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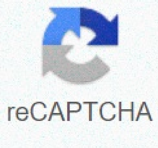

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# Accounting for vendor rebates received gaap

Coupons and rebates are great promotional incentives to encourage customers to buy items from a business. Properly accounting for coupons and rebates is often done incorrectly because the classification gets confused. Coupons discount a price at the time of purchase. Rebates are a payment back to the buyer. No all companies follow the same guidelines for recording rebates and treat different types of rebates differently. Sales rebates pay the customer back for the sale. The rebate could be for some or all of the purchase. The rebate has a cash value, because it is given to the customer after the purchase, though it is sometimes treated as a coupon – for example, when rebates are given at the register. The key difference is that a coupon discounts a price, while a rebate refunds part of the full price back to the customer. Rebates paid for by the supplier are accounted for as a reduction of the cost of goods sold (COGS). For example, a car dealership sells a car that has a $200 factory rebate. The dealership isn't reducing the price of the car. The customer is getting money from the manufacturer that made the product. To the dealership, this is a reduction in the wholesale purchase price of the car. In this case, the reduction also reduces the depreciation cost of the car. When a business provides services to another business or customer, it may be eligible for a vendor rebate from a third party. This is common with utility companies paying for solar installation or water conservation landscaping. The installation company gets paid by the customer to perform the duties. In many cases, these service providers have the homeowner complete the paperwork to get the rebate sent to the service provider. Essentially, the company is giving the consumer a discounted upfront price in exchange for the rebate. The rebate funds paid by the utility company to the service provider are considered income. Some rebates are never claimed. These may be refunded checks that never got cashed. Record them according to the rules you set forth for claimed rebates for that particular product or service. Then report unclaimed rebates based on state commerce rules. Most unclaimed property, including rebates, are recorded with the state controller. Coupons are discounts on an existing or future purchase. The accounting for this often depends on when the money is likely to be given to the company. A coupon that discounts the price immediately at the time of purchase is recorded as a reduction in revenue. For example, if a 10 percent coupon is given on a $20 purchase, the recorded revenue is $18 ($20 x 10% = $2 discount). If the coupon is given for the next purchase, the full revenue of the immediate purchase is recorded. There is no discount to COGS, and the coupon only reduces revenue if it is used at a later purchase. Until the coupon actually reduces a sales price, it isn't accounted for on the books because there is no guarantee it will be used. Many manufacturers and wholesalers offer rebates if a specific volume is met over time. For example, a buyer might say he will purchase 15,000 units over the course of 12 months. You might have a rebate of 10 percent issued when the purchase meets this threshold. When you send the rebate to the buyer, you adjust your revenues with a reduction because the COGS remained the same. In this scenario, the rebate affects net sales and would be accounted for as a deduction from gross revenues. April 12, 2021 April 12, 2021/ Steven Bragg A sales discount is a reduction in the price of a product or service that is offered by the seller, in exchange for early payment by the buyer. A sales discount may be offered when the seller is short of cash, or if it wants to reduce the recorded amount of its receivables outstanding for other reasons.An example of a sales discount is for the buyer to take a 1% discount in exchange for paying within 10 days of the invoice date, rather than the normal 30 days (also noted on an invoice as "1% 10/ Net 30" terms). Another common sales discount is "2% 10/Net 30" terms, which allows a 2% discount for paying within 10 days of the invoice date, or paying in 30 days.If a customer takes advantage of these terms and pays less than the full amount of an invoice, the seller records the discount as a debit to the sales discounts account and a credit to the accounts receivable account.Presentation of Sales DiscountsThe sales discounts account appears in the income statement and is a contra revenue account, which means that it offsets gross sales, resulting in a smaller net sales figure. The presentation of a sales discount in the income statement is: Gross sales $xxx,xxx Less: sales discounts (xxx,xxx) Net sales $xxx,xxx A company may choose to simply present its net sales in its income statement, rather than breaking out the gross sales and sales discounts separately. This is most common when the sales discount amount is so small that separate presentation does not yield any material additional information for readers.Example of a Sales DiscountABC International issues a $10,000 invoice to a customer that offers a 2% discount if the customer pays the invoice within 10 days. The customer does so, sending in a payment of $9,800. ABC records the payment with this transaction: Debit Credit Cash 9,800 Sales discounts 200 Accounts receivable 10,000 If this billing were the only invoice issued by ABC during the reporting period, and if the customer paid within the reporting period, then the revenue section of ABC's income statement would look like this: Gross sales $10,000 Less: sales discounts (200) Net sales $9,800 If the number of discounts taken by customers are few and the impact of these discounts on reported sales results are minimal, then the accounting treatment just noted is acceptable. However, what if many discounts are taken? You could have a situation where a company issues most of its invoices at the end of a month (a common scenario) and then customers take discounts in the following month, which reduces sales in a different period from the one in which the invoices were originally generated. This scenario does not pass the standard set by the matching principle, where all revenues and expenses associated with a transaction should be recognized within the same period.If there is a risk that a large proportion of sales discounts will be recognized in a later period, create a sales discounts allowance account, in which you record an estimate of what the sales discounts will actually be in a later period. By doing so, you can immediately reduce sales by the amount of estimated discounts taken, thereby complying with the matching principle.If ABC International were to use an allowance account to record the preceding transaction, the entry at the time when it issued the $10,000 would include the following: Debit Credit Sales discounts 200 Allowance for sales discounts 200 Then, when the customer later paid the invoice, the entry would be: Debit Credit Cash 9,800 Allowance for sales discounts 200 Accounts receivable 10,000 Thus, the net effect of the allowance technique is to recognize the estimated amount of the discount at once and park that amount in an allowance account on the balance sheet. Then, when the customer actually takes the discount, you charge it against the allowance, thereby avoiding any further impact on the income statement in the later reporting period.Most businesses do not offer early payment discounts, so there is no need to create an allowance for sales discounts.Related CoursesBookkeeping Guidebook How to Audit Receivables New Controller Guidebook April 12, 2021/ Steven Bragg/ Discounts are probably the most popular selling tool in business. Without a doubt, many companies discount the price for their products or services in various forms, for example: Buy 1, get 1 free (and modifications), Get 10% off for purchases over CU 100 (and modifications), Gift vouchers, Settlement discounts (bonus for early payment or for cash payment), and many others. What do discounts really mean for us, accountants? In most cases, troubles. The reason is that discounts directly affect measurement of various items in the financial statements and potentially the accounting treatment (timing and journal entries). In this article, I explain how you should treat the discounts from the point of view of both seller and buyer. My good friend, Prof. Robin Joyce added a bonus to this article. We try to explain why discounting is not always that great and how you should decide on the amount of your discount based on your own margins and sales. Maybe you'll be surprised to find out that not every single business can afford discounting. Yes, it's an expensive selling tool! Sellers provide discounts When a seller provides a discount, it directly affect the amount of his revenue. Special For You! Have you already checked out the IFRS Kit ? It's a full IFRS learning package with more than 40 hours of private video tutorials, more than 140 IFRS case studies solved in Excel, more than 180 pages of handouts and many bonuses included. If you take action today and subscribe to the IFRS Kit, you'll get it at discount! Click here to check it out! Therefore logically, we should look to the standard IAS 18 Revenue or IFRS 15 Revenue from Contract with Customers for guidance. Both standards specify that you should present the revenue net of discounts. Just refer to IAS 18.7 or IFRS 15.47 and following). In other words, discounts reduce the amount of your revenue and do not represent cost of sales (or cost of promotion etc.). For example, when you sell a machine for CU 100 and you decide to provide a discount of 3%, then you present a revenue of CU 97, and NOT the revenue of CU 100 and cost (of sales, marketing, whatever) of 3. This rule seems very basic and very simple, yet its practical application can be challenging at some circumstances. Let me give you 2 examples. Example 1: Discount coupons Imagine you run an e-shop with books. To support your sales, you send a discount coupon for CU 5 that your customers can use with every purchase over CU 100. How should you account for the discount coupon? In this particular example, you don't recognize a provision in your financial statements for a discount at the time of distributing a coupon. Why? Because there's no past event. Remember, a customer would have to make a purchase over 100 and only then you have a liability to provide a discount of CU 5. Instead, you simply recognize revenue net of CU 5 discount when a coupon is redeemed. Example 2: Buy 1, get 1 free (or any free items) Instead of giving discount coupons, you promise to deliver a book "Thai cuisine" for free with every purchase of "Thailand travel guide" for CU 50. You normally sell Thai cuisine for CU 10, its cost in your inventory is CU 6 and the cost of Thailand travel guide is CU 35. What do to now? Under IAS 18, you simply recognize revenue for both books of CU 50 and cost of sales of CU 41 (35+6). Cost of free item is not a marketing or promotion cost in this case, because a free item increases revenues (supports spending). Under IFRS 15, the accounting treatment is the same if both books are delivered at the same time. However, if you deliver Thailand travel guide in September and Thai cuisine in October due to low stock, then you would need to split the transaction price of CU 50 based on the relative stand-alone selling prices and recognize revenue accordingly. More specifically: Total stand-alone selling prices: CU 50+CU 10 = CU 60 Revenue allocated to Thailand travel guide: CU 50/CU 60*CU 50= CU 42 to be recognized in September. Revenue allocated to Thai cuisine: CU 10/CU 60*CU 50 = CU 8 to be recognized in October. Costs of sales are recognized accordingly. Buyers get discounts When buyers get discounts, it's a totally different story. We need to look at IAS 2 Inventories, IAS 16 Property, plant and equipment or other similar standards for guidance. Both IAS 2 and IAS 16 prescribe that we should initially measure an item of PPE or inventories at its cost including purchase price. And, it's net of discounts. However, let me stop here. You should examine the reason for getting a discount. If you receive a discount as a reduction in the purchase price of inventories, then you should deduct it from their costs. When discounts refund some selling expenses, then these discounts are not deducted from the costs of inventories, but treated as income. Another consideration might relate to settlement discounts, i.e. discounts received from quick payment. They should not be treated as finance income, but again, they reduce the cost of inventories. Example 3 Rebates on inventories Supermarket wants to purchase 1 000 Chocobars. What is their cost, based on the following information: Sales price per unit: CU 5 Volume discount per 1000 units: 10% Settlement discount: 2% when paid within 30 days Contribution for leaflet printing costs: 1% If the supermarket intends to pay within 30 days, then it should reduce costs of inventories by settlement discount, too. Contribution for leaflet printing costs is clearly refunding some selling expenses and therefore it should be treated as income, not as cost of inventories. The costs of inventories is: CU 5*1 000 – CU 5*1 000*(10%+2%) = CU 4 400. What about inventories received for free? Well, it depends. If a government (including governmental agencies) donated you some inventories, then you should apply the standard IAS 20 Accounting for Government grants and Disclosure of government assistance. Special For You! Have you already checked out the IFRS Kit ? It's a full IFRS learning package with more than 40 hours of private video tutorials, more than 140 IFRS case studies solved in Excel, more than 180 pages of handouts and many bonuses included. If you take action today and subscribe to the IFRS Kit, you'll get it at discount! Click here to check it out! If you received some units of inventories for free as a "gift" with your purchase, then you should apply the standard IAS 2 – i.e. measure inventories at cost. For example, you purchased 1 000 units at CU 2/unit and received 50 units for free, then you record 1 050 units at CU 2 000, i.e. CU 1,90/unit. I have also seen that some companies record free items at their fair value while a credit entry goes in profit or loss (as an income). However, this approach is not supported by IFRS. In any case, you should always seek the substance of a transaction and then make appropriate decision. When you should NOT discount your goods or services Let's take a different angle of looking at discounts. My friend, Prof. Robin Joyce helped me with that. Discounts represent a very powerful selling tool, but at the same time, they are like marketing's nuclear weapon. Why? The reason is that discounts can lower price perception permanently or make your product a commodity. It means that clients will see no difference between your product and other products – they will just buy the cheapest (not necessarily the best). What do discounts do to your profit? Do you really need to discount your products or services in order to increase your profits? If you sell some tangible products, then you need to know the exact financial impact of your planned discounts on sales and the net profit. The following table sums it up (read the explanation below the table): This table shows you how many additional items you should sell at your present profit margins, if you want to keep the same profit. For example, if you are making 80% margin (top row), and you provide a discount of 20% (side column), you need to sell 33% more units to get the same financial result as without giving a discount. Putting some numbers to it: Let's say you sell a product for CU 100 with 80% margin, therefore its cost of sale is CU 20. You sell normally 100 units, therefore your gross profit is CU 80*100 units = 8 000. You'd like to give a discount of 20%. Looking at a table above, you need to sell 33% more units than before to have the same effect. For verification, your new discounted sales price is CU 80, therefore your gross profit with 33% more units sold is CU 60 (80-20) * 133 units = 7 980 (Cu 20 is a rounding difference). This table assumes that you provide discounts for all your units sold, not just some of them (in this case, you would need to adjust the calculation). What are the conclusions? You need to know your gross margin before considering a discount. You need to know how many additional units you need to sell after discount to keep the profit. And, are you able to do so? Will your customers really buy 33% more with 20% discount? If you operate with low margins, you cannot afford any discount. For example, if you operate at 10% margin, you cannot give away any discount without hurting your gross profit. You simply cannot sell enough items to pay for it. It's your turn now! If you have any questions or concerns with regards to discounts and their accounting, please let me know in the comments below this article. Thank you!

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