

## Accounting for a Merchandising Business

Chapter 10

## AGENDA

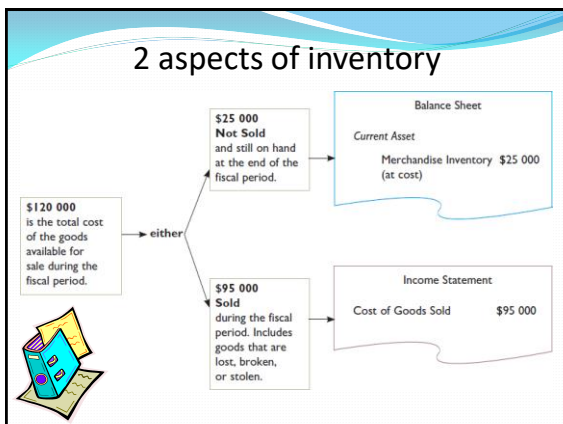
- The merchandise business
- What is inventory?
  - Definition
  - 2 aspects of inventory
- Periodic inventory system
- The inventory cycle
- Inventory on B/S and COGS on I/S
- Accounting procedures with inventory
- Sales returns and allowances
- Purchase returns and allowances
- Sales discounts
- Terms of sale

## The Merchandise Business

- The merchandise business is a business that buys goods/products and sells them at a profit
  - **Wholesaler** – buys goods from manufacturers and sells them to retailers
  - **Retailer** – buys goods from wholesalers and sells them to the public

## What is inventory?

- The quantity of **merchandise on hand for resale** is known as merchandise inventory, inventory, stock-in-trade, or stock
- Examples of inventory:
  - Convenience store: candies, drinks, small food items
  - Large department store: clothes, shoes, cosmetics
- 2 aspects of inventory
  - Goods sold
  - Goods not sold



## What is Inventory?

- In the B/S of merchandising and manufacturing companies, inventory is a very significant **current / short term asset**.
- Inventory are those items that are ready for sale:
  - Raw Materials
  - Work-in-Progress
  - Finished Goods
- In the I/S, inventory is vital in determining the results of operations for a particular period.
- **Gross Profit\* = Sales – Cost of Goods Sold**
- Important for management, owners, & other users

\* Gross Profit shows only the profit made by sale of merchandise

## Periodic Inventory System

2 methods for inventory recording:

### Perpetual

- Updates inventory and COGS after every purchase & sale

### Periodic – We only cover this!

- Delays updating inventory & COGS until the end of period
- Misstates inventory during the period



## What is Inventory?

### 3 Characteristics of Inventory:

- In order to prepare F/S, it is necessary to determine the **number** of units of inventory, their **ownership** status, and the selected **valuation** method.
- To determine the number of units of inventory, take a *physical inventory* of goods on hand.
- Taking a physical inventory involves counting, weighing, or measuring each kind of inventory on hand.



## The Inventory Cycle

- Inventory is generally sold fairly quickly
- Businesses usually have to renew their inventory regularly
- Inventory moves in and out of the business:
  - There is inventory at the beginning of the fiscal year
  - Inventory is sold and moves out of the business regularly
  - Inventory is purchased from time to time
  - The inventory at the end of the fiscal year is more or less the same as at the beginning of the fiscal year



## The Inventory Cycle

	Units (# of items)	Dollars (worth of items)
Beginning Inventory	100	1000
Purchases	300	3000
Goods Available for Sale	400	4000
Inventory Sold	310	3100
Ending Inventory	90	900



## The Inventory Cycle - Formula

Beginning Inventory	+	Purchases	-	Cost of Goods Sold	=	Ending Inventory
Cost of Goods Sold	=	Beginning Inventory	+	Purchases	-	Ending Inventory



## Physical Inventory Count

- To determine the number of units of inventory, take a physical inventory of goods on hand.
- Taking a physical inventory involves counting, weighing, or measuring each kind of inventory on hand.
- This count will give you the balance of the EI
  - Important asset on the B/S
  - Needed to calculate COGS for I/S
  - Will be used as BI for the next fiscal year



## Inventory on B/S

EASTPORT HARDWARE BALANCE SHEET JUNE 30, 20--		
<b>Assets</b>		
<b>Current Assets</b>		
Bank	\$ 1 205	
Accounts Receivable	18 305	
Merchandise Inventory	42 582	
Supplies	3 526	
Prepaid Insurance	3 564	\$ 69 182
<b>Plant and Equipment</b>		
Store Equipment	\$ 25 658	
Delivery Equipment	18 350	44 008
		<u>\$ 113 190</u>

## COGS on I/S

EASTERN TRADING COMPANY INCOME STATEMENT YEAR ENDED DECEMBER 31, 20--		
Revenue		
Sales		\$231 967
Cost of Goods Sold		
Inventory, January 1	\$ 55 325	
Purchases	120 402	
Cost of Goods Available for Sale	\$175 727	
Less Inventory, December 31	57 350	
Cost of Goods Sold		118 377
Gross Profit		\$113 590
Operating Expenses		
Bank Charges Expense	\$ 375	
Building Maintenance Expense	875	
Car Expense	2 507	
Depreciation Expense	1 075	
Miscellaneous Expense	275	
Rent Expense	12 000	
Telephone Expense	957	
Utilities Expense	1 850	
Wages Expense	36 587	
Total Operating Expenses		56 501
Net Income		<u>\$ 57 089</u>

## COGS on I/S

- COGS is very significant
  - I/S is now prepared in 2 stages
    - Sale - COGS = **Gross Profit**\*
    - Gross Profit - Operating Expenses = NI / NL
  - COGS calculation is on the I/S
  - The expenses are now titled "**Operating Expenses**"

**Matching Principle:**  
match the largest  
**expense (COGS)**  
against the **revenue**  
(Sale) it directly help  
create.

\*GP is the difference between the **cost price** and **selling price** of goods

## Limitations of the Periodic Inventory System

- Accurate financial statements can not be obtained unless a physical inventory count is taken
- This procedure is time consuming
- It also disrupts the normal business routine

## The Inventory System So Far...

- The final inventory amount is included on the B/S as a current / short term asset
- The COGS is included on the I/S
- The inventory amount and the COGS amount are NOT known during the fiscal year
- COGS = BI + Purchases - EI

## Accounting Procedures with Inventory

- There are 2 accounts:
  - Inventory
  - Purchases
- The inventory account represent the BI balance and then at the end of the fiscal year, a journal entry is made to ensure that the inventory account now represents the EI balance

## Accounting Procedures with Inventory

When you buy inventory with cash:

DR Purchases	1000	
DR HST Recoverable	130	
CR Bank		1130

When you buy inventory on account:

DR Purchases	1000	
DR HST Recoverable	130	
CR A/P		1130

## Accounting Procedures with Inventory

- Any transportation cost that is related to inventory purchase is considered **freight-in**
- Any transportation cost that is related to the sale of inventory items is considered **delivery expense**

For freight-in, the journal entry is:

DR Purchases / Freight-in	100	
DR HST Recoverable	13	
CR Bank		113

## Accounting Procedures with Inventory

When you sell inventory items for cash:

DR Bank	1130	
CR Sales		1000
CR HST Payable		130

When you sell inventory items on account:

DR A/R	1130	
CR Sales		1000
CR HST Payable		130

## Closing Entries for Inventory

BI + Purchases - EI

At the end of the fiscal year:	
DR Capital	1
CR Inventory	

The amount is the **Beginning Inventory** balance

For the purchases account:	
DR Capital	2
CR Purchases	

The amount is the total amount of **purchases** made during the year

DR Inventory	3
CR Capital	

The amount is the **Ending Inventory** amount determined through count

## Purchase Returns and Allowances

(without HST)

- You purchase \$3,000 of goods on cash

DR Purchases	3,000	
CR Cash		3,000

- You return \$300 of goods

DR Cash	300	
CR Purchases Returns		300

- You purchase \$3,000 of goods on account

DR Purchases	3,000	
CR A/P		3,000

- You return \$300 of goods

DR A/P	300	
CR Purchases Returns		300

## Purchase Returns and Allowances

(with HST)

- You purchase \$3,000 of goods on cash

DR Purchases	3,000	
DR HST Recoverable	390	
CR Cash		3,390

- You return \$300 of goods

DR Cash	339	
CR Purchase Returns	300	
CR HST Recoverable		39

- You purchase \$3,000 of goods on account

DR Purchases	3,000	
DR HST Recoverable	390	
CR A/P		3,390

- You return \$300 of goods

DR A/P	339	
CR Purchase Returns	300	
CR HST Recoverable		39

## Sales Returns and Allowances

(without HST)



- You sell \$3,000 of goods to a customer on cash
- You sell \$3,000 of goods to a customer on account
- The customer returns \$300 of goods
- The customer returns \$300 of goods

DR Cash 3,000  
CR Sales 3,000

DR A/R 3,000  
CR Sales 3,000

DR Sales Return 300  
CR Cash 300

DR Sales Return 300  
CR A/R 300



## Sales Returns and Allowances

(with HST)



- You sell \$3,000 of goods to a customer on cash
- You sell \$3,000 of goods to a customer on account
- The customer returns \$300 of goods
- The customer returns \$300 of goods

DR Cash 3,390  
CR Sales 3,000  
CR HST Payable 390


DR A/R 3,390  
CR Sales 3,000  
CR HST Payable 390

DR Sales Returns 300  
DR HST Payable 39  
CR Cash 339

DR Sales Return 300  
DR HST Payable 39  
CR A/R 339




## Sales Invoice

		<b>ECHO BAY</b> <b>VANCOUVER, BC</b> <b>MASTHEAD MARINE</b>		P.O. Box 298 Station 8 V7C 8P7 Phone 604-842-9999 Fax 604-842-9966	
<b>SOLD TO:</b>		Penticton Marina 4000 Skaha Lake Road Penticton, BC V2A 6G9		<b>DATE</b> Apr. 16, 20-  <b>TERMS</b> Net 60 days	
<b>QUANTITY</b>		<b>PART NO.</b>		<b>DESCRIPTION</b>	
2		15-2500		Quaker '25' pump	
8 Pcs.		48-1020		Skyblazer Red Signal Flares	
				18.50	
				148.00	
				HST	
				Total	
				101.14	
				879.14	
<b>SALES INVOICE</b>		<b>CUSTOMER'S COPY</b>		<b>NO. 8321</b>	

SALES INVOICE CUSTOMER'S COPY NO. 8321

## Credit Note – for sales returns

	<b>ECHO BAY</b> <b>VANCOUVER, BC</b> <b>MASTHEAD MARINE</b>		<b>P.O. Box 298</b> <b>Station 8</b> <b>V7C 8P7</b> <b>Phone 604-842-9999</b> <b>Fax 604-842-9966</b>	
<b>SOLD TO:</b>	<b>Penticton Marina</b> 4000 Skaha Lake Road Penticton, BC V2A 6G9	<b>DATE</b>  <b>TERMS</b>	<b>Apr. 16, 20-</b>  <b>Net 60 days</b>	
<b>QUANTITY</b>	<b>PART NO.</b>	<b>DESCRIPTION</b>	<b>PRICE</b>	<b>AMOUNT</b>
8 Pcs.	48-1020	Skyblazer Red Signal Flares (defective merchandise)	18.50	148.00
		HST		19.24
		Total		<u>168.24</u>
<b>SALES INVOICE</b>			<b>NO. 841</b>	


SALES INVOICE CUSTOMER'S COPY NO. 841

## Terms of Sale – for sales on account

- Refers to arrangements made with customers as to when they will pay and if there is a cash discount being offered:
- COD: must pay for the goods/services at the time they are delivered
- Net 30: the full amount of the invoice is due within 30 days of the date of invoice
- Net 60: the full amount of the invoice is due within 60 days of the date of invoice
- 2/10, n/30: if the invoice is paid within 10 days, a discount of 2% may be taken. Otherwise, the full amount of the invoice is due within 30 days.
- 1/15, n/30: if the invoice is paid within 15 days, a discount of 1% may be taken. Otherwise, the full amount of the invoice is due within 30 days.



## Example of Invoice with Terms of Sale

		<b>ECHO BAY</b> <b>VANCOUVER, BC</b> <b>MASTHEAD MARINE</b>		<b>P.O. Box 298</b> <b>Station 8</b> <b>V7C 8P7</b> <b>Phone 604-842-9999</b> <b>Fax 604-842-9966</b>	
<b>SOLD TO:</b>		Nanaimo Marina 5000 Departure Bay Road Nanaimo, BC V9T 4B9		<b>DATE</b> June 4, 20-  <b>TERMS</b> 2/10, n/30	
<b>QUANTITY</b>	<b>PART NO.</b>	<b>DESCRIPTION</b>	<b>PRICE</b>	<b>AMOUNT</b>	
12	HA 346	Tubular Jam Cleat 1/2 in.	\$ 3.85	\$ 46.20	
6	HA 433	Mast Gate Muscle Box	35.95	215.70	
12	HA 4872	Shroud Adjuster	12.50	411.90	
		HST		53.55	
		Total		<u>\$465.45</u>	
<b>SALES INVOICE</b>			<b>CUSTOMER'S COPY</b>		<b>NO. 10094</b>

SALES INVOICE CUSTOMER'S COPY NO. 10094



## Purchase and Sales Discounts

- Notice that sales discounts are DR to Sales Discounts
  - This reduces the amount of Sales
  - This reduces NI
- Notice that purchase discounts are CR to Purchase Discounts
  - This reduces the amount of Purchases
  - This increases NI
- Some businesses DR Sales and CR Purchases directly



## Purchase Discounts

- You purchase \$3,000 of goods on account with 2% discount

DR Purchases	3,000	
DR HST Recoverable	390	
CR A/P		3,390



- You pay within 30 days and earn the 2% discount

DR A/P	3,390	
CR Cash		3,330
CR Purchase Discounts		60



## Sales Discounts

- You sell \$3,000 of goods to a customer on account with 2% discount

DR A/R	3,390	
CR Sales		3,000
CR HST Payable		390



- The customer pays within 30 days and earns the 2% discount

DR Cash	3,330	
DR Sales Discounts	60	
CR A/R		3,390

