

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 discounts and pricing
- Understand the importance of credit control
- Understand the need for a systematic filing system
- Understand the function and services of banks
- Be able to describe the treatment of various methods of paying money via the banking system.
- Have finished an assignment

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.

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 53.
- **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 55.
- **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 57.
- **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 58.

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
			605.00
Less Trade discount 15%			90.75
Sub Total			514.25
VAT 17.5%			89.99
Postage			5.00
Purchase Order Total			£609.24
To ensure prompt payment please include the Purchase order number on your Invoice and all other correspondence			

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 which 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 but the seller keeps at least one copy of each sales invoice for his own records.

An example of an invoice is given on page 55. It is the invoice matched against the Purchase order shown on page 53 – look at the detail given on the invoice carefully and compare with the Purchase order.

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

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.

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.

An example is given on the next page.

DIDDI GRAPHICS		3 The Parade Lodge Road Mortimer DZ1 3AT	Phone:08901 336785 Fax:08901 336786
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		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>

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 53 and the invoice on page 55 show 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 page 59 a total of £116 will be entered into the ledger accounts when recording the invoice as this is the amount actually received.

Because a 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 57.

Pricing

As we have already said, businesses exist to make a profit and as such although the discounts detailed above are universally used for a variety of reasons if too much discount is given too often then there may not be enough income to cover the expenses of the business and the business will record 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

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 to break-even.

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

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 then 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, Tesco’s will add an average of 25% “mark up”; clothes shops will look for a 100% “mark up” – for cosmetics firms the “mark up” can be as high as 200%.

EXAMPLE

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%

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

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

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.