Direct write off method violates what principle

Because customers do not always keep their payment promises, companies must include these non-recoverable accounts in their records. Companies use two methods for processing unaccountable accounts. The direct depreciation method recognizes bad accounts as an expense at the time they are deemed uncollectible, and is the required method for federal income tax purposes. The compensation method provides in advance that bad accounts think of a reserve account as a side dish. The compensation method represents the accrual accrual basis for accounting and is the accepted method for recording bad accounts for financial accounting purposes. Direct depreciation The direct depreciation method is only used if we decide that a customer does not pay. We do not collect estimates and do not use the allowance for dubious accounts as part of the direct depreciation method. We record the cost of bad debt for the amount we determine is not paid. This method violates the GAAP matching principle of revenue and expenses recorded during the same period. If we write off an account using this method, the entry would be: Debit Credit Bad Debt Expense X Accounts Receivable X The amount used is the amount that the customer owes that we cannot collect. The allowance method follows the GAAP matching principle, as we estimate bad accounts at the end of the year. We use this estimate to record spending on bad debt and to set up a reserve account called Grant for Doubtful Accounts (also known as an uncashable account allowance) based on previous experience with previous due accounts. We can calculate these estimates based on the revenue (profit/loss invoice) for the year or on the basis of the customer balance at the time of the estimate (balance sheet). As a contra-asset account to the account The customer reduces the compensation for dubious accounts (also referred to as a subsidy for bad debts or bad loss allowance) to their net realizable value. The net realizable value is the amount that the company intends to recover from receivables. When the company adjusts the bad debts, it doesn't know which specific accounts will become uncollectible. Therefore, the company cannot enter loans in the customer tax account or in the customer-subsidiary ledger accounts. If only one or the other were credited, the customer control balance would not match the sum of the balances in the customer subsidiary ledger entry. Without crediting for the Customer Tax account, the certificate account can show that some of its accounts have accounts are probably uncollectible. If we decide that a customer does not pay the amount owed, we use the doubtful account allowance to offset that loss instead of receivables expenses. At the end of each year, we estimate receivables expenses and make the following entry: Debit Credit Bad Debt Expense X Allowance for Doubtful Accounts X The amount used is the estimated amount calculated on sales or receivables. If we write off a customer account as part of the compensation method, the entry: Debit Credit Allowance for Accounts X Accounts Receivable X Notice would be how we do not use receivable expenses for bad receivables in a depreciation method according to the compensation method. Let's try to make customers more relevant or understandable by using an actual company. What does Coca-Cola's Form 10-k tell us about its demands? Coca-Cola has several assets listed on its balance sheet. Let's look at what is reported on Coca-Cola's Form 10-K about its claims. A 10-K is another name for a company's annual report. In addition, a 10-Q is a company's quarterly report. See the following extracts from Coca-Cola Form 10-K 2013: Partially Consolidated Balance Sheets with Current Assets (page 76); Receivables for trading accounts (page 89); and partial income accounts (page 74). Questions What is the total value (gross) value of Coca-Cola's claims (before deduction of compensation for doubtful accounts) as of December 31, 2013? As of December 31, 2012? What is net realizable value? What factors does Coca-Cola use to determine the amount of its compensation for dubious accounts? In which position in the income statement would the cost of bad debt be included? Paying customers within a reasonable time after purchasing a product or service makes the purchase process smoother and increases overall sales. Unfortunately, not all customers pay their debts in full. If a customer refuses to pay, a company can sell the account to a debt collection agency or stop collecting the debt in full. Either way, the company suffers a loss on sale and must be accountable for it. The direct depreciation method causes the total loss when it occurs. While only listed companies are required to file financial statements prepared in accordance with the generally accepted accounting principles of the United States, the direct depreciation method violates GAAP. The prohibits direct depreciation because they do not comply with the matching principle, which requires that each transaction that affects an account, e.B inventory, be matched to another account, e..B cash. Lenders may require that GAAP-based financial statements are also prepared by privately held companies. With the direct depreciation method, the profit from the sale overvalues, undervalued profits when the loss is depreciated, and overvalued receivables in between. Receivables are the assets that a company recognises when customers owe them money. These effects make forecasts less accurate and can make an insolvent business seem more financially sound. Companies recognize the total loss at the time of occurrence. Because the company determines when an account can no longer be registered, it decides when the loss occurs. An entity could abuse this discretionary power to manage its revenue, such as.B delays in detecting losses until after the end of the quarter. By postponing the loss, the company can report inflated profits for a number of reasons, such as.B raising funds or preventing disappointing profits for shareholders. Despite the drawbacks of the direct depreciation method for entrepreneurs, managers, and investors, there are no fraudulent reasons why a company wants to use it to balance losses. Unlike GAAP-approved methods such as percent of revenue or aging methods, the direct depreciation method is simple. It does not require adjusting entries made to counter accounts, or tracking historical averages of how much is collected or depreciated. GAAP allows companies to write off losses if those losses are negligible, such as a loss of USD 100 on a one-time sale made by a company with an annual turnover of more than USD 1 million. The direct depreciation method involves the collection of bad debts only if individual invoices have been identified as uncollectible. The specific measure that is used to write off a claim for this method with accounting software is to create a credit memo for that customer that sums the amount of the receivable. Create the credit memo creates a charge for a non-bond account and a credit memo to the customer account. The method does not include a reduction in the amount of recorded sales, but only an increase in the cost of debt. For example.B, a company records a sale with a loan of USD 10,000 and debiting the customer account and a credit memo to the sales account. After two months, the customer can only pay 8,000 US dollars of the open balance, so that the seller has to write off 2,000 US dollars. This is done with a balance of USD 2,000 to the customer account and a set-off to the account for bad debts. Thus, the income amount remains the same, the remaining receivable is eliminated and an expense Amount of bad debt. The direct depreciation approach violates the matching principle, which states that all costs related to revenue in the same period in which you record revenue are incurred, so that a company's financial results disclose the full extent of a revenue-generating transaction in a single accounting period. The direct depreciation method delays the recording of expenses related to a revenue-generating transaction and is therefore considered an overly aggressive accounting method because it delays some cost recognition and makes a reportable company appear more profitable in the short term than it actually is. For example, a company can record a turnover of USD 1 million over a period of time, and then wait three or four months to collect all related receivables before eventually deducting some bad debts on the costs. This results in a long delay between revenue recognition and the recording of expenses directly related to that revenue. Thus, the profit is overvalued in the first month, while the profit is undervalued in the month in which the bad debts are finally charged on the costs. The direct depreciation method can be considered an appropriate accounting method if the depreciated amount is an intangible amount, as this has minimal impact on an entity's reported financial results and would therefore not distort the decisions of a person using the financial statements of the entity. The alternative to the direct depreciation method is to create a provision for debt subject to exposure during the same period during which you acknowledge income, based on an estimate of the claim for receivables. This approach balances revenue with expense and is therefore considered to be the more acceptable accounting method. The direct depreciation method is required to report taxable income in the United States because the Internal Revenue Service (possibly rightly) believes that companies would otherwise be tempted to inflate their bad debt reserves to report a smaller amount of taxable income. 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