



Accounts Payable vs. Accrued Expenses: Invoices, Cash Flows, and Interview Questions

Would You Like an Invoice with Your
Inventory?



This Lesson: AP vs. AE

Question: “I’ve read your guides, but I still don’t understand **Accounts Payable (AP) vs. Accrued Expenses (AE)**.”

You say that AP is for expenses with invoices, but couldn’t items associated with AE, such as rent and utilities, also have invoices?”

This Lesson: AP vs. AE

For the files and resources, please go to:

<https://breakingintowallstreet.com/kb/accounting/accounts-payable-vs-accrued-expenses/>

(Free “Interview Question” Model)

The Short Version of AP vs. AE

- **Accounts Payable and Accrued Expenses:** Liabilities used to record owed payments for products/services a company has *ordered and received but not yet paid for in cash*

		Cash Collected or Paid Upfront?	
		No	Yes
Ordered and Received?	No		Prepaid Expenses Deferred Revenue (**) Inventory
	Yes	Accounts Receivable (*) Accounts Payable (*) Accrued Expenses	

(*) These correspond to **invoices**, not delivery, but they're often considered the same.

(**) Cash treatment varies for subscriptions / multi-pay contracts.

The Short Version of AP vs. AE

- **Mechanics:** In some cases, AE and AP work nearly the same way on the financial statements
- **Basics:** Record the expense on the IS, make the Liability increase, and then reduce it when the cash payment is made
- **Difference #1:** AP is used more for irregular items with specific invoices outside of weekly/monthly schedules (e.g., Inventory purchases or one-off professional services)
- **Difference #2:** AP tends to be used for purchases of items that eventually *get delivered to the customer* (e.g., Inventory)



AP vs. AE: Lesson Overview

- **Part 1:** Simple Accrued Expense Example **3:45**
- **Part 2:** Simple Accounts Payable Example **7:05**
- **Part 3:** AP and AE in Financial Models and Valuations **11:21**

Part 1: Simple Accrued Expense Example

- **EX:** Order a service from an outside contractor for \$100 but do not pay in cash right away
- **Item:** Could use *either* AP or AE for this, but we'll assume AE
- **IS:** \$100 expense is recorded, and Net Income is down by \$75 at a 25% tax rate
- **CFS:** Net Income is down by \$75, but AE is up by \$100, so Cash at the bottom is up by \$25
- **BS:** Cash up by \$25; AE up by \$100; Equity down by \$75



Part 1: Simple Accrued Expense Example

- **Intuition:** The company has saved \$25 in taxes, even though it hasn't paid for the expense in cash yet
- **Cash Payment:** When it finally pays, its AE on the L&E side will decrease by \$100, and so will Cash on the Assets side
- **Start to Finish:** Cash is down by \$75, and so is Equity, reflecting a \$100 payment and \$25 of tax savings



Part 2: Simple Accounts Payable Example

- **Scenario:** Company purchases \$100 of Widgets so it can produce, sell, and deliver \$180 of Products
- **Payment:** Nothing upfront; company will pay the supplier later, after it sells the Products and collects the cash
- **Items:** Would **NOT** use AE for this; only AP
- **Initial:** Inventory increases by \$100, and AP increases by \$100
- **Why:** Company is not the “end user” – customers are, and they haven’t received the Products yet, so there’s no expense



Part 2: Simple Accounts Payable Example

- **Next:** Company records \$180 in Revenue and \$100 of COGS as it delivers the products; it pays its supplier as well



- **IS:** Pre-Tax Income up by \$80 and Net Income up by \$60 at a 25% tax rate



- **CFS:** Net Income up by \$60, Inventory falls by \$100, and Accounts Payable falls by \$100; Cash up by \$60



- **BS:** Cash up by \$60, Inventory down by \$100, so Total Assets down by \$40 *relative to Step 1*; AP down by \$100, Equity up by \$60, so Total L&E down by \$40 *relative to Step 1*



Part 2: Simple Accounts Payable Example

- **Start to Finish:** Inventory and AP do not change; Cash and Equity increase by \$60 to represent the after-tax profits earned by the company



- **Intuition:** Company sells the Products for a profit of \$80 and pays \$20 in taxes on it



Part 3: AP and AE in Financial Models

- **Accounts Payable:** Typically linked to COGS
- **Accrued Expenses:** Typically linked to SG&A or OpEx
- **Why:** Many companies use AP primarily for Inventory or related product/service delivery costs
- **Cash Flow Impact:** They're both Liabilities, so when they increase, they boost cash flow (and vice versa)
- **Valuation:** Delaying cash payments boosts a company's FCF and, therefore, its value in a DCF analysis



Recap and Summary

- **Part 1:** Simple Accrued Expense Example
- **Part 2:** Simple Accounts Payable Example
- **Part 3:** AP and AE in Financial Models and Valuations

