

CHAPTER 5  
ACCOUNTING FOR MERCHANDISING OPERATIONS

**Objectives:** After studying this chapter, you should be able to:

- Identify the differences between service and merchandising companies
- Explain the recording of purchases under a perpetual inventory system and periodic inventory system.
- Explain the recording of sales revenue under perpetual inventory system and periodic inventory system
- Explain the steps in accounting cycle for a merchandising company.
- Preparing work sheet for a merchandiser.
- Prepare Income statement, Retained earnings statement and Statement of financial position for a merchandiser.

**Merchandising Companies** are those businesses who buy and sell merchandise (goods / products) for their primary source of revenue.

- Merchandising Companies that purchase and sell directly to consumers are called retailers.
- Merchandising Companies that sell to retailers are called wholesalers.

The primary source of revenue is by selling merchandise, often referred to as **sales revenue or sales**.

- The two main expenses for a merchandiser are:
  - ❖ Cost of goods sold
  - ❖ Operating expenses.
- The added asset account for a merchandising company is the **Inventory account**.

The accounting for inventory depends on which method the company is using:

**Perpetual Inventory system or Periodic inventory system**

Perpetual inventory system	Periodic inventory system										
<ul style="list-style-type: none"><li>• Companies keep detailed records of cost of each inventory purchase and sale.</li><li>• These records continuously-perpetually-show the inventory that should be on hand for every item.</li><li>• A company determines the cost of goods sold each time a sale occurs.</li></ul>	<ul style="list-style-type: none"><li>• No detailed inventory records of the goods on hand throughout the period are kept.</li><li>• The cost of goods sold is determined only at the end of the accounting period.</li><li>• <b>Calculating Cost of goods sold:</b><table><tr><td>Beginning inventory</td><td>\$100,000</td></tr><tr><td>Add: Purchases, net</td><td><u>800,000</u></td></tr><tr><td>Goods available for sale</td><td>900,000</td></tr><tr><td>Less: Ending inventory</td><td><u>125,000</u></td></tr><tr><td>Cost of goods sold</td><td><u>\$775,000</u></td></tr></table></li></ul>	Beginning inventory	\$100,000	Add: Purchases, net	<u>800,000</u>	Goods available for sale	900,000	Less: Ending inventory	<u>125,000</u>	Cost of goods sold	<u>\$775,000</u>
Beginning inventory	\$100,000										
Add: Purchases, net	<u>800,000</u>										
Goods available for sale	900,000										
Less: Ending inventory	<u>125,000</u>										
Cost of goods sold	<u>\$775,000</u>										

**Few Terms in Merchandising Business.**

**Discount**

- **Purchase Discounts**

Credit terms may permit buyer to claim a cash discount for prompt payment.

Example: Credit terms of 3/15, n/30, is read “three-fifteen, net thirty.” 3% cash discount if payment is made within 15 days.

- **Sales Discount**
  - Offered to customers to promote prompt payment.
  - “Flipside” of purchase discount.
  - Contra-revenue account (debit).

**Freight terms**

**FOB shipping point**

Seller places goods Free on Board the carrier, and **buyer must pay to get the goods delivered i.e.: buyer pays freight costs.**

**FOB destination**

Legal title of the goods remain with the seller until the goods reach the buyers location.

Seller places goods Free on Board to the buyer’s place of business, and **seller pays freight costs.**

JOURNAL ENTRIES

Transactions	Perpetual inventory system	Periodic Inventory system
<b>Journal entries for the Buyer</b>		
1.Purchased merchandise	Inventory..... xx Cash/ Accounts Payable... xx	Purchase..... xx Cash/ Accounts Payable..... xx
2.Return of merchandise purchased	Cash/Accounts payable..... xx Inventory..... xx	Cash/Accounts payable..... xx Purchase return and Allowance..... xx
3.Paid freight cost (FOB Shipping Point)	Inventory..... xx Cash..... xx	Freight-in/Transportation –in.. xx Cash..... xx
4. Payment during the discount period	Accounts Payable..... xx Cash..... xx Inventory..... xx	Accounts Payable..... xx Cash..... xx Purchase discount ..... xx
<b>Journal entries for the Seller</b>		
1. Sale of merchandise	Accounts Receivable/ Cash..... xx Sales revenue..... xx Cost of goods sold..... xx Inventory..... xx	Accounts Receivable/ Cash...xx Sales revenue..... xx
2. Customer returns merchandise sold	Sales return & Allowance..... xx Accounts receivable / Cash..... xx Inventory..... xx Cost of goods sold..... xx	Sales return & Allowance....xx A/R / Cash ..... xx
3. Paid freight (FOB Destination)	Freight-out/Delivery expense... xx Cash..... xx	Freight-out/Delivery expense...xx Cash..... xx
4. Collected cash during the discount period	Cash..... xx Sales discount..... xx Accounts receivable.... .. xx	Cash.....xx Sales discount..... xx Accounts receivable..... xx

Purchase Returns and Allowances

Purchaser may be dissatisfied because goods are damaged or defective, or of inferior quality, or do not meet specifications.

- Purchase Return  
Return goods for credit if the sale was made on credit, or for a cash refund if the purchase was for cash.
- Purchase Allowance  
May choose to keep the merchandise if the seller will grant an allowance (deduction) from the purchase price.

Sales Returns and Allowances

- “Flipside” of purchase returns and allowances.
- Contra-revenue account (debit).

Financial Statements for a merchandising business. (Under perpetual Inventory system)

1.

<u>Name of business</u>			
<u>Multiple step Income statement (Income statement)</u>			
<u>For the Month/ Quarter/ year ended .....</u>			
<b>Sales revenue:</b>			
Sales			480,000
Less: Sales returns and allowance	12,000		
Sales discount	8,000	20,000	
Net sales			460,000
Less: Cost of goods sold			316,000
Gross profit			144,000
<b>Operating expenses:*</b>			
Sales salaries expense	64,000		
Advertising expense	17,000		
Delivery expense	16,000		
Depreciation expense-Delivery equipment	8,000		
Office salaries expense	7,000		
Utilities expense	2,000		
Total operating expense			114,000
Income from operations			30,000
<b>Other Incomes and Gains:</b>			
Interest revenue	3,000		
Gain on disposal	600	3,600	
<b>Other Expenses and Losses: **</b>			
Loss on disposal	(200)		
Interest expense	(1,800)	(2,000)	1,600
Net Income			\$31,600

Note :       \*    Expenses incurred in the process of earning sales revenue  
              \*\* Expenses that occur outside of a company’s day to day activities and it is recorded immediately after company’s primary operating activities. Other income and expense consists of various revenues and gains and expenses and losses that are unrelated to the company’s main line of operations.

2.

<u>Name of business</u>	
<u>Retained Earnings Statement</u>	
<u>For the year/ quarter/ month ended.....</u>	
Retained earnings, beginning balance	xxxx
Add: Net income/ (Less. if net loss)	xxx
	xxxx
Less: Dividend	xxx
Retained earnings, ending balance	xxxx

**FORMAT OF STATEMENT OF FINANCIAL POSITION**

**ABAC Company**  
**Statement of Financial Position**  
**December 31, 20xx**

**ASSETS**

<b>Current Assets:</b>			
Cash		\$9,000	
Marketable securities		200	
Accounts receivable		4,800	
Notes receivable		5,000	
Inventory		200	
Supplies		1,800	
Prepaid expense		<u>1,400</u>	
Total Current Assets			22,400
<b>Non-Current Assets:</b>			
Property, Plant and Equipment:			
Land		\$11,500	
Building	15,000		
Less: Accumulated Depreciation-Building	<u>1,000</u>	14,000	
Equipment	7,500		
Less: Accumulated Depreciation-Equipment	<u>500</u>	<u>7,000</u>	
Total Property Plant and Equipment		\$32,500	
Intangible Assets			...0...
Total Non-current assets			<u>\$32,500</u>
Total Assets			<u>\$54,900</u>

**LIABILITIES AND SHAREHOLDERS' EQUITY**  
**LIABILITIES**

<b>Current Liabilities:</b>			
Notes payable	4,000		
Accounts Payable	3,000		
Interest Payable	500		
Salaries and Wages Payable	800		
Unearned Revenue	<u>1,000</u>		
Total Current Liabilities		9,300	
<b>Non-current Liabilities:</b>			
Mortgage Payable	12,000		
Bank Loan	7,000		
Bonds payable	<u>3,000</u>		
Total Non-current liabilities		<u>22,000</u>	
<b>Total Liabilities</b>			31,300
<b>Shareholders' Equity:</b>			
Share Capital-Ordinary shares	\$15,000		
Retained Earnings	<u>8,600</u>		
Total Shareholder's Equity			<u>23,600</u>
Total Liabilities and Shareholders' Equity			<u>\$54,900</u>

**Adjusting entry for adjustment of Inventory account:**

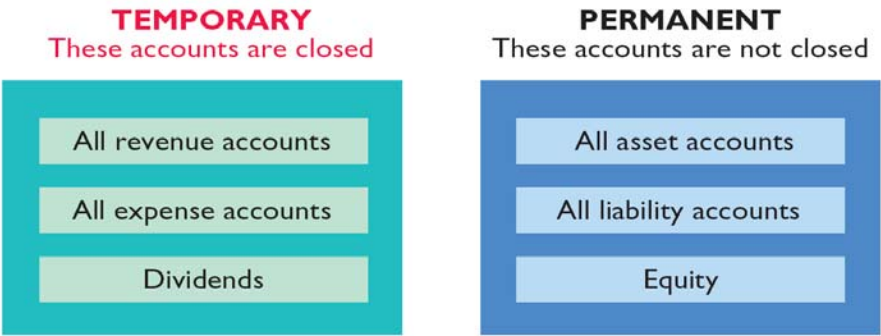
- A merchandising company generally has the same adjusting entries as a service company.
- A merchandising company that uses perpetual inventory system will require one additional adjustment to make the records agree with the actual inventory on hand.
- The perpetual inventory records may be incorrect due to recording errors, theft or waste.
- Thus, the company need to adjust the perpetual records to make the recorded inventory amount agree with the inventory on hand. This involves adjusting the inventory and cost of goods sold. The adjusting entry is:

**Adjusting entry**

	Cost of goods sold	xxx	
	Inventory		xxx

**Closing entries**

- At the end of the accounting period, the company makes the accounts ready for the next period.
- Merchandising companies closes to **Income Summary (a temporary account used for closing purposes)** all accounts that affect net income. In journalizing, the company credits all temporary accounts with debit balances, and debits all temporary accounts with credit balances.



- **Closing entries** formally recognize, in the general ledger, the transfer of net income (or net loss) and dividends to **Retained Earnings**.

Closing Journal entries

▪ <u>Close revenue accounts</u>			
Dr. Revenues.....	xxx		
Cr. Income Summary		xxx	
▪ <u>Close expense Accounts</u>			
Dr Income Summary.....	xxx		
Cr. Expenses.....		xxx	
▪ <u>Close Income summary account to retained earnings ( net income)</u>			
Dr Income Summary.....	xxx		
Cr. Retained Earnings.....		xxx	
▪ <u>Close Income Summary account to retained earnings ( net loss)</u>			
Dr Retained Earnings.....	xxx		
Cr. Income Summary.....		xxx	
▪ <u>Close Dividend account</u>			
Dr. Retained Earnings.....	xxx		
Cr. Dividend.....		xxx	
<b>Note: Dividends are closed directly to Retained Earnings and <i>not</i> to Income Summary because Dividends are not an expense.</b>			

## Problems

### Problem 5-1:

The following transactions were completed during April, 20XX for William Sports Shop.

- April 4 Purchased cricket bat and balls from Heidi Co. \$ 860, terms 3/10, n/30, FOB Shipping point.
- 6 Paid freight on Heidi Co. purchase \$74.
- 8 Sold merchandise to customers \$900, terms n/30.
- 10 Received credit of \$60 from Heidi Co. for a cricket bat that was returned.
- 11 Purchased sports shoes from Velky Sports for cash \$300.
- 13 Paid Heidi Co. in full.
- 14 Purchased sports shirts and shorts from Lizen Sportswear \$700, terms 2/10, n/60.
- 15 Received cash refund of \$50 from Velky Sports for damaged merchandise that was returned.
- 17 Paid freight on Lizen Sportswear purchase \$30.
- 18 Sold merchandise to customers \$1,200, terms n/30.
- 20 Received \$500 in cash from customers in settlement of their accounts.
- 21 Paid Lizen Sportswear in full.
- 27 Granted an allowance of \$25 to customers for sports clothing that did not fit properly.
- 30 Received cash payments on account from customers \$620.

**Instruction:**

Journalize the April transactions for William Sports Shop using a periodic inventory system.

## Journal entries

[illegible]








**Problem 5-4:**

Natalie distributes books to retail stores and extends credit terms of 2/10, n/30 to all of its customers. At the end of May, Natalie’s inventory consisted of books purchased for €1,800. During June the following transactions occurred.

- June
- 1

Purchased books on account for €1,850 from Philip Publishers, FOB destination, terms 2/10, n/30. The appropriate party also made a cash payment of €50 for the freight on this date.
- 3

Sold books on account to Ester for €2,500. The cost of goods sold was €1,440.
- 6

Received €150 credit for books returned to Philip Publishers.
- 9

Paid Philip Publishers in full.
- 15

Received payment in full from Ester.
- 17

Sold books on account to Bunker Readers for €1,800. The cost of books sold was €1,020.
- 20

Purchased books on account for €1,500 from DC Publishers, FOB destination, terms 2/15, n/30. The appropriate party also made a cash payment of €50 for the freight on this date.
- 24

Received payment in full from Bunker Readers.
- 26

Paid DC Publishers in full.
- 28

Sold books on account to Cozy Corner for €1,300. The cost of the books sold was €850.
- 30

Granted Cozy Corner credit of €120 for books returned, costing €72.

**Instruction:**

Journalize the transactions for the month of June for Natalie Warehouse using **a perpetual inventory system**.

**Journal entries**

Date	Account Title	Debit	Credit

[illegible]

### Problem 5-5:

Sissy Supply is a wholesaler dealing in sports bags. On September 1, Sissy Supply had an inventory of 15 sports bags at a cost of \$200 each. During September, the following transactions and events occurred.

Sept. 4 Purchased 80 sports bags at \$200 each from Mabel, terms 2/10, n/30, FOB destination.

Sept. 6	Received credit of \$1200 for the return of 6 sports bags purchased on September 4 that were defective.
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Sept. 9 Sold 40 sports bags for \$250 each to Oliver Co, terms 2/10, n/30, FOB Destination.

Sept. 10 Paid \$500 freight on September 9 sales.

Sept. 13 Granted Oliver Co \$1,250 credit for 5 sports bags that were returned due to damage.

Sept. 14 Paid Mabel in full for September 4 purchase.

Sept. 20	Received payment in full from Oliver Co.
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Sept. 25 Purchased 10 sports bags for cash at a cost of \$250 each.

Sept. 26 Received refund of \$500 from supplier of Sept. 25, for 2 sports bags that were damaged.




b) Journal entries for Everest Company

Date	Account title	Debit	Credit

**Problem 5-7:**

The trial balance of Casinova Company at December 31, 20XX, the end of the company’s fiscal year is shown on the worksheet:

The following adjustment data is provided:

- 1. Supplies on hand totaled \$3,500.
- 2. Depreciation is \$9,000 on the equipment.
- 3. Interest of \$4,080 is accrued on notes payable at December 31.
- 4. Inventory on December 31 is \$44,400.

**Instructions:**

- 1. Complete the worksheet.
- 2. Prepare a multiple-step income statement and a statement of financial position.
- 3. Journalize the closing entries

Casinova Company  
Work sheet  
For the year ended December 31, 20XX

	Trial balance		Adjustments		Adjusted Trial balance		Income Statement		ST: of Financial Position	
Account Title	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr
Cash	\$ 51,700									
Accounts Receivable	30,700									
Inventory	44,700									
Supplies	6,200									
Equipment	85,000									
Accumulated Depreciation- Equip		\$ 18,000								
Notes Payable		51,000								
Accounts Payable		48,200								
Share Capital-Ordinary		80,000								
Retained Earnings		55,000								
Dividends	12,000									
Sales Revenue		717,500								
Sales Returns & Allowances	6,800									
Sales Discounts	2,000									
Cost of goods sold	497,400									
Salaries expense	140,000									
Advertising expense	26,400									
Utilities expense	14,000									
Repair expense	12,100									
Delivery expense	16,700									
Rent expense	24,000									
Total	\$969,700	\$969,700								

## 2. Multiple-Step Income Statement

Casinova Company

Multiple-Step Income Statement

For the year ended December 31, 20XX

## Statement of Financial Position

Casinova Company

## Statement of Financial Position

December 31, 20XX





MIRANDA COMPANY  
Work Sheet  
For the year ended Dec 31, 20XX

Account Title	Trial Balance		Adjustments		Adj: Trial Balance		Income Statement		St of Financial Position	
	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr	Dr	Cr
Cash	\$25,400									
Accounts Receivable	37,600									
Inventory	90,000									
Land	92,000									
Building	197,000									
Accumulated Dep-Building		\$54,000								
Equipment	83,500									
Accumulated Dep-Equipment		42,400								
Notes Payable		50,000								
Accounts Payable		37,900								
Share Capital-Ordinary		200,000								
Retained Earnings		68,900								
Dividends	10,000									
Sales Revenue		904,100								
Sales Returns & Allowances	2,000									
Sales Discount	4,100									
Cost of goods sold	709,900									
Freight-out	2,000									
Salaries Expense	67,800									
Utilities Expense	19,400									
Repair Expense	5,900									
Gas & oil Expense	7,200									
Insurance Expense	3,500									
Total	\$1,357,300	\$1,357,300								

## 2. Multiple-Step Income Statement

[illegible]

## Statement of Financial Position

Miranda Company

Statement of Financial Position

December 31, 20XX



Revathy Trading Company  
Partial Work Sheet  
For the 6 months ended Dec 31, 20XX

Account Title	Trial balance		Adjustments		Adjusted Trial balance	
	Dr	Cr	Dr	Cr	Dr	Cr
Cash	\$23,500				\$23,500	
Inventory	50,000					
Prepaid Insurance	2,000					
Truck	20,000				20,000	
Accumulated depreciation-Truck		0				
Equipment	60,000				60,000	
Accumulated depreciation- Equipment		\$10,000				
Note payable		5,750				5,750
Unearned rent revenue		1,500				
Share capital- Ordinary		127,000				127,000
Retained earning		6,000				6,000
Dividends	1,000				1,000	
Sales		201,000				201,000
Sales returns and allowances	11,000				11,000	
Cost of goods sold	180,000					
Salaries expense	3,750					
Total	\$351,250	\$351,250				

## 2. Multiple-Step Income Statement

[illegible]

### 3. Statement of Financial Position

Revathy Trading Company  
Statement of Financial Position  
December 31, 20XX

**Problem 5-10:**

The trial balance of Kosio Company at December 31, 20XX, the end of the company’s fiscal year is shown on the worksheet:

**Adjustment data:**

- 1. Supplies on hand total \$2,500.
- 2. Depreciation is \$7,000 on buildings and \$3,000 on equipment.
- 3. Interest of \$2,000 is due and unpaid on notes payable at December 31.
- 4. Inventory on December 31 is \$22,000.

**Instructions:**

- 1. Complete the worksheet.
- 2. Prepare multiple-step income statement for the period ended December 31, 20XX.
- 3. Prepare a classified statement of financial position as of December 31, 20XX.

**Kosio Company**  
**Worksheet (Partial)**  
**For the Year Ended December 31, 20XX**

Account Title	Trial Balance		Adjustments		Adjusted Trial Balance	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	\$97,500					
Accounts Receivable	35,200					





**Kosio Company**  
**Statement of Financial Position**  
**December 31, 20XX**

[illegible]

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