Accounting for Merchandising Operations

Chapter 5

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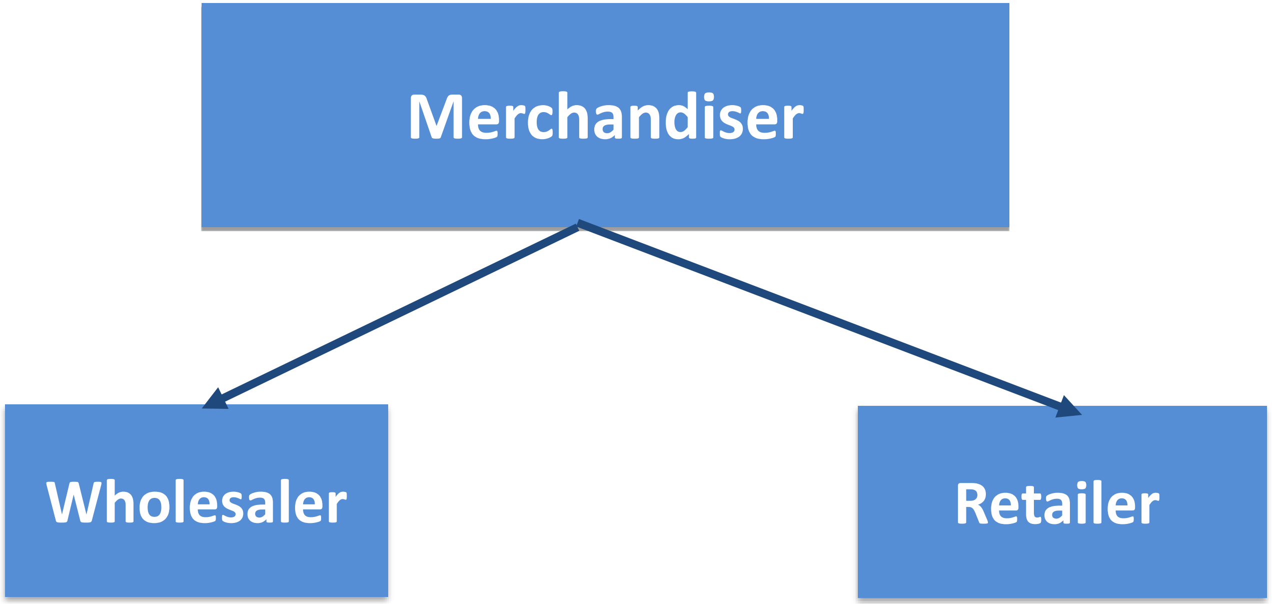
Fundamental Accounting Principles

3rd Edition

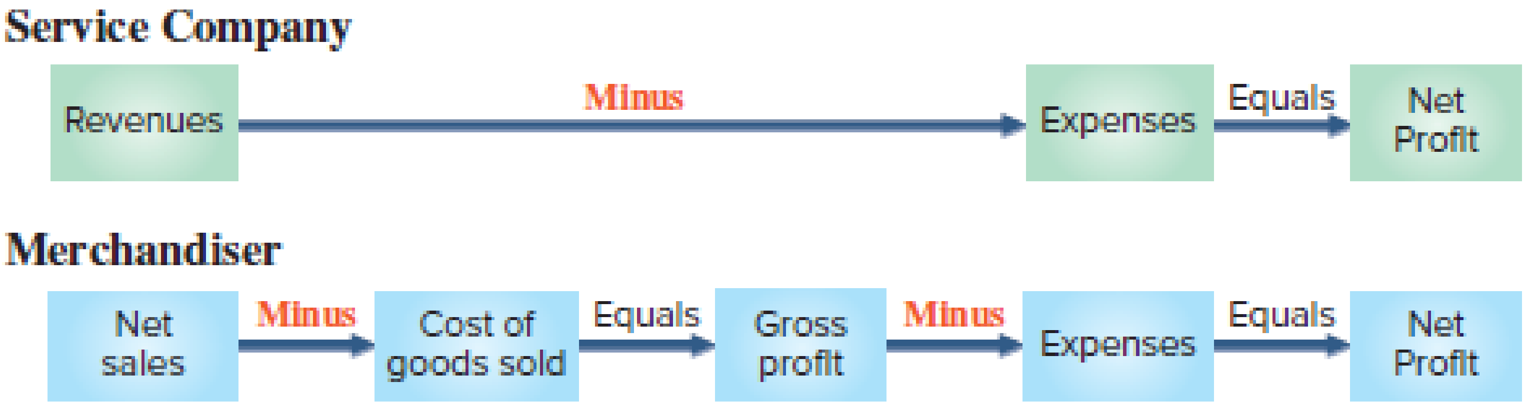
Merchandiser

Merchandising companies sell products to earn revenue.

Examples: sporting goods, clothing, and auto parts stores



Reporting Profit for a Merchandiser



Service Company

LIBERTY TAX Income Statement ($ millions)	
Revenues	$174
Expenses	162
Net profit	$ 12

Merchandising Company

NORDSTROM INC. Income Statement ($ millions)	
Net sales	$14,757
Cost of goods sold	9,440
Gross profit	5,317
Expenses	4,963
Net profit	$ 354

Exhibit 5.2

Learning Objective C1: Describe merchandise activities and identify income components for a merchandising company.

Discussion Question

Q: Explain how a business can earn a positive gross profit on its sales and still have a net loss?

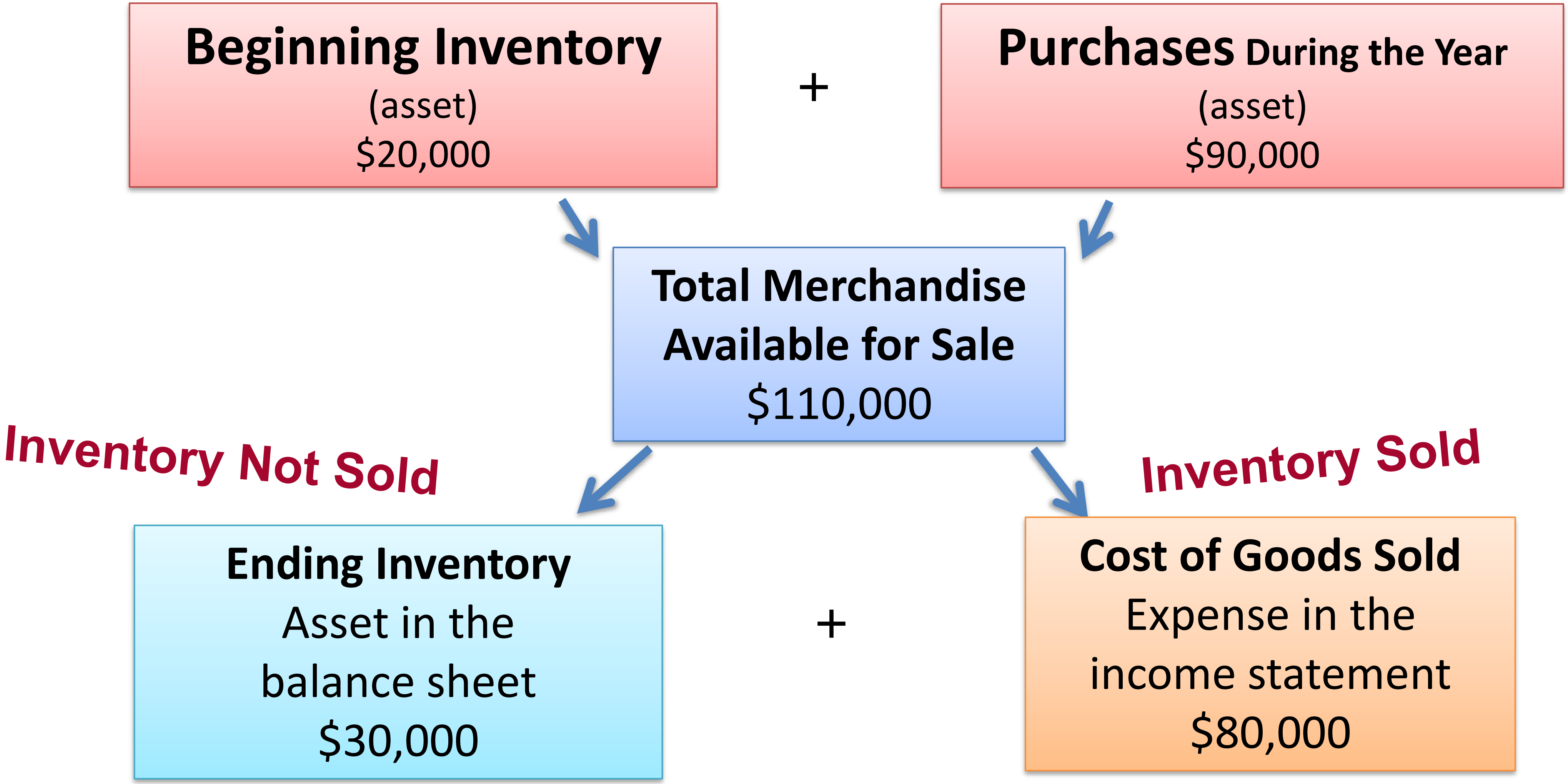
Operating Cycle for a Merchandiser

Begins with the purchase of merchandise and ends with the collection of cash from the sale of merchandise.

Exhibit 5.3

Learning Objective C2: Identify and explain the inventory asset and cost flows of a merchandising company.

Inventory System



Inventory Systems: Definitions

- Perpetual systems
  - updates accounting records for each purchase and sale of merchandising

- Periodic systems
  - Updates records for purchase and sale of merchandise only at the end of the accounting period

Learning Objective C2: Identify and explain the inventory asset and cost flows of a merchandising company.

Purchases without Cash Discounts

On November 2, Z-Mart purchased $500 of merchandise inventory for cash.

Nov. 2	Merchandise Inventory	500	
	Cash		500
	Purchased goods for cash.		

If Purchase On Credit:

Dr. Merchandise Inventory	500	
Cr. Accounts Payable		500

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Purchases with Cash Discounts

On November 2, Z-Mart purchased $500 of merchandise inventory on account, credit terms are 2/10, n/30.

(a) Nov. 2	Merchandise Inventory	500	
	Accounts Payable		500
	Purchased goods, terms 2/10, n/30.		

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Credit Terms

A deduction from the invoice price granted to induce early payment of the amount due.

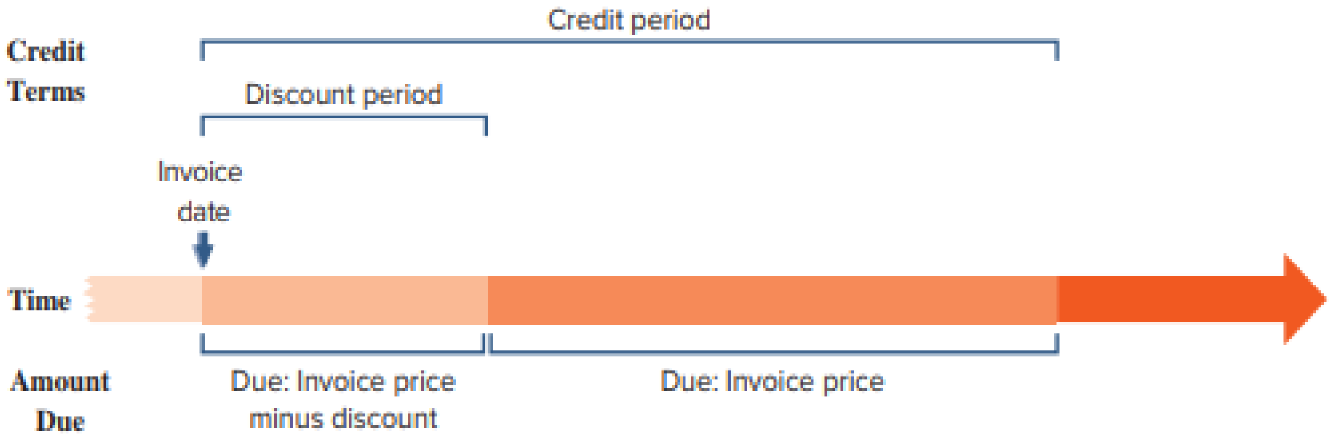


Exhibit 5.5

Buyer—Purchase discount
Seller—Sales discount

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Invoice

Exhibit 5.6

INVOICE

1 TREX
W9797 Cherry Rd.
Antigo, WI 54409

Invoice	
Date	Number
2 11/2/21	4657-2

SOLD TO 3

Firm Name	Z-Mart
Attention of	Tom Novak, Purchasing Agent
Address	10 Michigan Street
City	Chicago
State	Illinois Zip 60521

4 P.O. Date	Salesperson	5 Terms	6 Freight	Ship
10/30/21	#141	2/10, n/30	FOB Destination	Via FedEx

Model No.	Description	Quantity	Price	Amount
7 CH015	Toddler–Challenger X7	1	150	150
SD099	Boys/Girls–Speed Demon	1	350	350

See reverse for terms of sale and returns.

Subtotal	500
Shipping	—
Tax	—
8 Total	500

Net of Discount $490 9

Key:
1. Seller
2. Invoice date
3. Purchaser
4. Order date
5. Credit terms
6. Freight terms
7. Goods
8. Total invoice amount
9. Net amount

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Gross Method

On November 2, Z-Mart purchased $500 of merchandise inventory on account, credit terms are 2/10, n/30.

Pay within discount period (Nov. 2—Nov. 12): Due=$500-$500*2%=$490
Pay after discount period (Nov. 13—Dec. 2): Due=$500

(a) Nov. 2	Merchandise Inventory	500	
	Accounts Payable		500
	Purchased goods, terms 2/10, n/30.		

The Gross Method records the purchase at its gross(full) invoice amount.

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Payment within Discount Period: Journal Entry

On November 12, Z-Mart paid the amount due on the purchase of November 2.

(*b1*) Nov. 12	Accounts Payable	500	
	Merchandise Inventory.		10
	Cash*		490
	*Payment for goods within discount period. *$500 × (100% − 2%)*		

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Payment within Discount Period: Ledger Accounts

After we post these entries, the accounts involved look like these:

Accounts Payable			
		Nov. 2	500
Nov. 12	500		
		Bal.	0

Merchandise Inventory			
Nov. 2	500		
		Nov. 12	10
Bal.	490		

Cash			
		Nov. 12	490

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Payment after Discount Period

On December 2, Z-Mart paid the amount due on the purchase of November 2.

(*b2*) Dec. 2	Accounts Payable	500	
	Cash		500
	Payment for goods outside discount period.		

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Purchases with Returns and Allowances

Purchase Return:

Merchandise returned by the purchaser to the supplier.

Purchase Allowance:

A price reduction to the buyer of defective or unacceptable merchandise.

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Purchases Allowances

On November 5, Z-Mart (buyer) agrees to a $30 allowance from Trex for defective merchandise.

(c1) Nov. 5	Accounts Payable	30	
	Merchandise Inventory..........................		30
	Allowance for defective goods.		

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Purchases Returns

Z-Mart purchases $250 of merchandise on June 1 with terms 2/10, n/60. On June 3, Z-Mart returns $50 of goods before paying the invoice. When Z-Mart pays on June 11, it takes the 2% discount only on the $200 remaining balance.

June 1	Merchandise Inventory	250	
	Accounts Payable		250
	Purchase goods, terms 2/10, n/60.		
(c2) June 3	Accounts Payable	50	
	Merchandise Inventory		50
	Return goods to seller.		
June 11	Accounts Payable	200	
	Merchandise Inventory		4
	Cash		196
	Payment for $200 of goods less $4 discount.		

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Purchases and Transportation Costs

Exhibit 5.7

Shipping Terms	Ownership Transfers at	Goods in Transit Owned by	Transportation Costs Paid by
FOB shipping point	Shipping point	Buyer	**Buyer** Merchandise Inventory . . . # Cash . . . . #
FOB destination	Destination	Seller	**Seller** Delivery Expense . . . . # Cash . . . . #

Transportation-in/freight-in

Transportation-out/freight-out

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Transportation Costs

Z-Mart purchased merchandise on terms of FOB shipping point. The transportation charge is $75.

(*d*) Nov. 24	Merchandise Inventory	75	
	Cash		75
	Pay freight costs on goods.		

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Itemized Costs of Purchases

Itemized Costs of Merchandise Purchases	
Invoice cost of merchandise purchases	$ 235,800
Less: Purchases discounts received	(4,200)
Purchases returns and allowances.	(1,500)
Add: Costs of transportation-in	2,300
Total net cost of merchandise purchases	**$232,400**

Exhibit 5.8

Learning Objective P1: Analyze and record transactions for merchandise purchases using a perpetual system.

Accounting for Merchandise Sales

Computation of Gross Profit	
Net sales (net of discounts, returns, and allowances)	$314,700
Cost of goods sold	230,400
Gross profit	$ 84,300

Exhibit 5.9

Sales of Merchandise

Each sales transaction for a merchandiser involves two parts:

Revenue received (and asset increased) from the customer.

Cost of goods sold incurred (and asset decreased) to the customer.

Learning Objective P2: Analyze and record transactions for merchandise sales using a perpetual system.

Sales without Cash Discounts

Z-Mart sold $1,000 of merchandise on credit. The merchandise has a cost basis to Z-Mart of $300.

Revenue side journal entry:

Nov. 12	Accounts Receivable	1,000	
	Sales		1,000
	Sell goods on credit.		

Cost side journal entry:

Nov. 12	Cost of Goods Sold	300	
	Merchandise Inventory.		300
	Record cost of Nov. 12 sale.		

Learning Objective P2: Analyze and record transactions for merchandise sales using a perpetual system.

Sales <u>with</u> Cash Discounts

Z-Mart completes a $1,000 credit sale with terms of 2/10, n/45.

Nov. 12	Accounts Receivable	1,000	
	Sales		1,000
	Sell goods, terms 2/10, n/45.		
Nov. 12	Cost of Goods Sold	300	
	Merchandise Inventory		300
	Record cost of Nov. 12 sale.		

Buyer pays <u>within</u> discount period:

Nov. 22	Cash*	980	
	Sales Discounts	20	
	Accounts Receivable		1,000
	Receive payment on Nov. 12 sale less discount.		
	**$1,000 – ($1,000 × 2%)*		

Buyer pays <u>after</u> discount period:

Dec. 27	Cash	1,000	
	Accounts Receivable		1,000
	Receive payment on Nov. 12 sale <u>after</u> discount period.		

Learning Objective P2: Analyze and record transactions for merchandise sales using a perpetual system.

Sales Returns and Allowances

Sales returns and allowances usually involve dissatisfied customers and the possibility of lost future sales.

Sales returns refer to merchandise that customers return to the seller after a sale.	Sales allowances refer to reductions in the selling price of merchandise sold to customers.

Sales <u>with</u> Returns and Allowances

Customer returns merchandise which sold for $15 and cost $9.

Revenue Side

(e1) Nov. 26	Sales Returns and Allowances	15	
	Cash		15
	Goods return from Nov. 12 sale.		

Returned Goods - <u>Not</u> Defective:

Cost Side

(e2) Nov. 26	Merchandise Inventory	9	
	Cost of Goods Sold.		9
	Returned goods are added back to inventory.		

Returned Goods - <u>Are</u> Defective:

Nov. 26	Merchandise Inventory	2	
	Loss from Defective Merchandise	7	
	Cost of Goods Sold.		9
	Returned defective goods to inventory and record loss.		

Learning Objective P2: Analyze and record transactions for merchandise sales using a perpetual system.

Buyer Granted Allowances

Assume that $40 of the merchandise Z-Mart sold on November 12 is defective but the buyer decides to keep it because Z-Mart offers a $10 price reduction.

(*f*) Nov. 24	Sales Returns and Allowances	10	
	Cash		10
	Grant sales allowance.		

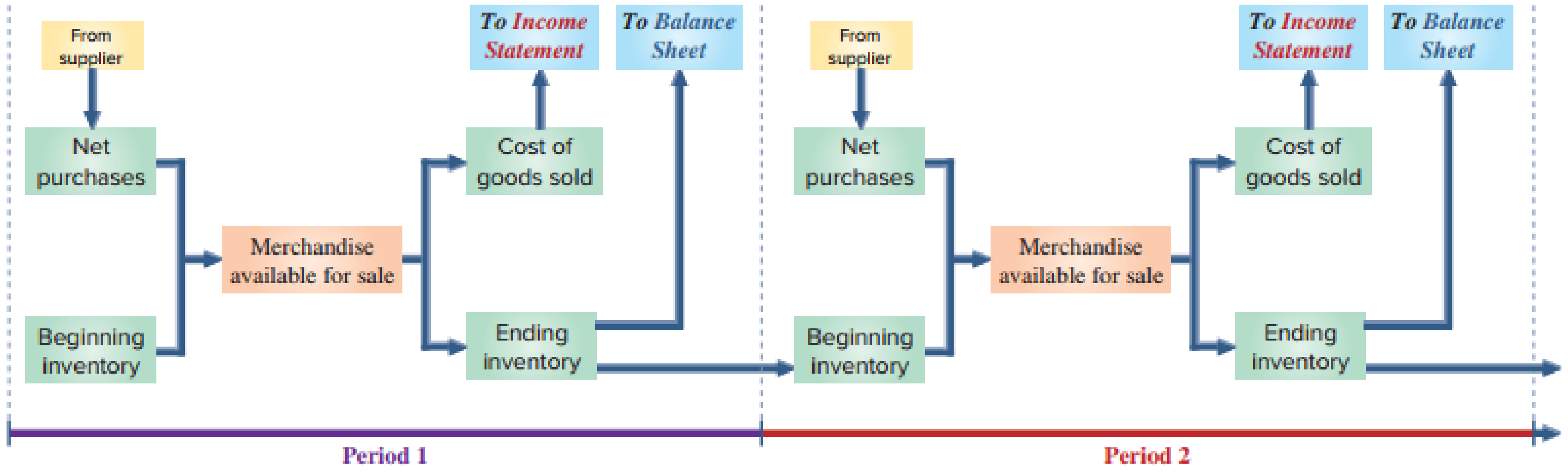
Learning Objective P2: Analyze and record transactions for merchandise sales using a perpetual system.

Discussion Question

Q: What is the difference between a sales discount and a purchases discount?

Merchandising Cost Flow in the Accounting Cycle

Exhibit 5.10



Learning Objective P3: Prepare adjustments and close accounts for a merchandising company.

Adjusting Entries for Merchandisers

Shrinkage: adjustment to reflect loss of merchandise:

Dec. 31	Cost of Goods Sold	250	
	Merchandise Inventory		250
	Adjust for $250 shrinkage.		

Sales Discounts, Returns and Allowances:

Revenue recognition rules require sales to be reported at the amount expected to be received. Adjusting entries are made for:

1. Expected sales discounts
2. Expected returns and allowances (revenue side)
3. Expected returns and allowances (cost side)

Learning Objective P3: Prepare adjustments and close accounts for a merchandising company.

Closing Entries for Merchandisers

Exhibit 5.11

Step 1: Close Credit Balances in Temporary Accounts to Income Summary.

Dec. 31	Sales	321,000	
	Income Summary		321,000
	Close credit balances in temporary accounts.		

Step 2: Close Debit Balances in Temporary Accounts to Income Summary.

Dec. 31	Income Summary	308,100	
	Sales Discounts		4,300
	Sales Returns and Allowances		2,000
	Cost of Goods Sold		230,400
	Depreciation Expense		3,700
	Salaries Expense		43,800
	Insurance Expense		600
	Rent Expense		9,000
	Supplies Expense		3,000
	Advertising Expense		11,300
	Close debit balances in temporary accounts.		

Step 3: Close Income Summary.

Dec. 31	Income Summary	12,900	
	K. Marty, Capital		12,900

Step 4: Close Withdrawals.

Dec. 31	K. Marty, Capital	4,000	
	K. Marty, Withdrawals		4,000

Learning Objective P3: Prepare adjustments and close accounts for a merchandising company.

	Merchandising Transactions	Merchandising Entries	Dr.	Cr.
Purchases	Purchasing merchandise for resale.	Merchandise Inventory	#	
		Cash or Accounts Payable		#
	Paying freight costs on purchases; FOB shipping point.	Merchandise Inventory	#	
		Cash		#
	Paying within discount period.	Accounts Payable	#	
		Merchandise Inventory		#
		Cash		#
	Paying outside discount period.	Accounts Payable	#	
		Cash		#
	Recording purchases returns or allowances.	Cash or Accounts Payable	#	
		Merchandise Inventory		#
Sales	Selling merchandise.	Cash or Accounts Receivable	#	
		Sales		#
		Cost of Goods Sold	#	
		Merchandise Inventory		#
	Receiving payment within discount period.	Cash	#	
		Sales Discounts	#	
		Accounts Receivable		#
	Receiving payment outside discount period.	Cash	#	
		Accounts Receivable		#
	Receiving sales returns of nondefective inventory.	Sales Returns and Allowances	#	
		Cash or Accounts Receivable		#
		Merchandise Inventory	#	
		Cost of Goods Sold		#
	Recognizing sales allowances.	Sales Returns and Allowances	#	
		Cash or Accounts Receivable		#
	Paying freight costs on sales; FOB destination.	Delivery Expense	#	
		Cash		#

	Merchandising Events	Adjusting and Closing Entries	Dr.	Cr.
Adjusting	Adjustment for shrinkage (occurs when recorded amount larger than physical inventory).	Cost of Goods Sold	#	
		Merchandise Inventory		#
	Period-end adjustment for expected sales discounts.*	Sales Discounts	#	
		Allowance for Sales Discounts		#
	Period-end adjustment for expected returns—both revenue side and cost side.*	Sales Returns and Allowances	#	
		Sales Refund Payable		#
		Inventory Returns Estimated	#	
		Cost of Goods Sold		#
Closing	Closing temporary accounts with credit balances.	Sales	#	
		Income Summary		#
	Closing temporary accounts with debit balances.	Income Summary	#	
		Sales Returns and Allowances		#
		Sales Discounts		#
		Cost of Goods Sold		#
		Delivery Expense		#
		"Other Expenses"		#

*Period-end adjustments depend on unadjusted balances, which can reverse the debit and credit in the adjusting entries shown; these three entries are covered in Appendix 5B.

Merchandise Inventory

Beginning inventory Purchases Freight-in (FOB shp pt)	Pur. returns Pur. allowances Pur. discounts Shrinkage
Goods avail. for sale Customer returns	COGS
Ending inventory	

Income Statement

Exhibit 5.13

Z-MART
Income Statement
For Year Ended December 31, 2021

Sales		$321,000
Less: Sales discounts	$ 4,300	
Sales returns and allowances	2,000	6,300
Net sales		314,700
Cost of goods sold*		230,400
Gross profit		84,300
Operating expenses		
Selling expenses		
Depreciation expense—Store equipment	3,000	
Sales salaries expense	18,500	
Rent expense—Selling space	8,100	
Store supplies expense	1,200	
Advertising expense	11,300	
Total selling expenses		42,100
General and administrative expenses		
Depreciation expense—Office equipment	700	
Office salaries expense	25,300	
Insurance expense	600	
Rent expense—Office space	900	
Office supplies expense	1,800	
Total general and administrative expenses		29,300
Total operating expenses		71,400
Profit from operations		12,900
Other revenues and gains (expenses and losses)		
Interest revenue	1,000	
Gain on sale of building	2,500	
Interest expense	(1,500)	
Total other revenues and gains (expenses and losses)		2,000
Net profit		$ 14,900

Gross profit computation

Income from operations computation

Nonoperating activities computation

*Cost of goods sold:	
Beginning inventory	$ 19,000
Net cost of purchases	232,400
Goods available for sale	251,400
Less ending inventory	21,000
Cost of goods sold	$230,400

Learning Objective P4: Define and prepare financial statements for a merchandising company.

Classified Balance Sheet

Exhibit
5.14

Z-MART Balance Sheet (partial) December 31, 2021	
Current assets	
Cash	$ 8,200
Accounts receivable	11,200
Merchandise inventory	**21,000**
Office supplies	550
Store supplies	250
Prepaid insurance	300
Total current assets	$41,500

Highly Liquid

Less Liquid

Learning Objective P4: Define and prepare financial statements for a merchandising company.

Learning Objective P5

Appendix 5A

Record and compare merchandising transactions using both periodic and perpetual inventory system.

Periodic Inventory System - Purchases

Periodic inventory system updates inventory only at the end of a period to reflect the quantity and cost of goods available and goods sold.

Transaction		Periodic	Debit	Credit	Perpetual	Debit	Credit
Credit Purchase	(a)	Purchases	500		Merchandise Inventory	500	
		Accounts Payable		500	Accounts Payable		500
Payment within discount period	(b1)	Accounts Payable	500		Accounts Payable	500	
		Purchases Discounts*		10	Merchandise Inventory*		10
		Cash		490	Cash		490
		*$500 × 2%			*$500 × 2%		
Payment after discount period	(b2)	Accounts Payable	500		Accounts Payable	500	
		Cash		500	Cash		500
Purchase allowance	(c1)	Accounts Payable	30		Accounts Payable	30	
		Purchases Returns and Allowances		30	Merchandise Inventory		30
Purchase return	(c2)	Accounts Payable	50		Accounts Payable	50	
		Purchases Returns and Allowances		50	Merchandise Inventory		50
Transportation-in	(d)	Transportation-In	75		Merchandise Inventory	75	
		Cash		75	Cash		75

Learning Objective P5: Record and compare merchandising transactions using both periodic and perpetual inventory system.

Periodic Inventory System - Sales

Periodic inventory system updates inventory only at the end of a period to reflect the quantity and cost of goods available and goods sold.

Credit sale

	Periodic			Perpetual		
	Accounts Receivable..........	1,000		Accounts Receivable..............	1,000	
	Sales..................		1,000	Sales......................		1,000
				Cost of Goods Sold..............	300	
	No cost-side entry			Merchandise Inventory		300

Sale return

	Periodic			Perpetual		
(e1)	Sales Returns and Allowances	15		Sales Returns and Allowances......	15	
	Cash		15	Cash		15
(e2)				Merchandise Inventory	9	
	No entry			Cost of Goods Sold		9

Sale allowance

	Periodic			Perpetual		
(f)	Sales Returns and Allowances	10		Sales Returns and Allowances......	10	
	Cash		10	Cash		10

Learning Objective P5: Record and compare merchandising transactions using both periodic and perpetual inventory system.

Periodic Inventory– Adjusting & Closing Entries

Exhibit 5A.1

Shrinkage

	Periodic Adjusting Entries	Debit	Credit	Perpetual Adjusting Entries	Debit	Credit
(z)	None			Cost of Goods Sold	250	
				Merchandise Inventory		250
(g)	Sales Discounts	50		Sales Discounts	50	
	Allowance for Sales Discounts		50	Allowance for Sales Discounts		50
(h1)	Sales Returns and Allowances	900		Sales Returns and Allowances	900	
	Sales Refund Payable		900	Sales Refund Payable		900
(h2)	Inventory Returns Estimated	300		Inventory Returns Estimated	300	
	Purchases		300	Cost of Goods Sold		300

Entries in gray are covered in Appendix 5B. Entries in gray are covered in Appendix 5B.

Closing entries

	Periodic Closing Entries	Debit	Credit	Perpetual Closing Entries	Debit	Credit
(1)	Sales	321,000		Sales	321,000	
	Merchandise Inventory (ending)	**21,000**				
	Purchases Discounts	**4,200**				
	Purchases Returns and Allowances	**1,500**				
	Income Summary		347,700	Income Summary		321,000
(2)	Income Summary	334,800		Income Summary	308,100	
	Sales Discounts		4,300	Sales Discounts		4,300
	Sales Returns and Allowances		2,000	Sales Returns and Allowances		2,000
	Merch. Inven. (beginning)		**19,000**			
	Purchases		**235,800**	**Cost of Goods Sold**		**230,400**
	Transportation-In		**2,300**			
	Depreciation Expense		3,700	Depreciation Expense		3,700
	Salaries Expense		43,800	Salaries Expense		43,800
	Insurance Expense		600	Insurance Expense		600
	Rent Expense		9,000	Rent Expense		9,000
	Supplies Expense		3,000	Supplies Expense		3,000
	Advertising Expense		11,300	Advertising Expense		11,300
(3)	Income Summary	12,900		Income Summary	12,900	
	K. Marty, Capital		12,900	K. Marty Capital		12,900
(4)	K. Marty, Capital	4,000		K. Marty, Capital	4,000	
	K. Marty, Withdrawals		4,000	K. Marty, Withdrawals		4,000

Learning Objective P5: Record and compare merchandising transactions using both periodic and perpetual inventory system.

P 5–2A: Prepare journal entries to record the following merchandising transactions of Lowe's, which uses the perpetual inventory system and the gross method. *Hint*: It will help to identify each receivable and payable; for example, record the purchase on August 1 in *Accounts Payable--Aron*.

- Aug 1. Purchased merchandise from Aron Company for $7,500 under credit terms of 1/10, n/30, FOB destination, invoice dated August 1.
- Aug 5. Sold merchandise to Baird Corp. for $5,200 under credit terms of 2/10, n/60, FOB destination, invoice dated August 5. The merchandise had cost $4,000.
- Aug 8. Purchased merchandise from Waters Corporation for $5,400 under credit terms of 1/10, n/45, FOB shipping point, invoice dated August 8.
- Aug 9. Paid $125 cash for shipping charges related to the August 5 sale to Baird Corp.
- Aug 10. Baird returned merchandise from the August 5 sale that had cost Lowe's $400 and was sold for $600. The merchandise was restored to inventory.
- Aug 12. After negotiations with Waters Corporation concerning problems with the purchases on August 8, Lowe's received a price reduction from Waters of $400 off the $5,400 of goods purchased. Lowe's debited accounts payable for $400.
- Aug 14. At Aron's request, Lowe's paid $200 cash for freight charges on the August 1 purchase, reducing the amount owed (account payable) to Aron.
- Aug 15. Received balance due from Baird Corp. for the August 5 sale less the return on August 10.
- Aug 18. Paid the amount due Waters Corporation for the August 8 purchase less the price allowance from August 12.
- Aug 19. Sold merchandise to Tux Co. for $4,800 under credit terms of n/10, FOB shipping point, invoice dated August 19. The merchandise had cost $2,400.
- Aug 22. Tux requested a price reduction on the August 19 sale because the merchandise did not meet specifications. Lowe's gave a price reduction (allowance) of $500 to Tux and credited Tux's accounts receivable for that amount.
- Aug 29. Received Tux's cash payment for the amount due from the August 19 sale less the price allowance from August 22.
- Aug 30. Paid Aron Company the amount due from the August 1 purchase.

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Aug 14. At Aron’s request, Lowe’s paid $200 cash for freight charges on the August 1 purchase, reducing the amount owed (account payable) to Aron.

Aug 15. Received balance due from Baird Corp. for the August 5 sale less the return on August 10.

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Aug 29. Received Tux’s cash payment for the amount due from the August 19 sale less the price allowance from August 22.

Aug 30. Paid Aron Company the amount due from the August 1 purchase.

End of Chapter 5