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Methodological Strategy for the Recovery of Overdue Portfolio in the Textile Sector

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Abstract

The overdue portfolio is the accounts receivable that a company has, whose payment date has already expired and has not yet been collected. Its proper management represents a fundamental aspect both in the financial planning and in the entity's growth, as it reflects possible significant risks in its finances. This study aims to propose a strategy for the mitigation of the overdue portfolio and its economic impact on the textile sector. In this sense, it is evident that the null or deficient policies of cash sales or credit, and of the latter in turn of extrajudicial and judicial collection policies, affect the correct presentation of the financial statements, directly affecting the company's economy, which leads to stagnation in production and sales. Therefore, the need to prioritize efficient collection management is corroborated. The descriptive methodology was used through four stages for the interpretive analysis of bibliographic documents. Theoretical methods such as logical history, synthesis analysis, inductive deductive, and empirical were used. Finally, as a result, a reference framework is obtained on which alternatives, and corrective actions can be managed and implemented that will allow the business sector, as well as the accounting, financial and legal areas, to enhance their strengths, for the proper management of sales and the prevention of uncollectible overdue portfolio.

Keywords: methodological strategy, overdue portfolio, economic impact, liquidity, accounts receivable, IFRS

1. Introduction

The Central Bank of Ecuador (BCE, 2020) projects the Ecuadorian Gross Domestic Product (GDP) will rise 3.1% and USD 67,539.00 million in constant values at the end of the year. This growth is due to the stimulus of three elements: an increase in private investment, a rise in household consumption, and a more significant influx of remittances from migrants. The report highlights that the production of textile products, clothing, leather manufacturing, and their articles will have a growth percentage of 4.7%, equivalent to a movement of USD 526.00 million, thus ranking among the ten activities that will help economic growth in 2021.

In this context, companies in the textile sector have a significant economic contribution to the province of Tungurahua-Ecuador. One of its central cantons is San Pedro de Pelileo, located in the center of the inter-Andean region of the country, where it is among the primary producers of clothing such as jeans. This information is highlighted by the Decentralized Autonomous Government of the San Pedro de Petiole Canton (GAD Municipal del Cantón San Pedro de Pelileo, 2021). The Internal Revenue Service (SRI, 2021), in its collection statistics for January of the current year, places Pelileo as the second contributor at the provincial level.

Additionally, in 2020, due to the health emergency caused by Covid-19, the economic crisis has affected companies, especially those classified as microenterprises. In this sense, the textile sector is experiencing problems in collecting its accounts receivable and overdue portfolio. This statement is corroborated by Morales & Carhuancho (2020), when they consider that liquidity in this sector is affected by the payment of current expenses, which causes the closure of businesses.

In turn, Filgueira (2017) and Angulo (2018), agree that the International Financial Reporting Standards (IFRS), issued by the International Accounting Standards Board (IASB), allow the information in the financial statements to be transparent and comparable with the objective that the financial statements investors can interpret and make decisions. It should be noted that, per IFRS 9, the impairment of accounts receivable is recognized following the internal policies that the company deems uncollectible, arising from a past event and future scenarios. In this way, they are recognized as a fund for delinquency or default of the debtor in a loss account (Uribe, 2016); (NIIF, 2021).

In this regard, the collection and its subsequent hardening caused by the rusticity in the accounts receivable by the debtors is the main problem pointed out by Ortiz, Nolazco, & Carhuancho (2020), which generates commercial credit received and granted, originating an expansion in the economic boom stage and a deletion during the current situation. Consequently, it is the companies most financially affected that, in times of crisis, present a greater conflict to obtain financing by requesting loans and, at the same time, increase their credit to clients (Canto, Palacín, & Di Pietro, 2016).

In addition, in the textile sector, the lack of knowledge of strategies for recovering overdue loans is an evident problem, directly affecting the economy within the business environment; where, in addition, the following is highlighted:

- As stated by the Superintendency of Companies, Securities and Insurance (SUPERCIAS, 2018), a stagnation in production and sales, for which the need to improve cash collection management is corroborated.
- The increase in bad debts in the economic sector is a serious indication of a recession in the economy according to Fierro & Fierro (2015), he considers that allowing a form of payment in installments in the sale of products and services, without the correct and due application of the international standards and policies inherent to the issue, encourages late payment of clients when they cannot honor their obligations due to incurring debts that exceed their ability to pay and borrow.
- Debtors exercise unfair practices based on their market power, which leads to an increase in signs of impairment (Horngren, Sundem, & Elliott, 2000).
- Difficulty in the application and interpretation of the International Accounting Standard (IAS), regarding the impairment of the overdue portfolio (NIC 8, 2021).

Given the above, this research aims to propose a methodological strategy for recovering the overdue portfolio in the textile sector.

2. Methodology

This research is descriptive with an interpretive analysis of bibliographic documents. The method proposed by Samaniego (2008), was taken as a reference. A previous conceptualization of credit risk management and its areas of application and antecedents of the object of study was overviewed. Subsequently, the planning stage was executed, where the research questions were defined, including studies related to the business environment of the last five years in high-impact databases; excluding unreliable sources, non-academic documents, and publications not related to the overdue portfolio.

The search stage was carried out from January to November 2021, where the keywords were: strategy, overdue portfolio, economic impact, liquidity, accounts receivable, IFRS. Finally, in the documentation stage, a total of 757 investigations were obtained that meet the established criteria, selecting 50 for the present analysis (see figure 1).

The use of theoretical methods referred by Perez, Perez, & Seca (2020); Trejo (2021), such as analysis-synthesis, is highlighted to reach conclusions from the study objective. The historical-logical method to know the evolution of the strategy term and its main contributions. In addition, we relied on the deductive-inductive method to analyze the subject from the general to the particular and vice versa. Furthermore, the statement by Grados & Sánchez (2017), was taken as a guide, referring to empirical methods such as in-depth interviews and document analysis. As a last resort, a spreadsheet was used, which allowed the analysis of financial information according to the proposed guidelines.

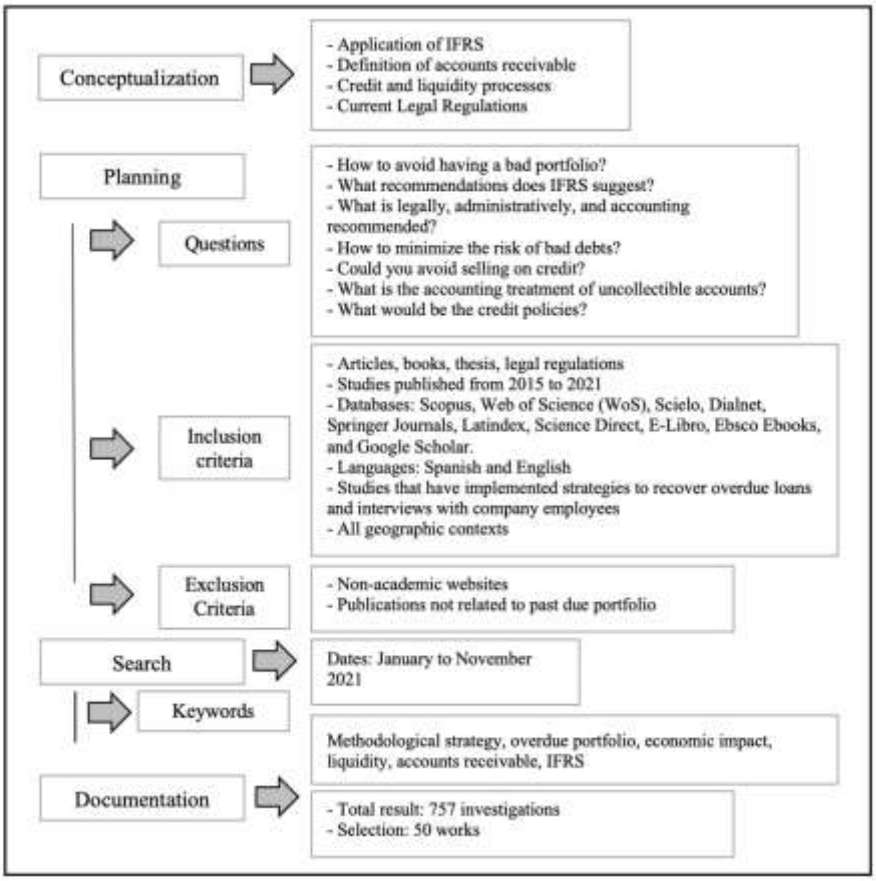

Figure 1. Model for the theoretical review

3. Results

From a more general perspective, concepts regarding the International Financial Reporting Standards IFRS 9 - Financial instruments, the impairment of accounts receivable, the past due portfolio, the processes of credit, liquidity, and the regulation of the legal base are explained. Within this framework, it is evident that the active portfolio represents rights to claim cash or other goods and services due to maintaining credit operations. Therefore, the portfolio and the economic recession mean that customers lose the ability to pay their obligations, and thus the indication of impairment increases.

Therefore, it is imperative to include the opportunity cost of the investment or implicit interest and 2% of the country risk in the sale price, as referred to by Fierro & Fierro (2015), to bear the overdue portfolio so that a company does not reduce its profitability due to the granting of credits. In turn, when the terms for their recovery have expired, they are classified as uncollectible accounts. When the means of collection end, the provision is punished through a control record in the memorandum accounts.

Fundamentally, for entities that apply IFRS, accounts receivable that have a longer credit term than normal current are recognized at their net present value by using the amortized cost method and recognizing the effective interest rate. The impairment loss is the difference between the asset's carrying amount and the best estimate of the amount that the entity would receive for it. For this reason, the SRI (2021) clarifies that, when initially recognizing a financial asset whose subsequent consequence impacts its future cash flows, it represents an asset that produces an impairment loss.

In this sense, it should be noted that accounts receivable represent the total credit granted by a company to its clients, which is determined through its volume of credit sales. As mentioned by Umasi & Choquepuma (2018), this modality will be effective when the organizations have correctly stipulated the guidelines and conditions under which this payment modality is being offered. Otherwise, it is difficult to know if the accounts receivable are being made effective in reasonable periods of time.

On the other hand, the impairment of the accounts receivable will be evaluated at the end of each reporting period, as reported by Vargas (2020); Santillana (2020), by assessing objective evidence of impairment of financial assets. In addition, financial difficulties in the business operations of the obligor due to late payments, possible bankruptcy, significant changes in the technological, economic, or legal environment of the market are causes of loss.

In this sense, the overdue portfolio is understood as an account that is difficult to collect due to the expiration of the term granted, according to Wang & Qin (2017). It is essential to resort to the persuasive collection through the extrajudicial collection policy or judicial collection through the execution of embargoes on the client's solvency. Therefore, the portfolio is uncollectible when customer accounts are reported as loss, as highlighted by Louhichi & Boujelbene (2016), after classifying them as difficult-to-collect debts once authorized by the board of directors. In turn, when the collection management is exhausted and if there are no legal resources for its recovery, it continues to cancel against the provision and with the deterioration of accounts receivable. It is vital to consider portfolio recovery when obtaining this income.

In this perspective, the credit and liquidity processes are complemented because all credit granted to a third party constitutes a portfolio that is recovered through collection, as stated by Tutillo (2017); Vásquez, Terry, Huaman, & Cerna (2021). However, excessive credit to customers helps not to keep production in stock but allows an excessive increase in accounts receivable. Likewise, the absence of the collections department and transparent policies to evaluate each client's payment capacity significantly affects the company's liquidity.

Thus, the accounts receivable management must have indicators that allow measuring both efficiency and effectiveness in the process, which is suggested by Koju, Koju, & Wang (2020); Tochukwu (2020); (INCP, 2021). In such a way, corrective actions are implemented that allow optimizing collection management and knowing the behavior of customers, among other variables. It should be noted that employees are willing to adapt to new changes that provide better collection mechanisms in the credit area.

Consequently, as collection management is a set of coordinated actions, when applied promptly towards clients, a recovery of credits is achieved, as stated in the research by Correa & Eslao (2018); Lopez (2020). Therefore, maintaining contact and constant communication become optimal alternatives as well as the monitoring record and compliance control. In turn, liquidity measures the ability to meet payment obligations over time because, when making decisions such as an investment, purchase of shares or assets, according to Gulati, Goswami, & Kumar (2019); Kabir, Dulal, & Huda (2020), it is crucial to have cash and its equivalents. Thus, at the end of the period, its recoverability is evaluated technically, and the contingencies of loss of its value are recognized, as long as it shows signs of default in its normal collection.

For its part, the Internal Tax Regime Law (LORTI, 2021), in paragraph 11 of article 10, states that: "provisions for bad debts originated in ordinary business operations, carried out in each tax year at the rate of 1% per year on the commercial credits granted in that period and that are pending collection at closing, without the accumulated provision being able to exceed 10% of the total portfolio". Therefore, the application of this article represents a deductible expense for the business sector.

Moreover, numeral 3 of article 28 of the Regulation for the Application of the Law of Internal Tax Regime RLRTI (2021), provides that "the values recorded for impairment of financial assets corresponding to bad credits generated in the fiscal year are deductible and originated in operations of the ordinary course of the business, registered according to the accounting technique, the level of risk and the essence of the operation, in each tax year, which may not exceed the limits indicated in the Law." Consequently, the total elimination of bad debts is carried out by recording the accumulated impairment value, and the unhedged value is applied to the results for the year.

In this sense, this benefit applies if one of the following conditions is met:

- Being in accounting for two years or more;
- The passing of more than three years since the original expiration date of the credit;
- Prescribing the action for the collection of the credit;
- The debtor declares bankruptcy or insolvency; and,
- If the debtor is a company declared canceled.

Preparation of the strategy.

It is important to consider that the development of the methodological strategy was chosen because a series of steps will be followed that comply with the processes in a structured, orderly, and formal way for decision-making and management based on the recovery of the overdue portfolio in a company. Depending on what has been raised, it is explained in (table 1).

Table 1. Approach on the development of methodological strategy

Author	Year	Reference	Conceptualization
Tarziján	2018	Strategy	It is a favorable procedure for determining the goals and objectives that allow acting in front of a particular situation using making decisions.
The application of the strategy is focused on the establishment of the objectives and actions to be fulfilled, with an emphasis on the value that it will create, the adaptability to the needs of the environment through the use of a value proposition both inside and outside of the organization.			
Langa	2018	Formulation of a strategy	-Organize the information acquired when diagnosing the current situation of the entity. -Determine the objectives to be achieved. -Develop activities and proposals to fulfill. -Distribute human, technical, and financial resources in the company and its control.
It focuses specifically on placing the company in a position that provides facilities when executing its mission efficiently and effectively. In addition, formulating a strategy at the enterprise level lies in the ability to integrate goals, policies, and tactics, guided by the reality of the business itself.			
Zúñiga, Terrazas, & Zorrilla	2021	Methodological Strategy	It consists of a set of planned actions to facilitate the development of reading comprehension, the methodology being a set of criteria that highlight and explain reality, and concentrate the procedures for data processing. Carried out in a structured, orderly, systematic, logical, rigorous, exact, and objective manner.
The process carried out is based on the methodological strategy. Each step is represented in a system of actions carried out in a logical and coherent order, depending on the fulfillment of objectives. Therefore, through planned activities, the phases within the administrative process will be established.			

Source: Own elaboration

Considering these antecedents, it is essential to create a methodological strategy that also considers Blandez (2016); Bernal & Sierra (2017), who highlight the administrative process as an organizational model aimed at the implementation of the planning, organizing, directing and controlling phases. Moreover, a reform established by the University of California, Los Angeles (UCLA), adds to the integration phase in the intermediate part of the administrative process, which facilitated the incorporation of the proposal to the research.

Subsequently, the proposal's structure, the results of an in-depth interview carried out with the collaborators, established by a set of questions generated while the diagnosis of the current situation of the company was performed, as well as a review of financial documents, a methodological analysis, and a bibliographic analysis were taken as sources of information. In addition to the phases of the administrative process, the development process is evident:

Diagnosis of the current situation

For the exemplification, the results of this research consider a company dedicated to washing and dyeing jean garments within the textile production sector of Pelileo. In recent years, the textile sector has become one of the main economic activities of the canton. Therefore, it is necessary to analyze the behavior of accounts receivable ratios from 2018 to 2021.

For this purpose, these topics were analyzed: describe overdue portfolios and the high-risk portfolio through the measurement of efficiency in the rotation of accounts receivable and the collection period, which will determine the behavior of the financial situation in the last three years. It is essential to clarify that all the numerical representation used is expressed in US dollars. Therefore, taking into account this diagnosis, the problem is thus summarized (figure 2):

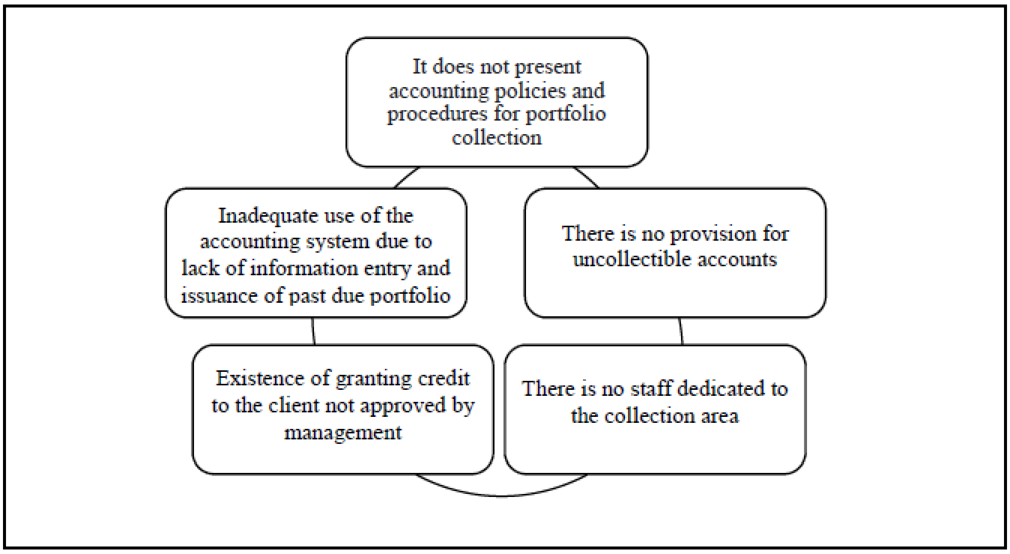

Figure 2. Existing problems of the company

For the analysis of the liquidity ratio of the last three periods, it was observed that in 2018 the entity, in its current assets with 0.99 cents for every dollar, has in debt to meet its payment commitments with suppliers in the shortest time possible, the immediate liquidity being the most favorable. In 2019 the result fell to 0.85 cents; this indicates that the entity does not have sufficient liquid resources to face the debts and obligations that expire in the short term. However, 2020 presented an atypical report of 0.65 cents because its current assets do not have the adequate solvency to face its accounts payable (figure 3).

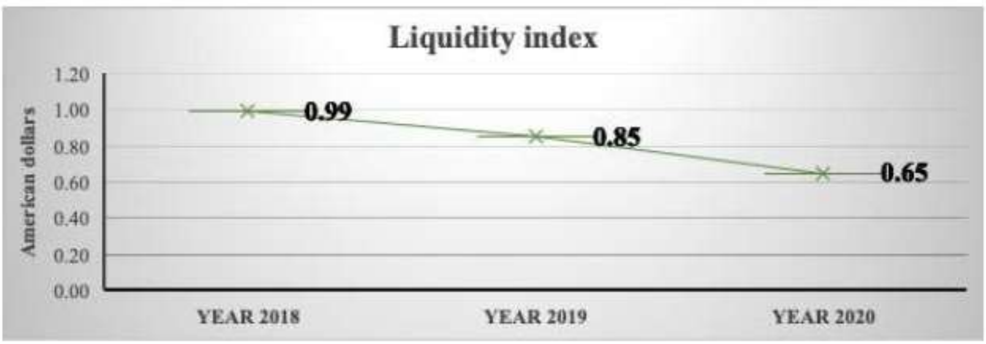

Figure 3. Existing problems of the company

Concerning the above, collections' rotation was analyzed. The initial collection amounts to high amounts, the high-risk portfolio exceeds 150 collection days, and the amount of receipts amounts to 59.95%, accounting for bad debts in some cases. Consequently, it was found that customers do not cancel services on time, affecting the delay in meeting the payment date stipulated by the providers. In fact, by not applying policies, procedures, and adequate credit periods to the business and the personnel dedicated to this area that project economic benefits, there is an overdue collection of the portfolio in arrears with potential problems, registering the largest number of late receipts.

Within this framework, these observations are related to the collection period every 30 days concerning sales made with cash prices. It is an essential result up to the current date because the collection turnover decreased. This represents 17.92% of the total due to the lack of adequate collection management, generating a one-month credit term for the return of cash to the organization, without the consent or control of the management (figure 4).

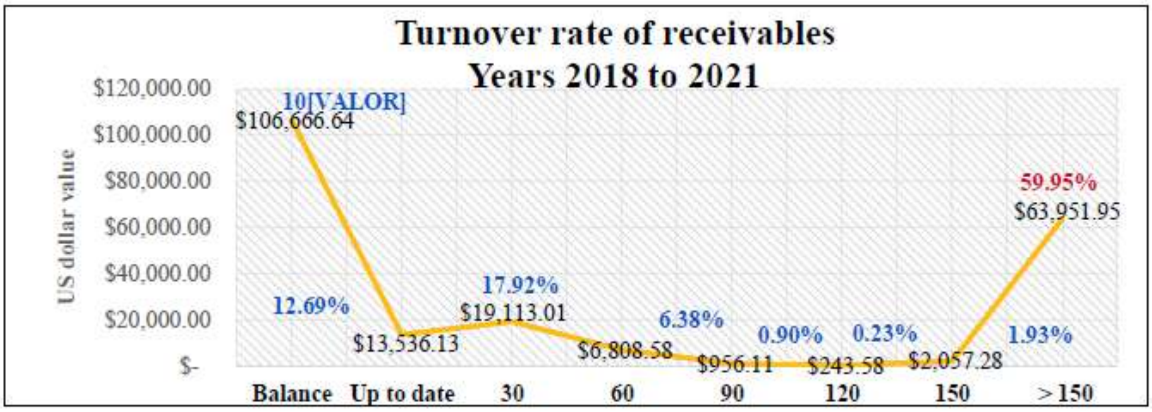

Figure 4. Collection turnover ratio and its representation percentage

On the other hand, according to the horizontal analysis carried out for the last three periods, it is denoted that the cash and cash equivalents of 2018 decreased by USD 29,065.73, represented by 7%. This differs from 2019, when the percentage variation increased considerably to USD 84,782.48, referred to 21%. The said increase is due to the rise in sales for 2019, which means that the company has cash available for that year. Unlike in 2020, there was no cash available. It is important to mention that, due to the pandemic, many potential clients stopped working and closed their businesses. Therefore, an accumulated deterioration in the value of accounts and documents to charge commercial was determined for bad debts (figure 5).

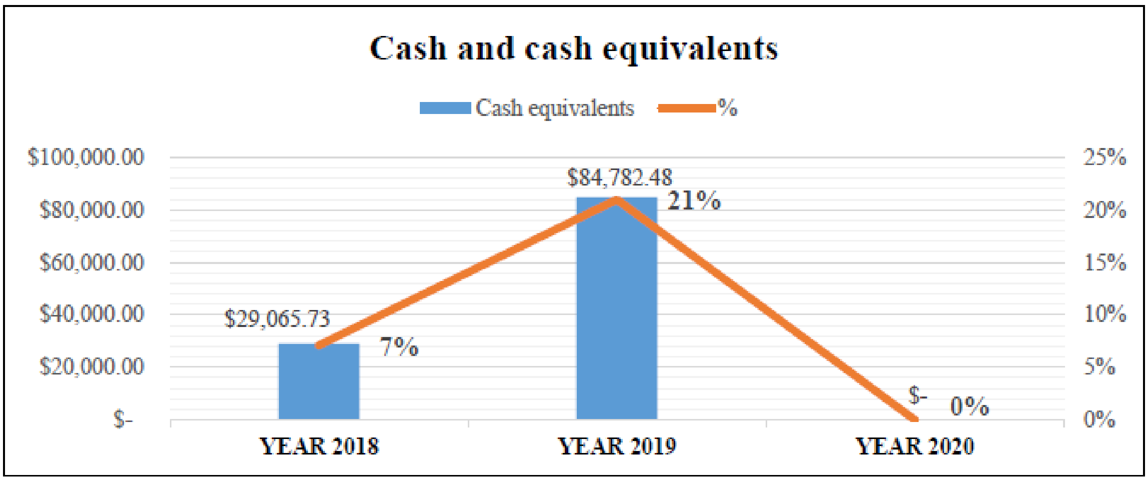

Figure 5. Annual percentages of cash and its equivalents

The strategic rationale is structured as follows (figure 6).

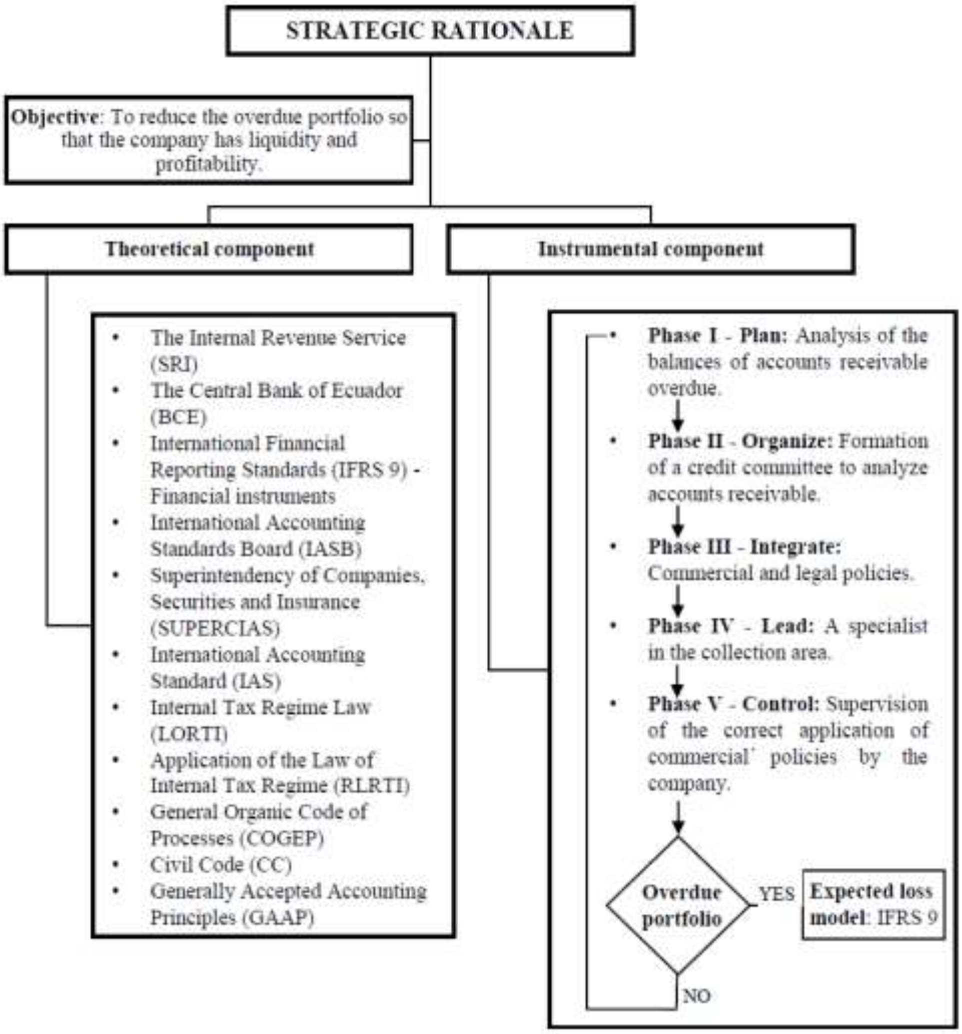

Figure 6. Graphical outline of the proposed strategy

Based on what has been stated in previous paragraphs, the process of developing the proposed strategy is carried out:

Phase I: Plan

Under the criteria of Peña & Rivera (2016), in this phase, the objectives are defined by establishing some important aspects such as training, linkage, response to changes, resource analysis. Therefore, guiding decisions and having a clear route on the direction of people's efforts will reduce uncertainty and clarify what is essential to achieve (table 2).

Table 2. Activities of the planning phase

Activities	Normative	Source of information
Analysis of the balances of accounts receivable overdue for more than 150 days.	IFRS 9 - Classification of past due portfolio	Company accounting system
Diagnosis of the accounting system to verify the information entered for each client, billing terms.	IAS 8- Accounting policies, changes in accounting estimates and errors	Microsoft Excel pivot table
Functional planning of the financial accounting areas and the sales area of the organization.	Internal policies and procedures manual	Report on the status of accounts and documents receivable
Definition of criteria that promulgate the periodic review of progress, through adequate and effective controls to measure results.	Internal policies and procedures manual.	Company collection management.

Source: Own elaboration

Phase II: Organize

For his part, Rum ń (2019) asserts that, companies must design their organizational structures through the order of their resources, tasks, or positions so that the performance of their activities responds competitively to the demands and changes of the environment. For this reason, centralization in the decision-making process is essential, as well as the formalization of procedures, relationships, and standards at work (table 3).

Table 3. Activities of the organization phase

Activities	Normative	Source of information
Formation of a credit committee to analyze accounts receivable of doubtful recoverability.	IFRS for SMES Section I - Small and medium-sized entities	Company departments
Division and specialization of work in the areas of collections and sales.	Internal policies and procedures manual.	Company departments
Organize the work around the collection and recovery procedures of the portfolio through the support of Information and Communication Technologies (ICT) to increase the degree of automation and virtualization of the processes.	IFRS 9 - Accounts and notes receivable.	Company Accountant

Source: Own elaboration

Phase III: Integrate

It is essential to emphasize that the conditions set out by the IFRS 9 standard were applied and linked with the interview, allowing the collection of information from a planned and controlled conversation with an interlocutor, which constitutes a key subject for their experience for the investigation.

Based on the preceding, a methodological strategy is integrated for the recovery of overdue portfolio in the textile sector through the applicability of activities proposed for cash and credit sales, under diligent, responsible, and technical administration, to provide a quality service to set the guidelines within your scope or area. Therefore, in all sales, it is imperative to standardize the subscription of all the documents necessary for their possible sale in factoring, judicial collection, or securitization of invoices to convert the portfolio into cash.

- **General policies for cash sales:**

- Application of a commercial discount (unconditional), through the presentation of alternatives to buyers or clients that increase their volume of purchases. A discount will be offered according to the corresponding economic sector if they buy or acquire the service according to a certain scale of merchandise.

- Use of a financial discount (conditional) as a sales policy to obtain more significant financing and liquidity by conditioning the client by means of discounts to be paid in cash in the shortest time possible, always considering their current situation. This can be applied for up to thirty days. In addition, it is essential to incorporate these factors at the end of the invoice.

- Announce special offers, for example: if the chain discount is applied to the invoice balances, the first is discounted first and then the second.

Normative: IFRS 9 Financial Instruments - Portfolio Discounts

- **General policies for credit sales:**

The method of selling on credit through proper management represents a real advantage for a company's growth. Essentially, this benefit should be offered to a small number of customers in the company since it minimizes the risk of loss while evaluating if these policies are correct. Therefore, if the results are positive, the credit percentage can be increased.

In this way, since not everyone can be verifying the debtor client profile through an analysis of their credit score, payment history, pending obligations, and the ability to cover their obligations regarding the last semester by hiring and using the specialized Equifax system will be imperative.

Moreover, it will be optimal to review the system of consultation of causes of the SATJE judicial function in search of ordinary, executive, or monitoring proceedings initiated against the prospect, in addition to investigating the page of the State Attorney General's Office to determine if there are complaints, specifically with infractions related to the commercial sphere such as breach of trust, theft, fraud or fraudulent bankruptcy.

Furthermore, it is essential that whoever intends to be a credit subject must have a business line with a certain time of antiquity, which in turn reflects whether it is constant and profitable, for which it would be feasible and beneficial to review the monthly, quarterly or semi-annual statements of the Value Added Tax and the annual taxes of the Income Tax.

In this sense, in addition to carrying out an exhaustive review, it is important that the already-qualified subject presents real guarantees of their assets to strengthen his profile. Indeed, if the credit represents a large amount, it is recommended to make a mortgage in the case of real estate or a pledge in the case of movable property.

Therefore, if the person has a good credit profile, but does not have assets of any kind, they can sign a commercial surety contract as a personal guarantee in favor of the same, where one or more people assume the obligation of others and they would commit to making the payment if the principal debtor does not do so. Thus, the person signing as guarantor will be subject to exhaustive review.

Within this order, the documents will be subscribed, among which the negotiable commercial invoices with their respective annexes, the reception guides, referral guides, and delivery orders will be signed. Additionally, an executive title will be signed, preferably a bill of exchange as a supporting document, which will be returned if the obligation contracted is fulfilled. In addition, if the case warrants it, it must be accompanied by the guarantee of a person with a good profile.

It should be noted that, by stating a date after the origin of the obligation, a transactional act can be signed because, as authorized by COGEP, it can be directly collected without proving the existence of the obligation. In other words, to execute an obligation, one would normally have to carry out two judgments, one executive and one for execution, but with the signing of the transaction, only the one for execution would be carried out (COGEP, 2021).

It is worth mentioning that, in all credit sales, interest rates will be charged that do not exceed the limits allowed by the Central Bank of Ecuador because, after thirty days onwards, a person is considered delinquent, according to Samaniego (2008). Therefore, the interest will be transformed into a monthly rate for its entry into an accounting system that calculates as of day 31. IFRS recommends that, at the price of sale to the public, they should already be included, and if there are advance payments, the customer would be stimulated through discounts. It is advisable to set a price that contains the surcharges for waiting times and reward with discounts in the case of prompt payment.

On the other hand, a more permissive credit sales policy would be to use the lien, applied to movable property, where the customer pays the fees they reach, and their merchandise would be delivered proportionally. Additionally, as an internal policy, after 90 days, these assets will be auctioned, with which at least the investment will be recovered.

It should be noted that, to obtain liquidity, it would benefit from the use of the factoring service through the advisory contract in the granting of credit and portfolio sale through a discount. For this, the overdue portfolio must be presented, together with the format of negotiable and endorsable commercial invoices, the reception guides, referral guides, and delivery orders. Therefore, it is possible to recharge this cost of the service commissions by including them in the final price to the client.

Moreover, the application of portfolio securitization is added through the constitution of autonomous equity in a financial entity authorized to create trusts through the issuance of securities with returns to investors through the support of a healthy portfolio delivered by the company when it loses operational capacity.

To this, the portfolio discount in banks is added through the delivery of registered and authenticated receivables from an active portfolio of clients to financial institutions as a means of deferred payment of a bank loan and is discounted when clients respond with their obligations.

Normative: Internal Tax Regime Law (LORTI), Art. 10, numeral 11- Portfolio Impairment. Regulation to the Internal Tax Regime Law (RLORTI), Art. 28, numeral 3. Deductible expenses. Legal basis: Circular No. NAC-DGECCGC19-00000003, numeral 2.- Provision for uncollectible accounts.

Collection policies:

There are two ways, the extrajudicial and the judicial.

Extrajudicial

Friendly requirements for the payment of outstanding obligations, through few visits and/or phone calls to delinquent clients.

Judicial

Proposal of judicial processes, being possible at the choice of the creditor the executive, monitoring, or enforcement route.

Normative: General Organic Code of Processes (COGEP), Chapter I - Executive procedure, Art. 347, 348; Chapter II Order for payment procedure, aRT. 356; Book V- Title I - Chapter I Execution Art. 362, 363. Civil Code (CC), Title XXXVIII Of the transaction. Art. 2348 (Banco de Desarrollo del Ecuador, 2021).

Phase IV: Lead

According to Izar (2016); Cerón, Mera, Llangarí, Fernández, & Villamarin (2017), management is the process related to teamwork, motivation, change management, leadership to guide people to achieve objectives. Therefore, recognizing the true potential of the organization's collaborators will allow the development of their skills by putting everything learned into practice (table 4).

Table 4. Steering phase activities

Activities	Normative	Source of information
Accounting at fair value for accounts receivable that have not been recovered within the term established by accounting policy (table 7).	IFRS 9 - Bad debt	-Board of Directors.
Establish a specialist in the collection area.	Internal policies and procedures manual.	-Departments of the company.

Source: Own elaboration

Table 5. Accounting entry for bad debts

Accounts	**Debit ($)**	**Credit ($)**
Accumulated impairment (difficult-to-collect debts: customers)	XXX	
Accounts receivable (customers)		XXX
Bad portfolio record.		

Source: IFRS 9 - Bad debt

Phase V: Control

Freire, Rocha, Cáceres, & Llanes (2019), refer that control lies in the methodical process of evaluating the organization's activities to guarantee that what is planned is carried out. For this reason, being a system that allows feedback through continuous improvement, before, during, and after the process occurs, will allow the monitoring of material, financial and human resources in the entity (table 6).

Table 6. Control phase activities

Activities	Normative	Source of information
Analysis by the credit committee of the possible cancellation or recovery of uncollectible accounts and their deterioration and loss for the company.	IFRS 9 - Financial Instruments.	-Use of expected loss model. -Determination of bad debts, write-off of bad debts, and loan recovery (table 9, 10, 11).
Use of ICT tools as a method of administrative control. Use of the Equifax report to identify the financial-commercial situation, as well as the customer's credit score, to evaluate the risk within the company.	Internal policies and procedures manual.	-Complete financial history of each client. -Graphic indicator of changes in the credit profile. -Visibility of current and historical debts.
Financial analysis through the application of liquidity and efficiency indicators.	IFRS 9 - Financial Analysis	-Presentation of financial statements on a quarterly basis. -Monthly financial analysis through the application of the current ratio, acid test, portfolio turnover, and collection period.

Source: Own elaboration

Expected loss model:

- As a recommendation, IFRS 9 - Financial Instruments recommends that, if there are sales on credit, the optimal thing would be to implement an expected loss model through the integration of the following procedures detailed below:

Step 1. grouping of the company's client portfolio, through the identification of similar characteristics of credit risk. Terms for each one:

- **Current portfolio:** Includes the regular charge values. From the total trade accounts receivable, balances that exceed 360 days are excluded.
- **Related companies:** Corresponds to balances receivable from related companies, on which internal collection procedures are carried out. These balances are subject to internal evaluation by the entity.

- **Clients in collection management and others:** Corresponds to overdue balances based on the analysis of each type of portfolio, which are provisioned according to the analysis carried out by the Administration considering the probability of recovery. In addition, an expected impairment based on past recovery is considered. If that is not observable in the previous three years, the provision is 100%.

Step 2. Determination of the period during which the observed historical loss rates are appropriate.

Considering that in IFRS 9 there is no specific guidance on how far historical data should be collected, the company is the one that determines the period over which reliable historical data can be obtained from the portfolio balances.

Step 3. Determination of historical loss rates

The company can determine the portfolio balances for each of the months starting and divide into maturity categories, with a percentage probability of default:

Considering the historical proportion of collections from portfolios, the company can determine that balances with maturities greater than 200 days have a probability of default of collection of 100%.

Step 4. Determination of loss given default

Table 7. Percentages of estimate for loss of default

Days past due	0	1-30	31-60	61-90	91-120	121-150	151-180	181-210	211–forward
Loss of default	2%	4%	9%	19%	37%	55%	60%	84%	100%

Source: Own elaboration

Step 5. Calculation of the general provision

- Applying the measurement principles recommended by IFRS 9, of reasonable and supported information about past events, current conditions, and forecasts of future conditions that is available without undue cost or effort. It is important to consider that voluntary provisions greater than 1% determined by law will not be deductible for tax purposes. Therefore, these are the reasonable amounts for accounting:

- 5% for debts that have more than three months past due on the last day of the taxable year, up to six months.
- 10% for debts that on the last day of the taxable year are more than six months past due, up to one year.
- 15% for debts that on the last day of the taxable year have more than one year (361 and more days).

Table 8. Provision accounting entry

Accounts	**Debit ($)**	**Credit ($)**
Provisions: Debtors	XXX	
Clients		XXX
Registers the general portfolio provision as of December 31.		

Source: IFRS 9 - General provision

- In addition to this, the uncollectible portfolio will be written off once the collection management through the courts has been exhausted. If there is no legal recourse for its recovery, it will be canceled against the provision. In the same way, the accounts receivable that have the same function will be impaired. Similarly, if the portfolio is recovered, it will be proceeded to carry out its recognition in the accounting part and based on IFRS:

Table 9. Accounting entry for the write-off of bad debts

Accounts	**Debit ($)**	**Credit ($)**
Accumulated impairment (provisions: customers)	XXX	
Difficult to collect debts: clients		XXX
Record of cancellation of invoice No. 000 for exhausted collection management.		

Source: IFRS 9 - Overdue portfolio

Table 10. Portfolio recovery accounting entry in the same year

Accounts	**Debit ($)**	**Credit ($)**
Accounts receivable (customers)	XXX	
Accumulated impairment (provisions)		XXX
Records the reinstatement of invoice No. 000		

Source: IFRS 9 - Overdue portfolio

Table 11. Portfolio recovery accounting entry after one year

Accounts	Debit ($)	Credit ($)
General cash	XXX	
Impaired recovery (bad debts)		XXX
Records the recovery of invoice No. 000		

Source: IFRS 9 - Overdue portfolio

4. Conclusions

Based on the theoretical foundation, it can be seen that the correct application of IFRS allows an adequate treatment of the accounting and financial area within a company, which results in having transparent and reliable information that reflects its true situation. However, it is necessary to point out that such information is limited to focusing and singling out a certain problem, since it in no way corrects it or, even worse, is the solution.

The investigation in a representative local and provincial jeans laundry and dry cleaning reflects that, despite being fully aware of the problem, it is the lack of an intelligent and concrete strategy for credit sales that maintains and increases the collectible and uncollectible overdue portfolio.

The innovative five-phase strategy developed, in a practical way, details the parameters to be followed to avoid overdue portfolio receivable, this being the preventive part; and, in the event that it is generated, under no circumstances should it become uncollectible, since in a premeditated way there would be guarantees to execute the obligation with interest, facilitating the work of the legal area, this being the corrective part. The approach is: no more unnecessary losses.

Finally, the allowance for overdue portfolio model developed by IFRS represents the ideal way of recording doubtful accounts so that, if necessary, they can be eliminated in accordance with current tax regulations.

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