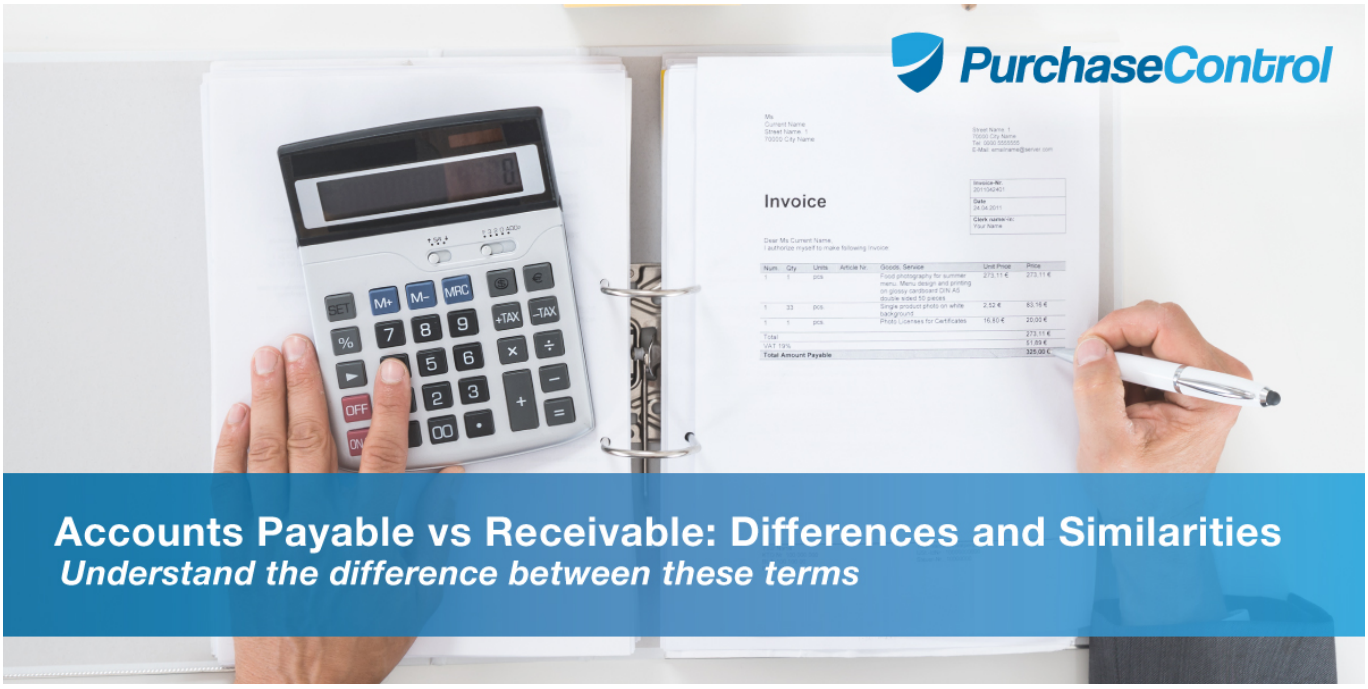
Accounts Payable vs Receivable: Differences and Similarities



No matter the size of your business, finance is a critical piece of the puzzle. As you grow and continue to process more transactions every day, you must have processes in place to handle both Accounts Payable and Accounts Receivable. Not doing so means you risk not paying all your bills, or not being paid for all the goods and services you provide. That could easily spell disaster.

The Differences Between Accounts Payable and Accounts Receivable

What is Accounts Payable?

Accounts Payable (AP) handles paying what you owe, or your liabilities. They keep track of the money that goes out of your business. When you purchase goods or services from a vendor on credit, the bill goes to AP to be paid. AP decreases your company's cash flow.

What is Accounts Receivable?

Accounts Receivable (AR) handles the money you're owed, or your assets. They keep track of the money that comes into the business. When you sell goods or services to your clients on credit, these amounts go to AR so they can collect them from your clients at a later date. Where AP decreases your company's cash flow, AR increases it. Information from accounts receivable will play an important role in preparing the income statement in financial accounting.

Let's say your company – company A, purchases supplies on credit from company B. Your company records the transaction in AP, as a liability because you owe company B money. Company B records the same transaction in AR, because they will be able to collect the debt from you.

> "When there's too much going out through AP, and not enough coming into AR to balance it out, you'll run into negative cash flow issues. Staying on top of both departments ensures you'll be able to handle financial issues as they arise."

Balancing AP and AR: Tips for Managing Working Capital

Working capital (WC) is the difference between your current assets and current liabilities. In healthy businesses, you always have a positive net working capital because you're able to collect on your assets faster than you pay out your liabilities, or because you have more AR than you do AP. Ensuring your company's balance sheet is healthy will keep your business in a strong position.

Examine Transaction Cycles

How long is it taking your departments to issue purchase orders and invoices? What timelines have been established for each department? Ideally, your receivables timeline should be shorter than your payables, to allow an additional period of time for you to build positive cash flow to handle your payables.

For example, do your best to keep your days sales outstanding (DSO) at no more than 45 days. This means that all accounts receivable are paid at an average of 45 days after the sale is made. Then, set your days payable outstanding (DPO) to 60 days, so you have flexibility in when the money is coming in and when it is going out.

Whatever timelines you establish, have your teams issue purchase orders and invoices on the same day of the week, or a designated day of the month. This establishes a routine to keep everyone on the right track and reduce the likelihood of missed or overpayments.

Make it Easy for the AP and AR to Communicate With One Another

Both departments need to consult with one another on purchases and sales. If Accounts Receivable notices there is a high consumer demand, they can let Accounts Payable know it's okay to order more supplies. At the same time, if they notice a lower demand, they can let AP know to slow down procurement until they slump is over.

Establish Credit Policies

When handling credit sales establishing credit terms enables you to know when to expect payment and when to reach out to customers who haven't paid according to those terms. Your AR department will set these terms, likely on a customer-by-customer basis based on their credit with you. Customers with a long history of paying on time will be given more leeway, whereas newer customers or those who have struggled to pay on time in the past will have stricter payment terms. To encourage earlier payments you can offer early payment discounts.

When you purchase goods or services on credit, aim to pay those on time or ahead of time when possible. Doing so may make you eligible for discounts or better credit terms.

Monitor Aging Accounts

Record all transactions immediately, so as not to lose track of them. Issue statements regularly. Check often to ensure the accounts are settled. If you find aging receivables on your books, reach out to those accounts to check status of payment. Stop doing business with the client until the balance is cleared. Make sure you have a policy in place that clearly defines the maximum length of time it should take to clear the account.

Do the same for all accounts payable, to ensure you don't fall behind on your bills. If you haven't made payments within the designated timeframe, make payments as soon as possible, and ensure a proper payment timeline is established to prevent falling behind on the account in the future.

Use Automation Where Possible

Monitoring your AR and AP involves a lot of moving parts. You have to create invoices and receipts, purchase orders, shipping orders, manage journal entries to relevant general ledger accounts, and other documentation to support your financial statements. If one thing falls through the cracks, it can wreak havoc on your entire accounting department.

Purchasing software can automate all your transactions in real-time, ensuring nothing is overlooked. It can also make financial reporting much easier, and help you find issues such as delinquent accounts.

Your AR and AP are the two primary indicators of cash flow – and being cash flow positive is essential to your company's financial health. Without proper AR and AP management, you risk running into financial obstacles that could make or break the company, and being unable to make data-driven decisions to support company growth.

Automate your AP and AR to simplify your company’s accounting.

[Find Out How]

— About **PurchaseControl**

PurchaseControl is cloud based procurement software for business spend managemen. We empower businesses by providing greater transparency and oversight into the purchasing process. With PurchaseControl, you have the flexibility to manage how spend actually happens instead of how you wish it would happen.

The entire PurchaseControl team has experience within a range of businesses, and as such, we bring a practical, holistic approach to purchasing. We understand what it takes to run a business and apply that knowledge to make PurchaseControl as effective as possible for all users.

Learn more at www.purchasecontrol.com

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