

Financial Accounting Chapter 4

Summary: Cheat Sheet

MERCHANDISING ACTIVITIES

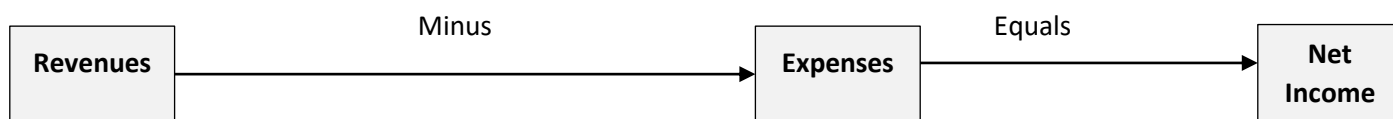
Merchandise: Goods a company buys to resell.

Cost of goods sold: Costs of merchandise sold.

Gross profit (gross margin): Net sales minus cost of goods sold.

Computing net income (service company vs. merchandiser):

Service Company



Merchandiser



Inventory: Costs of merchandise owned, but not yet sold. It is a current asset on the balance sheet.

Merchandise Cost Flows:



Perpetual inventory system: Updates accounting records for each purchase and each sale of inventory.

Periodic inventory system: Updates accounting records for purchases and sales of inventory only at the end of a period.

MERCHANDISING PURCHASES

Cash discount: A purchases discount on the price paid by the buyer; or a sales discount on the amount received for the seller.

Credit terms example: "2/10, n/60" means full payments is due within 60 days, but the buyer can deduct 2% of the invoice amount if payment is made within 10 days.

Gross method: Initially record purchases at gross (full) invoice amounts.

Purchasing Merchandise for Resale Entries:

Purchasing merchandise on credit	Merchandise Inventory	500	
	Accounts Payable		500
Paying within discount period (Inventory reduced by discount taken)	Accounts Payable	500	
	Merchandise Inventory		10
	Cash		490
Paying outside discount period	Accounts Payable	500	
	Cash		500
Recording purchases returns or allowances	Cash or Accounts Payable	30	
	Merchandise Inventory		30

Transportation Costs and Ownership Transfer Rules:

Shipping Terms	Ownership Transfers at	Goods in Transit Owned by	Transportation Costs Paid by	
FOB shipping point	Shipping point	Buyer	Buyer	Merchandise Inventory Cash
FOB destination	Destination	Seller	Seller	Delivery Expense Cash

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MERCHANDISING SALES

Selling merchandise on credit	Accounts Receivable	1,000	
	Sales		1,000
	Cost of Goods Sold	300	
	Merchandise Inventory		300
Receiving payment within discount period	Cash	980	
	Sales Discounts	20	
	Accounts Receivable		1,000
Receiving payment outside discount period	Cash	1,000	
	Accounts Receivable		1,000

Sales Discounts: A contra revenue account, meaning Sales Discounts is subtracted from Sales when computing net sales.

Customer Merchandise Returns Entries:

Receiving sales returns of nondefective inventory	Sales Returns and Allowances	15	
	Cash or Accounts Receivable		15
	Merchandise Inventory	9	
	Cost of Goods Sold		9

Sales allowance: A price reduction agreed to when a buyer is unsatisfied with the goods.

Recognizing sales allowances	Sales Returns and Allowances	10	
	Cash or Accounts Receivable		10

MERCHANDISER REPORTING

Inventory shrinkage: An adjusting entry to account for the loss of inventory due to theft or deterioration. It is computed by comparing a physical count of inventory with recorded amounts.

Adjustment for shrinkage (occurs when recorded amount larger than physical inventory)	Cost of Goods Sold	250	
			250

Closing entries: Differences between merchandisers and service companies in red.

Step 1: Close Credit Balances in Temporary Accounts to Income Summary	Sales	321,000	
	Income Summary		321,000
Step 2: Close Debit Balances in Temporary Accounts to Income Summary	Income Summary	308,100	
	Sales Discounts		4,300
	Sales Returns and Allowances		2,000
	Cost of Goods Sold		230,400
	Other Expenses		71,400

Steps 3 and 4: Same entries as those for service companies.

Multiple-step income statements: Three parts: (1) gross profit; (2) income from operations, which is gross profit minus operating expenses; and (3) net income, which is income from operations plus or minus nonoperating items.

Operating expenses: Separated into selling expenses and general & administrative expenses.

Selling expenses: Expenses of advertising merchandise, making sales, and delivering goods to customers.

General & administrative expenses: Expenses that support a company's overall operations, including accounting and human resources.

Nonoperating activities: Consist of expenses, revenues, losses, and gains that are unrelated to a company's main operations.

Multiple-Step Income Statement Example

Sales		\$321,000
Less: Sales discounts	\$ 4,300	
Sales returns and allowances	<u>2,000</u>	<u>6,300</u>
Net sales		314,700
Cost of goods sold		<u>230,400</u>
Gross profit		84,300
Operating expenses		
Selling expenses*		
General and administrative expenses*		
Total operating expenses		<u>71,400</u>
Income from operations		12,900
Total other revenues and gains (expenses and losses)		<u>2,000</u>
Net income		<u>\$ 14,900</u>

*Must list all individual expenses and accounts Exhibit 4.13 (not done here for brevity).

Single-Step Income Statement Example

Revenues		
Total revenues*		\$318,200
Expenses		
Total expenses*		<u>303,300</u>
Net income		<u>\$ 14,900</u>

*Must list all individual expenses and accounts Exhibit 4.14 (not done here for brevity).