

User Guide

Writing Off Bad Debts

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BAD DEBTS WRITE OFF

Businesses may find themselves unable to recover payments for certain invoices. If these invoices are considered bad debts they should be written off. Writing off bad debts is particularly important for businesses who report on accrual basis, as they can claim a credit of GST and reduce their taxable income.

A debt is considered bad in the following circumstances:

- There must be a debt. In other words, there must have been an invoice raised that remains outstanding. Sufficient steps have been taken to recover the debt, and there is justification for no longer pursuing the debt as it has no likelihood of being recovered.
- The debtor has died, leaving no assets or insufficient assets;
- The debtor cannot be traced and no assets discovered;
- The debtor is bankrupt or in liquidation, and insufficient funds exist;

A bad debt can be written off using either the direct write off method or the provision method.

Direct write off method.

The business is certain that the debt will not be paid, therefore the debt amount is recorded as a loss by posting the transaction to a 'Bad Debt' expense account.

Provision method.

The business still believes they may recover the debt or the customer is going into liquidation, therefore the value of the unpaid debt amount is posted to a provisional balance sheet account.

WRITING OFF A BAD DEBT IN XERO

In Xero a bad debt is written off by closing the original unpaid invoice. The steps involved in writing off a bad debt change depending on the applicable method:

Direct write off method

1. Create a Bad Debt Expense Account
2. Create a 'Bad Debt' Credit Note
3. Allocate the Bad Debt Credit Note to the unrecoverable unpaid sale

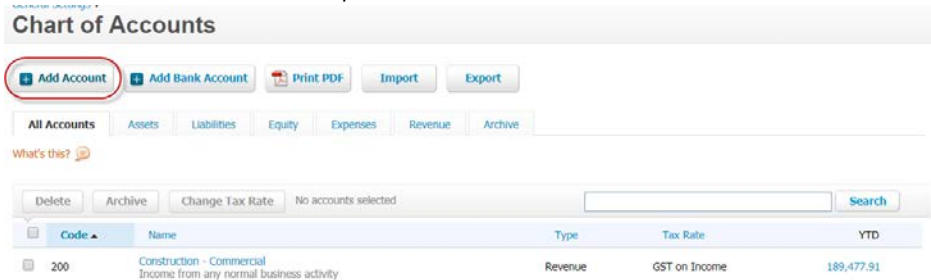
Provision method

1. Create a Provisional Doubtful Debt Asset Account
2. Create a 'Bad Debt' Credit Note
3. Allocate the Bad Debt Credit Note to the unrecoverable unpaid sale
4. At the end of the financial year, record a journal entry to expense the debt

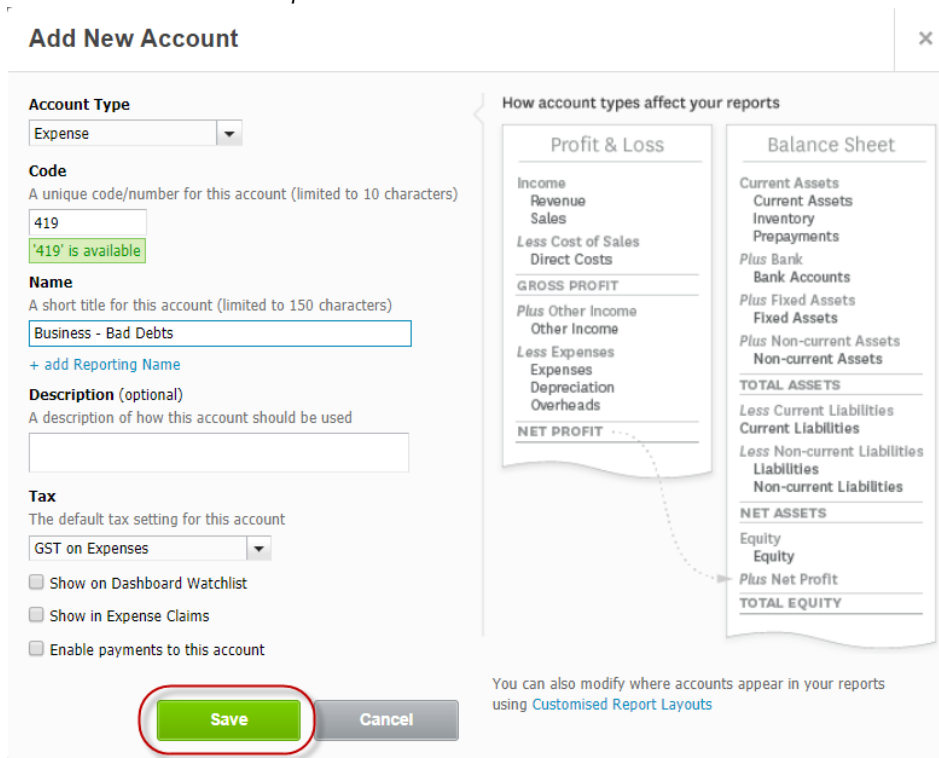
How to write off a bad debt (direct write off method)

CREATE THE BAD DEBT EXPENSE ACCOUNT

1. Go to Xero → Settings → General Settings
2. Click on **Chart of Accounts**
 - *The Chart of Accounts screen opens*



3. Click on **[Add Account]**
 - *The Add Account screen opens*



4. Select/Enter the following details:
 - Account Type → Select: **Expense**
 - Code → Enter a 3-digit code starting with **4**
 - Name → Enter: **Bad Debts**
 - Tax → Select: **GST on Expenses**
5. Click on **[Save]**

CREATE THE BAD DEBTS CREDIT NOTE AND ALLOCATE IT TO THE UNPAID INVOICE

1. Go to Accounts → Sales

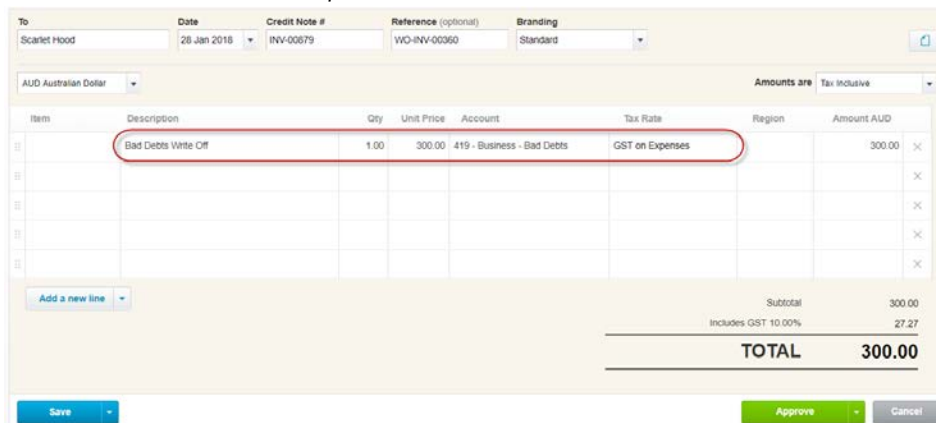
→ The Sales screen opens



Customer	Amount	Status
Scopeview Construction	6,875.00	
Ridgeway University	6,187.50	6,187.50
DIISR - Small Business Services	3,850.00	3,850.00
Pinnacle Management	3,080.00	3,080.00
Basket Case	914.55	914.55

2. Click on New → Credit Note

→ The New Credit Note screen opens



Item	Description	Qty	Unit Price	Account	Tax Rate	Region	Amount AUD
	Bad Debts Write Off	1.00	300.00	419 - Business - Bad Debts	GST on Expenses		300.00

Subtotal: 300.00
Includes GST 10.00%: 27.27
TOTAL: 300.00

3. Select/Enter the following details:

- To → Select the customer
- Date → Confirm the current date
- Credit Note # → Confirm the default number
- Reference → Enter: WO-INV#XXX (cross reference with original invoice number)
- Description → Enter: **Bad Debt Write Off**
- Qty → Enter: 1
- Unit Price → Enter the amount of the original invoice
- Account → Select: **4XX – Bad Debts**
- Tax Rate → Confirm: **GST on Expenses**

4. Click on [\[Approve\]](#)

➔ *The Allocate a Credit Balance screen opens*

Sales > Invoice INV-00879 >
Allocate Credit Balance

Allocate balance on [Credit Note INV-00879](#)

Invoice	Date	Invoiced	Amount Due	Amount to Credit
<input type="checkbox"/> INV-00360	5 Jan 2017	300.00	300.00	<input type="text" value="300.00"/>

Cash refund

Outstanding Credit Balance	300.00
Total Amount to Credit	300.00
Remaining Credit	0.00

5. In the **Amount to Credit** enter the value of the Credit Note

6. Click on [\[Allocate Credit\]](#)

➔ *The Invoice is closed and the transaction is posted to the Bad Debts Account*

How to write off a bad debt (provision method)

CREATE THE PROVISION ASSET ACCOUNT

1. Go to Xero → Settings → General Settings

2. Click on [Chart of Accounts](#)

➔ *The Chart of Accounts screen opens*

Chart of Accounts

All Accounts | Assets | Liabilities | Equity | Expenses | Revenue | Archive

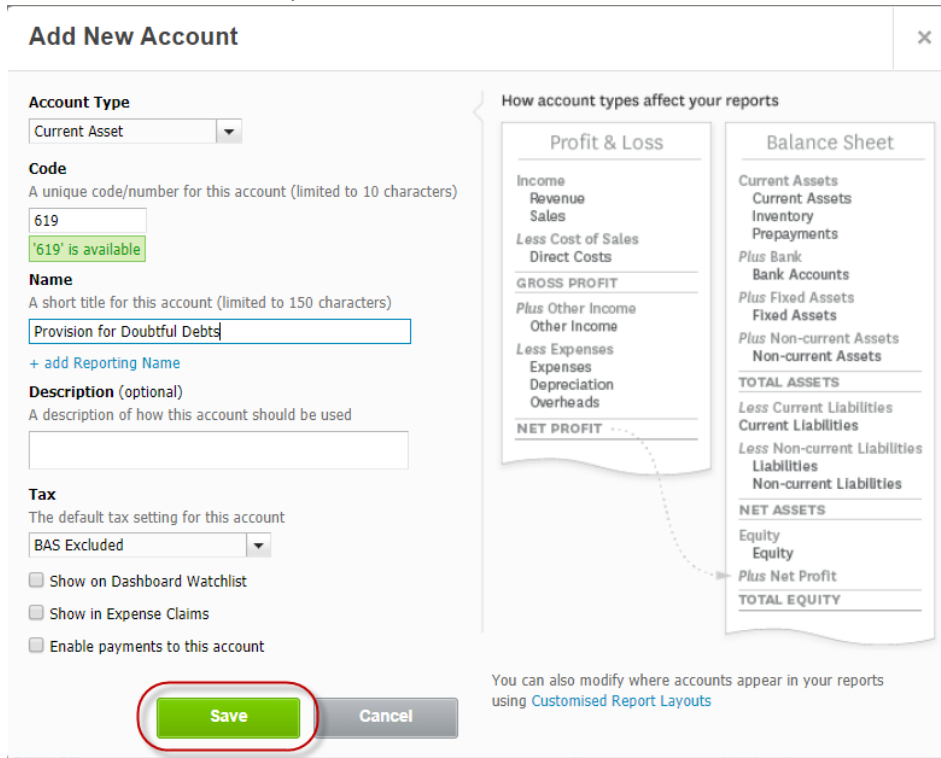
What's this?

Delete | Archive | Change Tax Rate | No accounts selected |

Code	Name	Type	Tax Rate	YTD
<input type="checkbox"/> 200	Construction - Commercial Income from any normal business activity	Revenue	GST on Income	189,477.91

3. Click on [\[Add Account\]](#)

→ The Add Account screen opens



Add New Account

Account Type
Current Asset

Code
A unique code/number for this account (limited to 10 characters)
619
'619' is available

Name
A short title for this account (limited to 150 characters)
Provision for Doubtful Debts

Description (optional)
A description of how this account should be used

Tax
The default tax setting for this account
BAS Excluded

Show on Dashboard Watchlist
 Show in Expense Claims
 Enable payments to this account

How account types affect your reports

Profit & Loss	Balance Sheet
Income	Current Assets
Revenue	Current Assets
Sales	Inventory
Less Cost of Sales	Prepayments
Direct Costs	Plus Bank
GROSS PROFIT	Bank Accounts
Plus Other Income	Plus Fixed Assets
Other Income	Fixed Assets
Less Expenses	Plus Non-current Assets
Expenses	Non-current Assets
Depreciation	TOTAL ASSETS
Overheads	Less Current Liabilities
NET PROFIT	Current Liabilities
	Less Non-current Liabilities
	Liabilities
	Non-current Liabilities
	NET ASSETS
	Equity
	Equity
	Plus Net Profit
	TOTAL EQUITY

You can also modify where accounts appear in your reports using [Customised Report Layouts](#)

Save **Cancel**

4. Select/Enter the following details:

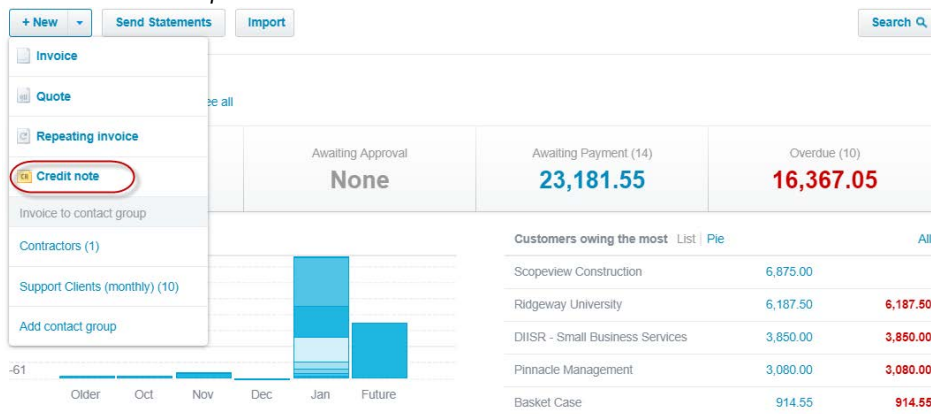
- Account Type → Select: **Current Asset**
- Code → Enter a 3-digit code starting with **6**
- Name → Enter: **Provision for Doubtful Debts**
- Tax → Select: **BAS Excluded**

5. Click on [Save]

CREATE THE DOUBTFUL DEBT CREDIT NOTE AND ALLOCATE IT TO THE INVOICE

1. Go to Accounts → Sales

→ The Sales screen opens



Invoice **Quote** **Repeating invoice** **Credit note**

Awaiting Approval: **None**

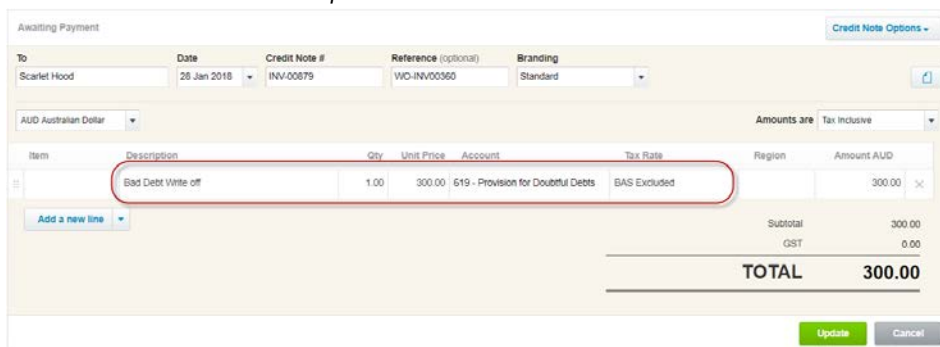
Awaiting Payment (14): **23,181.55**

Overdue (10): **16,367.05**

Customers owing the most	List	Pie	All
Scopeview Construction	6,875.00		
Ridgeway University	6,187.50		6,187.50
DISR - Small Business Services	3,850.00		3,850.00
Pinnacle Management	3,080.00		3,080.00
Basket Case	914.55		914.55

2. Click on **New** → **Credit Note**

→ *The New Credit Note screen opens*



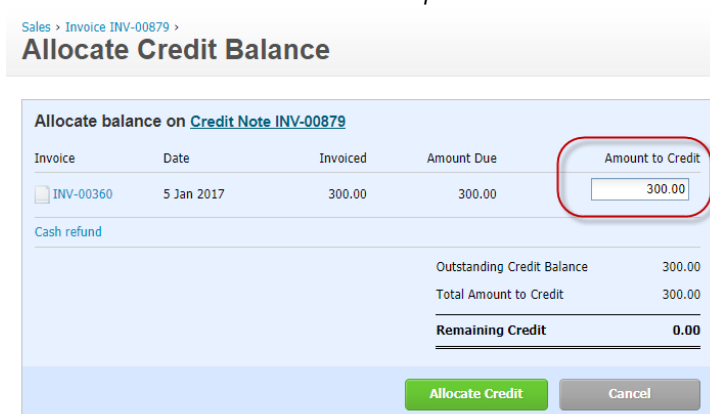
Item	Description	Qty	Unit Price	Account	Tax Rate	Region	Amount AUD
	Bad Debt Write off	1.00	300.00	619 - Provision for Doubtful Debts	BAS Excluded		300.00
Subtotal							300.00
GST							0.00
TOTAL							300.00

3. Select/Enter the following details:

- To → Select the customer
- Date → Confirm the current date
- Credit Note # → Confirm the default number
- Reference → Enter: WO-INV#XXX (cross reference with original invoice number)
- Description → Enter: **Bad Debt Write Off**
- Qty → Enter: 1
- Unit Price → Enter the amount of the original invoice
- Account → Select: **6XX – Provision for Doubtful Debts**
- Tax Rate → Confirm: **BAS Excluded**

4. Click on **[Approve]**

→ *The Allocate a Credit Balance screen opens*



Invoice	Date	Invoiced	Amount Due	Amount to Credit
INV-00360	5 Jan 2017	300.00	300.00	300.00
Cash refund				
Outstanding Credit Balance				300.00
Total Amount to Credit				300.00
Remaining Credit				0.00

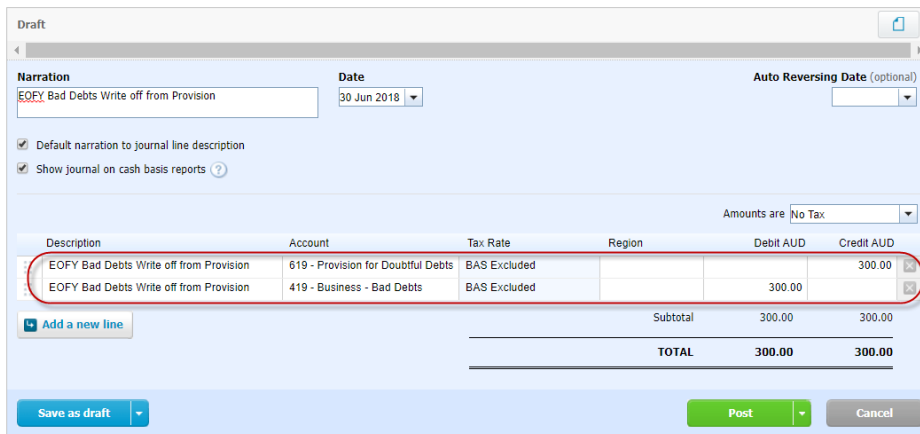
5. In the **Amount to Credit** enter the value of the Credit Note

6. Click on **[Allocate Credit]**

→ *The Invoice is closed and the transaction is posted to the Provision Account*

RECORD THE JOURNAL ENTRY AT THE END OF THE FINANCIAL YEAR

1. Go to Adviser → Manual Journals
 - The Manual Journals screen opens
2. Click on [New Journal]
 - The New Manual Journal screen opens



Description	Account	Tax Rate	Region	Debit AUD	Credit AUD
EOFY Bad Debts Write off from Provision	619 - Provision for Doubtful Debts	BAS Excluded			300.00
EOFY Bad Debts Write off from Provision	419 - Business - Bad Debts	BAS Excluded		300.00	
Subtotal				300.00	300.00
TOTAL				300.00	300.00

3. Select/Enter the following details:
 - Narration → Enter EOFY Bad Debts Write off from Provision
 - Date → Enter the 30th June of the correct financial year
 - Default Narration to journal... → Select this option
 - Show journal on cash basis report → Select this option
 - Description → Is copied from Narration
4. Post the transaction as follows:
 - Credit Entry → 6XX Provision for Doubtful Debts
 - Debit Entry → 4XX Bad Debts
5. Click on [Post]