Credit Note: What Is It, Examples, And How to Process Them



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Inevitably, there will come a time when an order you've placed is incorrect.

Perhaps you only received a portion of the original order or maybe you had to return several items because they were damaged in shipping.

Whatever the circumstances, when this happens, a supplier issues a credit note.

But what exactly is a credit note, what information is typically included on the note, and how should your business handle one?

What Is a Credit Note?

Credit notes, also known as credit memos or credit memorandums, are considered legal documents that are used to notify a customer that a credit amount is being applied to their account.

While the credit amount is automatically applied to the customer's balance on the vendor/supplier's end, it's the responsibility of the buyer to properly record the credit on their books as well.

What a Credit Note Is Used For

A credit memo is issued by a supplier for a variety of reasons.

If you're selling products, you may issue a credit memo to your customers.

If you've purchased goods or materials, you may receive a credit memo from your vendor.

Regardless of whether you issue or receive a credit memo, the list of possible reasons that one is issued will remain the same:

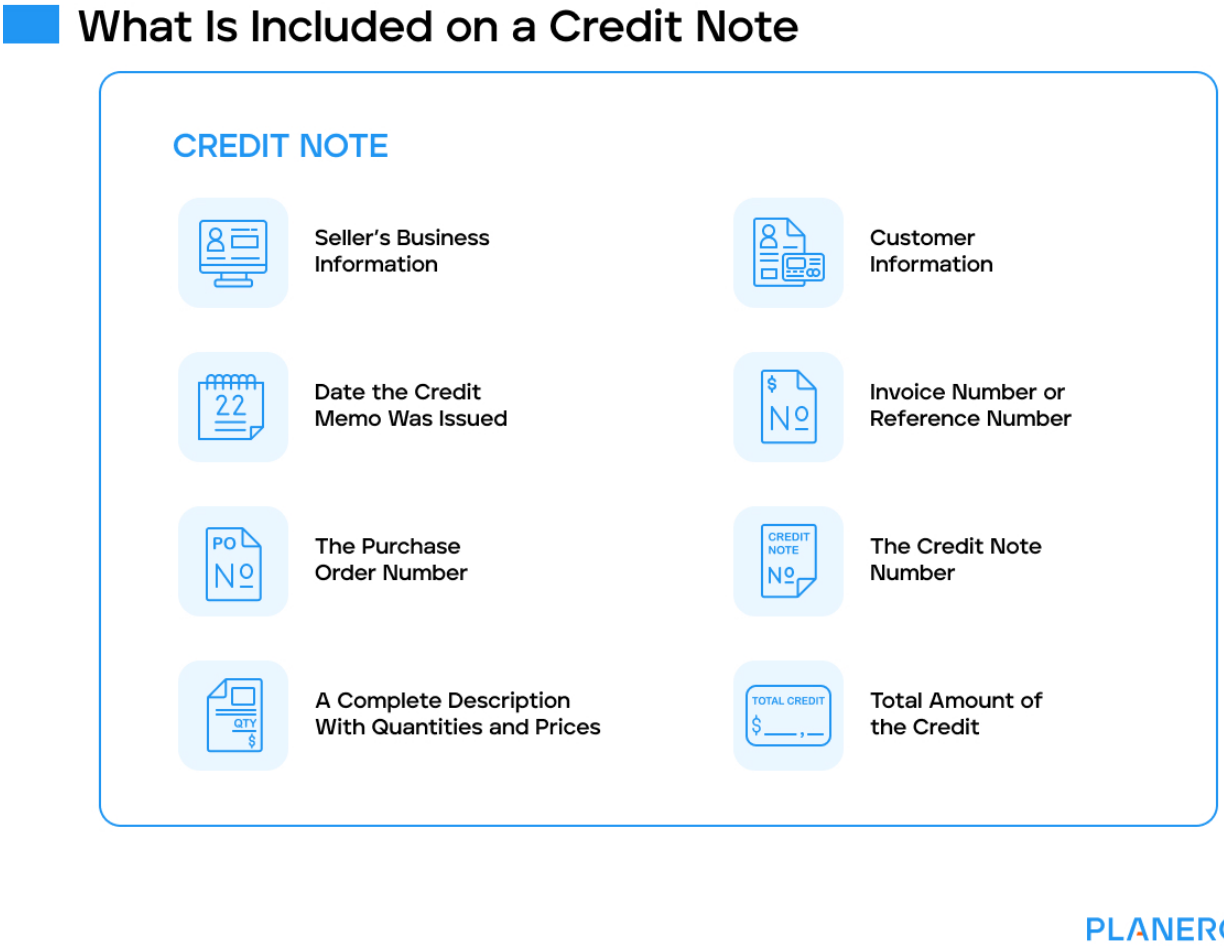
- The customer returned materials, supplies, or other goods to the vendor
- An overpayment was made by the customer on the original invoice
- Invoice errors appear on the original invoice
- Goods or materials were damaged in transit
- The customer received less than the amount ordered but was invoiced in full

What Should Be Included on a Credit Note

A credit memo includes pertinent information that is used to tie the note back to the original invoice.

Whether you're a multi-million-dollar business using an automated system, or a

small business owner using a credit note template, the following information should be present on any credit note issued or received:



- Seller's business information including name, address, phone number, and email address
- Customer information including name, address, phone number, and email address
- Date the credit memo was issued
- Existing invoice number or reference number
- The purchase order number
- The credit note number
- A complete description of what is being credited, along with the appropriate quantities and prices
- Total amount of the credit

CREDIT MEMO or *CREDIT NOTE* should always be written at the top of the document so that the business receiving the document knows exactly what it is.

How To Process a Credit Note

How bookkeeping processes a credit note largely depends on whether the company is issuing the credit note or receiving the credit note.

Accounting For a Credit Memo As a Buyer

If you're the buyer and you're issued a credit memo from a vendor, you'll need to record the transaction by debiting the supplier's account (accounts payable) for the amount of the credit note and crediting the purchase return account.

Creating this entry will reduce the vendor account balance to properly reflect the amount of the credit memo and will also reduce your purchase account for the same amount.

For example, you ordered $15,000 worth of materials from your materials supplier, but you only received $10,000 worth of materials.

When you receive the invoice after the purchase, the amount due is shown as $15,000. Three days later, the supplier issued a credit memo for $5,000.

Rather than wait for the seller to issue a credit memo, you can choose to issue a debit memo in the amount you need to be credited.
Either way, the journal entry will be the same.

Account	Debit	Credit
Vendor/Supplier Account (AP)	$5,000	
Purchase Return		$5,000

If you mistakenly pay the entire invoice, any unused credit will be placed on your account and used as a credit for your next order.

In certain circumstances, you can opt to request a refund from the vendor if you aren't planning on using them again in the future.

Accounting For a Credit Memo As a Seller

If you're the seller and you regularly issue credit notes to your customers, the process is similar.

When you issue the credit memo, you will need to debit the sales return account and credit the customer's account (accounts receivable).

This will reduce your sales total while also reducing the accounts receivable balance of the customer.

For example, if you sell $5,000 worth of goods to your customer, but $1,000 worth of those goods are damaged during transit, you would need to issue a credit memo, while also completing the following journal entry.

Account	Debit	Credit
Sales Return	$1,000	
Customer Account (AR)		$1,000

When you create a credit note on a customer's account, the credit should be applied promptly to avoid out-of-balance customer accounts that can cause issues at year end.

Is a Credit Note a Refund?

A credit note is not a refund but is used to adjust the amount of an invoice to reflect a return of materials or supplies.

A credit can also be given if someone purchases a service that they are dissatisfied with.

If the original invoice is still outstanding, a credit memo can be applied to reflect the current amount due.

If an invoice has already been paid before a credit memo is received, the credit is posted and later applied to a future purchase.

In some cases, a buyer may request a refund from a seller.

This usually occurs when a one-time purchase is made from a vendor and the

company has no intention of purchasing additional goods and services from that supplier.

In that case, you would simply receive a refund, not a credit note.

What Is the Difference Between a Debit Note and a Credit Note?

Both debit notes and credit notes are issued in response to a purchase of goods and/or services that have been canceled, damaged in transit, are of poor quality, or were never received.

A debit note is issued by the purchaser and is used to notify a vendor that they're returning materials or supplies.

A debit note can also be used when a buyer is dissatisfied with a service received.

For example, ABC Construction purchased 50 hammers at $4 per hammer from Jake's Supplies for the business.

They only received 40 hammers but were billed for the entire 50, with the invoice totaling $200.

They immediately issued a debit memo to Jake's Supplies for $40 to advise Jake's Cleaning that they would be taking a credit for the difference.

A credit note is issued by a vendor to notify the buyer that they will apply a credit of a specified amount against an invoice for a purchase made.

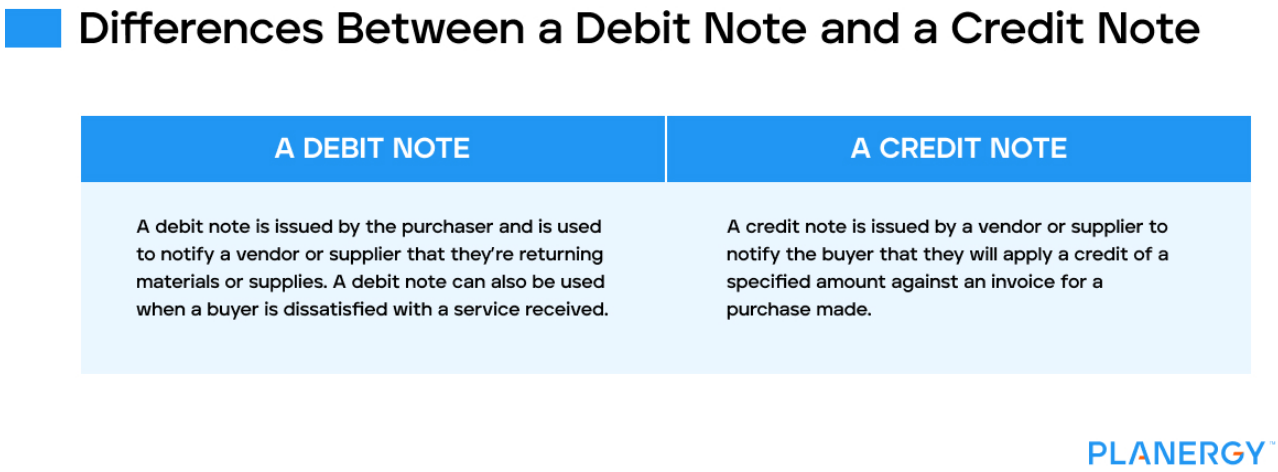
Using the example above, after being notified that ABC Construction did not receive their complete order, Jake's Supplies issued a credit memo for $40 to reduce the amount of the invoice that had already been sent.

Both ABC Construction and Jake's Cleaning Service will need to properly record the debit and credit memos.

ABC Construction will debit Jake's Cleaning Service account for $40 and credit the purchase return account for $40.

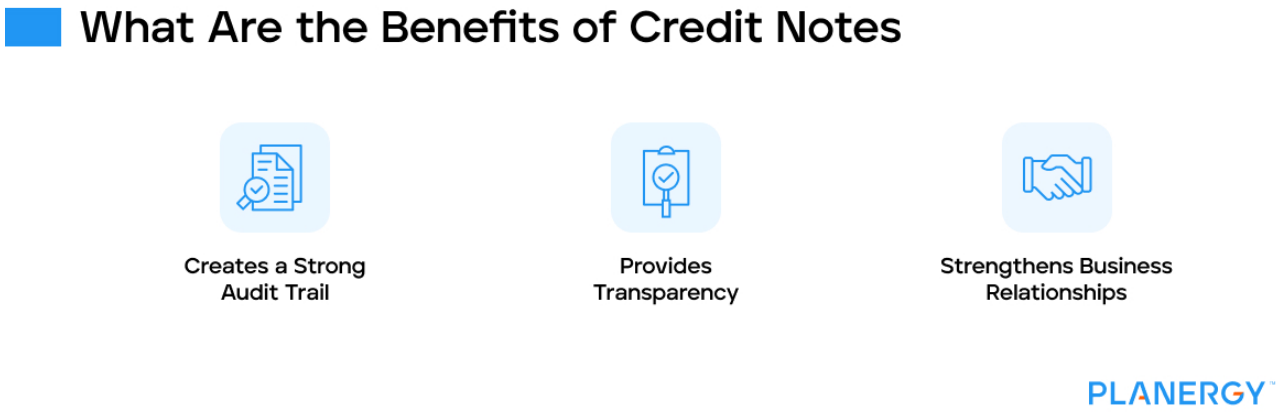
Meanwhile, Jake's Cleaning Service will need to create a journal entry as well,

debiting the sales return account while crediting ABC Construction's account.



The Benefits of Credit Notes

There are benefits to issuing and recording credit notes including:



- ## Creates a Strong Audit Trail

  Having a strong audit trail is a must for all businesses.

  Issuing a credit note provides sellers with a way to document why they are reducing the amount due from the buyer, while buyers can use the credit memo to indicate why the amount they paid was less than the original invoice.

Having a credit note also provides backup for any journal entry made to record the note.

Strengthens Business Relationships

Mistakes happen. Products get damaged or lost in the mail. How a supplier handles those mistakes is what matters.

Promptly issuing a credit note for a botched shipment or damaged pieces can assure customers that their business is valued and strengthen relationships between the vendor and the buyer.

Provides Transparency

If credit notes are issued when necessary, they serve to keep both buyer and seller accounts in balance with clarity on what happened and when.

Best Practices For Credit Notes

Ensure Credits are Issued Promptly

Credit notes work best when issued promptly.

Issuing a credit memo before an invoice is paid allows the customer to simply reduce the amount they pay while ensuring the payment is processed promptly.

If you wait to issue a credit memo, your customer may end up with a credit on their account that they can’t use.

Use Journal Entries Correctly

Remember to make a journal entry to record any credit or debit memo issued. If you issue a note and don’t make the proper journal entry, your accounts will be out of balance.

- ## Record Credit Notes Against The Relevant Invoices

  Those receiving the credit memo should always attach a copy of the memo to the original invoice for auditing purposes.

  That way, if the document is selected in an audit, there will be a clear paper trail available that explains the invoice total and any corresponding adjustments that were made.

- ## Investigate Why You Have To Issue Credit Notes

  If you find that you're issuing too many credit memos, take some time to investigate why.

  While lost and damaged shipments are out of your hands after they leave your business, if you issue numerous credit memos because of the quality of your products or shipments that are incomplete, you may need to review your shipping processes or look at purchasing better materials to sell.

- ## Automate Your AP or AR Process

  If you're still using manual processes, managing credit memos, whether as the buyer or the seller requires a great deal of work.

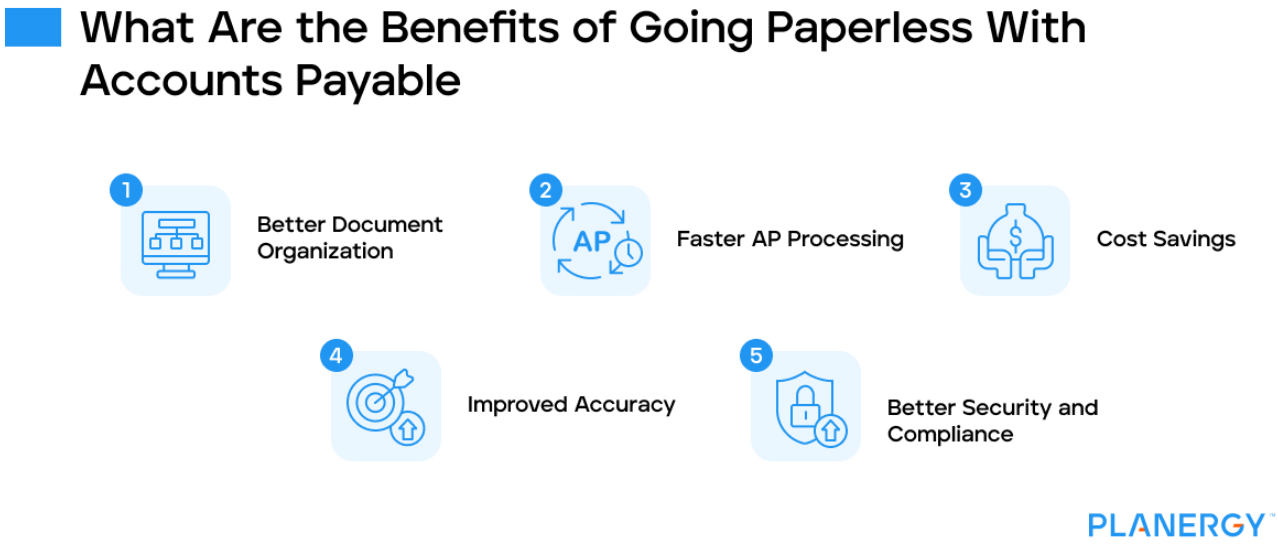
  By making the transition to using accounts payable automation software or accounts receivable automation, credit memos will be recorded when issued.

  There are several other benefits of making the move to accounts payable automation.

The Benefits of Going Paperless with

Accounts Payable

Transitioning to a paperless office offers a long list of benefits. In accounts payable going paperless has significant benefits including the below.



1. Better Document Organization

How much time do you or your staff spend looking for lost or misplaced documents?

With a paperless office, the file you need is always at your fingertips with powerful search functionality, so you and your staff can spend time on more important things.

2. Faster AP Processing

When you're dealing with paper invoices, there are so many things that can delay the processing of an invoice from routing errors to invoice approval delays.

Using a paperless invoicing process can expedite your entire workflow by automating time-consuming processes like three-way matching, manual invoice entry, approvals, and payment processing.

A paperless office also eliminates the need to copy and distribute invoices.

3. ## Cost Savings

   Every minute that is spent processing invoices manually costs money.

   Whether it’s money spent on wages, paper, ink, postage, and other peripherals, or offsite storage for all of those paper invoices, going paperless can save you a significant amount of money, improving your cash flow and your bottom line.

4. ## Better Security and Compliance

   Digitally managing your financial records allows you to determine who has access to those records at all times.

   Sure, file cabinets have locks, but they certainly don’t offer the level of security a multi-level digital security system does.

5. ## Improved Accuracy

   The more manual processes that are involved in accounting, the more errors there will be.

   Manual processing also makes it difficult to access reports in real time. If your invoices are sitting in someone’s inbox waiting to be improved, those invoice totals will not be reflected in any of your financial reports.

   Moving to an automated accounting software application or an automated invoicing software system provides real-time reporting that is essential for the transparency needed to manage accounts payable.

Process Your Credit Notes Properly

Whether you’re a buyer or a seller, issuing and accounting for credit notes properly will help keep accounts in balance.

Whether they’re issued to your business or you’re issuing them to your customers,

these commercial documents will help keep disputes to a minimum and provide financial transparency for your business.

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