MERCHANDISING ACTIVITIES

Merchandising Operations

A merchandising business differs from a service business in that it buys and sells goods (merchandise inventory) in finished form.
A merchandiser engages in a series of transactions known as the **operating cycle**, consisting of:

a. the purchase of merchandise inventory
b. the payment for purchases made on credit
c. the sale of the inventory
d. the collection of cash from merchandise sales

Components of the Merchandising Income Statement

The following formulas define the calculation of net income for a merchandising company:

Net Sales
- Cost of Goods Sold
Gross Margin
- Operating Expenses
Net Income (Loss)

Beginning Inventory
+ Net cost of purchases
Goods Available for Sale
- Ending Inventory
Cost of Goods Sold

Gross Purchases
- Purchases Returns and Allowances
- Purchases Discounts
Net Purchases
+ Freight In
Net Cost of Purchases

Gross sales
- Sales Returns and Allowances
- Sales Discounts
Net Sales

Selling Expenses
+ General and Administrative Expenses
Operating Expenses

Note: **Freight In** is included in the calculation of Net Cost of Purchases *but* **Freight out expense** is included in operating expenses.

Periodic vs. Perpetual Inventory System

The periodic inventory system is used when it is unnecessary or impractical to keep track of the cost of each item. Under this method, the company instead waits until the end of the accounting period to take a physical inventory.
The perpetual inventory system is used when it is necessary to keep a record of the cost of each inventory item when it is purchased and when it is sold.
Ending inventory in one accounting period automatically becomes the beginning inventory of the next.
Merchandise may be quoted for sale at a list price less a **trade discount**. This discount is simply a reduction in original cost of the merchandise.
When goods are sold on credit, terms will vary as to when the payment must be made. For example, n/30 means that full payment is due within 30 days after the invoice date, and n/10 eom means that full payment is due 10 days after the end of the month.
Often a customer is given a discount for early payment and the merchandiser records a **sales discount**. Terms of 2/10, for example, mean that a 2 percent discount will be given if payment is made within 10 days of the invoice date. Otherwise the full amount is due within 30 days.
FOB Shipping Point means that ownership of the merchandise passes from seller to purchaser at the factory door, and hence, the purchaser pays transportation costs.

FOB Destination means that ownership of the merchandise passes from seller to purchaser at the buyer's doorstep, so in that case the seller pays transportation charges.
The following entries would be made for a company recording **purchases under the periodic inventory system** :

Purchase on account
Debit......Purchases
Credit..........Accounts Payable

Payment of transportation costs
Debit......Freight In
Credit..........Cash

Return of purchased merchandise
Debit......Accounts Payable
Credit..........Purchases Returns and Allowances

Payment on account
Debit......Accounts Payable
Credit..........Cash

Payment on account (with discount)

Debit...Accounts Payable

Credit...Cash

Credit...Purchases Discounts

The following entries would be made for **sales under the periodic inventory system** :

Sale on account
Debit......Accounts Receivable
Credit..........Sales

Payment of transportation
Debit......Freight Out Expense
Credit..........Cash

Receipt of sales return
Debit......Sales Returns and Allowances
Credit..........Accounts Receivable

Receipt of payment on account
Debit......Cash
Credit..........Accounts Receivable

Receipt of payment on account (less sales discount)

Debit...Cash

Debit...Sales Discounts

Credit...Accounts Receivable

Purchases under the perpetual inventory system differ with the following entries :

Purchase on account
Debit......Merchandise Inventory
Credit..........Accounts Payable

Return of purchased merchandise
Debit......Accounts Payable
Credit..........Merchandise Inventory
Sales under the perpetual inventory system differ with the following entries :

Sales on account
Debit......Accounts Receivable
Credit..........Sales
Debit......Cost of Goods Sold
Credit..........Merchandise Inventory

Receipt of sales return
Debit......Sales Returns and Allowances
Credit..........Accounts Receivable
Debit......Merchandise Inventory
Credit..........Cost of Goods Sold

Credit & Debit Memorandums

A **credit memorandum** is a message (memo) from the seller to the buyer indicating that the seller will *credit the account receivable* it holds in the name of the buyer. This would occur when the buyer returns merchandise previously purchased. It is a way to confirm for the buyer that the return was received and the appropriate account was updated.

A **debit memorandum** is a message (memo) from the buyer to the seller indicating that the buyer will *debit the account payable* it holds in the name of the seller. Again, this would occur when the buyer returns merchandise previously purchased. It is a way for the buyer to notify the seller that the merchandise is being returned and the appropriate account was updated.