# WHEN DOES THE DEBT BEGIN? PROBLEMS OF RECOGNIZING LIABILITIES IN SETTLEMENTS WITH SUPPLIERS

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**Abstract:** Accounts payable — the liability arising from an entity's obligations to its suppliers — looks deceptively routine on the balance sheet. In practice, however, its recognition is riddled with problems that neither standard-setters nor practitioners have fully resolved. This article examines the core difficulties: the contested moment at which an obligation comes into existence, the treatment of uninvoiced receipts and accrued liabilities, the measurement of payables subject to variable terms such as rebates and volume discounts, the special complications posed by disputed amounts and contingent obligations, the distorting effect of advance payments on liability recognition, and the asymmetric treatment of foreign currency payables under IAS 21. The article also traces the divergences between IFRS and US GAAP in this area — divergences that are narrower than widely assumed but still consequential for cross-border comparison. The central claim is that supplier liability recognition is not a mechanical exercise: it requires the same quality of judgment as any other element of financial reporting, and the consequences of getting it wrong extend well beyond accounting tidiness into credit analysis, covenant compliance, and the reliability of financial statements as a whole.

**Keywords:** accounts payable, liability recognition, accrued liabilities, IAS 37, uninvoiced receipts, contingent obligations.

## Introduction

There is a widespread assumption in corporate finance that accounts payable is the easy part of the balance sheet. Assets are complex — they require impairment testing, fair value measurement, and constant judgments about useful life and recoverability. Equity is complicated by capital structure decisions, buybacks, and the thorny classification of hybrid instruments. But supplier payables? You get the invoice, you book the liability, you pay it. What could be simpler?

Anyone who has spent time close to a month-end close process knows this assumption is wrong. Not marginally wrong — substantially wrong. The recognition of liabilities in settlements with suppliers involves a surprisingly dense set of conceptual and practical difficulties, and the errors that arise from mishandling them are not trivial. Under-recognition of payables inflates reported equity and understates leverage. Over-recognition distorts period profitability. Misclassification between short-term and long-term obligations misleads readers about liquidity. And the failure to capture liabilities at the right moment — what auditors call the cut-off problem — is one of the most persistent sources of material misstatement in financial reporting.

The literature on accounts payable has historically been dominated by two streams: supply chain finance (focused on the strategic management of payment terms) and corporate governance (focused on whether early or late payment reflects a firm's financial health). The accounting recognition problems — the ones that actually determine what appears on the balance sheet — have received comparatively less systematic treatment. This article tries to fill part of that gap.

The discussion draws primarily on IFRS — specifically IAS 37, IFRS 9, IAS 1, IAS 21, and the IFRS Conceptual Framework — but engages with US GAAP where the comparison is instructive. The article does not argue that the current framework is fundamentally broken; it argues that the framework, applied carelessly or mechanically, produces financial statements that misrepresent the genuine state of a company's obligations to its suppliers. And that matters.

**What Recognition Actually Means: The Conceptual Starting Point**

Before addressing any specific problem, it helps to be precise about what "recognition" means in this context. Recognition is the process of formally capturing an item in the financial statements — as opposed to merely disclosing it in the notes or acknowledging its existence informally. Under the IFRS Conceptual Framework (2018), a liability is recognized when it meets the definition of a liability and when recognizing it provides users with relevant information that faithfully represents what it purports to represent.

The definition itself has three components. A liability must be a present obligation — not a future one. It must arise from past events. And it must involve an expected transfer of economic resources. Each of these elements causes difficulty in the supplier context.

"Present obligation" is the most loaded phrase. An obligation is present, under IFRS, when the entity has no practical ability to avoid it — when the economic and legal substance of the situation means that walking away is not a realistic option. This is broader than purely legal liability. A company that has received goods and inspected them without objection has a present obligation to pay, even if the supplier's invoice hasn't arrived yet. The invoice is evidence of the obligation; it isn't the obligation itself. This distinction seems obvious in theory but is routinely ignored in practice.

The "past event" requirement is equally subtle. For supplier payables, the triggering event is typically the receipt of goods or services in the condition promised. Not the placement of a purchase order — that creates only a commitment, not a liability. Not the signing of the contract. The event that creates the obligation is the delivery that the supplier has already completed, leaving the buyer with the benefit and the corresponding duty to pay.

Getting these conceptual foundations right matters because they determine how preparers handle all the messier situations discussed below. When a practitioner misunderstands recognition as being driven by the invoice rather than the underlying event, every subsequent judgment follows from that flawed starting point.

**The Timing Problem: Invoice Receipt vs. Economic Substance**

In an ideal world, goods arrive on Tuesday, the invoice arrives on Wednesday, and the liability is recognized on Tuesday based on the economic substance of the delivery. In the real world, goods and invoices rarely keep the same schedule — and the gap between them is one of the most persistent sources of recognition error.

When goods arrive before the invoice, the entity has received an economic benefit and incurred a present obligation, but has no formal document triggering payment. The correct treatment under IFRS is to recognize a liability at the time of receipt, based on the best estimate of the amount owed. This might be the purchase order price, a contractual rate, or a prior invoice for similar goods. The amount will be confirmed and potentially adjusted when the invoice arrives. This type of liability — received but not invoiced — is called an accrued liability or an uninvoiced receipt, and its proper recognition is non-negotiable.

But what actually happens in many organizations is that the liability is recognized only when the invoice is processed through the accounts payable system. This creates a systematic understatement of payables at any given reporting date, particularly at period end when the volume of uninvoiced receipts tends to be highest. The error is not random; it is directional and repeatable. And it is especially damaging at year-end, where it understates liabilities, overstates net assets, and potentially overstates reported income — since the corresponding cost may also be deferred.

The mirror image also exists: invoices that arrive before goods are delivered. Here, the entity has received a financial document but not yet the economic substance it represents. Recognizing a liability at invoice receipt in this case would be premature. The obligation only arises when the goods arrive or the service is rendered. This is a less common error, but it does appear — particularly in industries with long lead times and advance billing practices.

**Uninvoiced Liabilities: A Structural Understatement Problem**

The uninvoiced receipt problem deserves more attention than it typically receives, because it's not just a timing quirk — it's a structural feature of most large organizations' procure-to-pay processes.

In practice, the receipt of goods triggers a goods receipt note (GRN) in the entity's ERP system, while the incoming invoice is processed separately through accounts payable. These two data streams are supposed to be matched — three-way matching against the purchase order, GRN, and invoice is the standard control. But in any organization of meaningful size, there is always a population of GRNs without matching invoices at any given point in time. The question is whether those unmatched GRNs create recognized liabilities on the balance sheet, or whether they simply accumulate in a suspense account until the invoice arrives.

Under a strict application of IFRS, they should create liabilities. The obligation exists, the amount can be estimated (from the purchase order), and the economic event — delivery — has already occurred. The accrual basis of accounting demands their recognition. But the practical challenge is real: large organizations may have thousands of unmatched GRNs, some of which represent genuine uninvoiced liabilities, others of which represent data entry errors, duplications, or deliveries that are actually disputed. Distinguishing between these requires work, and finance teams under deadline pressure tend to default to the simpler position of recognizing only what's been invoiced.

The accounting consequence, as noted, is systematic understatement. The business consequence is arguably more serious: a company that doesn't understand the population of its uninvoiced obligations can't accurately forecast cash requirements, negotiate payment terms, or manage working capital with any precision. Recognition accuracy and operational accuracy are not separate problems — they're the same problem.

**Measurement Under Uncertainty: Rebates, Discounts, and Variable Terms**

Even when the existence of a liability is not in doubt, its measurement frequently is. Supplier relationships are rarely governed by simple fixed-price arrangements. Volume rebates, settlement discounts, milestone-based adjustments, and end-of-period retrospective price reductions are standard features of commercial relationships in many industries — and each of them creates a genuine measurement problem.

Consider a volume rebate. A supplier agrees that if the entity purchases more than a specified threshold over the course of the year, the supplier will refund a percentage of the year's purchases. At any interim reporting date, the entity doesn't know whether it will reach the threshold. How should the liability be measured? IAS 37 requires that a liability be measured at the best estimate of the expenditure required to settle the obligation. Where there's a range of possible outcomes, the best estimate is typically the expected value — or, for a single-outcome probability, the most likely amount. This requires the entity to assess its own purchasing trajectory, which involves internal forecasting, commercial judgment, and documentation.

Settlement discounts — early payment incentives — pose a different challenge. When a supplier offers a two percent discount for payment within ten days rather than the standard thirty, the entity must decide whether to recognize the liability at the gross amount or the net amount. Under IFRS, this depends on whether the discount is expected to be taken. If it is, the liability should reflect the expected settlement amount, not the contractual gross figure. But this expectation has to be formed at the time of recognition and revisited if circumstances change. In practice, many organizations simply book gross and record discounts when taken, which overstates the liability initially and creates a matching problem when the discount is eventually recognized.

Supplier-funded rebates in retail industries add another layer. Retailers frequently negotiate substantial retrospective income from suppliers — contributions to promotional activities, listing fees, volume-based rebates — that function economically as reductions in the cost of goods purchased. The accounting question is whether these amounts should reduce the carrying value of inventory and cost of goods sold or be recognized as other income. IFRS 15 and IAS 2 both bear on this question, and the answer isn't always obvious. What's clear is that getting it wrong can distort gross margin — a figure that analysts and investors watch closely.

**Disputed Amounts: Somewhere Between Liability and Contingency**

Not every supplier relationship runs smoothly. Goods are delivered damaged. Services are underperformed. Invoices contain errors. And when the entity disputes an amount, the accounting question becomes genuinely difficult: is there still a liability, and if so, for how much?

IAS 37 draws a distinction between provisions — liabilities of uncertain timing or amount — and contingent liabilities, which are either possible obligations whose existence will only be confirmed by future events, or present obligations that fail the recognition criteria. Contingent liabilities are disclosed in the notes rather than recognized on the balance sheet. The threshold for recognition is that an outflow of economic resources is "probable" — interpreted under IFRS as more likely than not, a threshold broadly in line with the 50-plus-percent standard.

In the supplier dispute context, this framework can be tricky to apply. Suppose an entity has received goods that it considers partially defective, and it has withheld payment pending resolution with the supplier. The entity believes it owes something, but not the full invoiced amount. The right approach is to recognize a liability at the best estimate of the amount that will ultimately be paid — not zero (which would ignore the undisputed portion), not the full invoice amount (which would anticipate defeat in the dispute). This estimate requires a genuine assessment of the dispute's likely resolution, which in turn requires legal input, commercial judgment, and documentation.

What tends to happen instead is one of two things. Either the full liability is reversed on the grounds that the invoice is disputed — eliminating it from the balance sheet entirely, which may be appropriate for the disputed portion but is definitely wrong for the undisputed portion. Or the full invoice is recognized and left pending, which overstates liabilities and distorts period costs. Neither approach is right, but both are common because the correct approach demands effort.

The provision-vs.-contingency question also arises in a slightly different way when the entity has obligations to suppliers under framework agreements — minimum purchase commitments, for example, or take-or-pay contracts. These are onerous contracts under IAS 37 when the unavoidable costs of meeting the obligation exceed the expected economic benefits. The liability for the onerous element must be recognized. But identifying when a contract has become onerous — particularly in commodity markets where input prices fluctuate — requires ongoing monitoring and judgment that isn't always built into month-end processes.

**Advance Payments and the Confusion They Create**

Advance payments — amounts paid to suppliers before goods or services are received — sit on the asset side of the balance sheet as prepayments. But their interaction with subsequent liability recognition is a source of persistent confusion, and the errors that result can go in either direction.

When an entity pays an advance, it records a prepayment asset. When the goods are later delivered, the prepayment is reclassified: it reduces the liability that arises from the delivery. If the advance fully covers the purchase price, no net liability remains after delivery. If the advance is only partial, a residual liability is recognized for the balance owed.

The problem is that many entities — particularly those with less sophisticated systems — handle this reclassification inconsistently. Some recognize the full liability on delivery and then offset the prepayment against it; others simply reduce the prepayment by the amount invoiced without ever recognizing the gross liability. The gross liability approach is generally preferable for financial statement presentation because it makes the entity's obligations transparent. Netting the advance against the unpaid balance and showing only the residual can obscure the commercial substance of the arrangement, particularly where prepayments are large and the timing of delivery is uncertain.

There's also a credit risk dimension. Prepayments to suppliers create counterparty credit exposure: if the supplier fails to deliver after receiving advance payment, the entity may not recover the advance. IAS 37 and IFRS 9 (through expected credit loss principles) both bear on how this exposure should be reflected in the financial statements. In practice, prepayments to suppliers are rarely subjected to any form of credit assessment or expected credit loss calculation — they sit on the balance sheet at cost and are only written down when recovery appears hopeless. This is a recognized gap in practice, even if its frequency is difficult to quantify.

**The Cut-Off Problem: Period-End's Perennial Challenge**

Period-end cut-off is the process of ensuring that transactions are recorded in the correct accounting period. For supplier payables, this means ensuring that all goods and services received on or before the balance sheet date are recognized as liabilities in the closing balance sheet, and that no liabilities are recognized for deliveries that occur after the period end.

Cut-off errors in accounts payable are among the most common findings in external audits — and among the most persistent. The reason isn't primarily negligence; it's structural. At year-end or quarter-end, there's always a compressed timeline. Goods arrive in the final days of the period, invoices chase them by several days or weeks, and the systems that match the two don't always catch up before the books close. The result is that deliveries occurring just before the period end may slip into the subsequent period's payables, understating the closing balance.

The opposite error — recording a liability for goods that arrived in the new period but whose purchase order was dated before the period end — also occurs, though less frequently. This overstates closing liabilities and would typically reflect either a process failure or, in rare cases, an intentional attempt to accelerate expense recognition.

From an audit perspective, cut-off testing around the period end is standard procedure, precisely because the risk is well understood. Auditors examine the goods receipt records for a window around the balance sheet date — typically a few weeks on either side — and verify that each receipt is recognized in the correct period. The fact that this testing is necessary, and that it routinely surfaces errors, confirms that cut-off is not a theoretical problem. It is operational.

What makes the supplier payable cut-off problem particularly consequential is its directionality. When a company is under pressure to show strong year-end results, there is an obvious incentive to allow payables to slip into the new period — reducing closing liabilities, improving the working capital position, and potentially understating the period's cost of sales. Auditors are alert to this, but the testing procedures are not foolproof, especially when goods receipts are partially matched or when deliveries involve services rather than physical goods (where the "delivery date" is inherently more ambiguous).

**Foreign Currency Payables: A Measurement Problem That Recurs**

When a company imports goods from abroad and settles in foreign currency, the liability arising from that purchase is denominated in a currency other than the entity's functional currency. Under IAS 21, such monetary items must be translated at the closing exchange rate at each balance sheet date, with remeasurement gains and losses recognized in profit or loss.

The mechanics of this are not disputed. What causes problems is the interaction between the remeasurement requirement and the entity's hedging or commercial practices — and, in smaller organizations, the failure to apply the requirement consistently.

The translation gain or loss on a foreign currency payable is unrealized — the entity hasn't paid yet, and the rate at which it will ultimately pay is unknown. But it's real: it reflects a genuine change in the economic burden of the obligation. When the functional currency weakens against the payable currency, the obligation in local terms grows. Recognizing this in profit or loss is the correct treatment, but it introduces income statement volatility that bears no relationship to the underlying trading performance. For a manufacturing company with significant imported inputs, the remeasurement of supplier payables can produce material income statement swings that dwarf the operating profit from core activities. This makes comparisons across periods difficult and can lead users — particularly those focused on operating metrics — to misread the reported results.

Some entities use derivative instruments or natural hedges to manage this exposure, and the hedge accounting requirements under IFRS 9 are complex. But the more basic problem is entities that carry foreign currency payables without any hedging at all and fail to remeasure them consistently. In practice, particularly in economies where the local currency is volatile — a description that fits numerous emerging markets — the omission of proper remeasurement can produce substantially misstated payable balances. The error becomes visible only when a payment is made and the difference between the carrying amount and the settlement amount is recognized, at which point it's too late to allocate the exchange difference to the correct periods.

**Related Party Supplier Transactions: Recognition Through a Different Lens**

Transactions with related party suppliers introduce a set of concerns that go beyond mere recognition and measurement — though they affect those too.

IAS 24 requires disclosure of related party relationships and transactions, including purchases from suppliers that are related to the entity through common ownership, key management, or family connections. The disclosure requirement is widely understood. Less appreciated is how related party supplier arrangements affect the recognition of the underlying liabilities.

When an entity purchases from a related party at non-arm's-length terms — say, at a price significantly above or below market — the liability recognized should reflect the actual contractual amount. But the notes must convey enough information for readers to understand the nature and pricing of the arrangement. Where the pricing diverges significantly from market, questions arise about whether the difference represents a disguised distribution, a compensation arrangement, or an intercompany transfer that has been structured to shift profit between tax jurisdictions.

These questions matter for liability recognition because they can affect whether the full invoice amount should be recorded as a cost — and hence as part of accounts payable — or whether part of the amount should be reclassified as a dividend, compensation expense, or intercompany balance. Getting this wrong doesn't just affect the supplier payable balance; it affects the income statement classification of costs and the entity's transfer pricing documentation, which has its own regulatory exposure.

Group structures where the entity regularly purchases from subsidiaries or associates of the same parent add another dimension. Here, the elimination of intercompany balances in consolidation means that the supplier payable may be real at the entity level but disappears in the group accounts. The risk is that preparers become casual about recognizing these balances at the entity level precisely because they know they'll be eliminated in consolidation — a logical error with real consequences for the standalone financial statements.

**IFRS and US GAAP: The Differences That Actually Matter**

The convergence project between the IASB and FASB produced meaningful alignment across much of financial reporting. In the accounts payable space, the two frameworks are broadly consistent — but there are a few differences that are worth understanding, particularly for entities with cross-border operations or analysts comparing companies across regimes.

The most significant difference lies in the treatment of contingent liabilities. Under IAS 37, a provision is recognized when an outflow of resources is probable — which the standard defines as more likely than not, implying a probability above 50 percent. Under US GAAP (ASC 450), the threshold for recognizing a loss contingency as a liability is "probable", but

GAAP's application guidance has historically interpreted this threshold as significantly higher than 50 percent — closer to 70 to 80 percent in practice. The result is that similar uncertain obligations may be recognized under IFRS but disclosed only as a contingency under US GAAP. For supplier disputes or onerous contracts, this difference can be material.

The treatment of early payment discounts also diverges. Under IFRS, the entity's expected behavior governs the initial measurement of the liability. US GAAP guidance on trade payable measurement is less prescriptive in this regard, and practice tends to default to gross recognition with subsequent adjustment when discounts are taken. Neither approach is obviously superior, but they produce different patterns of payable balances and cost recognition.

Supply chain finance arrangements — where a bank pays the supplier early on the entity's behalf and the entity repays the bank on extended terms — have attracted attention from both standard-setters in recent years. The question is whether these arrangements should be classified as trade payables (short-term, operating) or as borrowings (financing). The IASB issued amendments to IAS 7 and IFRS 7 in 2023 specifically addressing the disclosure of supplier finance arrangements, requiring entities to provide information about the terms and conditions, the carrying amounts involved, and the liquidity risk implications. The underlying classification question remains a matter of judgment, and different entities make different calls — which limits comparability even within the IFRS regime.

**Disclosure: Where the Gaps Between Rules and Reality Are Widest**

The disclosure requirements applicable to trade payables are scattered across several standards — IAS 1 (presentation and classification), IAS 37 (for provisions and contingencies), IFRS 7 (for financial instruments), and IAS 24 (for related party transactions). Together, they require a substantial volume of information. In practice, many entities satisfy the letter of these requirements while falling short of their spirit.

The maturity analysis of financial liabilities — required under IFRS 7 — should give readers a clear picture of when trade payables fall due. But the standard permits groupings into broad time buckets (less than one year, one to two years, and so on), and within those buckets, the distribution can vary enormously. An entity with most of its payables concentrated at the very end of the "less than one year" bucket has a very different liquidity profile from one with payables evenly spread across the year — but both can present identical disclosures.

The provision disclosures required by IAS 37 — covering the nature of the obligation, the expected timing and amount, and the uncertainties involved — are routinely provided in the minimum detail that satisfies the requirement without actually informing the reader. "Various commercial disputes" appears as a provision description with depressing frequency. It tells the reader that a provision exists; it tells them essentially nothing about the underlying exposure, the assumptions driving the estimate, or the range of possible outcomes.

Related party payable disclosures, as noted, often focus on the dollar amount of transactions in the year without conveying the pricing terms, the nature of the commercial arrangement, or the basis on which the entity concluded that the terms were at arm's length. For a sophisticated user of financial statements, these disclosures are a starting point for further inquiry — not a destination.

None of this is a failure of the standards themselves. IAS 37 and IFRS 7 are reasonably well-drafted. The failure is in how preparers and auditors interpret the objective of disclosure. The question should not be "does this disclosure technically satisfy the standard?" but "does this disclosure give a reader what they need to understand the nature, amount, and uncertainty of the entity's supplier obligations?" Those are different questions, and the first is much easier to answer affirmatively.

**Toward Better Recognition Practice**

The problems surveyed in this article don't have simple fixes, but they do have identifiable causes — and addressing those causes is possible without waiting for new standards.

The most fundamental issue is the invoice-driven mentality that persists in many accounts payable functions. When the payable process begins with an invoice and not with the economic event underlying it, recognition is systematically delayed and cut-off errors are virtually guaranteed. Shifting the trigger point — so that goods receipts, service completions, and delivery confirmations are captured in real time and create provisional liability entries that are confirmed when invoices arrive — requires systems investment and process change, but it produces a fundamentally more accurate closing balance.

For variable-consideration payables — rebates, discounts, volume adjustments — the key is building the estimation process into the standard month-end routine rather than treating it as a year-end exercise. Estimates that are revised every quarter are more accurate than estimates that are only examined at year-end under audit pressure. The discipline of making and revisiting these estimates regularly also improves commercial awareness: a finance team that actively monitors supplier rebate accruals tends to be better informed about the company's purchasing patterns and contractual commitments.

For disputed amounts and contingent supplier obligations, the gap between practice and standard is mostly a gap in rigor. Entities that maintain a well-documented register of supplier disputes — with assessments of likely outcomes, amounts at risk, and the basis for those assessments — are both more compliant with IAS 37 and better positioned to understand and communicate their commercial risk profile. This is not a reporting exercise; it's good commercial housekeeping that happens to produce better financial reporting as a byproduct.

**Conclusion**

Supplier payables are not the most glamorous corner of financial reporting. They don't attract the theoretical debates that surround fair value measurement or the political controversy of revenue recognition. And yet they are, arguably, the place where accounting meets business operations most directly — where the daily reality of purchase orders, deliveries, invoices, and payment runs intersects with the formal requirements of financial reporting.

The problems examined here — timing and cut-off, uninvoiced liabilities, variable measurement, disputed amounts, advance payments, foreign currency remeasurement, and the complications of related party arrangements — are not exotic edge cases. They are features of ordinary commercial life that every entity with a supply chain must navigate. The fact that they are so persistent, and that they so regularly surface as audit findings or restatement drivers, suggests that the gap between the framework's requirements and actual practice remains wider than it should be.

Part of the answer lies in better training — ensuring that finance professionals understand that liability recognition is driven by economic substance, not by documentation. Part lies in better systems — ERP configurations that capture economic events in real time rather than waiting for invoice processing. And part lies in a different culture around disclosure — one that treats the notes to the financial statements as an opportunity to communicate, not a compliance exercise to be minimized.

The credibility of a company's financial reporting rests, in no small part, on whether readers can trust that the liabilities shown on the balance sheet are complete and accurate. For a number as fundamental as what the company owes its suppliers, that trust shouldn't be taken for granted.

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