Disclosure Principle- A business’s financial statements must report enough information for outsiders to make knowledgeable decisions about the company.

Materiality Concept- A Company must perform strictly proper accounting only for items that are significant to the business’s financial situation.

Conservatism – A business should report the least favorable figures in the financial statements when two or more possible options are presented.

LIFO (Last-In, First-Out) – Cost of goods sold consists of most recently purchased items.

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| **Effects of inventory Errors** | **Period 1** | | **Period 2** | |
|  | **Cost of Goods sold** | **Gross Profit and Net Income** | **Cost of Goods sold** | **Gross Profit and Net Income** |
| Period 1 Ending Merchandise Inventory *Overstated* | Understated | Overstated | Overstated | Understated |
| Period 1 Ending Merchandise Inventory *Understated* | Overstated | Understated | Understated | Overstated |

Inventory Turnover = Cost of goods sold / ((Beginning merchandise inventory + Ending merchandise inventory) / 2) Days’ sales in inventory = 365 days / Inventory Turnover

Merchandise inventory is classified as a current asset on the balance sheet. Merchandizers’ main source of income is sales (sales revenue) and the main source of costs is cost of goods sold.

Gross Profit Percentage = Gross Profit / Net Sales Revenue (measures profitability of each sales dollar to cost of goods sold). Net Sales Revenue = Sales Revenue – Sales return and Allowances – Sales Discounts.

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| Period of Rising inventory Costs | | | | |
|  | **Specific Identification** | **FIFO** | **LIFO** | **Weighted-Average** |
| **Income Statement** |  |  |  |  |
| Cost of Goods Sold | Varies | Lowest | Highest | Middle |
| Net Income | Varies | Highest | Lowest | Middle |
| **Balance Sheet** |  |  |  |  |
| Ending Merchandise Inventory | Varies | Highest | Lowest | Middle |
|  | | | | |
| Period of Rising inventory Costs | | | | |
|  | **Specific Identification** | **FIFO** | **LIFO** | **Weighted-Average** |
| **Income Statement** |  |  |  |  |
| Cost of Goods Sold | Varies | Highest | Lowest | Middle |
| Net Income | Varies | Lowest | Highest | Middle |
| **Balance Sheet** |  |  |  |  |
| Ending Merchandise Inventory | Varies | Lowest | Highest | Middle |

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| **Date** | **Accounts and Explanation** | **Debit** | **Credit** |
| 10-Jun | Merchandise Inventory | $ 5,250 |  |
|  | Accounts Payable |  | $ 5,250 |
|  | Purchased inventory on account |  |  |
|  |  |  |  |
| 15-Jun | Accounts Payable | $ 1,750 |  |
|  | Merchandise Inventory |  | $ 1,750 |
|  | Returned inventory to seller (Vendor) |  |  |
|  |  |  |  |
| 20-Jun | Accounts Payable ($5,250 - $1,750) | $ 3,500 |  |
|  | Cash ($3,500 - $105) |  | $ 3,395 |
|  | Merchandise Inventory($3,500 x 0.03) |  | $ 105 |
|  | Paid within discount period net of return |  |  |

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| **Date** | **Accounts and Explanation** | **Debit** | **Credit** |
| 19-Jun | Cash | $ 1,000 |  |
|  | Sales Revenue |  | $ 1,000 |
|  | Cash Sale |  |  |
|  |  |  |  |
| 19-Jun | Cost of Goods Sold | $ 700 |  |
|  | Merchandise inventory |  | $ 700 |
|  | Recorded the cost of goods sold |  |  |

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| **Date** | **Accounts and Explanation** | **Debit** | **Credit** |
| 21-Jun | Accounts Receivable | $ 5,000 |  |
|  | Sales Revenue |  | $ 5,000 |
|  | Sale on account |  |  |
|  |  |  |  |
| 21-Jun | Cost of Goods Sold | $ 3,500 |  |
|  | Merchandise inventory |  | $ 3,500 |
|  | Recorded the cost of goods sold |  |  |

Sales Discount and Sales Returns and Allowances’ normal balance is Debit and are both contra accounts to Sales Revenue.

FOB shipping point – Buyer owns the goods, also pays the freight, which gets added on to merchandise inventory.

FOB Destination – Seller owns the goods, also pays the freight, which is journaled as a Delivery expense.

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| **Date** | **Accounts and Explanation** | **Debit** | **Credit** |
| 25-Jun | Accounts Payable | $ 5,400 |  |
|  | Cash ($5,400 - $150) |  | $ 5,250 |
|  | Merchandise Inventory ($5,000 x 0.03) |  | $ 150 |
|  | Paid within discount period, including freight |  |  |

Purchase discounts are only taken from the merchandise inventory and does not include the merchandise inventory with the freight.

Sales discounts are applied based on the merchandise inventory, if any inventory is returned then the discount if taken on what is left of the inventory not the whole purchase.

Operating expenses are the major line of expenses for a business.

Freight In – is the transportation cost to ship goods into the purchaser’s warehouse; thus it is freight on purchased goods.

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| Date | Accounts and Explanation | Debit | Credit |
| 3-Jun | Merchandise Inventory | $ 60 |  |
|  | Cash |  | $ 60 |
|  | Paid a freight bill. |  |  |

Freight Out – is the transportation cost to ship goods out of the seller’s warehouse and to the customer; thus it is freight on goods sold.

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| Date | Accounts and Explanation | Debit | Credit |
| 21-Jun | Delivery Expense | $ 60 |  |
|  | Cash |  | $ 60 |
|  | Paid a freight bill. |  |  |

Credit terms – are stated in the form of “3/15, n/30” the 3/15 in this case means that the buyer gets a 3% discount on the goods sold if paid within 15 days of purchase. The n/30 means Net is due within 30 days of purchase.

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| Date | Accounts and Explanation | Debit | Credit |
| 30-Jun | Cash ($5,000 - $150) | $ 4,850 |  |
|  | Sales Discounts ($5,000 x0.03) | $ 150 |  |
|  | Accounts Receivable |  | $ 5,000 |