

Chapter 6

Accounting for Merchandising Businesses

Study Guide

Do You Know...?

Learning Objective 1: Distinguish between the activities and financial statements of service and merchandising businesses.

- Some distinguishing characteristics of merchandising and service businesses? (*See exercises 1–3*)
- How to calculate gross profit for a merchandising business? (*See exercises 4–6*)

Learning Objective 2: Describe and illustrate the accounting for merchandise transactions.

- The difference between perpetual and periodic inventory? (*See exercises 7–9*)
- How to find a buyer's savings from taking a credit discount or the cost associated with not taking a credit discount? (*See exercises 10–12*)
- The journal entries used to account for discounts? (*See exercises 13–15*)
- How to account for purchase returns and allowances? (*See exercises 16–18*)
- The journal entries used to record sales and the corresponding cost of merchandise? (*See exercises 19–21*)
- How to record sales discounts? (*See exercises 22–24*)
- How to record customer returns and allowances? (*See exercises 25–27*)
- The differences in accounting for merchandise when freight is classified as FOB shipping point and FOB destination? (*See exercises 28–30*)
- How various merchandise transactions are recorded for buyers and sellers? (*See exercises 31–33*)
- The journal entries to record sales taxes payable and the payment of the sales taxes? (*See exercises 34–36*)

Learning Objective 3: Describe and illustrate the adjusting process for a merchandising business.

- How to calculate and record inventory shrinkage? (*See exercises 37–39*)

Learning Objective 4: Describe and illustrate the financial statements of a merchandising business.

- How to prepare a multi-step income statement? (See exercises 40–42)
- How to prepare a single-step income statement? (See exercises 43–45)

Learning Objective 5: Describe and illustrate the use of asset turnover in evaluating a company's operating performance.

- If asset turnover represents an effective or ineffective use of assets? (See exercises 46–48)

Fill-in-the-Blank Equations

1. Sales – _____ = Gross profit
2. Merchandise inventory account balance – Physical merchandise inventory on hand = _____
3. Sales/Average total assets = _____

Exercises

1. Determine whether each of the following characteristics relates to a merchandising or service business.
 - a. At year-end, the company holds merchandise inventory that was not sold during the year.
 - b. The company's financial statements do not list cost of merchandise.
 - c. The company's largest current asset is inventory that is listed on the company's balance sheet.
2. Determine whether each of the following companies is a merchandising or service business.
 - a. Peters Paralegals' revenue consists of mainly revenue from providing advice to clients, which is billed at an hourly rate.
 - b. Crawford Insurance Co. provides health and home insurance for clients, which is billed at a monthly rate.
 - c. Fire Armor has a high inventory turnover for the year for its No Spark Fire Strips.

3. Determine whether each of the following companies is a merchandising or service business.
 - a. Classic Carpets' income statement shows net income as gross profit less other operating expenses.
 - b. Chef Express provides restaurants with professional chefs to improve recipes.
 - c. Kittens Inc. sells cat accessories to large retailers at a large discount.
4. Jeff's Bikes had sales on account of \$3,900 and cash sales of \$1,200. If the company's cost of the merchandise was \$1,100, what is the company's gross profit?
5. A company had a gross profit of \$4,500. If the cost of the merchandise was \$2,150, what were the company's total sales?
6. Torti Co. had cash sales of \$2,760 and sales on account of \$8,200. The company's gross profit at the end of the year totaled \$5,590. What was the cost of the merchandise for Torti Co.?
7. A company's manager would like to know how many of a certain product is on hand in order to fulfill a large upcoming order. If the manager can pull up a report to show the inventory on hand at any time, what kind of inventory system does the business use?
8. Before preparing the balance sheet at year-end, a company must count all inventory on hand. To find the cost of the merchandise sold, the accountants compare the inventory at the beginning of the year to the amount of inventory counted at the end of the year and purchases during the year. Does the company operate using a perpetual or periodic inventory system?
9. A company records the sales and purchases of merchandise as the transactions occur. The accountant also reviews the totals regularly to check the totals among journals. Does the company use a perpetual or periodic inventory system?
10. Tools & More orders \$40,000 of merchandise on account from Hammer Supply. Hammer Supply accepts the order by sending an invoice with the terms 2/10, n/30. Tools & More is considering taking the discount, but would have to borrow funds in order to pay within the discount period. The bank is charging a 5% annual interest rate. Assume a 360-day year.
 - a. What are the savings for Tools & More if it takes advantage of the discount? Round answers to the nearest whole dollar.
 - b. What would Tools & More's interest rate be for the remainder of the credit period if the company does not take advantage of the discount? Round to the nearest whole percentage.

- 11.** U.S. Anchors ordered \$24,000 of merchandise on account. The company receives an invoice on March 3 with the credit terms 3/15, n/45 from the supplier. To pay the amount owed during the discount period, U.S. Anchors would need to borrow funds at a 6% annual interest rate. Assume a 360-day year.
- How much would U.S. Anchors save if the company pays by March 18? Round answers to the nearest whole dollar.
 - What would the interest rate be for the remainder of the credit period if the company does not take advantage of the discount? Round to the nearest whole percentage.
- 12.** Bear Boards purchased \$16,000 of merchandise on account. On June 1, the company receives an invoice from the supplier with the credit terms 4/10, n/60. To pay the amount before the end of the discount period, Bear Boards would need to borrow at a 3% annual interest rate. Assume a 360-day year.
- What are the savings for Bear Boards if the company pays by June 11? Round answers to the nearest whole dollar.
 - What would the interest rate be for the remainder of the credit period if the company does not take advantage of the discount? Round to the nearest whole percentage.
- 13.** Assume that Tools & More pays Hammer Supply during the discount period for the purchase in Exercise 10. Show the journal entry to record the receipt of the invoice (on August 2) and payment for the merchandise (on August 7).
- 14.** Assume that U.S. Anchors pays for the invoice in Exercise 11 on March 12. Show the journal entry to record the receipt of the invoice and the payment made for the merchandise.
- 15.** Give the journal entry for Bear Boards to record the receipt of the invoice in Exercise 12. Also, show the journal entry to record the payment of the invoice if the company pays on June 9.
- 16.** If Tools & More returns \$10,000 of the merchandise purchased from Hammer Supply (information in Exercise 10) on August 5, give the journal entry to record the return of the merchandise. Also, prepare a new journal entry to record the payment on August 7 after the company's return.
- 17.** On March 10, U.S. Anchors returns \$5,000 of the merchandise from Exercise 11. Prepare the journal entries to record the return of the merchandise and the payment on the account on March 12 after the return.

- 18.** Bear Boards returns \$6,750 of damaged merchandise on June 6 that was included in the invoice from Exercise 12. Give the journal entries to record the return of the merchandise and the payment on June 9 after the return.
- 19.** TOL's Closet has sales of \$15,700 on August 7 and received \$9,900 in cash. The remaining customers put the sales on account. The company paid \$7,750 for the merchandise. Prepare the journal entries required to record the sales using a perpetual inventory system.
- 20.** Walden Movies receives \$1,170 in cash for sales on September 3. Other customers put their amounts owed, totaling \$900, on account during the day. The merchandise cost Walden Movies \$500. Prepare the journal entries required to record the sales using a perpetual inventory system.
- 21.** On September 4, Real Housewares has \$16,500 in sales, with customers paying \$10,750 in cash and the remainder on account. Real Housewares purchased the merchandise for \$4,800. Prepare the journal entries required to record the sales using a perpetual inventory system.
- 22.** Modern Glassware sold \$8,250 of merchandise to Kitchen Supply on account on October 10 with the terms 2/10, n/40. The company paid \$2,100 for the merchandise. Kitchen Supply paid for the purchase on October 17 to take advantage of the discount. Record the sale of the merchandise and the receipt of the payment.
- 23.** Assume that Real Housewares gives all customers that pay on account the credit terms 4/15, n/60. On September 1, the company makes sales of \$8,000 of merchandise on account, which cost \$3,500. If all customers pay by the end of the discount period, on September 15, prepare the journal entries to record the sale of goods and receipt of cash.
- 24.** TOL's Closet gives customers that pay for purchases on account credit terms of 3/15, n/30. Prepare the journal entries to record the sales of goods and receipt of cash if all customers that paid on account from Exercise 19 pay on the last day of the discount period, August 22.
- 25.** For the year ended December 31, 20Y5, Modern Glassware made total sales of \$1,000,000, but expects to receive requests for refunds of returned or damaged merchandise that are 2% of total sales. The company also expects to receive returns of merchandise costing \$12,000. Prepare the adjusting entries required at year-end if 20Y5 is the company's first year of operations.

- 26.** Assume that the following year Modern Glassware (information in Exercise 25) paid a refund of \$4,500 for inventory costing \$2,500. Prepare the journal entry to record the payment and reduction in inventory, which occurred on January 22, 20Y6.
- 27.** During 20Y5, its first year of operations, Purple Sun made total sales of \$2,500,000 for merchandise costing \$100,000. The company refunds all customers for returned or damaged merchandise. The company expects to receive requests for refunds that are 3% of total sales. The company also expects to receive returns of merchandise costing \$50,000.
- Prepare the journal entry required at year-end (assume a calendar year-end).
 - The company refunds customers for \$21,000 for merchandise costing \$15,000 on January 31 of the following year. Prepare the journal entry required for the refund and return of merchandise.
- 28.** Bird & Bottle purchases merchandise from Bottle Co. Delivery expenses are to be paid when the balance is due. Is this purchase considered to be FOB destination or FOB shipping? Who has title to the merchandise during shipping?
- 29.** When making a large purchase, the seller of merchandise agrees to pay the delivery expenses. Would the transaction be considered FOB destination or FOB shipping? Who has title to the merchandise during shipping?
- 30.** Jake's Diamonds purchases merchandise from a supplier on account. They do not discuss who will pay for shipping, but the supplier states that Jake's Diamonds will hold title during shipping. Is this a FOB destination or FOB shipping transaction? Who pays for the shipping expenses?
- 31.** Saxon Inc. sold and shipped merchandise to Baxon Co. for \$8,850 on January 1. Baxon Co. paid for the merchandise on account. Saxon Inc. purchased the inventory for \$2,300. Prepare the journal entries to record the sales transaction for both Saxon Inc. and Baxon Co.
- 32.** The transaction from Exercise 31 is made with FOB destination shipping terms. Shipping expenses were paid the following day, which totaled \$320. Prepare the journal entry, if any, for Saxon Inc. and Baxon Co.
- 33.** Saxon Inc. sold the merchandise in Exercise 31 on the credit terms 4/10, n/30. Prepare the journal entry for both companies if Baxon Co. pays the balance due on January 7.
- 34.** On July 3, Sally's Station sells merchandise to Bill's Buildings for \$13,000 on account. The transaction is subject to a 6.5% sales tax. Prepare the journal entry to show the sale, including sales taxes. Also, prepare the journal entry to record Sally's Station's payment of sales taxes, which totaled \$3,250 for the previous month on July 15.

- 35.** Bolton Inc. purchased \$12,000 of merchandise from Sutton Co. on August 3. The purchase is subject to a 5.7% sales tax. Sutton Co. also pays the sales taxes it collected from the previous month on August 5, which totaled \$8,350. Prepare the journal entries to record the sale of merchandise and the payment of sales taxes.
- 36.** Hilo Co. had sales of \$21,000 on September 6, of which \$7,000 was paid for with cash, and the remainder was put on the customer's account. All sales are subject to a 5.3% sales tax. On September 10, the company also pays the sales taxes owed for the previous month, which totaled \$9,900. Prepare the journal entries to record the sale of the merchandise and the payment of the sales taxes owed.
- 37.** TortiTops' has an ending account balance of \$4,950 for merchandise inventory on December 31, 20Y5. After performing a physical inventory count, the merchandise inventory on hand is actually \$4,690. Calculate the inventory shrinkage for the year and prepare the journal entry to record the loss in merchandise inventory.
- 38.** At the beginning of 20Y5, Myers Supplies had a merchandise inventory balance of \$7,950. The company's purchases totaled \$9,700, and cost of merchandise sold was \$5,200. At the end of 20Y5, the physical count of merchandise inventory showed a balance of \$11,900. Calculate the inventory shrinkage for the year and prepare the journal entry to record the costs of the shrinkage for the fiscal year ended March 31.
- 39.** Lakelands Shop had a beginning balance in merchandise inventory of \$2,600. Purchases for the year totaled \$1,200, and cost of goods sold totaled \$1,700. If the physical count of merchandise inventory at the end of the year indicated that \$1,990 of inventory was on hand, how much was inventory shrinkage for the year? Prepare the journal entry to record the inventory shrinkage for the fiscal year ended September 30, 20Y5.
- 40.** Sugar Bakeshop had sales totaling \$9,000 of merchandise costing \$800 during its first year. The company also had the following selling expenses: depreciation on store equipment, \$500; advertising expense, \$490; sales salaries expense, \$1,700; and store rental expense, \$2,200. Administrative expenses included office salaries expense, \$1,900; insurance expense, \$790; and office rental expense, \$990. Prepare a multi-step income statement for the calendar year, if Sugar began operations in October 20Y5.
- 41.** Party Place made sales of merchandise inventory of \$10,000 in 20Y5. The cost of sales for the year was \$1,200. Administrative expenses included depreciation on office equipment, \$850; insurance expense, \$690; and utilities at office, \$750. Selling expenses included sales salaries, \$2,200; advertising expense, \$890; depreciation on store equipment, \$1,200; and store rental expense, \$3,570. The company also had interest revenue of \$3,250. Prepare a multi-step income statement for the company's fiscal year, which ends September 30.

- 42.** Fabulous Finds sold \$17,790 of merchandise in 20Y5, with the cost of the merchandise totaling \$2,250. Fabulous Finds had the following expenses: sales salaries, \$2,100; office salaries, \$3,000; advertising expense, \$1,200; office supplies, \$700; office utilities, \$1,400; depreciation on store equipment, \$1,070; depreciation on office equipment, \$1,800; delivery expense, \$950; and insurance expense, \$1,200. The company also had interest revenue of \$2,200 and investment expense of \$900. Prepare the company's income statement for the fiscal year ended March 31.
- 43.** Using Sugar Bakeshop's information in Exercise 40, prepare a single-step income statement for the company.
- 44.** Using Party Place's information in Exercise 41, prepare a single-step income statement for the company.
- 45.** Prepare a single-step income statement for Fabulous Finds using the information in Exercise 42 for the 20Y5 fiscal year.
- 46.** Using the following information, calculate the asset turnover ratio for 20Y5 and 20Y6. Does the change in the ratios indicate a favorable or unfavorable trend? Round answers to two decimal places.

| | <u>20Y6</u> | <u>20Y5</u> |
|----------------------|-------------|-------------|
| Total sales revenues | \$16,050 | \$15,300 |
| Total assets: | | |
| Beginning of year | 6,300 | 7,050 |
| End of year | 6,160 | 6,300 |

- 47.** Calculate the asset turnover ratio for 20Y5 and 20Y6 for Sunny Patch with the information shown below. Does the change in ratios indicate a favorable or unfavorable trend? Round answers to two decimal places.

| | <u>20Y6</u> | <u>20Y5</u> |
|----------------------|-------------|-------------|
| Total sales revenues | \$7,250 | \$8,800 |
| Total assets: | | |
| Beginning of year | 1,690 | 1,350 |
| End of year | 1,700 | 1,690 |

- 48.** Zinnia's Blueberries had total sales revenues of \$12,200 for 20Y5 and \$16,700 for 20Y6. Using the account balances below, calculate the company's asset turnover ratio for the years. Does the change in ratios indicate a favorable or unfavorable trend? Round answers to two decimal places.

| | <u>20Y6</u> | <u>20Y5</u> |
|--------------------|-------------|-------------|
| Beginning of year: | | |
| Current assets | \$2,950 | \$3,450 |
| Fixed assets | 9,250 | 8,900 |
| End of year: | | |
| Current assets | 3,150 | 2,950 |
| Fixed assets | 9,500 | 9,250 |