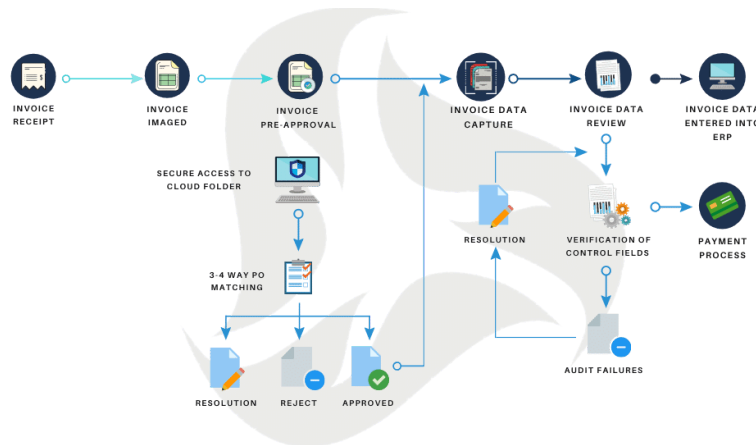


## Why Outsourcing of Accounts Payable and Receivable Have Grown in Importance

In the 1960s in the USA, companies stumbled upon paperless modes of processing invoices and contracts. Digital data sharing of invoice and purchase order details became prevalent. As a result, the accounts departments began using digital recording and processing of payments and orders, which eventually led to establishing standards for Electronic Data Interchange (EDI) by the Accreditation Standards Committee at American National Standards Institute (ANSI).



### [Digitization of accounting can ensure sophistication and accuracy](#)

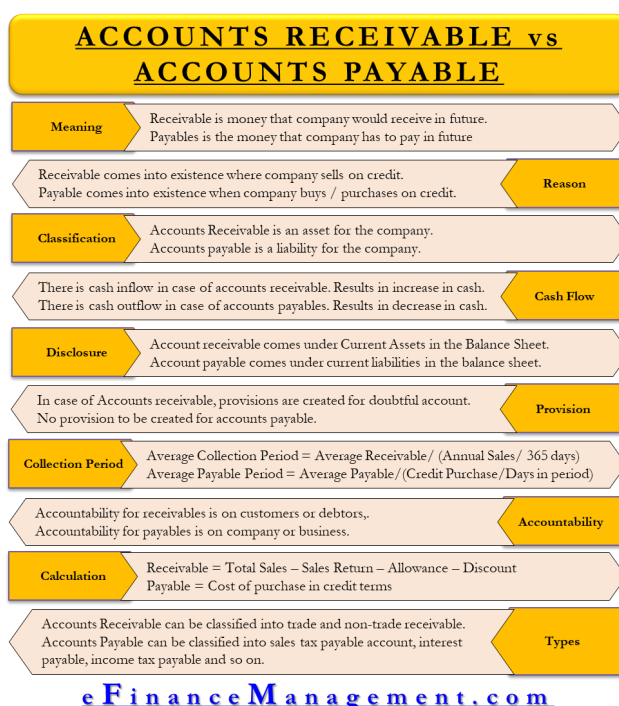
This led to saving of cost, energy and time as the US Treasury experienced nearly 50% cuts in the expenditure for accounts recording. As a result, the paperless format shot up in popularity. It led to using robotic process automation (RPA) which is an AI-based software that can process invoices and orders with speed and accuracy. It minimized human effort by great amounts.

With the internet boom in the 90s, the challenge of Accounts Payable (AP), for instance, became easier to face with increasing automation. Therefore, third party companies which partner with businesses grew in number and outsourcing accounts payable became a norm. EDI also largely is used as the norm for Accounts Receivable (AR). The difference lies in the fact that APs are liabilities and ARs are assets. Both however follow the norm of paper-based invoice transactions, supply contracts, purchase orders and more like futures contracts.

### **What are Accounts payable and receivable?**

APs are the pending payments that a business owes its suppliers for the services and goods purchased. ARs, on the other hand, are the payments pending to be received as charges or fees by a business from other businesses or vendors for purchases of supplies and services. In

a company's balance sheet, APs are liabilities and ARs are assets. Typically the APs and ARs are signed documents for an agreed future transaction upon completion of the services sought.



For example, Company A orders services or supplies from Vendor B who has agreed to complete the delivery within 30 days. Hence, the document of the agreement will have the details of the order and delivery dates and payment amount and date. The 30 days mentioned in the agreement are the credit days, which ensure that the manufacturing or preparation of the services promised will gradually increase in value, to eventually reach the agreed amount in the document. This way, the document serves as proof that the order made is a liability worth certain costs. It hence becomes an AP for Company A and an AR for Vendor B.

### Why do we need to outsource ARs and APs?

ARs and APs require diligent monitoring for the kind of record-keeping and analyses that we saw above. As a result, more often than not, the ARs and APs will become cumbersome. Hence, the presence of an accounting department is inevitable. For small businesses and individuals, the option of outsourcing steps in to ease the burden off of them. Besides, many firms may still be saddled with paper and file-based work methods and may not yet be able to digitize.

Assigning a trusted and qualitative partner to take charge of our financial records saves a lot of time and energy enabling us to focus on our commitments. There are several factors within the subject of accounting and amongst businesses that render outsourcing of the ARs and APs a

necessity. And we, therefore, understand that with the evolution of digital work methods, outsourcing of ARs and APs have become a norm. Let's explore the factors.

## **The general processes of Accounts Receivable and Payable:**

### **A. Complex Elements of ARs and APs**

An entry into the books for ARs and APs will have details such as:

1. Credit days
2. Payment due dates
3. Parties involved
4. Source documents for orders and invoices
5. Acknowledgements for goods or services dispatched and received
6. Itemized bills
7. Payment cycles if any such as advances and instalments.

Together, they give us precise information about the cash flow process and help with efficient Cash Flow Management in the organisation. This way, all AR and AP entries of a company will enter into the general ledger of their bookkeeping records as obligations and credits. We hence understand that the accounts payable and receivable essentially make double-entry records as assets and liabilities into the bookkeeping records of a company or an individual.

We can also note that the service availed of can be a capital asset such as loans, where it will later become liability. In that case, the AR and AP entries will undergo adjustments to reflect the emerging liabilities from our initial purchases. All such details will make up the balance sheet of the company, which is the most authentic resource of a company or an individual to understand their ARs and APs.

### **B. Ageing and analysis of the AR and AP entries**

ARs and APs are ageing entries meaning they are time-bound by the credit days agreed upon. If the credit days are 30 for an AR, for example, the age of the entry will be tracked until the due date of payment which is the 30th day. Typically, 30, 60 and 90 days ARs and APs are agreed to in the market. This aspect factors in the variable of time in a company's cash flow management system.

As a result, we find it necessary to calculate the turnover ratios for APs and ARs to evaluate the profit or loss performance of a company through its purchases. This is called as Accounts Payable or Receivable turnover ratio. Essentially, turnover ratios calculate how much a company is paying or receiving over a period of time. This is calculated by dividing the total amount paid or received by a company for its APs or ARs by the average of payments made or received in the time period.

$$\begin{aligned} \text{Accounts Payable Turnover Ratio} &= \$6,000,000 / ((\$500,000 + \$650,000) / 2) \\ &= \$6,000,000 / \$575,000 \\ &= 10.43 \text{ times} \end{aligned}$$

### [Sample of turnover ratio calculations](#)

For example, if company A has paid Rs. X in 6 months, we can divide 'X' by the average payments per month 'Y'. The average of 'Y' is the calculated amount of opening account and closing account balances. At the opening of a company's balance sheet, it would have, say, Rs. Y1 as the balance. At the end of 6 months, let the closing of the balance sheet have a balance of Rs. Y2. Hence the monthly average of APs across the 6 months is (Y1+Y2)/2. Therefore, the turnover ratio will be calculated as X/ [(Y1+Y2)/2].

This way, the turnover ratios reflect upon the total amount of APs and ARs which helps in identifying if the receivables are more and hence the profit.

### **C. Discount Calculations**

Many entries in the APs and ARs will have discount conditions. For example, if a company delivers goods and services a few specified days early, some percentage of discount will be offered in the charges. Hence, all AR and AP entries will undergo adjustments in the bookkeeping records. Accordingly, also, the final credit and debit balances at the trial balance stage will change, than expected initially. Therefore it is crucial to not miss the discount adjustments at each AR and AP entry.

Date	Particulars	Debit	Credit
12-03-2019	Cash A/c	23750	
	Sales Discount A/c	1250	
	To Account Receivables A/c		25000

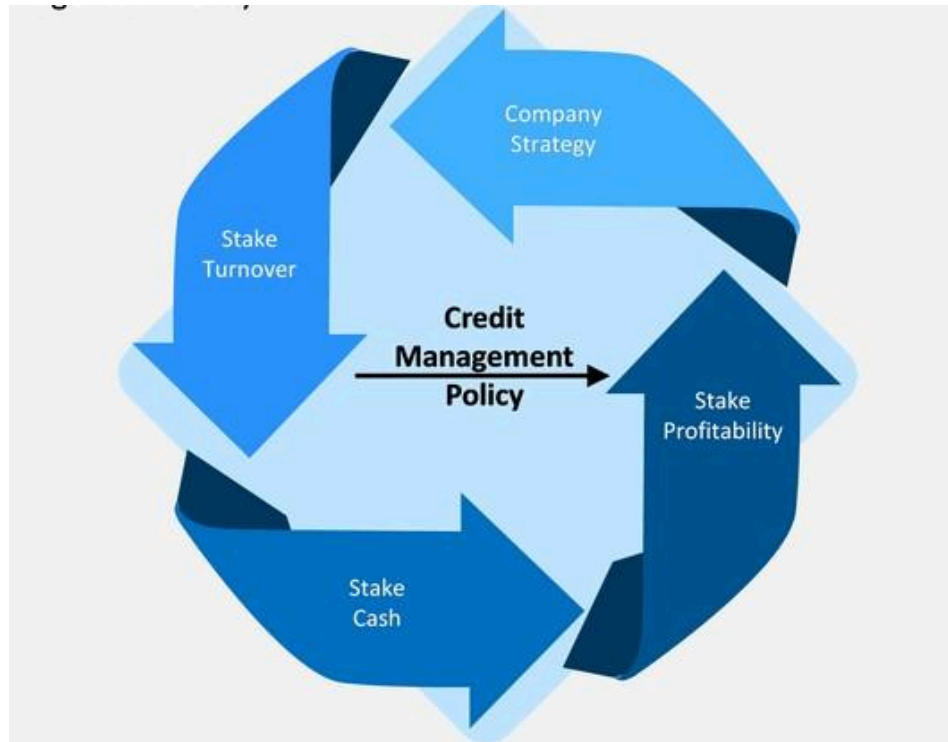
Being Full payment of 23750\$ received from Mr john stewart after allowing 5% discount

### [A sample of discount calculation](#)

### **D. The necessity of a credit management system**

As a part of the ARs, a business will be required to keep an eye on their different sales orders as many customers will pay on different dates. All such money will be received only upon the

closure of the orders and the invoices. Apart from keeping aside occupational disruptions, a sound and efficient credit management system will assist in tracking these different receivables. These receivables are important for the growth of a company. The ARs in the company ledgers hence also must make a comprehensive credit management system.



[Credit management covers a complex system of checks](#)

Credit management systems also bear the responsibility of allocating funds for the same company's overheads, payrolls and other payables in the AP entries. Credit management systems will also see through the ARs until they are realized into cash. All supply and sales orders will convert into cash for the company at later dates. Due to the presence of multiple such orders on one side and more liabilities on the other, faster cash realisation of the ARs can be achieved by the credit management system. Thus, overlooking the ARs as a credit management system is necessary for smooth cash flow in a business.

### **Pros and Cons of Outsourcing ARs and APs**

Outsourcing primarily means opting for automation of the complex AR and AP entries. For example, e-invoices which later can be printed and filed is an obvious advantage over manually making invoices for small and large businesses alike.

A famous example is the FASTag system in India for toll booth transactions. Earlier, payments were made in cash for printed bills at a toll booth was energy and time consuming leading to decadent work conditions and poor work ethic amongst the highway work personnel. With the FASTags now attached to every vehicle, traffic flows smoothly at toll booths and unnecessary

manpower on highways is replaced. The complete national level accounting of FASTag receivables and payables will be managed by digital credit and debt management systems.

Likewise, every company's sale and purchase documents and the corresponding ARs and APs will be handled by an outsourcing partner who would automate our accounting. Some popularly used software for ARs and APs are AvidXchange, Tlplati, Intuit Quickbooks, Stamppli, Netsuite ERP and more.

### **Pros of outsourcing:**

1. **Delegation:** Many AP and AR tasks like sending purchase orders, creating invoices and tracking due dates can be handed over to third party teams which require the company only to focus on their core areas of work
2. **Discrepancies:** All discrepancies within the bookkeeping records and financial analysis reports can be sorted by a team of experts dedicated to the records.
3. **Tools access:** Through outsourcing, the services of efficient and contemporary tools and technology are accessed. The third-party teams work on the foundation of such technology and assure human error is prevented.
4. **Cost and time:** Cost-effective and time-saving features are provided by outsourcing as the burden of bookkeeping and accounting are delegated to trusted partners.
5. **Constant reports:** The outsourcing partners will constantly report to the company and provide coverage of all records made of the sales and purchases.
6. **Security of accounts:** As the accounting system is integrated within the control of another team, the security of our cash flow is exclusively protected.

### **Cons of Outsourcing:**

Having said this, we need to ascertain that our outsourcing partners are reliable and trusted.

1. **Privacy:** A company must pre-plan the amount of data and private company details disclosure to the outsourcing partner. The agreements between the company and the outsourcing partner must outline the levels of disclosure and hold the third party team liable for any privacy violations or data misuse.
2. **Internal mismatches:** Since the outsourcing partner will use unique systems of account management, the internal company staff may find it difficult to align to their styles.
3. **Distant communications:** The outsourcers are working remotely with the company and error reporting will often be miscommunicated.
4. **Lack of Control:** Distant working relationships will also disrupt the control that exerts over the outsourcing partners, most often due to lack of transparency of what occurs at the outsourcers office.

**Conclusion:**

While many factors have led to the emergence of outsourcing habits for accounting and bookkeeping, it is only natural that accounting demands a separate focus. Money management, in essence, of a company or an individual will always be an integral part of the business. Accounting and bookkeeping will always find their way to becoming exclusively demanding jobs themselves. Therefore, at many levels, from individuals to multinationals and the government, accounting outsourcing will persist as an essential despite risks of occupational and security hazards.

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