

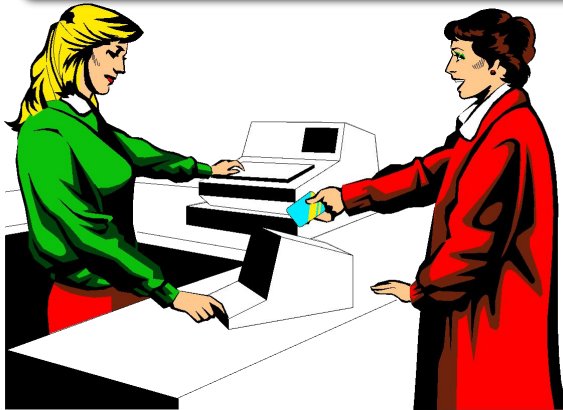
# Merchandising Activities

## Chapter 6



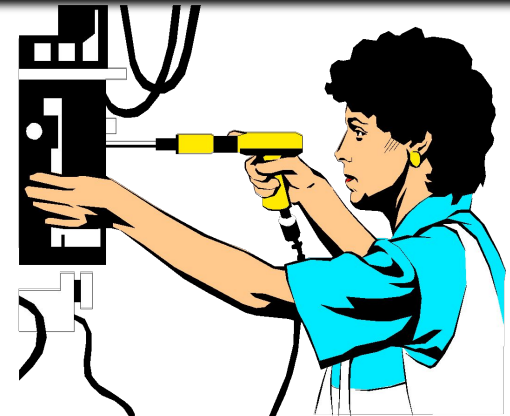
# Comparing Merchandising Activities with Manufacturing Activities

**Purchase  
inventory in  
ready-to-sell  
condition.**



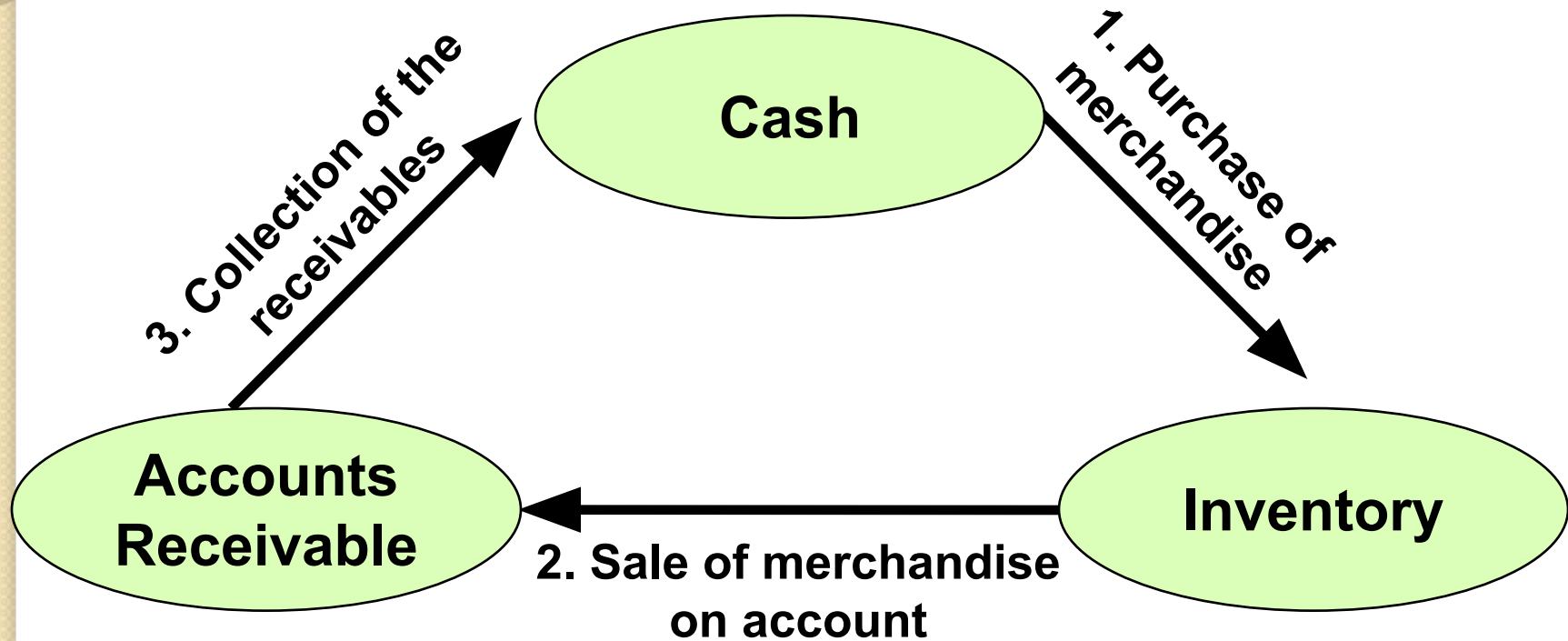
**Merchandising  
Company**

**Manufacture  
inventory and  
have a longer and  
more complex  
operating cycle.**



**Manufacturing  
Company**

# Operating Cycle of a Merchandising Company



# Retailers and Wholesalers



**Wholesalers** buy merchandise from several different manufacturers and then sell this merchandise to several retailers.



**Retailers** sell merchandise directly to the public.

# Income Statement of a Merchandising Company

**Computer City  
Condensed Income Statement  
For the Year Ended December 31, 2009**

Revenue from sales	\$ 900,000
Less: Cost of goods sold	<u>540,000</u>
Gross profit	\$ 360,000
Less: Expenses	<u>270,000</u>
Net income	<u><u>\$ 90,000</u></u>

**Cost of goods sold** represents the expense of goods that are sold to customers.

**Gross profit** is a useful means of measuring the profitability of sales transactions.

# Accounting System Requirements for Merchandising Companies

**Control Account**

**Subsidiary Ledgers**

General Ledger				
Accounts Receivable				
Date		Debit	Credit	Balance
2009				
June	1	10,000		10,000
	15		3,000	7,000

Subsidiary Ledger				
Sparks, Inc.				
Date		Debit	Credit	Balance
2009				
June	1	3,000		3,000
	15		1,000	2,000

Subsidiary Ledger				
Heather Jacobs Company				
Date		Debit	Credit	Balance
2009				
June	1	7,000		7,000
	15		2,000	5,000

# Perpetual Inventory Systems

On September 5, Worley Co. purchased 100 laser lights for resale for \$30 per unit from Electronic City on account.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	5	Inventory	3,000	
		Accounts Payable (Electronic City)		3,000

# Perpetual Inventory Systems

On September 10, Worley Co. sold 10 laser lights for \$50 per unit on account to ABC Radios.

$$10 \times \$30 = \$300$$

Date		Account Titles and Explanation	Debit	Credit
Sept.	10	Accounts Receivable (ABC Radios)	500	
		Sales		500
	10	Cost of Goods Sold	300	
		Inventory		300



# Perpetual Inventory Systems

On September 15, Worley Co. paid Electronic City \$3,000 for the September 5 purchase.

## GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit
Sept. 15	Accounts Payable (Electronic City)	3,000	
	Cash		3,000

# Perpetual Inventory Systems

On September 22, Worley Co. received \$500 from ABC Radios as payment in full for their purchase on September 10.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	22	Cash	500	
		Accounts Receivable (ABC Radios)		500

# Taking a Physical Inventory

In order to ensure the accuracy of their perpetual records, most businesses take a **complete physical count** of the merchandise on hand at least once a year.

Reasonable amounts of **inventory shrinkage** are viewed as a normal cost of doing business.

Examples include breakage, spoilage and theft.

On December 31, Worley Co. counts its inventory. An inventory shortage of \$2,000 is discovered.

Date		Account Titles and Explanation	Debit	Credit
Dec.	31	Cost of Goods Sold	2,000	
		Inventory		2,000

# Closing Entries in a Perpetual Inventory System

- Close Revenue accounts **(including Sales)** to Income Summary.
- ② Close Expense accounts **(including Cost of Goods Sold)** to Income Summary.
- Close Income Summary account to Retained Earnings.
- ④ Close Dividends to Retained Earnings.

The closing entries are the same!



# Periodic Inventory System

On September 5, Worley Co. purchased 100 laser lights for resale for \$30 per unit from Electronic City on account.

**Notice that no entry is made to Inventory.**

Date		Account Titles and Explanation	Debit	Credit
Sept.	5	Purchases	3,000	
		Accounts Payable (Electronic City)		3,000

# Periodic Inventory System

On September 10, Worley Co. sold 10 laser lights for \$50 per unit on account to ABC Radios.

<b>GENERAL JOURNAL</b>			
Date	Account Titles and Explanation	Debit	Credit
Sept. 10	Accounts Receivable (ABC Radios)	500	
	Sales		500

**Retail**

# Periodic Inventory System

On September 15, Worley Co. paid Electronic City \$3,000 for the September 5 purchase.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	15	Accounts Payable (Electronic City)	3,000	
		Cash		3,000

# Periodic Inventory System

On September 22, Worley Co. received \$500 from ABC Radios as payment in full for their purchase on September 10.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	22	Cash	500	
		Accounts Receivable (ABC Radios)		500



# Computing Cost of Goods Sold

The accounting records of Party Supply show the following:

Inventory, Jan. 1	\$ 14,000
Purchases (during year)	130,000
Inventory, Dec. 31	12,000

Inventory (beginning of the year)	\$ 14,000
Add: Purchases	130,000
Cost of goods available for sale	<u>144,000</u>
Less: Inventory (end of year)	12,000
<b>Cost of goods sold</b>	<b><u><u>\$ 132,000</u></u></b>

# Creating a Cost of Goods Sold Account

**Party Supply must create the **Cost of Goods Sold** account.**

Date		Account Titles and Explanation	Debit	Credit
Dec.	31	Cost of Goods Sold	144,000	
		Inventory (beginning of year)		14,000
		Purchases		130,000

**Party Supply must record the **ending inventory** amount.**

Date		Account Titles and Explanation	Debit	Credit
Dec.	31	Inventory (end of year)	12,000	
		Cost of Goods Sold		12,000

# Selecting an Inventory System

<b>Factors Suggesting a Perpetual Inventory System</b>	<b>Factors Suggesting a Periodic Inventory System</b>
<b>Large company with professional management.</b>	<b>Small company, run by owner.</b>
<b>Management and employees wanting information about items in inventory and the quantities of specific products that are selling.</b>	<b>Accounting records of inventories and specific product sales not needed in daily operations; such information developed primarily for use in annual income tax returns.</b>
<b>Items in inventory with a high per-unit cost.</b>	<b>Inventory with many different kinds of low-cost items.</b>
<b>Low volume of sales transactions or a computerized accounting system.</b>	<b>High volume of sales transactions and a manual accounting system.</b>
<b>Merchandise stored at multiple locations or in warehouses separate from sales sites.</b>	<b>All merchandise stored at the sales site (for example, in the store).</b>

# Credit Terms and Cash Discounts

When manufacturers and wholesalers sell their products on account, the **credit terms** are stated in the invoice.

Read as: “Two ten, net thirty”

2/10, net/30

Percentage  
of Discount

# of Days  
Discount Is  
Available

Otherwise,  
the Full  
Amount Is  
Due

# of Days  
when Full  
Amount Is  
Due

# Recording Purchases at Net Cost

On July 6, Jack & Jill, Inc. purchased \$4,000 of merchandise on credit with terms of 2/10, n/30 from Kid's Clothes.

Prepare the journal entry for Jack & Jill, Inc.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	6	Inventory	3,920	
		Accounts Payable (Kid's Clothes)		3,920

$$\$4,000 \times 98\% = \$3,920$$

# Recording Purchases at Net Cost

On July 15, Jack & Jill, Inc. pays the full amount due to Kid's Clothes. Prepare the journal entry for Jack & Jill, Inc.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	15	Accounts Payable (Kid's Clothes)	3,920	
		Cash		3,920

# Recording Purchases at Net Cost

Now, assume that Jack & Jill, Inc. waited until July 20 to pay the amount due in full to Kid's Clothes.

Prepare the journal entry for Jack & Jill, Inc.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	20	Accounts Payable (Kid's Clothes)	3,920	
		Purchase Discounts Lost	80	
		Cash		4,000

**Nonoperating Expense**

# Recording Purchases at Gross Invoice Price

On July 6, Jack & Jill, Inc. purchased \$4,000 of merchandise on credit with terms of 2/10, n/30 from Kid's Clothes.

Prepare the journal entry for Jack & Jill, Inc.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	6	Inventory	4,000	
		Accounts Payable (Kid's Clothes)		4,000



# Recording Purchases at Gross Invoice Price

On July 15, Jack & Jill, Inc. pays the full amount due to Kid's Clothes.

Prepare the journal entry for Jack & Jill, Inc.

**Reduces Cost of Goods Sold**

$$\$4,000 \times 98\% = \$3,920$$

Date	Account Titles and Explanation	Debit	Credit
July 15	Accounts Payable (Kid's Clothes)	4,000	
	Cash		3,920
	Purchase Discounts Taken		80

# Recording Purchases at Gross Invoice Price

Now, assume that Jack & Jill, Inc. waited until July 20 to pay the full amount due to Kid's Clothes.

Prepare the journal entry for Jack & Jill, Inc.

## GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit
July 20	Accounts Payable (Kid's Clothes)	4,000	
	Cash		4,000

# Returns of Unsatisfactory Merchandise

**On August 5, Jack & Jill, Inc. returned \$500 of unsatisfactory merchandise purchased from Kid's Clothes on credit terms of 2/10, n/30. The purchase was originally recorded at **net cost**. Prepare the entry for Jack & Jill, Inc.**

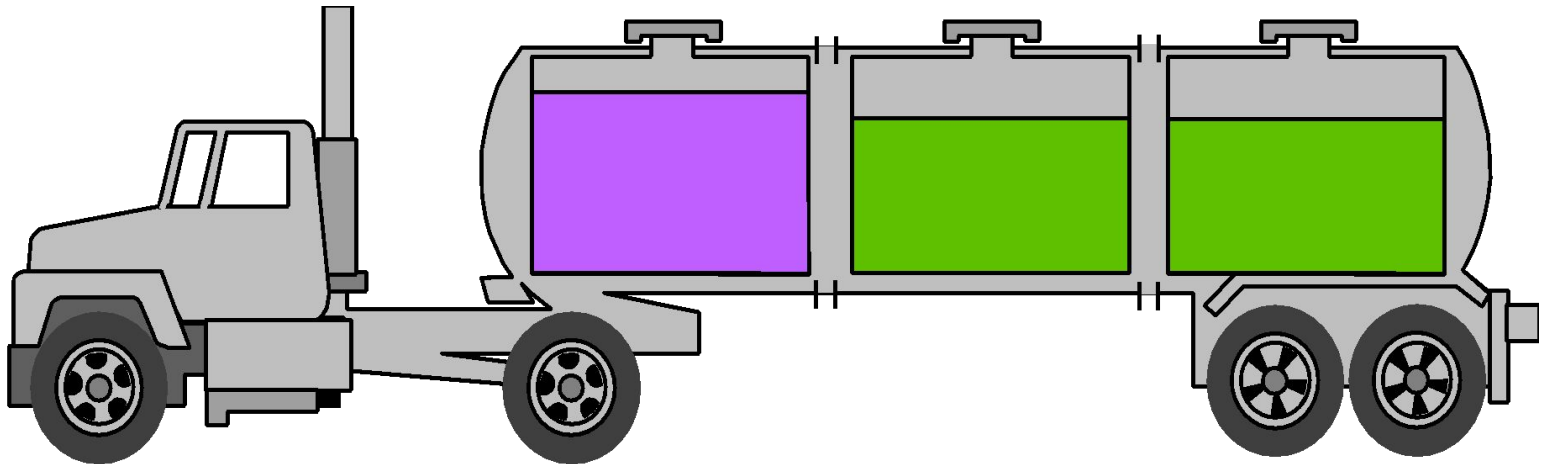
## GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit
Aug. 5	Accounts Payable (Kid's Clothes)	490	
	Inventory		490

$$\$500 \times 98\% = \$490$$

# Transportation Costs on Purchases

**Transportation costs related to the acquisition of assets are part of the **cost of the asset** being acquired.**



# Transactions Related to Sales

**Computer City**  
**Partial Income Statement**  
**For the Year Ended December 31, 2009**

<b>Revenue</b>		
<b>Sales</b>		<b>\$ 912,000</b>
<b>Less: Sales returns and allowances</b>	<b>\$ 8,000</b>	
<b>    Sales discounts</b>	<b>4,000</b>	<b>12,000</b>
<b>Net sales</b>		<b><u><u>\$ 900,000</u></u></b>

**Credit terms and merchandise returns  
affect the amount of revenue earned by  
the **seller**.**

# Sales

On August 2, Kid's Clothes sold \$2,000 of merchandise to Jack & Jill, Inc. on credit terms 2/10, n/30. Kid's Clothes originally paid \$1,000 for the merchandise.

Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Aug.	2	Accounts Receivable (Jack & Jill, Inc.)	2,000	
		Sales		2,000
	2	Cost of Goods Sold	1,000	
		Inventory		1,000

# Sales Returns and Allowances

On August 5, Jack & Jill, Inc. returned \$500 of unsatisfactory merchandise to Kid's Clothes from the August 2 sale. Kid's Clothes cost for this merchandise was \$250.

Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

## GENERAL JOURNAL

## Contra-revenue

Date		Account Titles and Explanation	Debit	Credit
Aug.	5	Sales Returns and Allowances	500	
		Accounts Receivable (Jack & Jill, Inc.)		500
	5	Inventory	250	
		Cost of Goods Sold		250

# Sales Discounts

On July 6, Kid's Clothes sold \$4,000 of merchandise to Jack & Jill, Inc. on credit with terms of 2/10, n/30. The merchandise originally cost Kid's Clothes \$2,000.

Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	6	Accounts Receivable (Jack & Jill, Inc.)	4,000	
		Sales		4,000
	6	Cost of Goods Sold	2,000	
		Inventory		2,000



# Sales Discounts

On July 15, Kid's Clothes receives the full amount due from Jack & Jill, Inc. from the July 6 sale.

Prepare the journal entry for Kid's Clothes.

**Contra-revenue**

**DUPLICATE**  $\$4,000 \times 98\% = \$3,920$

Date		Account Titles and Explanation	Debit	Credit
July	15	Cash	3,920	
		Sales Discounts	80	
		Accounts Receivable (Jack & Jill, Inc.)		4,000

# Sales Discounts

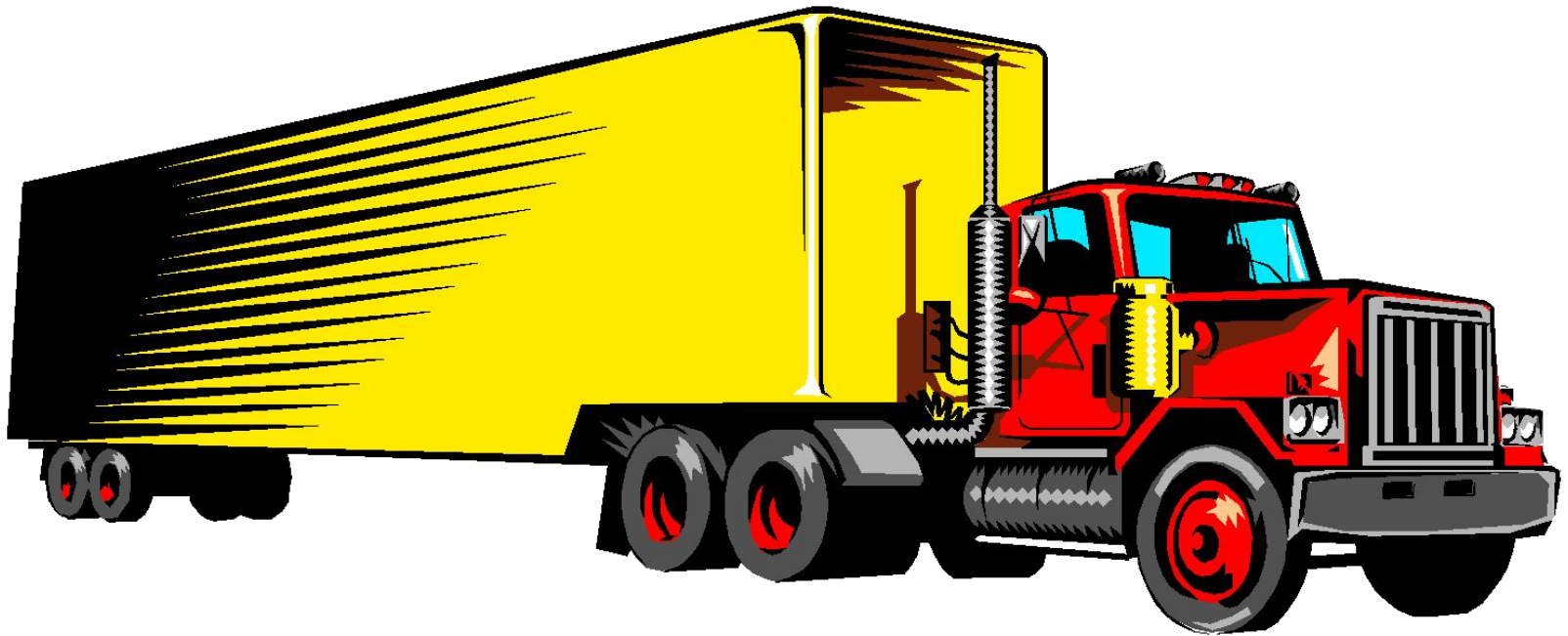
Now, assume that it wasn't until July 20 that Kid's Clothes received the full amount due from Jack & Jill, Inc. from the July 6 sale. Prepare the journal entry for Kid's Clothes.

## GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	20	Cash	4,000	
		Accounts Receivable (Jack & Jill, Inc.)		4,000

# Delivery Expenses

Delivery costs incurred by sellers are debited to **Delivery Expense**, an operating expense.



# Accounting for Sales Taxes

**Businesses collect sales tax at the point of sale.**

**Then, they remit the tax to the appropriate governmental agency at times specified by law.**

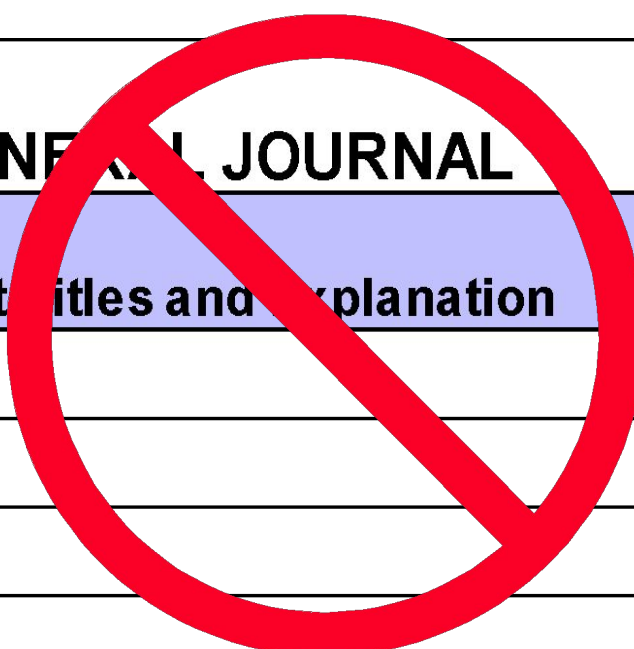
**\$1,000 sale × 7% tax = \$70 sales tax**

Date	Account Titles and Explanation	Debit	Credit
	Cash	1,070	
	Sales Tax Payable		70
	Sales		1,000

# Modifying an Accounting System

Most businesses use **special journals** rather than a general journal to record routine transactions that occur frequently.

GENERAL JOURNAL				
Date		Account titles and explanation	Debit	Credit



# Financial Analysis



**Net  
Sales**

- Trends over time
- Comparable store sales
- Sales per square foot of selling space



**Gross  
Profit  
Margins**

- Gross profit ÷ Net sales
- Overall gross profit margin
- Gross profit margins by department and products

# Ethics, Fraud, and Corporate Governance

**Sales discounts and allowances are contra-revenue accounts. Sales discounts and allowances reduce gross sales. As such, net income will be incorrect if discounts and allowances are not properly recorded.**

**The pressure brought to bear on subordinates to implement fraudulent schemes developed by top management can often be intense. Top management can threaten employees with termination if they fail to participate in the fraud. Unfortunately, employees who acquiesce to such pressure face tremendous legal risks.**

# End of Chapter 6

