

Accounting Foundations

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6 Discounts and Returns

You may have come across incentives to buy, such as *10% off marked prices* and incentives to settle a bill early, such as *5% off your next bill if you pay within thirty days*. You may also have returned goods found to be faulty after you had purchased them, or even received a cash allowance to compensate for faulty goods that you had purchased. We see how discounts and returns are recorded in the accounts.

6.1 Discounts

In general, manufacturers sell to wholesalers, who then sell to retailers, who then sell to the public.

If you are in business as a retailer and you purchase £100 worth of goods for £90, then you record £90 in the Purchases Account and the £10 saved is reflected in the gross profit. The discount is not shown explicitly in the accounts.

Discounts Given

But if you, a retailer, sells to a customer and offer 10% discount if the invoice is settled within 30 days, the full selling price is shown in the accounts because you do not know if, or when, the customer will pay.

For example, C Here buys goods from you for £100 and you offer a 10% discount if the invoice is settled in full within 30 days. At the time of sale you do not know whether C Here will take advantage of your offer. So the sale for the full price is posted in your accounts.

DR	Sales	CR
	£	£
		C Here
		100

DR	C Here	CR
	£	£
Sales		
	100	

Now, if two weeks later C Here sends you a cheque for £90 (£100 less 10%) as payment in full you might post

DR	C Here	CR
	£	£
Sales	100	Bank
	100	Discounts Allowed
	<u>100</u>	<u>100</u>

DR	Discounts Allowed	CR
	£	£
C Here	10	

The discount allowed to C Here is posted as a credit in C Here's account and as a debit in the Discounts Allowed Account.

Discounts Received

Now, if you purchase goods for resale from D Mand for £100 and a 10% reduction is given if you pay within 30 days, the purchase will appear almost immediately in your accounts as

DR	Purchases	CR
	£	£
D Mand	100	

DR	D Mand	CR
	£	£
		Purchases
		100

Suppose now one week later you settle D Mand's account in full with a cheque for £90.

DR	D Mand	CR
	£	£
Bank	90	Purchases
Discounts Received	10	
	<u>100</u>	<u>100</u>

You debit D Mand's account with the £10 discount you have received (otherwise the account will perpetually show you owe him £10). And you post £10 credit to the Discounts Received Account.

DR	Discounts Received	CR
	£	£
		D Mand
		10

At the end of the year the £10 credit balance on Discounts Received will be transferred as a profit to the Trading and Profit and Loss Account.

And similarly for rent received. If you receive rent for office space you would debit your cash account (assuming the tenant paid cash) and credit the nominal account, Rent Received.

6.2 Returns

Purchase Returns

Occasionally, goods purchased by you for resale might be returned to the supplier for some reason. Such returns are called *Purchase Returns*.

You purchase goods for resale from E Venn for £100 on credit.

DR	Purchases	CR
	£	£
E Venn	100	

DR	E Venn	CR
	£	£
		Purchases
		100

You discover that £10 worth of goods is damaged and you get E Venn's permission to return the damaged goods. So, now, you owe E Venn £90 and not £100. You reduce the balance owed to E Venn by £10 and debit the Purchase Returns Account for £10.

DR	E Venn	CR
	£	£
Purchase Returns	10	Purchases
		100

DR	Purchase Returns	CR
	£	£
		E Venn
		10

In a Trading and Profit and Loss Account you would normally show the Purchase Returns as a deduction on the debit side so that you can see at-a-glance that the net purchases is £90.

DR	Trading and Profit and Loss Account for year ...	CR
	£	£
Purchases	100	
Less Returns	10	
	90	

Purchase Returns is also known as *Returns Outwards*.

Sales Returns

You sell £100 good to G Harr on credit. G Harr returns £10 of goods as unsuitable. You agree and give him a credit note for £10.

DR		Sales		CR
	£		G Harr	£
				100
DR		G Harr		CR
		£		£
Sales	100		Sales Returns	10
DR		Sales Returns		CR
		£		£
G Harr	10			
DR	Trading and Profit and Loss Account for year ...	£		CR
			Sales	100
			Less Returns	10
				90

Sales Returns is also known as Returns Inwards.

6.3 Allowances

Instead of unsatisfactory goods being returned an allowance may be agreed as a reduction on the original price. Such allowances on purchases or sales are treated in the accounts in the same way that returns are treated, except that they would be described as allowances and not returns.

Exercise 6.1

1 Post the transactions shown below to the accounts of J Ames, a sole trader.

- Nov 3 Purchased on credit from I Vee garden composts for £300, garden fertilisers for £200, all less 10% trade discount.
- Nov 6 Sold on credit to K Aper composts for £240, fertilisers for £160, all less 5% trade discount.
- Nov 10 Purchased on credit from K Rank garden canes for £380, fertilisers for £270, no discount.
- Nov 13 Purchased on credit from I Vee garden canes for £410, fertilisers for £390, all less 5% trade discount.
- Nov 19 Sold on credit to L Vis garden canes for £170, fertilisers for £130, all less 10% trade discount.
- Nov 25 Sold on credit to K Aper garden composts for £220, fertilisers for £160, no trade discount.

2 Post the transactions shown below to the accounts of M Blemm. All purchases and sales are on credit.

- Dec 4 Purchased from N Terre 30 ties at £4.00 each less 10% trade discount.
- Dec 6 Purchased from O Liver 20 boxes of cuff links at £6.00 each less 15% trade discount.
- Dec 14 Sold to P Leisure 4 suits at £240 each less 5% trade discount.
- Dec 15 Paid the account of N Terre by cheque, being allowed 5% cash discount for paying promptly.
- Dec 16 Returned 2 boxes of cuff links to O Liver, which were damaged. Received O Liver's credit note.
- Dec 20 P Leisure complained a suit sold to him was soiled. M Blemm agreed an allowance of £30 for the damage.

3 The Trial Balance shown below was extracted from the accounts of H Ades, a sole trader.

Trial Balance as at 31 May		
	DR	CR
	£	£
Purchases & Sales	15,240	27,980
Capital		4,800
Bank Overdraft		2,900
Cash	60	
Discounts Allowed & Received	960	620
Returns Inwards	540	
Returns Outwards		380
Rent, Rates & Insurance	1,160	
Fixtures & Fittings	7,600	
Vehicle	1,400	
Debtors and Creditors	7,940	4,480
Salaries	5,960	
General Office Expenses	300	
	<u>41,160</u>	<u>41,160</u>

Prepare the Trading and Profit and Loss Accounts as at 31 May along with a Balance Sheet.

4 The Trial Balance shown below was extracted from the books of Q Warter. Prepare a Trading and Profit and Loss Account for the year end (31 March) along with a balance sheet.

Trial Balance as at 31 March		
	DR	CR
	£	£
Loan from R Kidds		10,000
Capital		33,700
Telephone	500	
Wages	5,300	
Bank & Cash	17,600	
Salaries	12,000	
Purchases & Sales	44,000	88,000
Debtors & Creditors	12,000	16,000
Vehicle Expenses	4,700	
Office Expenses	5,000	
Light & Heat	3,400	
Rates	1,200	
Premises	34,000	
Fixtures & Fittings	3,600	
Vehicles	4,000	
Sales & Purchase Returns	600	300
Discounts Allowed & Received	500	400
	148,400	148,400

We have seen how to account for discounts and returns. **Next** we see how to account for unsold stock.

Bibliography

HARRISON W *Stage One Financial Accounting* Northwick Publishers 1986 pp 61..71