

Financial Accounting

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MGM611

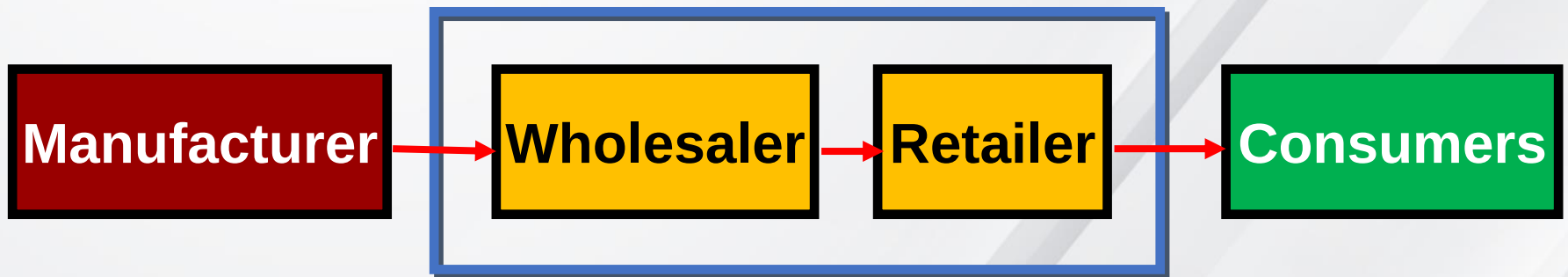
Lecture (6) Merchandising operations & Inventory systems



Learning Objectives

- LO 1** Describe merchandising operations and inventory systems.
- LO 2** Prepare a multiple-step income statement versus single - step income statement.
- LO 3** Record purchases under a perpetual inventory system.
- LO 4** Record sales under a perpetual inventory system.

Merchandising Companies



Merchandising Companies

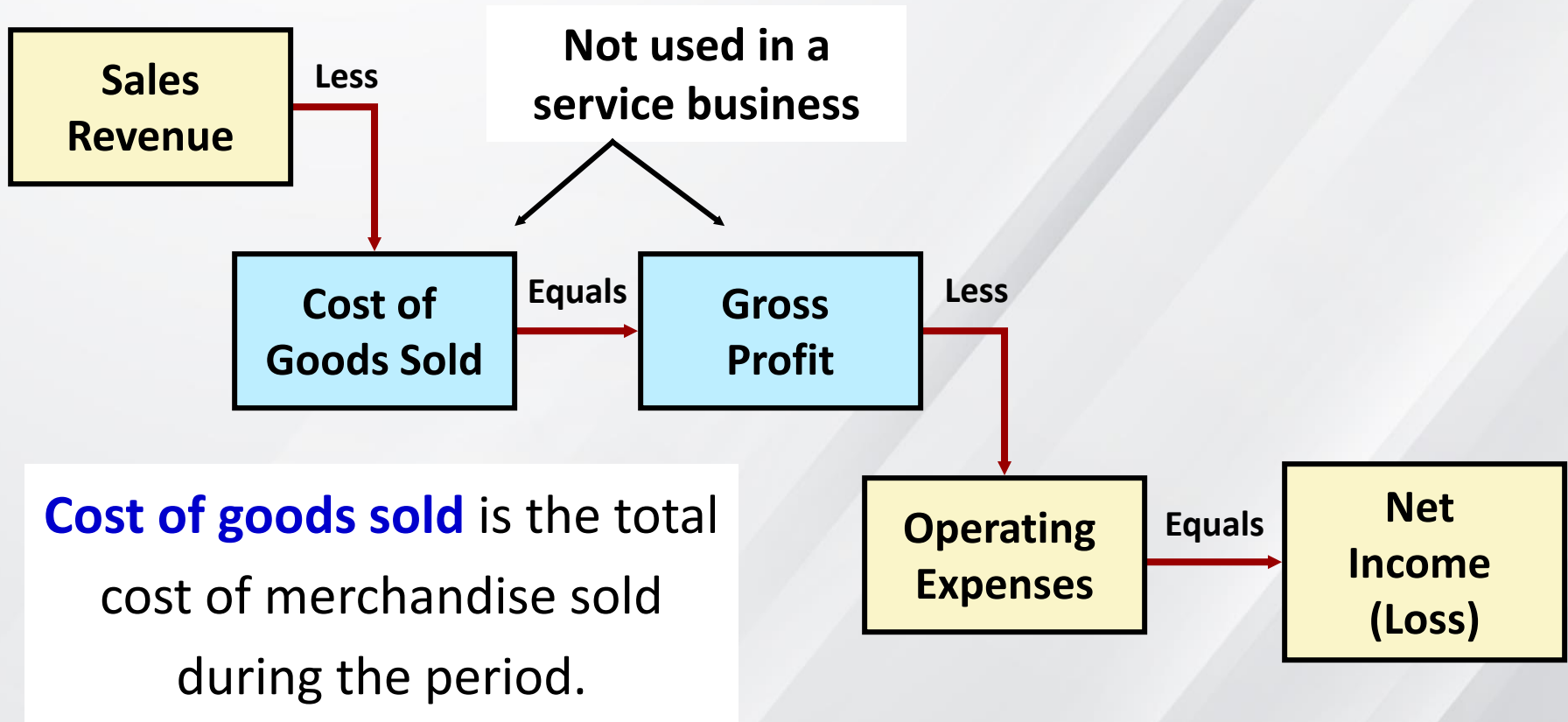
Buy and Sell Goods

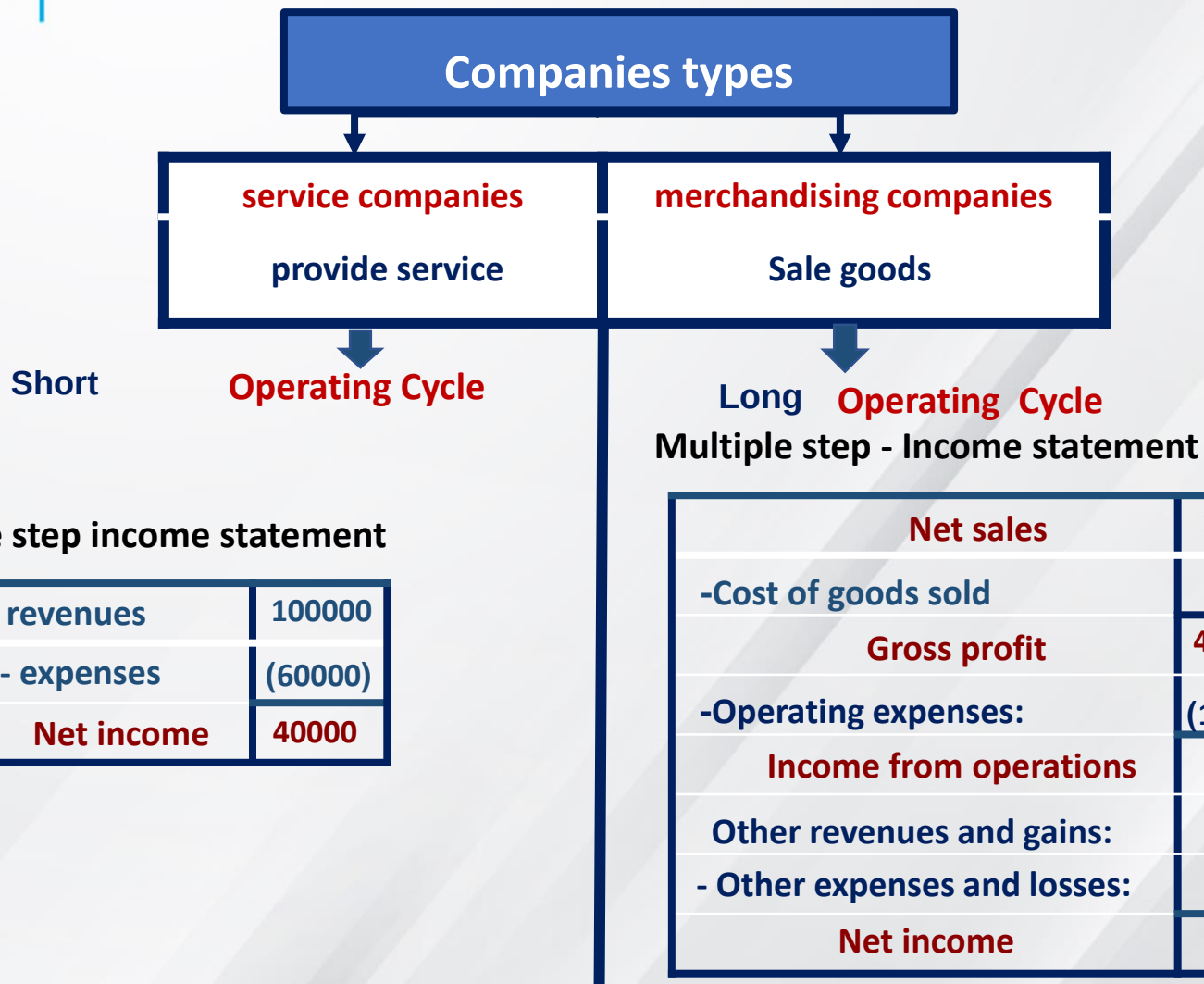
The primary source of revenues is referred to as **sales revenue** or **sales**.



Merchandising Operations

Income Measurement





Companies types

Merchandising companies

Sale goods

Operating Cycle

Multiple step income statement

- 1- **Net sales** = Sales - Sales returns and allowance - sales discount
- 2- **gross profit** = Net sales - cost of good sold
- 3- **operation income** = gross profit - operation expense
- 4- **Net income** = operation income + interest revenue and gains - interest expenses and loss

Net sales	100000
-Cost of goods sold	(60000)
Gross profit	40000
-Operating expenses:	(10000)
Income from operations	30000
Other revenues and gains:	5000
- Other expenses and losses:	(1000)
Net income	34000

Nonoperating Activities

Various revenues and expenses and gains and losses that are **unrelated** to company's **main line** of operations.

Other Revenues and Gains

Interest revenue from notes receivable and marketable securities.

Dividend revenue from investments in common stock.

Rent revenue from subleasing a portion of the store.

Gain from the sale of property, plant, and equipment.

Other Expenses and Losses

Interest expense on notes and loans payable.

Casualty losses from recurring causes, such as vandalism and accidents.

Loss from the sale or abandonment of property, plant, and equipment.

Loss from strikes by employees and suppliers.

**Multiple -Step income statement
for the year ended Dec. 31, 2022**

Sales	x	
- Sales returns & Allowances	(x)	
- Sales discount	(x)	
= Net sales		xx
Cost of goods sold		
Purchases	x	
- Purchases returns	(x)	(-)
- Purchases discount	(x)	
+ Freight- in	x	
= Net purchases		xx
(+) Beginning inventory		x
= Cost of goods available for sale		xx
(-) Ending inventory		(x)
Cost of goods sold		xx
Gross profit		xx
(-) Operating expenses		
Salaries expense		(x)
Advertising expense		(x)
Freight- out		(x)
Rent expense		(x)
Insurance expense		(x)
Total operating expenses		xx
Net operating income		xx
(-) Non operating expenses (Other Expenses & Losses)		
Interest expenses		(x)
Loss on sale of fixed Assets		(x)
Loss from employee strike		(x)
Loss from flood		(x)
Loss from fire		(x)
Loss from earthquakes		(x)
(+) Non operating revenues (Other Revenues & Gains)		
Dividends Revenue		x
Gain on sale of fixed assets		x
Net income		xx

The multiple-step income statement for a merchandiser shows each of the following features except:

- a. gross profit.
- b. cost of goods sold.
- c. a sales revenue section.
-  d. investing activities section.

Do IT

Indicate whether the following statements are **true** or **false**.

1. The primary source of revenue for a merchandising company results from performing services for customers.
2. The operating cycle of a service company is usually shorter than that of a merchandising company.
3. Sales revenue less cost of goods sold equals gross profit.
4. Ending inventory plus the cost of goods purchased equals cost of goods available for sale.

Solution: 1. 2. 3. 4.

Do IT

The following information is available for Art Center for the year ended December 31, 2020.

Other revenues and gains	\$ 8,000	Sales revenue	\$462,000
Other expenses and losses	3,000	Operating expenses	187,000
Cost of goods sold	147,000	Sales discounts	20,000

Prepare a multiple-step income statement for Art Center.

DO IT Multiple-Step Statement

**Art Center
Income Statement
For the Year Ended December 31, 2020**

Multiple step income statement

EX(1)

1- Net sales = Sales - Sales returns and allowance - sales discount
 $= 480000 - 12000 - 8000 = 460000$

2- gross profit = Net sales - cost of good sold
 $= 460000 - 316000 = 144000 \text{ LE}$

3- operation income = gross profit - operation expense
 $= 144000 - 114000 = 30000 \text{ LE}$

4- Net income = operation income + interest revenue and gains
 $30000 + 3000 + 600$
 $- \text{interest expenses and loss}$
 $1800 + 200$
31600

Sales revenue \$480.000 , sales returns and allowances \$ 12.000 , Sales discounts 8.000 , Salaries and wages expense 64.000 , Utilities expense 17.000 , Advertising expense 16.000 , Depreciation expense 8.000 , Freight – out 7.000 , Insurance expense 2.000 , Interest revenue 3.000 , Gain on disposal of plant assets 600 , Interest expenses 1800 , loss from vandalism 200 , Cost of goods sold 316.000

Salaries and wages expense	64.000
Utilities expense	17.000
Advertising expense	16.000
Depreciation expense	8.000
Freight – out	7.000
Insurance expense	2.000
Total operating expenses	114000

Enas company gathered the following data for the year ended December 31, 2022: cost of goods sold 690.000 - Net sales 1250.000- Administrative expenses 234.000- interest expense 58.000- dividend revenue 38.000 - loss from employee strike 233.000- selling expenses 45.000.

Required

- 1- Prepare a **single-step income statement** for the year ended December 31, 2022.
- 2- Prepare a **multiple-step income statement** for the year ended December 31, 2022.

Single - step income statement

Revenues;		
Net sales	1250000	
Dividend revenue	38000	
Total revenues		1288000
Expenses :		
Cost of goods sold	690000	
Administrative expenses	234000	(-)
Loss from employee strike	233000	
Interest expense	58000	
Selling expenses	45000	
Total expenses		1260000
Net income		28000

Multiple step income statement

Net sales		1250000
Less : Cost of goods sold		(690000)
Gross profit		560000
Less: Operating expenses:		
Administrative expenses	234000	(-)
Selling expenses	45000	
Total operating expenses		279000
Net operating profit		281000
Less: Non-Operating expenses		
Loss from employee strike		(233000)
Interest expense		(58000)
Add: Non-Operating revenues		
Dividend revenue		38000
Net profit		28000

DO IT

Purchase	100.000
Purchase returns	3000
Purchase discount	7000
Freight in	4000

Merchandise inventory

Beginning of the period	25.000
Ending of the period	30.000

Required

Using periodic systems:

- 1) **Compute net purchases.**
- 2) **Compute cost of goods available for sale.**
- 3) **Compute cost of goods sold.**

$$\text{1) Net purchases} = \text{Purchases} - \text{Purchases returns and allowance} - \text{Purchase discount} + \text{Freight in}$$

$$\begin{aligned} \text{Net purchases} &= 100.000 - 3.000 - 7.000 + 4.000 \\ &= \mathbf{94.000} \end{aligned}$$

$$\text{2) Cost of goods available for sales} = \text{Beginning inventory} + \text{Net purchases}$$

$$= 25.000 + 94.000$$

$$= \mathbf{119.000}$$

$$\text{3) Cost of goods sold} = \text{Cost of goods available for sales} - \text{Ending inventory}$$

$$= 119.000 - 30.000$$

$$= \mathbf{89.000}$$

Inventory Systems

➤ Perpetual systems

- Continually update accounting records for merchandising transactions
- companies keep detailed records of the cost of each inventory purchase and sale and determines the cost of goods sold each time a sale occurs.
- Applied in the Companies that sell merchandise with **high unit values**

➤ Periodic systems

- Accounting records relating to merchandise transactions are updated only at the end of the accounting period.
- **Applied in the Companies that sell merchandise with low unit values**

The cost of goods sold is determined and recorded each time a sale occurs in:

- a. periodic inventory system only.
-  b. a perpetual inventory system only.
- c. both a periodic and perpetual inventory system.
- d. neither a periodic nor perpetual inventory system.

First : Perpetual inventory system

(1) Purchase of Merchandise

- Merchandise is purchased for resale to customer.
- The account merchandise inventory is debited for the cost of goods.
- Purchase may be made for cash or on account (credit).

Record goods purchased for cash

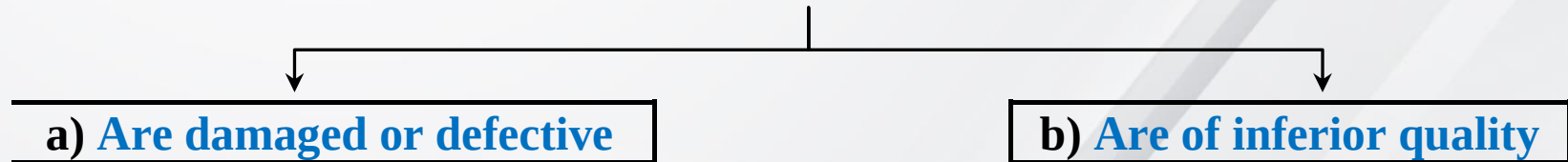
Date	Account title	Dr	Cr
	Merchandise inventory	x	
	Cash		x

Record goods purchases on account

Date	Account title	Dr	Cr
	Merchandise inventory	X	
	Accounts Payable		x

(1) Purchases Returns and Allowances:

A Purchases may be dissatisfied with merchandise received because goods.



journal entry

Date	Account title	Dr	Cr
	Accounts payable	X	
	Merchandise inventory		X
	(To record return of goods)		
	Cash	X	
	Merchandise inventory		X
	(to record return of cash goods)		

Shipping Terms

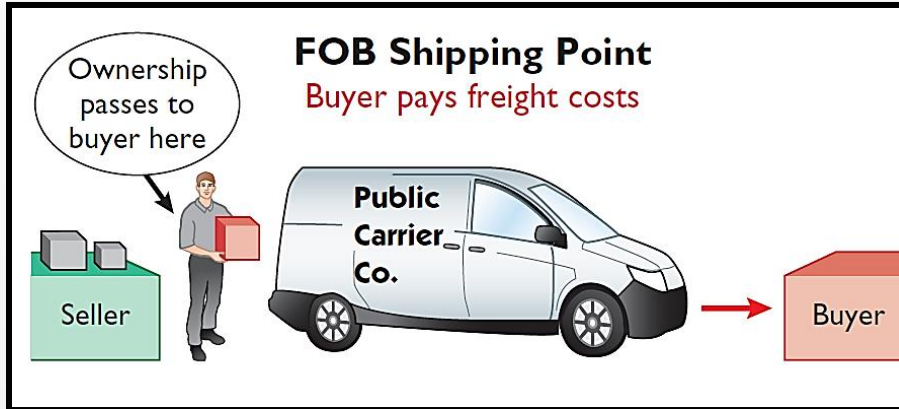
F. O. B Shipping point

- 1) Goods placed free on board the carrier by seller
- 2) **Buyer pays freight cost.**

F. O . B Destination

- 1) Goods placed free on board at buyers business
- 2) **Sellers pays freight cost.**

Freight Costs



Ownership of goods passes to buyer when public carrier accepts goods from seller.



Ownership of goods remains with seller until the goods reach buyer.

Freight costs incurred by the seller are an **operating expense**.

Accounting for freight cost paid by buyer

Date	Account title	Dr	Cr
	Merchandise inventory	x	
	Cash		x
	(To record Payment of freight , terms FOB shipping point)		

Note

Freight cost is part of cost of inventory purchased

Accounting for freight cost paid by seller

Date	Account title	Dr	Cr
	Freight-out (Delivery expense)	X	
	Cash		X
	(To record payment of freight on goods sold F.O.B Destination)		

Freight cost incurred by seller are selling expense called freight-out

(1) Purchase discount

There are (2) Cases

**Payment Within
Discount Period**

**Payment after
Discount period**

Purchase Discounts

2/10, n/30

2% discount if paid within 10 days, otherwise net amount due within 30 days.

1/10 EOM

1% discount if paid within first 10 days of next month

n/10 EOM

Net amount due within the first 10 days of the next month

First: Payment within discount period

Date	Account title	Dr	Cr
	Accounts payable	X	
	Cash		X
	(to record payment within discount period)		

N.B

If payment is made within the discount period, merchandise inventory is credited for the discount taken.

Second: Payment after discount period:

Journal entry:

Date	Account title	Dr	Cr
	Accounts payable	X	
	Cash		X
	(to record payment with no discount taken)		

N.B

If payment is made after the discount period , Accounts payable is debited and cash is credited for the full amount.

Recording Sales Entries

Date	Account title	Dr	Cr
	Cash Sales (To record daily cash sales)	X	X
	Cost of good sold Merchandising inventory (To record cost of goods sold)	X	X
	Account receivable Sales (To record daily credit soles)	X	X
	Cost of goods sold Merchandising inventory (To record cost of merchandise sold on account)	X	X

Sales Return and Allowances

Date	Account title	Dr	Cr
	Sales Return allowances Accounts receivable (To record return of goods)	x	x
	Merchandise inventory Cost of goods sold (To record cost of goods returned per credit)	x	x

Sales Discount

Credit terms

Term	Explanation
2/10. n. 30	A 2% discount may be taken if payment is made within 10 days of the invoice date
1/10,E.O.M	A 1% discount is available if payment made by the 10th if not the payment will be at the end of month

Journal entry:

Date	Account title	Dr	Cr
	Cash	x	
	Sales discount	x	
	Accounts receivable (To record collection within discount period)		x

Example (1)

On October, 1 Taylor bicycle store had an inventory of 20 speed bicycle at a cost of \$ 200 each. during the month of October the following transactions occurred.

- 1) **Oct. 4** Purchased 30 bicycle at a cost of \$200 each from Mann bicycle, terms **2/10, n/30**.
- 2) **Oct. 6** sold 18 bicycle to Team America for \$300 each, terms **2/10 , n/30**.
- 3) **Oct. 7** received credit from Mann bicycle company for the return of 2 defective bicycles.
- 4) **Oct. 13** issued a credit memo to team America for the return of a defective bicycle.
- 5) **Oct. 14** Paid Mann bicycle company in full **less** discount.

Instruction

Prepare the journal entries to record the transactions assuming the company uses a **perpetual inventory system**.

Date	Account title	Dr	Cr
Oct. 4	Merchandising inventory Accounts Payable (To record goods purchased on account)	6000	6000
Oct.6	Accounts Receivable Sales (To record credit sales)	5400	5400
Oct.6	Cost of goods sold Merchandising inventory (Record cost of merchandise sold on account)	3600	3600
Oct.7	Accounts payable Merchandising inventory (To record return of goods)	400	400
Oct.13	Sales return allowances Accounts receivable (To record return of goods)	300	300
Oct.13	Merchandising inventory Cost of goods sold (To record cost of good sold returned)	200	200
Oct.14	Accounts payable (6000 – 400) Cash (5600 x % 98) Merchandising inventory (5600x002) (To record payment within the discount period)	5600	5488 112

Information related to Almond Co. is presented below.

1. On April 5, purchased merchandise from Morris Company for \$23,000, terms 2/10, net/30, FOB shipping point.

Inventory	23000	
Acc . Payable		23000

- 2- On April 6, paid freight costs of \$900 on merchandise purchased from Morris.

Inventory	900	
cash		900

- 3- On April 7, purchased equipment on account for \$26,000.

Equipment	26000	
Acc . Payable		26000

Information related to Almond Co. is presented below.

1. On April 5, purchased merchandise from Morris Company for \$23,000, terms 2/10, net/30, FOB shipping point.

Inventory	23000	
Acc . Payable		23000

- 2- On April 6, paid freight costs of \$900 on merchandise purchased from Morris.

Inventory	900	
cash		900

- 4- On April 8, returned damaged merchandise to Morris Company and was granted a \$3,000 credit for returned merchandise.

Acc . Payable	3000	
Inventory		3000

Information related to Almond Co. is presented below.

- On April 5, purchased merchandise from Morris Company for \$23,000, terms 2/10, net/30, FOB shipping point.

Inventory	23000	
Acc . Payable		23000

- On April 8, returned damaged merchandise to Morris Company and was granted a \$3,000 credit for returned merchandise..

Acc . Payable	3000	
Inventory		3000

6- On April 15, paid the amount due to Morris Company in full.

Acc . Payable	20000	
Inventory		400
Cash		19600

$$20000 = 3000 - 23000 = \text{١- الصافي}$$

$$10 = 5 - 15 = \text{٢- المدة}$$

$$400 = 2\% \times 20000 = \text{٣- الخصم}$$

Information related to Almond Co. is presented below.

- On April 5, purchased merchandise from Morris Company for \$23,000, terms 2/10, net/30, FOB shipping point.

Inventory	23000	
Acc . Payable		23000

- On April 8, returned damaged merchandise to Morris Company and was granted a \$3,000 credit for returned merchandise..

Acc . Payable	3000	
Inventory		3000

- Assume that Almond Co. paid the balance due to Morris Company on May 4 instead of April 15. Prepare the journal entry to record this payment

Acc . Payable	20000	
Cash		20000

١- الصافي = 20000 = 3000 - 23000

٢- المدة = تجاوزت ١٠ أيام

٣- الخصم = Zero

Sales transactions under perpetual inventory system

1. On December 3, Sayed Company sold \$570,000 of merchandise to Shephard Co., terms 2/10, n/30, **FOB shipping point**. The cost of the merchandise sold was \$350,000.

sale of merchandise

Acc. receivable	570000	
Sales revenue		570000
Cost of good sold	350000	
inventory		350000

2. On December 8, Shephard Co. was granted an allowance of \$20,000 for merchandise purchased on December 3.

sale of merchandise

Acc. receivable	570000	
Sales revenue		570000
Cost of good sold	350000	
inventory		350000

sales returns and allowances

sales returns	20000	
Acc. receivable		20000
inventory	20000	
Cost of good sold		20000

3) On December 13, Sayed Company received the balance due from Shephard Co.

sale of merchandise

Acc. receivable	570000	
Sales revenue		570000
Cost of good sold	350000	
inventory		350000

sales returns and allowances

sale returns	20000	
Acc. receivable		20000
inventory	20000	
Cost of good sold		20000

3- collection entry

cash	539000	
Sales discount	11000	
Acc. receivable		550000

$$550000 = 20000 - 570000 = \text{١- الصافي}$$

$$10 = 3 - 13 = \text{٢- المدة}$$

$$11000 = 2\% \times 550000 = \text{٣- الخصم}$$

Thank You