

Handling Prepayments in QuickBooks® Financial Software

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OVERVIEW

The document is intended for accountants and end users to better understand how QuickBooks works so they can use it in a way that best meets their needs.

A prepayment, deposit, down-payment or retainer occurs when one party provides cash to another party prior to receiving a good or service. Typically, there is an agreement that the money received is to be held by the recipient until a good or service is provided. After the good or service has been provided the cash received is applied against a sales invoice. If the good or service is not provided then the cash is normally returned.

In a retail environment a pre-payment may be required to initiate an order or put a product on hold. In a service organization a company may not commence their work until the customer provides some cash commitment or retainer. A rental company that provides space or assets by time may require deposits to protect the company from any incidental charges that are incurred. Companies that sell large assets such as cars or houses typically want a down-payment in order to hold the property for the customer.

Although different industries may use different terms for these transactions, they all have similar attributes. The task for the QuickBooks user is to record the money received and make sure it is tracked to the customer who provided the cash. Accountants normally report these payments on the balance sheet as a liability and refer to them as "Unearned Income". This indicates to the reader of the financial statements that this money has been collected, but not earned by the organization. Because it is a liability, the amount is presented as owing to another party. When the organization does follow through on providing the good or service then the unearned income becomes earned, the customer is invoiced and the revenue is recognized.

The document provides details on some alternative methods to record, track and report on these prepayments in QuickBooks

ALTERNATIVE APPROACHES TO RECORDING PREPAYMENTS

The document describes the steps required for the user to record, track and report on prepayments. These steps are broken down into five main areas.

1. Recording prepayments from customers
2. Tracking the prepayment to the customer
3. Invoicing the customer
4. Applying the prepayment to the Invoice
5. Financial reporting

Within these areas there are three alternative methods that can be taken based on the needs of the business:

1. A common method for recording the prepayment received is to enter it through the **Receive Payment** window. The advantage of this approach is that the prepayment is recorded using a workflow similar to other payments made on a customer's account. There is no additional setup, data entry procedure or training required. Also, if you are using the *QuickBooks Merchant Account Service*, the Receive Payment window can capture the funds from the customer's credit card so no additional steps are required for prepayments by credit card. Another advantage is that you can create a printable form (Credit Memo) that shows the customer's prepayment transaction.

The disadvantage of this approach is that the prepayments are combined with other balances in AR. This will understate your AR balance because the prepayment remains as a credit in AR instead of being shown as a liability for unearned income. To reclassify these credits at year end will require an additional journal entry.

Another disadvantage to this method is the potential of losing track of the income when reporting on a cash basis.

QuickBooks recognizes income on the **later of the (pre)payment date and the invoice date**, regardless of the date on which the prepayment was applied. If you are applying payments subsequent to a period end and the invoice date and payment date are prior to the period end, revenue will be reported in the prior period. This happens without warning the user about the change in the prior period cash basis income. Consequently, it is important to understand this impact when applying the credits.

2. A second method is to use the **Make Deposits** screen. The advantage of the Make Deposits method is that the prepayments are tracked separately in the Unearned Income account whereas the Receive Payments method tracks the prepayments as negative AR. Recording the prepayment directly to the Unearned Income account removes the need to reclassify the prepayments when creating financial statements and it eliminates the problem of unapplied credits on cash basis reports. Also, although there are extra steps involved, it is relatively easy to create detail or summary reports on the Unearned Income account that show detailed, or summarized transaction information by customer, so this method still allows detailed tracking of prepayments by customer, just not in the AR account.

The disadvantages of the Make Deposits method are there is no credit memo created and thus no "receipt" to print for the customer; the prepayment is not tracked with other invoices and payments in the customer's AR detail; the prepayment won't show on the Customer Statement; and extra steps are required to capture credit card funds if the customer pays by credit card.

Both the Receive Payment and Make Deposit approaches are described in detail below.

3. A third alternative to record a prepayment is to create an other charge item which is attached to the Unearned Income account. This item is entered on an invoice at the time the prepayment is received. The user then completes a Receive Payment for this amount which removes the entry from AR. When the goods or services are actually invoiced, the other charge item is included on the invoice, but this time as a deduction from the other items on the invoice. The net result is that the initial entry will report the prepayment as unearned income on the financial statements, without a credit balance in the AR account. In addition, the subsequent invoice will clearly identify to the customer the prepayment that was applied. There are no issues about the cash basis of reporting as the prepayment remains in the unearned income account. One disadvantage is that the prepayment will show up on the sales reports. This can be overcome by filtering, but it adds to the complexity of this approach. A summary of using a prepayment item is included in Appendix A.

RECORDING PREPAYMENTS FROM CUSTOMERS

The exchange between your company and the customer is initiated by the customer providing some form of cash "prepayment" to your company. It is assumed that your company wants to track this deposit and apply it to a future sales invoice or perhaps refund the prepayment to the customer. This initial prepayment can be recorded in the **Receive Payments** window, or in the **Make Deposits** window. We will walk through both approaches in the following pages.

Recording the Prepayment Using the Receive Payments Window

The prepayment can be entered in the **Receive Payments** window as shown in Figure 1.

The screenshot displays the 'Receive Payments' window. At the top, there are navigation buttons: Previous, Next, History, Journal, and Get Online Pmts. The main title is 'Customer Payment'. Below this, there are several input fields: 'Received From' (Bob Jones), 'Customer Balance' (0.00), 'Amount' (1,000.00), 'Date' (08/07/2006), 'Pmt. Method', 'Reference #', 'Memo', 'Card No.', and 'Exp. Date'. There is a checkbox for 'Process credit card payment when saving' and a 'Find a Customer/Invoice...' button. Below the form is a table with columns: Date, Number, Orig. Amt., Amt. Due, and Payment. The table contains a message: 'There are no unpaid invoices for this customer'. At the bottom of the table, there is a 'Totals' row with values: 0.00, 0.00, 0.00. Below the table, there is a box with the text: 'Overpayment \$1,000.00. When you finish, do you want to:' and two radio buttons: 'Leave the credit to be used later' (selected) and 'Refund the amount to the customer'. There are also buttons for 'Un-Apply Payment', 'Discount & Credits...', 'View Customer Contact Information', 'Save & Close', 'Save & New', and 'Clear'. To the right of these buttons is a box titled 'Amounts for Selected Invoices' with the following values: Amount Due 0.00, Applied 0.00, and Discount and Credits Applied 0.00.

Figure 1 Recording a prepayment using the Receive Payments window

Enter the amount received into the amount field and make sure that the amount is not applied to any outstanding invoices. If you have the preferences set to automatically apply payments you will need to un-check any invoices that were selected. In the example here, there are no existing open invoices for the customer, so the transaction simply records the receipt of money as a "credit" in the AR account for this customer. For more clarity about this transaction in the future, enter a memo that identifies the payment as a prepayment and the purpose of the prepayment.

When you save the transaction you will be prompted to print a Credit Memo for this amount as shown in Figure 2.

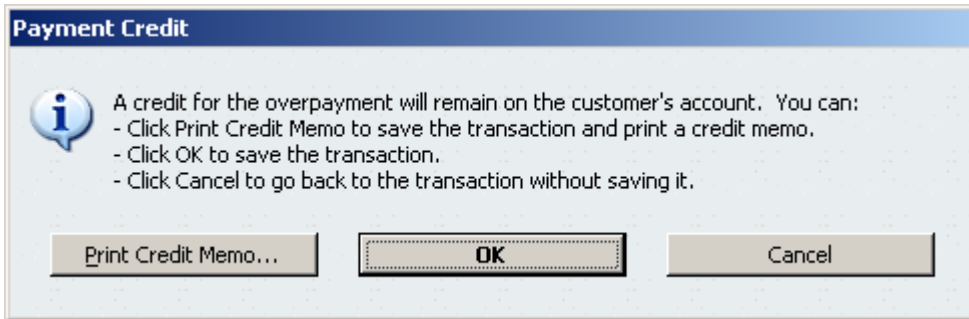


Figure 2 Options for handling the prepayment.

If your customer requires a receipt for the payment, print the Credit Memo.

The accounting entry generated by the transaction shown in Figure 1 is:

Debit Bank Account (or Undeposited Funds)

Credit AR

Using the Receive Payment should be a familiar workflow that keeps track of the payment within the AR account for the customer.

TRACKING CUSTOMER PREPAYMENTS

After the prepayment is recorded, it is useful to be able to see what prepayments are outstanding for each customer.

When Prepayments Were Recorded Using Receive Payments

If you entered prepayments using the **Receive Payments** method shown in Figure 1, the prepayments are a part of the AR detail for the customer. To see these summarized or detailed transactions, you can create an **Open Invoices** report.

To create the report, select the **Reports** menu, then **Customers & Receivables**, and then **Open Invoices**.

Type	Date	Num	P. O. #	Terms	Due Date	Class	Ag...	Open Balan...
Bob Jones								
Payment	08/07/2006							-1,000.00
Total Bob Jones								-1,000.00
Anderson Floors								
2nd Street Store								
Invoice	12/21/2005	4003		Net 30	01/20/2006	San Jo...	223	160.00
Total 2nd Street Store								160.00
Total Anderson Floors								160.00
Mason, Bob								
Invoice	12/18/2005	3947		Net 30	01/17/2006	San Jo...	226	415.68
Total Mason, Bob								415.68
TOTAL								-424.32

Figure 4 Open Invoices Report showing "open" invoices and prepayments.

As shown in Figure 4, prepayments are displayed on the Open Invoices report as negative amounts. Also, because you used the **Receive Payments** window to record the prepayments, they appear as **Payment** transactions in the Open Invoices report. To view more detail, double-click on any of the line items. The Customer Balance Detail (or Summary) report also provides the same information as the Open Invoices report.

The Open Invoices report shown in Figure 5 reflects the understatement in AR for Bob Jones. Any other open invoices for this customer will show in the list, so you can see which ones may need to have the prepayment applied to them.

On the Accrual Basis Balance Sheet, you can see the total balance in AR is understated because of the prepayments. The Accrual Basis Balance Sheet shows the total of all open invoices, reduced by all open (or unapplied) credits.

Academy Glass, Inc.		Aug 31, 06	
Balance Sheet			
As of August 31, 2006			
ASSETS			
Current Assets			
Checking/Savings			
Checking		17,959.60	
Money Market		<u>12,100.00</u>	
Total Checking/Savings		30,059.60	
Accounts Receivable			
Accounts Receivable		<u>-424.32</u>	
Total Accounts Receivable		-424.32	
Other Current Assets			
Inventory Asset		1,800.00	
Undeposited Funds		<u>1,000.00</u>	
Total Other Current Assets		<u>2,800.00</u>	
Total Current Assets		32,435.28	
Fixed Assets			
Fixed Assets			
Accumulated Depreciation		-1,325.00	
Cost		<u>13,250.00</u>	
Total Fixed Assets		<u>11,925.00</u>	
Total Fixed Assets		11,925.00	

Figure 5 Accrual Basis Balance Sheet showing an understatement in Accounts Receivable

The Cash Basis Balance Sheet removes all open invoices (if the items on the invoices point to income accounts), but it leaves any unapplied credits in the AR balance. This is because the credits (i.e. prepayments, unapplied payments, overpayments, and journal entries) hit other Balance Sheet accounts (namely Undeposited Funds), and QuickBooks only removes income and expense accruals when calculating the Cash Basis Balance Sheet. Therefore, any unapplied prepayments will remain as negative amounts in the AR account on the Cash Basis balance sheet as shown in Figure 6.

Academy Glass, Inc.	
Balance Sheet	
As of August 31, 2006	
Cash Basis	
◇ Aug 31, 06 ◇	
ASSETS	
Current Assets	
Checking/Savings	
Checking	▶ 17,959.60 ◀
Money Market	12,100.00
Total Checking/Savings	30,059.60
Accounts Receivable	
Accounts Receivable	-1,000.00
Total Accounts Receivable	-1,000.00
Other Current Assets	
Inventory Asset	1,800.00
Undeposited Funds	1,000.00
Total Other Current Assets	2,800.00
Total Current Assets	31,859.60
Fixed Assets	
Fixed Assets	11,925.00
Total Fixed Assets	11,925.00
TOTAL ASSETS	43,784.60
LIABILITIES & EQUITY	

Figure 6 Cash Basis Balance Sheet showing negative AR due to unapplied prepayments

Reclassifying Prepayments to a Liability Account

If you are at the end of a fiscal period and need to present proper financial statements, you can enter a journal entry adjustment (see Figure 7) to debit AR and credit Unearned Income for the total amount of the prepayments, either separately for each customer, or in one lump sum for all customers. If you are adjusting for several customers, you'll have to create a "dummy" customer name to track the adjustment since QuickBooks won't let you leave the customer field blank on the Accounts Receivable line. The advantage of using a "dummy" customer is you avoid additional entries to the customer's statements.

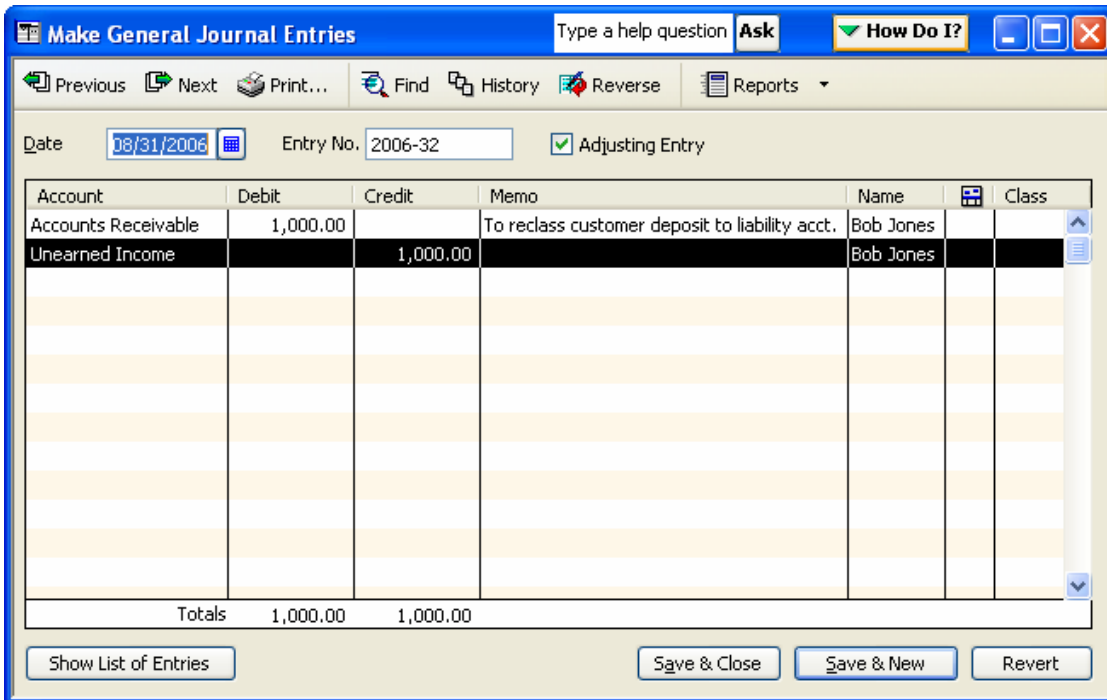


Figure 7 Adjusting entry to reclassify negative AR to Unearned Income

The journal entry shown in Figure 7 should be reversed in the next period because the invoice to which the credit will be applied will hit the AR account, and this entry just zeroed-out that balance. Therefore you should restore the AR balance on the first day of the next period in order to allow the invoice and the prepayment to offset in the AR account.

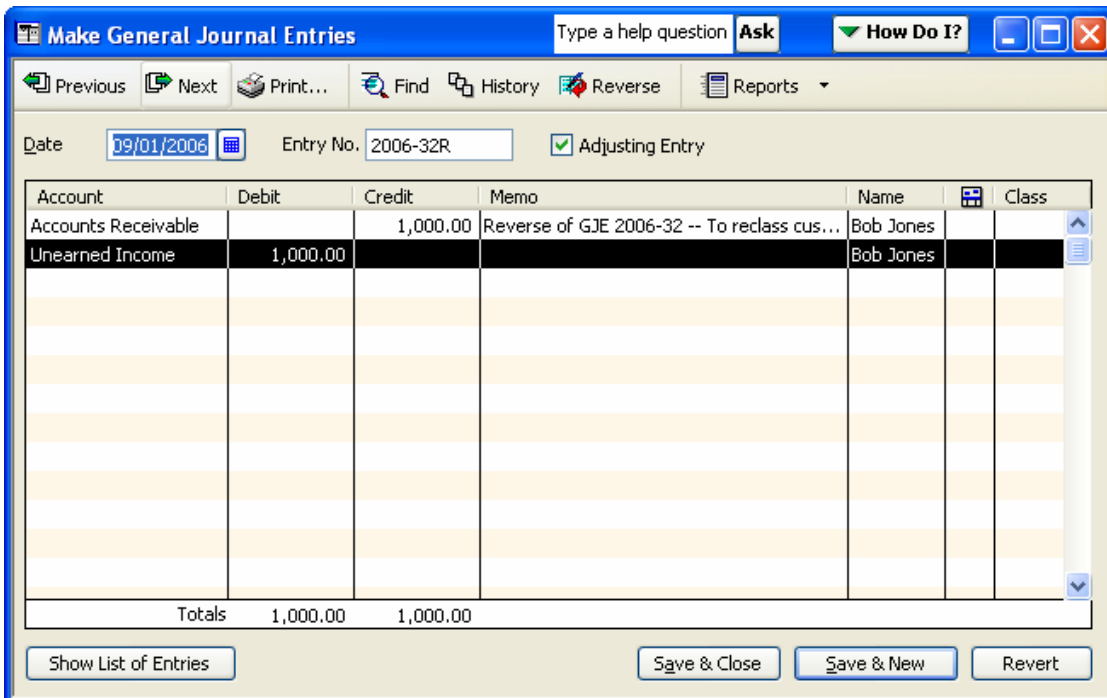


Figure 8. Reversing entry that puts the prepayment back in the AR account on the 1st day of the next period

Essentially, the journal entry and the reversal entry are used just to present financial statements while allowing bookkeepers to use the easy-to-understand workflow (i.e. Receive Payments method) for recording prepayments.

When Prepayments Were Recorded Using Make Deposits

If you entered the prepayment using the **Make Deposits** method shown in Figure 3, you can see all prepayments by customer, in summary or detail by creating a Custom Transaction Summary or Detail report, filtered for the Unearned Income account.

To create the report, select the **Reports** menu and then select **Custom Summary Report**. Then customize the report as shown in Figure 9.

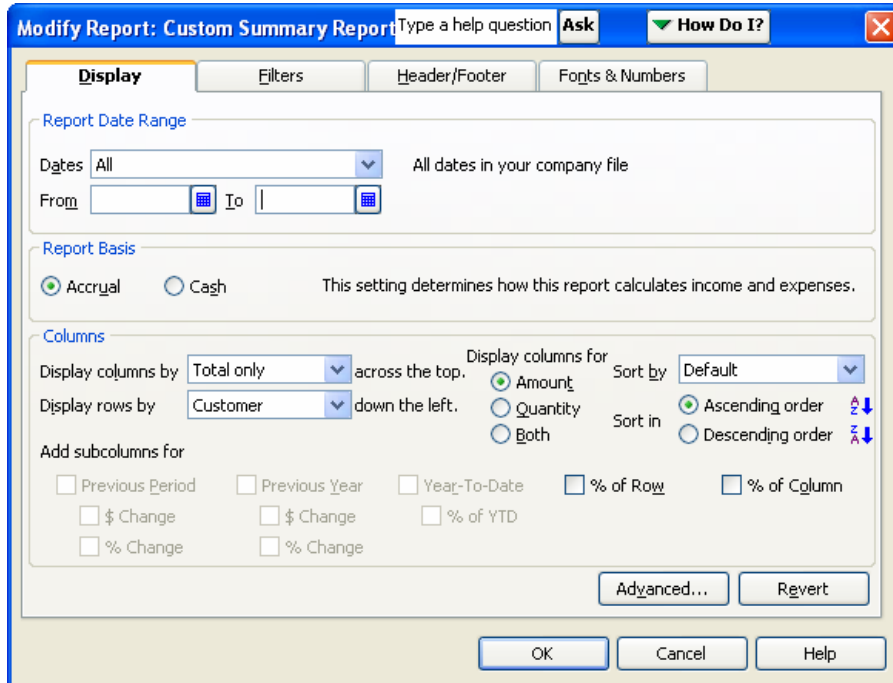


Figure 9 Customizing a Custom Summary Report

Next, click the **Filters** tab and set the filters as shown in Figure 10.

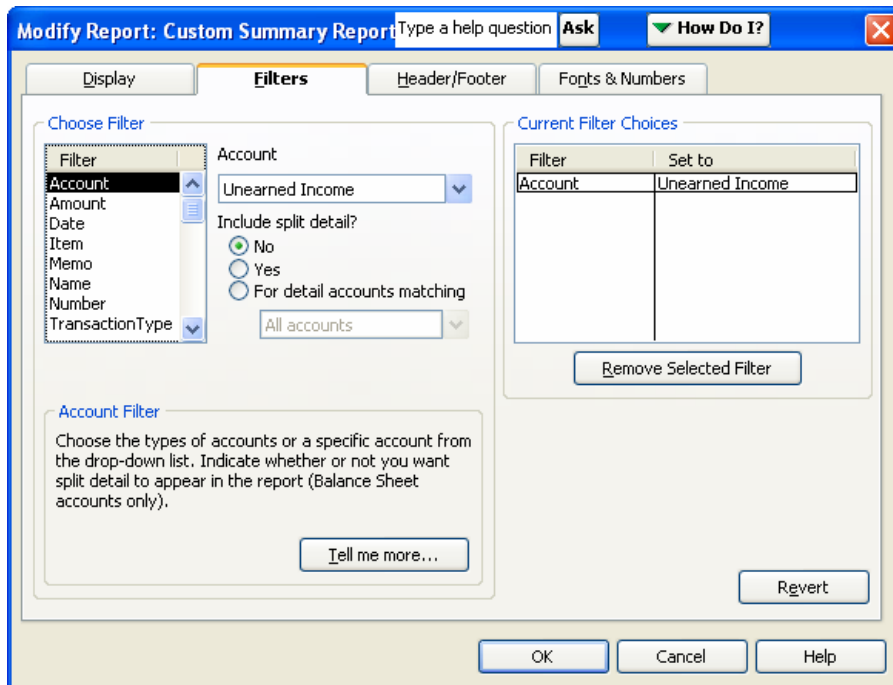


Figure 10 Filtering the Custom Summary Report to the Unearned Income account.

You can also customize the name of your report by clicking on the *Header/Footer* tab and entering the name you want to show at the top of the report. Figure 11 shows the customized report. Double-click on any line to view detailed transactions for any customer.

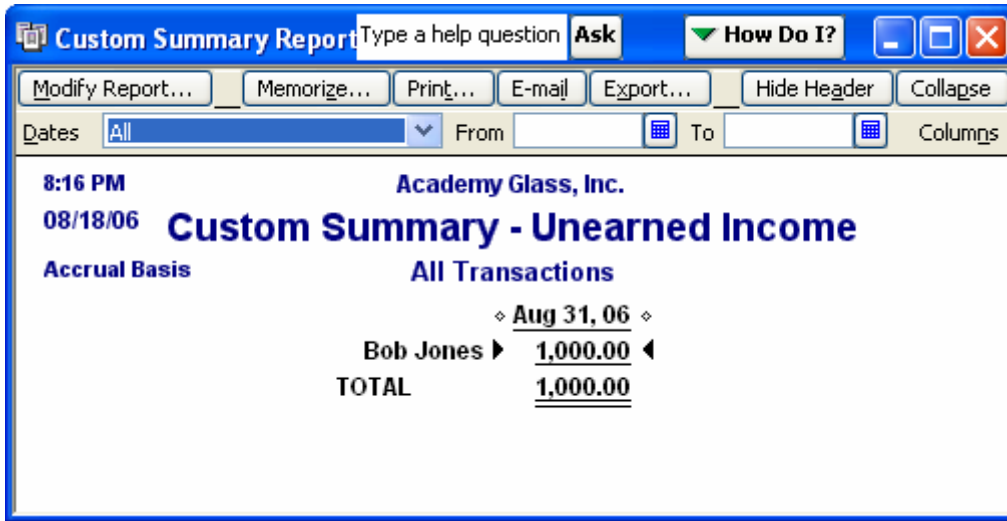


Figure 11 Custom Summary Report for the Unearned Income account.

INVOICING THE CUSTOMER

Once the company has completed some or all of the work or has shipped the goods, create an invoice for the customer with details of whatever was sold as shown in Figure 12.

The screenshot shows the 'Create Invoices' window in QuickBooks. The customer is 'Bob Jones' and the class is 'San Jose'. The invoice date is '09/05/2006' and the invoice number is '2006-322'. The 'BILL TO' section lists 'Bob Jones'. The main table contains one item: 'Subs:Painting' with a description of 'Subcontracted Painting Services', a quantity of 1, a rate of 1,000.00, a class of 'San Jose', and an amount of 1,000.00. The tax is 'Non' with a rate of 0.00. The total amount is 1,000.00. The window also shows options for printing, e-mailing, and applying credits.

ITEM	DESCRIPTION	QUANTITY	RATE	CLASS	AMOUNT	Tax
Subs:Painting	Subcontracted Painting Services	1	1,000.00	San Jose	1,000.00	Non
					Total	1,000.00

Figure 12 An invoice for services on which a prepayment was already received.

In QuickBooks, the invoice represents the transfer of goods or services between the seller and the customer. Consequently, on accrual basis reports, revenue is recognized and reported on the date of the invoice.

However, on cash basis reports, revenue is reported on the later of the invoice date and the payment (or prepayment) date. Also, if there are multiple payments (or pre-payments) applied to an invoice, the revenue is split between those payment dates in proportion to the amount of each payment to the total amount of the invoice. If the invoice is not connected to any payments, no revenue is recognized on cash basis reports.

APPLYING PREPAYMENTS TO CUSTOMER INVOICES

If you have any existing credits for the customer, then as soon as you record the invoice shown in Figure 12, QuickBooks will prompt you (see Figure 13) to apply the existing credits for the customer to that invoice.

Applying Prepayments to New Invoices

If you used the Receive Payments method (Figure 1), you will most likely have existing credits, but if you used the Make Deposits method (Figure 3), you won't have existing credits unless you do the extra step to move the prepayments into the AR account as shown in Figure 14 below.

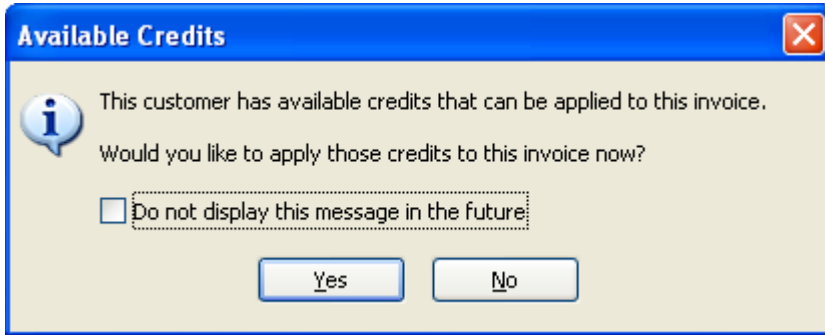


Figure 13 Prompt to apply existing credits to the invoice.

If you recorded the prepayment using the Make Deposit method, you need to create an additional entry that moves the prepayment from the Unearned Income account into the AR account for the appropriate customer. Use a Journal Entry as shown in Figure 14.

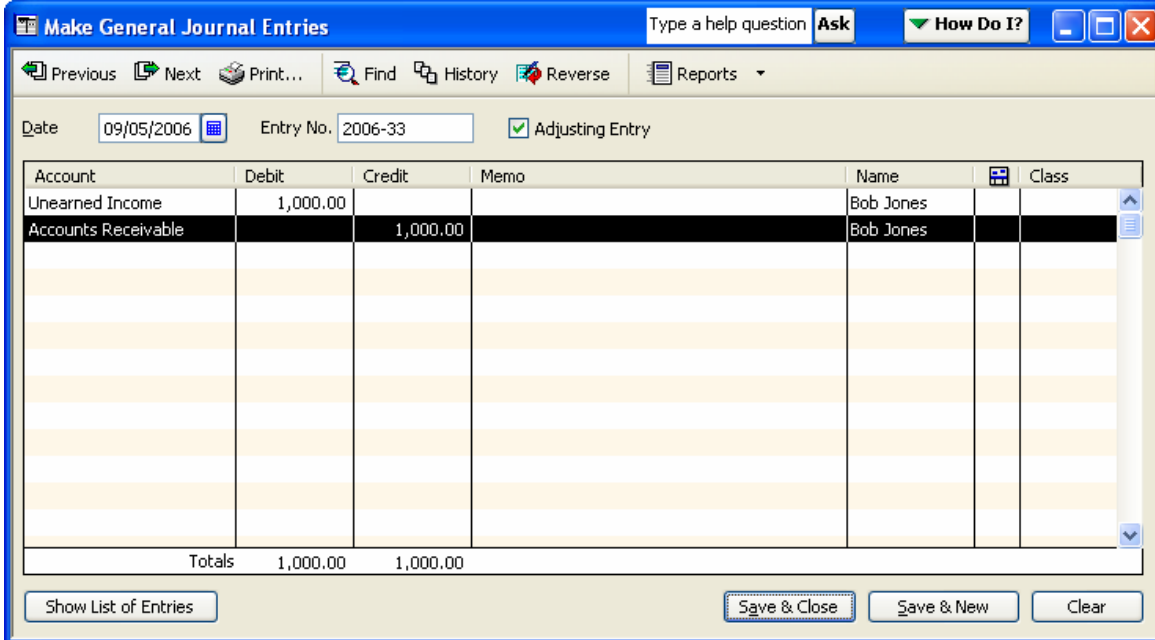


Figure 14 Moving Prepayments in Unearned Income over to the AR account.

It is critical that the name of the customer is included in the entry in Figure 14 because this associates the credit with the customer record, allowing you to apply the amount to the invoice and clear any outstanding balance for that customer.

Applying Prepayments to Existing Invoices

Any open (or unapplied) credit, including credits created using the Receive Payments method, the Journal Entry method, or using a Credit Memo, can be applied to an invoice. To apply the credits, use either the **Receive Payments** window, or the **Apply Credits** button at the bottom of the target Invoice.

Applying Prepayments Using the Receive Payments Window

To apply an existing credit (or prepayment) to one or more Invoices using the *Receive Payments* window, follow these steps:

- Step 1. Select the Customers menu and then select **Receive Payments**.
- Step 2. Enter the name of the customer in the Received From field at the top of the Receive Payments window and press Tab.
- Step 3. DO NOT enter an amount in the *Amount* field. Doing so will create a NEW payment, and you don't want to add a new payment here, only apply an existing payment to an invoice.
- Step 4. Disregard the *Date* field. Dates only apply to transactions so there is no need to enter a date here.

Important Note: Applying a credit to an invoice does not create a new transaction; rather, it links two existing transactions. Therefore, the **date** field on the Receive Payments window has no effect on when income is recognized or anything that can be seen on any report in QuickBooks.

Step 5. Verify that the customer has credits available (see Figure 15).

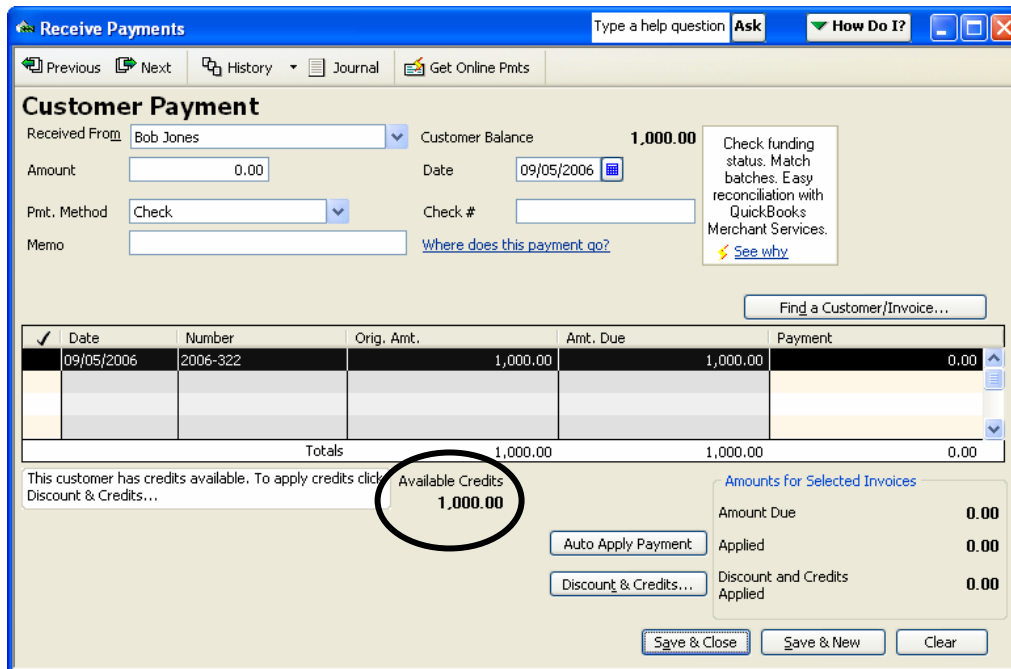


Figure 15 Customer Credit Available

Step 6. Select the invoice to which you want to apply the prepayment by clicking anywhere on the Invoice's row *except* the checkmark column (see Figure 16).

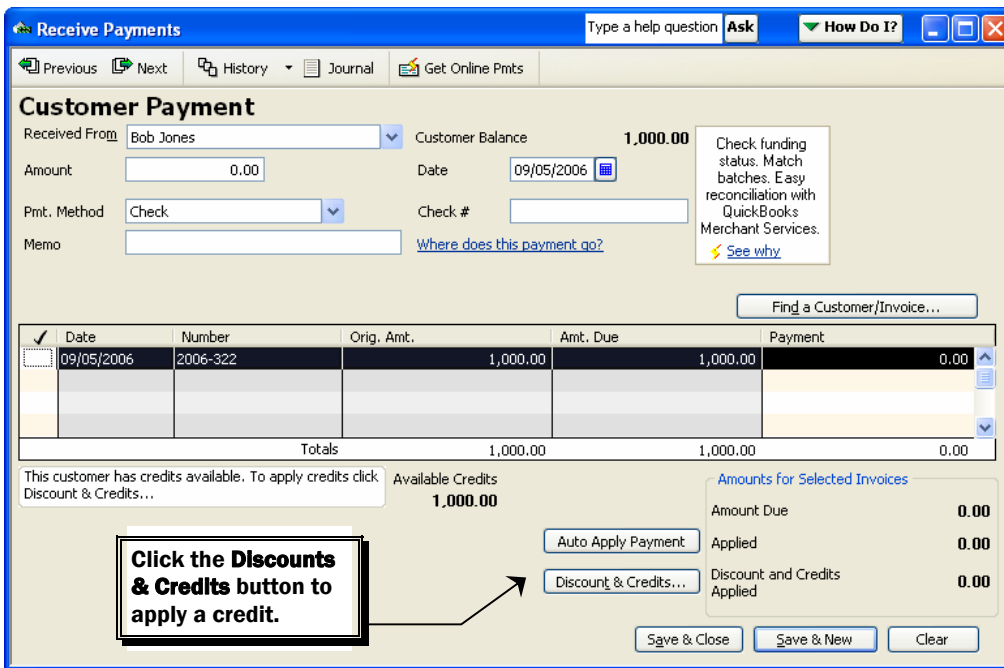


Figure 16 Receive Payment Window with Invoice Selected

Step 7. Click **Discount & Credits** and verify that QuickBooks applied the prepayment to the invoice (see Figure 17).

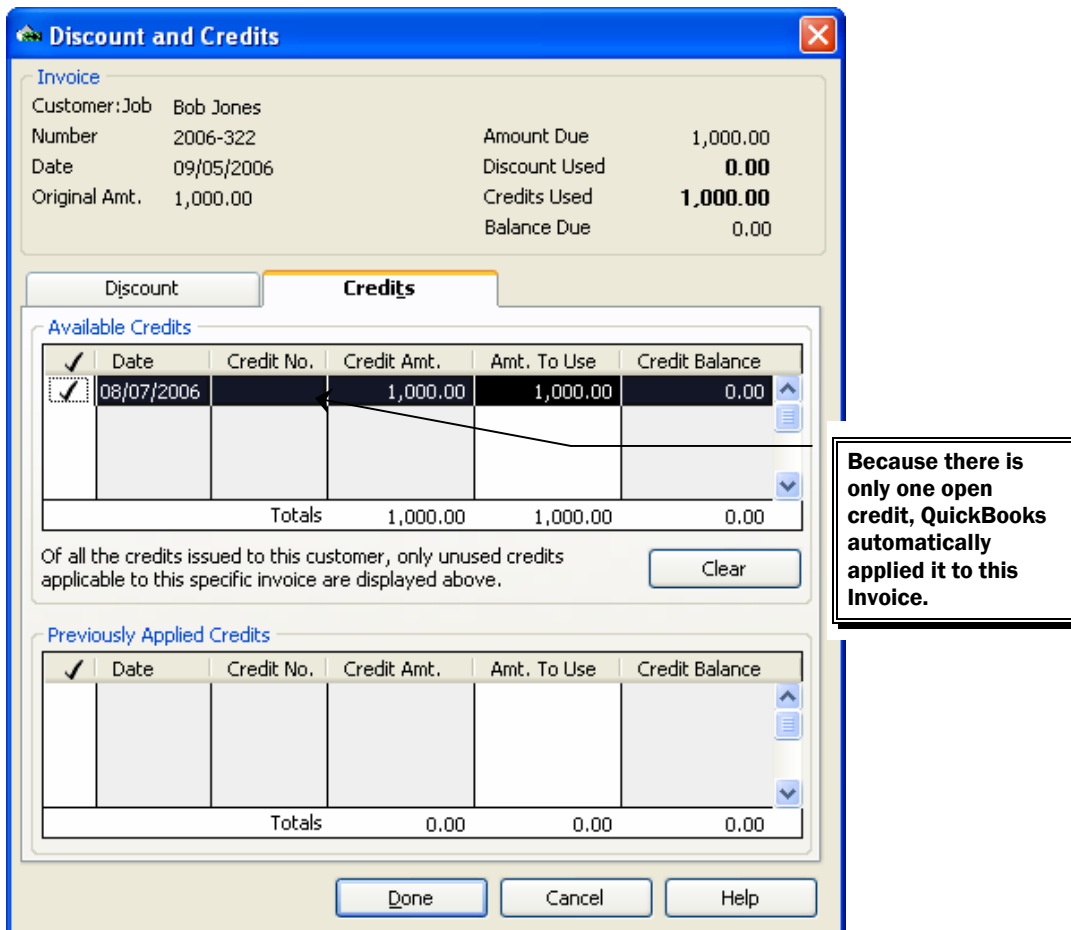


Figure 17 Credits tab of the Discounts and Credits window

Step 8. Click **Done** to return to the *Receive Payments* window.

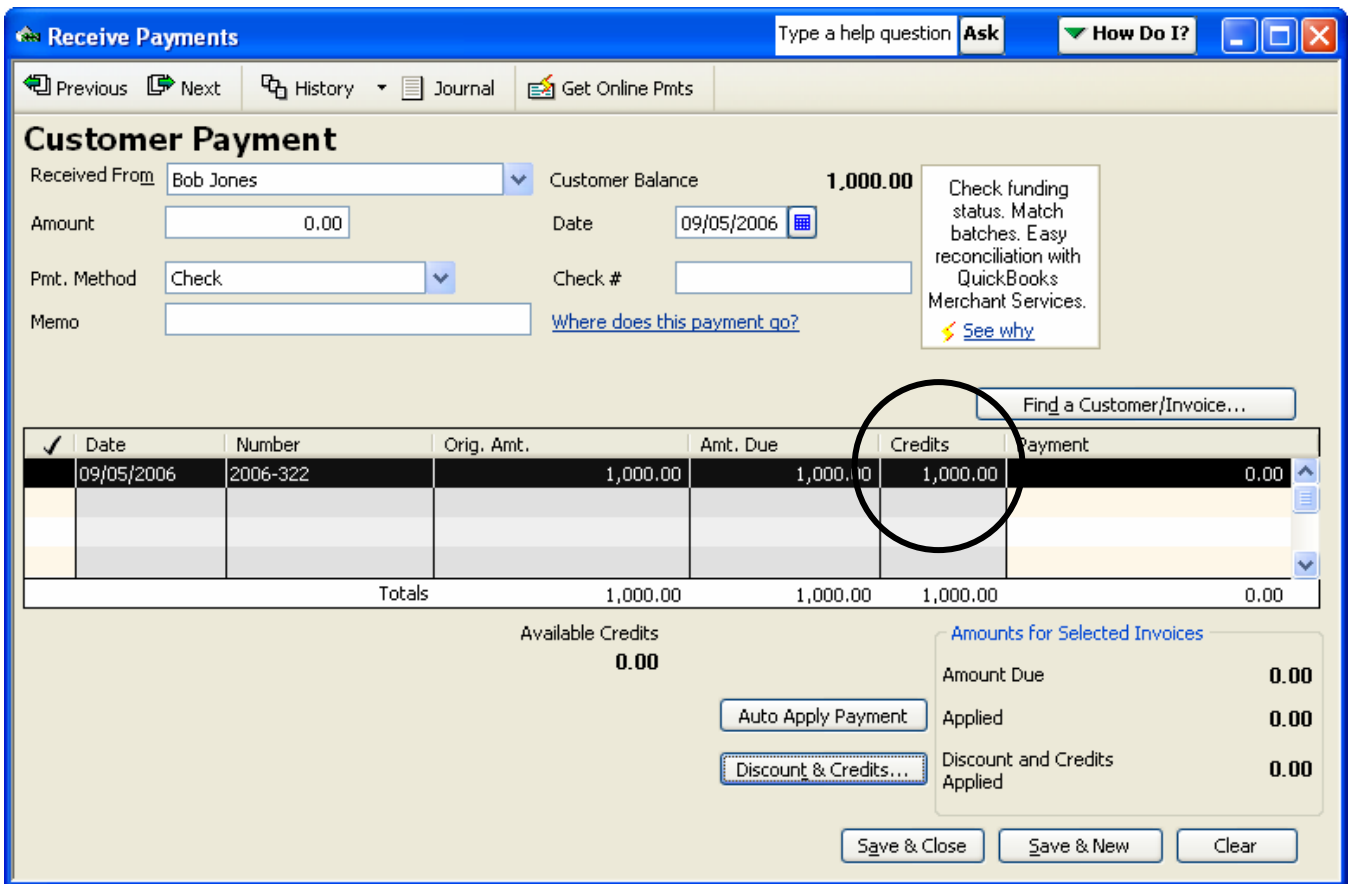


Figure 18 The Receive Payments window after the credit is applied.

Step 9. Click **Save & Close** on the Receive Payments window.

Notice in Figure 16 that there is a new column labeled Credits and the amount of the credit you just applied shows in that column. This completes the process of applying the credit (or prepayment) to an existing invoice using the Receive Payments window.

Applying Credits Directly from an Invoice

To apply credits to an Invoice, you can use the **Apply Credits** button at the bottom of the Invoice and then select which credits to apply. Follow these steps:

Step 1. First, display the Invoice to which you want the credit to apply (Figure 19) which shows that some payments (or credits) have already been applied. In addition, you can see that there is still a balance due on the invoice.

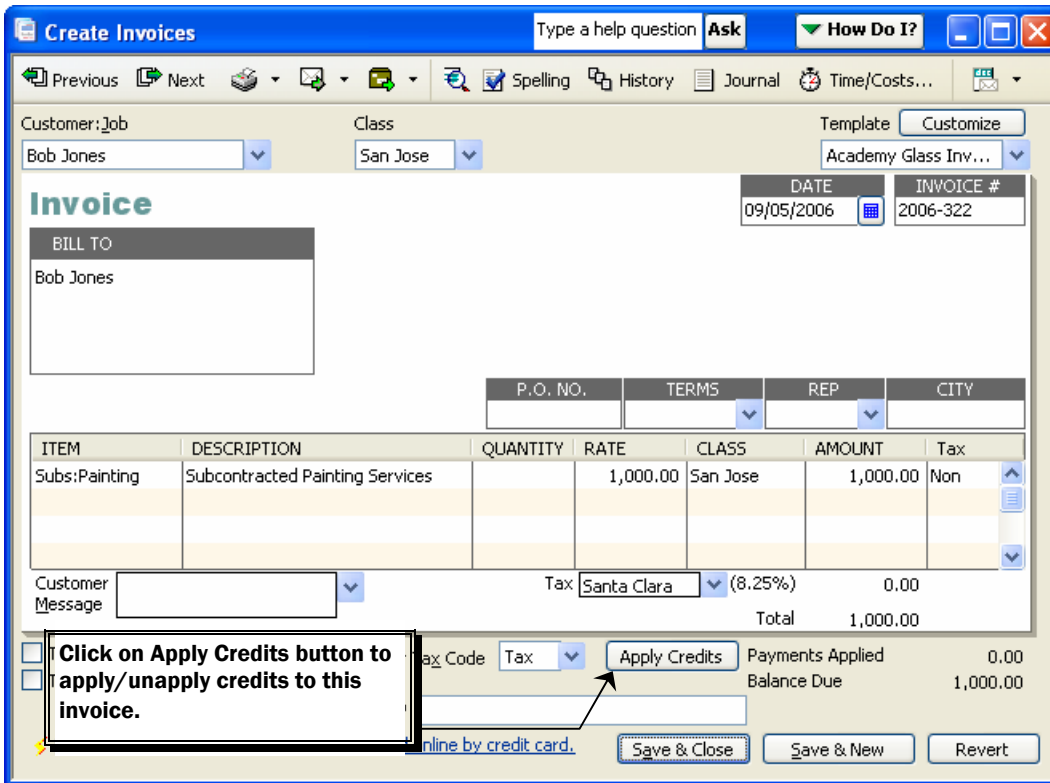


Figure 19 Target invoice for prepayment to be applied.

Step 2. Click **Apply Credits** at the bottom of the invoice to apply or unapply credits.

Step 3. The *Apply Credits* window displays (see Figure 20). The unapplied credit shows in the top section, and it is already selected. Click **Done** to apply it to the invoice.

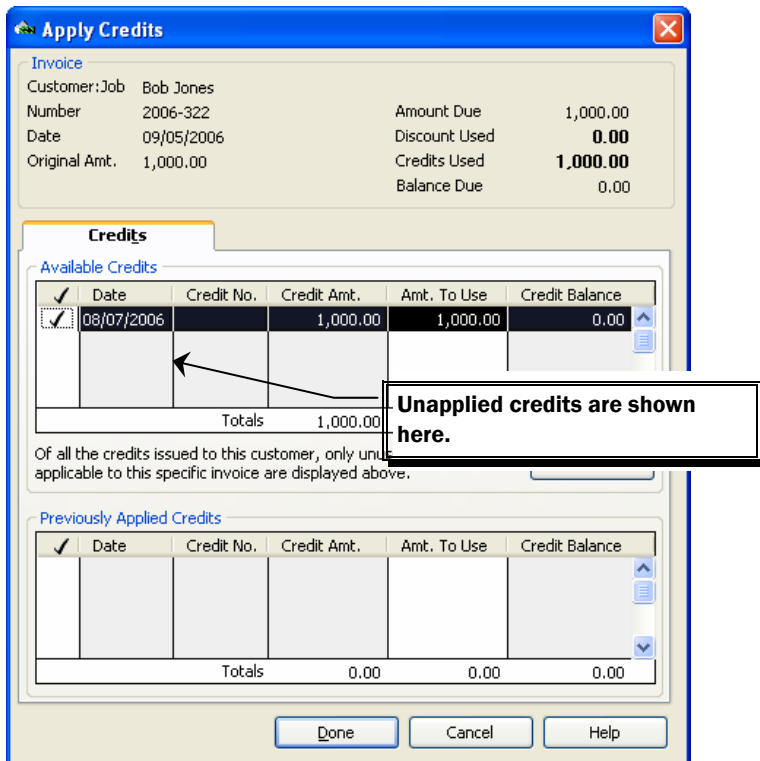


Figure 20 Apply Credit Window with available and used credits

Step 4. Click **Save & Close** to save the Invoice.

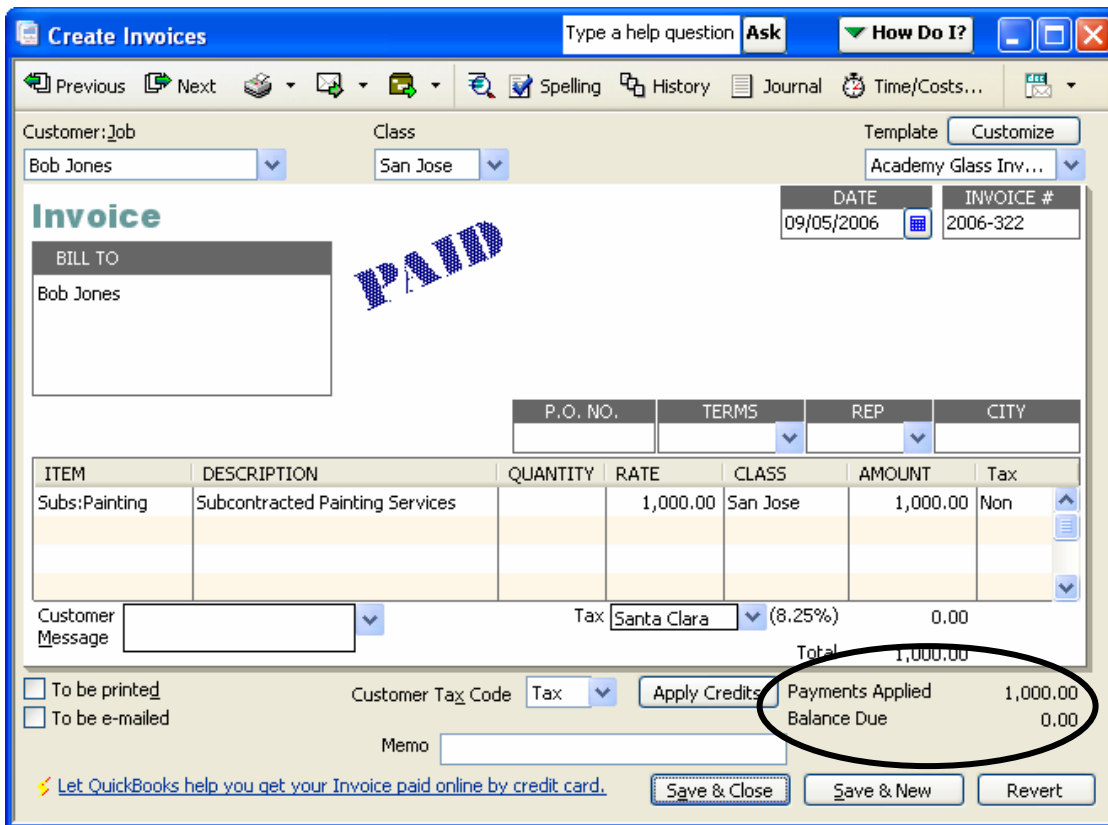


Figure 21 The invoice after the prepayment is applied

Links between Transactions in QuickBooks

When you apply a credit (or prepayment) to an invoice, QuickBooks creates a "link" between the credit and the invoice. These links allow QuickBooks to track which invoice is open, and which payment is applied to which invoice. Links also allow users to see the "history" of transactions, including what payments or credits were applied to an invoice. Links are not transactions themselves and do not have a unique transaction date or transaction type data.

A link can be displayed in the history of the invoice and the prepayment, but it is not a transaction that affects your account balances.

FINANCIAL REPORTING

Financial statement reports in QuickBooks present a summary of the transactions for the date range specified in the report. These financial statements can be modified to display data on the accrual basis or the cash basis.

Accrual Basis of Reporting

In QuickBooks, the invoice represents the date when the goods are delivered to the customer or the service was provided. Consequently, financial statements on an accrual basis report revenue on the date of the invoice. Prepayments that represent Unearned Income should be displayed on the balance sheet as a liability. The user must either record these prepayments directly to Unearned Income or they should be reclassified to Unearned Income on the financial statement date as discussed on pages 10 and 11.

Cash Basis of Reporting

If the financial statements are on a cash basis, QuickBooks uses the later of the date the payment was received and the date of the invoice to determine when revenue will be reported. In order for this calculation to work, the payment and the invoice must be linked.

The date on which the user creates the link between the payment and the invoice (the link date) is **NOT** used to determine the date the revenue is recognized. The reason is that the link date does not represent any exchange of payments, goods or services between the two parties in the transaction. It only represents the date on which the company completes the accounting task of applying a payment to an invoice.

One could argue that when reporting on a cash basis, the date the income should be recognized is the payment date and not the later of the invoice and payment date. There are two issues with this. First, the prepayment received is not for any services or goods that have been provided and there is an outstanding obligation to the recipient to refund this money if the goods or service are not provided. So it is difficult to justify this payment as income, even on a cash basis. Secondly, the payment transaction is recorded as an increase in the bank account with an offsetting entry to accounts receivable or unearned income. QuickBooks has no way to know that this amount should be reported to an income account. It is only when the payment is linked to an invoice that QuickBooks can determine the income account to which the cash payment should be reported on a cash basis.

Important: If you are applying payments subsequent to a period end and the invoice date and payment date are prior to the period end, revenue will be reported in the prior period. This happens without warning the user about the change in the prior period cash basis income. Consequently, it is important to understand this impact when applying the credits.

Another important issue for cash basis reporting is that credit balances in accounts receivable and any unearned income accounts should be reviewed at the end of the period to determine if any amounts need to be reclassified to income. A prepayment that is recorded as a credit will not be reported as income on a cash basis if it is not linked to an invoice. Only when the prepayment is linked to an invoice can QuickBooks determine the income account and the date to recognize the revenue.

PREVENTING AND RESOLVING ERRORS

The largest potential for an error to occur is with an organization that issues financial statements on a cash basis and delays the application of credits to invoices to a subsequent period. Applying the credit in a later period could result in a change to the prior period's financial statements.

To determine which period income should be recognized, you should review the appropriate tax regulations, as well as the revenue recognition accounting policies for your industry and product or service provided.

Typically, revenue is recognized in the period when the goods are shipped and ownership rights have been passed to the customer. If it is a service, it is calculated based on when service was provided. If the policies determine that the revenue should be recognized in the prior period, you may need to make an adjustment to cause QuickBooks to recognize this income. If the policies determine that the revenue should be recognized in the current period, you should verify that the payment or the invoice is dated in the current period. If both the invoice and the prepayment(s) are dated in the prior period, the income will be recognized in the prior period. The result is your income in the prior period is overstated, while your income in the current period is understated. The correcting entry for this situation for this is to create a journal entry dated in the prior period to debit income and credit the Unearned Income liability account. This will result in the prepayment showing as a liability at end of the prior period. In the current period you should reverse this entry with another journal entry that debits Unearned Income and credits the appropriate income account.

Errors based on the timing of the revenue in a cash based reporting system are prevented if the user understands that the **revenue is recorded at the later of the payment and invoice date**. If the business has a significant volume of prepayments, the company should establish a process to date the invoices on the date that revenue should be reported. When financial statements are prepared, the accountant must ensure that any prepayments for goods or services already provided have been properly applied to the invoices. This ensures that the income is reported in the proper period. Any prepayments not applied should appear in an Unearned Income liability account. Subsequent invoices for goods shipped or services provided in the current period should be dated in the current year to ensure that the revenue will not be recognized in a prior period.

The user may have more complex revenue recognition needs depending on the business transactions and policies, so it is up to the user or their accountant to review the data and prepare the necessary adjusting entries to properly recognize revenue.

SUMMARY

QuickBooks allows you to handle prepayments in a few different ways. Entering the prepayment through the Receive Payment window allows the user to record the payment with the customer and to see it in the customer's balance. The downside is that these prepayments must be reclassified to Unearned Income at the period end.

Entering the payment as a Deposit does allow you to track the prepayment directly to a liability account but it requires an additional journal entry to reclassify the entry into the Accounts Receivable balance before it can be applied to an invoice.

Under both approaches, income on an accrual method is reported on the date of the invoice. Income on a cash basis is reported at the later of the payment date or invoice date. Only when the prepayment has been linked to the invoice can QuickBooks calculate the cash basis income.

Accountants should make it a regular practice to review open (or unapplied) credits at period end to determine if they should have been applied to invoices or if they should be reclassified to Unearned Income.

As a company grows and the transactions become more complex it is a good idea to review whether a cash basis of reporting is the most appropriate accounting basis. Initially, it was designed to make it easier for organizations to report their income and to reduce the tax burden if sales have not been collected. If the cash basis is creating more work for the accountant and the difference in income is an immaterial timing difference it may be time to move to an accrual basis of accounting. The accounting principles are much clearer and the connection between a sales invoice being entered and income being reported is much more direct.

APPENDIX A – USING ITEMS TO RECORD PREPAYMENTS

A third alternative for recording prepayments can be accomplished using an Item, or a combination of Items and Liability accounts. This method is a bit more complex to manage, but it does overcome some of the disadvantages presented in the earlier methods.

Warning: The following method of accounting for customer prepayments may have serious tax consequences so you'll want to verify that you are handling prepayments correctly from the tax perspective. For example, if you are a cash basis taxpayer, you might have to treat customer prepayments as income for the year in which they were received.

Here is a brief list of steps for tracking customer prepayments.

- Step 1. Set up a liability account called **Unearned Income (or Client Retainers)**, an Other Charge Item called **Prepayment**, and a Sales Tax item called **Non-Sales**. The Deposit Item should point to the Unearned Income account. The Non-Sales item ensures that the Deposits received are separated out on the Sales Tax Liability report.
- Step 2. Each time you receive a deposit, create an Invoice for that customer using the "Deposit" Item. On the invoice, use the Non-Sales sales tax item to track the "sale" separately from other sales.
- Step 3. **Receive Payments** for the amount of the deposit you've received from the customer. This receipt will be added onto your next "Make Deposit" to the bank account.
- Step 4. When you perform services or sell product to that customer, create an **Invoice** for the detail of the sale, just as you normally do for sales to customers. The **Prepayment** item is added on the bottom of the invoice as a negative amount that reduces the total invoice.

This last step of entering the Prepayment item on the invoice will transfer money out of the Unearned Income liability account and reduce your AR balance for that customer. The invoice also shows the customer how the deposit was applied against their invoice. There are no issues about the cash basis of reporting as the prepayment remains in the unearned income account.

One disadvantage is that because your sales reports show all items from your invoices, these prepayments and the subsequent application of the prepayment will be included in your sales reports (Sales by Item, Sales by Customer, etc.). To remove these items from these reports you can filter the reports to remove the Prepayment item

Tip: For Cash Basis Taxpayers – If you need to treat customer prepayments as Income, all you need to do differently from this example is change the account type on the Prepayment item from the Unearned Income account to the Income account type.

ABOUT THE AUTHORS

Doug Sleeter, Certified QuickBooks ProAdvisor, is Founder and President of The Sleeter Group (www.sleeter.com).

Doug was a pioneer in developing the first QuickBooks seminars in the country and has worked with Intuit in the past in developing QuickBooks training materials. He consults with Intuit on the development of the QuickBooks product line and with software developers on QuickBooks Compatible Solutions. He provides expert level support and consulting to hundreds of QuickBooks consultants through the Sleeter Group's **Certified Consultant's Network**, a group of highly trained QuickBooks experts. He is the host of the Sleeter Group's annual QuickBooks Consultant's Conference, bringing together QuickBooks consultants and software developers from across the nation. The author of over 40 QuickBooks reference books and courseware materials, Doug also writes a regular column, "The QuickBooks Advisor" for *The CPA Technology Advisor* magazine.

Andrew Holmes has held many positions at Intuit relating to QuickBooks software and the QuickBooks ProAdvisor Program, always with a focus on improving the customer experience for QuickBooks users. In these roles he applied the insight that QuickBooks customer satisfaction rises significantly when the customer receives quality support from an accounting professional like a QuickBooks ProAdvisor.

Andrew, who moved on to other opportunities shortly after this white paper was completed, most recently was an advocate for accounting professionals in the development of QuickBooks financial software.

Jacint Tumacder is a Customer Advocate in Intuit's Mountain View office. As such he has first-hand experience with the struggles of some QuickBooks customers to accurately capture prepayments using QuickBooks financial software.

Intuit thanks all three writers for their contributions and for the opportunity to share this White Paper with accountants, bookkeepers, QuickBooks consultants, and other professionals who work with QuickBooks customers, day in and day out.