

## Chapter V

# Accounting for Merchandising Activities

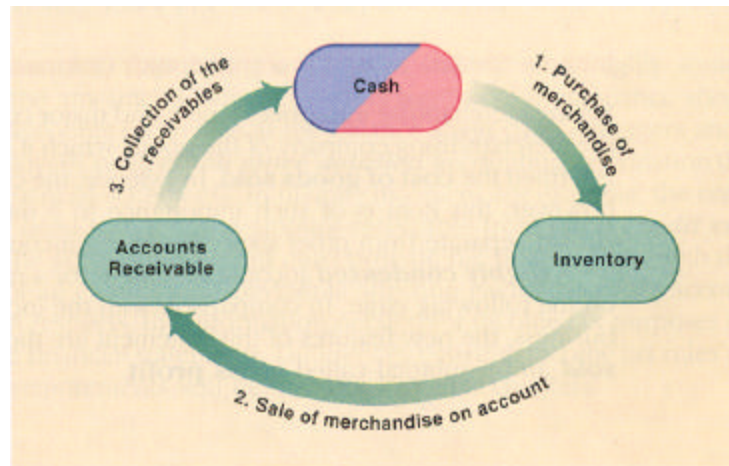
### I- Introduction:

America is the land of creative merchandising. It is the birthplace of television shopping channels, mail-order catalogs, and membership warehouse clubs. Merchandising business range in size from sidewalk vendors to corporate giants.

Every successful merchandising business makes extensive use of accounting information. It keeps track of inventory – what’s in stock, which products are the “best sellers” and when to buy more merchandise. It also keeps track of the amounts owed to each supplier and due from each credit customer. And it keeps a sharp eye on the trends in net sales and gross profit.

Because accounting in the “Language of business” it is also the language of buying and selling.

### II- The Operating Cycle of a merchandising Company:



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**III- Sample of Income Statement**

Computer Barn  
Income statement  
For the year ended Dec. 31, 2001

Revenue from sales.....	\$900,000
Less: Cost of goods sold .....	<u>540,000</u>
<b>Gross Profit</b> .....	<b>\$360,000</b>
Less: Expense .....	<u>270,000</u>
<b>Net Income</b> .....	<b>\$ <u>90,000</u></b>

**IV- Computation of the revenue from sales:**

Computer Barn  
**Partial Income statement**  
For the year ended Dec. 31, 2001

**Revenue:**

Sales.....	\$912,000
Less: Sales returns and allowances .....	\$8,000
Sales discounts .....	<u>4,000</u> ..... <u>12,000</u>
<b>Net sales</b> .....	<b>\$<u>900,000</u></b>

**V- Credit Term and sales discounts:**

- “**net 30days**” or “n/30” means that the net amount of the invoice or bill is due in 30 days.
- “**2/10, n/30**” means that if the customers pay within 10 days here in discount 2%. If not full amount is due in 30 days.

**VI- Computation of the Purchase**

Purchase.....	\$150,000
Less: Purchase return and allowance .....	\$5,000
Purchase discount .....	<u>1,000</u> ..... <u>6,000</u>
<b>Net Purchase</b> .....	<b>\$<u>144,000</u></b>

## VII- Cost of Goods Sold

a)- Inventory (Beginning). The amount to be used will be the same as the ending inventory of the last year.

b)- Purchases. This is the total amount of good bought for resale during the year, minus any purchases returned to the seller and any discounts given (Net Purchase), plus transportation.

c)- Goods Available for Sale. This is computed by adding the inventory at the beginning of the year to the net purchase during the year.

d)- Inventory (ending). This is determined by taking the physical count of all goods remaining in the business at the end of the period (a month, three months, six month or a year).

e)- Cost of goods sold. This is difference between what was available for sale and what is left at the end of the year. The cost of goods sold will then be deducted from net sales to determine the gross profit.

### Example

In the income statement, the cost of goods sold section might appear as

	Sale		\$45,000
	Cost of good sold		
(a)	Inventory, Jan 1	\$10,000	
	Purchase	\$25,000	
	Less: Purchase returns	<u>600</u>	
(b)	Net Purchase	<u>\$24,400</u>	
	Transportation-In	1,000	<u>25,400</u>
(c)	Goods available for Sale		35,000
(d)	Inventory, December 31		<u>12,000</u>
(e)	Total Cost of Goods Sold		<u>23,400</u>
	<b>Gross Profit on Sales</b>		<b><u>\$21,600</u></b>

## VIII- Income Statement for Merchandise Company

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Christophe's Accounting Firm  
As of Dec, 31 20X0

<b>(a) Gross Sales</b>			
Sales of Goods or Services		\$25,000	
Less: Sales Returns	\$1,250		
Sales Discount	750	<u>2,000</u>	
Net Sales			23,000
<b>(b) Cost of Goods Sold</b>			
Inventory, January		\$2,500	
Purchases		<u>16,500</u>	
Goods Available for Sales		<b>19,000</b>	
Inventory, Dec. 31		<u>300</u>	
	Cost of Good sold		<u>16,000</u>
<b>(c) Gross Profit</b>			\$7,000
	Gross Profit		
<b>(e) Operating Expense</b>			
Selling Expenses			
Sales Salaries Expense	1,200		
Travel Expense	200		
Advertising Expense	600	<u>2,000</u>	
General Expenses			
Officers' Salaries Exp.	1,000		
Insurance Exp.	600	<u>1,600</u>	
Total Operating Expense			<u>3,600</u>
<b>(e) Operating Income</b>			
Net Income from Operations			\$3,400
<b>(f) Other Expenses (net)</b>			
Interest Exp.	500		
Less: Interest Income	100		
Other Expense (net)		<u>400</u>	
<b>(g) Net Income</b>			
Net Income			<b><u>\$3,000</u></b>

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## IX- Inventory Measurement

To approach the problem of inventory measurement, in order to assign the business cost to each item, three methods of valuation (FIFO, LIFO, And Weighted Average) have been developed and approved by GAAP (General Accepted Accounting Principles). To compare these three methods, the same Identical data (Chart I) will be used in the following inventory examples.

**Chart I**

Date	Type	Units	Unit Cost	Totals
Jan. 1	Inventory	100	\$ 6	\$ 600
Mar. 10	Purchase	150	\$ 8	1,200
June 6	Purchase	200	\$ 9	1,800
Oct. 4	Purchase	250	# 10	2,500
<b>Available for Sales</b>		<b><u>700</u></b>		<b><u>\$6,100</u></b>

It is assumed that a physical count of inventory as of the last day of the accounting period (Dec, 31) showed 320 units on hand. Therefore, 380 units (700-320) were sold during the year.

### (A) Costing Inventory: First-In-First-Out (FIFO)

Under FIFO, those goods left at the end of the period are considered to be those received last. Therefore, the 320 units on hand on Dec, 31 would be costed as follows:

Most Recent Purchase (Oct. 4)	250 units	@ \$10 =	\$2,500
Next most recent purchase (June 6)	<u>70 units</u>	@ \$ 9 =	<u>630</u>
<b>Ending Inventory</b>	<b><u>320 units</u></b>		<b><u>\$3,130</u></b>

On the other hand, We can determine the Cost of Goods Sold by:

100 units of Inventory	@ \$6 =	\$ 600
150 units of Inventory	@ \$6 =	1,200
<u>130 units of Inventory</u>	@ \$9 =	<u>1,170</u>
<b><u>380</u></b>	<b>Total cost of goods sold</b>	<b><u>\$2,970</u></b>

**(B) Costing Inventory: Last-In-First-Out (LIFO)**

Earliest purchase (Jan 1)	100 units	@ \$ 6=	\$ 600
Next purchase (Mar. 10)	150 Units	@ \$ 8=	1,200
Next Purchase (June 6)	70 units	@ \$ 9=	630
<b>Ending Inventory</b>	<b><u>320 units</u></b>		<b><u>\$2,430</u></b>

On the other hand, We can determine the Cost of Goods Sold by:

Oct 4.	250 units	@ \$ 10 =	\$ 2,500
June 6	130 units	@ \$ 9 =	1,170
<b>Cost of Good Sold</b>	<b><u>380 units</u></b>		<b><u>\$ 3,670</u></b>

**(C) Costing Inventory: Average Cost Valuation**

Referring to the same data in Chart I, the cost of the 320 units on hand would be calculated as follows:

1.  $\$6,100/700\text{units} = \$8.71$  unit cost.
2.  $\$8.71 \times 32$  units on hand = \$2,787

On the other hand, We can determine the Cost of Goods Sold by:

$$\begin{aligned} &\text{Goods Available for Sales} - \text{Ending Inventory} \\ &\$ 6,100 - 2,787 = \$ 3,313 \end{aligned}$$

**Comparison**

Use Chart I

	<b>FIFO</b>	<b>LIFO</b>	<b>WA</b>
Sales ( Assumed)	\$20,000	\$20,000	\$20,000
Cost of Good Sold			
Goods Avail. for Sales	6,100	6,100	6,100
Less: Ending Inventory	<u>3,130</u>	<u>2,430</u>	<u>2,787</u>
Cost of Good sold	<u>2,970</u>	<u>3,670</u>	<u>3,313</u>
<b>Gross Profit</b>	<b><u>\$ 17,030</u></b>	<b><u>\$ 16,330</u></b>	<b><u>\$ 16,687</u></b>

**PROBLEM**

- 1- The Folk Company purchased merchandise costing \$ 150, 000. What is the cost of good sold under each assumption below?

	Beginning Inventory	Ending Inventory
a-	100,000	60,000
b-	75,000	50,000
c-	50,000	30,000
d-	0	10,000

- 2- Compute the cost of goods sold from the following information: Beginning Inventory, \$20,000; Purchase, \$70,000; Ending Inventory, \$34,000.
- 3- Product information

Jan. 1	Inventory	50 units @ \$10	=	\$ 500
Apr. 24	Purchase	30 units @ \$8	=	240
July 10	Purchase	40 units @ \$7	=	280
Nov 15	Purchase	35 units @ \$8	=	280

**Units Available** **155 Units** **Total Cost \$1,300**

By a physical count, it is estimated that 95 units are left in the ending inventory.

- a- What is the value of the ending inventory under FIFO valuation?  
 b- Determine the cost of goods sold.
- 4- Based upon the following information, determine under LIFO valuation
- a. Ending Inventory of 120 units
  - b. Cost of good sold.

Beginning Inventory	100	units @ \$15 =		\$1,500
Apr. 30	100	units @ \$17 =		1,700
Sept. 30	100	units @ \$18 =		1,800
Dec.30	100	Units @ \$21 =		2,100
<b>Available for Sale</b>	<b><u>400</u></b>	<b>Units</b>		<b><u>\$7,100</u></b>

5- The SB Co, Ltd. provide the information as the following:

Sales .....	\$50,000
Sales Returned & Allowance .....	1,500
Sales Discount.....	500
Beginning Inventory .....	4,000
Purchase .....	5,000
Purchase discount .....	1,300
Purchase Return & Allowance .....	800
Ending Inventory.....	3,500

**Calculate:**

- 1- Net Sales
- 2- Net Purchase
- 3- Goods Available for Sales.
- 4- Cost of goods sold
- 5- Gross Margin

