Financial Accounting (Chapter 5)
Accounting for Merchandising Activities

I. Introduction

A. We now want to look at accounting for a merchandising business
   1. Those that buy goods and resell them
   2. Accounting cycle is basically the same -- uses some different accounts
   3. Note, Income Statement on page 201
   4. Balance sheet reports “inventory”

II. Analysis of revenues from Sales

A. Gross Sales
   1. Both cash and credit sales (merchandise held for resale)
   2. Recorded when earned -- when title passes
   3. Typical journal entry
      Cash           XX
      Accounts Receivable XX
      Sales          XXX

B. Sales Returns and Allowances
   1. Records return of unsatisfactory goods and/or reductions in sales prices (Issue credit memo)
   2. Contra Revenue
   3. Typical Journal Entry
      Sales Returns and Allowances  XXX
      Accounts receivable          XXX
      and/or Cash                  XXX

C. Sales Discounts
   1. Amount you allow your customers to subtract from payment to encourage early payment
   2. Credit terms govern discount allowed
   3. Typical transaction sequence -- Assume we sell $100 Merchandise -- terms 2/10, n/30
   4. Contra Revenue

D. Net Sales =
   1. Gross Sales less Sales Return and Allowances less Sales discount

E. Introduction to Subsidiary Ledgers
   1. What does the balance in the Accounts Receivable account represent??
      a. What does balance in Accounts Payable represent?
   2. Accounts Receivable Subsidiary Ledger
      a. Separate ledger from General Ledger
      b. Contains an account for each customer we sell on credit to!!
3. Accounts Payable Subsidiary Ledger—same concepts for Accounts Payable—each vendor from which we buy on credit.

4. Concept of Controlling account.

III. Cost of Goods Sold
A. Represents what it cost you to acquire goods you sold this period.

B. What about goods acquired but not sold?
1. This is an asset called "Merchandise Inventory"
2. Two types of systems to account for inventory
   a. Perpetual -- keep a constant balance of inventory on hand (updates Inventory account when Merchandise is bought and sold, hence we also continually update COGS)
   b. Periodic -- do not keep a running balance of inventory on hand. Must make periodic physical count.
      (1) When goods are bought use "purchases" account (recorded from purchase invoice)
      (2) Cost of Goods Sold is a residual amount

c. Formula for Cost of Goods Sold (COGS)
   
   Beginning Inventory
   + Purchases (Net) (Cost of Goods Purchased =
   + Transportation-In Net Purchases + Transportation-In)

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   Goods Available for Sale
   - Ending Inventory
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   Cost of Goods Sold

   (1) Note -- beginning inventory is the same as prior years ending inventory
   (2) Purchases -- used to accumulate cost of merchandise bought for resale
      (a) Concept of trade discounts

   (3) Purchases Return and Allowances
      (a) Unsatisfactory merchandise we return
          Accounts Payable or Cash XX
          Purchases returns & Allow. XX

      (b) Issuance of debit memorandums
      (c) Contra account - subtracted from purchases

   (4) Purchases discounts
      (a) Discounts our suppliers offer us if we make early payment
(b) Very Important to TAKE!!!!!!!
  i) Cost of Not Taking - ex 1/10, n/30
     Discount%  360
     -------------- X --------------
     1-Discount % Credit period -
     Discount period

(c) Alternative Ways to record purchases
  i) Gross method -- record invoice at gross amount and
     any discounts taken as purchase discount

  ii) Net Method -- Record invoice at NET amount, record
     "Discounts Lost" as an operating expense

(5) Transportation-In ---&gt; Costs we incur to get merchandise to our place of
    business
    (a) F.O.B. Shipping point
    (b) F.O.B. Destination

(6) Cost of goods purchased = Purchases less Purchase R & A less Purchase
    Discount + Transportation-In

(7) Goods Available for Sale -- what we had at beginning plus additional bought
(8) Ending inventory -- cost of goods on hand at year end -- Determined by
    physical count. Assign a cost thereto.

IV. Gross Profit on Sales
    A. Net Sales less COGS
    B. Also commonly called Gross Margin
    C. Gives you an idea of average markup on goods sold

V. Operating Expenses
    A. Expenses other than COGS
    B. Broad Classifications
       1. Selling
       2. General and Administrative

VI. Worksheet for Merchandising Company
    A. Use Adjusting Entry approach for inventory
       1. Get out Old Balance
       2. Put in New Balance

    B. Merchandise Inventory is an Asset -- Extend to Balance Sheet column
C. The Other New Accounts -- Extend to Income Statement

D. Note -- Income summary will have both a Debit AND Credit extension in the income statement columns.

VII. Closing Entries
A. Same as before -- Revenue    Income Summary    Expense    Withdrawals

B. The following "NEW" accounts must be closed:
   Sales                          Purchases Return and Allowance
   Sales Return and Allowance     Purchases Discount
   Sales Discounts               Transportation-In
   Purchases                     

C. Balance of "Income Summary" will be affected by adjustment of inventory before being closed

VIII. Income Statement Formats
A. Single Step
   1. Net income determined in one step -- Revenues - expenses

B. Multiple Step
   1. Shows several intermediate subtotals in arriving at net income
      a. Gross Profit
      b. Selling expenses
      c. G & A expenses
      d. Income from Operations

C. Classified
   1. High level of detail
   2. It is likely that this would be used internally by company managers.