



Dutchess Community College
ACC 104 – Financial Accounting
Quiz Prep Chapter 5
Merchandising Operations

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Disclaimer

This *Quiz Prep* is provided as an outline of the key concepts from the chapter.

It is not intended to be comprehensive or exhaustive.

Quizzes may include material from the classroom lectures, the text or the homework assignments.

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Two Inventory Systems

Perpetual Inventory System– detailed records are maintained for the purchase cost and sale of every item in inventory. An auto dealer would be a good example of a company that would use a perpetual inventory system.

Periodic Inventory System – detailed records are not kept of each item in inventory. The cost of goods sold is determined *periodically* at the end of the accounting period when an inventory is taken.

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Two Inventory Systems

**This *Quiz Prep* will only address the
Perpetual Inventory System**

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Purchase Inventory

Purchase \$11,000 of inventory

	Dr	Cr
Inventory	11,000	
Accounts Payable		11,000

Pay \$500 freight on inventory purchase

	Dr	Cr
Inventory	500	
Cash		500

Freight costs are only relevant if **you** have to pay them.

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Return Purchased Inventory

Return \$1,000 of inventory to the seller

	Dr	Cr
Accounts Payable	1,000	
Inventory		1,000

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Allowance for Purchased Inventory

Rather than return the merchandise, the seller may grant you an *allowance*, i.e., a reduction in the price of the goods, if for example it was slightly damaged.

Either way, the entry is the same: the amount due and the cost of the inventory are reduced.

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Purchase Discounts

The supplier offers terms of **2/10 net 30**.

This means that you can take a 2% discount if you pay within 10 days...

... and this means the total amount is due within 30 days.

Note that the discount can be something other than 2%, the discount period can be something other than 10 days and the net due date can be something other than 30 days, but logically must be greater than the discount period.

You must pay attention to all the dates!

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Purchase Discounts

Assume that you pay within the 10 days.

Note that the discount is applicable only to the net amount owed after returns and allowances:

Purchases	\$ 11,000
- Purchase Returns & Allowances	<u>1,000</u>
= Net Amount Owed	10,000
x Discount Rate	<u>.02</u>
= Discount Amount	200

You must pay attention to all the dates!

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Purchase Discounts

Therefore, if you pay within 10 days the entry would be:

	Dr	Cr
Accounts Payable	10,000	
Cash		9,800
Inventory		200

This reduces your payable to the supplier

This reduces the cost of your inventory

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Record A Sale

You sell \$9,800 of inventory for \$20,000 **under a perpetual inventory system**

	Dr	Cr
Accounts Receivable	20,000	
Sales Revenue		20,000

	Dr	Cr
Cost Of Goods Sold (COGS)	9,800	
Inventory		9,800

NOTE WELL: Sales under a **Perpetual** Inventory System require 2 entries: the Sale and COGS

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Shipping Expense On A Sale

You pay \$ 500 to ship the inventory to the customer.

	Dr	Cr
Shipping Expense	500	
Cash		500

NOTE: Shipping costs **to** a customer **paid by the seller** is an **Operating Expense of the Seller.**

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Sales Return

Your customer returns \$2,000 of inventory they did not want.

	Dr	Cr
Sales Returns & Allowances	2,000	
Accounts Receivable		2,000

Note that the debit is to *Sales Returns & Allowances*, a *contra-revenue* account.

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Sales Return

	Dr	Cr
Sales Returns & Allowances	2,000	
Accounts Receivable		2,000

Note that since this is a **Perpetual Inventory** system, similar to a Sale, **Sales Returns** **require 2 entries:** one for the sale return and one for the COGS.

	Dr	Cr
Inventory	980	
Cost Of Goods Sold (COGS)		980

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Sales Discounts

You offer your customer terms of 2/10 net 30.
Assume that they pay within the 10 days.

Note that the discount is applicable only to the net amount owed after returns and allowances:

Sales	\$ 20,000
- Sales Returns & Allowances	<u>2,000</u>
= Net Amount Owed	18,000
x Discount Rate	<u>.02</u>
= Discount	360

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Sales Discounts

You offer your customer terms of 2/10 net 30.
Assume that they pay within the 10 days.

Note that the discount is applicable only to the net amount owed after returns and allowances:

Sales	\$ 20,000
- Sales Returns & Allowances	<u>2,000</u>
= Net Amount Owed	18,000
x Discount Rate	<u>.02</u>
= Discount	360

You must pay attention to all the dates!

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Sales Discount

The entry would be:

	Dr	Cr
Cash	17,640	
Sales Discounts	360	
Accounts Receivable		18,000

Note that the debit is to *Sales Discounts*, a *contra-revenue* account.

Perpetual Inventory Journal Entry Recap

	Seller	Buyer
Sale / Purchase	Accts Receivable Sales Revenue COGS Inventory	Inventory Acct Payable
Shipping	(if paid by seller) Shipping Expense (Operating) Cash	(if paid by buyer) Inventory Cash
Returns	Returns & Allowances (contra) Acct Receivable Inventory COGS	Acct Payable Inventory
Payment (with 2% Discount)	Cash (98%) Sales Discounts (contra) (2%) Acct Receivable (100%)	Acct Payable (100%) Inventory (2%) Cash (98%)

Multi-Step Income Statement

Revenue			Gross Sales
		-	Less: Sales Returns & Allowances
Contra- Revenue Accounts	}	-	Sales Discounts
		=	Net Sales
		-	Cost Of Goods Sold (COGS)
		=	Gross Profit
Wages, Rent, Utilities, Shipping (Out), etc.		-	Operating Expenses
		=	Operating Profit
		+/-	+/- Other Revenues & Losses
Most likely Non- Operating Item		+/-	+/- Interest
		=	Earnings Before Taxes (EBT)
		-	Income Taxes
		=	Net Income

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Profitability Ratios

$$\text{Gross Profit Rate} = \frac{\text{Gross Profit}}{\text{Net Sales}}$$

$$\text{Profit Margin} = \frac{\text{Net Income}}{\text{Net Sales}}$$

NOTE:
Net Sales

As with profits,
Higher Is Better

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