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Returns and Refunds

ACCOUNTING GUIDE FOR ECOMMERCE BUSINESSES

SPEND LESS TIME MANAGING RETURNS AND REFUNDS WITH EFFICIENT ACCOUNTING STRATEGIES AND AUTOMATED TOOLS

Disclaimer

The information and advice given in this guide is general in nature and does not take into account your objectives, financial situation, or needs. You should consider whether the advice is suitable for you and your personal circumstances. Before you make any decision about whether to acquire a certain product or service, you should obtain and read the relevant product disclosure statement or other relevant documents.

About Amaka

Amaka offers accounting integrations to sync sales and payments from eCommerce and POS systems to cloud-based accounting software. The integrations automate data entry and fast-track the bank reconciliation process. We're trusted by over 90,000 small businesses and accounting professionals globally with over 1,400 5-star reviews.

We offer our integration solutions on a freemium model, with a 100% free plan available for businesses with less than 60 transactions per month. For businesses operating above that, our premium plan comes with a 7-day free trial. Our 5-star rated customer support team offers completely free 1-on-1 support sessions, for both free and premium customers, to walk you through the setup process and to answer any questions you may have.

About ReturnGO

ReturnGO is a complete post-purchase solution that automates everything from order tracking to returns and exchanges all in one place. With advanced automation capabilities at its core, ReturnGO offers a fully customizable return policy, enabling eCommerce businesses to tailor the return process to handle any scenario, no matter how complex.

ReturnGO seamlessly integrates with any eCommerce platform and any other systems and service providers you currently use, making it a flexible solution for businesses of all sizes and types, for an efficient workflow. Comprehensive returns analytics offer valuable insights into return patterns and customer behavior, so you can make data-driven decisions. ReturnGO's customizable platform provides the flexibility and control online merchants need to balance profitability with a positive customer returns experience.

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Introduction

As the eCommerce industry booms, more and more budding entrepreneurs are starting their own businesses. The barriers to entry can be quite low, meaning almost anyone can become a seller on platforms like Shopify, BigCommerce, or WooCommerce.

However, a key pain point for many businesses is managing returns while keeping customers satisfied. When handled incorrectly, there are a myriad of costs that can add up. In order to effectively analyze customer behaviors and make informed decisions to improve returns, you need precise accounting processes.

Fortunately, we've put together this comprehensive guide with everything you need to know to manage your returns effectively, understand your accounting, and draw insights that help you make business decisions.

CHAPTER 2

What are eCommerce Returns?

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An eCommerce return occurs when a customer who has purchased a product from an online store decides to return it to the seller. There are five key types of returns that each serve a different purpose and each impact your business differently. By offering the right types of returns for your business, you can increase customer satisfaction and repeat buyers.

Refunds

Refunds are the most straightforward and well-known type of return. Refunds are where your customers get some or all of their money back when returning an item.

How quickly and easily refunds are processed plays a crucial role in shaping your customers' return experience. In fact, 65% of customers say the speed and ease of refunds affect where they choose to shop. By offering a quick and efficient refund process you can encourage customers to keep coming back to your store.

While refunds offer simplicity and convenience for customers, they're not always ideal for your business. Refunds result in lost revenue and potentially, the loss of future business from that customer. This is why it's often beneficial to explore ways to convert refund requests into exchanges or alternative options whenever possible.

Exchanges

Offering easy exchanges is an effective strategy to decrease your refund rate and maintain revenue. When customers need a different size or color of the same item, a simple exchange process can often meet their needs. The two primary types of exchanges are variant and product exchanges.

Variant Exchange

Variant exchanges are where a customer swaps an item for a different version of the same item, such as another size or color. Since many returns are due to size or style issues, offering variant exchanges can resolve a large portion of your return requests.

Product Exchanges

Product exchanges are where customers swap their original item for an entirely different product from your store. When the new item costs more than the original, customers might need to pay the difference, and if it's less expensive, the difference can be refunded.

Store Credit

Offering store credit instead of full refunds for eCommerce returns can be a more strategic and beneficial approach. While customers may not take immediate action, store credit keeps them loyal to your brand, as they can only use it with your store

About 68% of customers who receive store credit make another purchase, often spending an additional $20 on average. So offering store credit helps increase your customer lifetime value (CLV) and, as a result, your overall profits.

Additionally, store credit can be used as an incentive, with bonus credits offered to encourage specific return methods or special promotions, ultimately increasing CLV and overall profits.

Gift Cards

Another form of virtual currency that you can offer instead of a refund is gift cards. Using them can be a smart strategy since they allow you to retain revenue while also keeping your customers satisfied.

When you issue a gift card refund, you keep the original revenue from the sale in your store while also ensuring that the customer is happy and increasing the chances of them buying from you again. We'll go through the accounting for gift cards later on.

Each eCommerce platform treats gift cards and store credit slightly differently. In Shopify for example, store credit is associated with a certain customer account and can be accumulated, whereas gift cards aren't customer-specific and can be used to pay for the entire amount of an order, including fees and shipping in the same way as credit cards.

Warranty Claims

While warranties are often overlooked as a type of return, handling a product warranty claim is just like processing any other kind of return request. The main difference is in the policy conditions and eligibility.

Types of Warranty

- **Extended Warranty or Service Agreement:** Extends protection beyond the manufacturer's warranty, offering peace of mind for high-value purchases.
- **Third-Party Warranty:** Covers repairs or replacements for products not bought directly from your store, enhancing customer service and standing out despite verification challenges.
- **Accidental Damages and Handling (ADH) Plan:** Protects products damaged during shipping, reassuring customers about making high-value purchases.
- **Implied Warranty of Merchantability:** Assures that products meet basic expectations of quality and functionality.
- **Implied Warranty of Fitness:** Guarantees a product for a specific use, based on recommendations beyond basic expectations.

CHAPTER 3

Understanding the Financial Impact of Returns and Refunds

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Understanding the Financial Impact of Returns and Refunds

Returns and refunds are a fundamental aspect of eCommerce, but their financial impact is often underestimated. These processes don't just reverse sales—they can also influence key financial metrics and introduce unexpected costs. Understanding the full scope of these impacts is essential for maintaining a healthy bottom line and making informed business decisions.

Revenue Recognition

When a product is returned by a customer, the initial sale needs to be reversed, therefore reducing the revenue previously recognized. This reduction can have a ripple effect across several key financial metrics such as net sales, CLV, and customer acquisition cost (CAC) can be skewed.

For example, if your business has high return rates over a period of time, your net sales will suggest weaker performance. However, your gross sales may still be strong in comparison. Hence, it's important to understand how returns can impact different metrics to get a complete understanding of your financial performance.

Similarly, CLV, the total revenue you can expect from a customer in the long-term, can be skewed by returns. If a customer has been given refunds, the actual revenue they generate is lowered. Hence, you have to adjust how much you're willing to spend on acquisition and retention.

Cost of Goods Sold (COGS)

The Cost of Goods Sold (COGS) represents the direct costs associated with producing or purchasing the goods a company sells during a specific period. Returned items need to be inspected and then restocked or written off. If restocked, you may have to sell the product at a discount, thereby adjusting the COGS (cost of goods sold).

For example, you initially sold a handmade necklace for $250 with a COGS of $90. However, when it was returned to you, the box you sold it in was damaged and the cost of replacing it was $5. Additionally, you spend an hour of your time inspecting, repackaging and restocking the item. This labor costs your business $20. The COGS is now $115.

You may decide to sell the necklace at a discounted price of $200 since it's a return item. In this case, the gross profit (revenue – COGS) will change drastically as well. It was initially $160 ($250 – $90) and would now be $85 ($200 – $115).

Logistics and Handling

Beyond the direct financial implications of returns, there are logistics and handling costs, such as shipping, warehousing, and disposal. These costs, often overlooked, can accumulate quickly and significantly impact the overall profitability of a business. Understanding and managing these expenses is crucial for maintaining a healthy bottom line.

One of the most immediate and tangible costs is the expense of return shipping. In many cases, businesses offer free returns as part of their customer service strategy, absorbing the shipping costs themselves. Even when customers cover return shipping fees, the logistics of coordinating these returns still incur costs for the business. For companies that operate on thin margins, these shipping expenses can quickly erode profitability, particularly if return rates are high.

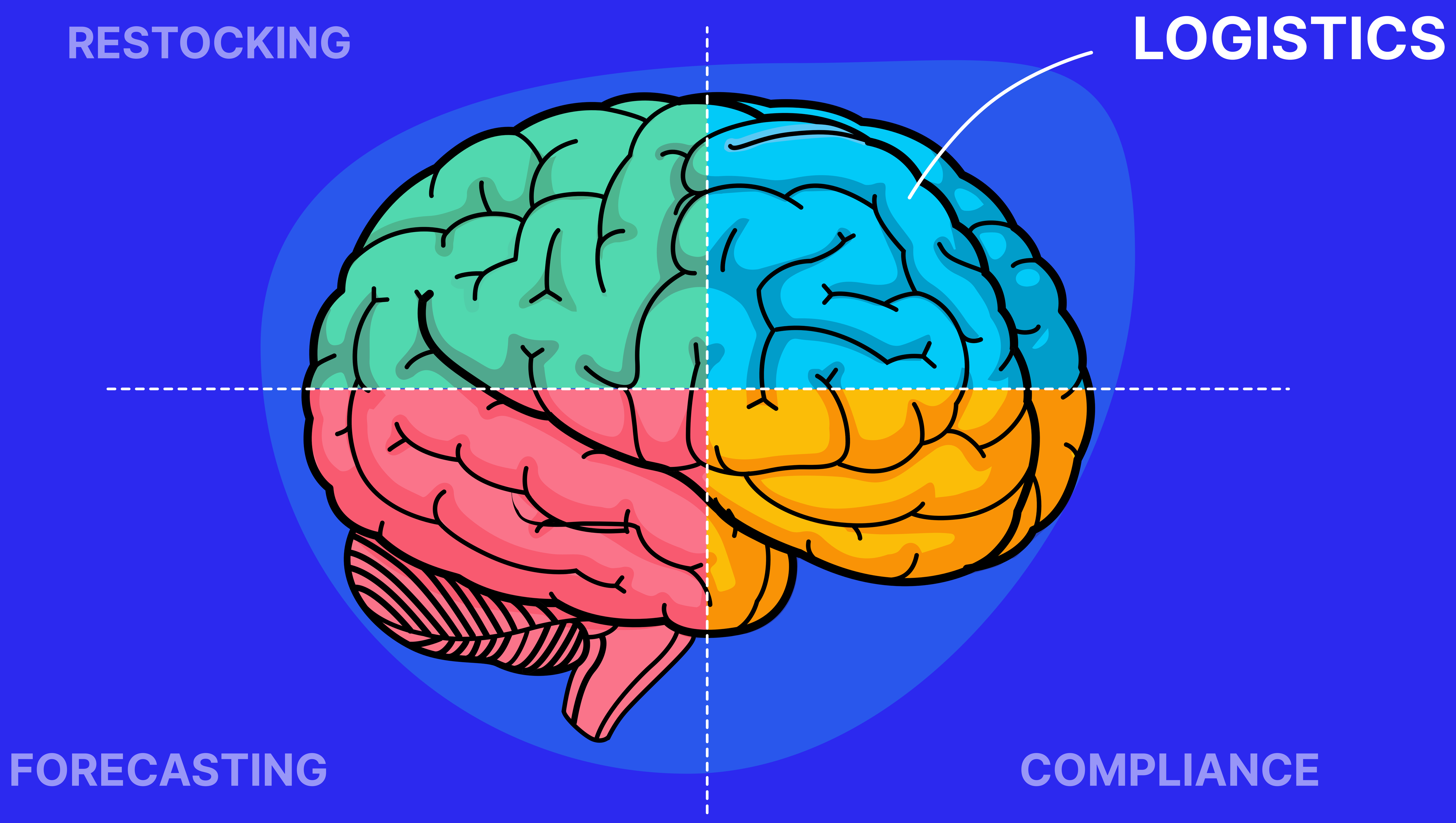
Additionally, the cost of shipping replacement products, in cases where an exchange is requested, further adds to the logistical burden. This can double the shipping expenses for a single transaction, making it a significant cost factor in managing returns.

Handling returns also puts pressure on warehouse operations. Returned items need to be processed, sorted, and re-entered into inventory systems. This requires not just labor but also warehouse space, which is a finite and costly resource. Furthermore, high return rates can lead to overstock situations where the warehouse holds more inventory than necessary.

Items that are damaged, outdated, or otherwise unsellable must be disposed of. Disposal may include recycling fees, waste management services, or even environmental compliance costs. Some businesses opt to invest in recycling or donating unsellable items to reduce their environmental impact. While these practices are beneficial, they also introduce additional costs that must be factored into the overall return management strategy.

CHAPTER 4

Challenges in Managing Returns and Refunds



CHAPTER 4

Challenges in Managing Returns and

One of the major benefits of running an e-commerce business is the access you have to a range of different apps. Amaka is the gold standard in accounting integrations, allowing you to sync transactions to your accounting software. Once you're set up, data entry becomes completely automated and bank reconciliation becomes lighting-fast.

Logistical Challenges

First and foremost, returns come with a few logistical challenges. When returned items arrive at your warehouse, they need to be carefully inspected to determine if they can be resold, or if they need to be repaired or just disposed of. There need to be clear processes and guidelines in place to minimize delays and ensure consistency.

In the case that an item is deemed suitable for resale, it then needs to be restocked physically as well as in the inventory management system. As explained in the accounting chapter later on, this may involve adjusting records as well.

Lastly, you need to determine if your business will charge a handling fee for returns. There's a difficult balance between covering your business costs and keeping customers satisfied. That's why we generally recommend incentivising customers with options other than traditional refunds such as store credit, thus keeping the revenue in the store.

Forecasting Return Rates

The next challenge that eCommerce businesses face when handling returns and refunds is the ability to accurately predict return rates. Returns impact revenue forecasting by reducing recognized sales and consequently, net sales, CLV and CAC. Hence, it's important to consider seasonality, product types and customer behavior related to returns when forecasting your revenue.

Maintaining Compliance

Finally, there are a range of different regulations associated with returns and refunds that you may need to comply with depending on your location. For instance, there could be consumer protection laws that limit what you can include in your return policies. Proper accounting for returns and refunds is also essential for tax compliance.

CHAPTER 5

Accounting for Returns & Refunds: Key Principles

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Accounting for Returns and Refunds: Key Principles

Effective accounting for returns and refunds is essential to maintain accurate financial records, both for compliance and so that your business can make informed decisions. Returns and refunds can complicate your accounting processes, but managing these doesn't have to be difficult.

Why Do You Need Accurate Accounting?

Accurate accounting for returns ensures that your financial statements reflect the true state of your business. Precise data allows you to analyze customer behavior, identify trends, and pinpoint product or service issues. This information is invaluable for making informed business decisions, such as improving customer satisfaction and minimizing return rates.

Furthermore, accuracy in accounting is vital for compliance and auditing purposes. Adhering to accounting standards and regulations is non-negotiable, and discrepancies in your records can lead to significant issues during audits. For this reason, working with a tax accountant is highly recommended to ensure that all transactions are correctly recorded and that your business meets regulatory requirements.

Standard Accounting Entries for Returns and Refunds

When handling returns and refunds, it's important to follow standard accounting practices to ensure that every transaction is accurately reflected in your books. When a product is returned, the initial sale must be reversed. This involves creating a journal entry that debits the sales revenue account and credits the accounts receivable or cash account.

Upon receiving a returned product, your inventory records need to be updated. If the item is restocked, you must increase your inventory account by the cost of the item. Conversely, if the item is written off due to damage or other reasons, it's necessary to recognize a loss by increasing the Cost of Goods Sold (COGS) account.

For example, you sell a leather jacket for $150 with a COGS of $70. Here's how you would reverse the original sale. This reversal ensures that the revenue previously recognized is now removed, reflecting the fact that the sale no longer contributes to the company's net sales.

Original Sale Entry:
- **Debit** Accounts Receivable (or Cash) $150
- **Credit** Sales Revenue $150

Entry to Reverse the Sale:
- **Debit** Sales Revenue $150
- **Credit** Accounts Receivable (or Cash) $150

In the case that you can restock the item, you must include an entry to restock the item.

Original COGS Entry:
- **Debit** Cost of Goods Sold (COGS) $70
- **Credit** Inventory $70

Entry to Restock the Item:
- **Debit** Inventory $70
- **Credit** Cost of Goods Sold (COGS) $70

However, in the case that the value of the item has reduced due to damage or other factors, you will also need to record this. This entry accounts for the reduction in the jacket's value, recognizing the loss as an expense and ensuring that the inventory value accurately reflects the product's current worth.

Original Inventory Value: $70
New Value After Write-Down: $50

Entry for Inventory Write-Down:
- **Debit** Loss on Inventory Write-Down $20
- **Credit** Inventory $20

Using Gift Cards for Return Management

Finally, a unique accounting situation to consider is the use of gift cards for return management. On many eCommerce platforms, rather than issuing a refund, your eCommerce business can issue a gift card to encourage customers to make additional purchases with your store. It helps to retain customers and can increase sales when customers spend more than the gift card amount.

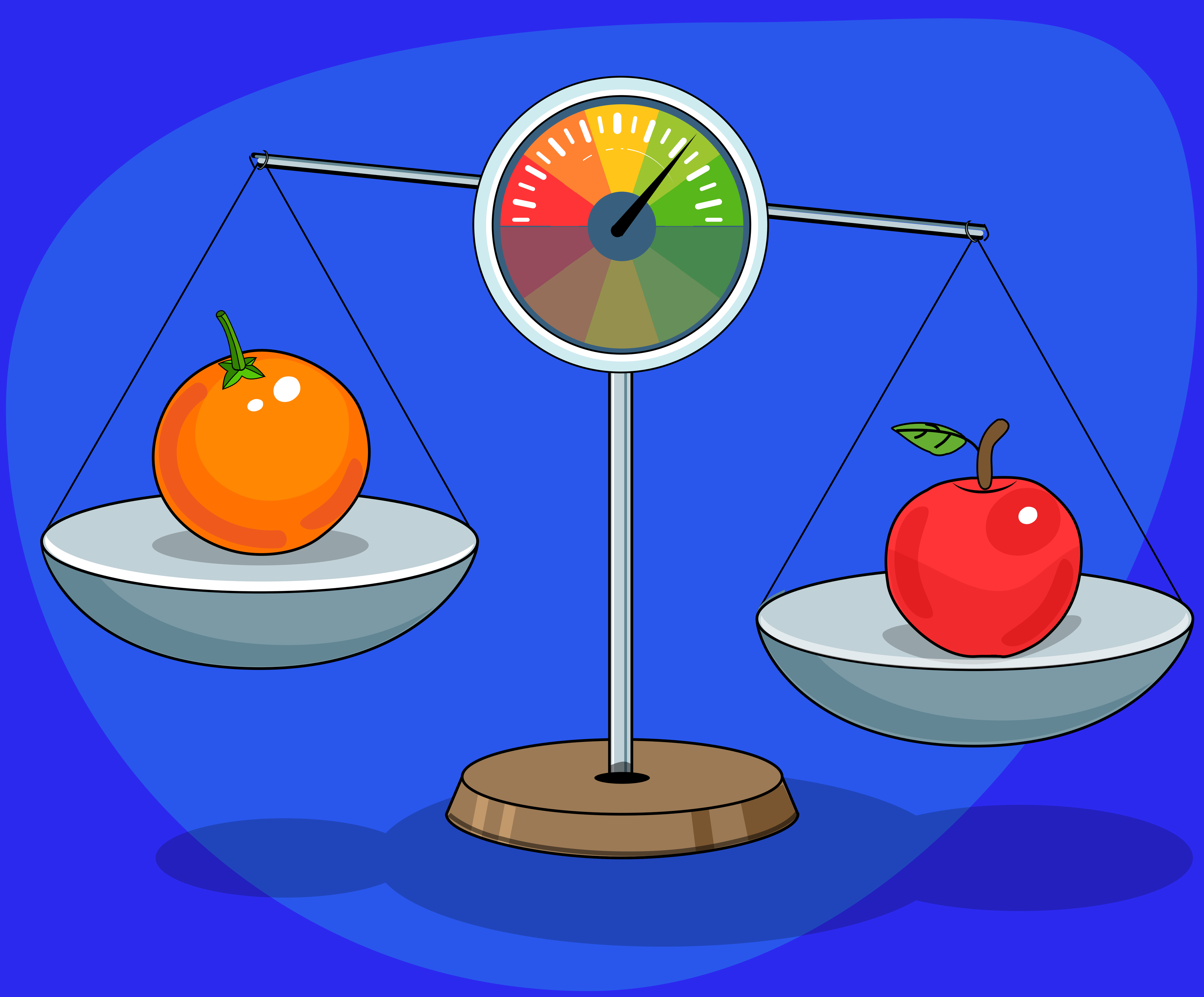
To record this, the revenue from the original sale remains the same and the gift card is entered as a liability. The liability represents your store's obligation to honor the gift card when it's used in the future. After the customer uses the gift card, the liability is settled.

Let's refer back to the previous example. You sell a leather jacket for $150 but in this case, the customer is issued a $150 gift card instead of a cash refund. Your company retains the revenue, but records a liability for the gift card. This entry removes the revenue from the sale and replaces it with a liability, which will be settled when the customer uses the gift card.

Entry to Record Gift Card Issuance:
- **Debit** Sales Revenue $150
- **Credit** Gift Card Liability $150

CHAPTER 6

Best Practices for Accurate Accounting



CHAPTER 6

Best Practices for Accurate

Fortunately, there are a few best practices that you can use to make accounting for returns as easy as possible. This involves maintaining accurate records, doing periodic audits, and considering working with a professional.

Start with an Accounting Software

To get started, you want to create an integrated ecosystem where all your different systems communicate seamlessly. Your accounting software should act as the core of this ecosystem and as the source of truth. Aim to find one that can integrate with your eCommerce platform, expense management, inventory management, CRM system, and any other tool you commonly use.

Automate Data Entry with Amaka

Then, you can automate the data entry process through an accounting integration by Amaka. By syncing transactions from your eCommerce platform directly to your accounting software, you can save dozens of hours every month. Amaka's accounting integrations also make bank reconciliation lightning fast by automatically matching up transactions to your bank feed.

All kinds of transactions including sales, payments, refunds, gift cards, shipping and more are automatically synced. Refunds automatically appear as a credit note or negative amount. You can rest assured that your data is up-to-date and accurate.

Benefits of Using Amaka

- ✔ Completely free plan available as well as affordable paid plans.
- ✔ Save hours on manual data entry and reconciliation.
- ✔ Sales, fees, taxes, COGS, discounts, shipping, gift cards, tips, refunds and more are automatically synced.
- ✔ Custom account mapping and grouping options.
- ✔ Unlimited, round-the-clock support from a CPA-trained support team through video call or help desk.

You can schedule a full walkthrough of an integration with our support team at a time that suits you. Otherwise, get started on a 100% free plan with basic features or a 7-day free trial for premium plans.

Periodic Audits and Reconciliations

Performing regular audits and reconciliations is a crucial part of maintaining the integrity of your financial data, especially when dealing with returns. Audits help verify that your records match actual sales and inventory levels, while reconciliations ensure that your accounting system aligns with your bank statements.

Conducting periodic inventory audits ensures that returned items are accurately tracked and properly reflected in financial records. These audits help verify that restocked items are recorded correctly, discounted sales are accounted for at their lower value, and unsellable products are properly written off.

Reconciliation is the process of comparing the transactions in your books to your bank statement to ensure there aren't any discrepancies. This is typically a manual process that could take many hours.

Though Amaka's integrations speed up this process by automatically suggesting matches between your accounting software and bank feed, it could still take awhile in the case that you find a discrepancy. However, with Amaka's Managed Reconciliation Service, you can entirely outsource this process.

Working with an Accounting Professional

Working with professionals ensures that your accounting remains accurate and compliant with regulations. A tax accountant can help verify that all return transactions are recorded properly, preventing errors that could affect your financial statements. They can also assist in navigating complex issues like refund liabilities, inventory write-downs, and revenue recognition, helping your business avoid potential penalties during audits or tax season.

Additionally, experienced accountants can offer insights into optimizing your accounting processes. By leveraging their expertise, you can streamline return management and identify opportunities for cost savings or process improvements. This ultimately helps your business maintain financial transparency and positions you for sustainable growth.

CHAPTER 7

Strategies for Effective Return Management

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Strategies for Effective Return

There are several best practices that you can use to manage returns as efficiently as possible. We will discuss how to create an effective return policy, use a returns management system (RMS), and ensure compliance with local refund regulations.

We'll also explore how to reduce return rates and improve customer satisfaction through detailed product information and self-service return options.

Create a Clear Return Policy

A return policy outlines the specific requirements as to how, when, and under what conditions customers can return purchased items to your online store.

You should outline the steps that customers need to follow in order to return a product, as well as any limitations or exclusions that may apply. Also included in a return policy is the timeframe within which customers can return a product, the required condition of returned products, and any restocking fees that may be charged.

Make sure to comply with any relevant consumer protection laws that apply to returns and refunds, such as the right to a refund within a certain timeframe or the requirement to issue a full refund in certain circumstances.

With a returns management system like ReturnGO, you can automatically enforce your return policy with different smart rules per region, product type, return reason, and more.

For example, you could set different return windows for states or countries that require you to provide a refund within 30 days and for those that require you to provide a refund within 14 days. That way, only eligible items will be returned.

Automate the Returns Process with ReturnGO

Automating your returns process using ReturnGO's returns management platform can help create a better experience for customers while also saving you time and resources.

Create a branded return and exchange portal that lets customers do a self-service return or exchange. You can also encourage customers to choose alternatives to refunds that help to retain revenue.

Customize your returns workflow to automate as much of the process as you want. There is also a range of customization options to let you enforce your store's return policy, no matter how complex.

Manage your entire returns process in one place, and integrate with shipping services, warehouse management systems, and more to ensure your data is synchronized perfectly at all times.

Benefits of Using ReturnGO

- ✔ Offer a self-service return portal.
- ✔ Issue store credit, easy exchanges, and other smart refund alternatives.
- ✔ Automate the returns process to save time and money.
- ✔ Configure custom return policy rules.
- ✔ Integrate with a range of platforms, services, and providers.
- ✔ Track return analytics to inform business decisions.
- ✔ Keep customers updated on the status of their return.

ReturnGO also enables you to manage your online as well as in-person stores, so that customers can order online and return in-store, and the whole process is synced perfectly.

You can schedule a demo of the returns automation software at a time that suits you. Otherwise, get started with a 14-day free trial to try it out.

Analyze Returns Data and Reduce Return Rates

ReturnGO's returns analytics can help you with this by providing a comprehensive understanding of your returns data and enabling you to make data-driven decisions that lead to reduced returns rates and happier customers.

In order to discourage frequent returns, you can start by creating a return policy with specific guidelines. For instance, offering store credit instead of refunds to retain revenue, charging restocking fees, or passing the cost of return shipping to the customer.

Additionally, you can improve product listings with high-quality images, videos, descriptions, size guides, etc, to help customers make more informed purchasing decisions. By setting clear expectations for the customer in advance, they'll be less likely to return it.

CHAPTER 8

Current and Future Trends

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Current and Future Trends

Understanding the current and future trends in eCommerce returns and refunds is crucial for staying ahead in a competitive market. This chapter delves into the latest statistics and predictions to help you anticipate changes and adapt their strategies accordingly.

Current Trends

These trends give insight into the general expectations that consumers currently have. With these in mind, you can customize your own return policy to balance satisfying customers with profitability. For example, only 43% of stores offer store credit. By implementing this strategy, you can help your business stand out while retaining customers and reducing logistics costs.

Recent Insights from ReturnGO

- The average return rate is 18.5%.
- The most offered return resolutions include exchanges (83%), refunds (66%), store credit (43%) and gift cards (28%).
- The most offered return methods include ship with any carrier (61%), ship with prepaid label (53%), return to drop-off location (13%), and no shipment required (7%).
- 62.7% of eCommerce businesses offer fee-free returns, whereas 28.6% charge a return label fee.

Looking into the Future

As eCommerce continues to grow and evolve, so will the demand for returns automation technology. 80% of companies are already using or planning on implementing automation software and tools, a trend that will become almost universal in the eCommerce industry over the next few years.

Due to the expansion of eCommerce globally, returns management has to adapt to the complexities of managing cross-border returns. By automating the returns process with a returns management system, you can more easily manage the flow of returns across various countries and regions, including customs clearance, local regulations, and language barriers.

Additionally, 81% of consumers say they want more self-service returns options whereas only 15% reported that they were satisfied with current options. Hence, implementing a system such as ReturnGO can help you maintain a competitive advantage by both satisfying customers and reducing the time your team spends managing returns.

Sustainable Practices Likely to Become More Prevalent

- Reusing and recycling returned items instead of discarding them.
- Using biodegradable or recyclable packaging materials.
- Reducing return rates by improving product quality, accuracy, and descriptions.
- Supporting social causes or charities by donating returned items.
- Educating customers about the environmental impact of returns and encouraging them to make responsible choices.

CHAPTER 9

Final Words

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Final Words

All done! You're ready to tackle the bookkeeping and accounting for your returns and refunds on your own. Managing returns and refunds effectively is crucial for maintaining the financial health and operational efficiency of eCommerce businesses. Returns not only affect revenue recognition and profitability but also have far-reaching implications for metrics related to net sales, CLV, and inventory management.

By adopting best practices such as maintaining accurate accounting records, automating processes with tools like Amaka, and conducting regular audits, businesses can ensure that their financial processes are both efficient and compliant. Understanding the true financial impact of returns will enable you to make informed decisions that support both customer satisfaction and long-term growth.

Key strategies for effective return management include developing a clear return policy that aligns with consumer protection laws, utilizing automation tools like ReturnGO to streamline the process, and analyzing returns data to understand and address the underlying causes of returns. By implementing these practices, businesses can enhance their operational efficiency, increase profitability, and improve customer loyalty.

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