

## ACCOUNTING FEATURES FOR UNCOLLECTIBLE RECEIVABLES

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**Abstract:** Under the competitive economy, the entities tend to increase their sales by accepting the subsequent payment for the delivered goods or services. However, in an unstable economic situation, such as in the Republic of Moldova, may arise cases when customers do not have the ability to honor their payment obligations and will not pay the amounts due. In this situation, the entity will recognize uncollectible (doubtful) receivables. The purpose of the present article is to examine the problems related to the uncollectible (doubtful) receivables accounting and to emphasize the directions for their improvement in accordance with the international requirements and the current level of economic development of the local entities.

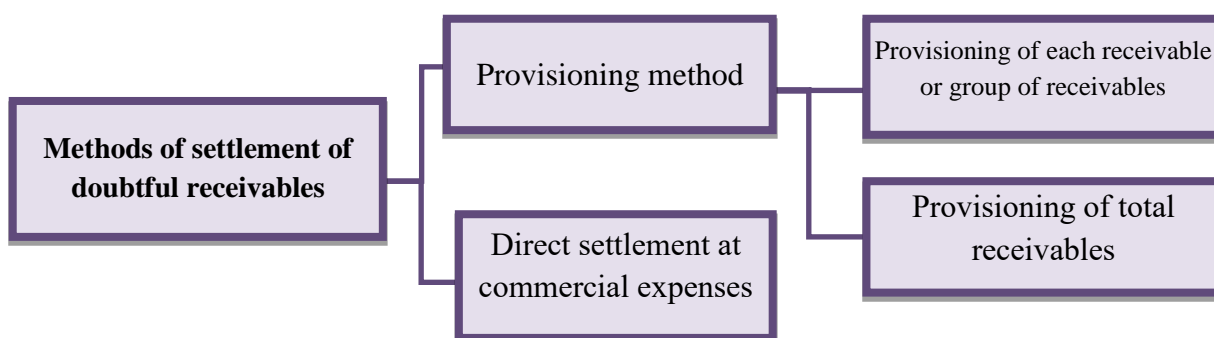
**Keywords:** doubtful receivables, commercial receivables, net sales volume, collection period, customers, bankruptcy, insolvency.

**JEL:** M41

**Introduction.** The activity of any entity involves various relationships with customers, employees, budget, etc. If the parties do not fulfill their assumed contractual commitments, especially, those related to the payment terms, appear the doubtful receivables.

The way of determining doubtful receivables, as well as the way of their settlement and deduction are regulated by the articles 259-283 of the Civil Code [1], articles 31 and 116 of the Tax Code [2], articles 97-105 of the Regulation on inventory [3]. Thus, according to the mentioned legislation, as well as to the point 36 of the NAS „Receivables and financial investments”, receivables are considered to be doubtful if the limitation period provided by the legislation in force has expired or the buyer (the customer) is in an unfavorable financial situation (the receivables have not a guaranteed coverage and can not be collected).

**Main content.** Accounting of doubtful receivables follows two basic tasks: detecting the receivables and their settlement. After the expiration of the limitation period (in most cases it is 3 years) or if receivables cannot be recovered because of the bankruptcy, insolvency, etc., the receivables can be settled in the financial accounting either by the direct method or by the provisioning method (Figure 1).



**Figure 1. Methods of settlement of the doubtful receivables**

Source: summarized on NAS „Receivables and financial investments”

In the case of the *direct method*, the doubtful receivables are settled as the current expenses, with the following accounting records:

- at the sum (without VAT) of commercial doubtful receivables settled of non-affiliated and affiliated parties and of advances granted:

- **Debit account 712 „Distribution expenses”**
- **Credit accounts 221 „Commercial receivables”, 223 „Short-term receivables from related parties”, 224 „Short-term advances granted”;**

- at the sum of commercial doubtful receivables settled of budget, staff, calculated revenues, social security bodies and of other debtors:

- **Debit account 714 „Other operating expenses”**
- **Credit accounts 225 „Short-term receivables settlement with budget”, 226 „Short-term receivables related to personnel”, 231 „Receivables on revenues from assets renting”, 233 „Insurance receivables”, 234 „Other current receivables”.**

If the amount of settled doubtful receivables is recognized as a deduction for tax purposes, the entity is entitled to transfer to the account the sum of VAT from the amount of settled doubtful receivables. If the doubtful receivables are not recognized as a deduction for tax purposes, the amount of the VAT related to them is transferred to the expenses of the period.

It is worth mentioning that, the doubtful receivables accounting certain basic accounting principles will be followed. In line with the prudence principle, it should be taken into account the potential losses of the current or future year, in order to not allow the overvaluation of assets, as well as the undervaluation of debts and expenses. According to another principle, it is necessary to correlate the expenses with the related incomes and to reflect them in the period to which they are assigned (Matching Principle). Thus, if the sales of products with subsequent payment involves losses because of the non-collecting of the total amount of receivables, they will be incurred from the sales revenue recorded from the respective transaction. Since the doubtful receivables may generate losses not only in the year of their occurrence, but also in the future periods, the entity should anticipate the amount of those losses and reflect them in the period in which the sales revenue were recorded. If at the time of sale, the entity anticipates that a part of the receivables will not be recovered, it will use the *provisioning (adjustment) method*. It provides the *provisioning (adjustment)* for the sale of goods or services, within the deadlines set out in the accounting policies (monthly, quarterly, yearly), by applying the procedures recommended by NAS „**Receivables and financial investments**” or otherwise provided in the accounting policies.

The applicable procedures for the provisioning of the doubtful receivables are presented in Table 1.

**Table 1. The applicable procedures for the provisioning of the doubtful receivables**

No.	Procedure	Method of provisions calculation
1.	On each receivable	starting from the absolute amount of the doubtful receivables
2.	On groups of receivables	depending on expired payment term of the receivables
3.	On total amount of receivables	starting from the volume of net sales during the period and the share of the losses related to the doubtful receivables

*Source: summarized on NAS „Receivables and financial investments”*

According to the point 40 of the NAS „**Receivables and financial investments**”, the *provisioning (adjustment) method* may be applied only to adjust the commercial receivables. In this case, the provisions on the doubtful receivables are formed based on the distribution expenses of the period in which the corresponding transaction took place. The following accounting formulas are recorded in the entity's accounting for the settlement of the doubtful receivables by the provisioning method:

- the formation of the provisions on the doubtful receivables:
  - **Debit account 712 „Distribution expenses”**
  - **Credit account 222 „Adjustments (provisions) on doubtful receivables”;**
- the settlement of the doubtful receivables based on the formed provisions:
  - **Debit account 222 „Adjustments (provisions) on doubtful receivables”**
  - **Credit account 221 „Commercial receivables”;**

- recovering receivables previously settled as doubtful receivables based on the formed provisions:

- **Debit account 221 „Commercial receivables”**
- **Credit account 222 „Adjustments (provisions) on doubtful receivables”.**

The above-mentioned accounting formulas are drawn up based on the receivables inventory list (indicating the receivables with the expired limitation date) and on the order of the entity's head on the settlement of the doubtful receivables. At the same time, the entity records the settled receivables of insolvent clients at the off-balance sheet account **Dt 919** “Settled doubtful receivables”. If the financial situation of such debtors will improve, it will be possible to collect those receivables.

It is to mention that according to the accepted procedures within the entity, will be taken into account the unused balance of provisions previously created. Thus, according to point 44 of the **NAS „Receivables and financial investments”**, the provisions regarding the doubtful receivables determined on each individual receivable and on groups of receivables shall be adjusted with the difference between the amount of the calculated provisions and the unused balance of them according to the accounting data .

*Example 1. According to the accounting policies, the entity „Promo-Lag” LLC applies the provisioning method, determining their amount by groups of receivables after the expired payment term. As of 01.01.2017 the entity had an unused balance of provisions on doubtful receivables for 10 320 MDL.*

*The information on the groups of receivables, the share of the doubtful receivables and the amount of the calculated provisions are presented in Table 2.*

**Table 2. Calculation of provisions on doubtful receivables (MDL)**

No.	Buyer	Balance of receivables after the expired payment term					Total
		1-3 months	3-9 months	9-12 months	1-3 years	more than 3 years	
1.	„Solo” LLC		24 000				<b>24 000</b>
2.	„Primăvara” LLC			62 000			<b>62 000</b>
3.	„Rinop” JSC	102 000	57 000				<b>159 000</b>
4.	<b>Other buyers</b>	240 000	185 300	53 500	42 000	27 300	<b>548 100</b>
5.	<b>Total receivables (MDL)</b>	342 000	266 300	115 500	42 000	27 300	<b>793 100</b>
6.	<b>Share of the doubtful receivables (%)</b>	1,5	2	3	12	50	x
7.	<b>Provisions on doubtful receivables (MDL) (5x6:100)</b>	5 130	5 326	3 465	5 040	13 650	<b>32 611</b>

As of 31.12.2017 the provisions on doubtful receivables determined as the difference between the calculated provision in the sum of 32 611 MDL (5 130 MDL + 5 326 MDL + 3 465 MDL + 5 040 MDL + 13 650 MDL) and its unused balance (10 320 MDL) in the amount of 22 291 MDL (32 611 MDL – 10 320 MDL) are recorded by the following accounting formula:

- Dt 712; Ct 222 – 22 291 MDL.

If the entity determines the amount of the provision on total amount of receivables taking into account the average share of doubtful receivables in the volume of net sales or applies its own method of determining the provisions on doubtful receivables, arises the question whether or not it will be taken into account its unused balance? The answer is the following: if the method applied by the entity is based on the balance of receivables (the indicator that characterizes the financial position) then the balance of provisions is adjusted. However, if the entity, by the method applied,

takes into account the volume of net sales or another element of financial performance, then there is no need to adjust the balance to determine the amount of the provisions. According to the point 45 of the NAS „**Receivables and financial investments**”, the *net sales volume* represents the revenues from the sales in credit (with subsequent payment) adjusted by the value of the returned goods and/or the amount of discounts. The average share of doubtful receivables is calculated as the ratio between the effective amount of the losses on the doubtful receivables in the previous periods (for example 3-5 years) and the volume of net sales in the same period.

**Example 2.** *The accounting policies of the entity „Vedua” LLC contain the following provisions regarding the provisioning of doubtful receivables:*

- *for the determination of the provisions, the net sales volume procedure is applied*
- *the provisions are determined at the end of the year;*
- *the share of doubtful receivables is calculated as the ratio between the losses on the doubtful receivables and the volume of net sales in the last 3 years (table 3);*
- *the unused balance of provisions is 9 950 MDL.*

**Table 3. Calculation of the share of doubtful receivables**

Years	The net sales volume (MDL)	The losses on the doubtful receivables (MDL)
2014	480 000	16 000
2015	584 000	21 300
2016	623 000	20 500
<b>Total</b>	<b>1 687 000</b>	<b>57 800</b>
<b>The share of doubtful receivables (%)</b>	<b>3,4</b> (57 800 MDL : 1 687 000 MDL x 100)	

*For the determination of net sales, the entity uses the information on the balances of the accounts drawn at the end of 2017 from the verification balance:*

- *611 „Revenues from sales” – 830 000 MDL,*
- *833 „Return and discounts”:*
  - 8331 „Return of sold goods” – 12 000 MDL,*
  - 8332 „Discounts on sales” – 18 000 MDL.*

According to the data from the table 3, the share of doubtful receivables in the net sales volume represents 3,4 %. In this case the amount of provision on doubtful receivables will be 27 200 MDL [(830 000 MDL - 12 000 MDL – 18 000 MDL) x 3,4%], and the unused balance of provisions on doubtful receivables in the amount of 9 950 MDL will not be taken into account. As of 31 December 2017 the entity will record the following accounting formula:

- Dt 712; Ct 222 – 27 200 MDL

The result of the calculations will influence some of the indicators from the financial statements and tax reports of the entity „Vedua” LLC.:

- *In the balance sheet:* row 190 „Commercial receivables” – the commercial receivables are diminished with the sum of formed provisions;
- *In the profit and loss statement:* row 050 „Distribution expenses” – the distribution expenses are increased with the sum of formed provisions;
- *In the income tax statement:* row 03014 „Breakdowns in reserve funds (article 31 paragraph (2) from the Tax Code)” from Annex 2D „Adjustment (increase/decrease) of expenses according to the provisions of the tax legislation” – is reflected the size of the expenses related to the provisions formation (according to the article 31 from the Tax Code they are not allowed for deduction).

It is important to note that in the international practice the creation of provisions on doubtful receivables is a deductible expense for tax purposes. Such an approach ensures the reliability of the

information used to compile both the financial statements and the tax reports. Thus, in Romania, Hungary, Turkey, Russia and other countries, provisions on doubtful receivables are deductible for tax purposes and may be from 20% to 100% of the amount of the provisions created.

In order to be „attractive” to investors and creditors it is necessary to properly manage the data on the receivables of the entity, reflected in the financial statements and tax reports. For this purpose, entities must develop credit policies designed to determine the credit conditions to the customers, payment deadlines, maximum amount of receivables for each client, and other issues. Through such policies, each client will be also monitored from the point of view of honoring the obligations assumed within the set deadlines. For this purpose, it is recommended to distribute the customers to several risk groups, taking into account the probability of non-collection of receivables depending on certain factors: the recorded performance and customer's overall financial condition, the existence of a guarantee of payment, general economic trends and some special events with regional or sectoral character, which may affect the ability of customers to honor their payment commitments.

**Results and conclusions.** As it can be seen from the above-mentioned facts, entities now aim to increase their profitability by attracting new customers. Attracting new customers without having a deep study of them can create difficulties in collecting receivables.

Entities that record such receivables must focus on their management by ensuring that all the receivables are effectively monitored, with timely identification of doubtful receivables and the choice of the appropriate method of settlement of these receivables. Because the amount of receivables is determined by the level of sales and cash receipts, it will be considered acceptable the increase of the receivables as a result of the increase in sales, and not as a result of the decrease in the cash receipts. The structure of the receivables will be also assessed to determine whether their increase is due to an increase in the commercial receivables or other admissible receivables. In this respect, the entities will focus on developing relevant internal reports that allow systematization of all the accounting information necessary to perform the effective analysis of the doubtful receivables.

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