
CHAPTER 3

Accounting for Merchandising Enterprises

Merchandising enterprises are those business concerns which are established in order to purchase/acquire merchandise only for resale purpose rather than for further processing or consumption purpose.

Merchandises refer to items purchased for resale to customers, and merchandising is the process of purchasing & reselling items.

Accounting for purchases & sales

Purchases of merchandise are usually identified in the ledger as '**purchase**' whereas sales as '**sales**'. Merchandising enterprises accumulate all the cost of merchandise in the purchase account.

Purchase-----XXX

Cash/Accounts Payable-----XXX

(To record purchases)

Cash/Accounts Receivable-----XXX

Sales-----XXX

(To record sales)

Purchases/Sales Discount

The arrangements agreed upon by the buyer & the seller as to when payments for merchandise are to be made are called **Credit Terms**. If the payment for merchandise is made immediately, the arrangement on the agreement is said to be CASH/NET CASH. Otherwise the buyer is allowed a certain time of payment, known as the **Credit Period**. The credit period begins with the date of the sales as shown by the date of the invoice/bill.

- If the payment is due within the stated number of days after the date of the invoice, say 30 days, the terms are said to be Net 30 days_ '**n/30**'
- If the payment is due at the end of the month, in which the sales was made, it may be expressed as '**n/eom**'

As a means of encouraging payment before the end of the credit period, the sellers may offer a discount for early payments of cash. For example, if the seller offers 2% discount for payment within 10 days, even if the credit period is 30 days, can be expressed as '**2/10, n/30**'. This is known as a cash discount.

- ♥ **2/10, n/30** ⇌⇌⇌Credit term
- ♥ **2** ⇌⇌⇌Discount rate
- ♥ **10** ⇌⇌⇌Discount period
- ♥ **30** ⇌⇌⇌Credit period

Example: Zimmer Company sold merchandise of **Br180,000** on account to Minco ltd_ term **2/10, n/30**, Minco paid the amount within the discount period.

Purchase Discount- Minco ltd

Purchase-----**Br180,000**
 Accounts Payable-----**Br180,000**
 (To record Purchase)
 Accounts Payable-----**Br180,000**
 Cash-----**Br176,400**
 Purchase Discount----- 3,600
 (To record cash payment)

Sales Discount- Zimmer Co

Accounts Receivable----**Br180,000**
 Sales-----**Br180,000**
 (To record Sales)
 Cash-----**Br176,400**
 Sales Discount-----3,600
 Accounts Receivable-----**Br180,000**
 (To record cash collection)

Purchase/Sales Return & Allowance

In some special cases, part of merchandise purchased or sold might be returned & the price adjustment is requested. The buyer asks for purchase return & allowance writing the Debit Memorandum. The Debit Memorandum is the convenient medium to inform the seller/creditor/ the amount of the buyer/debtor/ & the purposes to debit accounts payable or cash.

The seller gives a Credit Memorandum that shows the amount for which it is going to Credit its Accounts Receivable or cash. Purchase Return & Allowance is a deduction/a contra (offsetting account of)/ to purchase account, whereas Sales Return & Allowance is a deduction/a contra (offsetting account of)/ to Sales Account.

Illustration

On July 3, year 3, ABC ltd purchased supplies of **Br5,000** on account from XYZ Company; unfortunately supplies of **Br450** were defective & ABC wrote a Debit Memorandum to XYZ on July 11, year 3. Record the original transaction & the return on the behalf of the buyer & the seller.

ABC ltd

July 3, year: Purchase-----**Br5,000**
 Accounts Payable-----**Br5,000**
 (To record purchase)
 July 11, year 3: Accounts Payable-----**Br450**
 Purchase Return & Allowance---**Br450**
 (To record **Purchase Return & Allowance**)

XYZ Company

Accounts Receivable-----**Br5,000**
 Sales -----**Br5,000**
 (To record sales)
 Sales Return & Allowance-----**Br450**
 Accounts Receivable----**Br450**
 (To record **Sales Return & Allowance**)

Activity

On July 4, 2000, Pinkie Company purchased items of **Br20,000**, term 2/10, n/45 from Rainbow ltd & paid the amount within the discount period. Three days after the last date of the discount period, items of **Br1,280** were returned for some defects.

Instruction

1. Record the original transaction on the behalf of the seller & the buyer
2. Record the payment on the last date of the discount period for both the seller & the buyer
3. Record the return of the items for both the buyer & the seller specifying the date of the transaction.

Transportation Costs

The terms of agreement between the buyer & the seller include provisions concerning:

- a. When the ownership title of the merchandise transfers to the buyer
- b. Which party is to bear the cost of delivering the merchandising to the buyer (transportation cost).

There are two terms: *FOB shipping point*

FOB destination

FOB (Free On Board) Shipping point: - the ownership title transfers to the buyer at the shipping point, & the transportation costs are to be covered by the buyer itself. The transportation costs paid by the buyer are then debited to Transportation/Freight In & credited to cash.

But in some special cases, the seller may repay the transportation costs & adds the amount to the invoice by debiting to Accounts Receivable & crediting to cash; and the buyer will debit Transportation In & credit Accounts Payable.

FOB (Free On Board) Destination: - the seller places merchandise free on board to its destination paying all transportation/delivery costs, & the ownership title is transferred to the buyer at the destination of the merchandise/at the address of the buyer/.

Illustration

On June 10, 2002, Durban Company purchased merchandise from Bell Corporation **Br900**, term FOB shipping point, 2/10, n/30, with the prepaid transportation cost of **Br50** that is added to the invoice. Pass necessary entries for both the entities.

Durban Company

June 10, 2002: Purchase-----**Br900**

Freight In ----- 50

Accounts Payable-----**Br950**

(To record Purchase)

Bell Corporation

Accounts Receivable-----**Br950**

Sales-----**Br900**

Cash-----50

(To record Sales)

June 20, 2002: Accounts Payable-----**Br950**

Cash-----**Br932**

Cash-----**Br932**

Sales Discount-----18

Purchase Discount----- 18

Accounts Receivable-----**Br950**

(To record the cash payment)

(To record the cash collection)

✚ Note that the discount rate is not applicable to the prepaid transportation cost.

When the agreement term is FOB destination, the transportation cost paid by the seller will be debited to Transportation out/ Delivery Expense, & reported on the seller's Income Statement as selling expense. And no entry is needed by the buyer to record the transportation cost paid by the seller.

Example: GTY Company sold merchandise of **Br400**, FOB destination paying **Br12** to RABS ltd.

GTY: Accounts Receivable-----**Br400**

RABS: Purchase-----**Br400**

Sales-----**Br400**

Accounts Payable-----**Br400**

(To record sales)

(To record Purchase)

Transportation out-----**Br12**

(No Entry)

Cash-----**Br12**

(To record transportation cost)

Sales Taxes

Taxing units (states) levy (impose) tax on retail sales of merchandise. The liability for sales tax is ordinarily incurred regardless of the terms of the sales. Sellers add the percent of the tax on the normal selling price of the commodities.

Example: A sale on account of **Br100** is subject to sales tax of 4%

Accounts Receivable -----104

Sales-----**Br100**

Sales tax payable----- 4

Periodically, the appropriate amount of sales tax is paid to the taxing unit & the sales tax payable is debited.

Sales tax payable-----**Br4**

Cash-----**Br4**

Activity: Record the following transactions

- Purchased merchandise on account **Br15,000**, 2/10, n/30
- Sold **Br3,000** of merchandise on account, subject to tax of 6%
- Paid the amount owed in 'a' within the discount period
- Paid **Br1,650** to the State Revenue Department for sales tax collected

Merchandise Inventory Systems

There two main systems for accounting for merchandise held for sale:

a. Periodic inventory system

✓Records items purchased by temporary account called purchase

Eg. Purchase.....xxxx
A/P(Cash).....xxxx

✓Is used by entities having low priced small items.

✓maintains purchase contra accounts (PD & PRAA)

✓Ending inventory or inventory on hand is determined at the end of the accounting period through physical count

✓Records an entry up on sales:

A/R(Cash).....xxxx
Sales.....xxxx

b. perpetual inventory system

✓record items purchased by permanent account called merchandise inventory.

merchandise inventory...xxx
A/P(Cash).....xxx

✓is used by entities having high priced large items.

✓treats every increase/decrease in inventory to merchandise inventory account.

✓continuously updates of inventory level & cost of merchandise sold periodically.

✓records two entries up on sale.

i. sales value

A/R(Cash).....xxx
Sales.....xxx

ii. cost of sales

cost of merch. Sold.....xxx
merch. Inventory.....xxx

Cost of Merchandises Sold

Merchandising Enterprises determine cost of merchandise sold as follows:

Cost of merchandise sold:			
Beginning Inventory			xxx
Add: Purchases	Xxx		
Less: Purchase discount			
Purchase return &	(xx)		

allowance	<u>(xx)</u>		
Net Purchase		Xx	
Add: Transportation cost			
Cost of merchandise purchased		<u>Xx</u>	
			<u>xxx</u>
Cost of merchandise available for sale			xxx
Less: Ending Inventory			<u>(xx)</u>
Cost of merchandise sold			<u>xxx</u>

Activity: Based on the following data, prepare statement of cost of merchandise sold for the fiscal year ended on June 30, 2020 for ABC Limited Company.

Merchandise Inventory:	
➤ June 30, 2020	Br 236,000
➤ June 30, 2019	127,000
Purchase	760,000
Purchase return and allowance	8,200
Purchase discount	4,800
Transportation cost	3,000