discuss and explain the methods used to handle bad debt expenses

Bad debt expense is handled mainly through two accounting methods: the direct write-off method and the allowance method, each with different effects on the timing and presentation of expenses.[1]

What bad debt expense is

Bad debt expense is the cost recognized when a company concludes that some of its credit sales will not be collected from customers.[1]
It reflects the loss from uncollectible accounts receivable and is reported on the income statement as an operating expense.[2]

Direct write-off method

Under the direct write-off method, the company records bad debt only when a specific customer account is clearly uncollectible (for example, after bankruptcy or failed collection efforts).[2]
The entry is typically a debit to bad debt expense and a credit to accounts receivable, which reduces receivables but may recognize the expense in a later period than the related sale, so it does not comply with GAAP's matching principle for most larger entities.[2]

Allowance method – overall idea

The allowance method estimates bad debts in advance and records an expense in the same period as the related credit sales, matching revenue and expected losses.[1]
It uses a contra-asset account called **allowance** for doubtful accounts, which reduces accounts receivable on the balance sheet to show the amount expected to be collected.[3]

Allowance method – key estimation approaches

Two common estimation bases are used:

- Percentage of credit sales: bad debt expense is calculated as a fixed percentage of the period's credit sales, focusing on matching expense to revenue in the income statement.[1]
- Aging of accounts receivable: outstanding receivables are grouped by age, and different loss rates are applied; the total desired allowance balance is computed, and the expense is the amount needed to adjust the allowance to that level.[1]

Handling recoveries and management actions

If a previously written-off account later pays, the company reverses the write-off (re-establishing receivables and the allowance) and records the cash collection, ensuring receivables and bad debt expense are not overstated.[4]
Operationally, businesses also use credit checks, clear payment terms, collection procedures, and automation of invoicing and reminders to reduce future bad debt expense and improve recovery rates.[5]

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1. https://corporatefinanceinstitute.com/resources/accounting/bad-debt-expense/
2. https://www.bill.com/learning/bad-debt-expense
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