad debt expense.