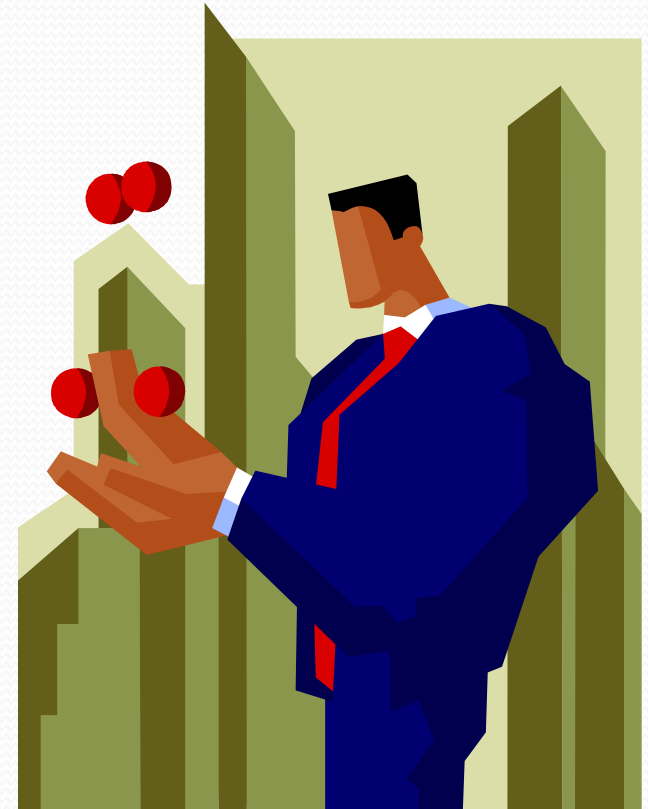


Chapter

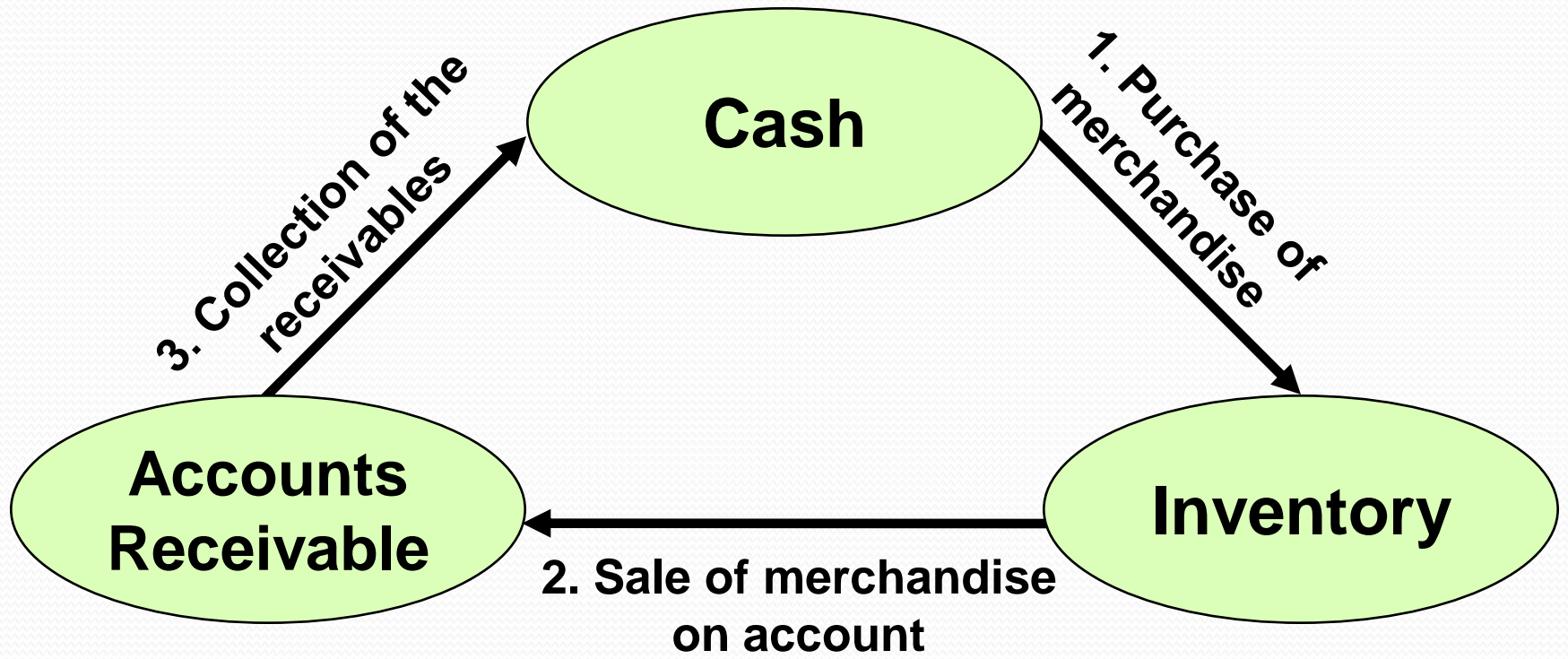
6

ACCOUNTING FOR MERCHANTISING ACTIVITIES

Presented by:
Endra M. Sagoro
Economic Faculty YSU
endra_ms@uny.ac.id



Operating Cycle of a Merchandising Company



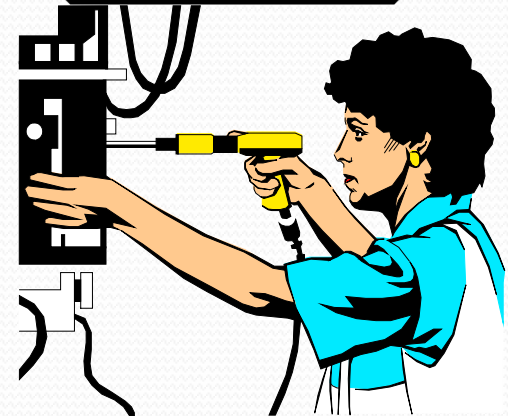
Comparing Merchandising Activities with Manufacturing Activities

Purchase inventory in **ready-to-sell** condition.



**Merchandising
Company**

Manufacture inventory and have a longer and more complex operating cycle



**Manufacturing
Company**

Retailers and Wholesalers



Wholesalers buy merchandise from several different manufacturers and then sell this merchandise to several retailers.



Retailers sell merchandise directly to the public.

Income Statement of a Merchandising Company

Computer Barn

Condensed Income Statement

For the Year Ended December 31, 2002

Revenue from sales	\$ 900,000
Less: Cost of goods sold	540,000
Gross profit	<u>\$ 360,000</u>
Less: Expenses	270,000
Net income	<u><u>\$ 90,000</u></u>

Cost of goods sold represents the expense of goods that are sold to customers.

Gross profit is a useful means of measuring the profitability of sales transactions.

What Accounting Information Does a Merchandising Company Need?

Examples

Financial Reporting Requirements

- Revenues
- Expenses

Daily Business Operating Requirements

- Customer Ledgers

Special Reporting Requirements

- Tax Reports

General Ledger Accounts

Although **general ledger accounts** provide useful information, they do not provide much of the detailed information needed in the daily business operations.

General Ledger				
Accounts Receivable				
Date		Debit	Credit	Balance
2001				
June	1	10,000		10,000
	15		3,000	7,000

Who
owes us
money?

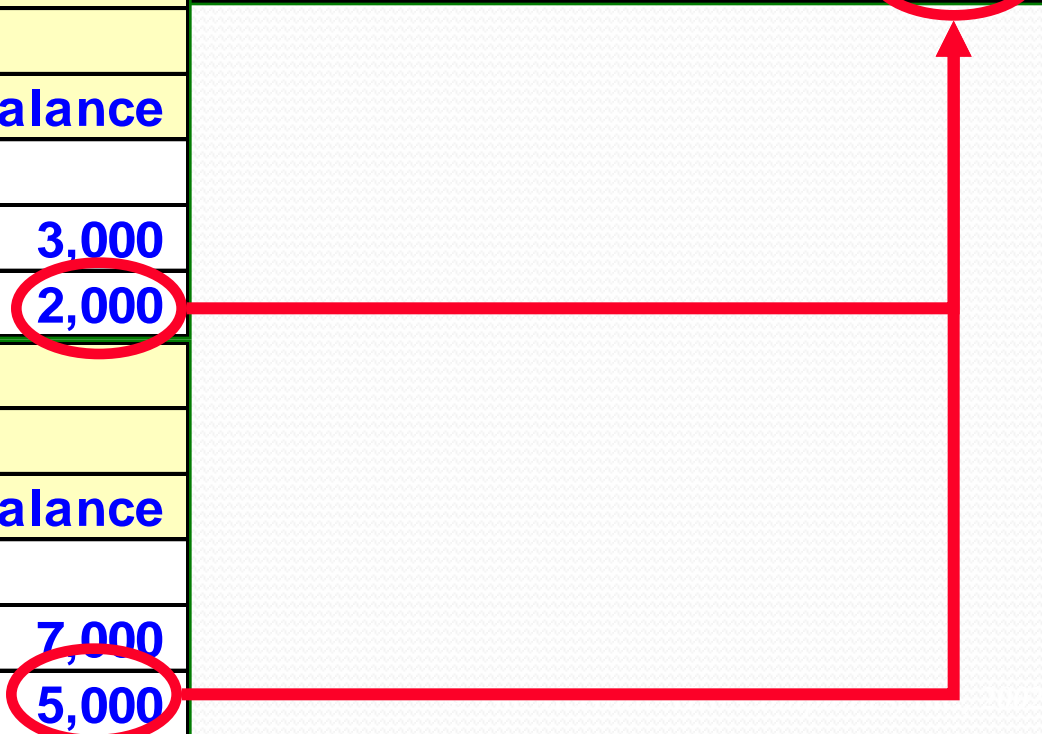
Subsidiary Ledgers: A Source of Needed Details

Controlling Account

General Ledger				
Accounts Receivable				
Date		Debit	Credit	Balance
2001				
June	1	10,000		10,000
	15		3,000	7,000

Subsidiary Ledger				
Jake Sparks				
Date		Debit	Credit	Balance
2001				
June	1	3,000		3,000
	15		1,000	2,000

Subsidiary Ledger				
Heather Jacobs				
Date		Debit	Credit	Balance
2001				
June	1	7,000		7,000
	15		2,000	5,000



Controlling Account in the General Ledger

Unit of Organization Within the Subsidiary Ledger

Inventory

Each type of product offered for sale

Plant assets

Each asset (or group of similar assets)

Accounts payable

Each creditor

Capital stock

Each stockholder

Sales

Each department, branch location, or product line

Cost of goods sold

Same organization as the sales ledger

Many expense accounts

Each department incurring these types of expenses

Payroll expenses

Each employee

Two Approaches Used in Accounting for Merchandise Transactions

**Perpetual
Inventory
System**

**Periodic
Inventory
System**

Perpetual Inventory System

The inventory account is continuously updated to reflect items on hand.



Let's look
at some
entries!



Perpetual Inventory System

On September 5, Worley Co. purchased 100 laser lights for resale for \$30 per unit from Electronic City on account .

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	5	Inventory	3,000	
		Accounts Payable (Electronic City)		3,000

Perpetual Inventory System

On September 10, Worley Co. sold 10 laser lights for \$50 per unit on account to ABC Radios.

GENERAL JOURNAL

$$10 \times \$30 = \$300$$

Date		Account Titles and Explanation	Debit	Credit
Sept.	10	Accounts Receivable (ABC Radios)	500	
		Sales		500
	10	Cost of Goods Sold	300	
		Inventory		300

Perpetual Inventory System

On September 10, Worley Co. sold 10 laser lights for \$50 per unit on account to ABC Radios.

GENERAL JOURNAL

Retail

Date		Account Titles and Explanation	Debit	Credit
Sept.	10	Accounts Receivable (ABC Radios)	500	
		Sales		500
	10	Cost of Goods Sold	300	
		Inventory		300

Cost

Perpetual Inventory System

On September 15, Worley Co. paid Electronic City \$3,000 for the September 5 purchase.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	15	Accounts Payable (Electronic City)	3,000	
		Cash		3,000

Perpetual Inventory System

On September 22, Worley Co. received \$500 from ABC Radios as payment in full for their purchase on September 10.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	22	Cash	500	
		Accounts Receivable (ABC Radios)		500

The Inventory Subsidiary Ledger

Item <u>LL002</u>				Primary supplier <u>Electronic City</u>					
Description <u>Laser Light</u>				Secondary supplier <u>Electric Company</u>					
Location <u>Storeroom 2</u>				Inventory level: Min: <u>25</u> Max: <u>200</u>					
	Purchased			Sold			Balance		
Date	Units	Unit Cost	Total	Units	Unit Cost	Cost of Goods Sold	Units	Unit Cost	Total
Sept. 5	100	\$ 30	\$ 3,000				100	\$ 30	\$ 3,000
Sept. 10				10	\$ 30	\$ 300	90	30	2,700

At the end of the period, management compares the **physical inventory count** with the inventory ledger to determine **inventory shrinkage**.

Taking a Physical Inventory



In order to ensure the accuracy of their perpetual records, most businesses take a **complete physical count** of the merchandise on hand at least once a year.

Taking a Physical Inventory

Reasonable amounts of inventory shrinkage are viewed as a normal cost of doing business. Examples include breakage, spoilage and theft.

On December 31, Worley Co. counts its inventory. An inventory shortage of \$2,000 is discovered.

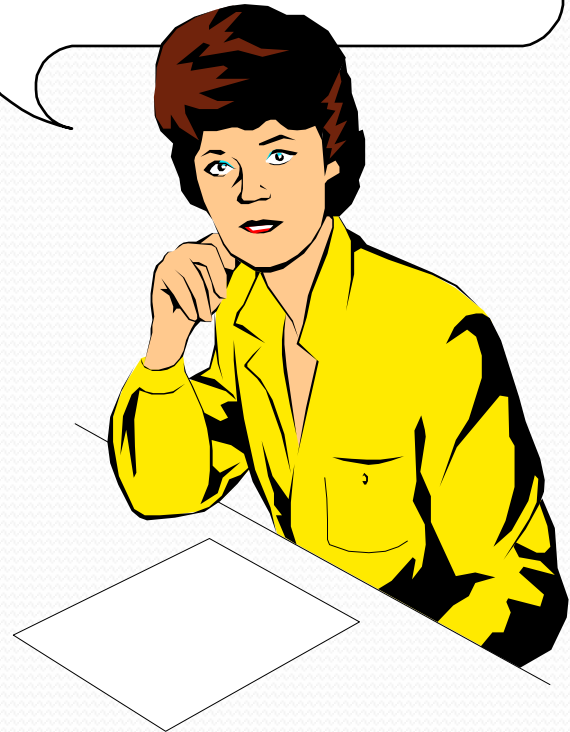
GENERAL JOURNAL


Date	Account Titles and Explanation	Debit	Credit
Dec. 31	Cost of Goods Sold	2,000	
	Inventory		2,000

Closing Entries in a Perpetual Inventory System

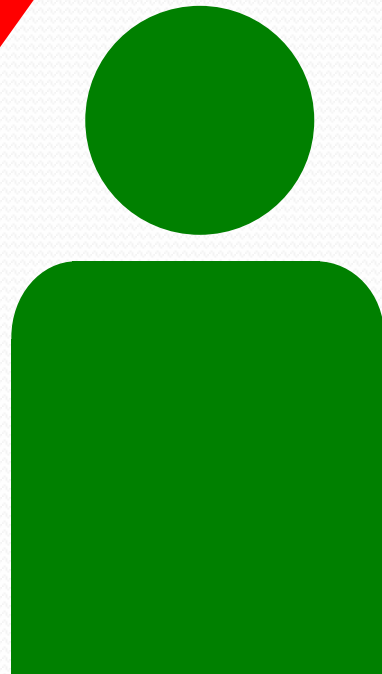
- ➊ Close Revenue accounts (including Sales) to Income Summary.
- ➋ Close Expense accounts (including Cost of Goods Sold) to Income Summary.
- ➌ Close Income Summary account to Retained Earnings.
- ➍ Close Dividends to Retained Earnings.

The closing entries are the same!





**Next is the
periodic
inventory
system!**



Periodic Inventory System

No effort is made to keep up-to-date records of either inventory or cost of goods sold.



**Let's look
at some
entries!**



Periodic Inventory System

On September 5, Worley Co. purchased 100 laser lights for resale for \$30 per unit from Electronic City on account .

Notice that no entry is made to Inventory.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	5	Purchases	3,000	
		Accounts Payable (Electronic City)		3,000

Periodic Inventory System

On September 10, Worley Co. sold 10 laser lights for \$50 per unit on account to ABC Radios.

GENERAL JOURNAL

Retail

Date		Account Titles and Explanation	Debit	Credit
Sept.	10	Accounts Receivable (ABC Radios)	500	
		Sales		500

Periodic Inventory System

On September 15, Worley Co. paid Electronic City \$3,000 for the September 5 purchase.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	15	Accounts Payable (Electronic City)	3,000	
		Cash		3,000

Periodic Inventory System

On September 22, Worley Co. received \$500 from ABC Radios as payment in full for their purchase on September 10.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Sept.	22	Cash	500	
		Accounts Receivable (ABC Radios)		500

Computing Cost of Goods Sold in a Periodic Inventory System

The accounting records of Party Supply show the following:

Inventory, Jan. 1, 2003 \$ 14,000

Purchases (during 2003) 130,000

At December 31, 2003, Party Supply counted the merchandise on hand at \$12,000.

Calculate Party Supply's cost of goods sold for 2003.



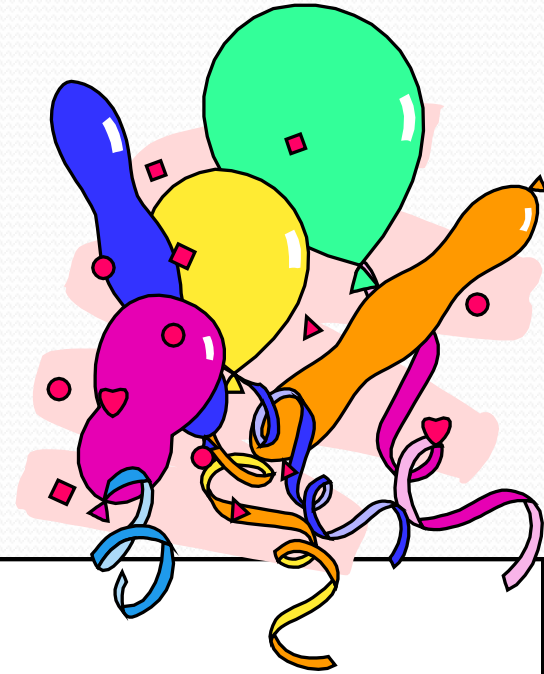
Computing Cost of Goods Sold in a Periodic Inventory System

Cost of Goods Sold can be calculated as follows:

Inventory (beginning of the year)	\$ 14,000
Add: Purchases	130,000
	<hr/>
Cost of goods available for sale	144,000
Less: Inventory (end of year)	12,000
	<hr/>
Cost of goods sold	<u><u>\$ 132,000</u></u>

Creating Cost of Goods Sold in a Periodic Inventory System

Now, Party Supply must create the **Cost of Goods Sold** account.

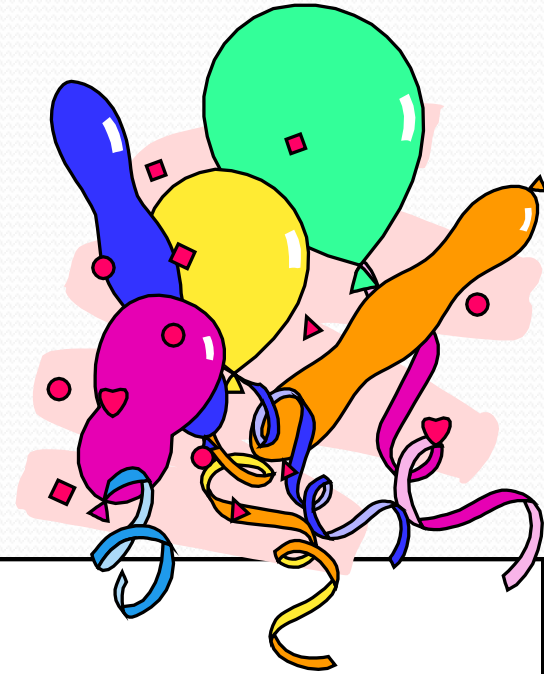


1

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Dec.	31	Cost of Goods Sold	144,000	
		Inventory (beginning of year)		14,000
		Purchases		130,000

Creating Cost of Goods Sold in a Periodic Inventory System
 Now, Party Supply must record the **ending inventory** amount.



GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Dec.	31	Inventory (end of year)	12,000	
		Cost of Goods Sold		12,000

Completing the Closing Process

- 1 Close Revenue accounts (including Sales) to Income Summary.
- 2 Close Expense accounts (including Cost of Goods Sold) to Income Summary.
- 3 Close Income Summary account to Retained Earnings.
- 4 Close Dividends to Retained Earnings.

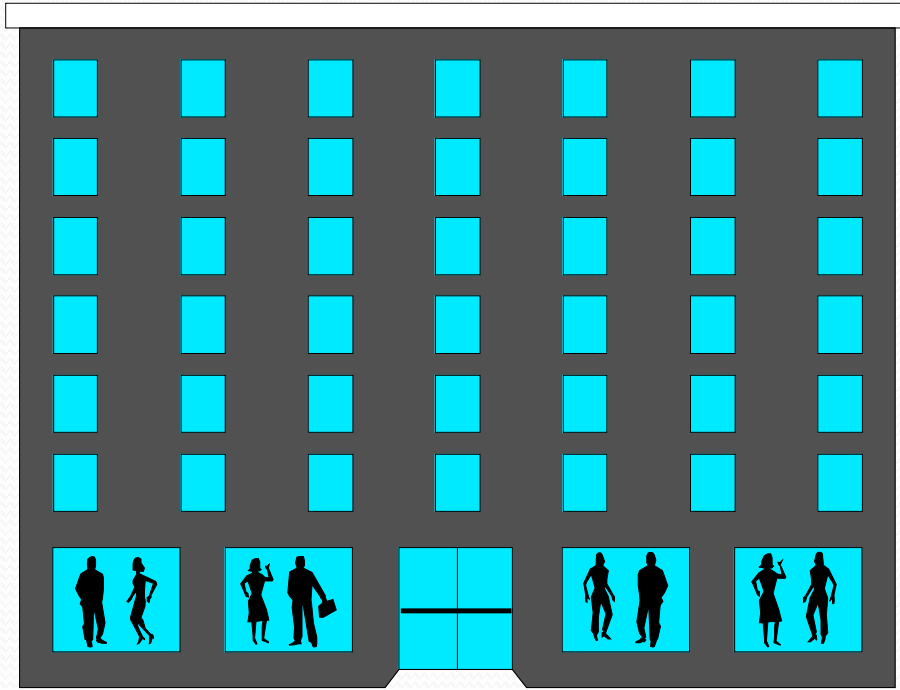
The closing entries are the same!



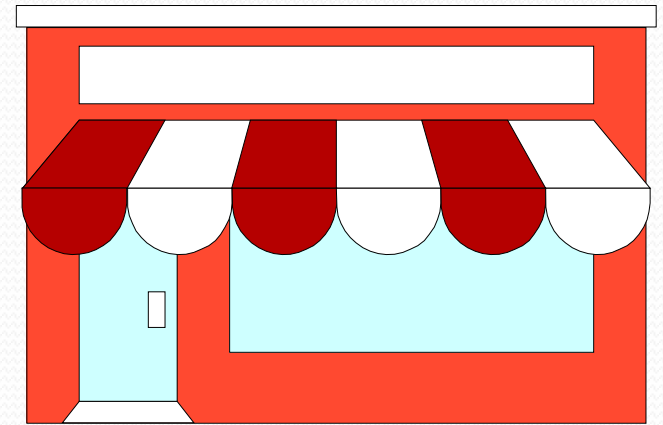
Comparison of Perpetual and Periodic Inventory Systems

Perpetual Inventory System

Periodic Inventory System



Large Department Stores



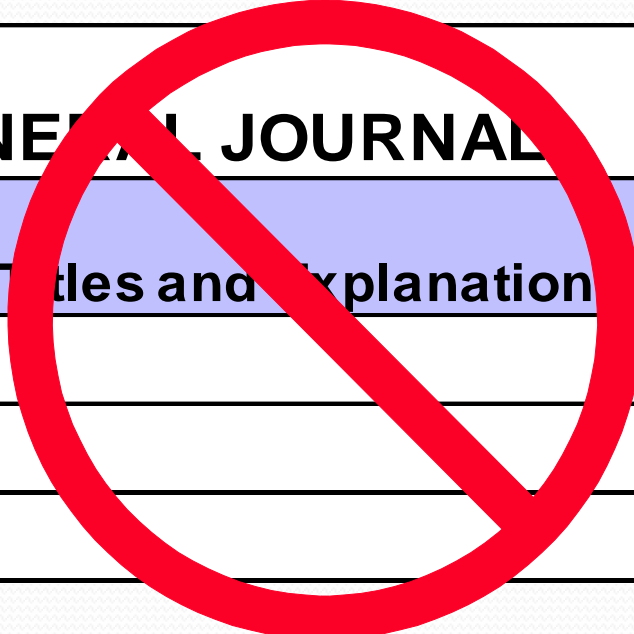
Jo's Dress Shop

Modifying an Accounting System

Most businesses use **special journals** rather than a general journal to record routine transactions that occur frequently.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit



Credit Terms and Cash Discounts
When manufacturers and wholesalers sell their products on account, the **credit terms** are stated in the invoice.

2/10, n/30

Read as: “Two ten, net thirty”

Credit Terms and Cash Discounts

2/10, n/30

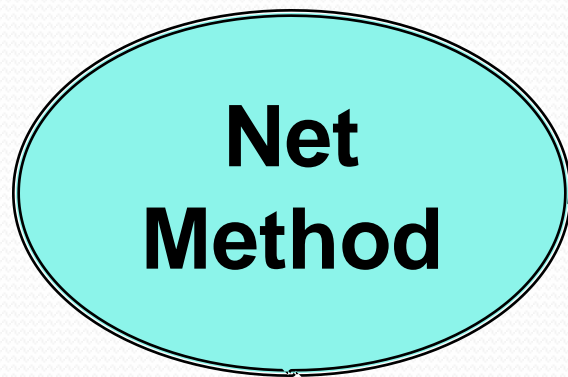
**Percentage
of Discount**

**# of Days
Discount Is
Available**

**Otherwise,
the Full
Amount Is
Due**

**# of Days
when Full
Amount Is
Due**

Credit Terms and Cash Discounts



Purchases are recorded at their net amounts.

Purchase discounts lost are recorded when payment is made **outside the discount period.**

Credit Terms and Cash Discounts

On July 6, Play Clothes purchased \$4,000 of merchandise on credit with terms of 2/10, n/30 from Kid's Clothes.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit

Credit Terms and Cash Discounts

On July 6, Play Clothes purchased \$4,000 of merchandise on credit with terms of 2/10, n/30 from Kid's Clothes.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	6	Inventory	3,920	
		Accounts Payable (Kid's Clothes)		3,920

$$\text{\$4,000} \times 98\% = \text{\$3,920}$$

Credit Terms and Cash Discounts

On July 15, Play Clothes pays the full amount due to Kid's Clothes.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit

Credit Terms and Cash Discounts

On July 15, Play Clothes pays the full amount due to Kid's Clothes.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	15	Accounts Payable (Kid's Clothes)	3,920	
		Cash		3,920

Credit Terms and Cash Discounts

Now, assume that Play Clothes waited until July 20 to pay the amount due in full to Kid's Clothes.
Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit

Credit Terms and Cash Discounts

Now, assume that Play Clothes waited until July 20 to pay the amount due in full to Kid's Clothes. Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Nonoperating Expense

Date		Account Titles and Explanation	Debit	Credit
July	20	Accounts Payable (Kid's Clothes)	3,920	
		Purchase Discounts Lost	80	
		Cash		4,000

Recording Purchases at Gross Invoice Price



Purchases are recorded at their gross amounts.

Purchase discounts taken are recorded when payment is made **inside the discount period.**

Recording Purchases at Gross Invoice Price

On July 6, Play Clothes purchased \$4,000 of merchandise on credit with terms of 2/10, n/30 from Kid's Clothes.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit

Recording Purchases at Gross

Invoice Price

On July 6, Play Clothes purchased \$4,000 of merchandise on credit with terms of 2/10, n/30 from Kid's Clothes.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	6	Inventory	4,000	
		Accounts Payable (Kid's Clothes)		4,000

Recording Purchases at Gross Invoice Price

On July 15, Play Clothes pays the full amount due to Kid's Clothes.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit

Recording Purchases at Gross Invoice Price

On July 15, Play Clothes pays the full amount due to Kid's Clothes.

Prepare the journal entry for Play Clothes.

Reduces Cost of Goods Sold

JOURNAL

$$\$4,000 \times 98\% = \$3,920$$

Date	Account Titles and Explanation	Debit	Credit
July 15	Accounts Payable (Kid's Clothes)	4,000	
	Cash		3,920
	Purchase Discounts Taken		80

Recording Purchases at Gross

Invoice Price

Now, assume that Play Clothes waited until July 20 to pay the full amount due to Kid's Clothes.
Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit

Recording Purchases at Gross

Invoice Price

Now, assume that Play Clothes waited until July 20 to pay the full amount due to Kid's Clothes.
Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	20	Accounts Payable (Kid's Clothes)	4,000	
		Cash		4,000

Returns of Unsatisfactory Merchandise

On August 5, Play Clothes returned \$500 of unsatisfactory merchandise purchased from Kid's Clothes on credit terms of 2/10, n/30. The purchase was originally recorded at **net cost**.

Prepare the journal entry for Play Clothes.

GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit

Returns of Unsatisfactory Merchandise

On August 5, Play Clothes returned \$500 of unsatisfactory merchandise purchased from Kid's Clothes on credit terms of 2/10, n/30. The purchase was originally recorded at **net cost**.

Prepare the journal entry for Play Clothes.

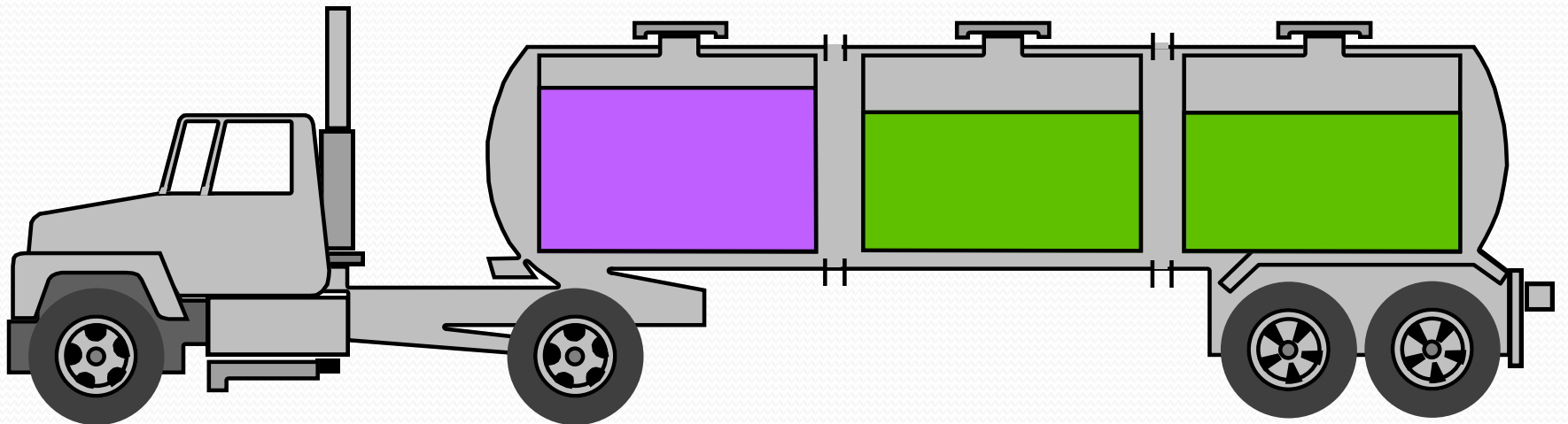
GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Aug.	5	Accounts Payable (Kid's Clothes)	490	
		Inventory		490

$$\text{\$500} \times 98\% = \text{\$490}$$

Transportation Costs on Purchases

Transportation costs related to the acquisition of assets are part of the cost of the asset being acquired.



**Now, let's talk
about sales!**



Transactions Relating to Sales

Computer Barn
Partial Income Statement
For the Year Ended December 31, 2002

Revenue		
Sales		\$912,000
Less: Sales returns and allowances	\$ 8,000	
Sales discounts	4,000	12,000
Net sales		<u><u>\$900,000</u></u>

**Credit terms and merchandise returns
affect the amount of revenue earned by
the **seller**.**

Sales Returns and Allowances

On August 2, Kid's Clothes sold \$2,000 of merchandise to Play Clothes on credit terms 2/10, n/30. Kid's Clothes originally paid \$1,000 for the merchandise. Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

1

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Aug.	2	Accounts Receivable (Play Clothes)	2,000	
		Sales		2,000

Sales Returns and Allowances

On August 2, Kid's Clothes sold \$2,000 of merchandise to Play Clothes on credit terms 2/10, n/30. Kid's Clothes originally paid \$1,000 for the merchandise. Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

2

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Aug.	2	Cost of Goods Sold	1,000	
		Inventory		1,000

Sales Returns and Allowances

On August 5, Play Clothes returned \$500 of unsatisfactory merchandise to Kid's Clothes from the August 2 sale. Kid's Clothes cost for this merchandise was \$250.

Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

1

GENERAL JOURNAL

Contra-revenue

Date		Account Titles and Explanation	Debit	Credit
Aug.	5	Sales Returns and Allowances	500	
		Accounts Receivable (Play Clothes)		500

Sales Returns and Allowances

On August 5, Play Clothes returned \$500 of unsatisfactory merchandise to Kid's Clothes from the August 2 sale. Kid's Clothes cost for this merchandise was \$250.

Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

2

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
Aug.	5	Inventory	250	
		Cost of Goods Sold		250

Sales Discounts

On July 6, Kid's Clothes sold \$4,000 of merchandise to Play Clothes on credit with terms of 2/10, n/30. The merchandise originally cost Kid's Clothes \$2,000. Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

1

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	6	Accounts Receivable (Play Clothes)	4,000	
		Sales		4,000

Sales Discounts

On July 6, Kid's Clothes sold \$4,000 of merchandise to Play Clothes on credit with terms of 2/10, n/30. The merchandise originally cost Kid's Clothes \$2,000. Because Kid's Clothes uses a perpetual inventory system, they must make two entries.

2

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	6	Cost of Goods Sold	2,000	
		Inventory		2,000

Sales Discounts

On July 15, Kid's Clothes receives the full amount due from Play Clothes.

Prepare the journal entry for Kid's Clothes.

GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit

Sales Discounts

On July 15, Kid's Clothes receives the full amount due from Play Clothes.

Prepare the journal entry for Kid's Clothes.

Contra-revenue

JOURNAL

$$\$4,000 \times 98\% = \$3,920$$

Date		Account Titles and Explanation	Debit	Credit
July	15	Cash	3,920	
		Sales Discounts	80	
		Accounts Receivable (Play Clothes)		4,000

Sales Discounts

Now, assume that it wasn't until July 20 that Kid's Clothes received the full amount due from Play Clothes.

Prepare the journal entry for Kid's Clothes.

GENERAL JOURNAL

Date	Account Titles and Explanation	Debit	Credit

Sales Discounts

Now, assume that it wasn't until July 20 that Kid's Clothes received the full amount due from Play Clothes.

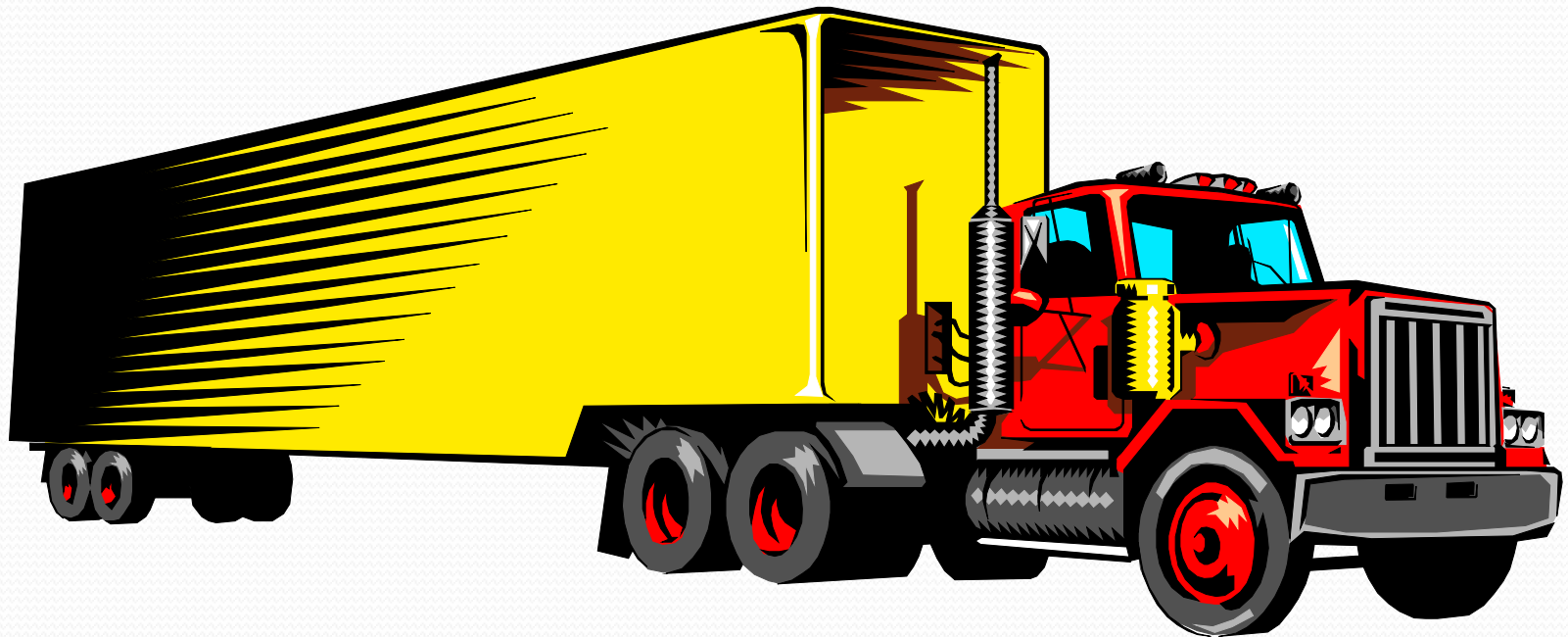
Prepare the journal entry for Kid's Clothes.

GENERAL JOURNAL

Date		Account Titles and Explanation	Debit	Credit
July	20	Cash	4,000	
		Accounts Receivable (Play Clothes)		4,000

Delivery Expenses

Delivery costs incurred by sellers are debited to **Delivery Expense**, an operating expense.



Accounting for Sales Taxes

Businesses collect sales tax at the point of sale.

Then, they remit the tax to the appropriate governmental agency at times specified by law.

\$1,000 sale × 7% tax = \$70 sales tax

G

Date	Account Titles and Explanation	Debit	Credit
	Cash	1,070	
	Sales Tax Payable		70
	Sales		1,000

Evaluating the Performance of a Merchandising Company

Net Sales

- Trends overtime
- Comparable store sales
- Sales per square foot of selling space

Gross Profit Margins

- $\text{Gross Profit} \div \text{Net Sales}$
- Overall Gross Profit Margin
- Gross Profit Margins by Department and Products

Reference

Williams et al. 2011. *Financial and Managerial Accounting: The Basis for Business Decision* 16 ed. New York: McGraw-Hill.