

## Chapter 5      MERCHANDISING TRANSACTIONS

Distinguish between service, merchandising, and manufacturing businesses.

- Service business- provides a service, does something for you
  - Doctor, landscaper, etc.
- Merchandising business- buys products for resale to customers
  - Sears, target, amazon, etc.
- Manufacturing business- creates new products for sale
  - Buy rubber and leather and turn it into shoes

### REVENUE FOR A MERCHANDISING COMPANY

Sales revenue (or [just] SALES)

- Revenue recognition- generally revenue is recognized when the customer receives the goods
  - Point of sale

Sales discounts/Credit terms

- Also, a contra account to revenue
- Offered by the seller to encourage prompt payment
- Trying to encourage the customers to pay their balances
- At the bottom of the invoice it might have 2/10, n/30
  - Means that the customer will get a 2% discount if paid within 10 days
  - But, also it must be paid in full within 30 days
- 3/15, n/60
  - 3% discount if paid within 15 days
  - Must be paid in full within 60 days

Sales returns and allowances

- Companies have a separate account from revenue
- Contra- revenue
- Used when customer returns goods
  - Every company has their own policy
- Add to the company when they make a sale, and when someone returns, instead of just reducing the sale they put it in this category
- Lets the company keep track of anything that has been returned, so they can see the ratio of defective or not liked products

### Example 1

Kyle Company sold \$4,000 of merchandise on account to a customer on November 23 with credit terms of 2/10, n/30. On November 25, the customer returned \$600 of the goods; on November 30 the customer paid the balance due.

How much cash did Kyle Company receive from the customer?

What is the amount of Net sales revenue Kyle will report from this transaction?

$$4000 - 600 = 3400$$

$$3400 \times .02 = 68 \text{ disc}$$

$$3400 - 68 = 3332$$

Sales rev	4000
- Sales R&T	(600)
- Sales Disc	<u>(68)</u>
Net Sales	3332

**COST OF GOODS SOLD (= expense, aka "cost of sales")**

Objective:

- Matching
- Record expense in the same period as revenue that the inventory helped generate
  - When you buy inventory it is an asset, when you sell inventory it becomes an expense

There are two basic approaches to determining a company's cost of goods sold for a period, perpetual and periodic inventory.

1. Periodic method - inventory account balance is updated and the amount of expense is determined at end of accounting period
  - Use adjusting at end of period
2. Perpetual method - inventory account balance and amount of expense is calculated **continuously** throughout the accounting period
  - At any time the inventory balance should be equal to the inventory on hand
  - Example:
    - T-shirts for sale
    - As soon as someone buys a t-shirt I record
      - Record selling price of the item to revenue
      - Record my price for the t-shirt to expense
  - This method equals better record, but the cost is higher
    - This method was very unattainable before computers

***Does a company using a perpetual inventory system need to complete a physical count of inventory at the end of the period? Why?***

- Need to verify inventory on hand!
- Accounts for theft, employee embezzlement, miscount, etc..

## Purchasing inventory:

### Inventory/Purchases

- At the time of the purchase the asset increases, or purchases increases

### Purchase discounts

- Offered by the seller to encourage the buyer to pay promptly
- If we pay within a set time, we get a purchase discount

### Purchase returns and allowances

- Buyer returns goods to seller

### Freight charges (Transportation in) "Freight In"

- Increases inventory cost
- Generally, the party paying freight owns the goods in transit
  - If you are the seller and the buyer pays shipping you get revenue as soon as it ships
  - If the seller pays shipping you do not record revenue until the customer receives the goods

### FOB shipping point

- Buyer pays freight

### FOB destination

- Seller pays the freight

\*Asset cost- all costs to get assets in location and condition that we want it in\*

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## Example 2 Purchasing inventory

Sunshine company sells outdoor furniture and accessories. On March 29, Sunshine purchased 10 patio tables costing \$75 each from Picnic Manufacturing Company. Credit terms noted on the invoice were 1/10, n/30. Picnic Company prepaid the freight charges of \$50 and added that amount to the invoice.

- FOB shipping point (buyer pays freight)
- Purchase discount applies only to goods, NOT shipping

a. If Sunshine pays the amount due on April 5, what is the amount of the payment?

$$\begin{aligned} 10 \times 75 &= 750 - (.01 \times 750) = 742.50 \\ &\quad + 50.00 \\ &792.50 \end{aligned}$$