Bad Debt Expense vs. Credit Memos

Background

Over the past year, Corporate Accounting has noted several instances where the recognition of bad debt expense has been confused with the issuance of a credit memorandum.

A specific example regarding this issue is a Brink's subsidiary that inappropriately recorded a customer default as the reversal of revenue (i.e. issuance of a credit memo) as opposed to bad debt expense.

Lesson Learned

The following information outlines the general guidelines for when bad debt expense should be recorded and for when revenue should be reversed because a credit memo has been issued.

Bad debt expense

Bad debt expense should be recorded based on Section 5.2 of the *Allowance for Doubtful Accounts* policy. In summary, the policy states that bad debt expense should be recorded for the following:

- The total amount of all uncollected customer and inter-company accounts aged greater than 120 days beyond the invoice date and

- Any additional customer accounts receivable balances where it is probable that the customer will not pay the amounts due to Brink's.

In these cases, the journal entry to record the bad debt expense is a debit to bad debt expense on the income statement and a credit to allowance for doubtful accounts on the balance sheet.

Credit memos

Credit memos should be issued when there is a reason to refund the customer all or a portion of the invoice previously issued. For example, a credit memo may be issued if Brink's incorrectly overbilled the customer or when we have agreed to provide a refund because the customer was not satisfied with our service.

When credit memos are issued, the journal entry is a debit to revenue on the income statement and a credit to accounts receivable on the balance sheet.

Conclusion

In the example above, the customer default should have been recorded to bad debt expense with a corresponding entry to allowance for doubtful accounts on the balance sheet (as opposed to a debit to revenue and a credit to accounts receivable).