

Lesson 2

Business Documents Discounts, Pricing and The Banking System

On completing this lesson you should:

- Be able to design and produce purchase orders, sales invoices, credit notes and statements of account
- Understand pricing and discounts
- Understand the various methods of ordering
- Understand the need for a systematic filing system
- Understand the importance of credit control
- Understand the functions and services of banks
- Be able to describe the treatment of various methods of paying money via the banking system.

Business Documents

Almost every business transaction begins with a document. Examples used by everyone who has a bank account are cheque counterfoils and bank paying in slips. In a business there are other documents that need to be considered.

Methods of ordering goods

The initial stage with any transaction is the ordering of the goods which can now be done in a variety of ways – in writing, by telephone, by fax or over the Internet. It is important that a record is kept of all orders received.

- If the order is in **writing** or by **fax** then that letter (or purchase order) acts as the record.
- If the order is made over the **telephone**, the purchaser may ask the seller for confirmation that the order has been placed and, on receipt, the confirmation should be placed on file. Sometimes the seller gives the purchaser an order number as confirmation that the order has been placed.
- If the order is made over the **Internet** stringent checks should be used. An order should only be placed if it is company policy to do so and has been authorised in writing by someone with the required authorisation. A copy of the order should be placed on file.

Quotation Notice

A quotation notice will be issued particularly if the order has been placed over the telephone or if the supplier has a number of items to sell.

A **Source document** (or “original” document) is an individual record relating to a business transaction. The main source documents are:-

- **Purchase order**: notification of an *intent* to purchase goods/ services from a business. Prepared by the purchaser. For an example see page 46.
- **Sales order**: notification of an *intent* to sell goods/services to a customer. Prepared by the seller.
- **Sales invoice**: an essential source document - it is a formal record of the amount of money due from the customer as a result of the sale transaction. To the *customer*, the invoice represents a purchase and thus he will refer to it as a **purchase invoice**. It provides the information which will be entered into the accounting

records of a business. Prepared by the seller. For an example see page 48.

- **Credit note:** records goods returned by a customer or the reduction of monies owed by a customer. To the *customer* this will be referred to as a **Debit note**. It provides the information which will be entered into the accounting records of a business. Prepared by the seller. For an example see page 50.
- **Advice note:** This will be sent to the customer before the goods are despatched to notify the customer that the goods are on the way, the method of transport and when they are expected to arrive. If the goods do not arrive within a reasonable time then the customer will notify the seller, so that enquiries can be made to establish what has happened to the goods. Prepared by the seller.
- **Delivery note:** This is sent with the goods so that the customer can check immediately that all the items have been received. Prepared by the seller.
- **Statements:** This shows the customer what the supplier believes is the current position regarding his account at a set date. Prepared by the seller. For an example see page 51.

Documents relevant to bookkeeping

Purchase Order

A Purchase order is a written notification issued by the purchaser confirming that he *intends* to purchase goods/ services from the seller. It is not an invoice and as such does not form part of the accounts (also, it should not show the VAT registration number). Some bookkeeping systems require that a purchase order be issued and then, when the invoice is subsequently received, the invoice is matched against the purchase order; this method ensures that an invoice has been issued for each sale made. An example is given below:-

MARK PRINTERS		10 The Avenue Bartrum DZ2 5LT	Phone:01234 56478 Fax:08901 995511
PURCHASE ORDER	Sellers No	SLB 1000	
SELLERS ADDRESS:	Purchase Order No.	BM00987	
DIDDI GRAPHICS 3 The Parade Lodge Road Mortimer DZ1 3AT	Date	30th June 200X	
	Shipped Via	Post	
	Delivery Date	3rd August 200X	
Quantity	DESCRIPTION	UNIT PRICE	AMOUNT
56	Printing Plates	6.95	389.20
20	5 Litre Inks	10.79	215.80
		Sub Total	605.00
		Less Trade discount 15%	90.75
		Sub Total	514.25
		VAT 17.5%	89.99
		Postage	5.00
To ensure prompt payment please include the Purchase order number on your Invoice and all other correspondence		<u>Purchase Order Total</u>	<u>£609.24</u>

Invoices

In many businesses most of the sales will be made on a credit basis (to be paid for at a future date) rather than for immediate cash. There are some businesses which consist entirely of credit sales.

When goods are sold on credit the seller will send a document to the buyer giving full details of the goods sold and the prices of the goods. This document is called an **invoice** and to the firm selling the goods it is known as a *sales invoice*. It is the original document which provides the financial information that will subsequently be recorded in the ledger.

Invoices will differ in appearance, as each business will have its own individual design. For convenience, invoices are frequently prepared in sets, with each copy being used for a specific purpose. This enables a firm to properly organise the sending of goods and ensures that it can confirm safe receipt of the goods, but the seller keeps at least one copy of each sales invoice for his own records.

An example of an invoice is given on the next page. It is the invoice matched against the Purchase order on the previous page – look at the detail given on the invoice carefully and compare with the Purchase order.

An invoice must show:-

- The sellers' name, address and VAT registration number if relevant
- The sellers number (or account number) referring to Diddi Graphics account. This is another example of the use of coding.
- The purchase order number which will be able to be matched with the invoice number
- The invoice date – this is the date from which the date of payment is calculated
- The date of delivery
- The details of goods
- The price including and excluding VAT
- Details of any discounts allowed
- The payment terms are shown in the invoice below at the bottom left corner; 'net 30 days' means that payment is due within 30 days from the invoice date. 'E & OE' is a term used on many documents literally meaning '**E**rrors & **O**missions **E**xcepted' and means that if there is an error on the invoice then the seller will issue an amended invoice.

<h1 style="margin: 0;">DIDDI GRAPHICS</h1>		3 The Parade Phone:08901 Lodge Road 336785 Mortimer Fax:08901 DZ1 3AT 336786	
		INVOICE	
SOLD TO: Mark Printers 10 The Avenue Bartrum DZ2 5LT		Customer Acc No	SLB 1000
SHIPPED TO: As Above.		Invoice Number Invoice Date Purchase Order No. Payment Terms	3392 4 th August 200X BM00987 30 Days
		Despatch Date	3 rd August 200X
Quantity	DESCRIPTION	UNIT PRICE	AMOUNT
56	Printing Plates	6.95	389.20
20	5 Litre Inks	10.79	215.80
		Sub Total Less Trade discount 15% Sub Total VAT 17.5% Postage	605.00 90.75 514.25 89.99 5.00
VAT Registration No: 764 8424 23		<u>Invoice Total</u>	<u>£609.24</u>

NOTE: When an invoice is received the details should be checked against the purchase order, the delivery note and goods received note. If the delivery note shows, for example, that not all items were received, the invoice should not be paid until a related credit note is received.

Debit and Credit Notes

Goods are sometimes found to be defective, wrongly priced or oversupplied. If this is the case then the goods are likely to be returned to the seller with a **Debit Note**. This is an **advice** note which tells the supplier that the buyer is going to debit the seller's account in his Ledger with the cost of the returned goods. It is called a "Debit note" because the customer wants to *debit* the *suppliers* account with the value of the goods being returned.

A Debit note should show:

- The debit note number
- The order number which should match the order number on the invoice
- The details of goods
- The gross amount of payment including any discount (and inclusive of VAT charged)
- Reason for the goods being returned
- The document should be signed and authorised by someone so authorised.

The supplier will then issue a **Credit Note** which tells the purchaser that his customer account is being credited with the cost of the goods. Credit notes are usually printed in red to distinguish them from invoices. They are made out by the seller showing full details of the goods returned, prices and any trade discount. The top copy is sent to the customer and the seller keeps copies of all credit notes issued for his own records. It is the original document which provides the financial information which will subsequently be recorded in the ledger. It is called a "Credit note" because the customer's account will be *credited* to show a reduction in the amount owed.

The Credit note should show:

- a credit note number plus order number and account number so that the order can be traced. (code number)
- The reason for the issue of the credit note
- The gross amount showing any discount.

The credit note will include all the details shown on the invoice and the same checks as to accuracy should be made.

An example is given on the next page.

DIDDI GRAPHICS		<i>3 The Parade Lodge Road Mortimer DZ1 3AT</i>	<i>Phone:08901 336785 Fax:08901 336786</i>
CREDIT NOTE			
TO: Mark Printers 10 The Avenue Bartrum DZ2 5LT		Customer Acc No SLB 1000	Original Invoice Ref. 3392 Date: 30th Sept 200X
QUANTITY	DESCRIPTION	UNIT PRICE	AMOUNT
6	Printing Plates	6.95	41.70
Reason(s) for credit	6 plates damaged in transit	Sub Total	41.70
		Less trade discount 15%	6.26
		Sub Total	35.44
		VAT 17.5%	6.20
		Postage	5.00
VAT Registration No: 764 8424 23		<u>Total Credit</u>	<u>£46.64</u>

NOTE: When you are entering Credit Notes that you must always check to see if there was a discount on the original invoice – if there is the discount must also be on the Credit Note.

Statements

If we look at all our debtors' accounts in the Sales Ledger we will know the exact amount owed to us by our customers at any one time. All accounts in the Sales Ledger should be balanced monthly and a copy of the account sent to each of the customers. This is called a **Statement of Account** and shows the customer what we believe to be the current position regarding his account.

An example follows: NOTE: "Total Due" £2,666.93 equals Aug 1st balance, less Aug 8th payment. The Terms are 30 days therefore this payment has now been owing for one month; none of the August invoices are yet "Due" as at 31st August 200X and are therefore shown in the 'Current Box'.

DIDDI GRAPHICS					
3 The Parade, Lodge Road Mortimer West Country DZ1 3AT Tel: 08901 336785					
STATEMENT OF ACCOUNT					
DATE: 31 st August 200X				ACCOUNT NO: SLB 1000	
				Credit Terms: 30 Days	
Date	Type	Reference	Debit £	Credit £	Balance £
Aug 1	Balance				6231.21
Aug 3	Invoice	10028	969.24		7200.45
Aug 5	Invoice	10029	965.46		8165.91
Aug 8	Payment			3564.28	4601.63
Aug 9	Invoice	10031	966.98		5568.61
Aug 12	Invoice	10032	866.54		6435.15
Three Months	Two Months	One Month	Current Month		
		2666.93	£3768.22	Total Due	£2666.93
PAYMENTS RECEIVED AFTER DATE WILL BE SHOWN ON NEXT STATEMENT					

Discounts

You will have noticed that each of the documents detailed so far show an item for “trade discount”.

The various types of discounts are:

- **Cash Discount** being a reduction of the amount to pay if paid for promptly.
- **Trade Discount** being a reduction on the list price of goods.
- **Quantity Discount** being a reduction for buying in large quantities.

Trade Discounts

Manufacturers and wholesalers usually set list prices for their goods. In practice, they may well offer their products to their customers at prices lower than these list prices. Trade discount is a reduction usually quoted as a percentage of the selling price which is given by a supplier to a customer in the same trade.

For example, Mr Jones is a plumber and he is able to buy the materials he needs in his work from a wholesaler at a lower (discounted) price than the general public. Mr Jones will charge his customers the recommended retail price (RRP)

Quantity Discounts

This is a discount given for buying in bulk. For example, if a grocery store owner were to buy just one can of soup from the wholesalers, he would be charged at a rate that would not be much less than the price that he would be able to resell it at. If he buys a case of tins of soup, the price for buying in quantity is far lower.

How to show discounts on an invoice

In bookkeeping, trade and quantity discounts are deducted from the cost price of the goods. For example the invoice will show:

1 Carburettor	£145
less Trade Discount 20%	<u>£ 29</u>
Invoice Price	<u>£116</u>

The purchase order on page 46 and the invoice on page 48 shows trade discount being given.

The bookkeeping entries for discounts

As far as the bookkeeping entries are concerned trade discounts are never recorded – they are shown **only** as a deduction on an invoice. In the example on the previous page a total of £1116 will be entered into the ledger accounts when recording the invoice as this is the amount actually received.

Because trade discount was allowed on the original invoice it must *also* be deducted on any credit note issued for the item returned -it is important to understand this principle. When goods are sold less a trade discount it reduces the price of the goods; if the discount is not then deducted on a subsequent issued credit note then the customer will receive a higher price for the returned goods than was first paid. It would be wrong to give a customer a credit note for the full price if trade discount was allowed on the original invoice as he would actually be making a profit on the returned goods.

The credit note must only be made out for the amount charged in the first place. This concept is often a pitfall for students and is frequently tested in examination questions. An example of a credit note including a trade discount is shown on page 50.

Pricing

As we have already said, businesses exist to make a profit. Although the discounts detailed above are used for a variety of reasons, if too much discount is given too often, there may not be enough income to cover the expenses of the business, resulting in a loss. Therefore for a business to thrive, the owner must set a price for his product, which not only covers the materials purchased and expenses incurred, but also allow for any discounts that may be given. There are several methods of calculating the final price but the most commonly used method is by the use of “mark up”

“Mark Up”

A “mark up” is usually a percentage based on the cost of the goods and added on in order to arrive at a selling price. The owner of the business calculates the total expenses incurred for a year (the purchase of materials plus wages, electric, rates, motor expenses, drawings etc) and divides this amount by the number of units the business produces – this is then the minimum price that each good can be sold at just to ensure that the business breaks even (ie that income = expenses). To this figure will be added a “mark up”.

EXAMPLE 1

A business manufactures educational CD's. The owner calculates that the total overheads (or expenses) amount to £140,000 in any one year. If 20,000 CD's are manufactured a year the cost of each CD must average at least £7.

$$\text{ie } \frac{\pounds 140,000}{20,000} = \pounds 7$$

The business need not sell EVERY CD at £7 but can sell some for more and some for less (possibly deducting discounts) - so long as overall the CD's are sold at £7 the business will cover its costs but not make a profit. Once this amount is calculated a mark up is then added to give the selling price. In this case the business adds 200% mark up and as such the average selling price is now increased to £21.

$$\text{ie } \pounds 7 + (7 \times 200\%) = \pounds 21$$

The mark up used varies from producer to producer, market to market and product to product. For example, Tescos will add an average of 25% mark up; clothes shops will look for a 100% mark up – for cosmetics the mark up can be as high as 200%.

EXAMPLE 2

The total cost of a product per unit is £12 and it is sold at £15 per unit. The profit therefore = £3 and the mark up is 25%

$$\text{Mark up \%} = \frac{\text{Profit} \times 100}{\text{Cost price}}$$

$$\frac{\pounds 3 \times 100}{\pounds 12} = 25\% \text{ mark up}$$

Once a mark up percentage is established by a company it becomes a guideline to selling price. If the market is willing to pay £15 per unit the mark up may well be adequate but if competition becomes intense the company will need to review its prices in line with market forces.