

ACCOUNTING FOR MERCHANDISING OPERATIONS IN HOSPITALITY



THE NAVIGATOR ✓

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- Read *Feature Story*
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- Read text and answer *Before You Go On*
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CONCEPTS FOR REVIEW

Before studying this chapter, you should know or, if necessary, review:

- a. How to close revenue, expense, and dividend accounts. (Ch. 5, pp. 145–150)
- b. The steps in the accounting cycle. (Ch. 5, pp. 150–151)

F FEATURE STORY

Selling Dollars for 85 Cents

For most of the last decade, **Wal-Mart** has set the rules of the retail game. Entrepreneur Scott Blum, founder and CEO of **Buy.com**, has a different game plan. He is selling consumer products at or below cost. Buy.com is trying to create an outlet synonymous with low prices—in the hope of becoming the leading e-commerce portal on the Internet. He plans to make up the losses from sales by selling advertising on the company's Web site and in a magazine to be mailed to Buy.com customers.

As if the idea of selling below cost weren't unusual enough, Blum has added another twist to merchandising: Unlike **Amazon.com**, he doesn't want to handle inventory. So he has wholesalers and distributors ship the products directly to his Web site customers.

Buy.com's slogan, "The lowest prices on earth," may be the most eye-catching sales pitch ever. The company is ruthlessly committed to

being the price leader—even if it means losing money on every sale. Its own computers search competitors' Web sites to make sure that Buy.com has the lowest prices on the Internet. When Amazon.com, in June 2002, reduced its minimum-purchase order for free shipping to \$49 (from \$99), Buy.com one-upped that move a day later by offering free shipping with no minimum purchase.

eToys, **Pets.com**, and **Cyberian Outpost** all went under during the dot-com wreck of 2000–2001; and Amazon.com, after seven years, had yet to turn a profit. Only **eBay**, an auction site, is consistently profitable. Still, Scott Blum stretches for a bigger portion of a \$50 billion online sales market by being the low-cost e-tailer.

Consider the implications if Buy.com is successful: Buy.com's success could change the very way wholesalers and



distributors view their businesses. Its success may have an impact on all kinds of retailers—starting with Buy.com itself. If Buy.com proves that the ad space on a product order form—its Web site—is almost as valuable as the product being ordered, another virtual reseller is sure to enter the market with even lower prices.

Of course, there is one big winner if Buy.com succeeds: you. It has never been a better time to be a customer.

SOURCE: Quentin Hardy, "The Death and Life of Buy.com," *Forbes*, January 21, 2002, pp. 86–89.

www.buy.com



S TUDY OBJECTIVES

After studying this chapter, you should be able to

1. Identify the differences between a service enterprise and a merchandiser.
2. Explain the entries for purchases under a perpetual inventory system.
3. Explain the entries for sales revenues under a perpetual inventory system.
4. Explain the steps in the accounting cycle for a merchandiser.
5. Prepare a work sheet for a merchandiser.

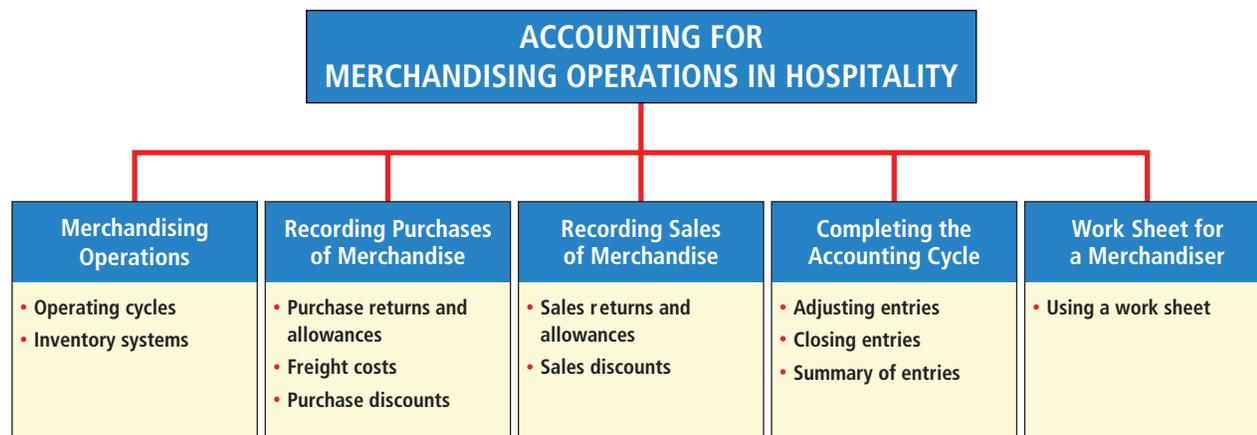


PREVIEW OF CHAPTER 8

As indicated in the Feature Story, selling below cost or having a “lost-leader” item as a special on a restaurant menu is not a new concept. Hotels often offer free weekends to special targeted guests so as to sell them vacation packages and timeshare units. At the same time, restaurants, hotels, country clubs, and theme parks also sell merchandise in addition to food, room, membership, and an entrance fee to a fun day at the park. Merchandise can be in any form from food items, such as those sold by PepsiCo, to souvenirs and T-shirts that bear a hotel, club, or park logo. Merchandisers that purchase and sell directly to consumers—such as **Wendy’s**, **Burger King**, and **McDonald’s**—are called *retailers*. In contrast, merchandisers that sell to retailers, such as **PepsiCo** or **SYSCO**, are called *wholesalers*.

The steps in the accounting cycle for a merchandiser are the same as the steps for a service enterprise. But merchandisers use additional accounts and entries that are required in recording merchandising transactions.

The content and organization of Chapter 8 are as follows:



MERCHANDISING OPERATIONS

STUDY OBJECTIVE 1

Identify the differences between a service enterprise and a merchandiser.

Measuring net income for a merchandiser is conceptually the same as for a service enterprise. That is, net income (or loss) results from the matching of expenses with revenues. For a merchandiser, the primary source of revenues is the sale of merchandise. This revenue source is often referred to as **sales revenue** or **sales**. Unlike expenses for a service company, expenses for a merchandiser are divided into two categories: (1) the cost of goods sold and (2) operating expenses.

The **cost of goods sold** is the total cost of merchandise sold during the period. This expense is directly related to the revenue recognized from the sale of the goods. Sales revenue less cost of goods sold is called **gross profit** on sales. For example, when a calculator costing \$15 is sold for \$25, the gross profit is \$10. Merchandisers report gross profit on sales in the income statement.

After gross profit is calculated, operating expenses are deducted to determine net income (or net loss). **Operating expenses** are expenses incurred in the process of earning sales revenue. Examples of operating expenses are sales salaries, advertising expense, and insurance expense. The operating expenses of a merchandiser include many of the expenses found in a service company.

The income measurement process for a merchandiser is diagrammed in Illustration 8-1. The items in the three blue boxes are peculiar to a merchandiser. They are not used by a service company.

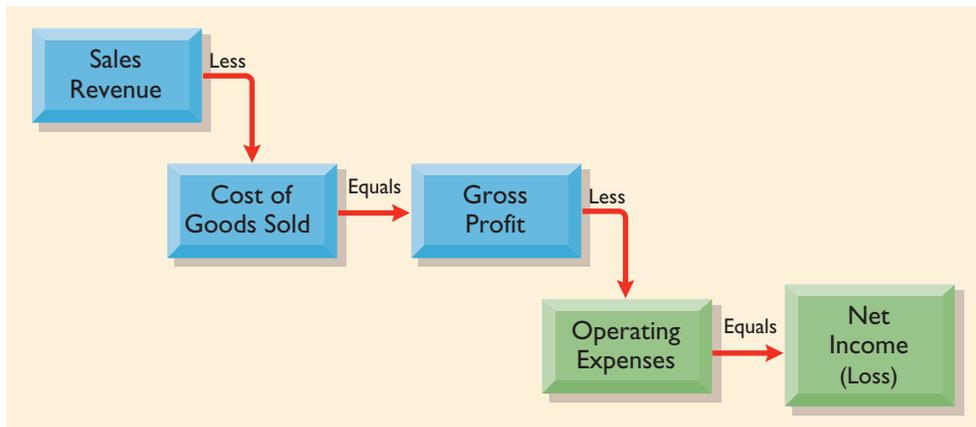


Illustration 8-1

Income measurement process for a merchandiser

In hospitality, the *cost of goods sold* concept is further divided into cost of *food sold* and cost of *beverage sold*. All food items, including all meat products, produce, coffee, baked goods, tea, candy, cigarettes, and soft drinks and other non-alcoholic beverages are considered food. Only alcoholic beverages, namely, liquor, beer, and wine, are included as beverages. These two items have to be separated and accounted for differently because they have unique cost structure and tax implications.

Food cost percentage can be anywhere from 20 percent to more than 50 percent, depending on the type of establishment. Quick-service restaurants and cafeterias normally have lower food costs, whereas country clubs have higher food costs. This is the case because members pay their monthly dues to the club. Thus, to encourage members to dine at the club, the menu prices are often lower than those of a freestanding restaurant or a restaurant in a hotel. Therefore, with the same quality of food served, the food cost percentage is higher at the club. As for beverages, each state alcoholic beverage commission needs to keep track of alcohol sales and consumption. Therefore, alcoholic beverages must be accounted for separately.

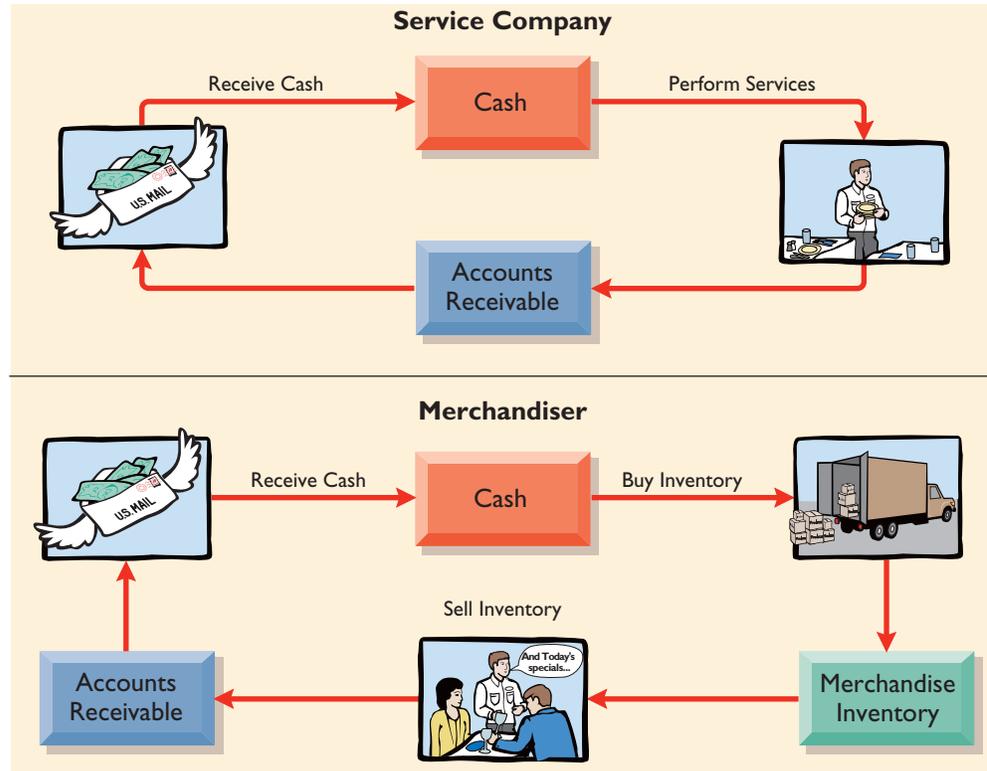
As for the accounting procedure, the calculation is the same as cost of goods sold. Sales less cost is gross profit on sales. For example, if a prime rib dinner is sold for \$19.95 and the plate cost is \$8.00, then food sales is \$19.95, cost of food sold is \$8.00, and gross profit on food is \$11.95. Similarly, if a bottle of wine that costs \$7.25 is sold for \$25.00, then beverage sales is \$25.00, cost of beverage sold is \$7.25, and gross profit on beverages is \$17.75.

OPERATING CYCLES

The operating cycle of a merchandiser differs from that of a service company, as shown in Illustration 8-2. The operating cycle of a merchandiser ordinarily is longer than that of a service company. The purchase of merchandise inventory and its eventual sale lengthen the cycle. Note that the added asset account for a merchandising company is an **inventory** account. It is usually titled Merchandise Inventory. Merchandise inventory is reported as a current asset on the balance sheet.

Illustration 8-2

Operating cycles for a service company and a merchandiser



INVENTORY SYSTEMS

A merchandiser keeps track of its inventory to determine what is available for sale and what has been sold. One of two systems is used to account for inventory: a perpetual inventory system or a periodic inventory system.

Perpetual System

In a **perpetual inventory system**, detailed records of the cost of each inventory purchase and sale are maintained. This system continuously—perpetually—shows the inventory that should be on hand for every item. For example, a wine cellar has separate inventory records for each variety of Chardonnay, Merlot, Beaujolais, or Cabernet. With the use of bar codes and optical scanners, a grocery store can keep a daily running record of every box of cereal and every jar of jelly that it buys and sells. Under a perpetual inventory system, the cost of goods sold is determined *each time a sale occurs*.

Many software companies have products for perpetual inventory usage for the hospitality industry to use in office supply rooms, storerooms for hotel guests' amenities, food service outlets, freestanding restaurants, and grocery stores and meat companies.

With today's technology, storeroom inventory software is quite affordable and easy to use. In dry storerooms, canned goods can be scanned as they are stocked. The software maintains a perpetual inventory of the number of cans so that when items are received, inventory levels go up, and when items are issued, inventory levels go down. Some software even can include other functions, such as triggering automatic reorder points, reminding the purchaser of set expiration dates, and tracking lot code in the case of a recall. In this last function of recalls for food items, not only can an automatic system prevent financial loss, but more important, it can protect the health of guests. In some hotel engineering departments,

HELPFUL HINT

For control purposes, a physical inventory count is taken under the perpetual system, even though it is not needed to determine cost of goods sold.

especially in the megahotels that have a few thousand rooms, a perpetual inventory system can help to track spare parts and supplies so that engineers will always be able to have the tools available to take care of any problems. Just imagine not having the right parts to fix an air-conditioning system in a hotel in Las Vegas during the summer months. This is not a problem that anyone would like to experience.

There is also certain software that is specifically designed for performing perpetual inventory on perishable items, such as meat and baked goods. This type of software is very useful for food service outlets and especially for food retail grocery places, where ready-to-eat food, from lasagna to stuffed veal chops and take-home meals, are sold to customers. Any items received, produced, sold, marked down, and thrown away can be tracked with a client Web-browser in-store user interface. Some of this software even will print cut lists, cutting tests, cost analyses, and at-case bar-coded markdown labels from hand-held Web-browser scanners. This actually can help in production planning and thus minimize waste.

TECHNOLOGY IN ACTION



What's in a bar code? First, the bar code usually doesn't contain descriptive data (just as your Social Security number or car's license plate number doesn't have anything about your name or where you live). For example, the bar codes found on food items at grocery stores don't contain the price or description of the food item. Instead, the bar code has a 12-digit "product number" in it. When read by a bar code reader and transmitted to the computer, the computer finds the disk file item record(s) associated with that item number. In the disk file is the price, vendor name, quantity on hand, description, and so on. The computer does a "price lookup" by reading the bar code, and then it creates a register of the items and adds the price to the subtotal of the groceries sold. It also subtracts the quantity from the "on-hand" total.

How is a grocery store's accounting equation changed by the computer's bar code actions?

SOURCE: Excerpted from *A Bar Code Primer*, © 1997 Worth Data.



Periodic System

In a **periodic inventory system**, detailed inventory records of the goods on hand are not kept throughout the period. The cost of goods sold is determined *only at the end of the accounting period*—that is, periodically. At that time, a physical inventory count is taken to determine the cost of goods on hand (Merchandise Inventory). To determine the cost of goods sold under a periodic inventory system, the following steps are necessary: (1) Determine the cost of goods on hand at the beginning of the accounting period. (2) Add to it the cost of goods purchased. (3) Subtract the cost of goods on hand at the end of the accounting period.

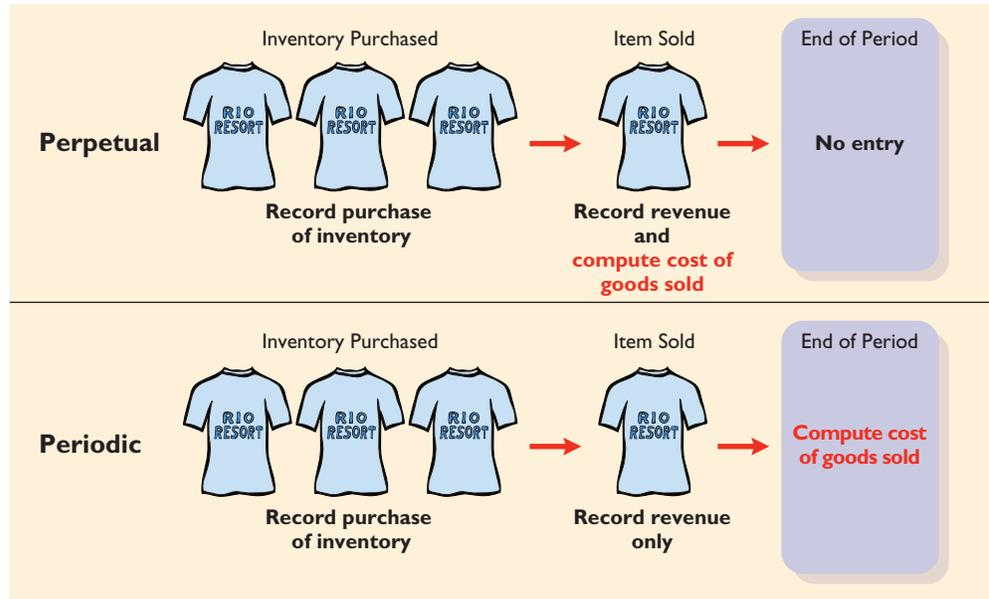
Illustration 8-3 graphically compares the sequence of activities and the timing of the cost of goods sold computation under the two inventory systems.

Additional Considerations

Perpetual systems traditionally have been used by companies that sell merchandise with high unit values. Examples are automobiles, furniture, and major home appliances. The widespread use of computers and electronic scanners now enables

Illustration 8-3

Comparing periodic and perpetual inventory systems



many more companies to install perpetual inventory systems. The perpetual inventory system is so named because the accounting records continuously—perpetually—show the quantity and the cost of the inventory that should be on hand at any time.

A perpetual inventory system provides better control over inventories than a periodic system does. The inventory records show the quantities that should be on hand. So the goods can be counted at any time to see whether the amount of goods actually on hand agrees with the inventory records. Any shortages uncovered can be investigated immediately. A perpetual inventory system does require additional clerical work and additional cost to maintain the subsidiary records. But a computerized system can minimize this cost.

RECORDING PURCHASES OF MERCHANDISE

STUDY OBJECTIVE 2

Explain the entries for purchases under a perpetual inventory system.

Purchases of inventory may be made for cash or on account (credit). Purchases are normally recorded when the goods are received from the seller. Every purchase should be supported by business documents that provide written evidence of the transaction. Each cash purchase should be supported by a canceled check or a cash register receipt indicating the items purchased and amounts paid. Cash purchases are recorded by an increase in Merchandise Inventory and a decrease in Cash.

Each credit purchase should be supported by a **purchase invoice**. This document indicates the total purchase price and other relevant information. But the purchaser does not prepare a separate purchase invoice. Instead, the copy of the sales invoice sent by the seller is used by the buyer as a purchase invoice. Illustration 8-4, for example, describes a transaction between Beyer Theme Park and Sellers T-Shirts. Beyer purchases logo T-shirts and other merchandise from Sellers to be sold in its retail outlets throughout the theme park. The sales invoice prepared by Sellers T-Shirts (the seller) is used as a purchase invoice by Beyer (the buyer).

Illustration 8-4

Sales invoice used as purchase invoice by Beyer Theme Park



SELLERS T-SHIRTS
27 CIRCLE DRIVE
HARDING, MICHIGAN 48281

INVOICE NO. 731

**S
O
L
D
T
O** Firm Name Beyer Theme Park

Attention of James Hoover, Purchasing Agent

Address 125 Main Street

Chelsea Illinois 60915

City State Zip

Date	5/4/08	Salesperson	Malone	Terms	2/10, n/30	Freight Paid by Buyer	
Catalog No.		Description		Quantity	Price	Amount	
X572Y9820		Logo T-shirts		1000	5.00	\$5,000	
A2547Z45		Logo Baseball Caps		500	6.00	3,000	
IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS						TOTAL	\$8,000

HELPFUL HINT

To better understand the contents of this invoice, identify these items:

1. Seller
2. Invoice date
3. Purchaser
4. Salesperson
5. Credit terms
6. Freight terms
7. Goods sold: catalog number, description, quantity, price per unit
8. Total invoice amount

The associated entry for Beyer Theme Park for the invoice from Sellers T-Shirts looks like this:

May 4	Merchandise Inventory	8,000	
	Accounts Payable		8,000
	(To record goods purchased on account from Sellers T-Shirts)		

A	=	L	+	SE
+8,000		+8,000		

Under the perpetual inventory system, purchases of merchandise for sale are recorded in the Merchandise Inventory account. Thus a retailer of general merchandise, such as **Wal-Mart**, would debit Merchandise Inventory for clothing, sporting goods, and anything else purchased for resale to customers.

Not all purchases are debited to Merchandise Inventory, however. Purchases of assets acquired for use and not for resale (such as supplies, equipment, and similar items) are recorded as increases to specific asset accounts rather than to Merchandise Inventory. Beyer would increase Supplies to record the purchase of materials used to make shelf signs or of cash register receipt paper.

PURCHASE RETURNS AND ALLOWANCES

A purchaser may be dissatisfied with the merchandise received. The goods may be damaged or defective, of inferior quality, or perhaps do not meet the purchaser’s specifications. In such cases, the purchaser may return the goods to the seller. The purchaser is granted credit if the sale was made on credit or a cash refund if the purchase was for cash. This transaction is known as a **purchase return**. Or the purchaser may choose to keep the merchandise if the seller is willing to grant an allowance (deduction) from the purchase price. This transaction is known as a **purchase allowance**.

The purchaser initiates the request for a reduction of the balance due through the issuance of a **debit memorandum**. A debit memorandum is a document issued by a purchaser to inform a supplier that a debit has been made to the supplier’s account on the purchaser’s books. The original copy of the memorandum is sent to the supplier, and one copy is retained by the purchaser. The information contained in a debit memorandum is shown in Illustration 8-5; it relates to the sales invoice shown in Illustration 8-4.

Illustration 8-5
Debit memorandum

DEBIT-DM126

Beyer Theme Park
125 Main Street
Chelsea, IL 60915

Purchased From:

Firm Name Sellers T-Shirts

Attention of Susan Malone, Sales Representative

Address 27 Circle Drive

Harding MI 48281

City State Zip

Date	5/8/08	Salesperson	Malone	Invoice No.	731	Invoice Date	5/4/08	Approved	Reid
Catalogue No.	A2547Z45	Description	Logo Baseball Caps (Beyer's name was misspelled)	Quantity	500	Price	6.00	Amount	\$3,000

Cash Refund Debit Account Other

HELPFUL HINT

Note that the debit memorandum is prenumbered to help ensure that all memoranda are accounted for.

As shown in the debit memorandum, Beyer returned goods costing \$3,000 to Sellers on May 8. The entry by Beyer Theme Park for the returned merchandise looks like this:

A	=	L	+	SE
-3,000		-3,000		

May 8	Accounts Payable Merchandise Inventory (To record return of defective logo caps received from Sellers T-Shirts, DM No. 126)	3,000	3,000
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Beyer Theme Park increased Merchandise Inventory when the goods were received. So Beyer decreases Merchandise Inventory when it returns the goods or when it is granted an allowance.

FREIGHT COSTS

The sales agreement should indicate whether the seller or the buyer is to pay the cost of transporting the goods to the buyer's place of business. When a common carrier such as a railroad, a trucking company, or an airline is used, the transportation company prepares a freight bill (often called a *bill of lading*) in accordance with the sales agreement. Freight terms are expressed as either **FOB shipping point** or **FOB destination**. The letters FOB mean *free on board*. Thus *FOB shipping point* means that goods are placed free on board the carrier by the seller, and the buyer pays the freight costs. Conversely, *FOB destination* means that the goods are placed free on board to the buyer's place of business, and the seller pays the freight. For example, the sales invoice in Illustration 8-4 on page 239 indicates that the buyer (Beyer Theme Park) pays the freight charges.

When the purchaser directly incurs the freight costs, the account Merchandise Inventory is debited. For example, if on delivery of the goods on May 6, Beyer pays Acme Freight Company \$150 for freight charges, the entry on Beyer's books looks like this:

May 6	Merchandise Inventory	150	
	Cash		150
	(To record payment of freight on goods purchased)		

HELPFUL HINT

Freight terms may be stated by location. A Chicago seller may use "FOB Chicago" for FOB shipping point and the buyer's city for FOB destination.

A	=	L	+	SE
+150				
-150				

In contrast, **freight costs incurred by the seller on outgoing merchandise are an operating expense to the seller**. These costs increase an expense account titled Freight-out or Delivery Expense. If the freight terms on the invoice in Illustration 8-4 had required that Sellers T-Shirts pay the \$150 freight charges, the entry by Sellers would look like this:

May 4	Freight-out (or Delivery Expense)	150	
	Cash		150
	(To record payment of freight on goods sold)		

A	=	L	+	SE
-150				-150

When the freight charges are paid by the seller, the seller will usually establish a higher invoice price for the goods to cover the expense of shipping.

PURCHASE DISCOUNTS

The credit terms of a purchase on account may permit the buyer to claim a cash discount for prompt payment. The buyer calls this cash discount a **purchase discount**. This incentive offers advantages to both parties: The purchaser saves money, and the seller is able to shorten the operating cycle by converting the accounts receivable into cash earlier.

The **credit terms** specify the amount of the cash discount and the time period during which it is offered. They also indicate the length of time in which the purchaser is expected to pay the full invoice price. In the sales invoice in

HELPFUL HINT

The term *net* in “net 30” means the remaining amount due after subtracting any sales returns and allowances and partial payments.

Purchase Discount



Merchandise Inventory
XXX

Illustration 8-4, credit terms are 2/10, n/30. This is read “two-ten, net thirty.” It means that a 2 percent cash discount may be taken on the invoice price, less (“net of”) any returns or allowances, if payment is made within 10 days of the invoice date (the *discount period*). If payment is not made in that time, the invoice price, less any returns or allowances, is due 30 days from the invoice date. Or the discount period may extend to a specified number of days after the month in which the sale occurs. For example, 1/10 EOM (end of month) means that a 1 percent discount is available if the invoice is paid within the first 10 days of the next month.

The seller may elect not to offer a cash discount for prompt payment. In that case, credit terms will specify only the maximum time period for paying the balance due. For example, the time period may be stated as n/30, n/60, or n/10 EOM. These mean, respectively, that the net amount must be paid in 30 days, 60 days, or within the first 10 days of the next month.

When an invoice is paid within the discount period, the amount of the discount decreases Merchandise Inventory. Inventory is recorded at its cost; and by paying within the discount period, the merchandiser has reduced its cost. To illustrate, assume Beyer Theme Park pays the balance due of \$5,000 (gross invoice price of \$8,000 less purchase returns and allowances of \$3,000) on May 14, the last day of the discount period. The cash discount is \$100 ($\$5,000 \times 2\%$), and the amount of cash paid by Beyer is \$4,900 ($\$5,000 - \100). The entry to record the May 14 payment by Beyer looks like this:

A	=	L	+	SE
-4,900		-5,000		
-100				

May 14	Accounts Payable	5,000	
	Cash		4,900
	Merchandise Inventory		100
	(To record payment within discount period)		

If Beyer failed to take the discount and instead made full payment on June 3, Beyer’s entry would be

A	=	L	+	SE
-5,000		-5,000		

June 3	Accounts Payable	5,000	
	Cash		5,000
	(To record payment with no discount taken)		

ACCOUNTING MATTERS! *Ethics Insight*



How high is too high? Returns can become so high that it is questionable whether sales revenue should have been recognized in the first place. An example of high returns is **Florafax International, Inc.**, a floral supply company, which was alleged to have shipped its product without customer authorization on ten holiday occasions, including 8,562 shipments of flowers to customers for Mother’s Day and 6,575 for Secretary’s Day. The return rate on these shipments went as high as 69 percent of sales. As one employee noted, “Products went out the front door and came in the back door.”

How does management know the amount of sales returns? Would returns for a floral supply company have a greater negative impact on earnings than returns for a department store?



A merchandiser usually should take all available discounts. Passing up the discount may be viewed as *paying interest* for use of the money. For example, if Beyer passed up the discount, it would be like paying an interest rate of 2 percent for the use of \$5,000 for 20 days. This is the equivalent of an annual interest rate of approximately 36.5 percent ($2\% \times 365/20$). Obviously, it would be better for Beyer to borrow at prevailing bank interest rates of 8 percent to 12 percent than to lose the discount.

HELPFUL HINT

So as not to miss purchase discounts, unpaid invoices should be filed by due dates. This procedure helps the purchaser to remember the discount date, prevents early payment of bills, and maximizes the time that cash can be used for other purposes.

BEFORE YOU GO ON...**REVIEW IT**

1. How does the measurement of net income in a merchandising company differ from that in a service enterprise?
2. In what ways is a perpetual inventory system different from a periodic system?
3. Under the perpetual inventory system, what entries are made to record purchases, purchase returns and allowances, purchase discounts, and freight costs?



RECORDING SALES OF MERCHANDISE

Sales revenues, like service revenues, are recorded when earned. This is done in accord with the revenue recognition principle. Typically, sales revenues are earned when the goods are transferred from the seller to the buyer. At this point, the sales transaction is completed, and the sales price has been established.

Sales may be made on credit or for cash. Every sales transaction should be supported by a business document that provides written evidence of the sale. **Cash register tapes** provide evidence of cash sales. A **sales invoice**, like the one that was shown in Illustration 8-4 (page 239), provides support for a credit sale. The original copy of the invoice goes to the customer. A copy is kept by the seller for use in recording the sale. The invoice shows the date of sale, customer name, total sales price, and other relevant information.

Two entries are made for each sale. The first entry records the sale: Cash (or Accounts Receivable, if a credit sale) is increased by a debit, and Sales is increased by a credit at the selling (invoice) price of the goods. The second entry records the cost of the merchandise sold: Cost of Goods Sold is increased by a debit, and Merchandise Inventory is decreased by a credit for the cost of those goods. As a result, the Merchandise Inventory account will show at all times the amount of inventory that should be on hand.

To illustrate a credit sales transaction, Sellers sale of \$8,000 on May 4 to Beyer (see Illustration 8-4, page 239) is recorded as follows (assume the merchandise cost Sellers \$1,600):

May 4	Accounts Receivable	8,000	
	Sales		8,000
	(To record credit sale to Beyer Theme Park per invoice #731)		

STUDY OBJECTIVE 3

Explain the entries for sales revenues under a perpetual inventory system.

A	=	L	+	SE
+8,000				+8,000

A	=	L	+	SE
-1,600				-1,600

May 4	Cost of Goods Sold	1,600	
	Merchandise Inventory		1,600
	(To record cost of merchandise sold on invoice #731 to Beyer Theme Park)		

HELPFUL HINT

The Sales account is credited only for sales of goods held for resale. Sales of assets not held for resale (such as equipment or land) are credited directly to the asset account.

For internal decision-making purposes, merchandisers may use more than one sales account. For example, Sellers T-Shirts may keep separate sales accounts for its key chains, sweatshirts, and pens. By using separate sales accounts for major product lines, company management can monitor sales trends more closely and respond more strategically to changes in sales patterns. For example, if key chain sales are increasing while sweatshirt sales are decreasing, the company could reevaluate its advertising and pricing policies on each of these items.

However, on its income statement presented to outside investors, a merchandiser normally would provide only a single sales figure—the sum of all its individual sales accounts. This is done for two reasons: First, providing detail on individual sales accounts would add length to the income statement. Second, companies do not want their competitors to know the details of their operating results.

SALES RETURNS AND ALLOWANCES

We now look at the “flip side” of purchase returns and allowances, which are **sales returns and allowances** recorded on the books of the seller.

To grant the customer a sales return or an allowance, the seller normally prepares a **credit memorandum**. This document informs a customer that a credit has been made to the customer’s account receivable for a sales return or an allowance. The information contained in a credit memorandum is similar to the information found in the debit memorandum in Illustration 8-5 (page 240). The original copy of the credit memorandum is sent to the customer, and a copy is kept by the seller as evidence of the transaction.

Sellers T-Shirts’ entries to record credit for returned goods involve two entries: (1) The first is an increase in Sales Returns and Allowances and a decrease in Accounts Receivable at the \$3,000 selling price. (2) The second is an increase in Merchandise Inventory (assume a \$900 cost) and a decrease in Cost of Goods Sold. The entries are as follows:

A	=	L	+	SE
-3,000				-3,000

May 8	Sales Returns and Allowances	3,000	
	Accounts Receivable		3,000
	(To record credit granted to Beyer Theme Park for returned goods)		

A	=	L	+	SE
+900				+900

8	Merchandise Inventory	900	
	Cost of Goods Sold		900
	(To record cost of goods returned)		

HELPFUL HINT

Remember that the increases, decreases, and normal balances of contra accounts are the opposite of the accounts to which they correspond.

If goods are returned because they are damaged or defective, then the entry to Merchandise Inventory and Cost of Goods Sold should be for the estimated value of the returned goods rather than their cost. For example, if the goods returned to Sellers were defective and had a scrap value of \$50, Merchandise Inventory would be debited for \$50, and Cost of Goods Sold would be credited for \$50.

Sales Returns and Allowances is a **contra revenue account** to Sales. The normal balance of Sales Returns and Allowances is a debit. A contra account is used, instead of debiting Sales, to disclose in the accounts the amount of sales returns and allowances. This information is important to management. Excessive returns and allowances suggest inferior merchandise, inefficiencies in filling orders, errors in billing customers, and mistakes in delivery or shipment of goods. Also, a debit recorded directly to Sales could distort comparisons between total sales in different accounting periods.

SALES DISCOUNTS

As mentioned in our discussion of purchase transactions, the seller may offer the customer a cash discount for the prompt payment of the balance due. From the seller's point of view, this is called a **sales discount**. Like a purchase discount, a sales discount is based on the invoice price less returns and allowances, if any. The Sales Discounts account is debited for discounts that are taken. The entry by Sellers T-Shirts to record the cash receipt on May 15 from Beyer Theme Park within the discount period looks like this:

May 15	Cash	4,900	
	Sales Discounts	100	
	Accounts Receivable		5,000
	(To record collection within 2/10, n/30 discount period from Beyer Theme Park)		



A	=	L	+	SE
+4,900				-100
-5,000				

Like Sales Returns and Allowances, Sales Discounts is a contra revenue account to Sales. Its normal balance is a debit. This account is used, instead of debiting Sales, to disclose cash discounts taken by customers. If the discount is not taken, Sellers T-Shirts debits Cash for \$5,000 and credits Accounts Receivable for the same amount at the date of collection.

BEFORE YOU GO ON...

▶ REVIEW IT

- Under a perpetual inventory system, what are the two entries that must be recorded at the time of each sale?
- Why is it important to use the Sales Returns and Allowances account, rather than simply reducing the Sales account, when goods are returned?

▶ DO IT

On September 5, De La Hoya Hotels buys merchandise on account from Junot Diaz Company. The selling price of the goods is \$1,500, and the cost to Diaz Company was \$800. On September 8, defective goods with a selling price of \$200 and a scrap value of \$80 are returned. Record the transaction on the books of both companies.

ACTION PLAN

- Purchaser: Record purchases of inventory at its cost and directly reduce the Merchandise Inventory account for returned goods.
- Seller: Record both the sale and the cost of goods sold at the time of the sale. Record returns in a contra account, Sales Returns and Allowances.

SOLUTION

De La Hoya Hotels

Sept. 5	Merchandise Inventory Accounts Payable (To record goods purchased on account)	1,500	1,500
8	Accounts Payable Merchandise Inventory (To record return of defective goods)	200	200

Junot Diaz Company

Sept. 5	Accounts Receivable Sales (To record credit sale)	1,500	1,500
5	Cost of Goods Sold Merchandise Inventory (To record cost of goods sold on account)	800	800
8	Sales Returns and Allowances Accounts Receivable (To record credit granted for receipt of returned goods)	200	200
8	Merchandise Inventory Cost of Goods Sold (To record scrap value of goods returned)	80	80



COMPLETING THE ACCOUNTING CYCLE

STUDY OBJECTIVE 4

Explain the steps in the accounting cycle for a merchandiser.

Up to this point we have illustrated the basic entries in recording transactions relating to purchases and sales in a perpetual inventory system. Now we consider the remaining steps in the accounting cycle for a merchandiser. Each of the required steps described in Chapter 5 for a service company applies to a merchandising company. Use of a work sheet by a merchandiser (an optional step) is shown in the next section.

ADJUSTING ENTRIES

A merchandiser generally has the same types of adjusting entries as a service company. But a merchandiser using a perpetual system will require one additional adjustment to make the records agree with the actual inventory on hand. Here's why: At the end of each period, a merchandiser using a perpetual system will take a physical count of its goods on hand for control purposes. A company's unadjusted balance in Merchandise Inventory usually will not agree with the actual amount of inventory on hand at year-end. The perpetual inventory records may be incorrect

HELPFUL HINT

The steps required to determine the actual inventory on hand are discussed in Chapter 9.

owing to a variety of causes such as recording errors, theft, or waste. As a result, the perpetual records need adjustment to ensure that the recorded inventory amount agrees with the actual inventory on hand. **This involves adjusting Merchandise Inventory and Cost of Goods Sold.**

For example, suppose that the records of Sellers T-Shirts report an unadjusted balance in Merchandise Inventory of \$40,500. Through a physical count, the company determines that its actual merchandise inventory on hand at year-end is \$40,000. The adjusting entry would be to debit Cost of Goods Sold for \$500 and to credit Merchandise Inventory for \$500.

CLOSING ENTRIES

For a merchandiser, like a service enterprise, all accounts that affect the determination of net income are closed to Income Summary. In journalizing, all temporary accounts with debit balances are credited, and all temporary accounts with credit balances are debited, as shown below for Sellers T-Shirts. Cost of goods sold is a new account that must be closed to Income Summary.

Dec. 31	Sales	480,000	
	Income Summary		480,000
	(To close income statement accounts with credit balances)		
31	Income Summary	450,000	
	Sales Returns and Allowances		12,000
	Sales Discounts		8,000
	Cost of Goods Sold		316,000
	Store Salaries Expense		45,000
	Salaries Expense		19,000
	Freight-out		7,000
	Advertising Expense		16,000
	Utilities Expense		17,000
	Depreciation Expense		8,000
	Insurance Expense		2,000
	(To close income statement accounts with debit balances)		
31	Income Summary	30,000	
	Retained Earnings		30,000
	(To close net income to retained earnings)		
31	Retained Earnings	15,000	
	Dividends		15,000
	(To close dividends to retained earnings)		

HELPFUL HINT

The easiest way to prepare the first two closing entries is to identify the temporary accounts by their balances and then prepare one entry for the credits and one for the debits.

After the closing entries are posted, all temporary accounts have zero balances. In addition, Retained Earnings has a credit balance of \$48,000: beginning balance + net income – dividends (\$33,000 + \$30,000 – \$15,000).

SUMMARY OF MERCHANDISING ENTRIES

The entries for the merchandising accounts using a perpetual inventory system are summarized in Illustration 8-6.

Illustration 8-6

Daily recurring and adjusting and closing entries

	<u>Transactions</u>	<u>Daily Recurring Entries</u>	<u>Dr.</u>	<u>Cr.</u>
Sales Transactions	Sell merchandise to customers.	Cash or Accounts Receivable Sales Cost of Goods Sold Merchandise Inventory	XX XX	 XX XX
	Grant sales returns or allowances to customers.	Sales Returns and Allowances Cash or Accounts Receivable Merchandise Inventory Cost of Goods Sold	XX XX XX	 XX XX
	Pay freight costs on sales; FOB destination.	Freight-out Cash	XX XX	 XX
	Receive payment from customers within discount period.	Cash Sales Discounts Accounts Receivable	XX XX XX	 XX
Purchase Transactions	Purchase merchandise for resale.	Merchandise Inventory Cash or Accounts Payable	XX XX	 XX
	Pay freight costs on merchandise purchased; FOB shipping point.	Merchandise Inventory Cash	XX XX	 XX
	Receive purchase returns or allowances from suppliers.	Cash or Accounts Payable Merchandise Inventory	XX XX	 XX
	Pay suppliers within discount period.	Accounts Payable Merchandise Inventory Cash	XX XX XX	 XX XX
	<u>Events</u>	<u>Adjusting and Closing Entries</u>		
	Adjust because book amount is higher than the inventory amount determined to be on hand.	Cost of Goods Sold Merchandise Inventory	XX XX	 XX
	Close temporary accounts with credit balances.	Sales Income Summary	XX XX	 XX
	Close temporary accounts with debit balances.	Income Summary Sales Returns and Allowances Sales Discounts Cost of Goods Sold Freight-out Expenses	XX XX XX XX	 XX XX XX XX

WORK SHEET FOR A MERCHANTISER

USING A WORK SHEET

STUDY OBJECTIVE 5

Prepare a work sheet for a merchandiser.

As indicated in Chapter 5, a work sheet enables financial statements to be prepared before the adjusting entries are journalized and posted. The steps in preparing a work sheet for a merchandiser are the same as they are for a service enterprise (see page 139). The work sheet for Sellers T-Shirts is shown in Illustration 8-7. The unique accounts for a merchandiser using a perpetual inventory system are shown in capital letters in green.

Illustration 8-7Work sheet for
merchandiser

SELLERS T-SHIRTS										
Work Sheet										
For the Year Ended December 31, 2008										
	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	9,500				9,500				9,500	
Accounts Receivable	16,100				16,100				16,100	
MERCHANDISE										
INVENTORY	40,500			(a) 500	40,000				40,000	
Prepaid Insurance	3,800			(b) 2,000	1,800				1,800	
Equipment	80,000				80,000				80,000	
Accumulated Depreciation		16,000		(c) 8,000		24,000				24,000
Accounts Payable		20,400				20,400				20,400
Common Stock		50,000				50,000				50,000
Retained Earnings		33,000				33,000				33,000
Dividends	15,000				15,000				15,000	
SALES		480,000				480,000	480,000			
SALES RETURNS AND										
ALLOWANCES	12,000				12,000		12,000			
SALES DISCOUNTS	8,000				8,000		8,000			
COST OF GOODS SOLD	315,500		(a) 500		316,000		316,000			
Freight-out	7,000				7,000		7,000			
Advertising Expense	16,000				16,000		16,000			
Salaries Expense	19,000				19,000		19,000			
Store Salaries Expense	40,000		(d) 5,000		45,000		45,000			
Utilities Expense	17,000				17,000		17,000			
Totals	<u>599,400</u>	<u>599,400</u>								
Insurance Expense			(b) 2,000		2,000		2,000			
Depreciation Expense			(c) 8,000		8,000		8,000			
Salaries Payable				(d) 5,000		5,000				5,000
Totals			<u>15,500</u>	<u>15,500</u>	<u>612,400</u>	<u>612,400</u>	<u>450,000</u>	<u>480,000</u>	<u>162,400</u>	<u>132,400</u>
Net Income							30,000			30,000
Totals							<u>480,000</u>	<u>480,000</u>	<u>162,400</u>	<u>162,400</u>

Key: (a) Adjustment to inventory on hand, (b) Insurance expired, (c) Depreciation expense, (d) Salaries accrued.

Trial Balance Columns

Data for the trial balance are obtained from the ledger balances of Sellers T-Shirts on December 31. The amount shown for Merchandise Inventory, \$40,500, is the year-end inventory amount from the perpetual inventory system.

Adjustments Columns

A merchandiser generally has the same types of adjustments as a service company. As you see in the work sheet, adjustments (b), (c), and (d) are for insurance, depreciation, and salaries. These adjustments also were required for

Premier Staffing Agency, as illustrated in previous chapters. Adjustment (a) was required to adjust the perpetual inventory carrying amount to the actual count.

After all adjustments data are entered on the work sheet, the equality of the adjustments column totals is established. The balances in all accounts are then extended to the adjusted trial balance columns.

Adjusted Trial Balance

The adjusted trial balance shows the balance of all accounts after adjustment at the end of the accounting period.

Income Statement Columns

The accounts and the balances that affect the income statement are transferred from the adjusted trial balance columns to the income statement columns. For Sellers T-Shirts, Sales of \$480,000 is shown in the credit column. The contra revenue accounts Sales Returns and Allowances \$12,000 and Sales Discounts \$8,000 are shown in the debit column.

Finally, all the credits in the income statement column should be totaled and compared to the total of the debits in the income statement column. If the credits exceed the debits, the company has net income. In Sellers T-Shirts' case, there was net income of \$30,000. If the debits exceed the credits, the company would report a net loss.

Balance Sheet Columns

The major difference between the balance sheets of a service company and a merchandiser is inventory. For Sellers T-Shirts, the ending inventory amount of \$40,000 is shown in the balance sheet debit column. The information to prepare the retained earnings statement is also found in these columns. That is, the retained earnings account beginning balance is \$33,000. The dividends are \$15,000. Net income results when the total of the debit column exceeds the total of the credit column in the balance sheet columns. A net loss results when the total of the credits exceeds the total of the debit balances.

BEFORE YOU GO ON...

► REVIEW IT

1. Why is an adjustment to the Merchandise Inventory account usually needed?
2. What merchandising account(s) will appear in the postclosing trial balance?

► DO IT

The trial balance of Revere Finest Foods on December 31 shows Merchandise Inventory \$25,000; Sales \$162,400; Sales Returns and Allowances \$4,800; Sales Discounts \$3,600; Cost of Goods Sold \$110,000; Rental Revenue \$6,000; Freight-out \$1,800; Rent Expense \$8,800; and Salaries and Wages Expense \$22,000. Prepare the closing entries for the above accounts.

ACTION PLAN

- Close all temporary accounts with credit balances to Income Summary by debiting these accounts.
- Close all temporary accounts with debit balances to Income Summary by crediting these accounts.

SOLUTION

The two closing entries are

Dec. 31	Sales Rental Revenue Income Summary (To close accounts with credit balances)	162,400 6,000 168,400	168,400
Dec. 31	Income Summary Cost of Goods Sold Sales Returns and Allowances Sales Discounts Freight-out Rent Expense Salaries and Wages Expense (To close accounts with debit balances)	151,000 110,000 4,800 3,600 1,800 8,800 22,000	110,000 4,800 3,600 1,800 8,800 22,000



D

EMONSTRATION PROBLEM

Gregory Scott, a former professional golf star, operates Greg’s Pro Shop at Bay Golf Course. At the beginning of the current season on April 1, the ledger of Greg’s Pro Shop showed Cash \$2,500; Merchandise Inventory \$3,500; and Common Stock \$6,000. The following transactions were completed during April:

- Apr. 5 Purchased golf bags, clubs, and balls on account from Hardy Co., \$1,600, FOB shipping point, terms 2/10, n/60.
- 7 Paid freight on Hardy purchase, \$80.
- 9 Received credit from Hardy Co. for merchandise returned, \$100.
- 10 Sold merchandise on account to members, \$1,100, terms n/30. The merchandise sold had a cost of \$730.
- 12 Purchased golf shoes, sweaters, and other accessories on account from Titleist Sportswear, \$660, terms 1/10, n/30.
- 14 Paid Hardy Co. in full, less discount.
- 17 Received credit from Titleist Sportswear for merchandise returned, \$60.
- 20 Made sales on account to members, \$700, terms n/30. The cost of the merchandise sold was \$490, less discount.
- 21 Paid Titleist Sportswear in full.
- 27 Granted an allowance to members for clothing that did not fit properly, \$30.
- 30 Received payments on account from members, \$1,200.

The chart of accounts for the pro shop includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Merchandise Inventory, No. 201 Accounts Payable, No. 311 Common Stock, No. 401 Sales, No. 412 Sales Returns and Allowances, No. 505 Cost of Goods Sold.

Instructions

- (a) Journalize the April transactions using a perpetual inventory system.
- (b) Enter the beginning balances in the ledger accounts and post the April transactions. (Use J1 for the journal reference.)
- (c) Prepare a trial balance on April 30, 2008.

SOLUTION TO DEMONSTRATION PROBLEM

(a)		GENERAL JOURNAL			J1
Date	Account Titles and Explanation	Ref.	Debit	Credit	
Apr. 5	Merchandise Inventory	120	1,600		
	Accounts Payable	201		1,600	
7	Merchandise Inventory	120	80		
	Cash	101		80	
9	Accounts Payable	201	100		
	Merchandise Inventory	120		100	
10	Accounts Receivable	112	1,100		
	Sales	401		1,100	
	Cost of Goods Sold	505	730		
	Merchandise Inventory	120		730	
12	Merchandise Inventory	120	660		
	Accounts Payable	201		660	
14	Accounts Payable (\$1,600 – \$100)	201	1,500		
	Merchandise Inventory (\$1,500 × 2%)	120		30	
	Cash	101		1,470	
17	Accounts Payable	201	60		
	Merchandise Inventory	120		60	
20	Accounts Receivable	112	700		
	Sales	401		700	
	Cost of Goods Sold	505	490		
	Merchandise Inventory	120		490	
21	Accounts Payable (\$660 – \$60)	201	600		
	Merchandise Inventory (\$600 × 1%)	120		6	
	Cash	101		594	
27	Sales Returns and Allowances	412	30		
	Accounts Receivable	112		30	
30	Cash	101	1,200		
	Accounts Receivable	112		1,200	

(b)						GENERAL LEDGER					
Cash			No. 101			Accounts Payable			No. 201		
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 1	Balance	✓			2,500	Apr. 5		J1		1,600	1,600
7		J1		80	2,420	9		J1	100		1,500
14		J1		1,470	950	12		J1		660	2,160
21		J1		594	356	14		J1	1,500		660
30		J1	1,200		1,556	17		J1	60		600
						21		J1	600		-0-
Accounts Receivable			No. 112			Common Stock			No. 311		
Date	Explanation	Ref.	Debit	Credit	Balance	Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 10		J1	1,100		1,100	Apr. 1	Balance	✓			6,600
20		J1	700		1,800						
27		J1		30	1,770	Sales			No. 401		
30		J1		1,200	570	Date	Explanation	Ref.	Debit	Credit	Balance
Merchandise Inventory			No. 120			Apr. 10		J1		1,100	1,100
Date	Explanation	Ref.	Debit	Credit	Balance	20		J1		700	1,800
Apr. 1	Balance	✓			3,500	Sales Returns and Allowances			No. 412		
5		J1	1,600		5,100	Date	Explanation	Ref.	Debit	Credit	Balance
7		J1	80		5,180	Apr. 27		J1	30		30
9		J1		100	5,080	Cost of Goods Sold			No. 505		
10		J1		730	4,350	Date	Explanation	Ref.	Debit	Credit	Balance
12		J1	660		5,010	Apr. 10		J1	730		730
14		J1		30	4,980	20		J1	490		1,220
17		J1		60	4,920						
20		J1		490	4,430						
21		J1		6	4,424						

(c)			GREG'S PRO SHOP		
			Trial Balance		
			April 30, 2008		
		<u>Debit</u>	<u>Credit</u>		
Cash		\$1,556			
Accounts Receivable		570			
Merchandise Inventory		4,424			
Common Stock			\$6,000		
Sales			1,800		
Sales Returns and Allowances		30			
Cost of Goods Sold		<u>1,220</u>			
		<u>\$7,800</u>	<u>\$7,800</u>		



SUMMARY OF STUDY OBJECTIVES

1. Identify the differences between a service enterprise and a merchandiser. Because of inventory, a merchandiser has sales revenue, cost of goods sold, and gross profit. To account for inventory, a merchandiser must choose between a perpetual inventory system and a periodic inventory system.

2. Explain the entries for purchases under a perpetual inventory system. The Merchandise Inventory account is debited for all purchases of merchandise, freight-in, and other costs; and it is credited for purchase discounts and purchase returns and allowances.

3. Explain the entries for sales revenues under a perpetual inventory system. When inventory is sold, Accounts Receivable (or Cash) is debited, and Sales is credited for the *selling price* of the merchandise. At the same time, Cost of Goods

Sold is debited, and Merchandise Inventory is credited for the cost of the inventory items sold.

4. Explain the steps in the accounting cycle for a merchandiser. Each of the required steps in the accounting cycle for a service enterprise applies to a merchandiser. A work sheet is again an optional step. Under a perpetual inventory system, the Merchandise Inventory account must be adjusted to agree with the physical count.

5. Prepare a work sheet for a merchandiser. The steps in preparing a work sheet for a merchandiser are the same as they are for a service company. The unique accounts for a merchandiser are Merchandise Inventory, Sales, Sales Returns and Allowances, Sales Discounts, and Cost of Goods Sold.



GLOSSARY

Contra revenue account An account that is offset against a revenue account on the income statement (p. 245).

Cost of goods sold The total cost of merchandise sold during the period (p. 234).

Credit memorandum A document issued by a seller to inform a customer that a credit has been made to the customer's account receivable for a sales return or an allowance (p. 244).

Credit terms Conditions specified on a sales invoice as to when and in what amount a cash discount will be offered (p. 241).

Debit memorandum A document issued by a buyer to inform a seller that a debit has been made to the seller's account because of unsatisfactory merchandise (p. 240).

FOB destination Freight terms indicating that the goods will be placed free on board at the buyer's place of business and that the seller pays the freight costs (p. 241).

FOB shipping point Freight terms indicating that goods are placed free on board the carrier by the seller and that the buyer pays the freight costs (p. 241).

Gross profit The excess of net sales over the cost of goods sold (p. 234).

Operating expenses Expenses incurred in the process of earning sales revenues that are deducted from gross profit in the income statement (p. 234).

Periodic inventory system An inventory system in which detailed records are not maintained throughout the accounting period and the cost of goods sold is determined only at the end of an accounting period (p. 237).

Perpetual inventory system An inventory system in which the cost of each inventory item is maintained throughout the accounting period and detailed records continuously show the inventory that should be on hand (p. 236).

Purchase allowance A transaction in which the seller deducts from the purchase price to compensate the buyer for less-than-satisfactory merchandise (p. 240).

Purchase discount A cash discount claimed by a buyer for prompt payment of a balance due (p. 241).

Purchase invoice A document that supports each credit purchase (p. 238).

Purchase return A transaction in which a dissatisfied purchaser returns the goods for credit or cash (p. 240).

Sales discount A reduction given by a seller for prompt payment of a credit sale (p. 245).

Sales invoice A document that supports each credit sale (p. 243).

Sales revenue (sales) Primary source of revenue in a merchandising company (p. 234).

EXERCISES

Journalize purchase transactions.

(SO 2)

8-1 Information related to Giberto Pizza and Games is presented below.

- On April 5, purchased merchandise from Allman Company for \$20,000 terms 2/10, net/30, FOB shipping point.
- On April 6, paid freight costs of \$900 on merchandise purchased from Allman.
- On April 7, purchased equipment on account for \$26,000.

4. On April 8, returned damaged merchandise to Allman Company and was granted a \$4,000 allowance for returned merchandise.
5. On April 15, paid the amount due to Allman Company in full.

Instructions

- (a) Prepare the journal entries to record these transactions on the books of Gilberto Pizza and Games under a perpetual inventory system.
- (b) Assume that Gilberto Pizza and Games paid the balance due to Allman Company on May 4 instead of April 15. Prepare the journal entry to record this payment.

8-2 On September 1, Eden County Club had an inventory of 30 golf shirts at a cost of \$18 each. The company uses a perpetual inventory system. During September, the following transactions occurred.

Journalize perpetual inventory entries.
(SO 2, 3)

- Sept. 6 Purchased 80 golf shirts at \$17 each from Mozart Co. for cash.
 9 Paid freight of \$80 on golf shirts purchased from Mozart Co.
 10 Returned 2 golf shirts to Mozart Co. for \$36 credit (including freight) because they did not meet specifications.
 12 Sold 26 golf shirts costing \$18 (including freight) for \$31 each to the Annual Golf Tournament, terms n/30.
 14 Granted credit of \$31 to the Annual Golf Tournament for the return of one shirt that was not ordered.
 20 Sold 30 golf shirts costing \$18 for \$31 each to Mr. Sox, terms n/30.

Instructions

Journalize the September transactions.

8-3 On June 10, Lippizan Crab Shack purchased \$6,000 of merchandise from Bristol Company FOB shipping point, terms 2/10, n/30. Lippizan pays the freight costs of \$400 on June 11. Damaged goods totaling \$300 are returned to Bristol for credit on June 12. The scrap value of these goods is \$150. On June 19, Lippizan pays Bristol Company in full, less the purchase discount. Both companies use a perpetual inventory system.

Prepare purchase and sale entries.
(SO 2, 3)

Instructions

- (a) Prepare separate entries for each transaction on the books of Lippizan.
- (b) Prepare separate entries for each transaction for Bristol Company. The merchandise purchased by Lippizan on June 10 had cost Bristol \$3,000.

8-4 Presented below are transactions related to Rebecca Company.

Journalize sales transactions.
(SO 3)

1. On December 3, Rebecca Company sold \$480 of merchandise to Simonis Putt Putt Golf, terms 2/10, n/30, FOB shipping point. The cost of the merchandise sold was \$350.
2. On December 8, Simonis was granted an allowance of \$27 for merchandise purchased on December 3.
3. On December 13, Rebecca Company received the balance due from Simonis.

Instructions

- (a) Prepare the journal entries to record these transactions on the books of Rebecca Company using a perpetual inventory system.
- (b) Assume that Rebecca Company received the balance due from Simonis Putt Putt Golf on January 2 of the following year instead of on December 13. Prepare the journal entry to record the receipt of payment on January 2.

8-5 The adjusted trial balance of Schinzer Gourmet Deli shows the following data pertaining to sales at the end of its fiscal year October 31, 2006: Sales \$800,000; Freight-out \$16,000; Sales Returns and Allowances \$20,000; and Sales Discounts \$15,000.

Prepare sales revenues section and closing entries.
(SO 3, 4)

Instructions

- (a) Prepare the sales revenues section of the income statement.
- (b) Prepare separate closing entries for (1) sales and (2) the contra accounts to sales.

Prepare adjusting and closing entries.
(SO 4)

8-6 Presented is information related to Taylor Memories, Inc., for the month of January 2006.

Ending inventory per perpetual records	\$21,600	Insurance expense	\$12,000
Ending inventory actually on hand	21,000	Rent expense	20,000
Cost of goods sold	208,000	Salary expense	61,000
Freight-out	7,000	Sales discounts	10,000
		Sales returns and allowances	13,000
		Sales	350,000

Instructions

- (a) Prepare the necessary adjusting entry for inventory.
- (b) Prepare the necessary closing entries.

Prepare correcting entries for sales and purchases.
(SO 2, 3)

8-7 An inexperienced accountant for Gulliver Company made the following errors in recording merchandising transactions.

1. A \$175 refund to a customer for faulty merchandise was debited to Sales \$175 and credited to Cash \$175.
2. A \$160 credit purchase of supplies was debited to Merchandise Inventory \$160 and credited to Cash \$160.
3. A \$110 sales discount was debited to Sales.
4. A cash payment of \$30 for freight on merchandise purchases was debited to Freight-out \$300 and credited to Cash \$300.

Instructions

Prepare separate correcting entries for each error, assuming that the incorrect entry is not reversed. (Omit explanations.)

Compute missing amounts.
(SO 5)

8-8 Presented below is financial information for two different companies.

	Lee Company	Chan Company
Sales	\$90,000	(d)
Sales returns	(a)	\$ 5,000
Net sales	81,000	95,000
Cost of goods sold	56,000	(e)
Gross profit	(b)	41,500
Operating expenses	15,000	(f)
Net income	(c)	15,000

Instructions

Determine the missing amounts.

Journalize, post, and prepare a trial balance.
(SO 2, 3, 4)

8-9 J. Ackbar, a former professional tennis star, operates Ackbar's Tennis Shop at the Miller Lake Resort. At the beginning of the current season, the ledger of Ackbar's Tennis Shop showed Cash \$2,500; Merchandise Inventory \$1,700; and Common Stock \$4,200. The following transactions were completed during April.

- Apr. 4 Purchased racquets and balls from Jay-Mac Co. \$640, FOB shipping point, terms 2/10, n/30.
- 6 Paid freight on purchase from Jay-Mac Co. \$40.
- 8 Sold merchandise to members \$1,150, terms n/30. The merchandise sold had a cost of \$790.
- 10 Received credit of \$40 from Jay-Mac Co. for a damaged racquet that was returned.
- 11 Purchased tennis shoes from Venus Sports for cash, \$420.
- 13 Paid Jay-Mac Co. in full.

- 14 Purchased tennis shirts and shorts from Serena's Sportswear \$700, FOB shipping point, terms 3/10, n/60.
- 15 Received cash refund of \$50 from Venus Sports for damaged merchandise that was returned.
- 17 Paid freight on Serena's Sportswear purchase \$30.
- 18 Sold merchandise to members \$760, terms n/30. The cost of the merchandise sold was \$530.
- 20 Received \$500 in cash from members in settlement of their accounts.
- 21 Paid Serena's Sportswear in full.
- 27 Granted an allowance of \$30 to members for tennis clothing that did not fit properly.
- 30 Received cash payments on account from members, \$660.

The chart of accounts for the tennis shop includes the following: No. 101 Cash, No. 112 Accounts Receivable, No. 120 Merchandise Inventory, No. 201 Accounts Payable, No. 311 Common Stock, No. 401 Sales, No. 412 Sales Returns and Allowances, No. 505 Cost of Goods Sold.

Instructions

- (a) Journalize the April transactions using a perpetual inventory system.
- (b) Enter the beginning balances in the ledger accounts and post the April transactions. (Use J1 for the journal reference.)
- (c) Prepare a trial balance on April 30, 2008.

EXPLORING THE WEB

8-10 No financial decision maker should ever rely solely on the financial information reported in the annual report to make decisions. It is important to keep abreast of financial news. This activity demonstrates how to search for financial news on the Web.

Address: biz.yahoo.com/i

Steps

1. Type in either Hilton Hotels or Disney.
2. Choose **News**.
3. Select an article that sounds interesting to you.

Instructions

- (a) What was the source of the article? (For example, Reuters, Businesswire, PR Newswire.)
- (b) Pretend that you are a personal financial planner and that one of your clients owns stock in the company you chose. Write a brief memo to your client, summarizing the article and explaining the implications of the article for his or her investment.

ETHICS CASE

8-11 Rita Pelzer was just hired as the assistant controller of Yorkshire Inns. The company is a specialty chain hotel with nine hotels concentrated in one metropolitan area. Among other things, the payment of all invoices is centralized. Her primary responsibility is to maintain the hotels high credit rating by paying all bills when due and to take advantage of all cash discounts.

Jamie Caterino, the former assistant controller who has been promoted to controller, is training Rita in her new duties. He instructs Rita that she is to continue the practice of preparing all checks "net of discount" and dating the checks the last day of the discount period. "But," Jamie continues, "we always hold the checks at least four days beyond the discount period before mailing them. That way we get another four days of interest on our money. Most of our creditors need our business and don't complain. And if they scream about our missing the discount period, we blame it on the mail room or the post office. We've only lost one discount out of every hundred we take that way. I think everybody does it. By the way, welcome to our team!"

Instructions

- (a) What are the ethical considerations in this case?
- (b) Who are the stakeholders that are harmed or benefited in this situation?
- (c) Should Rita continue the practice started by Jamie? Does she have any choice?



Remember to go back to the Navigator box on the chapter-opening page and check off your completed work.