What is the Experience of Companies in Accounting for Impairment of Receivables?

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Abstract

Account receivables constitute a significant portion of current assets, and the issue of receivables management is studied from many aspects and in many different contexts and levels. The purpose of this paper is to analyse the use of the prudence principle in the account's receivables area in Czech companies. This research paper aims to evaluate the view of enterprises whether they are willing to make impairment of receivables, what types of impairment they prefer, and how they assess the impairment of receivables. The research was done through a questionnaire survey. We received a total of 185 completed questionnaires. The research was done in 2019 in enterprises from the Czech Republic. Our results show that the enterprises make the impairment of receivables regardless of their sector. The impairment of receivables is more preferred in medium-sized and large enterprises. The medium-sized and large enterprises prefer a combination of tax and non-tax impairment of receivables. At the same time, the medium-sized and large enterprises more appreciate the impairment of receivables as a percentage of the value of particular receivable.

Keywords

JEL Classification

Introduction

In principle, every business would want to receive payment for the goods and services immediately after sales are realized. Based on the realization concept in accounting, revenue is recognized once a sale takes place, and hence profit is realized (Ndebugri & Tweneboah Senzu, 2017). However, it is a common practice for a supplier to allow customers to delay payment (Li, Mai, Zhang, & Tian, 2019). Though some clients adhere to the terms and conditions agreed, there are many cases where clients are in default and in a manner that totally violates and dislocates the stipulated terms and conditions. Many organizations are trapped into problems since not all customers pay-in time, or ever at all (Ndebugri & Tweneboah Senzu, 2017). In that case, the prudence principle should be applied. Receivables affect liquidity and ensuring liquidity is one of the primary tasks of financial management and competitiveness of every organization (Otrusinova, 2019).

The Prudence principle belongs to traditionally generally accepted accounting principles to ensure fair presentation (Suhanyiova, Suhanyi, Mokrisova, & Horvathova, 2015). The Prudence principle is closely linked with another accounting principle - going concern in the foreseeable future. Both of these accounting principles have one common denominator; it is measured as one of the basic methodological elements of accounting (Paseková, Strouhal, & Müllerová, 2011). Prudence means a degree of caution in making estimates under uncertain conditions. Eventually, the assets or revenues should not be overestimated and liabilities or expenses underestimated. („Conceptual Framework for Financial Reporting 2018", 2018; Paseková et al., 2011)

The aim of this research paper is devoted to the issue of the impairment of assets. We want to evaluate the view of enterprises if they make impairment of receivables, what types of impairment of receivables they prefer, and

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how these enterprises assess the impairment of receivables. We want to compare if the impairment of receivables varies in different types of enterprises, whether the combination of tax and non-tax impairment of receivables is preferred by different types of enterprises and whether the enterprises appreciate their impairment of receivables as a percentage of the value of a particular receivable.

The structure of this paper is as follows: The second section is devoted to the issues of impairment of receivables. The next section includes research objectives, research hypotheses, description of data and research methods. The fourth section contains the interpretation of results and comparison with the results of other studies. Finally, the last section is devoted to the overall summary and proposals for further research.

Literature Review

Trade credit involves post-shipment financing in which the seller offers extended payment terms to its customer after order delivery (Zhao & Huchzermeier, 2019). This concept is beneficial to both buyers and suppliers in several ways. Not having to pay for the goods immediately, provides the purchasing company with time to obtain the money (Ndebugri & Tweneboah Senzu, 2017) and it also improves the buyer's working capital, which can be used to fund growth in new markets (Li et al., 2019). A firm may offer credit sales to preserve and protect its market share from competing forces around and to entice and invite new clients to its market and products at good terms (Ndebugri & Tweneboah Senzu, 2017). Credit sales activities result in account receivables.

According to Kubickova and Soucek (2013), the issue of account receivables management is studied from many aspects and in many different contexts and levels. There are many publications about receivables – an element of organization management, performance management, cash management, risk management, cash flow, and liquidity management (Czopek and TrzaskuŚ-Zak, 2013, Kalibayev, M.K., 2015). In terms of performance management, Kontus (2013) discusses a system of company receivables management, which directly affects the profitability of the company. The purpose of this study is to determine ways to find the optimal amount of receivables along with optimal use of another loan in order to achieve maximum return (ROA). In terms of cash flow management, Le, Vu and Nquyen (2020) studied cash flow management in Vietnamese construction companies. They identified accounts receivables as one of the six main groups of factors affecting the cash flow.

Despite the numerous benefits of trade credit provision, it is also characterized by several challenges. Delay in payments and payment defaults should be mentioned. Until payment is received, the inputs in the process cannot be utilized in another operating cycle. Therefore, robust management of the entity's credit transaction and the account receivables asset is required (Ndebugri & Tweneboah Senzu, 2017). The receivables management should aim to optimize receivables (Bikchantaeva, Samolyanov, & Stepanova, 2019). Companies need to balance the cost, risk, and utility gained from offering credit to buyers (Nicholas, Holt, & Love, 2000).

The level of credit risk may be affected by factors such as the probability of debt non-repayment or delay in repayment what can be determined based on the credit history of the customer (Belás, 2017, Michalski, 2016). Companies need to evaluate the client's creditworthiness. This could be understood as a set of conditions under which a buyer may obtain credit. Determination of such standards is one of the main points when dealing with credit risk. Receivables management includes ranking clients, evaluation of their significance for the organization, and elaboration of criteria for granting instalments and credit period determination (Leontieva et al., 2019). However, many companies have formal accounts receivable management policies that dictate when to bill, how much to bill, and when to collect, not all of them enforce those policies effectively (Remenarić, Čevizović, & Kenfelja, 2018).

The most difficult part regarding measuring accounts receivable performance, is the estimation of its impairment, according to the balance sheet data (Vićentijević, Jović, & Petrović, 2015). The impairment of receivables follows the prudence principle (Suhanyiova, 2015). IAS 36 – Impairment of Assets seeks to ensure that assets of an entity are not carried at more than their recoverable amount. Entities are required to conduct impairment tests where there is an indication of impairment of an asset („IAS 36—Impairment of Assets", 2013). Receivables can be tested for impairment individually for receivables that are individually significant and individually or collectively for receivables that are individually insignificant (Remenarić et al., 2018). This reduction is called an impairment loss and is recognized immediately in the income statement (Pasekavá et al., 2011). The correct amount of impairment of accounts receivable is the postulate for realistic financial reporting: realistic indication of impaired expenses in profit/loss account and the realistic value of account receivables in the balance sheet. The fundamental problem in the use of the instruments of the prudence principle in SMEs is a strong dependency on the accounting of the companies on tax incidences (Pasekavá et al., 2011).

According to the Act on Provisions, it is possible to create tax-deductible impairment on receivables. The Act regulates the creation and use of such impairment in modes such as impairment for receivables for insolvent debtors; impairment for outstanding receivables in the event that it has been more than 18 months since the end of the agreed period for payment, up to 50 % of the book value of receivables; impairment for outstanding receivables in the event that it has been more than 30 months since the end of the agreed period for payment, up to 100 % of the book value of receivables; impairment for the receivables acquired by assignment can only be created by the income taxpayers, who have submitted a proposal to initiate proceedings against the debtor

pursuant to the provisions on arbitration or court and the amount of the receivable exceed CZK 200 000 without accessories. (Czech National Board, 1992).

Methods

This research paper aims to evaluate the view of enterprises whether they make the impairment of receivables, what types of impairment of receivables they prefer, and how they assess their impairment of receivables. The research was done in 2019 in enterprises from the Czech Republic. The research was carried out through a questionnaire survey. The authors designed an online questionnaire that was sent to enterprises in the Czech Republic for completion. The stratified random sampling method was used to identify the basic sample of enterprises. The enterprises were selected by random sampling from the database "Albertina". We contacted 800 enterprises from different sectors by email and asked them to complete an online questionnaire. We received the answers from 185 enterprises from the Czech Republic. The response rate was 23.1%. This distribution adequately represents the structure of enterprises in the Czech Republic, as according to the Czech Statistical Office, 73.4% of companies operate in the Bohemian region and 26.6% of companies operate in the Moravian regions (Ministry of Industry and Trade, 2021). The majority (48%) of respondents reported to be at the lower managerial level (economics), 31% of respondents were accountants and 21% respondents were top managers. The sample was divided rather proportionally, which gave a good platform for the conclusions of the research. We concluded, that the sample of respondents can be considered to be representative.

The size of the companies in the tested sample and its comparison to the actual representation of companies in the Czech Republic can be referenced in Table 1. The composition of the sample is different when compared to the actual structure of companies in the Czech Republic, this is mainly due to the fact that in the Czech Republic the amount of large companies is only 0.2% and if such a limitation would be placed on the tested sample, the actual amount of responses from this category would be less than 1. We tried to obtain sufficient representation from each category in our research and we rather aimed for equal representation of each size group.

Table 1. Representation of companies according to size in the sample.

Type of Enterprise	Sample Count	Sample Percentage	Czech Republic
Microenterprises	74	40.0	81.0
Small Enterprises	52	28.1	17.0
Medium-sized Enterprises	34	18.4	2.0
Large Enterprises	25	13.5	0.2
Total	185	100.0	100.0

Source: Own research; Czech Statistical Office (2019).

The enterprises were divided according to the prevailing line of business and by the number of employees. 42.2% of them were from the service sector, 38.4% of them were from the manufacturing sector and 19.5% of them were from the trade sector. 40% of them were micro-enterprises, 28.1% were small enterprises, 18.4% of them were medium-sized enterprises, and 13.5 % of them were large enterprises.

We stated the following hypotheses:

H1: Impairment of receivables prevails in the manufacturing sector rather than in other sectors (trade, services).

H2: The medium-sized and large enterprises make the impairment of receivables rather than the small enterprises or the microenterprises.

H3: The combination of tax and non-tax impairment of receivables prevails in the trade sector rather than in the manufacturing or service sectors.

H4: Large and medium-sized enterprises prefer a combination of tax and non-tax impairment of receivables rather than small enterprises or microenterprises.

H5: Manufacturing enterprises appreciate their impairment of receivables as a percentage of the value of a particular receivable rather than other types of enterprises (services, trade).

H6: Medium-sized and large enterprises appreciate their impairment of receivables as a percentage of the value of a particular receivable rather than other types of enterprises (trade, services).

The hypotheses were verified through the tests of proportions. We used this test to compare two proportions to see if they are the same or not.

Problem solving

Hypothesis 1: Impairment of receivables prevails in the manufacturing sector than in other sectors (trade, services).

Table 2 represents the answers of enterprises according to their prevailing line of business. 63.4% of manufacturing enterprises and 61.1% of enterprises from the trade sector make the impairment of receivables. On the other hand, 57.7% of enterprises from the service sector do not make the impairment of receivables at all.

Table 2. The answers by the prevailing line of business.

The Prevailing Line of Business	Answer		
	Yes	No	Total
Manufacturing Sector	45	26	71
Trade Sector	22	14	36
Service Sector	33	45	78
Total	100	85	185

Source: Own research.

The representation of observed cases in these sectors is summarized in Table 3.

Table 3. The answers by the prevailing line of business.

% of impairment of receivables in the manufacturing sector	% of impairment of receivables in other sectors (trade, services)
71 (63.4 %)	114 (48.25 %)

Source: Own research.

We rejected the hypothesis 1 because the differences between these enterprises are sufficiently great ($P = .02$). We can say that the manufacturing enterprises make the impairment of receivables more than the enterprises in the trade or service sectors.

Hypothesis 2: The medium-sized and large enterprises create the impairment of receivables rather than the small enterprises or the microenterprises.

Table 4 shows the answers of enterprises according to their number of employees. We see that 59.6% of small enterprises, 76.5% of medium-sized enterprises, and 84% of large enterprises make the impairment of receivables. 70.3% of microenterprises do not make any impairment of receivables at all.

Table 4. The answers by the number of employees.

Type of Enterprise	Answer		
	Yes	No	Total
Microenterprises	22	52	74
Small Enterprises	31	21	52
Medium-sized Enterprises	26	8	34
Large Enterprises	21	4	25
Total	100	85	185

Source: Own research.

The representation of observed cases in these enterprises is summarized in Table 5.

Table 5. The answers by the number of employees.

% of impairment of receivables in the large and medium-sized enterprises	% of impairment of receivables in the microenterprises and small enterprises
59 (79.7 %)	126 (42.1 %)

Source: Own research.

We rejected the hypothesis 2 because the differences between these enterprises are sufficiently great (P < .001). We can say that the medium-sized and large enterprises make the impairment of receivables more than the microenterprises or the small enterprises.

Hypothesis 3: The combination of tax and non-tax impairment of receivables more prevails in the trade sector than in the manufacturing or service sectors.

Table 6 shows the answers of enterprises by their prevailing line of business. 51.5% of enterprises from the service sector, 44.4% of manufacturing enterprises, and 36.4% of enterprises from the trade sector prefer tax impairment of receivables. We see that 63.6% of enterprises from the trade sector, 44.4% of manufacturing enterprises, and 33.3% of enterprises from the service sector prefer a combination of tax and non-tax impairment of receivables. Only 11.1 % of manufacturing enterprises and 15.2% of enterprises from the service sector prefer the non-tax impairment of receivables. The enterprises from the trade sector do not make the non-tax impairment of receivables at all.

Table 6. The answers by the prevailing line of business.

The Prevailing Line of Business	Type of Impairment of Receivables			
	Tax	Non-tax	Both Tax and Non-tax	Total
Manufacturing Sector	20	5	20	45
Trade Sector	8	0	14	22
Service Sector	17	5	11	33
Total	45	10	45	100

Source: Own research.

The representation of observed cases in these sectors is summarized in Table 7.

Table 7. The answers by the prevailing line of business.

% of tax and non-tax impairment of receivables in the trade sector	% of tax and non-tax impairment of receivables in other sectors
22 (63.6 %)	78 (47.6 %)

Source: Own research.

We failed to reject the hypothesis 3. The differences between these enterprises did not show a statistically significant difference (P = .09). We are able not to say that the combination of tax and non-tax impairment of receivables prevails in some sector.

Hypothesis 4: Large and medium-sized enterprises prefer a combination of tax and non-tax impairment of receivables rather than micro-enterprises or small enterprises.

Table 8 shows the answers of enterprises according to their number of employees. 68.2% of microenterprises and 61.3% of small enterprises prefer tax adjustments. A combination of tax and non-tax impairment of receivables is used by 66.7 % of large enterprises and 61.5% of medium-sized enterprises. We found that only 14.3% of large enterprises, 11.5% of medium-sized enterprises, 9.1% of microenterprises, and 6.5% of small enterprises prefer the non-tax impairment of receivables.

Table 8. The answers by the number of employees.

Type of Enterprise	Type of Impairment of Receivables			
	Tax	Non-tax	Both Tax and Non-tax	Total
Microenterprises	15	2	5	22
Small Enterprises	19	2	10	31
Medium-sized Enterprises	7	3	16	26
Large Enterprises	4	3	14	21
Total	45	10	45	100

Source: Own research.

The representation of observed cases in these enterprises is summarized in Table 9.

Table 9. The answers by the number of employees.

% of tax and non-tax impairment of receivables in the large and medium-sized enterprises	% of tax and non-tax impairment of receivables in the microenterprises and small enterprises
47 (63.8 %)	53 (28.3 %)

Source: Own research.

We rejected the hypothesis 2 because the differences between these enterprises are sufficiently great (P < .001). The medium-sized and large enterprises prefer more a combination of tax and non-tax impairment of receivables than the small enterprises or micro-enterprises.

Hypothesis 5: Manufacturing enterprises value the impairment of receivables as a percentage of the value of a particular receivable rather than other types of enterprises (services, trade).

Table 10 shows the answers of enterprises by their prevailing line of business. 62.5% of enterprises from the service sector and 56% of manufacturing enterprises appreciate their impairment of receivables as a percentage of a value of particular receivable. 42.9% of enterprises from the trade sector assess the impairment of receivables as a percentage of the value of overdue receivables. The valuation of impairment of receivables as a percentage of the value of total receivables is not preferred by these enterprises. 37.5% of manufacturing enterprises, 37.5% of enterprises from the trade sector, and 25% of enterprises from the service sector assess the impairment of receivables as a percentage of the value of total receivables.

Table 10. The answers by the prevailing line of business.

	The Prevailing Line of Business			
Assessment of Impairment as	Manufacturing	Trade	Service	Total
Percentage of a Value of Total Receivables	3	3	2	8
Percentage of a Value of Particular Receivable	14	5	10	29
Percentage of a Value of Overdue Receivables	8	6	4	18
Total	25	14	16	55

Source: Own research.

The representation of observed cases in these sectors is summarized in Table 11.

Table 11. The answers by the prevailing line of business.

% of impairment as a percentage of a value of particular receivable in the manufacturing sector	% of impairment as a percentage of a value of particular receivable in other sectors (trade, services)
25 (48.3 %)	30 (51.7 %)

Source: Own research.

We failed to reject the hypothesis 5. The differences between these enterprises did not show a statistically significant difference (P = .59). We are not able to say that the impairment of receivables valued as a percentage of the value of particular receivable prevails in some sector.

Hypothesis 6: Medium-sized and large enterprises appreciate the impairment of receivables as a percentage of the value of a particular receivable rather than other types of enterprises (trade, services).

Table 12 shows the answers of enterprises by the number of employees. 68.4% of medium-sized enterprises, 50% of small enterprises, and 47.1% of large enterprises appreciate the impairment of receivables as a percentage of the value of particular receivable. 42.9% of microenterprises assess the impairment of receivables as a percentage of a value of overdue receivables. The valuation of the impairment of receivables as a percentage of the value of total receivables is not preferred by these enterprises. 37.5% of medium-sized enterprises, 25% of large enterprises, 12.5% of small enterprises, and 25% of microenterprises assess their impairment of receivables as a percentage of the value of total receivables.

Table 12. The answers by the number of employees.

Impairment of Receivables as	Type of Enterprise				
	Micro	Small	Medium	Large	Total
Percentage of a Value of Total Receivables	2	1	3	2	8
Percentage of a Value of Particular Receivable	2	6	13	8	29
Percentage of a Value of Overdue Receivables	3	5	3	7	18
Total	7	12	19	17	55

Source: Own research.

The representation of observed cases in these sectors is summarized in Table 13.

Table 13. The answers by the prevailing line of business.

% of impairment of receivables in the large and medium-sized enterprises	% of impairment of receivables in the small enterprises and microenterprises
36 (72.4 %)	19 (27.6 %)

Source: Own research.

We reject the hypothesis 6 because the differences between these enterprises are sufficiently great (P < .001). The valuation of impairment of receivables expressed as a percentage of the value of particular receivable is more preferred by the large and medium-sized enterprises than by the small enterprises or microenterprises.

Discussion

Overall, we confirmed that the manufacturing enterprises make the impairment of receivables more than the enterprises from other sectors. The medium-sized and large enterprises make the impairment of receivables is more common than small enterprises or microenterprises. The enterprises from any sector do not prefer a combination of tax and non-tax impairment of receivables. On the other hand, a combination of tax and non-tax impairment of receivables is preferred more by medium-sized and large enterprises. The enterprises regardless of their sector do not assess the impairment of receivables as a percentage of the value of a particular receivable.

This paper also strove to demonstrate the dependency of adjustments on the tax base. We found out that the enterprises do prefer tax impairment of receivables. We found out that the enterprises do not assess their impairment of receivables as a percentage of a specific receivable.

These results can be compared with the results of previous studies in the unsettled receivables area in the Czech Republic and Slovakia. Paseková et al. (2011) studied using of impairment of assets within Czech small and medium-sized enterprises. Their study showed that 30 % of questioned companies do not make the impairment for bad debts. The majority of companies making impairment of bad debts prefer a combination of tax and non-tax impairment. Paseková, Homolka, Strouhal, and Müllerová (2011) studied small and medium-sized enterprises and their attitude to account receivables' adjustments. They found that reported companies follow the tax incidences of financial transactions more than a fair presentation of financial position in the financial statements. Therefore, they more often make impairment of receivables that affect the tax base. Kolarova et al. (2019) show that from the point of error occurrence, companies consider the tax area in receivables adjustments to be problematic in 58%. Kolarova and Otrusinova (2017) present the results of research in the situation of unsettled receivables in Czech enterprises in 2013 and 2016. Their results show that the creation of impairment of receivables is increasing, and there is a strong correlation between the impairment of receivables and the tax base. In 2013, 59,6 % of tested companies had created the adjustments to receivables, while in 2016, there was an increase to 68.3 %. In 2019 it is more than 50%. Suhanyiova et al. (2015) concluded, based on their research of impairment of receivables in Slovakia, that there is a strong dependence on the value of impairment of receivables on their total value. The study has demonstrated that businesses are still dealing with unsettled receivables that are able to apply in the tax base.

Conclusion

This research paper aimed to evaluate the opinion of enterprises whether they make the impairment of receivables, what types of impairment of receivables they prefer, and how they assess their impairment of receivables.

The results show that the enterprises make the impairment of receivables regardless of the sector. The impairment of receivables is more common in medium-sized and large enterprises. The combination of tax and non-tax impairment of receivables is not preferred by the enterprises from any sector. This combination is preferred more by medium-sized and large enterprises. We cannot say that the enterprises regardless of their sector assess the impairment of receivables as a percentage of the value of particular receivable. The evaluation of the impairment of receivables as a percentage of the value of particular receivable is more preferred by medium-sized and large enterprises.

From a practical perspective, the results of our research can be beneficial for auditors and financial statement processors. The most difficult part regarding measuring accounts receivable performance, is the estimation of its impairment, according to the balance sheet data.

The scientific contribution of the article is that receivables management could affect the performance and competitiveness of every organization. Receivable management affects main economic indicators for performance such as EVA, EBITDA, BSC, Z-score, or other indicators, so the role of further research is to provide an empirical study which will discuss the quality accounting information for performance measurements in the area of receivables. Our research concluded that the Czech companies do not implement robust management of the account receivables, which contradicts findings of Ndebugri and Tweneboah (2017) and this means that the receivables of the Czech companies are not adequately optimized as is proposed by Bikchantaeva et al. (2019). The results of the research confirm the findings of Remenarić et al. (2018) that companies usually only implement formal accounts receivable management policies. The results also indicate that in the Czech environment the companies mostly account only for tax allowances and do not specifically analyse and optimize their receivables from an accounting perspective. These findings further confirm previous findings of academics and propose a new area of research in the field of receivable management focusing on tax allowances. The issue of account receivables management could be studied from many aspects and in many different contexts and levels. The future research would focus on the information about other aspects of impairment of receivables in financial statements, namely in notes. Future research should be concentrated on a more detailed analysis of how the management of receivables could influence the EVA indicator, and thus value for shareholders nor owners may not be created. Regarding forthcoming research on this area, the authors recommend that future studies should use cross-country analysis for comparing the results from this study and examining the results across countries, industry and sectors.

Acknowledgement

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