

# Management & Principles of Accounting Date: 21/11/2018 Recording purchases

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Source: E-Book: (Basic accounting - how to prepare and analyze financial statements) edited by Patrizia Tettamanzi, Gaia Blandano, Sophie Goodman, Ipsoa Gruppo Wolters Kluwer



# E-Book



After this lesson you should be able to:

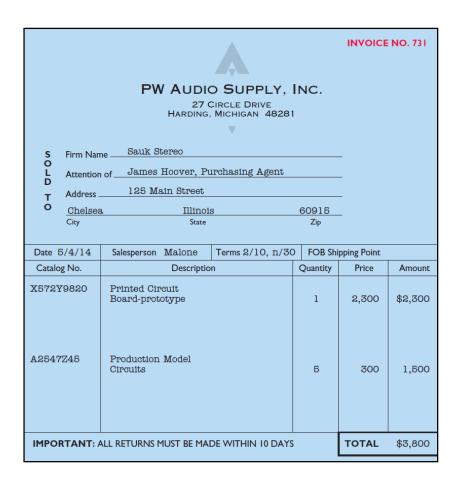
Explain the recording of purchases



#### Example of Purchase Invoice

#### Please identify:

- Invoice number
- Seller
- Invoice date
- Purchaser
- 5. Saleperson
- Credit Terms\*
- 7. Good purchased: catalog numer, description, quantity, price per unit
- 8. Total invoice amount



<sup>\*</sup> Terms: 2/10 n. 30: 2% discount if paid within 10 days, otherwise net amount due within 30 days.



# Recording purchases: cash vs. accounts payable

When we buy goods paying cash we make the following entry:

Inventory (A) 3.500

Cash (A) 3.500

Purchase of inventory, cost 3.500

 If we buy something "on account" we first record the debt and later the payment:

Furniture (A) 6.000

Accounts payable (L)

6.000

Purchase of furniture, cost 6.000, to be paid in one month

Accounts payable (L) 6.000

Cash (A) 6.000

Purchase of the debt related to the purchase of furniture



#### Recording purchases: notes payable

 The seller may ask to issue a "note payable", that is a formal promise to pay a definite sum at a specific date in the future, including also the promise that the creditor may claim certain assets (collateral) if the debtor fails to pay the amount due. In this case we record, for example:

Plants (A) 3.500

Note payable (L)

3.500

Purchase of a plant. Issued a note payable.

At maturity we'll record:

Notes payable (L) 3.500

Cash (A) 3.500

Payment of the note payable



# Note Payable - Example

	Promissory	note	
For value receive	d, the undersigned promises to pay	y to the order of Bar	ncZone, Inc.
the sum of:	*****Ten-Thousand and no/	100 Dollars****	(\$10,000.00)
	al interest of 8% on the unpaid bala ed interest, on June 30, 2008.	ance. This note sha	I mature and be payable
along with accru			l mature and be payable Oliva Zavala

Source: Google



### Recording purchases: notes payable

 The seller may also ask for interests in case of delayed payment. This interests are paid at maturity. Using the same example:

```
Notes payable (L) 3.500
Interest expense (E) 350
Cash (A) 3.850
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Payment of the note payable + interest for 350 euros



#### Recording purchases: advance payment

 If we pay our supplier in advance, that is before receiving the goods or services purchased, we have to record an asset (a receivable), representing the right to receive something in the future:

Advance to supplier receivable (A) 1.500

Cash (A) 1.500

Paid in advance to the supplier for the purchase of the furniture.

When we receive the goods or services and we pay for what is left:

Furniture (A)	3.500	
Advances to suppliers receiv. (A)	1.500	
Cash (A)	2.000	

Received the furniture, total cost 3.500, paid cash the remaining amount



# Recording purchases: returns, allowances and discounts

• If we return part of the goods purchased or ask for an allowance (reduction in price) we record:

Account payable (L)

300

Inventory (A

300

Returned (or received an allowance of) 300 euros of goods previously bought

 Sometimes, if we pay before the agreed deadline, we benefit from a cash discount:

Account payable (L)

Cash discounts on purchase (R)

Cash (A)

3.500

70

3.430

Paid 3.500 euros to our supplier in advance, received a cash discount of 70



#### Recording purchases: sales tax receivable

In some countries (like Italy) there are taxes on sales (e.g. VAT, value added tax). In most cases, if we are a business and we are buying goods or services for our business activity, we pay for the taxes to our supplier but we are reimbursed for the taxes paid by the government.

Inventory (A)	1.500	
VAT receivable (A)	330	
Accounts payable (L)		1.830

Purchase of goods, cost 1.500+VAT 22%. Payment postponed.

 Who bears the cost of sales taxes like VAT is only the "final consumer" of the goods or services sold, that is the person who uses them for his own consumption and not to produce any other good or service



# Recording purchases:Summary

	TRANSACTIONS	PERPETUAL INVENTORY SYSTEM		
MAY 4	Purchase of merchandise on credit	Inventory (A)	3.500	2 500
		Account Payable (L)		3.500
MAY 6	Advance payment	Advance to supplier receivable (A)	1.500	
		Cash (L)		1.500
MAY 8	Purchase returns and allowances	Account Payable (L)	300	
		Inventory (A)		300
MAY 12	Purchase discounts	Account Payable (L)	3.500	
		Cash (A)		3.430
		Cash discounts on purchase (R)		70



# **Review Questions**



### **Review Question**

A company makes a credit sale of € 750 on June 13 terms 2/10 n.30 What amount is received on June 23?



### **Review Question**

What is a purchase discount?