

47.2 An exercise on accounting for price discounts

In accounting, price discounts are normally considered only as insofar as they affect the calculation of a selling price. Once a selling price has been determined, the transaction is recorded at that price, with no separate record of the discount.

BUSINESS 5

At the height of the ‘dot.com boom’ (leading up to the year 2000) when the commercial exploitation of the Internet seemed to offer immeasurable wealth to the firms that got there first, new companies building a business on the Internet were rated by investors and analysts on the basis of sales growth. Profits were not expected. The essential thing was to gain customers and sales, from which it was expected that profits would flow in the future.

One such firm offered a *price* discount of £50 on all sales of £50 or more, and was immediately swamped with orders for goods with a value of exactly £50, or very little more.

Describe at least two ways in which these transactions *could* be reported in a firm’s P&L Account, and state the way in which the company (in the circumstances) would be most likely to account for them. Comment.

Response

Option 1: the convention accounting for price discounts is to take the agreed price to be paid as the value of the transaction to be recorded. Thus if goods with a list price of £54 are sold (after a special price discount of £50) for £4, the double entry to record the sale would be:

DR	Money or Promises	£4	
CR	Sales		£4

Option 2: a less conventional approach would be to account for such a sale at the full price of £54, with money or promises of only £4 coming in to pay for the sale, and the £50 special price discount recorded as an expense in the P&L Account like this:

DR	Money or Promises	£4	
DR	Special Price Discount (P&L Account)	£50	
CR	Sales		£54

In the circumstances the company would be most likely to adopt option 2 – this would inflate reported sales, in line with investors' wishes.