

How To Write Off Accounts Payable



Accounts Payable (AP) handles the money a company owes to its vendors. In terms of accounting, this represents liabilities.

A lot of companies have several accounts payable sub-accounts. Making payments on liabilities owed generally runs smoothly, but there always remains the possibility of a residual balance in their general ledger (GL).

If present, residual balances are usually the result of incorrect posting by accountants, or improper payments. After completing due diligence for each payables account, organizations can write these amounts off.

A write-off is an accounting action that debits a liability account while reducing the value of an asset.

Businesses seeking to account for losses on stored inventory, unpaid receivables, and unpaid loan obligations, use write offs.

In the broadest sense, it's something to help reduce an annual tax bill.

However, companies are always advised to speak with an accountant as laws sometimes differ based on industry and location of business operations.

Accounting standards may also vary depending on your business situation.

Steps in the Due Diligence Process

- **Step One:** Reach out to the vendor linked to the accounts payable on the general. Ask that they provide a full statement of account for the previous 12 months.
- **Step Two:** Reconcile the account to the vendor statement, marking off all invoices that the company has paid in full.
- **Step Three:** When you spot differences between vendor invoices and payments made by the company, mark them with a highlighter.
- **Step Four:** Look over the highlighted differences to determine if it's necessary to make an additional payment to the vendor. Mark those amounts with a comment to write off unidentified differences.
- **Step Five:** Write a journal entry to clear the account balances. Debit the AP account and credit Other Income. In some situations, companies are able to credit the account debited from the original entry.

Accounts payables cannot be written off solely because the deadline for payment of the liability has passed.

When Can Accounts Payable Be Written Off?

The International Financial Reporting Standards, or IFRS-9, provides a list of criteria that must be met before any account payable can be written off.

According to those guidelines, financial liabilities should only be derecognized by the company when the obligation to pay is expired, canceled, or discharged.

As such, they are not written off based on the time frame.

However, accounts receivable (AR) write offs occur once a substantial amount of time has passed after the final payment is due.

It's important to note that writing off accounts payable without valid reasons can lead to financial discrepancies and potential legal issues.

Regular audits and reviews can help ensure compliance with these standards and maintain accurate financial records.

The two are treated differently because of the prudence concept, which keeps financial statements fair to avoid overstating income and assets while understating expenses and liabilities.

Liability Discharge

The payment obligation is released when the liability is paid through either cash or another asset.

Liability is reduced according to the value of the resources paid. If the liability is offset in assets other than cash, the company must recognize a gain or loss for the difference in the liability offset and the value of the transferred asset.

Some terms in the payment of the liability indicate that if the payment is made during a set period, the payer gets a discount.

It reduces the amount of the accounts payable and is recognized as a discount received.

For instance, if an organization purchases \$4,000 worth of equipment on credit, the company's financial statements would record an accounts payable amount of \$4,000.

That account payable is discharged from the organization's financial statements when the company makes payment to the supplier.

Once the payment is made, the double-entry looks like this:

Debit Accounts Payable balance: \$4,000

Credit Cash/Bank/Other assets \$4,000

The entry discharges the account payable from the company's financial statements.

Cancellation of Liability

Accounts payables or trade creditors may be canceled in certain circumstances. These payment obligations may be reduced in part or in full.

Cancellation of liability can also occur when the creditor waives the balance, or when the creditor has breached their contract.

The payable party recognizes the canceled balance as income because of increased cash flow, since payment is no longer required.

For example, if \$4,000 is to be canceled, the journal entry looks like this:

Debit Accounts Payable balance: \$4,000

Credit Other income: \$4,000

The entry writes off the balance that the creditor cancels from the company balance sheet.

The impact is visible on both the balance sheet and income statement.

Expiration of the Term

This only applies in situations where there is a contract that states there is a duration in which the creditor has to claim the balance from the debtor.

After that duration passes, it is no longer considered a current liability because the creditor loses the power to claim the balance.

After the term expires, the payable amount can be written off, as shown below with this \$5,000 example.

Debit Accounts Payable balance: \$5,000

Credit Other income: \$5,000

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