Accounting Notes
Merchandising Companies

Inventory Systems:

Perpetual	Periodic
" Keeps running record of all goods bought and sold	" Does not keep a running record
" Inventory is counted once a year	" Inventory is counted at least once a year
" Used for all types of goods	" Used for inexpensive goods

Purchasing Merchandise under the Perpetual Inventory system:

Quantity discounts
- Discounts given when purchasing large quantities of merchandise
- Purchases are recorded at the net purchase price (Purchase Amount - Quantity Discount)
- No special account is needed to record the quantity discount

Purchase discounts
- Discounts given for the prompt payment of the amount due
- Purchases are recorded at the purchase price after taking any quantity discount but before deducting the purchase discount
- Purchase discount will be recorded when payment is made
- Discounts taken are credited to the Inventory account unless a special account (Purchases Discounts) is used to keep track of the discounts taken

Credit terms:

3/15, n/30	means you get a 3% purchase discount if payment is made within 15 days or the net (full) amount is due in 30 days
n/eom	means that the net amount is due at the end of the month

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        5/10              n/90

 Discount    Discount    net      Due in
 Percentage  Period      amount   x days
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Journal Entries for purchases:

Purchase	Inventory	Purchase amount	
	Accounts Payable		Purchase amount
Payment within discount period	Accounts Payable	Purchase amount	
	Cash		Amount paid
	Inventory		Purchase amount * discount %

Recording purchase returns and allowances:

purchase return - where a business chooses to return defective merchandise to the seller in exchange for a credit for the value of the merchandise returned

purchase allowances - where a business chooses to keep defective merchandise in return for an allowance (reduction) in the amount owed to the seller

Both are recorded the same way. Accounts Payable is debited and Inventory is credited.

Accounts Payable	Amount of return or allowance	
Inventory		Amount of return or allowance

Transportation Costs:

FOB determines

(1) When legal title to merchandise passes from the seller to the buyer
(2) Who pays for the freight costs

FOB Destination - legal title does not pass to the buyer until the goods arrive at the buyers place of business. The seller still owns the merchandise until delivered so the seller must pay the freight costs.

FOB Shipping point - legal title passes to the buyer when the merchandise leaves the sellers place of business. The buyer now owns the goods so the buyer must pay the freight costs.

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Recording the freight costs:

Under FOB Destination the seller records the following entry

Delivery Expense	Freight costs	
Cash (or Accounts Payable)		Freight costs

Under FOB Shipping point the buyer records the following entry

Inventory	Freight costs	
Cash (or Accounts Payable)		Freight costs

Use of Purchase Returns & Allowances, Purchase Discounts, and Freight In accounts:

Some businesses may want to use special accounts to keep track of their returns & allowances, discounts, and freight costs. Purchase returns & allowances and purchase discounts both have credit balances and are contra accounts to the inventory account

The cost of inventory is determined as follows:

Inventory		xxxxx
Less: Purchases Discounts	(xxxx)	
Purchases R & A	(xxxx)	(xxxx)
Net Purchases of Inventory		xxxxx
Freight In		xxx
Total cost of Inventory		xxxxx

Journal Entries:

Returns & Allowances	Accounts Payable	Amount of return or allowance	
	Purchases R & A		Amount of return or allowance
Purchase discount	Accounts Payable	Amount due	
	Cash		Amount paid
	Purchase discount		Amt due * discount %

Journal Entries (cont.):

Freight costs (buyer)	Freight In	Freight costs	
	Cash (or Accounts Payable)		Freight costs

Sales of Inventory:

When inventory is sold there are two journal entries that must be done:
(1) To record the actual amount the goods were sold for
(2) To record the cost we paid for the goods sold

Recording the sale

Cash (or Accounts Receivable)	Total sales price	
Sales		Total sales price

Recording the cost

Cost of goods sold	Original cost paid	
Inventory		Original cost paid

Recording receipt of payment

Cash	Amount received	
Accounts Receivable		Amount received

Sales discounts and Sales returns & allowances:

Sales discounts and sales returns & allowances are contra accounts to Sales and have a normal debit balance.

Sales discounts are always calculated after deducting any returns or allowances from the amount due from the customer

Net Sales = Sales - Sales Returns & Allowances - Sales Discounts

Sales Discount - an incentive given by the seller to the customer to encourage prompt payment

Cash	Amount Received	
Sales Discount	Amount due * discount %	
Accounts Receivable		Amount due

Sales Returns & Allowances - keeps track of defective merchandise returned to the seller by the customers

Sales returns required two journal entries just like the sale of merchandise

(1) to record the reduction in the amount due by the customer

Sales Returns & Allowances	$xxx	
Accounts Receivable		$xxx

(2) to record the cost of the defective merchandise returned by the customer

Inventory	$xxx	
Cost of Goods Sold		$xxx

For a sales allowance only the first journal entry, to record the reduction in the amount due, is required since the merchandise was not returned and added back into the inventory of the seller.

Adjusting Inventory for a Physical Count:

The inventory account will need to be adjusted if the physical count does not match the balance for the inventory account shown in the ledger.

If the physical count is less than the inventory account balance, then the difference is charged against the Cost of Goods Sold account.

Cost of Goods Sold	$xxx	
Inventory		$xxx

If the physical count is more than the inventory account balance, then the difference could indicate a purchase of inventory that was not recorded.

Inventory	$xxx	
Cash (or Accounts Payable)		$xxx

If the difference can not be identified then it is credit to the Cost of Goods Sold account.

Inventory	$xxx	
Cost of Goods Sold		$xxx

Financial Statement Ratios:

$$\text{Gross Margin \%} = \frac{\text{Gross Margin}}{\text{Net Sales}}$$

$$\text{Inventory Turnover} = \frac{\text{Cost of Goods Sold}}{\text{Average Inventory*}}$$

*Average Inventory = (Beginning Inventory + Ending Inventory) / 2

Single Step Income Statement Format:

Revenues:	
Net Sales	$xx,xxx
Interest Revenue	x,xxx
|	
Total Revenues	$xx,xxx
Expenses:	
Cost of Goods Sold	$xx,xxx
Wage Expense	x,xxx
|	
Total Expenses	$xx,xxx
Net Income	$xx,xxx

Multi-Step Income Statement Format:

Sales		$xx,xxx	
Less: Sales Discounts	$x,xxx		
Sales Returns & Allowances	x,xxx	x,xxx	
Net Sales			$xx,xxx
Cost of Goods Sold			xx,xxx
Gross Margin			$xx,xxx
Operating Expenses:			
Wage Expense		$ x,xxx	
Supplies Expense		x,xxx	
Total Expenses			xx,xxx
Operating Income			$xx,xxx
Other Revenues and Expenses:			
Interest Revenue		$ x,xxx	
Interest Expense		(x,xxx)	x,xxx
Net Income			$xx,xxx