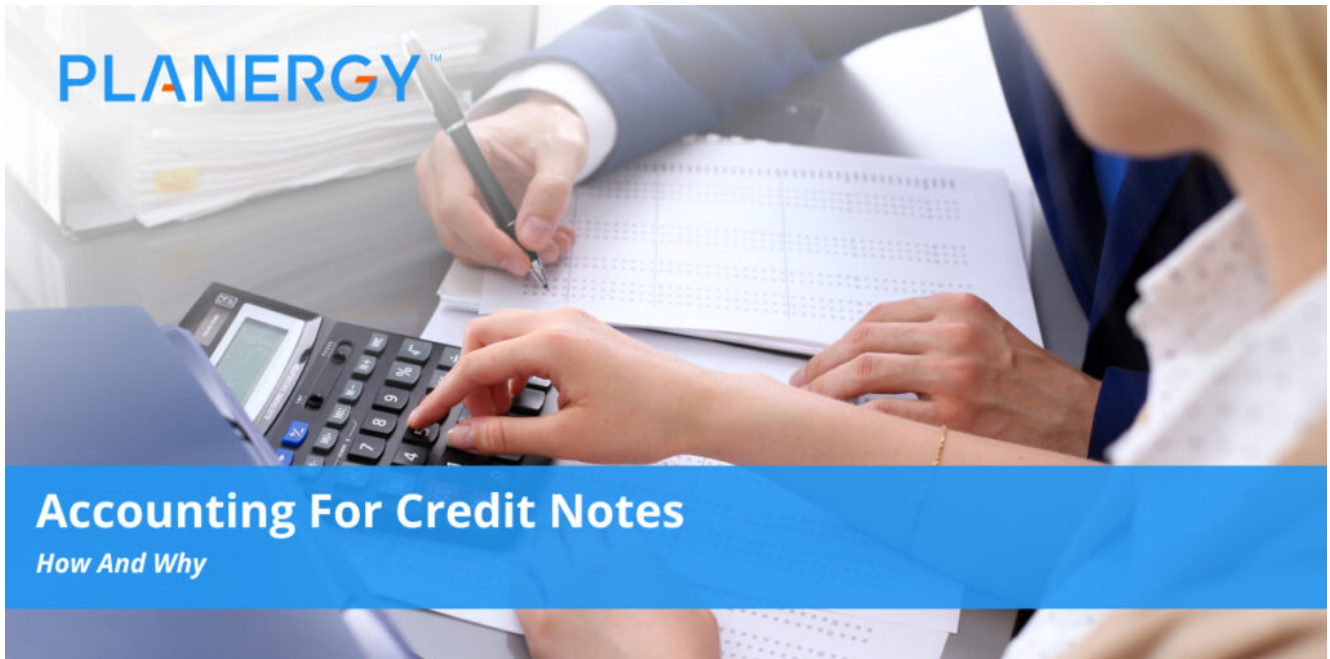


# Accounting For Credit Notes



Credit notes can sound intimidating but what they are and how they are accounted for is simple. Credit notes are a credit on a customer or vendor account.

Store credit is widely used for returns made by a customer at the local brick and mortar store.

Credit memos are sent to vendors when they return items that they cannot accept.

This may be because they no longer need the product, or due to shipping damage. Credit notes are handled differently based on the type of credit note and if you are the buyer or seller.

## When You Are the Buyer

When your company makes a purchase, but later decides to send it back to the vendor, it is considered a purchase return and decreases your liability to the creditor and decreases your expense.

If you have paid for the paper supplies and are issued a credit memorandum, you can use it on a future purchase.

Credit notes are often attached to the original invoice for your own records. You also have the option to demand cash back and forfeit the credit memo.

The latter is often used if you are unhappy with the paper supplier and are going to use a new supplier. Always be sure the credit note is for the amount of the invoice you originally paid for.

In the event of a credit memo, the journal entry you will make is a debit to the supplier's account, which reduces your liability. Then you credit the purchase return account, which decreases the expense.

## **When You Are the Seller**

When you have a return made to you, store credit is an option for a brick and mortar store and a credit note for business-to-business operations.

For small business owners to offer store credit, the journal entries look a bit different. In this case, there is a debit note to Accounts Payable and credit a Cash account.

When the store credit is used, you will debit the Cash account and credit Accounts Payable. This is only if the customer is not getting a refund to their credit card.

Business-to-business journal entries are easy but with a twist. When the return is received, the first journal entry made is a debit to a Sales Return account. The credit is made to the buyer's account or to accounts receivable.

The extra step is reviewing all outstanding credit memos each month. Ideally, the credits are applied as soon as the buyer makes another purchase. It doesn't always happen and can be an error by the bookkeeper or because the buyer hasn't made a purchase.

If you follow up each month with the outstanding credit notes, you will make sure that they are being used. This makes your general ledger cleaner and your buyer's happier.

*Either as a buyer or seller, credit notes play an important role in business accounting. Tracking them correctly is crucial.*

# Why Is Recording Credit Notes So Important?

The number one reason you are recording the credit notes is to watch your business health. If you are handing out credit notes on a regular basis, something is wrong.

Either your product is faulty or your shipper is mishandling shipments. Or a combination of both.

If the bookkeeping department is consistently handing out credit notes to the same buyer all the time, that will warrant further investigation as well.

Credit notes also decrease your net sales, that is something you don't want happening often.

Having that constant bite out of your sales will lend to financial instability. When you attempt to get a loan or extension of credit, the banks are going to look at your financial health.

Too small of a profit means you won't get the loan or extension of credit. Investors will look to your financial records and avoid investing in a company that appears to be financially unhealthy.

While all companies set out to offer the best product they can, knowing the many different aspects of how credit notes affect the business is also helpful.

During the monthly review, a quick look at the balance sheet and income statement will be able to tell you how well things are going.

One way to ensure that credit notes are being handled efficiently is to use automated accounting software. Automation is a great tool for managing your general ledger.

With the automatic application of credit notes, you will eliminate human error made by your bookkeepers. It gives them more time to work on other projects and not bogged down by a long to-do list.

Automating your financial statements can also help raise the red flags quickly

when reviewed each month. Automation for your invoicing is another bonus and can help add the credit notes appropriately.

Even with automation, it is important that your bookkeeper is reviewing everything on a monthly basis so they can follow up with the CFO on any red flags.

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