ACCOUNTING
Evaluating **Profitability** & **Solvency**

At the end of the fiscal year, Overnight Auto Service considers the financial results of its first year of operation:

- Impressive service revenue of $172,000
- A promising contract with Harbor Cab to rent storage space for its cabs. (Signed contract on Dec. 1—Harbor Cab paid for the first three months in advance.)
- In addition, if Harbor Cab stores its cabs in Overnight's garage, Overnight becomes the likely candidate to perform any necessary maintenance & repairs.

Evaluating Profitability: (USE OVERNIGHT'S STATEMENTS)

In 2009, Overnight earned a net income of nearly $__________. The stockholders' investment was $________________. Thus net income for the first year of operations amounts to _________% of the stockholders' investment.

What do you think of this rate of return for the first year of operation? Of course, Overnight's stockholders have taken a certain amount of risk by investing their financial resources in the business. Does this ***return on investment*** adequately compensate the stockholders for their risk? (Stated differently, could they invest their $80,000 in a less risky venture and still generate a 50% rate of return? What do you think? ___________

When evaluating *profitability*, the real question is not how the business did, but ***how it is likely to do in the future***. To generate a substantial return on investment in the first year of operations indicates good profit *potential*. In 2009, only $__________ in revenue was earned by renting storage space to the company for its cabs. (December's rent) What would you expect Overnight to earn in Rental Revenue in 2010? ___________

***Other commonly used measures of profitability include:

Measure	Computation	Overnight's Performance
Net Income Percentage	$\frac{\text{Net Income}}{\text{Total Revenue}}$	= __________%

What does this mean? This indicates management's ability to control ____________.

Measure	Computation	Overnight's Performance
Return on Equity	$\frac{\text{Net Income}}{\text{Average Stockholders' Equity*}}$	= __________%

What does this mean? This shows that for every dollar of equity capital, the company earned income of approximately $0.43.

*Average stockholders' equity is the average of **beginning** stockholders' equity and **ending** stockholders' equity

Evaluating Solvency:

Solvency refers to a company's ability to meet its ________ ______________ as they become due. Solvency, at least in the short term, may be *independent* of profitability.

Q: What do you think of Overnight's *solvency* in the short term? How would you go about determining whether this company is solvent or insolvent?

Calculations:

***Other commonly used measures of solvency include:

Measure	Computation		Overnight's Performance
Working Capital	Current Assets – Current Liabilities	=	$__________

What does this mean?
This is the **excess** of current assets over current liabilities. An analyst familiar with the nature of a company's operations usually can determine from the amount of working capital whether the company is in a sound financial position or is heading for financial difficulties.

Measure	Computation		Overnight's Performance
Current Ratio	$\frac{\text{Current Assets}}{\text{Current Liabilities}}$	=	__________:1

What does this mean? This means the company's current assets are times as large as its current liabilities. The **higher** the current ratio, the **more** liquid the company appears to be.

Amounts are taken directly from the adjusted trial balance

OVERNIGHT AUTO SERVICE
Income Statement
For the Year Ended December 31, 2002

Revenue:		
Repair service revenue		$172,000
Rent revenue earned		3,000
Total revenue		$175,000
Expenses:		
Advertising	$ 3,900	
Wages expense	58,750	
Supplies expense	7,500	
Depreciation: building	1,650	
Depreciation: tools and equipment	2,200	
Utilities expense	19,400	
Insurance	15,000	
Interest	30	108,430
Income before income taxes		$ 66,570
Income taxes		26,628
Net income		$ 39,942

Net income also appears in the statement of retained earnings

OVERNIGHT AUTO SERVICE
Statement of Retained Earnings
For the Year Ended December 31, 2002

Retained earnings, Jan. 20, 2002	$ 0
Add: Net income	39,942
Subtotal	$39,942
Less: Dividends	14,000
Retained earnings, Dec. 31, 2002	$25,942

The ending balance in the Retained Earnings account also appears in the balance sheet

OVERNIGHT AUTO SERVICE
Balance Sheet
December 31, 2002

Assets		
Cash		$ 18,592
Accounts receivable		7,250
Shop supplies		1,200
Unexpired insurance		3,000
Land		52,000
Building	$36,000	
Less: Accumulated depreciation	1,650	34,350
Tools and equipment	$12,000	
Less: Accumulated depreciation	2,200	9,800
Total assets		$126,192
Liabilities & Stockholders' Equity		
Liabilities:		
Notes payable		$ 4,000
Accounts payable		2,690
Wages payable		1,950
Income taxes payable		5,580
Interest payable		30
Unearned rent revenue		6,000
Total liabilities		$ 20,250
Stockholders' equity:		
Capital stock		80,000
Retained earnings		25,942
Total stockholders' equity		$105,942
Total liabilities and stockholders' equity		$126,192

3

ACCOUNTING

Chapter 6: Merchandising Companies

- **Merchandising Companies**

Comparing Merchandising Activities with Manufacturing Activities:

Merchandising companies vs. **Manufacturing companies**

______________________________ vs ___________________________________

Selling merchandise introduces a new and major *cost of doing business*--**the cost to the merchandising company of the goods that it resells to its customers.** This cost is termed the ***cost of goods sold.*** In essence, the cost of goods sold is an expense; however, this item is of such importance to a merchandising company that it is shown separately from other expenses in the income statement.

Condensed income statement for a merchandising company:

COMPUTER CITY
Condensed Income Statement
For Year Ended December 31, 2010

Revenue from sales	**$900,000**
Less: Cost of goods sold	**540,000**
Gross Profit	**$360,000**
Less: Expenses	**270,000**
NET INCOME	**$ 90,000**

- **Operating Cycle of a Merchandising Company**

The series of transactions through which a business generates its revenue and its cash receipts from customers is called the _______________ __________. The *operating cycle* of a merchandising company consists of the following basics transactions:

(1)
(2)
(3)

As the word *cycle* suggests, this sequence of transactions repeats continuously. Some of the cash collected from the customers is used to purchase more merchandise, and the cycle begins again.

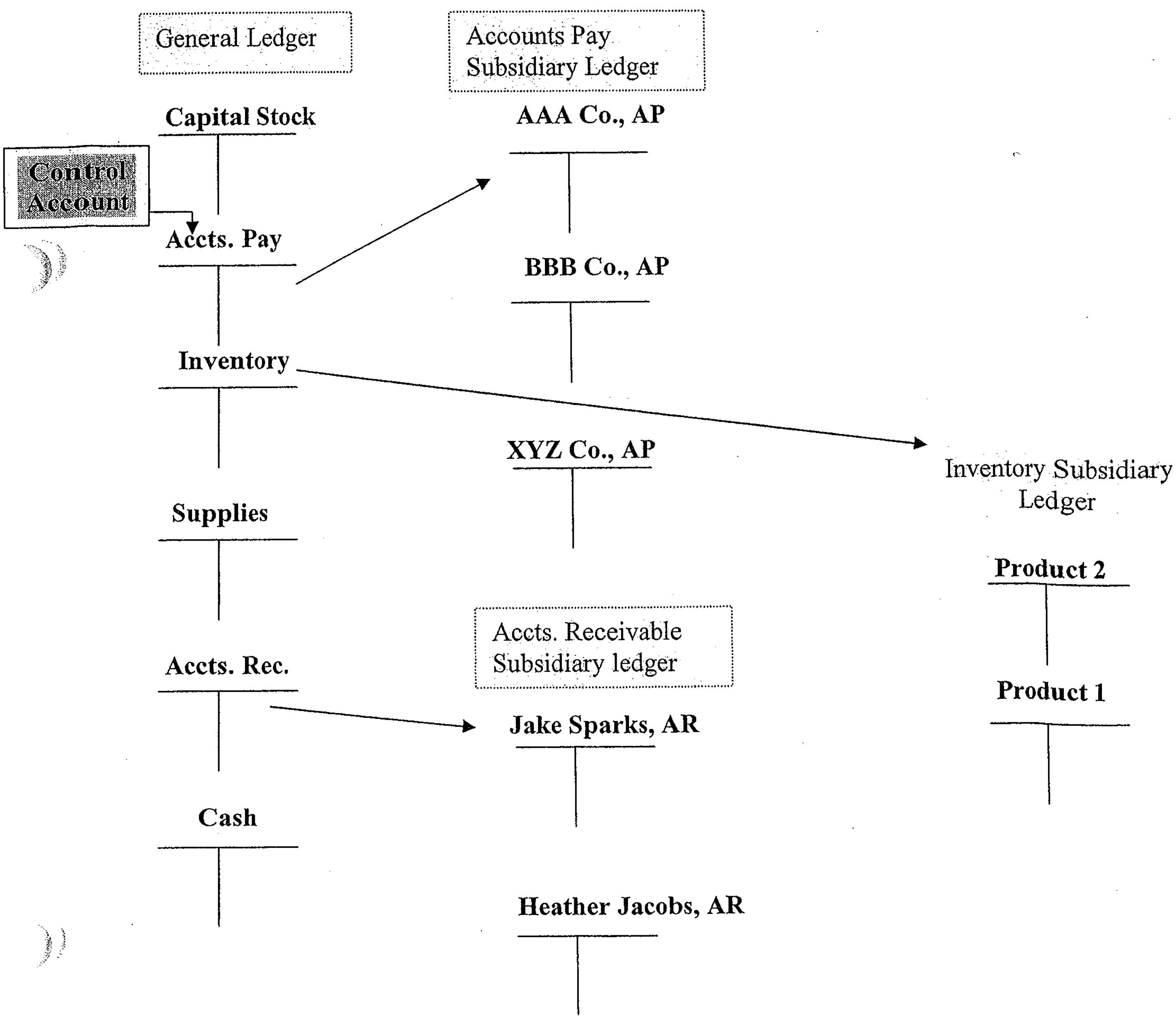
- **Accounting System Requirements for Merchandising Companies**

Although general ledger accounts such as AR & AP provide a useful overview of a company's financial activities, **they do not provide much of the detailed information needed in the daily business operations.**

This detailed information is found in an accounting record called a ________________ ________________. A **subsidiary ledger** contains a separate ________________ for each of the items included in the balance of a general ledger account.

***A general ledger account that summarizes the content of a subsidiary ledger is called a ____________ account. Examples are: AR, AP and Inventory**

General ledger accounts supported by a subsidiary ledger:



- **Inventory Systems—how do businesses keep track of their inventory?**
  - **Perpetual inventory system**—The inventory account is continuously ________________ to reflect items on hand. Purchases of merchandise are recorded by debiting an asset account entitled ______________________ at cost.
  - **Periodic inventory system**—*no* effort is made to keep up-to-date records of either inventory or the __________ of __________ sold. Instead, these amounts are determined only *periodically—usually at the end of the year.* The foundation of the periodic inventory system is the taking of a complete ***physical inventory*** at year-end.
  - Today, most businesses use computers to assist in maintaining ***perpetual*** systems. Therefore, we will focus only on the **perpetual inventory system**.
- Transactions of a merchandising business

<u>Purchases of Merchandise</u>

Sept 5 Worley Co. purchased 100 laser lights for resale for $30 per unit from Electronic City on account.

What account is debited? ____________________ 3,000
What account is credited? ________________________ 3,000

<u>Sales of Merchandise</u>

When merchandise is sold, two entries are necessary: one to recognize the ________________ ________________ and the second to recognize the related ______________ of ______________ sold.

Sept. 10 Worley Co. sold 10 laser lights for $50 per unit on account to ABC Radios.

*What account is debited?*____________________________ 500
*What account is credited?*_____________________ 500

*Remember, the matching principle requires that revenue be matched (offset) with all of the costs and expenses incurred in producing that revenue. Therefore, a second journal entry is required at the time of the sale to record the _________ of _________ sold.

*What account is debited?*___________________________. 300
What account is credited? ___________________ 300

(The second entry is based on the **cost** of the merchandise ***not*** on its retail price.)

Payment of Accounts Payable to Suppliers
On September 15, Worley Co. paid Electronic City $3,000 for the Sept. 5 purchase.

What account is debited? ______________________ 3,000
What account is credited? ______________________ 3,000

Collection of Accounts Receivable from customers
On September 22, Worley received $500 from ABC Radios as payment in full for their purchase on Sept. 10.

What account is debited? ______________________ 500
What account is credited? ______________________ 500

- ## Taking a Physical Inventory

The basic characteristic of the perpetual inventory system is that the Inventory account is *continuously updated* for all purchases and sales of merchandise. **In order to ensure the accuracy of their perpetual records, most businesses take a complete physical count of the merchandise on hand at least once a year.**

Reasonable amounts of inventory shrinkage are viewed as a normal cost of doing business. Examples include: ________________, ________________, ________________ and ________________.

Adjusting for Inventory shrinkage
At year-end the Inventory controlling account and the inventory subsidiary ledger of Worley Co. both show an inventory with a cost of $52,000. A physical count, however, reveals that some of the merchandise listed in the accounting records is missing; the items *actually on hand* have a total cost of $50,000. **(Inventory shortage of $2,000)**

What account is debited? ______________________ $2,000
What account is credited? ______________________ 2,000

- ## Closing Entries in a Perpetual Inventory System

As you know, *revenue* and *expense* accounts are **closed** at the end of each accounting period. A merchandising business with a perpetual inventory system makes closing entries that parallel those of a service-type business. What are some of the accounts of a merchandising business that would be closed?

▪ Transactions Relating to Purchases—Credit Terms & Discounts

In addition to the basic transactions illustrated and explained in this chapter, merchandising companies must account for a variety of additional transactions. Examples include ***discounts*** offered for prompt payment, ***merchandise returns***, and ***transportation*** **costs.**

Credit Terms and Cash Discounts

One common example of a credit term is ***"net 30 days,"*** or ***"n/30"*** meaning full payment is due in 30 days. Manufacturers and wholesalers usually allow their customers 30 or 60 days in which to pay for credit purchases. Frequently, however, sellers offer their customers a small discount to encourage earlier payment.

Perhaps the most common credit term offered by manufacturers and wholesalers are ***2/10, n/30.*** (Two ten, net thirty) This means that full payment is due in 30 days, but that the buyer may take a 2% discount if payment is made within 10 days.

▪ Recording Purchases at Net Cost

Most well-managed companies have a policy of taking advantage of *all* cash discounts available on purchases of merchandise. **These companies initially record purchases of merchandise at NET COST—that is, the invoice prices minus any available discount.**

Examples of net cost transactions:

On July 6 Play Clothes purchased $4,000 of merchandise on credit with terms of 2/10 n/30 from Kid's Clothes.. ***What account is debited? Credited?***

GENERAL JOURNAL			

On July 15 (within discount period), Play Clothes pays the full amount due to Kid's Clothes. ***What account is debited? Credited?***

GENERAL JOURNAL			

Now, assume that Play Clothes failed to make payment within the discount period. What account is debited? Credited?

GENERAL JOURNAL			

▪ Recording Purchases at Gross Invoice Price

As an alternative to recording purchases at ***net*** cost, some companies record purchases at the ***gross*** (total) invoice price. **Purchase discounts taken** are recorded when payment is made within the discount period.

On July 6, Play Clothes purchased merchandise of $4,000 on credit with terms 2/10, n/30 from Kid's clothes. ***What account would be debited? Credited?***

GENERAL JOURNAL			

On July 15, Play Clothes pays the full amount due to Kid's Clothes (within the discount period) ***What account would be debited? Credited?***

GENERAL JOURNAL			

Now, assume that Play Clothes waited until after the discount period (July 20) to pay the full amount. ***What account would be debited? Credited***?

GENERAL JOURNAL			

<u>Returns of Unsatisfactory Merchandise:</u>

On August 5 Play Clothes returned $500 of unsatisfactory merchandise purchased from Kid's Clothes, credit terms 2/10,n/30. (Initially this purchase was done at *net cost*) ***What account would be debited? Credited***?

GENERAL JOURNAL			

Transportation Costs on Purchases:

Transportation costs related to the acquisition of assets are part of the cost of the asset being acquired. Debit Inventory for the transportation costs and credit the payment (Cash or AP)

Inventory 50
Cash 50

Transactions Relating to Sales

Credit terms* and *merchandise returns* also affect the amount of sales revenue earned by the seller.** To the extent that credit customers take advantage of cash discounts or return merchandise for a refund, the seller's revenue is reduced. Thus, revenue shown in the income statement of a merchandising concern is often called ***net sales.

SALES
LESS: SALES RETURNS & ALLOWANCES
LESS: SALES DISCOUNTS
= NET SALES

Sales Returns & Allowances

Most merchandising companies allow customers to obtain a ***refund*** by returning any merchandise considered to be unsatisfactory. If the merchandise has only minor defects, customers sometimes agree to keep the merchandise if an ***allowance*** (reduction) is made in the sales price.

Remember the original sales transaction requires two parts. On August 2 Kid's Clothes sold $2,000 of merchandise to Play Clothes, credit terms 2/10, n/30. Kid Clothes originally paid $1,000 for the merchandise.

1)	Accounts Receivable (Play Clothes)	2,000	
	Sales		2,000
2)	Cost of the Goods Sold	1,000	
	Inventory		1,000

On August 5, Play Clothes returned $500 of unsatisfactory merchandise to Kid's Clothes from the Aug. 2 sale. Kid's Clothes ***cost*** for this merchandise was $250. **The return decreases the Sales account.** Do not credit sales; instead use a new account, **Sales Return & Allowance.**

Sales ________________________________ 500

________________________ (Play Clothes) 500

(Sales returns & allowances is a contra-revenue account—it is deducted from gross sales revenue to determine net sales). It is good to keep track of Sales Returns & Allowances because it gives management an indication of *customer satisfaction.*

A second entry is made to remove the cost of this merchandise from the cost of Goods Sold and restore it to the inventory records:

______________________ **. 250**

        ____________________________ **. 250**

Notice that this entry is based on the cost of the returned merchandise to the seller, not on its sales price.

Sales Discounts

On July 6, Kid Clothes sold $4,000 of merchandise to Play Clothes on credit, 2/10, n/30. The merchandise originally cost Kid's Clothes $2,000.

Accounts Receivable (Play Clothes)	**4,000**	
Sales		**4,000**
Cost of Goods Sold	**2,000**	
Inventory		**2,000**

On July 15, Kid's Clothes receives full amount due from Play Clothes from the July 6 sale.(within discount period)

_________________ **. 3,920**

__________________________ **. 80**

        ____________________________ **. . .4000**

Now, assume that it wasn't until July 20 (after discount period) that Kid's Clothes received the full amount due from Play Clothes from the July 6 sale.

____________________ 4,000

        _______________________________ 4,000

Delivery Expenses

If the seller incurs any costs in delivering merchandise to the customer, these costs are debited to an expense account entitled Delivery Expense.

_________________ **Expense 50**

        _____________ **. 50**

Accounting for Sales Taxes

Sales taxes are levied by many states and cities on retail sales. Sales taxes are imposed on the consumer, not on the seller. However, the seller must collect the tax, file tax returns at times specified by law, and remit to the governmental agencies the taxes collected.

On February 2 Play Clothes sold $1,000 in merchandise. Sales tax amounted to $80 and will be remitted to the state in the near future. ($1,000 sale x 8% tax = $80 sales tax)

______________ (or Accts Receivable) 1,080

Sales Tax ______________ 80

______________ 1,000

- Special Journals Provide Speed & Efficiency

A special journal is an accounting record or device designed to record a specific type of routine transaction quickly and efficiently. Most businesses use separate special journals to record repetitive transactions such as **sales of merchandise, cash receipts, cash payments, purchases of merchandise on account.**

When a merchandising company buys merchandise to resell, the transaction is recorded in a ______________ journal. (MUST PURCHASE ON ACCOUNT)

When a merchandising company sells merchandise to its customers, the transaction is recorded in a ______________ journal. (ON ACCOUNT)

When a merchandising business pays its salaries expense, the transaction is recorded in a ________ ______________ journal. (or ANY PAYMENT)

When a merchandising business receives a payment on account from a customer, it is recorded in a ________ ______________ journal. ($)

When a customer is given an allowance for merchandise that was not to the customer's satisfaction, the transaction would be recorded in a __________ journal.

Forms of Financial Statements

Illustration 5-11

PW AUDIO SUPPLY, INC.
Income Statement
For the Year Ended December 31, 2008

Sales revenues		
Sales		$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

Key Items:

- Net sales
- Gross profit
- Gross profit rate

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

Forms of Financial Statements

Illustration 5-11

PW AUDIO SUPPLY, INC.
Income Statement
For the Year Ended December 31, 2008

Sales revenues		
Sales		$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		
Selling expenses		
Store salaries expense	45,000	
Advertising expense	16,000	
Depreciation expense—store equipment	8,000	
Freight-out	7,000	
Total selling expenses	76,000	
Administrative expenses		
Salaries expense	19,000	
Utilities expense	17,000	
Insurance expense	2,000	
Total administrative expenses	38,000	
Total operating expenses	→	114,000
Income from operations		30,000

Key Items:

- Net sales
- Gross profit
- Gross profit rate
- Operating expenses

Forms of Financial Statements

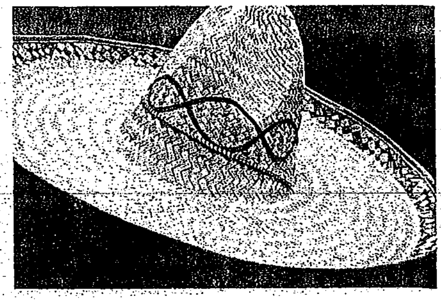
Key Items:

- Net sales
- Gross profit
- Gross profit rate
- Operating expenses
- Nonoperating activities
- Net income

Illustration 5-11

PW AUDIO SUPPLY, INC.
Income Statement
For the Year Ended December 31, 2008

Sales revenues		
Sales		$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
Income from operations		30,000
Other revenues and gains		
Interest revenue	3,000	
Gain on sale of equipment	600	
	3,600	
Other expenses and losses		
Interest expense	1,800	
Casualty loss from vandalism	200	
	2,000	
		1,600
Net income		$ 31,600



Mex-Tex Foods Inc.

End of the Fiscal Year Results:

Current Assets:	$18,000
Current Liabilities:	$12,000
Net Income:	$65,000
Total Revenue:	$205,000
Average Stockholders' equity:	$130,000

Determine the following:

Evaluating Profitability

Net Income Percentage ______________

Return on Equity ______________

*What do these measurements mean for Tex-Mex Food's profitability?

Evaluating Solvency

Working Capital ______________

Current Ratio ______________

*What do you think of the corporation's solvency in the short term?

Mandarin Foods

End of the Fiscal Year Results:

Current Assets:	$28,000
Current Liabilities:	$24,000
Net Income:	$44,000
Total Revenue:	$180,000
Average Stockholders' equity:	$125,000

Determine the following:

Evaluating Profitability

Net Income Percentage ______________

Return on Equity ______________

*What do these measurements mean for Mandaran Food'sprofitability?

Evaluating Solvency

Working Capital ______________

Current Ratio ______________

*What do you think of the corporation's solvency in the short term?

Guitar Universe, Inc.

End of the Fiscal Year Results:

Current Assets: $32,000
Current Liabilities: $24,000
Net Income: $45,000
Total Revenue: $180,000
Average Stockholders' equity: $105,000

Determine the following:

Evaluating Profitability

Net Income Percentage ______________

Return on Equity ______________

***What do these measurements mean for Guitar Universe's profitability?**

Evaluating Solvency

Working Capital ______________

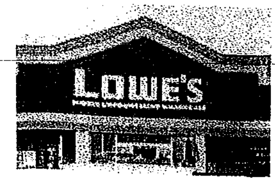
Current Ratio ______________

***What do you think of the corporation's solvency in the short term?**

PROFITABILITY AND SOLVENCY

Internet activity: www.finance.yahoo.com

Directions: Choose two public companies in the same industry (competing companies) and compare the profitability and solvency measurements of these companies.



Company A

____

PROFITABILITY

Net Income Percentage: ______________

Return on Equity: ______________

SOLVENCY

Working Capital: ______________

Current Ratio: ______________

Company B

____

PROFITABILITY

Net Income Percentage: ______________

Return on Equity: ______________

SOLVENCY

Working Capital: ______________

Current Ratio: ______________

Listed below are eight typical merchandising transactions of Everyday Auto Parts, a retail auto supply store.

a) Purchased merchandise from Acme Wholesale on account
b) Paid an account payable to a supplier.
c) Sold auto merchandise for cash
d) Sold auto merchandise on account
e) Collected an account receivable
f) Returned merchandise to a supplier, receiving credit against the amount owed.
g) Gave a cash refund to a customer who returned merchandise
h) Reduced the account receivable from a credit customer who returned merchandise.

Amount the accounting records of Everyday Auto Parts are subsidiary ledgers for inventory, accounts receivable, and accounts payable. For each of the above transactions, indicate any subsidiary ledger (or ledgers) to which the transaction would be posted. Use the following codes:

Inv = Inventory subsidiary ledger

AP = Accounts payable subsidiary ledger

AR = Accounts receivable subsidiary ledger

Also indicate whether each posting causes the balance in the subsidiary ledger account to increase or decrease.

EX.

Transaction	Subsidiary ledger	Effect on Subsidiary Account Balance
A	Inv	Increase
	AP	Increase

Office Solutions sells fax machines, copiers and other types of office equipment. On May 10, the company purchased for the first time a new plain paper fax machine manufactured by Mitsui Corporation. Transactions relating to this product during May and June were as follows.

May 10	Purchases five P-500 fax machines on account from Mistui Corporation, at a cost of $300 each. Payment due in 30 days.
May 23	Sold four P-500 fax machines on account to Foster & Cole, stockbrokers; sales price $500 per machine. Payment due in 30 days.
May 24	Purchased an additional seven P-500 fax machines on account from Mitsui. Cost, $300 per machine. Payment due in 30 days.
June 9	Paid $1,500 cash to Mitsui Corporation for the fax machines purchased on May 10.
June 19	Sold two P-500 fax machines to Tri-State Reality for cash. Sales price, $525 per machine.
June 22	Collect $2,000 from Foster & Cole in full settlement of the credit sale on May 23

Prepare journal entries to record these transactions. The company uses perpetual inventory system.

General Journal

Date		Account Titles	Ref.	Debit		Credit	

Claypool Hardware is the only hardware store in a remote area of northern Minnesota. Some of Claypool's transactions during the current year are as follows:

Nov. 5	Sold lumber on account to Bemidji Construction, \$13,390. The inventory subsidiary ledger shows the cost of the merchandise was \$9,105.
Nov. 9	Purchased tools on account from Owatonna Tool Company, \$3,800.
Dec. 5	Collected in cash the \$13,390 account receivable from Bemidji Construction.
Dec. 9	Paid the \$3,800 owed to Owatonna Tool Company.
Dec. 31	Claypool's personnel counted the inventory on hand and determined its cost to be \$182,080. The accounting records, however, indicate inventory of \$183, 790 and a cost of goods sold of \$695,222. The physical count of the inventory was observed by the company's auditors and is considered correct.

Prepare journal entries to record these transactions. The company uses perpetual inventory system.

General Journal

Date		Account Titles	Ref.	Debit		Credit	

Steve's Stereo shop sells home stereos. Some of their transactions during the month were:

May 4 — Purchased 6 Stereo's on account from Erik Electronics, at a cost of $200 each. Payment is due in 30 days.

May 13 — Sold 2 stereos on account to K & K. Sales price $375 per stereo. Payment is due in 30 days.

May 18 — Collected in cash the $750 receivable from K & K.

May 23 — Paid the $1,200 owed to Erik Electronics.

May 31 — At the end of the month Steve's Stereo shops inventory account showed a balance of $64,500, but when a physical inventory was taking the amount of inventory totaled $62,750.

Prepare the necessary entries for the transactions above.

General Journal

Date		Account Titles	Ref.	Debit		Credit	

Net Cost and Gross Price Methods

Alex Appliance uses a perpetual inventory system. The following are three merchandising transactions:

January 10	Purchased 10 televisions from AZ Industries on account. Invoice price, 400 per unit, for a total of $4,000.. The terms of the purchase were 2/10, n/30
January 12	Returned 1 of the televisions and received full credit.
January 17	Paid freight on purchase from AZ Industries for $50.
January 20	Paid the account payable to AZ Industries within the discount period.

A. Prepare the entries to record these transactions assuming Alex Appliance records purchase of merchandise at:
   1. Net Cost
   2. Gross Invoice Price

B. Assume Alex Appliance did not pay AZ Industries within the discount period but instead paid the full invoice price on July 10. Prepare journal entries to record this payment assuming the original liability had been recorded at:
   1. Net Cost
   2. Gross Invoice Price

General Journal

Date		Account Titles	Ref.	Debit		Credit	

Net Cost and Gross Price Methods

Grace Galaxy uses a perpetual inventory system. The following are her merchandising transactions:

January 10	Purchased 10 telescopes from Sam's Space Shop on account. Invoice price, 600 per unit. The terms of the purchase were 3/10, n/30
January 12	Returned 3 of the telescopes and received full credit.
January 17	Paid freight on purchase from Sam's for $100.
January 20	Paid the account payable to Sam's within the discount period.

A. Prepare the entries to record these transactions assuming Grace Galaxy records purchase of merchandise at:
   1. Net Cost
   2. Gross Invoice Price

B. Assume Grace Galaxy did not pay Sam's Space Shop within the discount period but instead paid the full invoice price on July 10. Prepare journal entries to record this payment assuming the original liability had been recorded at:
   1. Net Cost
   2. Gross Invoice Price

General Journal

Date		Account Titles	Ref.	Debit		Credit	

The following is a series of related transactions between Sunbelt Sandals and Specialty Shoes, a chain of retail clothing stores:

Feb. 9	Sunbelt Sandals sold Specialty Shoes 100 pairs of sandals. These sandals were sold on account with terms 2/10, n/30. The cost of these sandals to Sunbelt Sandals was $30 per pair, and the sales price was $70 per pair.
Feb. 12	FedEx charged $70 for delivering this merchandise to Specialty Shoes. These charges were split evenly between the buyer and the seller, and were paid immediately in cash.
Feb. 13	Specialty Shoes returned 5 pairs of sandals because they were the wrong size. Sunbelt allowed Specialty Shoes full credit for this return.
Feb. 19	Specialty Shoes paid the remaining balance to Sunbelt Sandals within the discount period.

Both companies use a perpetual inventory system.

Instructions

- **a.** Record this series transactions in the general journal of Specialty Shoes. (The company records purchases of merchandise at *net cost*)
- **b.** Record this series transactions in the general journal of Specialty Shoes. (This time use the Gross method)
- **c.** Record this series of transactions in the general journal of Sunbelt Sandals. (The company records sales at gross sales price.)

General Journal

Date		Account Titles	Ref.	Debit		Credit	

Problem 6.5A
Merchandising Transactions

The following is a series of related transactions between Leggy Pants and Viking, a chain of retail clothing stores:

Sept. 11	Leggy Pants sold Viking 200 pairs of pants on account, terms 1/10, n/30. The cost of these pants to Leggy Pants was $30 per pair, and the sales price was $70 per pair.
Sept. 14	United Express charged $60 for delivering this merchandise to Viking. These charges were split evenly between the buyer and the seller, and were paid immediately in cash.
Sept. 15	Viking returned 5 pairs of pants to Leggy Pants because they were the wrong size. Leggy Pants allowed Viking full credit for this return.
Sept. 21	Viking paid the remaining balance due to Leggy Pants within the discount period.

Both companies use a perpetual inventory system.

Instructions

a. Record this series of transactions in the general journal of Leggy Pants. (The company records sales at gross sales price.)

b. Record this series transactions in the general journal of Viking. (The company records purchases of merchandise at *net cost* and uses a Transportation-in account to record transportation charges on inbound shipments.)

c. Viking does not always have enough cash on hand to pay for purchases within the discount period. However, it has a line of credit with its bank, which enables Viking to easily borrow money for short periods of time at an annual interest rate of 11%. (The bank charges interest only for the number of days until Viking repays the loan.) As a matter of general policy, should Viking take advantage of 1/10, n/30 cash discounts even if it must borrow the money to do so at an annual rate of 12%? Explain fully – and illustrate any supporting computations.

General Journal

Date		Account Titles	Ref.	Debit		Credit	

Merchandising transactions

The following is a series of related transactions between Taylor TV's, a TV wholesaler, and Nick's Knack's, a chain of retail electronic stores.

February 9	Taylor TV's sold Nick's Knack's 50 TV's on account, terms 2/10, n/30. The cost of these TV's to Taylor TV's was $80, and the sales price was $200 per pair.
February 12	Nick's Knack's returned 10 TV's to Taylor TV's because they were the wrong size. Taylor TV's allowed Nick's Knack's full credit for this return.
February 14	United Shipping charged $150 for delivering the merchandise to Nick's Knack's. These charges were split evenly between the buyer and seller, and were paid immediately in cash.
February 19	Nick's Knack's paid the remaining balance due to Taylor TV's within the discount period.

A. Record this series of transaction in the general Journal for Nick's Knack's. (The company records purchases of merchandise at *net cost*)

B. Assume Nick's Knack's did not pay Taylor TV's within the discount period but instead paid the full invoice price on March 1. Prepare journal entries to record this payment

C. Record this series of transaction in the general Journal for Nick's Knack's. (The company records purchases of merchandise at *Gross Method*)

D. Assume Nick's Knack's did not pay Taylor TV's within the discount period but instead paid the full invoice price on March 1. Prepare journal entries to record this payment

E. Record this series of transactions in the general journal for Taylor TV's. (The company records sales at gross sales price.)

F. Assume Nick's Knack's did not pay Taylor TV's within the discount period but instead paid the full invoice price on March 1. Prepare journal entries to record this payment

General Journal

Date	Account Titles	Ref.	Debit	Credit

General Journal

Date		Account Titles	Ref.	Debit		Credit	

Merchandising transactions

The following is a series of related transactions between Shaq Shoes, as shoe wholesaler, and Sam's Sneaks, a chain of retail shoe stores.

February 9	Shaq Shoes sold Sam's Sneaks 100 pairs of hiking boots on account, terms 1/10, n/30. The cost of these boots to Shaq Shoes was $60 per pair, and the sales price was $100 per pair.
February 12	Sam's Sneaks returned 10 pairs of boots to Shaq Shoes because they were the wrong size. Shaq Shoes allowed Sam's Sneaks full credit for this return.
February 14	United Shipping charged $100 for delivering the merchandise to Sam's Sneaks. These charges were split evenly between the buyer and seller, and were paid immediately in cash.
February 19	Sam's Sneaks paid the remaining balance due to Shaq Shoes within the discount period.

A. Record this series of transaction in the general Journal for Sam's Sneaks. (The company records purchases of merchandise at *net cost*)

B. Assume Sam's Sneaks did not pay Shaq Shoes within the discount period but instead paid the full invoice price on March 1. Prepare journal entries to record this payment

C. Record this series of transaction in the general Journal for Sam's Sneaks. (The company records purchases of merchandise at *Gross Method*)

D. Assume Sam's Sneaks did not pay Shaq Shoes within the discount period but instead paid the full invoice price on March 1. Prepare journal entries to record this payment

E. Record this series of transactions in the general journal for Shaq Shoes. (The company records sales at gross sales price.)

F. Assume Sam's Sneaks did not pay Shaq Shoes within the discount period but instead paid the full invoice price on March 1. Prepare journal entries to record this payment

General Journal

Date		Account Titles	Ref.	Debit		Credit	

– The Recording Process

General Journal

Date		Account Titles	Ref.	Debit		Credit	