BLUE ONION

GUIDE

Streamlining Ecommerce Accounting Setbacks: Returns & Refunds; Discounts, Promotions, & Complimentary Products; and Gift Card Sales & Reward Programs

Navigating the ecommerce ecosystem as a professional in accounting and finance is no easy feat. From complicated returns and refunds, to flash sale promotions and gift cards that sit frozen in someone's virtual (or physical) wallet, we get that a headache awaits around every corner and only grows with things like seasonal trends and holidays.

The good news? We're here to help you master your ecommerce accounting by helping you to solve and streamline these common, but complex setbacks.

Refunds & Returns

Did you know that the average ecommerce return rate rests at around 20-30%? While the return rate may fluctuate based on the sales sector and timeframe, it's a figure that can truly throw a wrench in the works of closing the books.

Shopify reports that in 2023, the average return rate for online purchases stood at 17.6%, surpassing the average retail return rate of 14.5% and the brick-and-mortar stores' average of 10.02%. Interestingly, certain sectors like luxury apparel, swimwear, and bra retailers experience even higher return rates, sometimes hitting as high as 50%.

So, as return transactions flow in, what's the best way to capture the return data and what should you look out for? We're covering the basics and then some.

WHAT'S CONSIDERED A REFUND VS. A RETURN IN ECOMMERCE ACCOUNTING?

- A **return** is when a customer sends back (or returns) an item to the store or the warehouse.
- A **refund** is when a customer receives part or all of their money back - or when the brand refunds a customer's payment.

Depending on the company's policy, a customer may need to return an item before their money is refunded.

WHAT ARE THE KEY CHALLENGES IN RECORDING REFUNDS OR RETURNS IN ECOMMERCE?

A key challenge in recording refunds or returns in ecommerce is ensuring accuracy and efficiency. However, this requires a system for properly tracking and recording refunds and returns. This includes outlining timeframes for when returns can be accepted, if exchanges are allowed, any restocking fees that may apply, and how refunds will be issued (i.e. store credit or original form of payment).

With the high volume of transactions that occur online, it can be difficult to keep track of all the returns and refunds that need to be processed. This is especially true for brands with multiple channels, such as an online store and physical retail locations. It's important to have a centralized system in place to properly process requests, track transactions, and avoid any discrepancies or errors - like refunding a customer but never receiving the goods back into inventory.

There are some companies where you can't (or shouldn't) return a product - this is typically true in verticals such as beauty or food and beverage. In these cases, the company is primarily concerned with refunds since they don't typically accept returned products.

While companies that do accept returned goods such as clothing want to ensure they receive the product in good standing and can re-add it back into their inventory so they can eventually re-sell it. Above all, it's important for businesses to establish clear return and refund policies, transparently communicated to customers. This not only reduces confusion but also prevents disputes, ensuring a smooth customer experience.

TIP: There are some great return programs out there to help facilitate the customer service and operations component, including Loop Returns and Happy Returns. These services allow customers to easily initiate returns and provide tracking updates throughout the process.

HOW SHOULD REFUNDS OR RETURNS BE RECORDED TO COMPLY WITH GAAP?

As every company's setup and refund policy is different we recommend working directly with your auditors. While we can't provide specific financial advice, what we typically see are companies creating a contra revenue account for sales returns and allowances. This refers to booking the full amount of sales and then based on historical performance booking a refund amount based on the expected value of refunds.

Here are some additional general guidelines to keep in mind when recording refunds and returns:

- First, it's important to understand that refunds and returns are considered liabilities for a company and should be recorded as such on the balance sheet. This is because they represent an obligation to give back money or products to the customer. Once a refund request is received and approved, it should be recorded as a liability on the balance sheet.
- When recording refunds, it's important to have a clear policy in place. This includes outlining what items are eligible for a refund, any time limits for requesting a refund, and how the refund will be processed (e.g. cash or store credit).

HOW DOES BLUE ONION HELP TO MAKE THIS PROCESS EASIER?

Refunds logged in Blue Onion are matched back to their original order. Finance and accounting teams can use this data to estimate a company's expected refunds, see how many days on average between an order and a refund, and have better visibility into how refunds are impacting cash flow.

For those companies that use third-party refund and return applications, we can help simplify their accounting impact, specifically around fully discounted orders, exchange transactions, and gift cards.

Discounts, Promotions, & Complimentary Products

Ecommerce brands are constantly brainstorming innovative strategies to encourage customers to make more purchases - from Buy One, Get One (BOGO) free deals to can't-pass-up discounts to free gifts with purchase. But what's the most optimal accounting approach for tracking and reconciling these enticing programs?

WHAT ARE THE KEY CHALLENGES IN RECORDING AND RECONCILING DISCOUNTS, PROMOTIONS, & COMPLIMENTARY PRODUCTS IN ECOMMERCE?

It can be tough to effectively track and manage the myriad of discounts, promotions, and freebies that businesses in ecommerce frequently roll out - especially when spanning multiple products or limited-time windows. However, proper accounting for discounts and promotions is critical for accurate revenue recognition.

It's important to consider that with the use of discounts and promotions, the details surrounding a product like final cost or code may change frequently, which can make it difficult for accounting teams to properly record the transaction and ensure that it is reflected accurately in financial statements. Also, different types of discounts may need to be recorded differently (e.g., sales discount vs. trade discount), which adds another layer of complexity in reconciling these transactions.

Additionally, discounts and complimentary products often have specific terms and conditions attached to them, such as minimum purchase requirements or expiration dates. These conditions can vary and change over time, making it even more challenging to track and reconcile these transactions accurately.

IMPORTANT TO NOTE: A complimentary order is an order that's 100% discounted and could be used for a customer service issue (i.e. free replacement order) or in lieu of a free gift card for the company's VIPs or people they're hoping will promote the brand. We often see accounting teams separate these orders out — taking them out of revenue and discounts and booking them at the item's cost as a marketing or customer service expense.

For a lot of teams, a key challenge is identifying which orders are related to customer promotions and which orders are related to non-sale activities like influencer marketing or customer service. When planning, aim to differentiate between marketing discounts, promotions, and complimentary orders for a more accurate and efficient approach to reporting.

HOW SHOULD DISCOUNTS OR COMPLIMENTARY PRODUCTS BE RECORDED TO PROPERLY COMPLY WITH GAAP?

The general rule of thumb we've seen is if the discount is related to a customer transaction then it needs to be part of revenue and contra revenue. If it's not related to a sales event, such as influencer marketing or customer service issues, then it gets classified as an expense at cost.

Companies often set up a contra revenue account for discounts, recognizing them when the item is fulfilled and revenue is acknowledged. At the end of the day, every company's setup and promotional strategy is different and we recommend working directly with your auditors to ensure you're correctly accounting for the nuances of your business.

HOW DOES BLUE ONION HELP TO MAKE THIS PROCESS EASIER?

Blue Onion helps accounting teams identify orders so they can group them into the appropriate category. You can see orders that are 100% discounted along with order tags, discount codes, and notes.

Gift Card Sales & Reward Programs

Gift cards stand out as a smart and convenient choice for turbocharging sales in ecommerce. They keep the sales momentum going post-holidays and rake in billions of dollars in revenue every year. By 2030, the global gift card market is set to skyrocket to $3.09 trillion. However, surprisingly (or not so surprisingly) around 47% of American adults let their gift cards gather dust, accumulating a hefty $23 billion in unspent funds.

From a financial viewpoint, gift cards enable businesses to pocket money in advance and lock in future revenue. Despite their sales and cash flow perks, managing gift cards can pose a real puzzle for accounting teams.

WHAT ARE THE KEY CHALLENGES IN RECORDING AND RECONCILING GIFT CARDS IN ECOMMERCE?

The sheer number of gift cards can be overwhelming for an accounting team to track and organize. There are a lot of moving parts to a single gift - the original sale, the full or partial redemption of that gift card, and in some cases, a refund back onto the gift card.

We also see companies creating gift cards for marketing initiatives or giving them to partners or employees. These gift cards can be challenging to track since they were never sold, however, they still represent a liability to the company.

There are also third-party applications that help companies manage their returns and exchange programs. The primary way they do this is by creating (and sometimes disabling) gift cards for customers to use in lieu of a cash refund or in advance of receiving the returned product. While great for customers and support teams, this can create a massive challenge for accounting teams.

HOW SHOULD GIFT CARDS BE RECORDED TO BE IN COMPLIANCE WITH GAAP?

Gift card sales increase the company's gift card liability (credit) and increase cash (debit) on the balance sheet. The company has already collected the cash for the gift card and will need to provide a good or service in the future.

When the gift card is redeemed, the sale is captured as an increase to deferred revenue (credit) and the gift card liability is decreased (debit).

HOW DOES BLUE ONION HELP TO MAKE THIS PROCESS EASIER?

Blue Onion creates an audit trail for gift cards from point of sale through partial or full redemption, along with tracking refunds.

Our software also classifies gift cards so it's easier to identify complimentary gift cards, as well as gift cards created through various third-party applications.

WHAT ARE THE KEY CHALLENGES IN RECORDING AND RECONCILING REWARD PROGRAMS IN ECOMMERCE?

Recording and reconciling reward programs where customers eventually get money off a purchase in ecommerce (like Shop Cash) can present several key challenges. These challenges include:

ACCURATE RECORDING OF REWARDS

One of the key challenges in managing reward programs is accurately recording all rewards earned by customers. This requires a comprehensive system for tracking and monitoring rewards, as well as proper documentation of all transactions related to the program.

ENSURING CONSISTENCY ACROSS PLATFORMS

Many ecommerce businesses offer their customers multiple channels to earn and redeem rewards, such as through their website, mobile app, or social media platforms. Ensuring consistency across these different platforms can be a challenge, as there may be inconsistencies in how rewards are tracked and redeemed.

MANAGING COMPLEX REWARD STRUCTURES

Reward programs often involve complex structures with various tiers, levels, and conditions for earning and redeeming rewards. This complexity can make it difficult to accurately record and reconcile rewards earned by customers.

DEALING WITH RETURNS OR REFUNDS

In cases where a customer returns or cancels an order after using their earned reward, the business needs to have a process in place for deducting the appropriate amount from the refund or issuing store credit instead.

HOW SHOULD REWARD PROGRAMS BE RECORDED TO BE IN COMPLIANCE WITH GAAP?

Reward programs should be recorded in compliance with GAAP by following these general guidelines:

IDENTIFY THE TYPE OF REWARD PROGRAM

The first step is to determine the type of reward program - whether it is a customer loyalty program or a sales incentive program

TRACK REDEMPTION AND EXPIRATION OF REWARDS

Proper tracking of redeemed reward dates and expiration dates is crucial for accurate financial reporting and compliance with GAAP.

ALLOCATE COSTS TO INDIVIDUAL TRANSACTIONS

For customer loyalty programs, companies should allocate a portion of the reward cost to each transaction based on its estimated redemption rate. For sales incentive programs, the cost should be allocated to individual transactions based on their associated sales or revenue.

RECORD LIABILITIES FOR UNREDEEMED REWARDS

Companies should record a liability for any unredeemed rewards at the end of each reporting period. This liability represents the future obligation to provide goods or services (as long as they don't expire) in exchange for the accumulated rewards.

HOW DOES BLUE ONION HELP TO MAKE THIS PROCESS EASIER?

Overall, managing reward programs in ecommerce requires a well-designed and integrated system that can accurately track and reconcile rewards at every stage of the customer journey.

Blue Onion's Shop Cash feature to trace and allocate Shop Cash payouts to their original orders. This simplifies deposit reconciliation and ensures seamless integration into the General Ledger.