Is Accounts Payable A Liability Or An Asset?

Sometimes it's good to review the basics. For example, accounts payable (AP)—a major concern for every business that buys goods and services, pays bills, or manages its credit—are a familiar sight to your accounting team, but if you're not quite sure how they work, or whether they're a liability or an asset, it's a good idea to dig a little deeper to understand the impact they can have on your working capital and financial reporting.

Answering the question, "Is accounts payable a liability or asset?" requires a working knowledge of basic double-entry accounting (also called *accrual accounting*) and your company's balance sheet. Brushing up on how accounts payable function within your accounting system can help you produce more accurate financial statements, manage your cash flow more effectively, and ensure your company is meeting its financial obligations.

What Are Accounts Payable?

Generally speaking, accounts payable are the result of your company purchasing goods and services from a vendor on credit rather than cash. Purchasers record accounts payable on their balance sheets as *current liabilities*, which represent financial claims against the company's assets. These are short-term debts, with a clear due date that's usually 90 days or less, but can be as long as a year.

One specific type of accounts payable is *trade payables*, a series of payments made directly to a supplier for goods and services consumed during the regular course of operations, generally on credit.

These payables have a specific repayment period attached (up to a year), but are still considered current liabilities.

If the debt will persist longer than a year, these payables may be moved to *long-term liabilities* instead, and accrue interest (this is also known as a *long-term debt*.)
Note: Payables paid in cash rather than credit are not trade payables.

Because AP represents a debtor/creditor relationship, they require associated terms and conditions, negotiated between you as the buyer/debtor and the supplier as the seller/creditor.

These terms cover how you will pay, and the number of days you have to pay it. For example, a major supplier who provides large amounts of raw materials or components for production at a correspondingly substantial price might have 90-day terms, while an office supply store or local luncheonette might have 15-day or 30-day terms for more frequent, but much smaller, company purchases.

As liabilities, accounts payable will appear on your balance sheet alongside related short-term and long-term debts.

They are distinct from assets and also other liabilities, such as:

- Long-term liabilities
- Wages
- Payable dividends
- Utilities/rent
- Income taxes
- Payroll taxes
- Unearned revenue

Accounts payable are also separate from *shareholder's equity* (also known as *owners' equity*). Should your company be completely liquidated and all of its debts paid, the amount remaining to be returned to your investors (or yourself, in the case of a sole proprietorship) is the shareholders' equity.

Accounts payable can be recorded as either a debit or a credit on your balance sheet, depending on how you buy and when you pay.

Accounts payable are related to, but separate from, *accounts receivable* (AR), which represent money owed to your organization by its customers. As the opposite of AP, Accounts receivable are recorded as an asset, rather than a liability.

> *Without accurate information for each account payable, your company's creditworthiness, ability to properly manage cash flows for both investments and unexpected expenses, and general reputation as a debtor could be in peril.*

Why Accounts Payable Matter?

Clear and accurate accounts payable entries are essential to the strategic and competitive health of your business. Tied firmly to cash flow, every account payable journal entry bears a direct impact on working capital (current assets –

current liabilities).

Two other metrics—*Accounts Payable Turnover* (APT) and *Days Payable Outstanding* (DPO)—are used by creditors, auditors, and companies themselves to evaluate an organization's ability to meet its short-term financial obligations.

APT is a *frequency* metric, measuring how many times each accounting period a company pays off debts to vendors, service providers, creditors, etc. It is the ratio of your cost of goods sold (COGS) to accounts payable. Generally speaking, high APT means a company is struggling to find credit or simply not making effective use of the funds they do have. On the other hand, a low APT can indicate either extremely lenient creditor terms or that the company is behind in paying its bills.

DPO is a *duration* metric, measuring the average number of days your company needs to pay off a supplier. It's calculated by dividing the number of days per period by APT. The lower your company's DPO value, the more swiftly and efficiently it is meeting its outstanding short-term obligations.

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Sample Journal Entries for Accounts Payable

Let's say your company, Company A, has purchased $1,000 worth of office supplies from Company B on credit.

The bookkeeping looks like this:

1. Your accounting department creates a debit journal entry for the office supplies expense account in the amount of $1,000

2. Your accounting department simultaneously creates a credit journal entry to accounts payable (most likely a specific account payable for Company B) in the amount of $1,000.

If your company decides to pay off the debt a few days later, using a corporate credit card (for example), then the entries are reversed:

1. Your accounting department creates a credit journal entry for cash in the amount of $1,000.
2. Your accounting department simultaneously creates a debit journal entry for the Company B account payable.

This reconciles the debt and removes it from the books.

Note: Companies can also use accounts payable to purchase assets such as equipment, property, etc. In such a scenario, your accounts team would debit an asset account, rather than an expense account, for the first entry.

Managing Your Liabilities Effectively Can Be an Asset

Staying on top of your company's current liabilities doesn't have to be difficult. By taking the time to understand how accounts payable work and their importance to your business, your company will enjoy accurate financial statements, greater agility with working capital, and a positive reputation with your suppliers.

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