

Principles of Accounting
Help Lesson #4

*Accounting for
Merchandising Companies:
Journal Entries*

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Merchandising Company

A *merchandising business* is one that buys and sells goods in order to make a profit.



THIS PRESENTATION IS UNDER
CONTINUING DEVELOPMENT.

Merchandise



The goods that a company buys in order to resell are known as *merchandise*.

Accounting for Merchandise

Merchandise may be accounted for under one of two inventory methods:

- **Perpetual Inventory**
- **Periodic Inventory**

For this presentation, we will assume a perpetual inventory system.

Chart of Accounts

Additional accounts must be added to the Chart of Accounts for a merchandising company.

Account Title	Type of Account	Normal Balance	Purpose
Merchandise Inventory	Asset	Debit	To account for the value of merchandise held for sale
Sales	Revenue	Credit	To account for the sale of merchandise at the sales price.
Sales Returns and Allowances	Contra-Revenue	Debit	To account for returned or damaged merchandise
Sales Discounts	Contra-Revenue	Debit	To account for discounts offered to customers for prompt payment
Cost of Goods Sold	Expense	Debit	To account for the cost of merchandise sold
Shipping Expense	Expense	Debit	To account for the cost of shipping merchandise to customers

Merchandise Transactions

Several types of transactions are common for merchandising companies:

- **Purchase of Merchandise**
- **Sale of Merchandise**
- **Purchase Return**
- **Sales Return**
- **Payment on Account**
- **Receipt on Account**

Purchase of Merchandise

Before it can be sold, Merchandise must be **purchased**. The seller of merchandise is more commonly known as the *vendor*.

The source document for a purchase of merchandise is the purchase invoice.



Journal Entry for a Purchase of Merchandise

Jones Career Consulting purchased 24 books from XYZ Publishing about developing a resume to resell to clients. The total purchase cost, including shipping, was \$265. The books were purchased on account.

The journal entry to record this transaction in a perpetual inventory system is as follows.

Merchandise Inventory	265	
Accounts Payable-XYZ Pub		265

Purchase Returns & Allowances

Sometimes merchandise must be returned to the vendor or an adjustment is made to the amount due for the merchandise (**allowance**).

The source document for a purchase return or allowance is the *debit memorandum*.

Effect of Purchase Returns & Allowances

When a return is made or an allowance is granted for merchandise bought on account, the effect of the transaction is to reduce the amount due to the Vendor (Accounts Payable) and to reduce the value of Merchandise Inventory.

Journal Entry for a Purchase Return

Jones Career Consulting returned 4 damaged books to XYZ Publishing. The total value of the merchandise returned was \$50.

The journal entry to record this transaction in a perpetual inventory system is as follows.

Accounts Payable-XYZ Pub	50	
Merchandise Inventory		50

Journal Entry for a Purchase Allowance

The most typical reason for a purchase allowance is damaged merchandise.

The journal entry to record a purchase allowance is the same as the entry to record a purchase return.

Assume that JCC discarded the 4 damaged books and received an allowance from the vendor.

The journal entry would be the same as the previous transaction as shown below.

Accounts Payable-XYZ Pub	50	
Merchandise Inventory		50

Purchase Discounts



Merchandise is often purchased on account. When this occurs, the business and the vendor must agree on the credit terms. The *credit terms* determine when the invoice must be paid.

Many vendors offer a *discount* if the invoice is paid within a specified period of time that is less than the full credit term.

Purchase Discounts

Discount terms are stated in the following way

2/10, n/30

This term is read “Two ten, net thirty” and means that the buyer will receive a 2 percent discount on the purchase price if the invoice is paid within ten days of the invoice date, else the total (net) is due within thirty days.

Other discount terms include

1/15, n/30 and 3/10, n/45

Calculating a Purchase Discount

Examine this invoice.

Invoice	
Date: 6/15/03	
Terms: 2/10, n/30	
Purchase of 20 books at \$12.50 ea.	\$250.00
Shipping	15.00
Total Due	\$265.00

The credit terms for this invoice indicate that if this invoice is paid by June 25 (10 days after the invoice date), the buyer may take a 2% discount on the merchandise price. Otherwise, the total amount due (\$265.00) must be paid by July 15.

NOTE: Discounts are calculated on the merchandise cost only.

If this invoice is paid on June 15, the amount due would be \$260.00. The discount of \$5.00 ($\$250.00 \times .02$) is deducted from the total due in determining the amount to pay.

Journal Entry for Payment with a Purchase Discount

A compound entry is required to journalize the entry to record payment of an invoice when the discount is taken.

Assume that JCC pays the invoice of 6/15/03 on 6/22/03. Further assume that no merchandise has ever been returned or granted an allowance.

The journal entry to record the payment of the invoice is as follows.

Accounts Payable-XYZ Pub	265	
Cash		260
Merchandise Inventory		5

Affect of Discount on Accounts Payable

Notice that Accounts Payable is debited for \$265 even though the company was paid only \$260. If Accounts Payable were not debited for the full amount of the invoice, a balance of \$5 would remain in this account.

When a discount is granted, the purchaser pays the amount of the invoice less the discount but is given credit by the creditor for the full amount.

Accounts Payable-XYZ Pub	265	
Cash		260
Merchandise Inventory		5

Affect of Discount on Merchandise Inventory

Notice that the purchase discount is deducted directly from the Merchandise Inventory account. The affect of a purchase discount is to reduce the cost of the merchandise purchased. This is accomplished in the journal entry by crediting Merchandise Inventory.

Accounts Payable-XYZ Pub	265	
Cash		260
Merchandise Inventory		5

Journal Entry for Payment with a Purchase Discount

Now examine the journal entry when the allowance for the four books is taken into account.

Notice that the discount cannot be calculated on the amount of the returned merchandise, and the balance of Accounts Payable has been reduced by the amount of the return. (See the slide for **Journal Entry for a Purchase Allowance** if you need a reminder.)

Accounts Payable-XYZ Pub	215	
Cash		211
Merchandise Inventory		4

Explanation of the Calculation of the Payment amount with a Purchase Discount and Allowance

In order to calculate the amount due on the invoice, first deduct the amount of the purchase allowance.

<i>Original Invoice</i>	<i>Less</i>	<i>Allowance</i>		<i>Net Due</i>
\$265	-	\$50	=	\$215

Next, deduct the shipping cost in order to determine the amount of the discount.

<i>Net Due</i>	<i>Less</i>	<i>Shipping</i>	<i>Times</i>	<i>Discount Rate</i>		<i>Discount</i>
\$215	-	\$15	X	.02	=	\$4

The total due to XYZ is \$211 (\$215 less the \$4 discount).

Sale of Merchandise

The purpose of buying merchandise is to resell it, generally at a profit.

The source document for a sale of merchandise is the *sales invoice*.



Recording the Sale of Merchandise

Two journal entries are required to record the sale of merchandise in a perpetual inventory system--

1. The first entry records the sale of the merchandise and either the receipt of cash or the account receivable. The amount used in this transaction is the **sales price** of the merchandise.
2. The second entry records the reduction in merchandise and the recognition of an expense for the cost of merchandise sold. The amount used in this transaction is the **cost** of the merchandise.

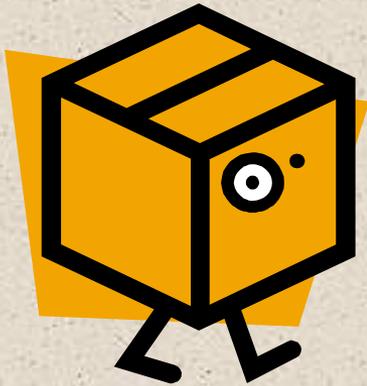
Journal Entry for a Sale of Merchandise

Jones Career Consulting sold 2 books to Harry Minor on account for a total of \$50. The total cost of the books sold was \$25.

The journal entries to record this transaction in a perpetual inventory system are as follows.

Accounts Receivable-H. Minor	50	
Sales		50
Cost of Merchandise Sold	25	
Merchandise Inventory		25

Sales Returns & Allowances



Just as merchandise is sometimes returned to the vendor or an adjustment is made to the amount due for the merchandise (**allowance**), the seller must sometimes account for a sales return or allowance.

The source document for a sales return or allowance is the *credit memorandum*.

Recording a Sales Return or Allowance

Recall that two journal entries are required to record the sale of merchandise in a perpetual inventory system. **Two journal entries** are also required to record a sales return or allowance.

1. The first entry recognizes the sales return or allowance and either the payment of cash or the reduction of the account receivable. The amount used in this transaction is the **sales price** of the merchandise returned or adjusted.
2. The second entry records the replacement of the merchandise in inventory and the reduction of the expense for the cost of merchandise sold. The amount used in this transaction is the **cost** of the merchandise.

Recording a Sales Return or Allowance

The essential affect of the journal entries to record a sales return or allowance is to reverse the original entry to record the sale—it is as if the merchandise was never sold.

The only difference is that instead of reducing the Sales account, the amount of returns and allowances are kept up with in the Sales Returns & Allowances account.

Journal Entry for a Sales Return or Allowance

Harry Minor returned one book. The book had been sold by JCC for \$25. The cost of the book was \$12.50.

The journal entries to record this transaction in a perpetual inventory system are as follows.

Sales Returns & Allowances	25.00	
Accounts Receivable-Minor		25.00
Merchandise Inventory	12.50	
Cost of Merchandise Sold		12.50

This concludes your review of
common transactions for
merchandising companies.