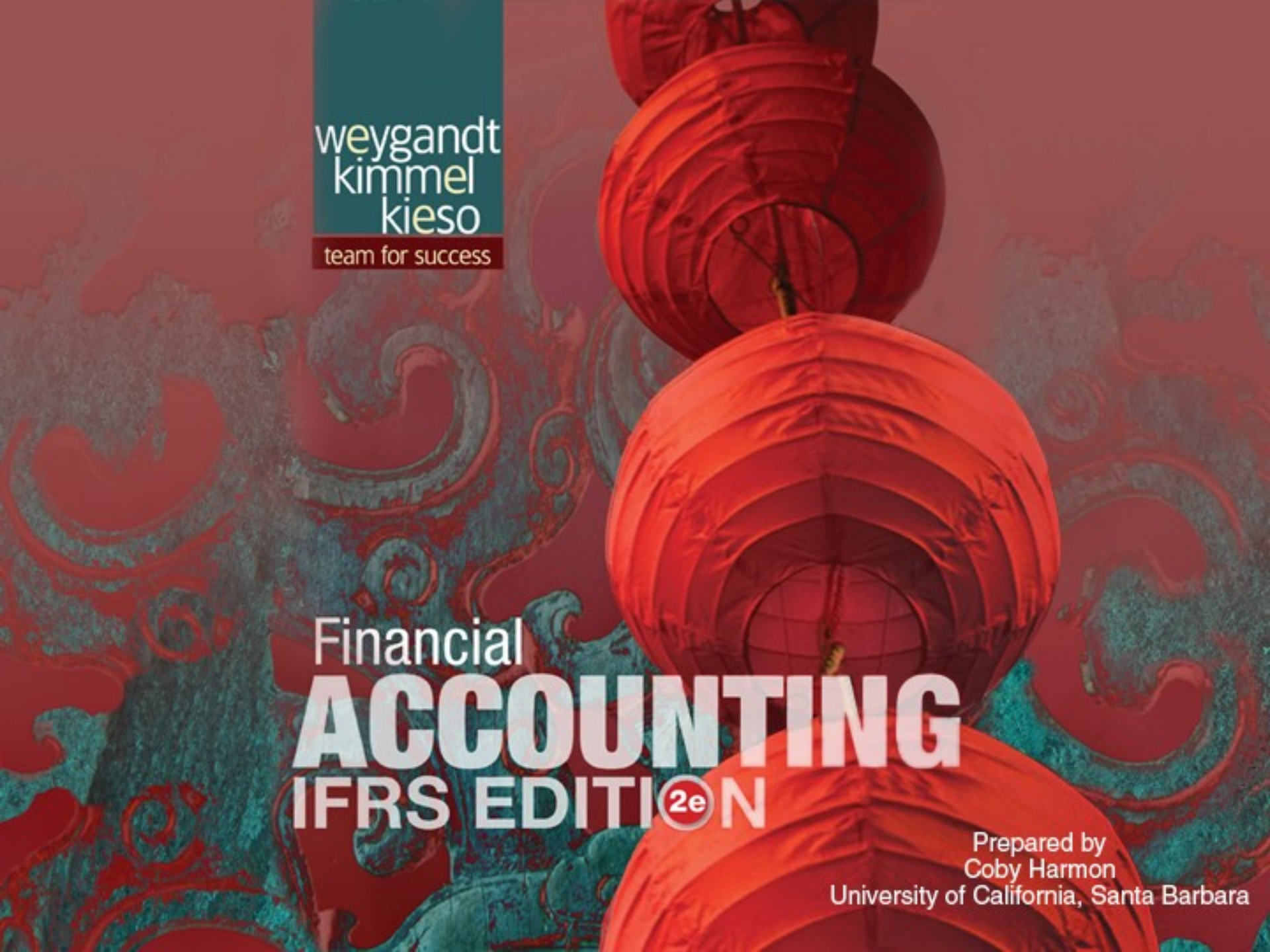




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kimmel
kieso
team for success

Financial
ACCOUNTING
IFRS EDITION ^{2e}

Prepared by
Coby Harmon
University of California, Santa Barbara

Chapter 5

Accounting for Merchandising

Learning Objectives

After studying this chapter, you should be able to:

- 1. Identify the differences between service and merchandising companies.**
- 2. Explain the recording of purchases under a perpetual inventory system.**
- 3. Explain the recording of sales revenues under a perpetual inventory system.**
- 4. Explain the steps in the accounting cycle for a merchandising company.**
- 5. Prepare an income statement for a merchandiser.**

Preview of Chapter 5

ACCOUNTING FOR MERCHANDISING OPERATIONS

Merchandising Operations	Recording Purchases of Merchandise	Recording Sales of Merchandise	Completing the Accounting Cycle	Forms of Financial Statements
• Operating cycles • Flow of costs—perpetual and periodic inventory systems	• Freight costs • Purchase returns and allowances • Purchase discounts • Summary of purchasing transactions	• Sales returns and allowances • Sales discounts	• Adjusting entries • Closing entries • Summary of merchandising entries	• Income statement • Classified statement of financial position

Financial Accounting
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Merchandising Operations

Merchandising Companies

Buy and Sell Goods



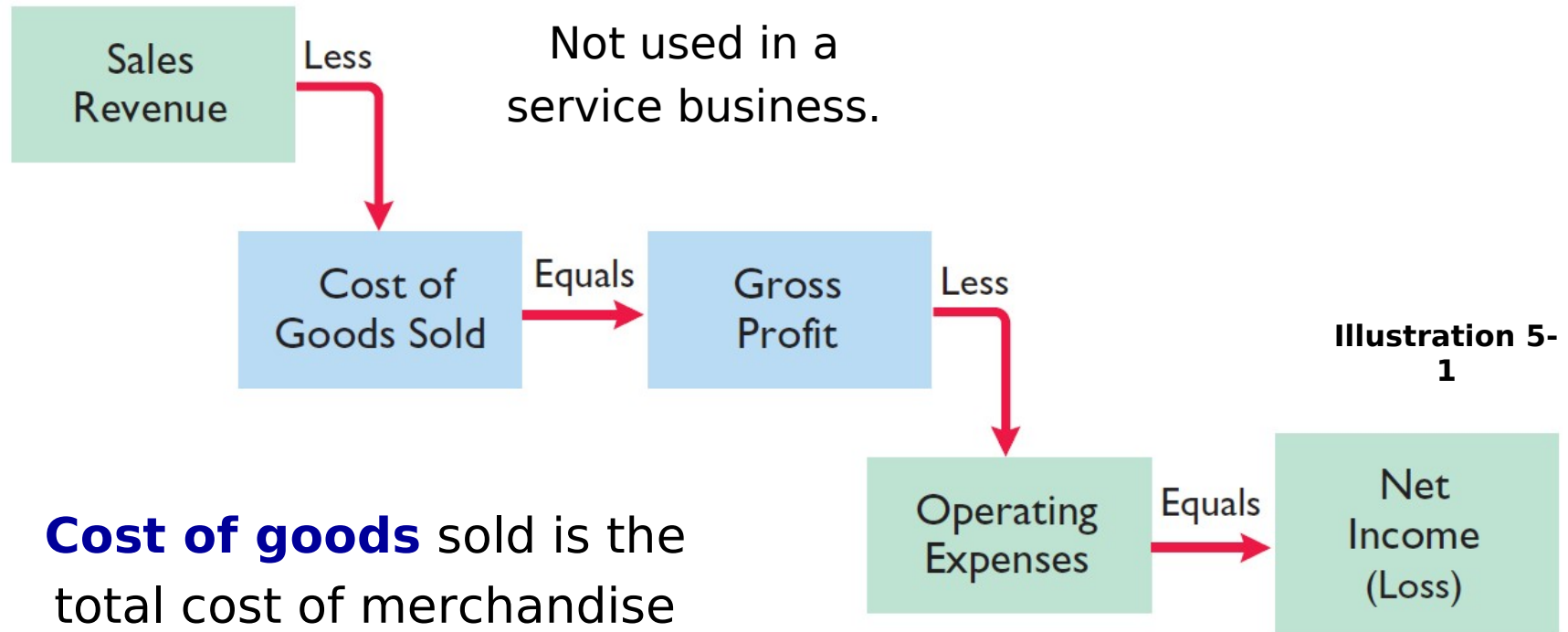
WAL★MART®



The primary source of revenues is referred to as **sales revenue** or **sales**.

Merchandising Operations

Income Measurement



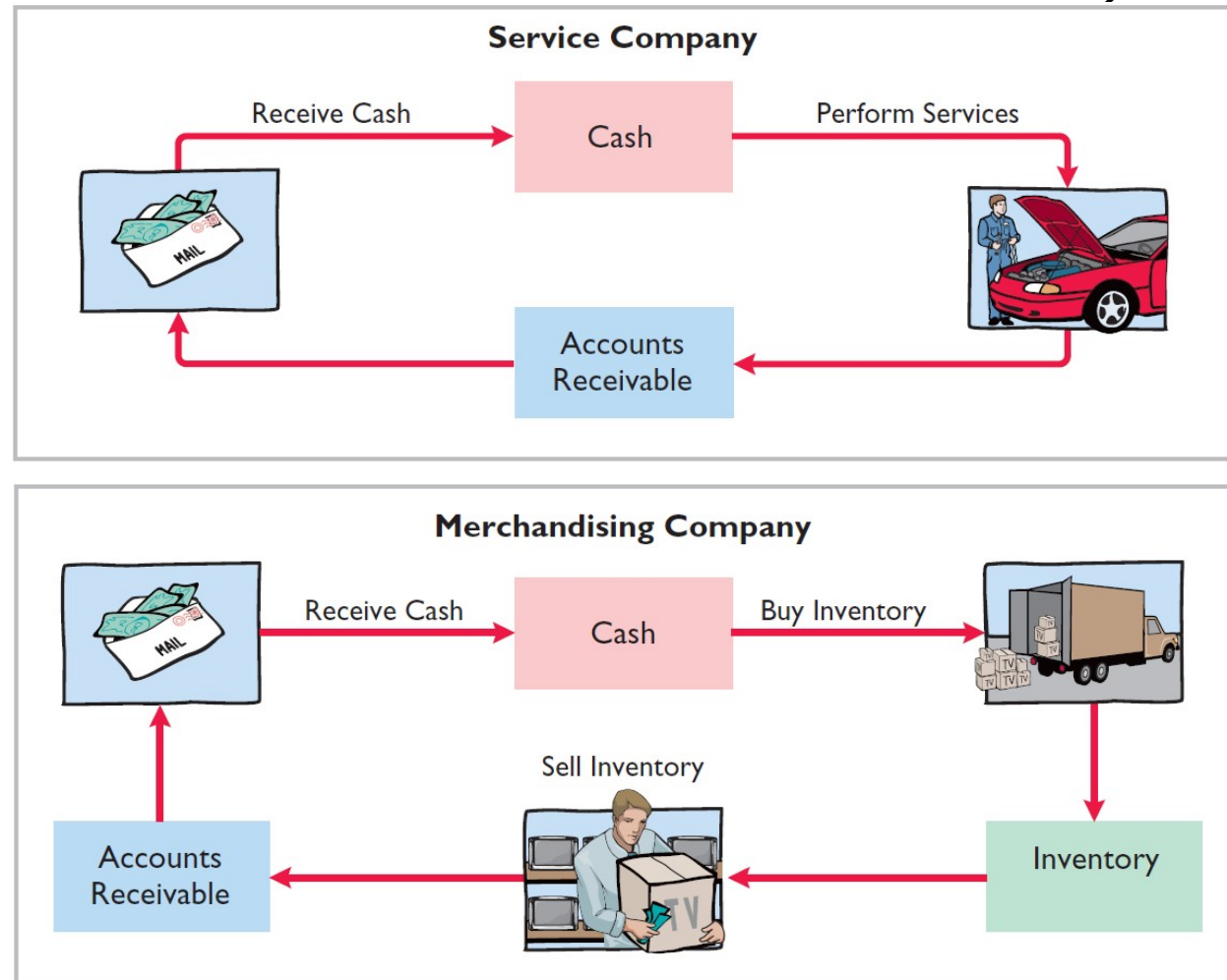
Cost of goods sold is the total cost of merchandise sold during the period.

Merchandising Operations

Operating Cycles

The operating cycle of a **merchandising company** ordinarily is longer than that of a **service company**.

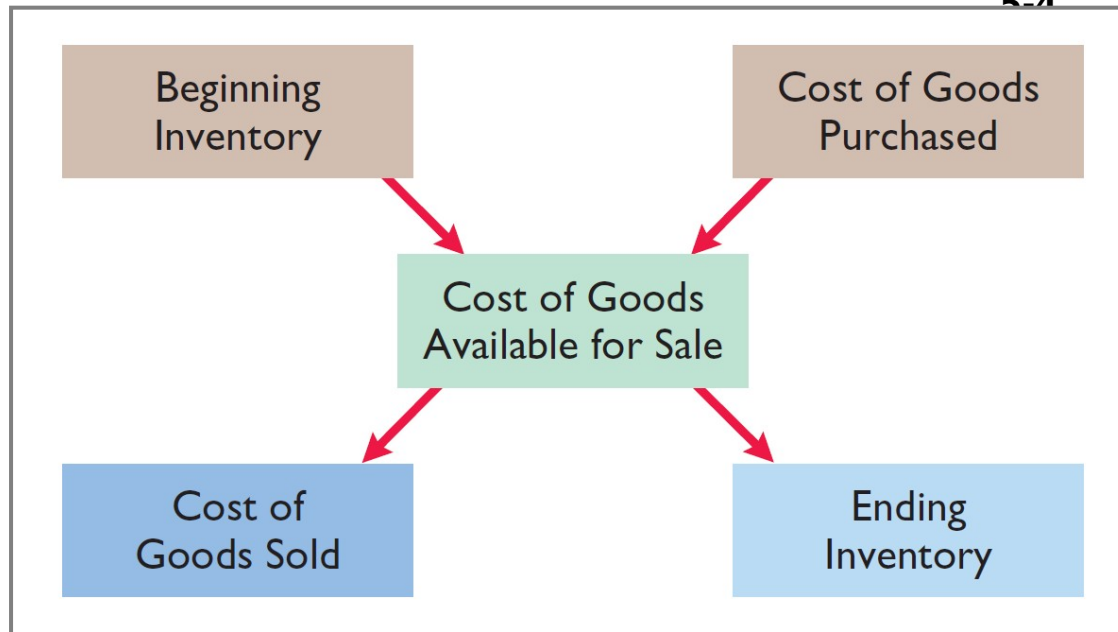
Illustration 5-3



Merchandising Operations

Flow of Costs

Illustration
5-4



Companies use either a **perpetual inventory system** or a **periodic inventory system** to account for inventory.

Merchandising Operations

Flow of Costs

Perpetual System

- ◆ Maintain detailed records of the cost of each inventory purchase and sale.
- ◆ Records continuously show inventory that should be on hand.
- ◆ Company determines cost of goods sold each time a sale occurs.

Merchandising Operations

Flow of Costs

Periodic System

- ◆ Do not keep detailed records of the goods on hand.
- ◆ Cost of goods sold determined by count at the end of the accounting period.
- ◆ Calculation of Cost of Goods Sold:
Beginning inventory

\$ 100,000

Add: Purchases, net

ooo ooo

Goods available for sale

Merchandising Operations

Flow of Costs

Additional Consideration Perpetual System:

- ◆ Traditionally used for merchandise with high unit values.
- ◆ Provides better control over inventories.
- ◆ Requires additional clerical work and additional cost to maintain inventory records.

INVESTOR INSIGHT

Snowboard Company Improves Its Share Appeal



Investors are often eager to invest in a company that has a hot new product. However, when a fast-growing snowboard-maker issued ordinary shares to the public for the first time, some investors expressed reluctance to invest in it because of a number of accounting control problems. To reduce investor concerns, the company implemented a perpetual inventory system to improve its control over inventory. In addition, it stated that it would perform a physical inventory count every quarter until it felt that the perpetual inventory system was reliable.



If a perpetual system keeps track of inventory on a daily basis, why do companies ever need to do a physical count? (See page 258.)



© Ben Blankenburg/iStockphoto

Recording Purchases of Merchandise

- ◆ Made using **cash or credit** (on account).
- ◆ Normally **recorded when** goods are received.
- ◆ **Purchase invoice** should support each credit purchase.

Illustration 5-6

 PW AUDIO SUPPLY, INC. 27 CIRCLE DRIVE AMSTERDAM, THE NETHERLANDS 1081							
INVOICE NO. 731							
S O L D T O	Firm Name <u>Sauk Stereo</u>						
	Attention of <u>James Hoover, Purchasing Agent</u>						
	Address <u>125 Main Street</u>						
	Oslo <u>Norway</u> 283						
Date	5/4/14	Salesperson	Malone	Terms	2/10, n/30	FOB Shipping Point	
Catalog No.		Description			Quantity	Price	Amount
X572Y9820	Printed Circuit Board-prototype			1	2,300	€2,300	
A2547Z45	Production Model Circuits			5	300	1,500	
IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS						TOTAL €3,800	

Recording Purchases of Merchandise

Illustration: Sauk Stereo (the buyer) uses as a purchase invoice the sales invoice prepared by PW Audio Supply, Inc. (the seller). **Prepare the journal entry** for Sauk Stereo for the invoice from PW Audio Supply.

Illustration 5-6

PW AUDIO SUPPLY, INC. 27 CIRCLE DRIVE AMSTERDAM, THE NETHERLANDS 1081				
INVOICE NO. 731				
S O L D T O	Firm Name <u>Sauk Stereo</u>			
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A2547Z45	Production Model Circuits	5	300	1,500
IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS				TOTAL €3,800

May 4 Inventory 3,800

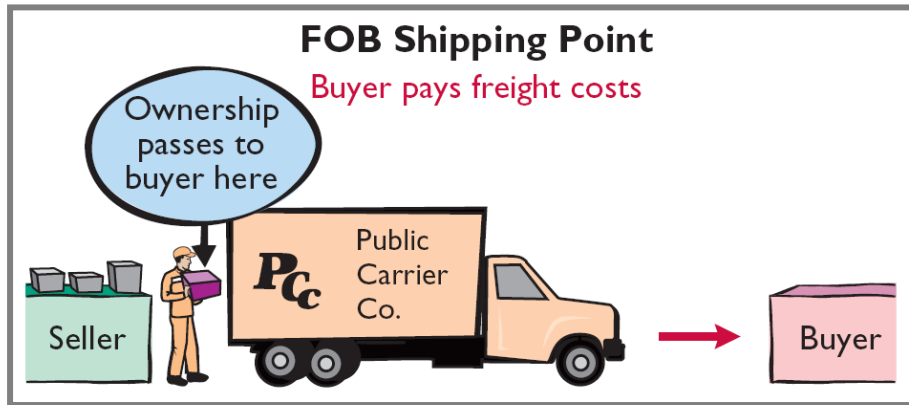
Accounts payable

3.800

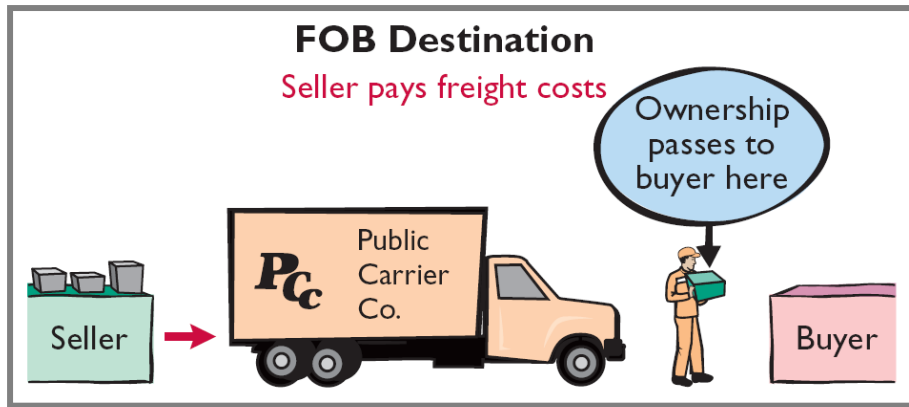
Recording Purchases of Merchandise

Freight Costs – Terms of Sale

Illustration 5-7 Shipping terms



Seller places goods Free On Board the carrier, and buyer pays freight costs.



Seller places goods Free On Board to the buyer's place of business, and seller pays freight costs.

Freight costs incurred by the seller are an **operating expense**.

Recording Purchases of Merchandise

Illustration: Upon delivery of the goods on May 6, **Sauk Stereo** (the buyer) pays Acme Freight Company €150 for **freight charges**, the entry on Sauk Stereo's books is:

May 6	Inventory	150	
	Cash		150

In contrast, if the freight terms on the invoice had required PW Audio Supply (the seller) to pay the **freight charges**, the entry by PW Audio Supply would have been:

May 4	Freight-out (Delivery expense)	150	
	Cash		150

Recording Purchases of

Merchandise

Purchase Returns and

Allowances

Purchaser may be dissatisfied because goods are damaged or defective, of inferior quality, or do not meet specifications.

Purchase Return

Return goods for credit if the sale was made on credit, or for a cash refund if the purchase was for cash.

Purchase Allowance

May choose to keep the merchandise if the seller will grant an allowance (deduction) from the purchase price.

Recording Purchases of Merchandise

Question

In a perpetual inventory system, a return of defective merchandise by a purchaser is recorded by crediting:

- a. Purchases
- b. Purchase Returns
- ☒ c. Purchase Allowance
- d. Inventory

Recording Purchases of Merchandise

Purchase Discounts

Credit terms may permit buyer to claim a cash discount for prompt payment.

Advantages:

- ◆ Purchaser saves money.
- ◆ Seller shortens the operating cycle.

Example:

Credit terms may read **2/10, n/30**.

Recording Purchases of Merchandise

Purchase Discounts

2/10, n/30

2% discount if paid within 10 days, otherwise net amount due within 30 days.

1/10 EOM

1% discount if paid within first 10 days of next month.

n/10 EOM

Net amount due within the first 10 days of the next month.

Recording Purchases of Merchandise

Illustration: Assume that on May 8 Sauk Stereo returned to PW Audio Supply goods costing €300.

May 8	Accounts payable	300	
	Inventory		300

Recording Purchases of Merchandise

Illustration: Assume Sauk Stereo pays the balance due of €3,500 (gross invoice price of €3,800 less purchase returns and allowances of €300) on May 14, the last day of the discount period. Prepare the journal entry Sauk Stereo makes to record its May 14 payment.

May	Accounts payable	3,500	
14			
	Cash		3,430
	Inventory		70

(Discount = €3,500 x 2% =
€70)

Recording Purchases of Merchandise

Illustration: If Sauk Stereo failed to take the discount, and instead made full payment of €3,500 on June 3, the journal entry would be:

June 3	Accounts payable	3,500	
	Cash		3,500

Recording Purchases of Merchandise

Purchase Discounts

Should discounts be taken when offered?

Discount of 2% on €3,500	€ 70.00
€3,500 invested at 10% for 20 days	<u>19.18</u>
Savings by taking the discount	<u>€ 50.82</u>

Example: 2% for 20 days = Annual rate of 36.5%
($365/20 = 18.25$ twenty-day periods $\times 2\% = 36.5\%$)

Recording Purchases of Merchandise

Summary of Purchasing Transactions

Inventory		
	Debit	Credit
4 th - Purchase	€3,800	8 th - Return
6 th - Freight-in	150	14 th - Discount
Balance	€3,580	

Recording Sales of Merchandise

- ◆ Made using **cash or credit** (on account).
- ◆ Normally recorded when earned, usually when goods transfer from seller to buyer.
- ◆ **Sales invoice** should support each credit sale.

Illustration 5-6

 PW AUDIO SUPPLY, INC. 27 CIRCLE DRIVE AMSTERDAM, THE NETHERLANDS 1081					
INVOICE NO. 731					
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A2547Z45	Production Model Circuits	5	300	1,500	
IMPORTANT: ALL RETURNS MUST BE MADE WITHIN 10 DAYS			TOTAL €3,800		

Recording Sales of Merchandise

Journal Entries to Record a Sale

#1

Cash **or** Accounts receivable XXX
Sales revenue

XXX } Selling Price

#2

Cost of goods sold	XXX
Inventory	

Cost

Recording Sales of Merchandise

Illustration: Assume PW Audio Supply records its May 4 sale of €3,800 to Sauk Stereo on account as follows. Assume the merchandise cost PW Audio Supply €2,400.

May 4	Accounts receivable	3,800	
	Sales revenue		3,800
May 4	Cost of goods sold	2,400	
	Inventory		2,400

ANATOMY OF A FRAUD¹

Holly Harmon was a cashier at a national superstore for only a short while when she began stealing merchandise using three methods. First, her husband or friends took UPC labels from cheaper items and put them on more expensive items. Holly then scanned the goods at the register. Second, Holly rang an item up but then voided the sale and left the merchandise in the shopping cart. A third approach was to put goods into large plastic containers. She rang up the plastic containers but not the goods within them. One day, Holly did not call in sick or show up for work. In such instances, the company reviews past surveillance tapes to look for suspicious activity by employees. This enabled the store to observe the thefts and to identify the participants.

Total take: \$12,000

The Missing Controls



Source: Adapted from Wells, *Fraud Casebook* (2007), pp. 251–259.

Recording Sales of Merchandise

Sales Returns and Allowances

- ◆ **“Flipside”** of purchase returns and allowances.
- ◆ **Contra-revenue** account (debit).
- ◆ **Sales not reduced** (debited) because:
 - ▶ Would obscure importance of sales returns and allowances as a percentage of sales.
 - ▶ Could distort comparisons.

Recording Sales of Merchandise

Illustration: Prepare the entry PW Audio Supply would make to record the credit for returned goods that had a €300 selling price (assume a €140 cost). Assume the **goods were not defective**.

May 8	Sales returns and allowances	300	
	Accounts receivable		300
May 8	Inventory	140	
	Cost of goods sold		140

Recording Sales of Merchandise

Illustration: Assume the **returned goods were defective** and had a scrap value of €50, PW Audio would make the following entries:

May 8	Sales returns and allowances	300	
	Accounts receivable		300
May 8	Inventory	50	
	Cost of goods sold		50

Recording Sales of Merchandise

Question

The cost of goods sold is determined and recorded each time a sale occurs in:

- a. periodic inventory system only.
- ☒ b. a perpetual inventory system only.
- c. both a periodic and perpetual inventory system.
- d. neither a periodic nor perpetual inventory system.

ACCOUNTING ACROSS THE ORGANIZATION



Should Costco Change Its Return Policy?

In most industries, sales returns are relatively minor. But returns of consumer electronics can really take a bite out of profits. Recently, the marketing executives at **Costco Wholesale Corp.** (USA) faced a difficult decision. Costco has always prided itself on its generous return policy. Most goods have had an unlimited grace period for returns. A new policy will require that certain electronics must be returned within 90 days of their purchase. The reason? The cost of returned products such as high-definition TVs, computers, and iPods cut an estimated 8¢ per share off Costco's earnings per share, which was \$2.30.

Source: Kris Hudson, "Costco Tightens Policy on Returning Electronics," *Wall Street Journal* (February 27, 2007), p. B4.



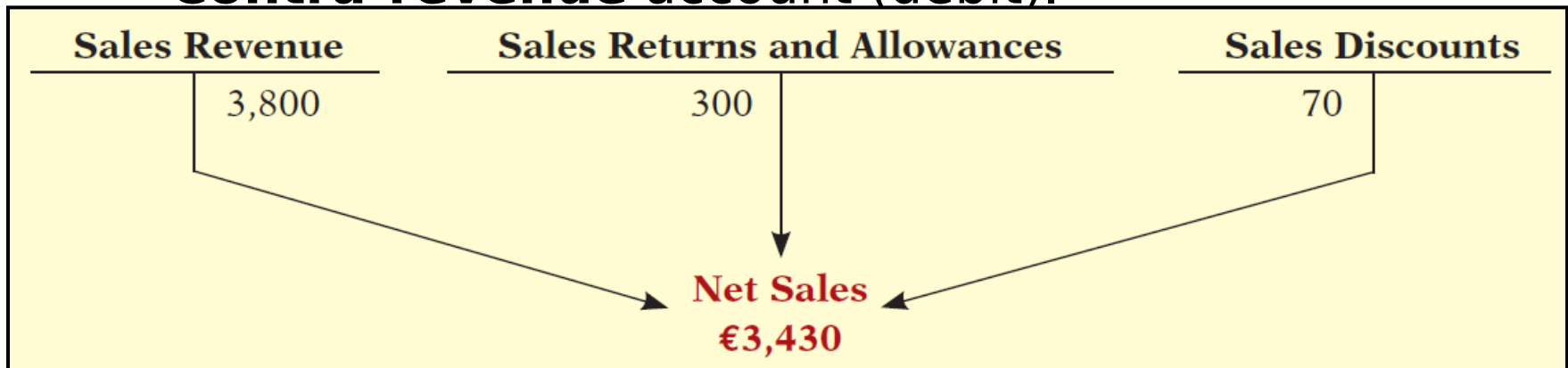
If a company expects significant returns, what are the implications for revenue recognition? (



Recording Sales of Merchandise

Sales Discount

- ◆ Offered to customers to **promote prompt payment**.
- ◆ “**Flipside**” of purchase discount.
- ◆ **Contra-revenue** account (debit).



Recording Sales of Merchandise

Illustration: Assume Sauk Stereo pays the balance due of €3,500 (gross invoice price of €3,800 less purchase returns and allowances of €300) on May 14, the last day of the discount period. Prepare the journal entry PW Audio Supply makes to record the receipt on May 14.

May	Cash	3,430	
14	Sales discounts	70 *	
	Accounts receivable		3,500

* $[(€3,800 - €300) \times 2\%]$

PEOPLE, PLANET, AND PROFIT INSIGHT



Selling Green

Here is a question an executive of **PepsiCo** (USA) was asked: Should PepsiCo market green? The executive indicated that the company should, as he believes it's the No. 1 thing consumers all over the world care about. Here are some thoughts on this issue:

If you are going to market green, what are some things we've learned? I'll share with you one thing we've learned at PepsiCo.

Sun Chips are part of the food business I run. It's a "healthy snack." We decided that Sun Chips, if it's a healthy snack, should be made in facilities that have a net-zero footprint. In other words, I want off the electric grid everywhere we make Sun Chips. We did that. Sun Chips should be made in a facility that puts back more water than it uses. It does that. And we partnered with our suppliers and came out with the world's first compostable chip package.

Now, there was an issue with this package: It was louder than the New York subway, louder than jet engines taking off. What would a company that's committed to green do: walk away or stay committed? If your people are passionate, they're going to fix it for you as long as you stay committed. Six months later, the compostable bag has half the noise of our current package.

So the view today is: we should market green, we should be proud to do it . . . it has to be a 360 process, both internal and external. And if you do that, you can monetize environmental sustainability for the shareholders.

Source: "Four Problems—and Solutions," Wall Street Journal (March 7, 2011), p. R2.



What is meant by "monetize environmental sustainability" for shareholders? .
page 259.)

Completing the Accounting Cycle

Adjusting Entries

- ◆ Generally the same as a service company.
- ◆ One additional adjustment to make the records agree with the actual inventory on hand.
- ◆ **Involves adjusting Inventory and Cost of Goods Sold.**

Completing the Accounting Cycle

Illustration: PW Audio Supply has an unadjusted balance of €40,500 in Inventory. Through a physical count, PW Audio determines that its actual inventory at year-end is €40,000. The company would make an adjusting entry as follows.

Cost of goods sold	500
Inventory	500

Completing the Accounting Cycle

Closing Entries

Dec. 31	Sales Revenue	480,000	
	Income Summary		480,000
	(To close income statement accounts with credit balances)		
31	Income Summary	450,000	
	Cost of Goods Sold		316,000
	Salaries and Wages Expense		64,000
	Utilities Expense		17,000
	Advertising Expense		16,000
	Sales Returns and Allowances		12,000
	Sales Discounts		8,000
	Depreciation Expense		8,000
	Freight-Out		7,000
	Insurance Expense		2,000
	(To close income statement accounts with debit balances)		

Completing the Accounting Cycle

Closing Entries

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)		



DO IT!

The trial balance of Celine's Sports Wear Shop at December 31 shows Inventory €25,000, Sales Revenue €162,400, Sales Returns and Allowances €4,800, Sales Discounts €3,600, Cost of Goods Sold €110,000, Rent 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.

Dec. 31			
	(To close accounts with credit balances)		

31			
		(To close accounts with debit balances)	

Forms of Financial Statements

Income Statement

- ◆ Primary source of information for evaluating a company's performance.
- ◆ Format is designed to differentiate between the various sources of income and expense.

Forms of Financial Statements

Income Statement Presentation of Sales

PW Audio Supply, Inc. Income Statement For the Year Ended December 31, 2014			
Sales revenues			
Sales revenue			€480,000
Less: Sales returns and allowances	€12,000		
Sales discounts	8,000		20,000
Net sales			460,000
Cost of goods sold			316,000
Gross profit			144,000
Operating expenses			
Salaries and wages expense	64,000		
Utilities expense	17,000		
Advertising expense	16,000		
Depreciation expense	8,000		
Freight-out	7,000		
Insurance expense	2,000		
Total operating expenses			114,000
Income from operations			30,000
Other income and expense			
Interest revenue	3,000		
Gain on sale of equipment	600		
Casualty loss from vandalism	(200)		3,400
Interest expense			1,800
Net income			€ 31,600

Forms of Financial Statements

Income Statement

Key Items:

◆ Net sales

PW Audio Supply, Inc. Income Statement For the Year Ended December 31, 2014			
Sales revenues			
Sales revenue			€480,000
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Interest expense		1,800	
Net income			
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Illustration 5-
14

Forms of Financial Statements

Income Statement

Key Items:

- ◆ Net sales
- ◆ **Gross profit**

Illustration 5-14

PW Audio Supply, Inc. Income Statement For the Year Ended December 31, 2014			
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Net income			
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Forms of Financial Statements

Income Statement

Key Items:

- ◆ Net sales
- ◆ Gross profit
- ◆ **Gross profit rate**

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Freight-out	7,000		
Insurance expense	2,000		
Total operating expenses			114,000
Net income			
			€ 31,600

Gross Profit	÷	Net Sales	=	Gross Profit Rate
€144,000	÷	€460,000	=	31.3%

Forms of Financial Statements

Income Statement

Key Items:

- ◆ Net sales
- ◆ Gross profit
- ◆ **Operating expenses**

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Forms of Financial Statements

Income Statement

Key Items:

- ◆ Net sales
- ◆ Gross profit
- ◆ Operating expenses
- ◆ **Other income and expense**

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Illustration 5-14

Forms of Financial Statements

Income Statement

Key Items:

- ◆ Net sales
- ◆ Gross profit
- ◆ Operating expenses
- ◆ **Other income and expense**

Illustration 5-14

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Salaries and wages expense	64,000		
Utilities expense	17,000		
Advertising expense	16,000		
Depreciation expense	8,000		
Other Income			
Interest revenue from notes receivable and marketable securities.			
Dividend revenue from investments in ordinary shares.			
Rent revenue from subleasing a portion of the store.			
Gain from the sale of property, plant, and equipment.			
Other Expenses			
Casualty losses from causes such as vandalism and accidents.			
Loss from the sale or abandonment of property, plant, and equipment.			
Loss from strikes by employees and suppliers.			

Forms of Financial Statements

Income Statement

Key Items:

- ◆ Net sales
- ◆ Gross profit
- ◆ Operating expenses
- ◆ Other income and expense
- ◆ **Interest expense**

Illustration 5-14

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Forms of Financial Statements

Illustration 5-14

Income Statement

Key Items:

- ◆ Net sales
- ◆ Gross profit
- ◆ Operating expenses
- ◆ Other income and expense
- ◆ Interest expense
- ◆ Net income

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Cost of goods sold			
			316,000
Gross profit			
			144,000
Operating expenses			
Salaries and wages expense	64,000		
Utilities expense	17,000		
Advertising expense	16,000		
Depreciation expense	8,000		
Freight-out	7,000		
Insurance expense	2,000		
Total operating expenses			114,000
Income from operations			
			30,000
Other income and expense			
Interest revenue	3,000		
Gain on sale of equipment	600		
Casualty loss from vandalism	(200)	3,400	
Interest expense			1,800
Net income			
			€ 31,600

Forms of Financial Statements

Question

The statement for a merchandiser shows each of the following features except:

- a. gross profit.
- b. cost of goods sold.
- c. a sales revenue section.
- ☒ d. investing activities section.

Forms of Financial Statements

Comprehensive Income

Includes certain adjustments to pension plan assets, gains and losses on foreign currency translation, and unrealized gains and losses on certain types of investments.

Illustration 5-15

Net income	€31,600
Other comprehensive income	
Unrealized holding gain on investment securities	<u>2,300</u>
Comprehensive income	<u><u>€33,900</u></u>

Reported in a combined statement of net income and comprehensive income, **or** in a separate schedule that reports only comprehensive income.

Forms of Financial Statements

Classified Statement of Financial Position

Illustration 5-16

PW Audio Supply, Inc. Statement of Financial Position (Partial) December 31, 2014		
	<u>Assets</u>	
Property, plant, and equipment		
Equipment	€80,000	
Less: Accumulated depreciation—equipment	<u>24,000</u>	€ 56,000
Current assets		
Prepaid insurance	1,800	
Inventory	40,000	
Accounts receivable	16,100	
Cash	<u>9,500</u>	<u>67,400</u>
Total assets		<u><u>€123,400</u></u>



DO IT!

You are presented with the following list of accounts from the adjusted trial balance for merchandiser Gorman Company. Indicate in which financial statement and under what classification each of the following would be reported.

Account	Financial Statement	Classification
Accounts payable	SFP	Current liabilities
Accounts receivable	SFP	Current assets
Accumulated Depreciation-Buildings	SFP	Property, plant, and equipment
Accumulated Depreciation-Equipment	SFP	Property, plant, and equipment
Advertising Expense	IS	Operating expenses
Buildings	SFP	Property, plant, and equipment
Cash	SFP	Current assets
Depreciation Expense	IS	Operating expenses
Dividends	RES	Deduction section



DO IT!

You are presented with the following list of accounts from the adjusted trial balance for merchandiser Gorman Company. Indicate in which financial statement and under what classification each of the following would be reported.

Account	Financial Statement	Classification
Equipment	SFP	Property, plant, and equipment
Freight-Out	IS	Operating expenses
Gain on Disposal of Plant Assets	IS	Other income and expense
Insurance Expense	IS	Operating expenses
Interest Expense	IS	Interest expense
Interest Payable	SFP	Current liabilities
Inventory	SFP	Current assets
Land	SFP	Property, plant, and equipment
Notes Payable	SFP	Non-current liabilities



DO IT!

You are presented with the following list of accounts from the adjusted trial balance for merchandiser Gorman Company. Indicate in which financial statement and under what classification each of the following would be reported.

Account	Financial Statement	Classification
Property Taxes Payable	SFP	Non-current liabilities
Salaries and Wages Expense	IS	Operating expenses
Salaries and Wages Payable	SFP	Current liabilities
Sales Returns and Allowances	IS	Sales revenue
Sales Revenue	IS	Sales revenue
Share Capital - Ordinary	SFP	Equity
Utilities Expense	IS	Operating expenses

Periodic Inventory System

- ◆ Record revenues when sales are made.
- ◆ Do not record cost of goods sold on the date of sale.
- ◆ Physical inventory count determines:
 - ▶ Cost of merchandise **on hand** and
 - ▶ Cost of goods **sold** during the period.
- ◆ Record purchases in Purchases account.
- ◆ Purchase returns and allowances, Purchase discounts, and Freight costs are recorded in separate accounts.

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Determining Cost of Goods Sold

Illustration
5A-2

PW Audio Supply, Inc. Cost of Goods Sold For the Year Ended December 31, 2014			
Cost of goods sold			
Inventory, January 1			€ 36,000
Purchases		€325,000	
Less: Purchase returns and allowances	€10,400		
Purchase discounts	6,800	17,200	
Net purchases		307,800	
Add: Freight-in		12,200	
Cost of goods purchased			320,000
Cost of goods available for sale			356,000
Less: Inventory, December 31			40,000
Cost of goods sold			€316,000

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Recording Purchases of Merchandise

Illustration: On the basis of the sales invoice (Illustration 5-6) and receipt of the merchandise ordered from PW Audio Supply, Sauk Stereo records the €3,800 purchase as follows.

May 4	Purchases	3,800
	Accounts payable	3,800

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Freight Costs

Illustration: If Sauk pays Haul-It Freight Company €150

for freight charges on its purchase from PW Audio

Supply on May 6, the entry on Sauk's books is:

May 6 Freight-in (Transportation-in) 150

Cash

150

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Purchase Returns and Allowances

Illustration: Sauk Stereo returns €300 of goods to PW Audio Supply and prepares the following entry to recognize the return.

May 8	Accounts payable	300
	Purchase returns and allowances	300

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Purchase Discounts

Illustration: On May 14 Sauk Stereo pays the balance due on account to PW Audio Supply, taking the 2% cash discount allowed by PW Audio for payment within 10 days. Sauk

Stereo records the payment and discount as follows.

May 14	Accounts payable	3,500
	Purchase discounts	
	Cash	70
		3,430

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Recording Sales of Merchandise

Illustration: PW Audio Supply records the sale of €3,800 of merchandise to Sauk Stereo on May 4 as follows.

May 4	Accounts receivable	3,800
	Sales revenue	3,800

No entry is recorded for cost of goods sold at the time of the sale under a periodic system.

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Sales Returns and Allowances

Illustration: To record the returned goods received from Sauk Stereo on May 8, PW Audio Supply records the €300 sales return as follows.

May 4	Sales returns and allowances	300
	Accounts receivable	
		300

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Sales Discounts

Illustration: On May 14, PW Audio Supply receives payment of €3,430 on account from Sauk Stereo. PW Audio honors the 2% cash discount and records the payment of Sauk's account receivable in full as follows.

May 14	Cash	3,430	
	Sales discounts	70	
	Accounts receivable		3,500

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Comparison of Entries—Perpetual Vs. Periodic

Illustration
5A-2

Entries on Sauk Stereo's Books					
Transaction		Perpetual Inventory System		Periodic Inventory System	
May 4	Purchase of merchandise on credit.	Inventory	3,800	Purchases	3,800
		Accounts Payable	3,800	Accounts Payable	3,800
6	Freight costs on purchases.	Inventory	150	Freight-In	150
		Cash	150	Cash	150
8	Purchase returns and allowances.	Accounts Payable	300	Accounts Payable	300
		Inventory	300	Purchase Returns and Allowances	300
14	Payment on account with a discount.	Accounts Payable	3,500	Accounts Payable	3,500
		Cash	3,430	Cash	3,430
		Inventory	70	Purchase Discounts	70

APPENDIX 5A PERIODIC INVENTORY SYSTEM

Comparison of Entries—Perpetual Vs. Periodic

Illustration
5A-2

Entries on PW Audio Supply's Books					
Transaction		Perpetual Inventory System		Periodic Inventory System	
May 4	Sale of merchandise on credit.	Accounts Receivable	3,800	Accounts Receivable	3,800
		Sales Revenue	3,800	Sales Revenue	3,800
		Cost of Goods Sold	2,400	No entry for cost of goods sold	
8	Return of merchandise sold.	Inventory	2,400		
		Sales Returns and Allowances	300	Sales Returns and Allowances	300
		Accounts Receivable	300	Accounts Receivable	300
14	Cash received on account with a discount.	Inventory	140	No entry	
		Cost of Goods Sold	140		
		Cash	3,430	Cash	3,430
		Sales Discounts	70	Sales Discounts	70
		Accounts Receivable	3,500	Accounts Receivable	3,500

APPENDIX 5B

Worksheet for a Merchandising Company

**LO 7 Prepare
a worksheet
for a
merchandising
company.**

5-69

Accounts	PW Audio Supply, Inc. Worksheet For the Year Ended December 31, 2014						Illustration 5B-1			
	Trial Balance		Adjustments		Adjusted Trial Balance		Income Statement		Statement of Financial Position	
	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	
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— Equipment		16,000		(c) 8,000		24,000				24,000
Accounts Payable		20,400				20,400				20,400
Share Capital—Ordinary		50,000				50,000				50,000
Retained Earnings		33,000				33,000				33,000
Dividends	15,000				15,000				15,000	
Sales Revenue		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 and Wages Expense	59,000		(d) 5,000		64,000		64,000			
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 and Wages 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

Another Perspective

Key Points

- ◆ Under both GAAP and IFRS, a company can choose to use either a perpetual or a periodic system.
- ◆ Inventories are defined by IFRS as held-for-sale in the ordinary course of business, in the process of production for such sale, or in the form of materials or supplies to be consumed in the production process or in the providing of services. The definition under GAAP is essentially the same.

Another Perspective

Key Points

- ◆ Under GAAP, companies generally classify income statement items by function. Classification by function leads to descriptions like administration, distribution, and manufacturing. Under IFRS, companies must classify expenses by either nature or by function. Classification by nature leads to descriptions such as the following: salaries, depreciation expense, and utilities expense. If a company uses the functional-expense method on the income statement, disclosure by nature is required in the notes to the financial statements.
- ◆ Presentation of the income statement under GAAP follows either a single-step or multiple-step format. IFRS does not mention a single-step or multiple-step approach.

Another Perspective

Key Points

- ◆ Under IFRS, revaluation of land, buildings, and intangible assets is permitted. The initial gains and losses resulting from this revaluation are reported as adjustments to equity, often referred to as other comprehensive income. The effect of this difference is that the use of IFRS instead of GAAP results in more transactions affecting equity (other comprehensive income) but not net income.
- ◆ IAS 1, “Presentation of Financial Statements,” provides general guidelines for the reporting of income statement information. Subsequently, a number of international standards have been issued that provide additional guidance to issues related to income statement presentation.

Another Perspective

Key Points

- ◆ Similar to GAAP, comprehensive income under IFRS includes unrealized gains and losses (such as those on so-called “available-for-sale securities”) that are not included in the calculation of net income.
- ◆ IFRS requires that two years of income statement information be presented, whereas GAAP requires three years.

Another Perspective

Looking to the Future

The IASB and FASB are working on a project that would rework the structure of financial statements. Specifically, this project will address the issue of how to classify various items in the income statement. A main goal of this new approach is to provide information that better represents how businesses are run. In addition, this approach draws attention away from just one number—net income. It will adopt major groupings similar to those currently used by the statement of cash flows (operating, investing, and financing), so that numbers can be more readily traced across statements. For example, the amount of income that is generated by operations would be traceable to the assets and liabilities used to generate the income. Finally, this approach would also provide detail, beyond that currently seen in most statements (either GAAP or IFRS), by requiring that line items be presented both by function and by nature. The new financial statement format was heavily influenced by suggestions from financial statement analysts.

Another Perspective

GAAP Self-Test Questions

Which of the following would not be included in the definition of inventory under GAAP?

- a) Photocopy paper held for sale by an office-supply store.
- b) Stereo equipment held for sale by an electronics store.
- ☒ c) Used office equipment held for sale by the human relations department of a plastics company.
- d) All of the above would meet the definition.

Another Perspective

GAAP Self-Test Questions

Which of the following would not be a line item of a company reporting costs by nature?

- a) Depreciation expense.
- b) Salaries and wages expense.
- c) Interest expense.
- ☒ d) Manufacturing expense.

Another Perspective

GAAP Self-Test Questions

Which of the following would not be a line item of a company reporting costs by function?

- a) Administration.
- b) Manufacturing.
- ☒ c) Utilities expense.
- d) Distribution.

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