

Remember - CASH Discounts

Seller Perspective

2/10 N/30 ~~CAF~~

Gross Method

vs

Net Method

Ignore discount unless customer takes it

Assumes customer would take the discount

ACCT

"Sales Discounts"

if customer takes discount in time

Contract Account to Sales Revenue

ACCT

"Sales Discounts forfeited"

if customer does not take (Expense in income) \Rightarrow to Interest income

Flip Side Purchaser Discounts

Gross Method

viewed as part of cost of inventory

Discounts NOT taken - ~~viewed~~

Net Method

viewed as Interest Expense

COST of inventory includes Net after discount

NO, unless ~~not~~ taken discount

Yes

Am 2 Supplement

Purchase Discounts

- Represents reductions in the amount to be paid by the buyer if remittance is made within a designated period of time
- **2/10, n/30**—means a 2% discount if paid within 10 days, otherwise full payment within 30 days
- Recorded by either gross method or net method

On October 5, Lothridge purchases \$20,000 of inventory and is offered a discount of 2% for any amount paid within 10 days. The full invoice is due within 30 days. (Lothridge uses a perpetual inventory system)

October 5, 2021	Debit	Credit
Gross Method		
Inventory	20,000	
Accounts payable		20,000
Net Method		
Inventory	19,600	
Accounts payable [$\$20,000 - (\$20,000 \times 2\%)$]		19,600

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*Gross...
View
discounts not taken as part of cost of inventory*

Perpetual inventory system

Illustration 8-5 Purchase Discounts Using the Gross Method versus Net Method—Perpetual System

Discounts offer incentives to the buyer to make quick payment. The amount of the discount and the time period within which it's available are conveyed by terms like 2/10, n/30 (meaning a 2% discount if paid within 10 days, otherwise full payment within 30 days). As with the seller, the purchaser can record these **purchase discounts** using either the **gross method** or the **net method**.

*Net
View
discounts not taken as interest expense*

On October 5, Lothridge purchases \$20,000 of inventory and is offered a discount of 2% for any amount paid within 10 days. The full invoice is due within 30 days.

Under the gross method, we record the purchase for the full (or gross) amount of the inventory's cost.

Under the net method, we record the purchase of inventory for its \$20,000 cost minus the possible discount of \$400 ($\$20,000 \times 2\%$), resulting in a net purchase amount of \$19,600.

The purchases account is used instead of inventory in a periodic inventory system.

Compare.

*ROR Summary:
SEE ATTACHED SPREAD SHEET
2-PP CH 4 SUPP 2*

Purchase Discounts (continued)

Lothridge paid \$13,720 (\$14,000 less the 2% cash discount) on October 14 (during the discount period). Lothridge employs a perpetual inventory system.

$\$14,000 \times 2\%$

October 14, 2021		Debit	Credit
Gross Method			
Accounts payable		14,000	
Inventory			280
Cash			13,720
Net Method			
Accounts payable		13,720	
Cash			13,720

08-30

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*purchase discount
Reduces the cost of the inventory
Perpetual inventory system*

Illustration 8-5 Purchase Discounts Using the Gross Method versus Net Method—Perpetual System

On October 14, Lothridge decides to make payment for \$14,000 of the \$20,000 purchase. Because payment is within the 10-day discount period, the company receives a discount of \$280 ($\$14,000 \times 2\%$) and must pay only \$13,720 ($\$14,000 - \280). The discount effectively reduces the cost of inventory.

Under the gross method, we record the discount by decreasing the inventory account.

Under the net method, the discount was recorded at the time of the purchase, so no further reduction to the inventory account is needed at the time of payment.

The purchase discounts account is used instead of inventory in a periodic inventory system.

eg

A/c payable	14000	
purchase discount		280
CASH		13,720

4 periodic system

Purchase Discounts (concluded)

The remaining balance of \$6,000 was paid on November 4 (after the discount period). Lothridge employs a perpetual inventory system.

$$\$6,000 \times 2\%$$

November 4, 2021		Debit	Credit
Gross Method			
Accounts payable		6,000	
Cash			6,000
Net Method			
Accounts payable		5,880	
Purchase discount lost		120	
Cash			6,000

08-31

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Illustration 8-5 Purchase Discounts Using the Gross Method versus Net Method—Perpetual System

On November 4, Lothridge makes final payment for the remaining \$6,000 of inventory. This payment is after the 10-day discount period. Lothridge loses the possible discount of \$120 ($\$6,000 \times 2\%$).

Under the gross method, we simply record the payment on account.

Under the net method, we record the purchase discount lost. Most companies that use the net method expect to pay within the discount period. In practice, purchase discounts lost are generally immaterial.

*Perpetual
Inventory
System*