ACCOUNTING FOR MERCHANDISING OPERATIONS IN HOSPITALITY

7

THE NAVIGATOR ✓

- Understand *Concepts for Review* ❑
- Read *Feature Story* ❑
- Scan *Study Objectives* ❑
- Read *Preview* ❑
- Read text and answer *Before You Go On* *p.* 208 ❑ *p.* 210 ❑ *p.* 215 ❑
- Work *Demonstration Problem* ❑
- Review *Summary of Study Objectives* ❑
- Complete *Assignments* ❑

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. 152–156)

b. The steps in the accounting cycle. (Ch. 5, pp. 156–158)

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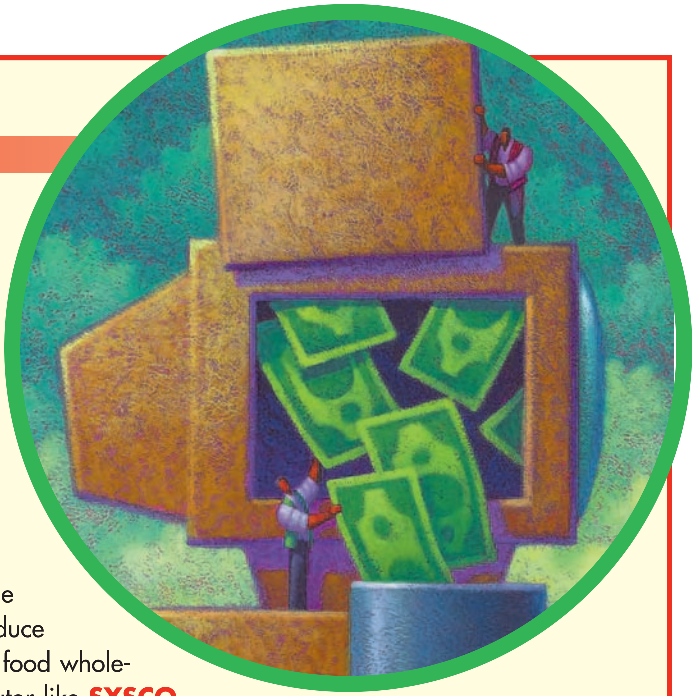
FEATURE STORY



Pricing for Profitable Margins

For most of the last decade, **Wendy's** has set the rules of the 99-cent menu items. Other quick-service restaurants may have a 2-for-$2 special during the year 2002 to have the play on numbers, but not have set a 99-cent menu board. This has changed in the last several years as the market has become more and more saturated. **Burger King** began a 99-cent Great Tastes Menu in 1998, and by 2002 a flood of television spots were promoting it. Even regional chains such as **Checkers Drive-In Restaurants** are offering 99-cent menu items. In June 2002, **McDonald's** announced its 10-item dollar menu, which is instituted in about a third of their 13,000 stores in the United States.

How can a burger be sold for 99 cents and make a profit? How much does it cost to make a hamburger? Will 99-cent items be available forever? These are questions quick-service restaurants have analyzed in great detail before launching any campaign.

The fact is that every item has a cost. Quick-service restaurants buy the meat, buns, french fries, oil, cheese, pickles, tomatoes, lettuce, ketchup, and all other ingredients from somebody. These somebodies range from a local produce house to a giant food wholesaler and distributor like **SYSCO**. Quick-service restaurants are not like the staffing companies. While staffing companies provide services, the quick-service restaurants buy merchandise, and with the service provided make the merchandise into finished products, selling them to customers. Therefore, it is important for these restaurants to know what they are buying and how much they are paying for it, so they can price their finish products correctly and make a profit.

Do 99-cent items make a good profit for these quick-service restaurants? Some do, some do not. For example, it does not cost much to produce a 99-cent soft drink, combining syrup and carbon dioxide. When the cost is less, the gross profit margin is higher. It does, however, cost more to produce the 99-cent hamburger. In this case, the gross profit margin is much lower. In certain cases, it may even be at a loss. It is the hope of the quick-service restaurants that they can use these "loss leaders" to attract you to the restaurant, and then upscale you on certain items in order to average out the cost structure. Of course, it is also the hope of these restaurants that they will impress you not just with the food but also with their friendly service, bringing you back in the future.

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STUDY 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.

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PREVIEW OF CHAPTER 7

As indicated in the Feature Story, hospitality companies generate revenues by selling food and other items to customers rather than simply performing services. 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 are known as wholesalers. For example, retailer **Landry's** might buy canned goods from wholesaler **SYSCO**.

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 7 are as follows.

ACCOUNTING FOR MERCHANDISING OPERATIONS

- **Merchandising Operations**
  - Operating cycles
  - Inventory systems
- **Recording Purchases of Merchandise**
  - Purchase returns and allowances
  - Freight costs
  - Purchase discounts
- **Recording Sales of Merchandise**
  - Sales returns and allowances
  - Sales discounts
- **Completing the Accounting Cycle**
  - Adjusting entries
  - Closing entries
  - Summary of entries
- **Work Sheet for a Merchandiser**
  - Using a work sheet

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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 7-1. The items in the three blue boxes are peculiar to a merchandiser. They are not used by a service company.

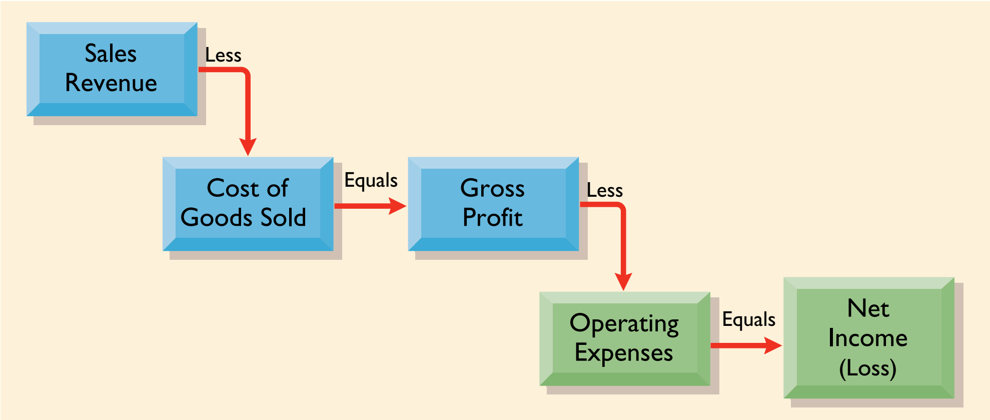


Illustration 7-1

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 and cigarettes, and soft drinks and other nonalcoholic 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 while 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 a freestanding restaurant or one that is in a hotel. Therefore, with the same quality of food served, the percentage is higher. 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.

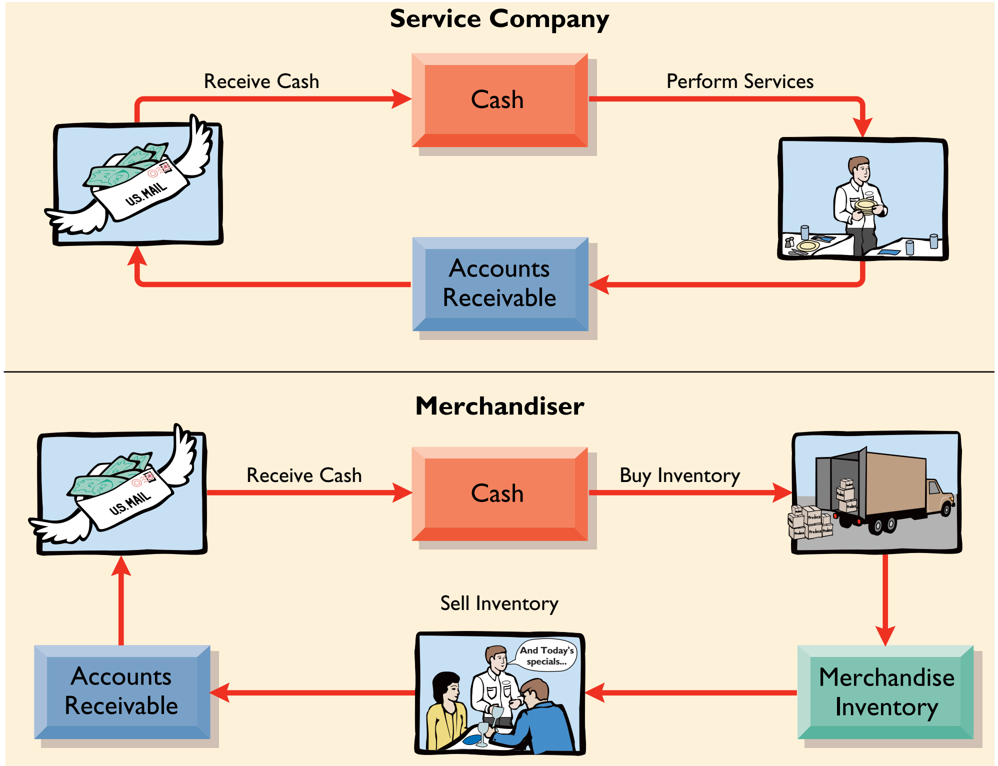
As for the accounting procedure, the calculation is the same as cost of goods sold. Sales less cost is gross profit on sales. For example, if a prime rib dinner is sold for $19.95 and the plate cost is $8.00, then food sales is $19.95, cost of food sold is $8.00, and gross profit on food is $11.95. Similarly, 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 7-2. 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 7-2

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.*

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.

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.

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 7-3 graphically compares the sequence of activities and the timing of the cost of goods sold computation under the two inventory systems.

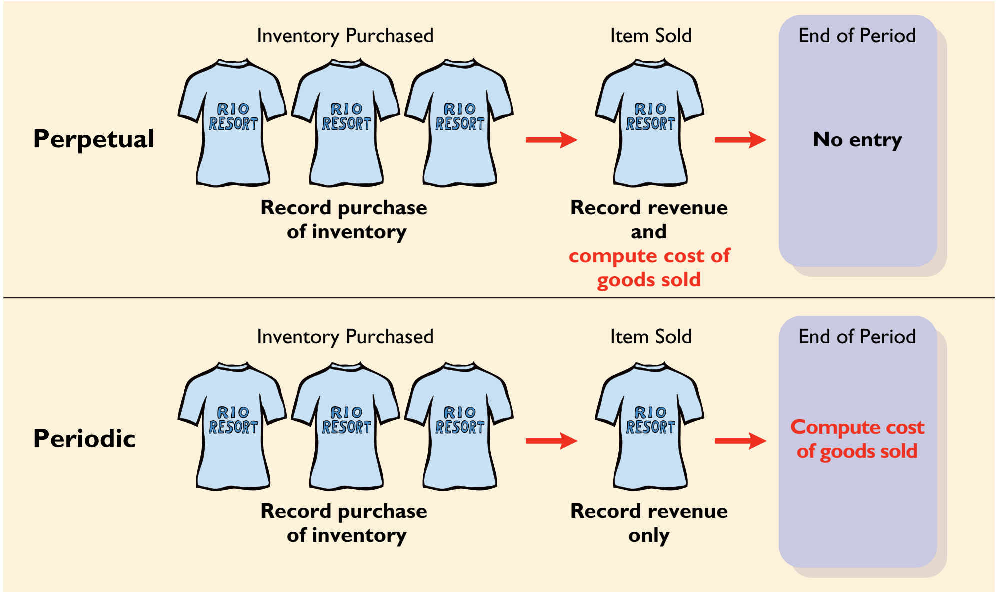


Illustration 7-3

Comparing periodic and perpetual inventory systems

Additional Considerations

Perpetual systems have traditionally 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 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 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. 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 7-4, 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 all 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 7-4

Sales invoice used as purchase invoice by Beyer Theme Park

INVOICE NO. 731

SELLERS T-SHIRTS
27 CIRCLE DRIVE
HARDING, MICHIGAN 48281

SOLD TO

Firm Name: Beyer Theme Park
Attention of: James Hoover, Purchasing Agent
Address: 125 Main Street

Chelsea (City) — Illinois (State) — 60915 (Zip)

Date 5/4/04	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:

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

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

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 for 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 they 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 7-5; it relates to the sales invoice shown in Illustration 7-4.

Illustration 7-5

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 5/8/04	Salesperson Malone	Invoice No. 731	Invoice Date 5/4/04	Approved Reid

Catalogue No.	Description	Quantity	Price	Amount
A2547Z45	Logo Baseball Caps (Beyer's name was mis-spelled)	500	6.00	$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	3,000	
	Merchandise Inventory		3,000
	(To record return of defective logo caps received from Sellers T-Shirts, DM No. 126)		

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, trucking company, or 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 7-4 on page 204 indicates that the buyer (Beyer Theme Park) pays the freight charges.

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.

When the purchaser directly incurs the freight costs, the account Merchandise Inventory is debited. For example, if upon 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:

A	=	L	+	SE
+150				
−150				

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

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 7-4 had required that Sellers T-Shirts pay the $150 freight charges, the entry by Sellers would look like this:

A	=	L	+	SE
−150				−150

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

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 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 Illustration 7-4, 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.

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

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.

Purchase Discount

Merchandise Inventory	
	XXX

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 × 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:

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

A	=	L	+	SE
−4,900		−5,000		
−100				

ACCOUNTING IN ACTION *Business Insight*

In the 1990s, **Sears** wielded its retail clout by telling its suppliers that, rather than pay its obligations in the standard 30-day period, it would now pay in 60 days. This practice is often adopted by firms that are experiencing a shortage of cash. A Sears spokesperson insisted, however, that Sears did not have cash problems. Rather, it was simply utilizing "vendor-financed inventory methods to improve its return on investment." Supplier trade groups were outspoken critics of Sears's policy. They suggested that consumers would be the ultimate victims, because the financing costs would eventually be passed on to them.

In the hospitality industry, hotels, restaurants, and larger corporations may or may not have the clout that is described in the Sears example. However, they can change the pricing structure if they negotiate properly and have good credit. For instance, produce houses will normally grant big hotel chains or a school district purchases on credit to be paid net in 30 days, with no discounts. However, if these hospitality companies are willing to pay the produce houses on a weekly basis, they may get a 2 percent purchase discount. As you will see in this chapter, taking a 2 percent discount is effectively taking a 36.5 percent return on the money.

Small "mom and pop" restaurants and start-up businesses may not have the credit history needed and are often faced with paying terms such as *cash on delivery* (COD) until they have proven themselves.

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)		

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

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% × 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.

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?

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RECORDING SALES OF MERCHANDISE

STUDY OBJECTIVE 3
Explain the entries for sales revenues under a perpetual inventory system.

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 7-4 (page 204), 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 7-4, page 204) 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)		
4	Cost of Goods Sold	1,600	
	Merchandise Inventory		1,600
	(To record cost of merchandise sold on invoice #731 to Beyer Theme Park)		

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

A	=	L	+	SE
−1,600				−1,600

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 would normally provide only a single sales figure—the sum of all of 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.

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.

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 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 allowance. The information contained in a credit memorandum is similar to the information found in the debit memorandum in Illustration 7-5 (page 205). 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.

HELPFUL HINT
If the customer is sent cash, then credit Cash rather than Accounts Receivable.

May 8	Sales Returns and Allowances	3,000	
	Accounts Receivable		3,000
	(To record credit granted to Beyer Theme Park for returned goods)		
8	Merchandise Inventory	900	
	Cost of Goods Sold		900
	(To record cost of goods returned)		

A	=	L	+	SE
−3,000				−3,000

A	=	L	+	SE
+900				+900

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 Discount

Sales Discounts	
XXX	

A	=	L	+	SE
+4,900				−100
−5,000				

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)		

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

1. Under a perpetual inventory system, what are the two entries that must be recorded at the time of each sale?
2. 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	1,500	
	Accounts Payable		1,500
	(To record goods purchased on account)		
8	Accounts Payable	200	
	Merchandise Inventory		200
	(To record return of defective goods)		

Junot Diaz Company

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

Related exercise material: 7-1, 7-2, 7-3, 7-7, and 7-8.

THE NAVIGATOR

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

HELPFUL HINT

The steps required to determine the actual inventory on hand are discussed in Chapter 10.

balance in Merchandise Inventory will usually not agree with the actual amount of inventory on hand at year-end. The perpetual inventory records may be incorrect due 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.

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.

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)		

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 7-6.

Illustration 7-6

Daily recurring and adjusting and closing entries

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

WORK SHEET FOR A MERCHANDISER

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 145). The work sheet for Sellers T-Shirts is shown in Illustration 7-7. The unique accounts for a merchandiser using a perpetual inventory system are shown in capital letters in red.

Illustration 7-7

Work sheet for merchandiser

SELLERS T-SHIRTS
Work Sheet
For the Year Ended December 31, 2004

	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	599,400	599,400								
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			15,500	15,500	612,400	612,400	450,000	480,000	162,400	132,400
Net Income							30,000			30,000
Totals							480,000	480,000	162,400	162,400

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 at 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 were also 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 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 post-closing trial balance?

DO IT

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

Related exercise material: 7-5 and 7-9.

THE NAVIGATOR

A LOOK BACK AT OUR FEATURE STORY

Refer back to the Feature Story about **Wendy's**, **Burger King**, and **McDonald's** on their 99-cent menu items, and answer the following questions:

1. What types of inventory do quick-service restaurants carry?
2. How does the operating cycle from quick-service restaurants differ from other retailer such as a department store or a car manufacturing plant?
3. How do quick-service restaurants carry these 99-cent items and still maintain a profit?

SOLUTION

1. Quick-service restaurants mainly carry food inventory in terms of bread items, meat, frozen items, produce, cheese and dairy, condiments, coffee, and other beverages. They also carry dry goods such as all the packaging and single-service utensils, and cleaning supplies from towels to chemicals.
2. Inventory in department stores and car manufacturing plants are much less perishable than the inventory in quick-service restaurants. In a car manufacturing plant, the inventory is further divided into raw materials (the steel), work in process (parts of a car), and finished products (actual car). In a department store, summer clothing may be put on sale in early autumn to make space for the display of new winter clothing. It may take a while to make a car and sell it, and this is also the same for clothing or other items found in a department store. However, it should take just a few minutes from the time a customer orders a burger until the customer can eat it. Therefore, the operating cycle in quick-service restaurants has a much shorter time span than a department store or car manufacturing plant.
3. Many of the 99-cent items have different cost structures. Some might cost only a few cents to produce, while others might actually be sold at a price less than the cost. However, using the law of averages and aggressive and effective marketing techniques, quick-service restaurants are trying to attract customers and then sell them not only the food, but the entire dining experience, from fast and prompt service, to service with a smile, to filling correct orders. The hoped-for result is that the restaurants can gain new or repeat customers for the future who will not only purchase the 99-cent items but try other regular-priced items, as well.

THE NAVIGATOR

DEMONSTRATION 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, 2004.

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

J1

Date	Account Titles and Explanation	Ref.	Debit	Credit
Apr. 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

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 1	Balance	✓			2,500
7		J1		80	2,420
14		J1		1,470	950
21		J1		594	356
30		J1	1,200		1,556

Accounts Receivable No. 112

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 10		J1	1,100		1,100
20		J1	700		1,800
27		J1		30	1,770
30		J1		1,200	570

Merchandise Inventory No. 120

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 1	Balance	✓			3,500
5		J1	1,600		5,100
7		J1	80		5,180
9		J1		100	5,080
10		J1		730	4,350
12		J1	660		5,010
14		J1		30	4,980
17		J1		60	4,920
20		J1		490	4,430
21		J1		6	4,424

Accounts Payable No. 201

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 5		J1		1,600	1,600
9		J1	100		1,500
12		J1		660	2,160
14		J1	1,500		660
17		J1	60		600
21		J1	600		0

Common Stock No. 311

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 1	Balance	✓			6,600

Sales No. 401

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 10		J1		1,100	1,100
Apr. 20		J1		700	1,800

Sales Returns and Allowances No. 412

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 27		J1	30		30

Cost of Goods Sold No. 505

Date	Explanation	Ref.	Debit	Credit	Balance
Apr. 10		J1	730		730
Apr. 20		J1	490		1,220

(c)

GREG'S PRO SHOP
Trial Balance
April 30, 2004

	Debit	Credit
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	1,220	
	$7,800	$7,800

THE NAVIGATOR

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.

THE NAVIGATOR

GLOSSARY

Contra revenue account An account that is offset against a revenue account on the income statement (p. 210).

Cost of goods sold The total cost of merchandise sold during the period (p. 200).

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 allowance (p. 208).

credit terms Conditions specified on a sales invoice as to when and in what amount a cash discount will be offered (p. 207).

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. 205).

FOB destination Freight terms indicating that the goods will be placed free on board at the buyer's place of business, and the seller pays the freight costs (p. 206).

FOB shipping point Freight terms indicating that goods are placed free on board the carrier by the seller, and the buyer pays the freight costs (p. 206).

Gross profit The excess of net sales over the cost of goods sold (p. 200).

Operating expenses Expenses incurred in the process of earning sales revenues that are deducted from gross profit in the income statement (p. 200).

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. 203).

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. 202).

Purchase allowance A transaction in which the seller deducts from the purchase price to compensate the buyer for less-than-satisfactory merchandise (p. 205).

Purchase discount A cash discount claimed by a buyer for prompt payment of a balance due (p. 206).

Purchase invoice A document that supports each credit purchase (p. 204).

Purchase return A transaction in which a dissatisfied purchaser returns the goods for credit or cash (p. 205).

Sales discount A reduction given by a seller for prompt payment of a credit sale (p. 210).

Sales invoice A document that supports each credit sale (p. 208).

Sales revenue (sales) Primary source of revenue in a merchandising company (p. 208).

EXERCISES

Compute missing amounts in determining net income.
(SO 1)

7-1 Presented below are the components in Sang Nam Asian Garden's income statement. Determine the missing amounts.

	Sales	Cost of Goods Sold	Gross Profit	Operating Expenses	Net Income
(a)	$75,000	?	$31,500	?	$10,800
(b)	$108,000	$70,000	?	?	$29,500
(c)	?	$71,900	$99,600	$39,500	?

Journalize perpetual inventory entries.
(SO 2, 3)

7-2 Keo Salad Buffet buys merchandise on account from Cesar Company. The selling price of the goods is $800, and the cost of the goods is $560. Both companies use perpetual inventory systems. Journalize the transaction on the books of both companies.

Journalize sales transactions.
(SO 3)

7-3 Prepare the journal entries to record the following transactions on Rowen Oven & Range books using a perpetual inventory system.

(a) On March 2, Rowen sold $800,000 of merchandise to Mosquera Eateries, terms 2/10, n/30. The cost of the merchandise sold was $580,000.
(b) On March 6, Mosquera returned $120,000 of the merchandise purchased on March 2 because it was defective. The cost of the returned merchandise was $90,000.
(c) On March 12, Rowen received the balance due from Mosquera.

Prepare adjusting entry for merchandise inventory.
(SO 4)

7-4 At year-end the perpetual inventory records of Kren Foods showed merchandise inventory of $98,000. The company determined, however, that its actual inventory on hand was $97,100. Record the necessary adjusting entry.

Prepare closing entries for merchandise accounts.
(SO 4)

7-5 Prasad Pasta Manufacturing has the following merchandise account balances: Sales $180,000, Sales Discounts $2,000, Cost of Goods Sold $105,000, and Merchandise Inventory $40,000. Prepare the entries to record the closing of these items to Income Summary.

Identify work sheet columns for selected accounts.
(SO 5)

7-6 Presented below is the format of the work sheet presented in the chapter.

Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Balance Sheet	
Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.

Indicate where the following items will appear on the work sheet: **(a)** Cash, **(b)** Merchandise Inventory, **(c)** Sales, **(d)** Cost of Goods Sold.

Example:
Cash: Trial balance debit column; Adjusted trial balance debit column; and Balance sheet debit column.

Journalize purchases transactions.
(SO 2)

7-7 Information related to Munoz Pizza is presented below.

1. On April 5, purchased merchandise from Freeman Tomato Sauce for $17,000 terms 2/10, net/30, FOB shipping point.
2. On April 6 paid freight costs of $900 on merchandise purchased from Freeman.
3. On April 7, purchased equipment on account for $26,000.
4. On April 8, returned damaged merchandise to Freeman and was granted a $3,000 allowance.
5. On April 15 paid the amount due to Freeman in full.

Instructions

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

Journalize perpetual inventory entries.
(SO 2, 3)

7-8 On September 1, Roth Seafood had an inventory of 30 golf shirts that bear the restaurant's logo at a cost of $20 each. The company uses a perpetual inventory system. During September, the following transactions occurred.

Sept.	6	Purchased 80 shirts at $19 each from Lanza Fashion for cash.
	9	Paid freight of $80 on shirts purchased from Lanza Fashion.
	10	Returned 2 shirts to Lanza for $40 credit (including freight) because they did not meet specifications.
	12	Sold 26 shirts costing $20 (including freight) for $31 each to ABC Company for their office party, terms n/30.
	14	Granted credit of $31 to ABC for the return of one shirt that was not ordered.
	20	Sold 30 shirts costing $20 for $31 each to Mallik Company, terms n/30.

Instructions
Journalize the September transactions.

7-9 Presented is information related to Croce Yogurt for the month of January 2004.

Prepare adjusting and closing entries. (SO 4)

Ending inventory per perpetual records	$ 21,600	Salary expense	$ 61,000
Ending inventory actually on hand	21,200	Sales discounts	8,000
Cost of goods sold	208,000	Sales returns and allowances	13,000
Freight-out	7,000	Sales	350,000
Insurance expense	12,000		
Rent expense	20,000		

Instructions

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

7-10 Presented below are selected accounts for Garland Decorating as reported in the work sheet at the end of May 2004.

Complete work sheet. (SO 5)

Accounts	Adjusted Trial Balance		Income Statement		Balance Sheet	
	Dr.	Cr.	Dr.	Cr.	Dr.	Cr.
Cash	9,000					
Merchandise Inventory	80,000					
Sales		450,000				
Sales Returns and Allowances	10,000					
Sales Discounts	7,000					
Cost of Goods Sold	250,000					

Instructions

Complete the work sheet by extending amounts reported in the adjusted trial balance to the appropriate columns in the work sheet. Do not total individual columns.

7-11 Mike Young, a former professional tennis star, operates Mike's Tennis Shop at the Jackson Lake Resort. At the beginning of the current season, the ledger of Mike's Tennis Shop showed Cash $2,500, Merchandise Inventory $1,700, and Common Stock $4,200. The following transactions were completed during April.

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

Apr. 4 Purchased racquets and balls from Sampras Co., $640, FOB shipping point, terms 3/10, n/30.
6 Paid freight on purchase from Sampras Co., $40.
8 Sold merchandise to members $1,150, terms n/30. The merchandise sold had a cost of $750.
10 Received credit of $40 from Sampras Co. for a damaged racquet that was returned.
11 Purchased tennis shoes from Alan Sports for cash, $300.
13 Paid Sampras Co. in full.
14 Purchased tennis shirts and shorts from Tiger's Sportswear, $700, FOB shipping point, terms 2/10, n/60.
15 Received cash refund of $50 from Alan Sports for damaged merchandise that was returned.
17 Paid freight on Tiger's Sportswear purchase, $30.
18 Sold merchandise to members $800, 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 Tiger'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, $675.

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, 2004.

EXPLORING THE WEB

7-12 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. Write a brief memo to your client, summarizing the article and explaining the implications of the article for their investment.

ETHICS CASE

7-13 Rita Pelzer was just hired as the assistant treasurer of Yorkshire Store. The company is a specialty chain store with nine retail stores concentrated in one metropolitan area. Among other things, the payment of all invoices is centralized in one of the departments Rita will manage. Her primary responsibility is to maintain the company's high credit rating by paying all bills when due and to take advantage of all cash discounts.

Jamie Caterino, the former assistant treasurer who has been promoted to treasurer, 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 4 days beyond the discount period before mailing them. That way we get another 4 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.