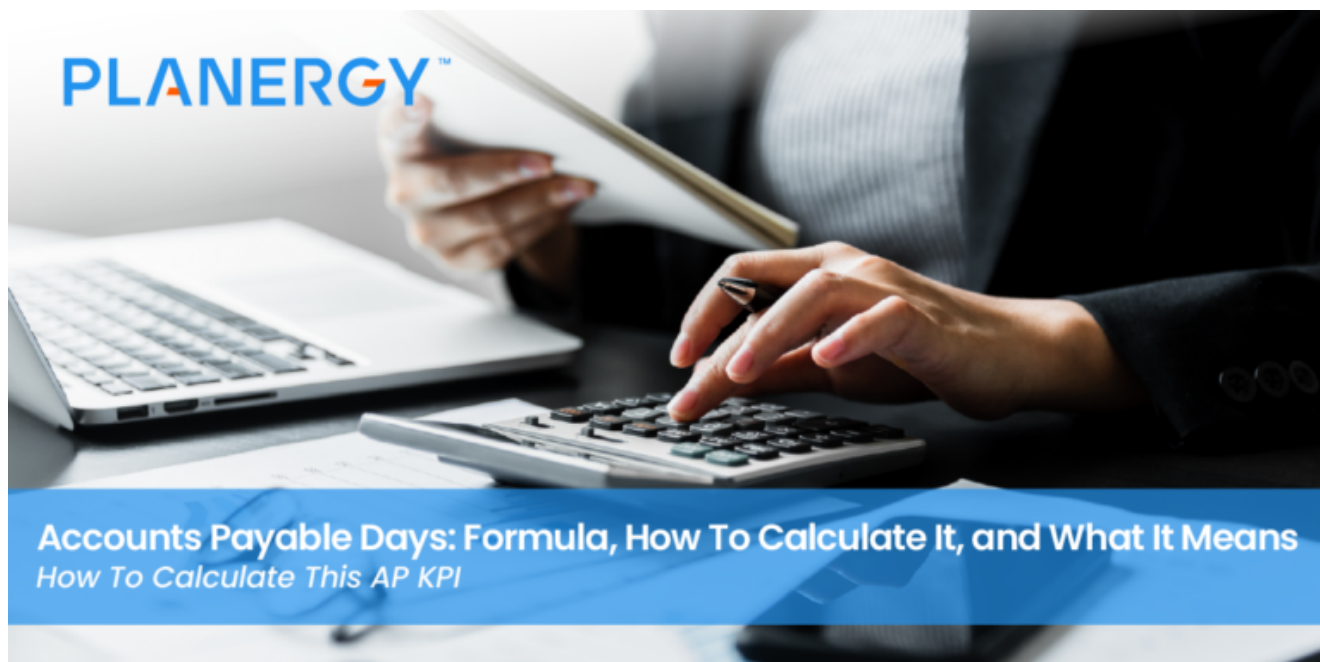


# Accounts Payable Days: Formula, How To Calculate It, and What It Means



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Accounts payable days, commonly known as days payable outstanding (DPO), is a calculation closely related to the AP turnover ratio.

While the AP turnover ratio tells you how many times per year your AP totals are paid off, the DPO calculates the average number of days it takes to pay them off.

Whether you call the calculation days payable outstanding (DPO), creditor days, or accounts payable days, this ratio is used to measure the average number of

days that your business takes to pay vendors and suppliers, from invoice receipt to payment issued.

DPO is typically calculated quarterly or annually as an accounts payable KPI with the metric results then compared with those of similar businesses.

A good DPO can also be used as a bargaining tool when setting up payment terms with current or new suppliers or vendors.

## **What Are Days Payable Outstanding (DPO) in Accounting and Why It Matters**

Days payable outstanding is a financial ratio that calculates the average number of days it takes for a business to pay vendors and suppliers for goods and services purchased.

Businesses choose to track DPO for a variety of reasons.

- **Capture Early Payment Discounts**

If your vendors commonly offer early payment discounts, tracking your DPO can help you understand why you aren't able to take advantage of those discounts, and what adjustments can be made so you can do so in the future.

- **Improve Vendor Relationships**

One of the ways to strengthen your business relationship with your suppliers is to ensure that they're paid on time. Paying vendors early can also be beneficial when an early payment discount is offered.

- **Provides a Benchmark for AP Processes**

Depending on your current AP system, late payments may be less about low cash flow and more about system inefficiencies. If vendor payments are late because of manual processes, look at updating your AP processes to incorporate AP Automation.

## • Monitor Cash Flow Status

Adequate cash flow improves liquidity and can help determine whether vendor payments are made on time or whether they're consistently late.

### Reasons To Track Days Payable Outstanding



Capture Early  
Payment Discounts



Improve Vendor  
Relationships



Provides a Benchmark  
for AP Processes



Monitor Cash  
Flow Status

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## How Do You Calculate Days Payable Outstanding?

There are three main components involved in calculating days payable outstanding. Reviewing your balance sheet and financial statements for the period you are reviewing will give you the information you need.

The first is the purchase of raw materials and associated supplies needed to complete and sell their products. These purchases become part of accounts payable, with a set due date assigned.

The second component is the cost of purchasing the products or supplies, along with associated costs such as labor and utility costs.

These costs are considered the cost of sales or cost of goods sold or COGS and are necessary to create the finished product.

A commonly used formula for Cost of Goods Sold is:

**Cost of Goods Sold = Beginning Inventory + Purchases - Ending Inventory**

The third component of DPO is the number of days. For example, if you're calculating DPO for the quarter, the number of days would be 90. If calculating

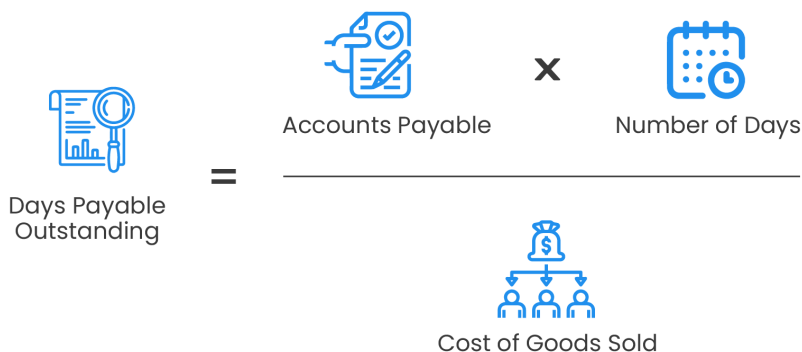
DPO for the year, the number of days would be 365.

Once you have these components in place, you can calculate this metric using the following days payable outstanding formula:

### **Accounts Payable x Number of Days / Cost of Goods Sold**

Note that you have the option to calculate DPO based on a specific period of time or by using the average AP balance for the period.

## Days Payable Outstanding (DPO) Formula


$$\text{Days Payable Outstanding} = \frac{\text{Accounts Payable} \times \text{Number of Days}}{\text{Cost of Goods Sold}}$$

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## What Is an Example of Days Payable Outstanding?

Company A is interested in calculating its DPO for 2022 using its average AP balance for the year.

Their beginning AP balance in January was \$470,000, with an ending AP balance of \$510,000, with the cost of goods sold totaling \$5,100,000 for 2022.

Here are the steps needed to calculate their DPO for 2022.

**Step 1.** The first step is to calculate the average accounts payable balance for the year.

$$(\$470,000 + \$510,000) / 2 = \$490,000$$

**Step 2.** Locate the cost of goods sold for 2022. Make sure that all returns and

other adjustments are included in the total.

### **Step 3.** Calculate the DPO

The DPO formula is:

$$\mathbf{\$490,000 \times 365 \text{ days} / \$5,100,000 = 35 \text{ days}}$$

There is a second method you can use to calculate DPO, using only the ending accounts payable balance rather than calculating the average AP for the entire fiscal year.

$$\mathbf{\$51,000 \times 365 \text{ days} / \$5,100,000 = 36.5 \text{ days}}$$

The first DPO calculation of 35 days represents the average for all of 2022 while the second calculation represents the DPO as of 12-31-2022 exactly. Either version can be used, depending on what information you're looking for.

## **What Is the Relationship Between Accounts Payable Turnover and DPO?**

For a more complete picture of your AP finances, you can calculate your accounts payable turnover ratio, and then calculate DPO by using the results from the turnover ratio calculation. You can then also use DPO to calculate your cash conversion cycle (CCC).

For example, your company had total purchases of \$9,250,000 in 2022, with a beginning AP balance in January of \$878,000 and an ending AP balance of \$892,000 in December. To calculate the AP turnover ratio, you would first calculate your average AP for the year:

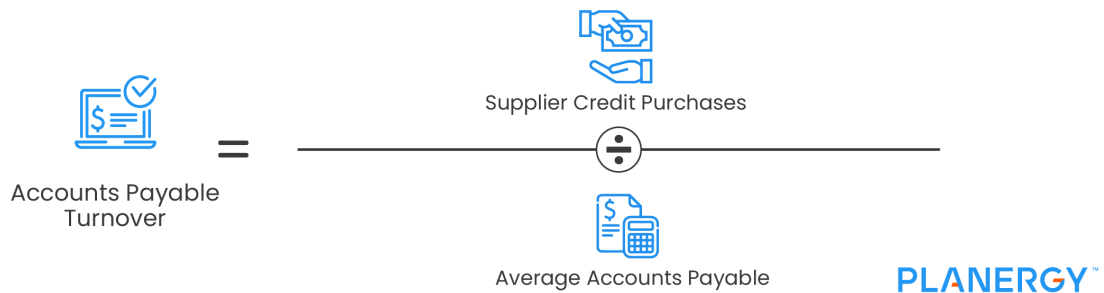
$$\mathbf{\$878,000 + \$892,000 / 2 = \$885,000 \text{ Average AP}}$$

Now you can calculate your AP turnover ratio:

$$\mathbf{\$9,250,000 / \$885,000 = 10.4}$$

When rounding down to 10, the result means that your AP balance turns over approximately 10 times per year.

## Accounts Payable Turnover Ratio Formula



The diagram illustrates the Accounts Payable Turnover Ratio Formula. On the left, there is an icon of a laptop with a dollar sign and a checkmark, labeled "Accounts Payable Turnover". This is followed by an equals sign. To the right of the equals sign is a horizontal line with a division symbol (a circle with a dot and a horizontal line) in the center. Above the line is an icon of a hand holding a check, labeled "Supplier Credit Purchases". Below the line is an icon of a document with a dollar sign and a calculator, labeled "Average Accounts Payable". The PLANERGY logo is located in the bottom right corner of the diagram.

$$\text{Accounts Payable Turnover} = \frac{\text{Supplier Credit Purchases}}{\text{Average Accounts Payable}}$$

Now, if you want to express the number as days payable outstanding or DPO, you would do the following calculation based on the number of days. Because we want to calculate this for the year, we'll use 365 days in our calculation:

$$365 / 10 = 36.5 \text{ days}$$

This means that your company's DPO is 36.5 days for the year.

## What Does DPO Tell You?

Unlike many financial ratios, there are benefits to both a high and a low DPO, depending on your business and your financial needs.

### • Higher DPO

A higher DPO means that it takes your business more time to pay your bills. A higher DPO can be the result of not having enough cash flow to pay bills faster, but it can also mean that your suppliers and vendors have provided you with more favorable payment terms.

There are numerous advantages to having a higher DPO, with the main advantage having more cash available for short-term investments or to boost working capital.

Investors also tend to look at businesses with a higher DPO more favorably, since it can indicate better cash management.

One significant drawback to a higher DPO is that you'll miss out on any early payment discounts you may be eligible for.

Of course, waiting too long to pay your vendor and supplier bills can result in late payment fees, and changes in your current payment terms, and may even jeopardize your vendor and supplier relationships.

Though it can be considered a strategic decision to pay bills less frequently, a higher DPO can also be the result of manual AP processing.

If you're still entering invoice data manually, three-way matching with paper documents, and routing paper invoices to approvers, the odds are good that your higher DPO is because of manual processes, not because you're proactively managing your cash flow.

If DPO is consistently high because of AP inefficiencies, you may want to consider switching to an AP automation software like PLANERGY, which uses machine learning and AI to automate time-consuming manual processes such as three-way matching and invoice approvals, allowing you to pay bills in a manner that can be beneficial for your suppliers and for your business.

## • **Low DPO**

A low DPO means that your business is paying your vendors and suppliers quickly. In some situations, a low DPO can be advantageous, particularly when looking to negotiate payment terms with new suppliers, or if looking to obtain supplier or vendor discounts.

However, a low DPO is viewed unfavorably by investors, who place a higher value on businesses with a more robust cash flow.

Paying your bills too early can also deplete cash flow levels, prohibiting your business from making any short-term investments or using your cash for business growth.

In many cases, it helps to determine payment frequency based on each vendor or supplier while keeping payment terms in mind.

Businesses often will pay some vendors early to take advantage of early payment discounts, while actively working with others to obtain more favorable credit terms which allow them to pay less frequently.

After calculating your DPO, it can also be beneficial to compare your results with that of similar companies. This is because acceptable DPO values can vary widely from industry to industry.

For example, Apple's DPO as of September 2022 was 97 days, while Walmart's DPO as of October 2022 was 46, but comparing the DPO of these two very different companies would not be helpful.

## **Should You Raise or Lower Your DPO?**

It really depends on why your DPO is at its current level. In some situations, you may want to lower your DPO, while other situations may indicate that you should raise it.

For example, a small business with a low DPO may want to look at internal processes to see where improvements can be made to improve short-term working capital.

On the other hand, a business with a high DPO may want to consider adjusting its payment frequency by taking advantage of favorable terms.

There are several things to consider if you're looking to change your DPO.

### **1. Check Industry Benchmarks**

The first thing you'll want to do after calculating your DPO is to check it against industry standards.

For example, if the standard DPO for your industry is 45 and your average time is 15, it means that you have less available cash, which may be a disadvantage.

### **2. Review Vendor and Supplier Terms**

If your DPO is low because your vendor terms are unfavorable, see if you can renegotiate better terms.

### 3. **Consider Paying Suppliers that Offer Discounts First**

Making the decision to prioritize payment based on early payment discounts can make a lot of sense, particularly for smaller businesses.

### 4. **Review Accounts Payable and Accounts Receivable Strategies**

If your outflow of cash via AP is faster than your inflow of cash via AR, your cash flow will be negatively impacted. Make sure that they work together.

One way to measure is to run DPO together with days sales outstanding or DSO, which tells you how long it takes for you to collect on sales. The two numbers should be similar, with DPO slightly higher.

### 5. **Consider AP Automation**

If many of your invoice processing issues are due to AP department inefficiencies, a lot of those will go away if you switch to an automated AP system.

While delaying payment may be a strategic decision, payment delays based on manual AP processing take the choice out of your hands.

## Things To Consider When Improving Your Days Payable Outstanding



Check Industry Benchmarks



Review Vendor and Supplier Terms



Consider Paying Suppliers that Offer Discounts First



Review Accounts Payable and Accounts Receivable Strategies



Consider AP Automation

Managing cash flow properly is important for any business. Calculating AP days outstanding using financial metrics such as DPO can help pinpoint trouble spots for any accounting period by giving you the information you need to maintain good supplier relationships while retaining enough cash to grow your business.

## **What's your goal today?**

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