Accounts Payable Vs Accounts Receivable: Differences and Examples



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Accounts payable and accounts receivable are two of the most important accounts that your business needs to manage.

Though both accounts are used to manage cash flow in your business operations, the two accounts are very different, making it easy for those with limited accounting or bookkeeping experience to confuse the two.

We'll explain the role that AP processes and AR processes play and their importance to business owners. We'll also discuss the similarities and differences between the two, and how each impacts your general ledger and your cash flow.

Accounts Payable vs. Accounts Receivable: What's the Difference?

Accounts payable and accounts receivable are an important part of the accounting cycle.
Both accounts are reflected on a company's balance sheet, with those balances directly impacting your cash flow.

If you're using accrual accounting, both balances will impact your business equally, since both are needed to complete create a budget, calculate cash flow, and create an accurate income statement.

What Is Accounts Payable?

Accounts payable refers to the short-term debts that your business owes to vendors and suppliers for items purchased on credit.

Accounts payable usually have specific credit terms, such as Net 30, meaning that the invoice will need to be paid within thirty days, or invoice late fees may be assessed. In some cases, companies may be given an incentive to pay earlier for a small discount.

Accounts payable can also refer to the department within the finance team whose role it is to process and pay vendor invoices.

What Are Examples of Accounts Payable?

Accounts payable is the purchase of goods and services on credit. Common items purchased on credit include:

- Utilities
- Office Supplies
- Raw Materials
- Subcontractor and Consultants Fees
- Dues and Subscriptions
- Printing Expenses
- Shipping Expenses



Other than payroll and items that are paid for immediately with cash, all company expenses usually fall into the accounts payable category.

How Do You Record Accounts Payable?

Accounts payable is recorded once an invoice has been validated and matched with a purchase order and shipping receipt. For invoices that don’t have a purchase order, they’ll need to be approved before recording them.

For example, you purchase 50 binders from your local office supply store.

The invoice arrives a few days later for $250. The invoice is validated, the purchase order attached, and it’s now ready to be entered into the accounts payable journal if you’re using a manual system or your accounting software application.

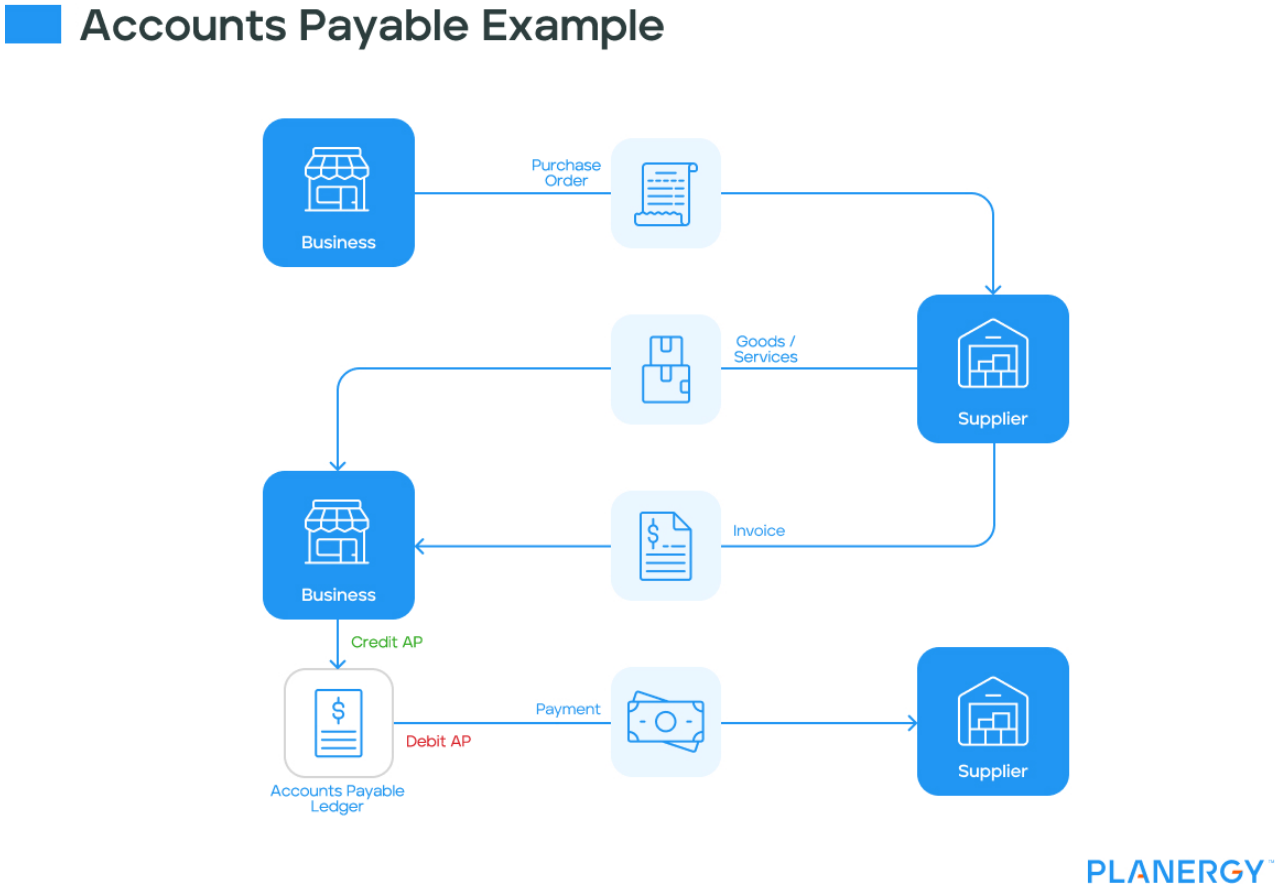
The journal entry is as follows:

Date	Account	Debit	Credit
5-15-2023	Office Supplies	$250	
5-15-2023	Accounts Payable		$250

Recording this invoice will increase your accounts payable account, which is a liability account found on your balance sheet. When the invoice is paid, you’ll complete the following journal entry:

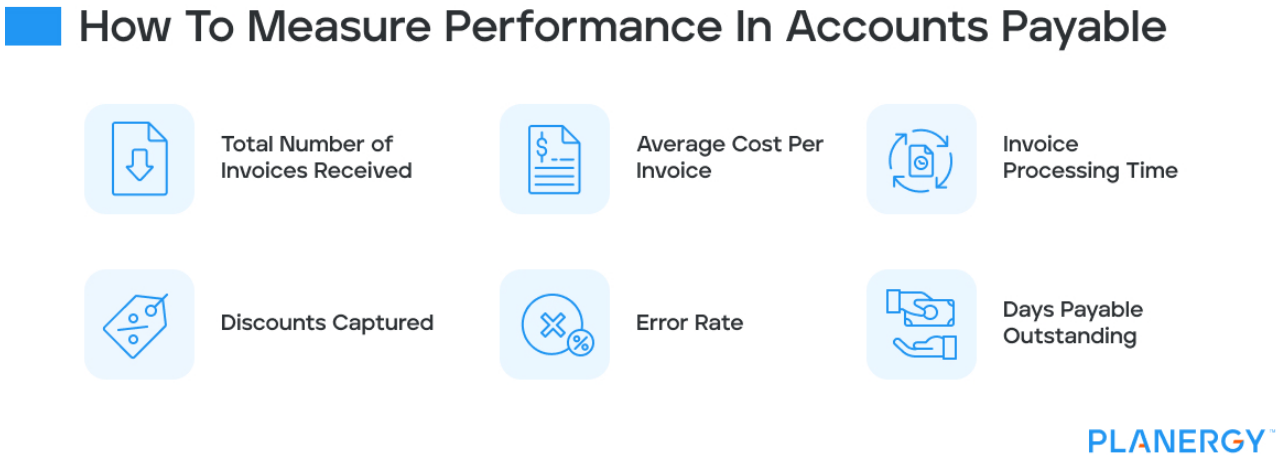
Date	Account	Debit	Credit
5-15-2023	Accounts Payable	$250	
5-15-2023	Bank Account		$250

Once the invoice is paid, your accounts payable liability balance is reduced.



How Do You Measure Performance in Accounts Payable?

If you're unsure whether your accounts payable department is operating optimally, there are several accounts payable performance metrics you can track that can help measure performance and identify weak spots in the accounts payable process.



These metrics include:

- ## Total Number of Invoices Received

  By tracking the number of invoices you receive during a specific period, you can be better prepared to handle busy times.

  For example, if you receive the majority of invoices the last week of the month, you can plan by increasing staff for the week.

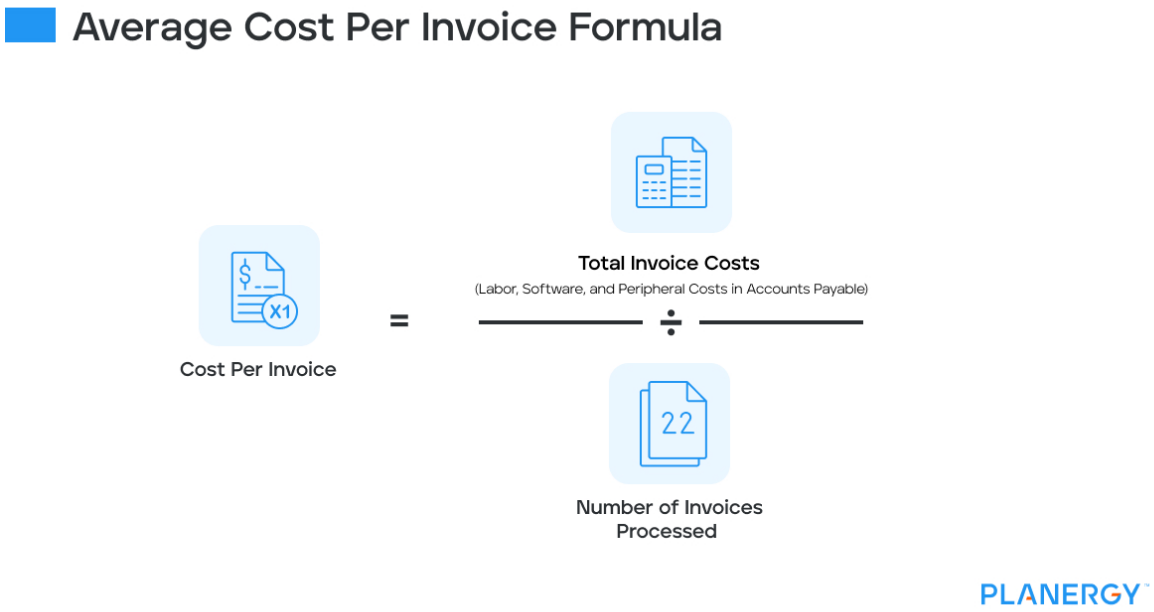
- ## Average Cost per Invoice

  Tracking the average cost per invoice can be an eye-opener. This is done by tracking labor costs, software infrastructure, and any other peripheral costs such as envelopes, paper checks, and postage.

  Depending on your average cost, you may want to consider switching to AP automation, which reduces processing costs across the board and improves your ability to scale.

  The formula for calculating average invoice cost is:

  Average Cost Per Invoice = Total Invoice Costs / Number of Invoices processed



Invoice Processing Cycle Time

Invoice cycle time measures how long it takes to receive, process, and pay supplier invoices. This is measured in days.

If you are taking too long to process invoice you run the risk of getting charged late fees or missing out on early payment discounts. Slow invoice processing can also negatively impact vendor relationships.

AP automation software can greatly improve invoice processing time. Ardent Partners State of ePayables for 2023 shows that best-in-class AP teams are processing invoices more than 5 times faster, 3.4 days per invoice compared to 17.9 days.

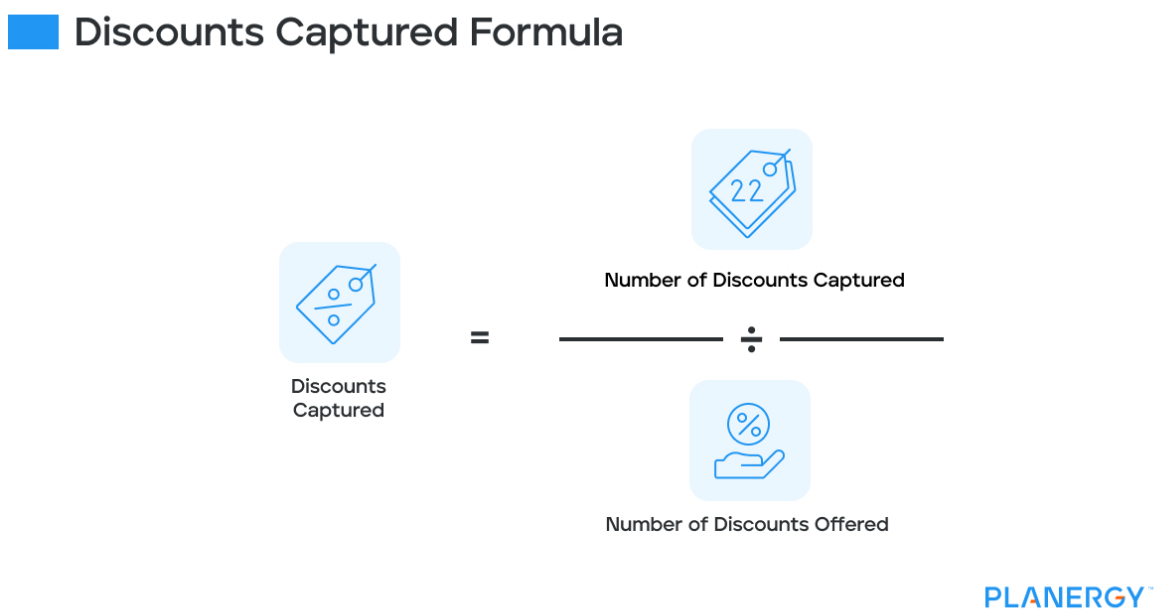
Discounts Captured

A useful metric for assessing performance is tracking discounts captured, which more importantly, displays how many early payment discounts you weren't able to capture because of slow invoice processing times.

A low result may convince you to seek out a more optimal system for processing accounts payable.

The formula for calculating discounts captured is:

Discounts Captured = Number of Discounts Captured / Number of Discounts Offered

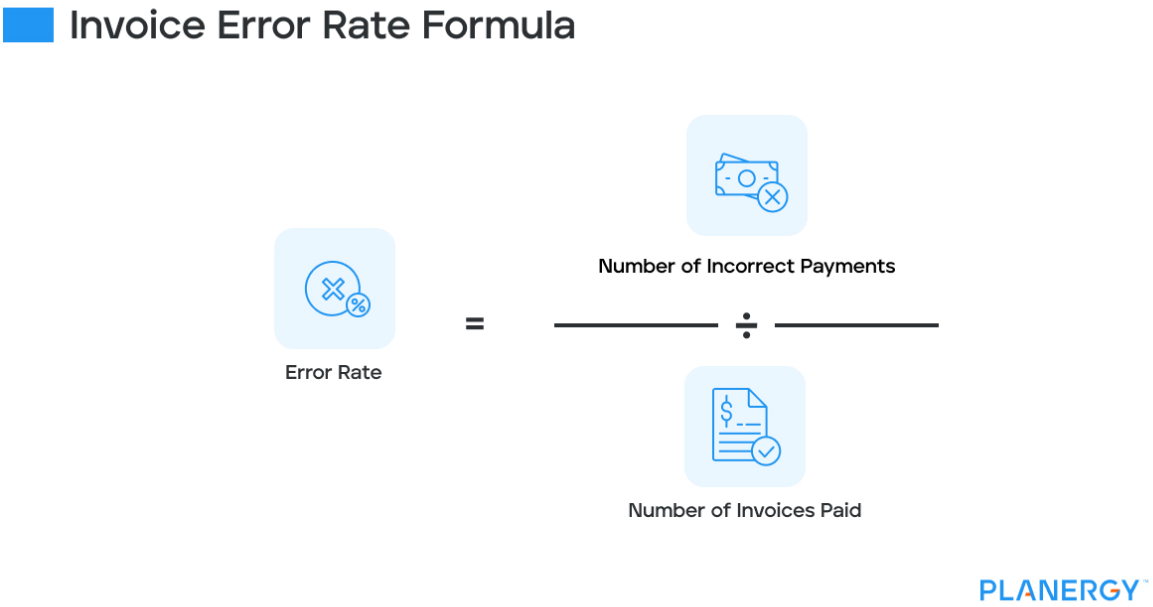


Error Rate

Tracking invoice processing error rates can be disheartening. This metric tracks common errors such as overpayments, underpayments, and duplicate payments and provides you with a percentage of invoice payment errors.

To track your error rate, use the following formula:

Error Rate = Number of Incorrect Payments / Number of Invoices Paid



What Are the Benefits of AP Automation Software?

AP automation software, like PLANERGY, can eliminate many of the bottlenecks and logjams a typical AP department deals with.

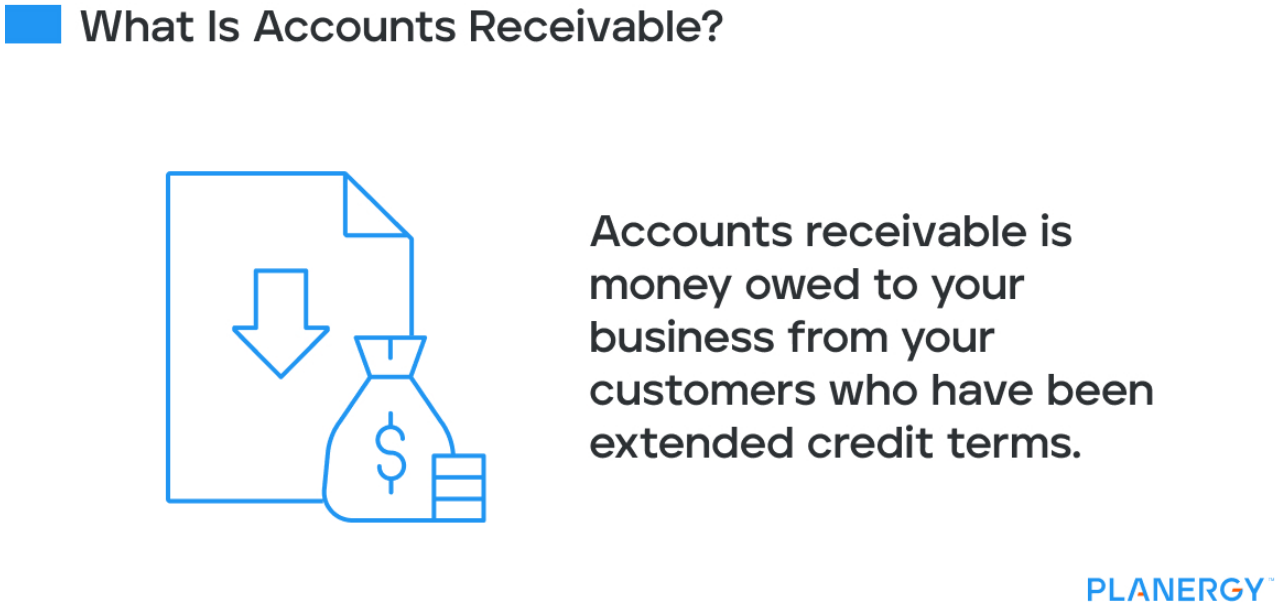
This is achieved by automating three-way matching, streamlining the entire invoice approval process, and improving accuracy by eliminating time-consuming data entry while providing businesses with accurate, real-time accounts payable reporting and accurate accruals.

What is Accounts Receivable?

Accounts receivable refers to the amount of money that your customers owe you.

Anytime you sell goods or services to customers on credit, you increase your accounts receivable balance. Like accounts payable, accounts receivable needs to be properly managed to ensure timely payment from customers.

Accounts receivable can also refer to the department within the finance team whose role it is to ensure payments are processed from customers.



What Is an Example of Accounts Receivable?

Accounts receivable is money owed to your business from your customers who have been extended credit terms.

Accounts receivable could be products sold to a customer for resale or services provided.

For example, your business sells 200 custom pens to a customer with Net 30 payment terms. According to those terms, your customer will need to pay you on or before the due date.

How Do You Record Accounts Receivable?

Accounts receivable transactions are recorded once a sale has been completed. For example, your business sells 100 custom calendars to a customer with Net 30 terms for a total of $500.

To record the sale, you would complete the following journal entry:

Date	Account	Debit	Credit

5-15-2023	Accounts Receivable	$500	
5-15-2023	Sales		$500

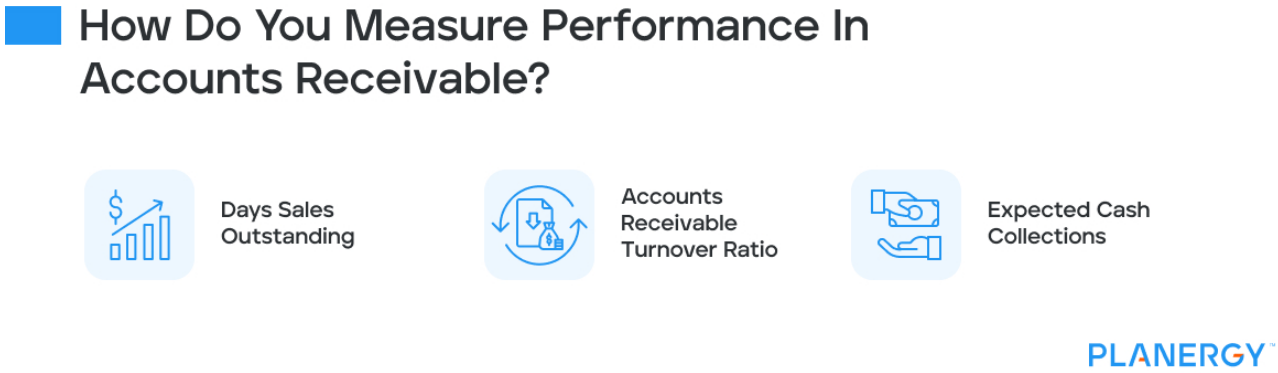
Recording this sale will increase your accounts receivable balance, which is an asset account since it represents money owed to your business. Like the accounts payable balance, the accounts receivable balance is found on your balance sheet.

When your customer pays the invoice, you'll need to complete the following journal entry:

Date	Account	Debit	Credit
5-15-2023	Bank Account	$500	
5-15-2023	Accounts Receivable		$500

How Do You Measure Performance in Accounts Receivable?

There are accounts receivable metrics that can help you measure AR performance.



Those metrics include:

Days Sales Outstanding

Days sales outstanding is the best metric to use when you want to know how quickly you're collecting on your accounts receivable balance. The standard goal is a DSO of less than 30 days.

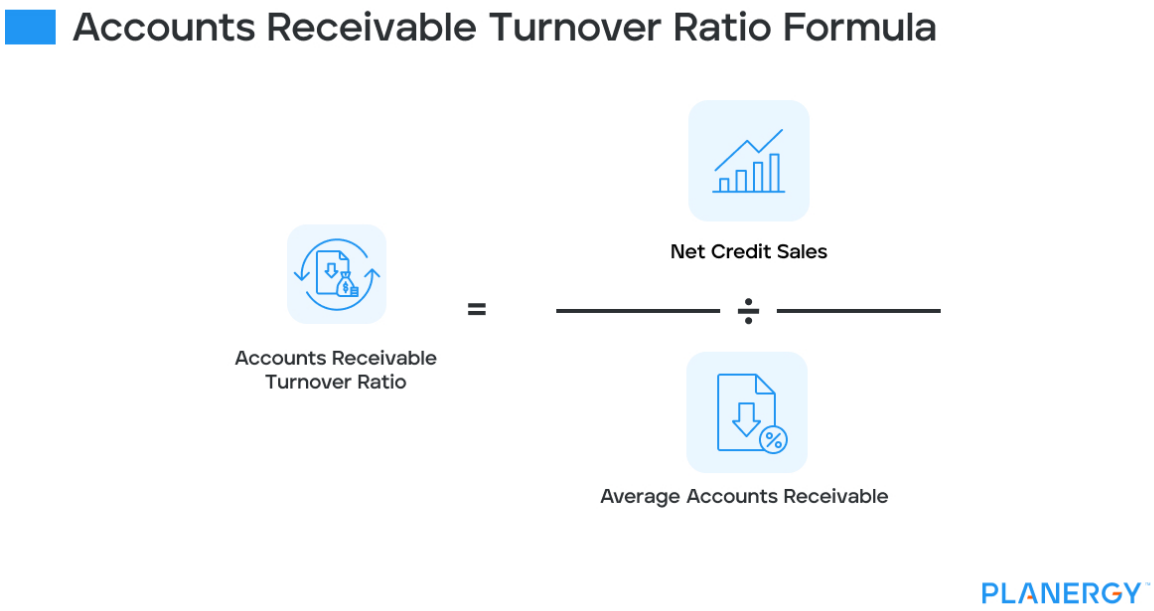
The DSO formula is:

DSO = Accounts Receivable / Total Credit Sales x Number of Days in the Period

Accounts Receivable Turnover Ratio

The accounts receivable turnover ratio (ART) is typically calculated annually, with results showing you how effective your company is at converting AR balances into cash.
The formula for calculating ART is:

Accounts Receivable Turnover = Net Credit Sales / Average Accounts Receivable



Expected Cash Collections

Expected cash collections can help a business budget more accurately by calculating the amount of cash they expect to collect.

The formula for calculating expected cash collections is:

Expected Cash Collections = Cash Sales + Projected Collections from Accounts Receivable



This calculation is a bit tricky since you'll first have to determine which accounts you are confident you can collect from and deduct any accounts that have been identified as less likely to collect on.

For more accurate results, you should first run an AR aging report and assign percentages based on the age of the receivable.

What Do Accounts Payable and Accounts Receivable Have in Common?

Accounts payable and accounts receivable represent money going into and out of your business.

Accounts payable represents the money that flows out of your business and is recorded on a balance sheet as a liability account, while accounts receivable represents money owed to your business and is recorded on your balance sheet as an asset account.

For example, accounts payable balances in your business are considered accounts receivable balances for your vendors and suppliers, since it represents money owed to them. In contrast, accounts receivable balances are accounts payable balances for your customers, since it represents money that they owe.

What Are the Differences Between Accounts Payable and Accounts Receivable?

Though both impact cash flow, either positively or negatively, and are considered two sides of the same coin, there are some significant differences between accounts payable and accounts receivable.

Accounts Payable	Accounts Receivable
Money that your business owes	Money that is owed to your business
Is a result of buying goods and services on credit	Is the result of selling goods and services to customers on credit
Recorded as a current liability on the balance sheet	Recorded as a current asset on the balance sheet
Represents cash outflow	Represents cash inflow
Decreases net profit	Increases net profit
Increases cash flow	Decreases cash flow

What Are the Differences Between Accounts Payable and Accounts Receivable?

ACCOUNTS PAYABLE	ACCOUNTS RECEIVABLE
Money that your business owes	Money that is owed to your business
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Represents cash outflow	Represents cash inflow
Decreases net profit	Increases net profit
Increases cash flow	Decreases cash flow

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Because each account affects your business differently, they will both impact cash flow differently.

How Do Accounts Payable and Accounts Receivable Impact Cash Flow?

One of the more interesting aspects of managing cash flow is realizing the impact that both accounts payable and accounts receivable have on your cash flow. And it may not be what you expect.

For example, your accounts payable balance recorded on your balance sheet has a positive impact on cash flow, since that number represents cash that has not yet been paid to vendors and suppliers.

On the other hand, an accounts receivable balance that is outstanding hurts cash flow because the amount represents money that has not yet been received from customers.

Use Automation To Manage Accounts Payable and Accounts Receivable

Managing accounting processes like accounts payable and accounts receivable can be overwhelming if you're using a manual accounting system.

For accounts payable, you need to manage the initial purchase order, validate an incoming invoice and shipping receipt, and later match those documents against the originating purchase order.

Next, you'll need to have the invoice properly approved and paid by the due date.

Any one of the steps outlined above can result in delayed payments, late payment fees, or lost or misplaced invoices. In turn, this directly impacts your financial statements, cash flow statements, and ultimately, your bottom line.

In turn, managing the accounts receivable process requires prompt, accurate customer invoicing, as well as regular follow-up with customers to ensure payment is made on time.

Any delays in this process results can result in delinquent payments, reduced cash flow, and even the ability to eventually collect on the invoice.

Making the move to complete accounting automation does most of the heavy lifting for you; making the appropriate journal entries, matching invoices with purchase orders, and sending payment reminders to your customers before payments become delinquent.

Automation also provides accurate, real-time financial reporting, while providing you with accurate cash flow statements, a necessity for making data-driven decisions for your business.

What’s your goal today?

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- Learn about us, and our long history of helping companies just like yours.

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