BA5401 Accounting

Merchandising Activities

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Service vs. Merchandiser

Service Co. Income Statement For the year ended 31/12/2012	Merchandising Co. Income Statement For the year ended 31/12/2012
Service Revenue	Sales Revenue
-Operating Expenses	-Cost of Goods Sold
Operating Profit	Gross Profit
-Interest Expenses	-Operating Expenses
Earnings Before Taxes	Operating Profit
-Tax Expense	-Interest Expenses
Net Income	Earnings Before Taxes
	-Tax Expense
	Net Income

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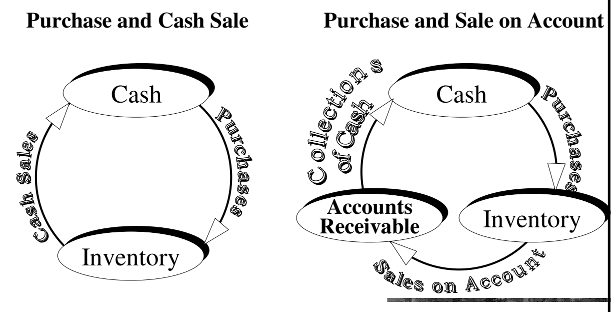
Operating Cycle of a Merchandising Business



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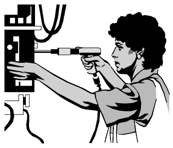
Merchandising vs. Manufacturing

Purchase inventory in ready-to-sell condition.

Manufacture inventory and have a longer and more complex operating cycle

Merchandising Company



Manufacturing Company

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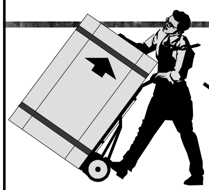
Retailers and Wholesalers



Wholesalers buy merchandise from several different manufacturers and then sell this merchandise to several retailers.

Retailers sell merchandise directly to the public.

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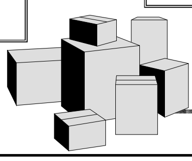
Inventory Defined

Inventory

- **Goods owned and held for sale to customers**
- **Current asset**



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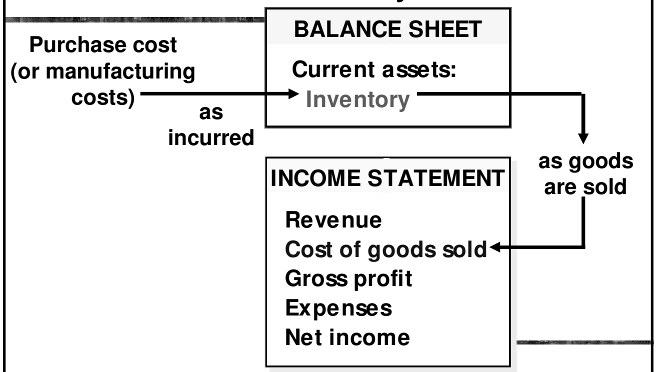
The Flow of Inventory Costs



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Inventory Systems

- Perpetual
- Periodic

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Inventory Accounting Systems

Perpetual systems maintain a running record to show the inventory on hand at all times.

Periodic systems do not keep a continuous record of inventory on hand.

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Computing the Cost of Goods Sold in a Periodic System

Purchases of inventory – Purchases discounts – Purchases returns and allowances = Net purchases

Beginning inventory + Net purchases + Freight-in = Cost of goods available for sale

Cost of goods available for sale – Ending inventory = Cost of goods sold

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Cost of Goods Sold

Beginning Inventory TL100,000 + Net Purchases TL560,000 =

Cost of Goods Available for Sale TL660,000 – Ending Inventory TL120,000 = Cost of Goods Sold TL540,000

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Computing the Cost of Goods Sold in a Periodic System

Beginning Inventory TL20,000

Purchases and Freight-In TL101,000

Cost of Goods Available for Sale TL121,000

Ending Inventory TL15,000

Cost of Goods Sold TL106,000

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Perpetual Inventory System

On September 5, Alp Co. purchased 100 laser lights for resale for TL30 per unit from Electronic City on account .

Assets		=	Liabilities		+	Equity	
Inventory	+3000		Accts. Payable	+3000			

Perpetual Inventory System

On September 10, Alp Co. sold 10 laser lights for TL50 per unit on account to ABC Radios.

Assets		=	Liabilities		+	Equity	
Accts. Receivable	+500					Sales Revenue	+500
Inventory	-300					COGS	-300

Perpetual Inventory System

On September 15, Alp Co. paid Electronic City TL3,000 for the September 5 purchase.

Assets		=	Liabilities		+	Equity	
Cash	-3000		Accts. Payable	-3000			

Perpetual Inventory System

On September 22, Alp Co. received TL500 from ABC Radios as payment in full for their purchase on September 10.

Assets		=	Liabilities		+	Equity	
Accts. Receivable	-500						
Cash	+500						

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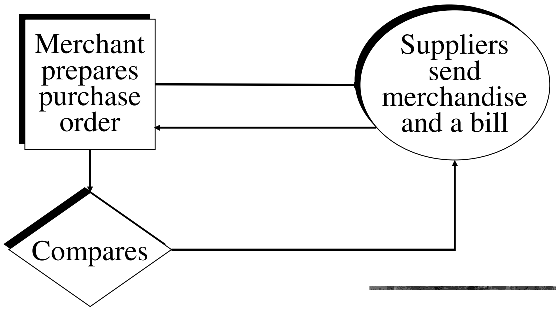
Purchase of Inventory



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Purchase Returns, Allowances and Discounts

- If there are damaged or undesirable items they should be returned and deducted from Inventory.
- If the seller offers a discount for early payment it should again be deducted from Inventory
- Credit terms like 2/10, N/30

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Transportation Costs

- Transportation costs from the seller to your location should be included in the cost of Inventory.
- Transportation costs from your location to your customer should be recorded as operating expenses.

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Sporting Store Example

- On May 15, the store sold to Arda Gym TL5,000 worth of merchandise with a cost of TL3,000.
- Terms are 2/10, N/30.

	Invoice
Arda Gym	Terms 2/10, N/30
Total	TL5,000

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Recording the Sales Transaction

Assets		=	Liabilities		+	Equity	
Accts. Receivable	+5000					Sales Revenue	+5000

Inventory	-3000					COGS	-3000

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Sales Discounts and Sales Returns and Allowances Example

- On May 17, Arda Gym returned TL1,500 worth of goods that cost TL900.
- In addition, a credit of TL100 was allowed for merchandise that was damaged.
- What are the entries?

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Sales Discounts and Sales Returns and Allowances Example

Assets		=	Liabilities		+	Equity	
Accts. Receivable	-1500					Sales Returns	-1500

Inventory	+900					COGS	+900

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Sales Discounts and Sales Returns and Allowances Example

Assets		=	Liabilities		+	Equity	
Accts. Receivable	-100					Sales Allow.	-100

- There is no entry required for inventory since the goods were not returned.

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Sales Discounts and Sales Returns and Allowances Example

- On May 20, the store received a check from Arda Gym for the balance due.
- What is the balance due?
- Accounts Receivable May 15 =TL5,000
- Less May 17 returns and allowances TL1,600
- Equals May 20 balance due of TL3,400

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Sales Discounts and Sales Returns and Allowances Example

- Arda took advantage of the sales terms – 2/10, N/30.

Assets		=	Liabilities		+	Equity	
Accts. Receivable	-3400					Sales Discounts	-68
Cash	+3332						

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Sales Returns, Allowances and Discounts

Merchandising Co.
Income Statement
For the year ended 31/12/2012

Sales Revenue
<u>-Cost of Goods Sold</u>
Gross Profit
<u>-Operating Expenses</u>
Operating Profit
<u>-Interest Expenses</u>
Earnings Before Taxes
<u>-Tax Expense</u>
Net Income

Merchandising Co.
Income Statement
For the year ended 31/12/2012

Gross Sales Revenue
-Sales Returns and Allowances
<u>-Sales Discounts</u>
Net Sales Revenue
<u>-Cost of Goods Sold</u>
Gross Profit
<u>-Operating Expenses</u>
Operating Profit
<u>-Interest Expenses</u>
Earnings Before Taxes
<u>-Tax Expense</u>
Net Income

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Taking a Physical Inventory

In order to ensure the accuracy of their perpetual records, most businesses take a complete physical count of the merchandise on hand at least once a year.

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Taking a Physical Inventory

The primary reason for taking a physical inventory is to adjust the perpetual inventory records for unrecorded shrinkage losses, such as theft, spoilage, or breakage.

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Adjustments to Inventory Example

Book Inventory Balance TL255,000

Physical Count TL252,500

TL2,500 difference

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Adjustments to Inventory Example

- What is the entry?

Assets		=	Liabilities		+	Equity	
Inventory	-2500					COGS	-2500

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Closing Entries for a Merchandising Business

- All temporary accounts (Revenues, Expenses, etc.) must be closed (set to zero) at the end of the period when preparing financial statements.
- The only accounts remaining will be Balance Sheet Accounts (A,L,E)

Which Unit Did We Sell? Does It Really Matter?

When identical units of inventory have different unit costs, a question naturally arises as to which of these costs should be used in recording a sale of inventory.

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Inventory Subsidiary Ledger

A separate subsidiary account is maintained for each item in inventory.

Item LL002 — Primary supplier Electronic City
Description Laser Light — Secondary supplier Electric Company
Location Storeroom 2 — Inventory level: Min: 25 Max: 200

	Purchased			Sold			Balance		
Date	Units	Unit Cost	Total	Units	Unit Cost	Cost of Goods Sold	Units	Unit Cost	Total
Sept. 5	100	30	3,000				100	30	3,000
Sept. 9	75	50	3,750				100 75	30 50	3,000 3,750
Sept. 10				10	?	?	? ?	? ?	? ?

How can we determine the unit cost for the Sept. 10 sale?

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To determine the cost of inventory sold, accountants use one of the following inventory valuation methods.

- **Specific identification**
- **Average cost**
- **FIFO**
- **LIFO**

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Information for the Following Inventory Examples

The Bike Company (TBC)

Cost of Goods Available for Sale					
Aug.	**1 Beg. Inventory**	**10 units @**	**91 TL**	**=**	**910 TL**
Aug.	**3 Purchased**	**15 units @**	**106 TL**	**=**	**1,590 TL**
Retail Sales of Goods					
Aug.	**14 Sales**	**20 units @**	**130 TL**	**=**	**2,600 TL**

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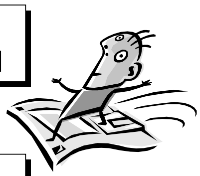
First-In, First-Out Method (FIFO)

Oldest Costs → **Costs of Goods Sold**

Recent Costs → **Ending Inventory**



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FIFO Example

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	10 @ 91 TL = 910 TL		910 TL
Aug. 3	15 @ 106 TL = 1,590 TL		2,500 TL

On August 14, TBC sold 20 bikes for 130TL each.

Continue

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FIFO Example

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	10 @ 91 TL = 910 TL		910 TL
Aug. 3	15 @ 106 TL = 1,590 TL		2,500 TL
Aug. 14		10 @ 91 TL = 910 TL 10 @ 106 TL = 1,060 TL	530 TL

The Cost of Goods Sold for the August 14 sale is 1,970TL, leaving 530TL and 5 units in inventory.

Continue **Let's look at the entries for the Aug. 14 sale.**

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FIFO Example

Retail

Assets		=	Liabilities		+	Equity	
Cash	+2600					Sales Revenue	+2600

Cost

Inventory	-1970					COGS	-1970

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FIFO Example

Cost of Goods Sold					Inventory Balance
					910 TL
					2,500 TL
10	@	91 TL	=	910 TL	
10	@	106 TL	=	1,060 TL	530 TL

Income Statement
COGS = $1,970

5	@	106 TL	=	530 TL
	End. Inv.			530 TL

Balance Sheet
Inventory = $530

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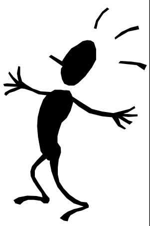
Last-In, First-Out Method (LIFO)

Recent Costs → **Costs of Goods Sold**

Oldest Costs → **Ending Inventory**



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LIFO Example

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	10 @ 91 TL = 910 TL		910 TL
Aug. 3	15 @ 106 TL = 1,590 TL		2,500 TL

On August 14, TBC sold 20 bikes for 130TL each.

Continue

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LIFO Example

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	10 @ 91 TL = 910 TL		910 TL
Aug. 3	15 @ 106 TL = 1,590 TL		2,500 TL
Aug. 14		15 @ 106 TL = 1,590 TL 5 @ 91 TL = 455 TL	455 TL

The Cost of Goods Sold for the August 14 sale is 2,045TL, leaving 455TL and 5 units in inventory.

Continue

Let's look at the entries for the Aug. 14 sale.

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LIFO Example

Retail

Assets		=	Liabilities		+	Equity	
Cash	+2600					Sales Revenue	+2600

Cost

Inventory	-2045					COGS	-2045

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LIFO Example

Cost of Goods Sold					Inventory Balance
					910 TL
					2,500 TL
15	@	106 TL	=	1,590 TL	
5	@	91 TL	=	455 TL	455 TL

Income Statement
COGS = 2,045TL

5 @ 91 TL = 455 TL
End. Inv. 455 TL

Balance Sheet
Inventory = 455TL

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Average-Cost Method

When a unit is sold, the average cost of each unit in inventory is assigned to cost of goods sold.

Cost of Goods Available for Sale ÷ Units on hand on the date of sale

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Average-Cost Method Example

Date	Purchases					Cost of Goods Sold	Inventory Balance
Aug. 1	10	@	91 TL	=	910 TL		**910 TL**
Aug. 3	15	@	106 TL	=	1,590 TL		**2,500 TL**

On August 14, TBC sold 20 bikes for 130TL each.

Continue

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Average-Cost Method Example

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	10 @ 91 TL = 910 TL		910 TL
Aug. 3	15 @ 106 TL = 1,590 TL		2,500 TL

The average cost per unit must be computed prior to each sale.

100TL = 2,500TL ÷ 25

Continue

Average-Cost Method Example

Date	Purchases	Cost of Goods Sold	Inventory Balance
Aug. 1	10 @ 91 TL = 910 TL		910 TL
Aug. 3	15 @ 106 TL = 1,590 TL		2,500 TL
Aug. 14		20 @ 100 TL = 2,000 TL	500 TL

The average cost per unit is 100TL.

100TL = 2,500TL ÷ 25

Continue

Let's look at the entries for the Aug. 14 sale.

Average-Cost Method Example

Retail

Assets		=	Liabilities		+	Equity	
Cash	+2600					Sales Revenue	+2600

Cost

Inventory	-2000					COGS	-2000

Average-Cost Method Example

Cost of Goods Sold	Inventory Balance
	910 TL
	2,500 TL
20 @ 100 TL = 2,000 TL	500 TL

Income Statement
COGS = 2,000TL

5 @ 100 TL = 500 TL
End. Inv. 500 TL

Balance Sheet
Inventory = 500TL

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	FIFO	LIFO	Average Cost
COGS	1,970	2,045	2,000
Ending Inventory	530	455	500
COGAS	2,500	2,500	2,500

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Accounting Principles: Conservatism

Err on the side of caution when reporting any item in the financial statements.

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Lower-of-Cost-or-Market

- An asset is reported at the lower of its historical cost or market (replacement) value.
- If the replacement cost falls below its historical cost, the business must write down the value of its inventory.

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Lower-of-Cost-or-Market Example

- Cost of inventory: 3,000TL
- Market value at balance sheet date: 2,200TL
- What is the entry?

Assets		=	Liabilities		+	Equity	
Inventory	-800					COGS	-800

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