

**Effective Bookkeeping and Payroll**

**Chapter 8 - Accounting for Merchandising**

**WORKBOOK**

## Merchandising Income Statement

A merchandising business buys goods from one company and resells the product at a profit. As such, the income statement has different terminology for expenses and profit.

**Sales** – Revenue from the sale of goods

**Cost of goods sold** – The expense of the product sold (inventory). It is recorded at the cost of the goods purchased and resold including any freight cost.

**Gross profit** – Sales minus Cost of Goods Sold

**Operating expenses** – All other expenses except the cost of the goods that are sold (inventory).

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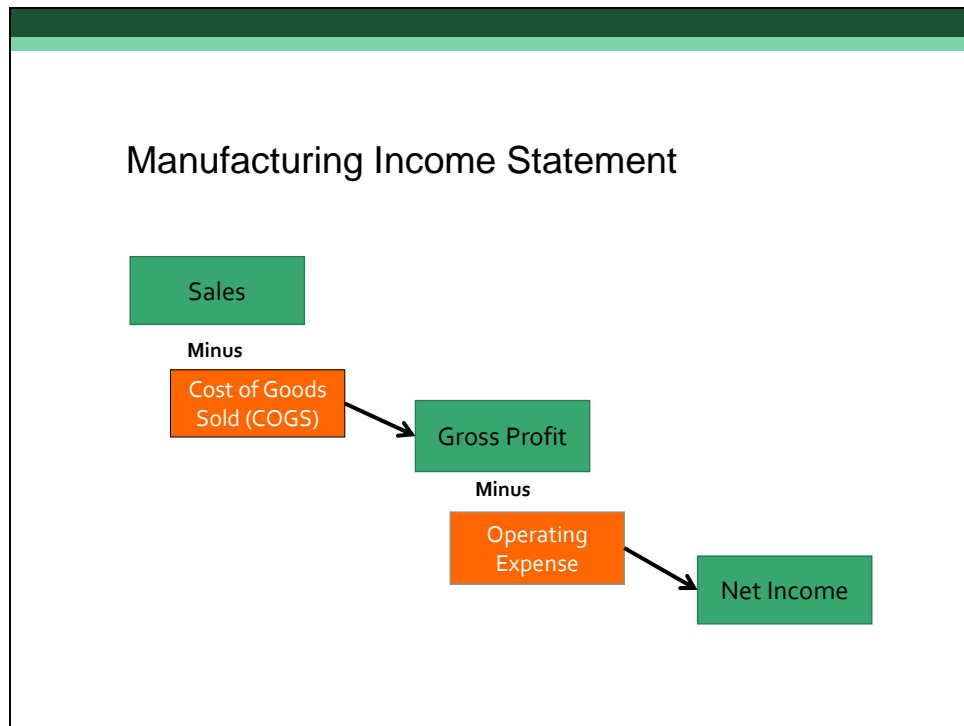
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## Merchandising Income Statement

| Income Statement for Period Ending December 20XX |                  |
|--|------------------|
| Sales  | 20,000,000       |
| Cost of Goods Sold                               | (10,000,000)     |
| Gross Profit                                     | 10,000,000       |
| Operating Expenses                               | (5,000,000)      |
| Earnings Before Interest & Taxes                 | 5,000,000        |
| Interest Expense                                 | (1,000,000)      |
| Taxes  | (1,000,000)      |
| <b>Net Income</b>                                | <b>3,000,000</b> |

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## Merchandising Revenue - Credits

When a return of goods is made, a **credit note** is issued to the customer.

- When a credit is given, it is recorded in the Sales Journal.
- The date and name are entered as usual, a credit note number is entered and all amounts are entered in brackets to indicate a reduction in sales.

An example is on the next page.....

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### Sample entry of a Credit Note in the Sales Journal

| SALES JOURNAL |    |                 |             |       |               |             | Page 511        |               |
|---------------|----|-----------------|-------------|-------|---------------|-------------|-----------------|---------------|
| Date<br>2015  |    | Customer        | Inv.<br>No. | Terms | Post.<br>Ref. | AR<br>Debit | Sales<br>Credit | STP<br>Credit |
| Jan           | 2  | Jim Jones       | 1           | n/30  | 125           | 105.50      | 100.00          | 5.50          |
|               | 16 | Paula Plenty    | 2           | n/15  | 127           | 369.25      | 350.00          | 19.25         |
|               | 24 | Kendra Friendly | 3           | n/30  | 129           | 59.08       | 56.00           | 3.08          |
|               | 25 | Paula Plenty    | CN 9        |       |               | (52.75)     | (50.00)         | (2.75)        |

### Posting Credit Note to the Customer Ledger Account.

| ACCOUNT: Paula Plenty |                    |            |                       |        | ACCT. NO. 127 |        |
|-----------------------|--------------------|------------|-----------------------|--------|---------------|--------|
| TERMS net 30          |                    |            | CREDIT LIMIT \$900.00 |        | SHEET NO. 1   |        |
| Date                  | Memo               | Post. Ref. | Debit                 | Credit | Balance       |        |
| 2015                  |                    |            |                       |        | Debit         | Credit |
| Jan 25                | Credit for return. | SJ1        |                       | 50.00  | 300.00        |        |

## Merchandising Revenue – Credit Notes

**Sales Returns and Allowances** is an account used to record the reduction in sales for returns and credit notes.

- This account is a contra-revenue account and, therefore, has a normal debit balance.
- It is used to record transactions affecting both sales on account and cash sales.

It is valuable to a business to track returns and be able to analyze returns as a % of sales over time.

|                                     | January | February | March | April | May |
|-------------------------------------|---------|----------|-------|-------|-----|
| Sales<br>returns as a<br>% of sales | 5%      | 3%       | 4%    | 7%    | 8%  |

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# Credit Notes

Recording a credit note in the General Journal

| ABC Grocery Store<br>General Journal |                              |              |       | Page<br>GJ1 |
|--------------------------------------|------------------------------|--------------|-------|-------------|
| Date<br>2015                         | Description                  | Post<br>Ref. | Debit | Credit      |
| Jan 25                               | Sales Returns and Allowances |              | 50.00 |             |
|                                      | Sales Tax Payable            |              | 2.75  |             |
|                                      | Accounts Receivable          |              |       | 52.75       |
|                                      | Returned merchandise         |              |       |             |
|                                      |                              |              |       |             |

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## Sales Discounts

A **Sales Discount** is a discount on a sale for an early payment by a customer. A seller typically wants to incent a customer to pay early rather than on time or late. Cash is critical to the business!!

The Sales Discounts Account is another **contra-revenue** account used to record what is essentially a reduction in sales due to early payment.

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## Calculating Sales Discounts

When a sale is made Net 30, it means that the invoice must be paid within 30 days.

If the sale is made under the terms 2/10, net 30, the customer will receive a 2% discount if paid within the first 10 days; otherwise, the full amount must be paid within 30 days

**Example:** A sale is made for \$300 and the terms are 2/10 net 30.  
The customer pays in 10 days so the discount is  $\$300 \times .02 = \$6$

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| ABC Groceries<br>General Journal |                              |              | Page<br>GJ1     |
|----------------------------------|------------------------------|--------------|-----------------|
| Date<br>2015                     | Description                  | Post<br>Ref. | Debit<br>Credit |
| Jan 23                           | Cash                         |              | 294.00          |
|                                  | Sales Discounts              |              | 6.00            |
|                                  | Paula Plenty, A/R            |              | 300.00          |
|                                  | Paid on account. 2% Discount |              |                 |

| CASH RECEIPTS JOURNAL |                |        |            |               |                |          |        | Page CRJ1    |            |
|-----------------------|----------------|--------|------------|---------------|----------------|----------|--------|--------------|------------|
| Date                  | Account Credit | Memo   | Post. Ref. | Accts Rec. Cr | Sales Disc. Cr | Sales Cr | STP CR | Gen. Led. Cr | Cash Debit |
| Jan 23                | Paula Plenty   | 2% Dis |            | 300.00        | 6.00           |          |        |              | 294.00     |
|                       |                |        |            |               |                |          |        |              |            |

## Sales Discounts – Customer Account

| ACCOUNT: Paula Plenty   |    |                             |                       |        | ACCT. NO. 127 |         |        |
|-------------------------|----|-----------------------------|-----------------------|--------|---------------|---------|--------|
| TERMS net 30, 3/15 n/30 |    |                             | CREDIT LIMIT \$900.00 |        | SHEET NO. 1   |         |        |
| Date                    |    | Memo                        | Post. Ref.            | Debit  | Credit        | Balance |        |
| 2015                    |    |                             |                       |        |               | Debit   | Credit |
| Jan                     | 15 | Inv #32, terms 2/15 n/30    | SJ 3                  | 300.00 |               | 300.00  |        |
|                         | 23 | Paid Inv #32 -2% disc taken | CRJ1                  |        | 300.00        |         | 0.00   |



The discount is only shown in the memo of the customer's account.

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## Net Sales On the Income Statement

| ABC Grocery<br>Income Statement<br>For the Month Ended Feb, 2015 |          |           |
|--|----------|-----------|
| Sales  |          | \$ 2,800  |
| Less: Sales returns and allowances                               | 50       |           |
| Sales discounts  | <u>6</u> | <u>56</u> |
| Net Sales  |          | \$ 2,744  |

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## Purchasing Merchandise

There are two types of inventory systems for merchandising companies.

A **Periodic Inventory System** records purchases and does not maintain detailed records of inventory and cost. Instead, we count inventory and calculate the cost of items sold. Used in smaller businesses and for low dollar items.

A **Perpetual Inventory System** where detailed records of the cost of each inventory item are maintained and continuously show the inventory that should be on hand. System is used for high dollar items like automobiles and electronics.

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## Periodic Inventory System

In a periodic inventory system:

- Purchases are recorded in the purchases account.
- Discounts are recorded in the purchase discounts account (a contra-asset account with a credit balance)
- Returns and Allowances are recorded in the purchases returns and allowances account (a contra-asset account with a credit balance)
- Cost of Goods Sold (the cost of the inventory sold) is calculated based on an inventory count performed at the end of each period.

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## Purchase Discounts

Like the sales discounts account, there is a specific account for recording **purchase discounts**. Purchase discounts are tracked separately so the owner is aware if discounts are forfeited.

The **Purchase Discounts** account is a contra-asset account.

Note: Like sales discounts, the discounts are computed on the pre-tax value of the invoice.

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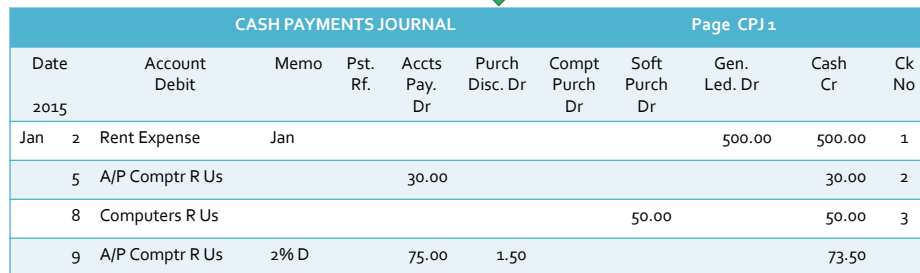
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The Cash Payments Journal has a special column for Purchase Discounts.



The following shows the purchase and payment for purchases on account.

| ABC Grocery<br>General Journal |                              |              |       | Page<br>GJ1 |
|--------------------------------|------------------------------|--------------|-------|-------------|
| Date<br>2015                   | Description                  | Post<br>Ref. | Debit | Credit      |
| Jan 3                          | Purchases                    |              | 75.00 |             |
|                                | Accounts Payable             |              |       | 75.00       |
|                                | On account, terms 2/10 n/30  |              |       |             |
|                                |                              |              |       |             |
| 12                             | Accounts Payable             |              | 75.00 |             |
|                                | Purchases Discounts          |              |       | 1.50        |
|                                | Cash                         |              |       | 73.50       |
|                                | Paid on account, 2% discount |              |       |             |

## Freight-in

The cost of freight is included in the cost of the purchases. The following shows the payment for freight on account.

| ABC Grocery<br>General Journal |              |              |       | Page<br>GJ1 |
|--------------------------------|--------------|--------------|-------|-------------|
| Date<br>2015                   | Description  | Post<br>Ref. | Debit | Credit      |
| Jan 3                          | Freight – In |              | 30.00 |             |
|                                | Cash         |              |       | 30.00       |
| Freight paid in cash           |              |              |       |             |
|                                |              |              |       |             |

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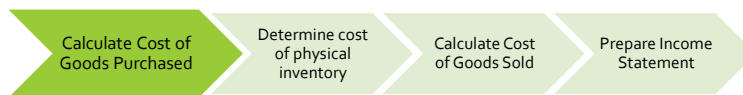
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## End of Period Income Statement

At the end of each period, the following calculations must be done in order to prepare the Income Statement.



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# Net Sales On the Income Statement

Cost of Goods Purchased is calculated any time you will need to prepare an income statement.

| Calculating Cost of Goods Purchased   |           |            |
|---------------------------------------|-----------|------------|
| Purchases                             |           | \$ 50,000  |
| Less: Purchase returns and allowances | 50        |            |
| Purchase discounts                    | <u>20</u> | <u>70</u>  |
| Net Purchases                         |           | 49,930     |
| Add Freight In                        |           | <u>450</u> |
| Cost of Goods Purchased               |           | \$ 50,380  |

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## Determine Cost of Goods On Hand

To determine the cost of the merchandise that was sold during the period so that this may be matched with Revenue on the income statement, it is necessary to take a **physical inventory**.

1. Count the units on hand for each item of inventory
2. Apply unit costs and calculate current value of inventory on hand.
3. Aggregate the costs for each item of inventory.

| Item            | Count | Cost | Total  |
|-----------------|-------|------|--------|
| Loaves of bread | 12    | 1.00 | 12.00  |
| Beans           | 15    | 0.50 | 7.50   |
| Gallon milk     | 4     | 1.00 | 4.00   |
| Total           |       |      | 35,000 |

Assume many more items in inventory

Aggregate cost

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## Compute COGS for Income Statement

Cost of Goods Sold is calculated any time you will need to prepare an income statement.

| Calculating Cost of Goods Sold   |  |                 |
|----------------------------------|--|-----------------|
| Beginning Inventory              |  | \$ 37,000       |
| Add: Cost of Goods Purchased     |  | <u>\$50,380</u> |
| Cost of goods available for sale |  | 87,380          |
| Less: Ending inventory           |  | <u>35,000</u>   |
| Cost of goods sold               |  | \$52,380        |

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## Income Statement

Cost of Goods Sold is calculated any time you will need to prepare an income statement.

| ABC Grocery<br>Income Statement<br>For the Month Ending Feb, 2015 |  |               |
|---|--|---------------|
| Net Sales   |  | \$ 110,000    |
| Cost of Goods sold  |  | <u>52,380</u> |
| Gross Profit  |  | 57,620        |
| Operating expenses  |  | <u>22,000</u> |
| Net Income  |  | \$37,620      |

Operating expenses include all other expenses of the company such as rent, salaries, utilities, supplies, taxes, depreciation etc...

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## Perpetual Inventory System

In a perpetual system purchases are recorded directly into the inventory account and expensed in cost of goods sold.

| ABC Grocery<br>General Journal |                             |              |        | Page<br>GJ1 |
|--------------------------------|-----------------------------|--------------|--------|-------------|
| Date<br>2015                   | Description                 | Post<br>Ref. | Debit  | Credit      |
| Jan 3                          | Inventory                   |              | 800.00 |             |
|                                | Accounts Payable            |              |        | 800.00      |
|                                | Inventory on account        |              |        |             |
|                                |                             |              |        |             |
| 12                             | Cost of Goods Sold          |              | 95.00  |             |
|                                | Inventory                   |              |        | 95.00       |
|                                | Inventory sold and expensed |              |        |             |
|                                |                             |              |        |             |

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## Perpetual Inventory System

The discounts account is still used for analysis and tracking, however, returns are credited directly to inventory.

| ABC Grocery<br>General Journal |                                 |              |        | Page<br>GJ1 |
|--------------------------------|---------------------------------|--------------|--------|-------------|
| Date<br>2015                   | Description                     | Post<br>Ref. | Debit  | Credit      |
| Jan 3                          | Accounts Payable                |              | 800.00 |             |
|                                | Inventory                       |              |        | 800.00      |
|                                | Returned damaged inventory      |              |        |             |
|                                |                                 |              |        |             |
| 12                             | Accounts Payable                |              | 100.00 |             |
|                                | Cash                            |              |        | 98.00       |
|                                | Discounts                       |              |        | 2.00        |
|                                | Paid invoice net of 2% discount |              |        |             |

## Discounts – Purchase Discounts

If the discount is on a **NON-MERCHANDISE** item, it is charged to the asset or expense item that was purchased, **NOT** Purchase Discounts.

| ABC Grocery<br>General Journal |                              |              |        | Page<br>GJ1 |
|--------------------------------|------------------------------|--------------|--------|-------------|
| Date<br>2015                   | Description                  | Post<br>Ref. | Debit  | Credit      |
| Jan 3                          | Office Supplies              |              | 500.00 |             |
|                                | A/P Offices R Us             |              |        | 500.00      |
|                                | On account, terms 2/10 n/30  |              |        |             |
|                                |                              |              |        |             |
| 12                             | A/P Offices R Us             |              | 500.00 |             |
|                                | Office Supplies              |              |        | 10.00       |
|                                | Cash                         |              |        | 490.00      |
|                                | Paid on account, 2% discount |              |        |             |

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## Cash on Delivery (COD)

Some companies have terms of COD – Cash on Delivery. This can be required for a customer with poor credit and who does not pay their bills on a timely basis.

- COD means that goods will not be delivered until full cash payment is made.
- This type of transaction is treated as a cash sale for the seller and a cash purchase for the buyer.



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Questions

and

Answers

## Review Questions:

1. The following accounts are specific to a merchandising business:
  - A. Operating expenses
  - B. Sales
  - C. Cost of goods sold
  - D. B and C only
2. When recording a credit note in the general ledger you record the following:
  - A. A debit to accounts receivable
  - B. A credit to sales tax payable
  - C. A debit to sales returns and allowances
3. True or False: Sales minus cost of goods sold equals gross profit.
4. True or False: The sales returns and allowances account is a contra-asset account.
5. True or False: When a sale is made 2/10 Net 30 it means that a 2% discount will be given if paid within 30 days.

## Answer Key:

1. D  
All businesses have operating expenses.
2. C  
We record a credit to A/R, a debit to sales tax payable and a debit to sales returns and allowances since it is a contra-revenue account.
3. A  
True. Sales minus cost of goods sold equals gross profit.
4. B  
False. It is a contra-revenue account.
5. B  
False. A 2% discount will be given if paid within 10 days.