

# How To Write Off Accounts Payable



## KEY TAKEAWAYS

- Accounts Payable should only be written off in specific cases like liability discharge, cancellation, or expiry, and always in compliance with regulations.
- Proper due diligence—reconciling vendor statements, verifying discrepancies, and confirming legitimacy—is essential before writing off any AP balance.
- AP write-offs must be recorded accurately with appropriate journal entries, as they directly impact financial statements, cash flow, and potential tax obligations.
- Using automated Accounts Payable systems reduces errors, improves reconciliation, and minimizes the need for write-offs altogether.

Unlike Accounts Receivable balances, which are often written off as bad debt, Accounts Payable (AP) balances are rarely written off.

However, there are circumstances when writing off AP balances is justified.

We'll explore the reasons for writing off Accounts Payable and how it should be done.

## When Can Accounts Payable Be Written Off?

Both the International Financial Reporting Standards (IFRS-9) and Generally Accepted Accounting Principles (GAAP) rules have a list of criteria that must be met before any Account Payable item can be written off.

According to both organizations, Accounts Payable items should only be written off when there is a:

### > When Accounts Payable Can Be Written Off



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## Discharge of Liability

The Accounts Payable item in question has been paid in full, or in part. In turn, the liability account is reduced either by cash payment or an offset in other assets.

In either case, the company is required to recognize the gain or loss. This includes when a discount is offered by the vendor and taken by the purchaser.

## **Cancellation of Liability**

The balance due is waived by the vendor, or the vendor breaches the terms of the contract.

Though rare, AP or trade payable amounts may be canceled either in part or in full. This happens when a vendor/creditor goes out of business, when the balance is waived by the vendor, or if a contract has been breached.

For example, if part of the contract states that a vendor will deliver an item by a certain date and the delivery does not happen, the contract has been breached.

## **Expiry of Terms**

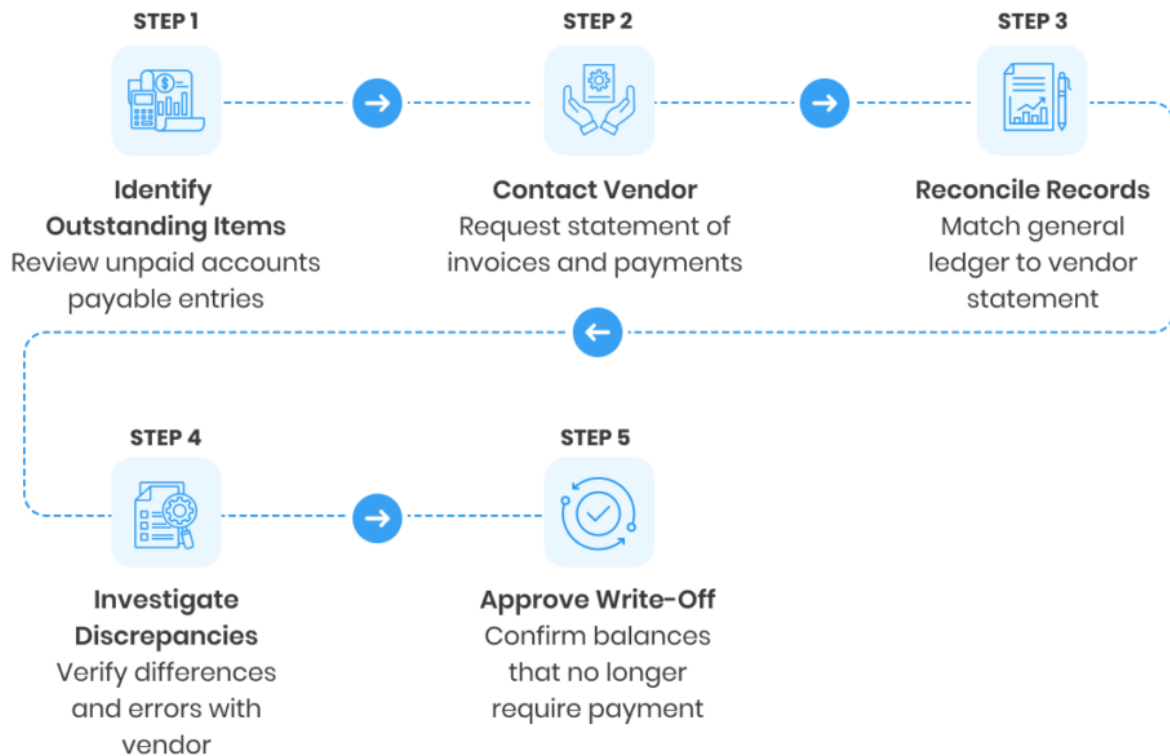
The terms and conditions of the invoice have expired, and the debt is no longer owed. This only applies when a contract is in place that includes a limited timeframe in which the vendor or creditor can claim the balance owed.

Once that term has passed, the balance is no longer owed and can be written off.

## **Steps In the Due Diligence Process**

Before writing off Accounts Payable, be sure to use due diligence to research the legitimacy of the write-off.

## > Due Diligence Process



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### Step 1

Identify any Accounts Payable entries that have remained on the books unpaid.

### Step 2

Contact the vendor(s) in question and obtain a current statement that lists all vendor invoices billed and payments made for the previous 12 months.

### Step 3

Reconcile the Accounts Payable amounts in the general ledger to the vendor statement.

### Step 4

Verify any discrepancies found with the vendor. For instance, if your AP account still shows an open invoice, but the vendor statement does not, try to determine if the invoice was entered in error.

### Step 5

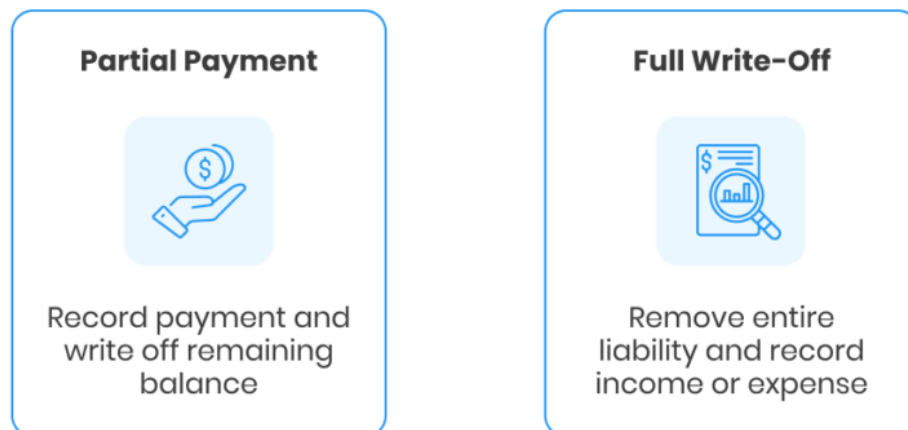
If you still have discrepancies that do not need to be paid or have identified AP

invoices that should not have been recorded, you will need to write them off properly.

# How to Properly Record an Accounts Payable Write-Off and Its Impact on Financial Statements

There are two ways to properly record Accounts Payable write-offs, depending on if you pay the debt in question or need to write the entire balance off.

## > How to Record an AP Write-Off



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For instance, your company purchases \$5,000 worth of equipment, but you only received \$3,000 worth of equipment.

You and the vendor agree that you will pay the \$3,000 and write off the \$2,000. To do so, you would make the following journal entries:

<b>Debit</b>	<b>Accounts Payable balance</b>	<b>\$3,000</b>
<b>Credit</b>	<b>Cash/Bank/Other assets</b>	<b>\$3,000</b>

The entry above records the payment made for the partial shipment.

<b>Debit</b>	<b>Accounts Payable balance</b>	<b>\$2,000</b>
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**Credit    Equipment Expense Account    \$2,000**

This entry shows the balance of the original AP invoice being written off.

Using the above figures, let's say that you ordered \$5,000 worth of equipment from your vendor with the stipulation in the contract that you would receive the equipment by a certain date.

The equipment is received a month late, putting the vendor in breach of the contract. In that type of situation, you would write off the AP balance as follows:

**Debit    Accounts Payable balance    \$5,000**

**Credit    Other Income    \$5,000**

Other income is credited because the elimination of the debt owed increases your cash flow since the debt is no longer owed.

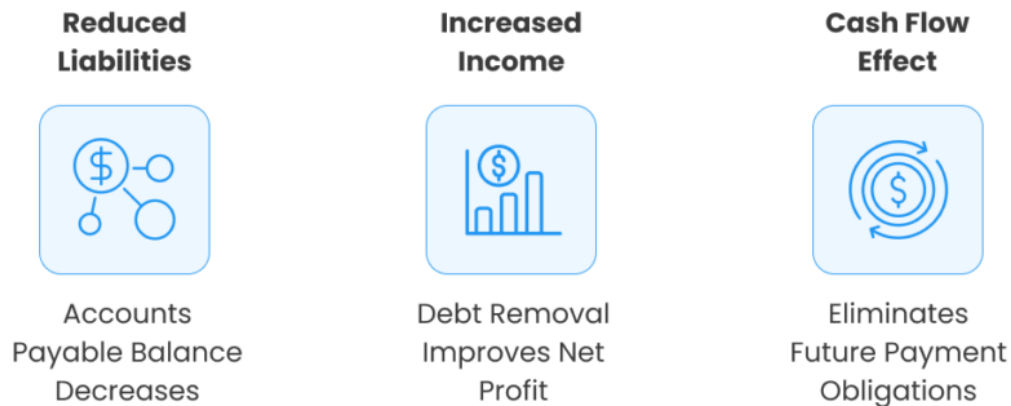
The same entry would be made should the vendor cancel the debt.

## **Key Accounting Principles for Writing Off Accounts Payable**

Writing off Accounts Payable uses the matching principle which states that expenses should be recorded in the same period as the revenues they generate.

When writing off Accounts Payable, the AP account should be debited to reduce liability while a corresponding expense or income account should be credited, depending on the circumstances behind the write-off.

## > Impact on Financial Statements



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# Tax Implications of Writing Off Accounts Payable

There are numerous tax implications when writing off Accounts Payable that you need to be aware of, since writing off an AP balance directly impacts your balance sheet and your income statement, reducing liabilities and increasing cash flow or net profit.

In either case, the best way to avoid any negative tax repercussions is to speak to an accountant or CPA before writing off an old Accounts Payable balance.

# Common Mistakes to Avoid When Writing Off Accounts Payable

Because of its rarity and its direct impact on financial statements and related tax implications, writing off Accounts Payable requires attention to detail.

Common mistakes that occur during the accounts payable write-off process include:

## **Lack of Sufficient Documentation**

Before writing off an Accounts Payable balance, be sure that you have the documentation to justify the write-off. This can include a copy of a contract or a letter from the vendor canceling the debt.

Where you never received the product, received it late, or the vendor went out of business, be sure that you have the documents needed to justify the write-off.

If you're only writing off a partial account balance, be sure to have the documentation to justify that portion of the write-off.

## > Common Mistakes to Avoid



## Account Errors

Errors happen, particularly if you're using a manual Accounts Payable system. For example, if you have multiple vendors with similar names, be sure that you're writing off the balance for the correct vendor.

## Data Entry Errors

When processing an Accounts Payable write-off, verify that the amount of the

write-off is correct and that it matches the amount recorded in the general ledger.

## **Eligibility of the Invoice**

Not all invoices should be written off. For example, if an invoice is issued and entered twice in error, a vendor can issue a credit memo for the incorrect invoice, eliminating the need to write off the balance.

Remember to investigate any invoices that may be considered for write-off before doing so to determine whether they're valid or not.

## **Not Updating Records Properly**

If you're still using a manual accounting system, it's easy to forget to update balances in your general ledger, including AP accounts.

Before writing off an Accounts Payable item that is still on the books, double-check to make sure that you haven't already paid it.

## **Best Practices for Managing Old or Unpaid Accounts Payable Balances**

If you're still unsure about managing AP write-offs, here are some best practices that can help.

## > Best Practices for Managing AP Write-Offs

### Define Policies



Establish clear procedures and rules

### Verify Balances



Confirm legitimacy before writing off

### Maintain Documentation



Keep records to support decisions

### Reconcile Regularly



Review accounts payable frequently

### Use Automation



Reduce errors and streamline processes

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- Create clear policies and procedures for handling AP write-offs that comply with all the necessary accounting standards and regulations.
- Conduct a thorough investigation of any doubtful account balances before proceeding with the write-off.
- Contact the vendor(s) in question to obtain a record of all invoices, due dates, and payments for reconciliation purposes.
- Verify that payment has not been made before writing off.
- Make any payments if the AP balance is determined to be valid.
- Ensure that a credit memo has not been received from the vendor for the AP invoice.
- Have the necessary documentation in place before writing off the AP balance.

- Upgrade your manual accounting system to an automated accounting software application, which helps reduce the need to write off AP.

# How Automation and AP Solutions Can Help Prevent Unnecessary Write-Offs

Writing off AP should be a rare occurrence. However, if you're still using a manual accounting system, chances are that you're writing off more AP balances than you should be.

## > How Automation Reduces Write-Offs



### **Audit Trail**

Tracks all transactions and changes



### **Duplicate Detection**

Flags repeated or incorrect invoices



### **Automated Matching**

Matches invoices with purchase orders



### **Real-Time Updates**

Keeps records accurate and current



### **Error Reduction**

Minimizes manual data entry mistakes

Making the switch to an automated AP solution can reduce AP write-offs

significantly.

Even small businesses with limited bookkeeping responsibilities can benefit from automation.

If you don't have the time or desire to manually reconcile GL accounts at year-end like Accounts Payable, automation can make the process much easier.

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