

Week-1; Session-2 (Part-2)

**Accounting for
Merchandising
Operations**

MERCHANDISING COMPANY

A merchandising company buys and sells goods to earn a profit.

1) Wholesalers sell to retailers

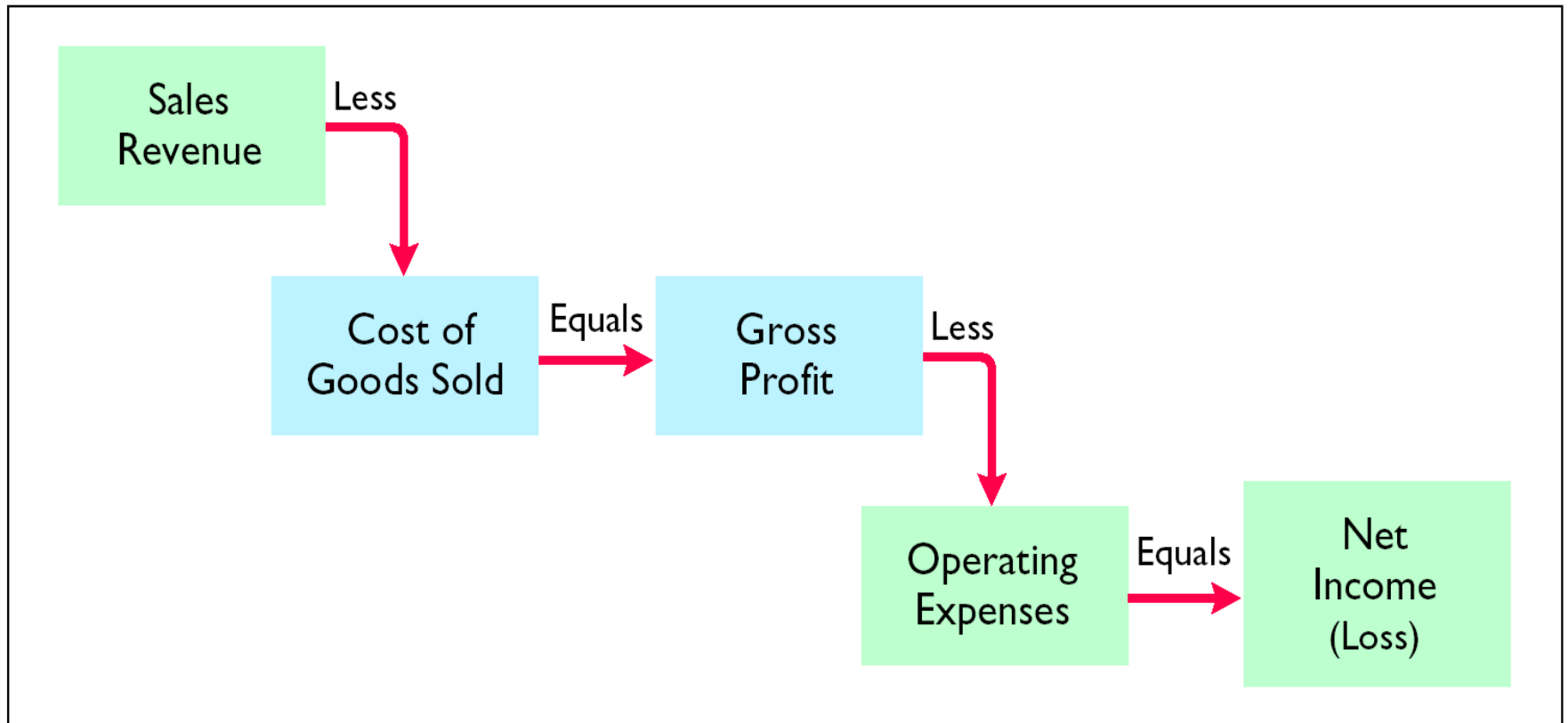
2) Retailers sell to consumers

Primary source of revenue is Sales

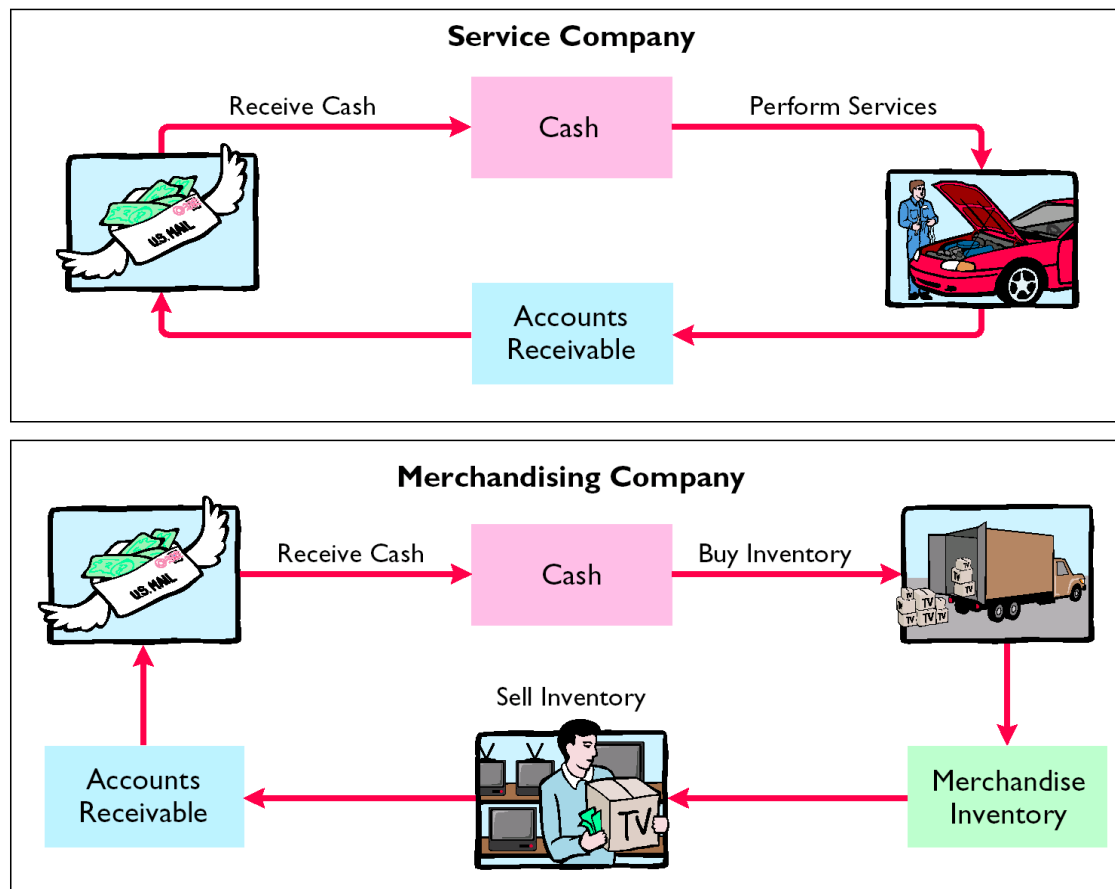
MEASURING NET INCOME

- **Expenses for a merchandiser** are divided into two categories:
 - 1 **Cost of goods sold**
 - The total cost of merchandise sold during the period
 - 2 **Operating expenses**
 - Expenses incurred in the process of earning sales revenue (Examples: sales salaries and insurance expense)
- **Gross profit** is equal to Sales Revenue less Cost of Goods Sold

INCOME MEASUREMENT PROCESS FOR A MERCHANDISING COMPANY



OPERATING CYCLES FOR A SERVICE COMPANY AND A MERCHANDISING COMPANY



COST OF GOODS SOLD

To determine the cost of goods sold under a **periodic inventory system**:

- 1)** Determine the cost of goods on hand at the beginning of the accounting period,
- 2)** Add to it the cost of goods purchased,
and
- 3)** Subtract the cost of goods on hand at the end of the accounting period.

PURCHASES OF MERCHANDISE

- Merchandise is purchased for resale to customers, the account
 - **Merchandise Inventory** is debited for the cost of goods.
- Like sales, purchases may be made for cash or on account (credit).
- The purchase is normally recorded by the purchaser when the goods are **received** from the seller.
- Each credit purchase should be supported by a **purchase invoice**.

PURCHASE RETURNS AND ALLOWANCES

- A purchaser may be dissatisfied with merchandise received because the goods:
 - 1) are damaged or defective,
 - 2) are of inferior quality, or
 - 3) are not in accord with the purchaser's specifications.
- The purchaser initiates the request for a reduction of the balance due through the issuance of a **debit memorandum** (purchaser's debit decreases A/P!).
- The **debit memorandum** is a document issued by a buyer to inform a seller that the seller's account has been debited because of unsatisfactory merchandise.

FREE ON BOARD

A sales agreement should indicate whether the seller or the buyer is to pay the cost of transporting the goods to the buyer's place of business.

- **FOB Shipping Point**

- 1) Goods placed free on board the carrier by seller

- 2) **Buyer** pays freight costs

- **FOB Destination (C & F/ CFR)**

- 1) Goods placed free on board at buyer's business

- 2) **Seller** pays freight costs

ACCOUNTING FOR FREIGHT COSTS

- **Merchandise Inventory** is debited if buyer pays freight.
- **Freight-out (or Delivery Expense)** is debited if seller pays freight.

PURCHASE DISCOUNTS

- **Credit terms may permit the buyer to claim a cash discount for the prompt payment of a balance due.**
- **The buyer calls this discount a **purchase discount**.**
- **Like a sales discount, a purchase discount is based on the invoice cost less returns and allowances, if any.**

SALES TRANSACTIONS

- **Revenues – (Revenue recognition principle)**
 - **Earned when the goods are transferred from seller to buyer**
- **All sales should be supported by a document such as a cash register tape or sales invoice.**

SALES RETURNS AND ALLOWANCES

- **Sales Returns**
 - Customers dissatisfied with merchandise and are allowed to return the goods to the seller for credit or a refund.
- **Sales Allowances**
 - Result when customers are dissatisfied and the seller allows a deduction from the selling price.

SALES DISCOUNTS

- **Sales discount**
 - Offer of a cash discount to a customer for the prompt payment of a balance due
 - Is a **contra revenue account** with a normal debit balance
- **Example:** Credit sale has the terms 3/10, n/30, a 3% discount is allowed if payment is made within 10 days. After 10 days there is no discount, and the balance is due in 30 days.

CREDIT TERMS

Credit terms specify the amount and time period for the cash discount

- Indicates the length of time in which the purchaser is expected to pay the full invoice price

T E R M S	E X P L A N A T I O N
2/10, n/30	A 2% discount may be taken if payment is made within 10 days of the invoice date.
1/10 EOM	A 1% discount is available if payment is made by the 10 th of the next month.

MULTIPLE-STEP INCOME STATEMENT

- Includes sales revenue, cost of goods sold, and gross profit sections
- Additional nonoperating sections may be added for:
 - 1) revenues and expenses resulting from secondary or auxiliary operations
 - 2) gains and losses unrelated to operations

MULTIPLE-STEP INCOME STATEMENT

Operating expenses may be subdivided into:

- a) Selling expenses**
- b) Administrative expenses**

Nonoperating sections are reported after income from operations and are classified as:

- a) Other revenues and gains**
- b) Other expenses and losses**

SINGLE-STEP INCOME STATEMENT

SELLERS ELECTRONIX Income Statement For the Year Ended December 31, 2024

Revenues

Net sales		\$ 460,000
Interest revenue		3,000
Gain on sale of equipment		600
Total revenues	1 Revenues	<u>463,600</u>

Expenses

Cost of goods sold	2 Expenses	\$ 316,000
Selling expenses		76,000
Administrative expenses		38,000
Interest expense		1,800
Casualty loss from vandalism		200
Total expenses		<u>432,000</u>

Net income		<u><u>\$ 31,600</u></u>
------------	--	-------------------------

All data are classified under two categories:

1 Revenues

2 Expenses

Only one step is required in determining net income or net loss.

COMPUTATION OF GROSS PROFIT

Gross profit is determined as follows:

Net sales	\$ 460,000
Cost of goods sold	<u>316,000</u>
Gross profit	\$ 144,000

OPERATING EXPENSES IN COMPUTING NET INCOME

Net income is determined as follows:

Gross profit	\$ 144,000
Operating expenses	<u>114,000</u>
Net income	<u>\$ 30,000</u>

Determining Cost of Goods Sold

SELLERS ELECTRONIX				
Cost of Goods Sold				
For the Year Ended December 31, 2005				
Cost of goods sold				
Inventory, January 1			\$36,000	
Purchases		\$325,000		
Less: Purchase returns and allowances	\$10,400			
Purchase discounts	<u>6,800</u>	<u>17,200</u>		
Net purchases		307,800		
Add: Freight-in		<u>12,200</u>		
Cost of goods purchased			<u>320,000</u>	
Cost of goods available for sale			356,000	
Inventory, December 31			<u>40,000</u>	
Cost of goods sold				316,000

RECORDING MERCHANDISE TRANSACTIONS UNDER A PERIODIC INVENTORY SYSTEM

- **Purchases**
 - Merchandise purchased for resale to customers
 - May be made for cash or on account (credit)
 - Normally recorded by the purchaser when the goods are **received** from the seller
 - Credit purchase should be supported by a **purchase invoice**

PURCHASE RETURNS AND ALLOWANCES

- A sales return and allowance on the seller's books is recorded as a **purchase return and allowance** on the books of the purchaser.
- **Purchase Returns and Allowances**
 - **contra account** to Purchases
 - Normal credit balance
- **Debit memorandum**
 - Purchaser initiates the request for a reduction of the balance due through the issuance of a debit memorandum
 - A document issued by a buyer to inform a seller that the seller's account has been debited because of unsatisfactory merchandise

ACCOUNTING FOR FREIGHT COSTS

- **Freight-in** is debited if buyer pays freight
- **Freight-out** (or **Delivery Expense**) is debited if seller pays freight

PURCHASE DISCOUNTS

- Credit terms may permit the buyer to claim a cash discount for the prompt payment of a balance due.
- The buyer calls this discount a **purchase discount**.
- Like a sales discount, a purchase discount is based on the invoice cost less returns and allowances, if any.