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SPECIFIC ITEMS

SECTION 3020

accounts and notes receivable

Additional Resources

STATEMENT PRESENTATION

- .01 ♦ *Accounts and notes receivable should be segregated so as to show separately ordinary trade accounts, amounts owing by related parties and other unusual items of substantial amount.* (With reference to amounts due from related parties, see RELATED PARTY TRANSACTIONS, Section 3840, and DISCLOSURE OF RELATED PARTY TRANSACTIONS BY NOT-**FOR**-PROFIT ORGANIZATIONS, Section 4460.) Since it is to be assumed that adequate **allowance for doubtful** accounts has been made if no statement is made to the contrary, it is not considered necessary to refer to such an **allowance**. [JUNE 1979]
- .02 ♦ *The amounts and, where practicable, maturity dates of instalment accounts maturing beyond one year should be disclosed* (see also FINANCIAL INSTRUMENTS — DISCLOSURE AND PRESENTATION, Section 3861, or FINANCIAL INSTRUMENTS — DISCLOSURES, Section 3862). [JAN. 1968 *]
- .03 Paragraphs 3020.04-.14 apply to short term accounts and notes receivable arising from the sale of goods and services. Allowances **for doubtful** accounts and bad debt losses in respect of other accounts and notes receivable are dealt with in IMPAIRED LOANS, Section 3025.

ALLOWANCE FOR DOUBTFUL ACCOUNTS AND BAD DEBT LOSSES

- .04 Because there are always some customers who cannot pay their debts, selling on credit necessarily involves credit losses. Such losses, as distinguished from amounts that are uncollectable because of damage to goods or failure to meet a specified quality or standard of performance, are "bad debt losses".
- .05 Over the entire life of an entity, the amount of bad debt losses is readily determined and this amount is deducted from revenue in ascertaining the aggregate net income or loss of the entity. It is a more difficult problem, however, to determine the bad debt losses applicable to any one period and various methods of calculating the **allowance for doubtful** accounts, and consequently the amount of the expense, have been followed.
- .06 The estimated **allowance** required is a matter of opinion and the actual loss eventually sustained may be more or less than the estimate. The variation will depend not only on the pessimism or optimism of the estimator but also on events that have yet to occur and that cannot be foretold, such as future collection policies of the entity and future business conditions. The impossibility of making an exact forecast does not, however, relieve management of the responsibility of making a careful estimate of the **allowance** required.
- .07 No formula can be set out that, by itself, provides a means by which the amount of an **allowance** can be determined. The nature of the particular business, the class of customers, the frequency and value of individual sales, the collection policy, the efficiency of the collection department and

general business conditions at the time are all factors that must be taken into account.

- .08 There are, however, certain general practices that should be followed and these are set out below:
- (a) In ordinary circumstances, an entity is to be considered as a "going concern" and no **allowance** need be made **for** the additional costs of collection that would be incurred if the entity were liquidated.
 - (b) In the case of accounts that are no longer active, the expected loss on ultimate realization, including legal and other direct collection costs (if any) that may have to be incurred, is estimated **for** each account.
 - (c) All entities, however, do not stop selling to a debtor as soon as there is a possibility, or even a probability, of loss. In some cases, to do so would force the customer into immediate bankruptcy with the resulting loss of the balance presently outstanding; whereas a continuation of credit on a restricted basis over a period of a year or more may give the customer an opportunity of restoring his financial solvency or, if not, of reducing the balance owing on the account and so reducing the loss. **For** this or other reasons, many entities continue to sell accounts on which there is a known probability of loss, and in such cases, the **allowance for doubtful** accounts includes some provision against the probable ultimate loss on such accounts even though the actual balance outstanding at the end of the period may subsequently be paid.
- .09 While it is presumed in the above remarks that an individual appraisal will be made of each account, this is not always practical. In some cases, a similar result may be obtained by aging the balance outstanding (**for** example, current, 30-60 days, 61-90 days, over 90 days) and by applying to the totals so determined varying percentages based on past experience, or an individual appraisal of larger balances may be combined with an aging of smaller balances. In some instances, the charge against income **for doubtful** accounts may be arrived at by applying a fixed percentage, calculated in light of the bad debt experience of corresponding prior periods, to the sales **for** the period. When this or any other alternative method is followed, the resulting **allowance** is reviewed from time to time to see that it is not materially more or less than the amount that would be required on the basis of providing **for** the probable loss on accounts outstanding at the balance sheet date.
- .10 ♦ *An account or note receivable should be written off as soon as it is known to be uncollectable or should be written down to its estimated realizable value as soon as it is known that it is not collectible in full.*
- .11 ♦ *Amounts subsequently recovered from accounts previously considered uncollectable and written off should be credited to income in the period of recovery; or, if the account was charged against an **allowance for doubtful** accounts when it was written off, the recovery may be credited to this **allowance**.*
- .12 ♦ *If, after writing off all known uncollectable accounts, it is expected that some further losses will be incurred in collecting the accounts and notes receivable outstanding, including notes receivable under discount, an **allowance for doubtful** accounts should be provided. The accounts and notes receivable, net of the **allowance** should be the best possible estimate of the amount **for** which reasonable assurance of collection exists, in the light of current conditions and assuming the continuation of the business as a "going concern". Where accounts under discount have been removed from the receivables, the related **allowance** will normally appear as a current liability. [FEB. 1995]*
- .13 ♦ *The amount of the **allowance for doubtful** accounts at the end of a financial period should be calculated by reference to the accounts outstanding at the end of the financial period after taking into consideration all circumstances known at the date of review (see SUBSEQUENT EVENTS, Section 3820).*
- .14 ♦ *The **allowance** should be determined in accordance with generally accepted practices regardless of how the **allowance** is determined **for** taxation purposes.*

Footnotes

* Editorial change — April 2005 and December 2006.

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