

CHAPTER 4

ACCOUNTING FOR MERCHANDISING OPERATIONS

Key Terms and Concepts to Know

Income Statements:

- Single-step income statement
- Multiple-step income statement
- $\text{Gross Margin} = \text{Gross Profit} = \text{Net Sales} - \text{Cost of Goods Sold}$
- $\text{Gross Margin ratio} = \text{Gross Margin} / \text{Net Sales}$

Operating Cycle:

- Purchase merchandise from vendors for inventory on account or for cash
- Sell inventory to customers on account
- Collect cash from customers
- Pay cash to vendors
- Repeat again and again
- Note that these steps overlap so that the cash collections from customers may occur before and/or after the cash payments to vendors.

Merchandise Inventory:

- Merchandise Inventory (Inventory or MI) refers to the goods the company has purchased and intends to sell to others.
- Inventory is a current asset since the company intends to sell it within one year.

Cost of Goods Sold:

- Inventory that has been sold becomes an expense, Cost of Goods Sold, in the period of sale.

Inventory Systems:

- Perpetual Inventory System records all inventory transactions as they occur in the Merchandise Inventory account.
- Perpetual Inventory System records all purchase-related inventory transactions as they occur in separate accounts and records the cost of goods sold only at the end of the period.

- Shrinkage is the cost of inventory not on hand and not sold. It is part of cost of goods sold under either inventory system.

Purchasing Transactions:

- Inventory account is increased for the cost of the merchandise purchased plus the freight cost necessary to transport the inventory to the buyer's place of business (FOB shipping point).
- Inventory is always recorded at the final cost to the buyer, purchase price less allowances received from the seller and any cash discounts taken
- Trade discounts are deducted as part of the initial purchase transaction; they are not a purchase discount.

Purchase returns:

- Inventory account is decreased for the cost of the merchandise returned to the seller less any allowances or discounts already recorded in the ledger.

Sales Transactions:

- Inventory account is decreased and cost of goods sold is increased for the cost of the merchandise sold.
- The freight cost necessary to transport the inventory to the buyer's place of business is an expense in the period of sale (FOB Destination). Transportation Out or Freight Out are typical accounts used to record the expense.
- The selling price of the merchandise sold represents revenue to the seller and is recorded in a separate transaction.
- Trade discounts are deducted as part of the initial sale transaction; they are not a sales discount nor a contra-revenue.

Sales Returns:

- Inventory account is increased and cost of goods sold is decreased for the cost of the merchandise returned by the buyer.
- Sales returns and allowances is increased and cash or A/R is decreased for the selling price of the merchandise returned by the buyer.

ALWAYS KNOW WHETHER YOU ARE THE BUYER OR THE SELLER IN THE TRANSACTION. SOME OF THE ACCOUNTS USED AND SOME OF THE DOLLAR AMOUNTS RECORDED WILL DIFFER DEPENDING ON WHETHER YOU ARE THE BUYER OR SELLER IN THE TRANSACTION.

Transportation (Freight) Costs:

- FOB Shipping Point – Purchaser is responsible for paying the shipping charges. They are usually prepaid by the seller and added to the invoice. Buyer adds the shipping costs to inventory. If seller prepays, seller has a receivable from buyer.

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- FOB Destination – Seller is responsible for paying the shipping charges and they are recorded as the expense Transportation Out. Buyer does not make an entry.
- Transportation (freight) costs are not subject to a cash discount.

Credit Terms:

- Generally take the form of 2/10, n/30 where
 - 2 is the discount %
 - 10 is the discount period in days
 - n is the net (total) amount to pay
 - 30 is the number of days after the invoice date that the net amount is due
- Only purchases are subject to the discount; transportation or freight costs paid by the seller on behalf of the buyer are not subject to a discount.
- Cash discounts reduce the cost of inventory for the buyer (credit merchandise inventory)
- Cash discounts reduce revenue for the seller (debit sales discounts, a contra-revenue account)

Acid-Test ratio and Gross Margin ratio

Key Topics to Know

Note: The same example transactions are presented for Purchase Transactions and Sales Transactions to highlight the differences between cost and selling price.

Purchase Transactions

When companies purchase goods they intend to sell to customers, the transaction is recorded in the Merchandise Inventory account, a current asset. Inventory is recorded at cost, which includes the price paid for the goods plus all necessary costs of getting the inventory to the company's place of business and ready to sell. The rules of FOB determine whether freight costs are included in the cost of inventory.

Example 1: \$800 of inventory is purchased for cash, FOB shipping point. In a separate transaction, the purchaser pays \$100 of shipping charges to the shipping company, which are added to the cost of the inventory. Therefore the total cost of the inventory purchased is \$800 purchase price + \$100 shipping charges:

Merchandise Inventory	800	
Cash		800
Merchandise Inventory	100	
Cash		100

\$200 of merchandise purchased is returned prior to payment:

Cash	200	
Merchandise Inventory		200

Example 2: \$800 of inventory is purchased on account, FOB shipping point. The seller pays \$100 to the shipping company on behalf of the buyer, which is added to the seller's invoice. The credit terms offered by the seller are 2/10, n/30. Therefore the total cost of the inventory purchased is \$800 purchase price + \$100 shipping charges:

Merchandise Inventory	900	
A/P		900

\$200 of merchandise purchased is returned prior to payment.

A/P	200	
Merchandise Inventory		200

When the invoice is paid within the discount period

\$800 purchase - \$200 return = \$600 merchandise * 2% = \$12 discount

\$700 owed (\$600 + \$100 shipping) - \$12 discount = \$688 paid

A/P	700	
Cash		688
Merchandise Inventory		12

Example 3: \$800 of inventory is purchased on account, FOB destination. In a separate transaction, the seller pays \$100 of shipping charges to the shipping company. The buyer records only the cost of the merchandise. The credit terms offered by the seller are 2/10, n/30. Therefore the total cost of the inventory purchased is \$800 purchase price.

Merchandise Inventory	800	
A/P		800

\$200 of merchandise purchased is returned prior to payment.

A/P	200	
Merchandise Inventory		200

When the invoice is paid within the discount period assuming credit terms of 2/10, n/30:

\$800 purchase - \$200 return = \$600 merchandise * 2% = \$12 discount

\$600 owed - \$12 discount = \$588 paid

A/P	500	
Cash		490
Merchandise Inventory		10

Practice Problem #1

Journalize the following purchase related transactions:

- Jingle Co. purchased \$4,000 worth of merchandise on account, terms 2/10, n/30, FOB shipping point. Prepaid transportation charges of \$200 were added to the invoice.
- Returned \$500 of merchandise purchased in (a).
- Paid on account for purchases in (a), less return (b) and discount.

Sales Transactions

When companies sell merchandise inventory, the transaction requires two journal entries: the first entry records the revenue from the sale at the selling price and the second entry decreases the inventory account and records the expense of the sale at cost.

Revenue (sales) is recorded at the time the transaction occurs, regardless of whether payment is received from the buyer. Revenue is always greater the cost of the goods being sold.

Inventory is decreased for the cost of the inventory sold, which includes the price paid for the goods plus all necessary costs of getting the inventory to the company's place of business and ready to sell as noted above.

The rules of FOB determine whether freight costs are recorded as transportation out, a selling expense.

The seller would record the examples in Purchase Transactions above as follows. Note that the seller had a gross margin ratio of 20%.

Example 1: Inventory is sold for \$800 cash (FOB shipping point. In a separate transaction, the purchaser pays \$100 of shipping charges to the shipping company. The total cost of the inventory when purchased was \$640 ($800 - (20\% * 800)$):

Cash	800	
Sales		800
Cost of Goods Sold	640	
Merchandise Inventory		640

\$200 of merchandise purchased is returned by the customer prior to payment:

Sales returns and Allowances	200	
Cash		200
Merchandise Inventory	160	
Cost of Goods Sold		160

Example 2: \$800 of inventory is sold on account, FOB shipping point. The seller pays \$100 to the shipping company on behalf of the buyer, which is added to the seller's invoice. The credit terms offered by the seller are 2/10, n/30. Therefore the total account receivable is \$900 selling price + \$100 shipping charges. The total cost of the inventory when purchased was \$640 ($800 - (20\% * 800)$):

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A/R	900	
Sales		800
Cash		100
Cost of Goods Sold	640	
Merchandise Inventory		640

\$200 of merchandise purchased is returned prior to payment.

Sales Returns and Allowances	200	
A/R		200
Merchandise Inventory	160	
Cost of Goods Sold		160

When the invoice is paid within the discount period

\$800 purchase - \$200 return = \$600 merchandise * 2% = \$12 discount

\$700 owed (\$600 + \$100 shipping) - \$12 discount = \$688 paid

Cash	688	
Sales Discounts	12	
A/R		700

Example 3: \$800 of inventory is sold on account, FOB shipping point. In a separate transaction, the seller pays \$100 to the shipping company. Therefore the total account receivable is \$800 selling price. The total cost of the inventory when purchased was \$640 (800 - 20% * 800):

A/R	800	
Sales		800
Cost of Goods Sold	640	
Merchandise Inventory		640
Transportation Out	100	
Cash		100

\$200 of merchandise purchased is returned prior to payment.

Sales Returns and Allowances	200	
A/R		200
Merchandise Inventory	160	
Cost of Goods Sold		160

When the invoice is paid within the discount period

\$800 purchase - \$200 return = \$600 merchandise * 2% = \$12 discount

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\$600 owed - \$12 discount = \$588 paid

Cash	588	
Sales Discounts	12	
A/R		600

Practice Problem #2

Journalize the following sales related transactions.

- a) Sold merchandise on account to Jangle Co., \$5,000, terms FOB Shipping Point, 2/10, n/30. The cost of the merchandise sold was \$3,000. Paid transportation charges of \$200, which were added to the invoice.
- b) Sold merchandise on account to Comet Co., \$10,000, terms FOB Destination, 1/10, n/30. The cost of the merchandise was \$6,000.
- c) Paid transportation charges of \$400 for delivery of merchandise sold to Comet Co.
- d) Issued credit memorandum for \$2,000 to Comet Co. for merchandise returned from sale in (b). The cost of the merchandise was \$1,200.
- e) Received amount due from Jangle Co. within the discount period.
- f) Received amount due, less return and discount from Comet Co.
- g) Sold merchandise on account to Jangle Co., \$5,000, terms FOB Shipping Point, 2/10, n/30. The cost of the merchandise sold was \$3,000. Paid transportation charges of \$200, which were added to the invoice.
- h) Sold merchandise on account to Comet Co., \$10,000, terms FOB Destination, 1/10, n/30. The cost of the merchandise was \$6,000.
- i) Paid transportation charges of \$400 for delivery of merchandise sold to Comet Co.
- j) Issued credit memorandum for \$2,000 to Comet Co. for merchandise returned from sale in (b). The cost of the merchandise was \$1,200.
- k) Received amount due from Jangle Co. within the discount period.
- l) Received amount due, less return and discount from Comet Co.

Inventory Shrinkage

When a company takes a physical count of its inventory, should it reasonably expect to find all of the inventory items present and accounted for? Unfortunately, this is not always the case. Inventory could have been stolen (e.g. shoplifting) or damaged, disposed of and not reported as such (e.g. the inventory fell off the shelf in the warehouse, was damaged by the fall and was disposed of by the cleaning crew). Although companies try to protect their inventory through proper internal controls, inventory losses or shrinkage still occur. Under the matching principle, these losses are recorded as expenses in the period in which they occur to match them against the revenue earned. Although the text suggests that they should be recorded as cost of goods sold, in practice they may be recorded in a separate inventory shrinkage expense account reported within cost of goods sold.

Example: The balance in the Merchandise Inventory account in the general ledger was \$300,000 before adjustment. A Physical Inventory was taken and the value of the merchandise on hand was \$294,000.

Adjusting entry required:

Cost of Merchandise Sold	6,000	
Merchandise Inventory		6,000

Multi-Step Income Statement

The Multi-Step Income statement provides a substantial amount of additional significant information to the user of the financial statements. It also incorporates revenues and expenses unique to the merchandising company versus a service provider.

Key changes compared to the single-step income statement include:

- Gross-to-Net Sales to account for contra-revenue accounts
- Gross Profit to report the margin or profit remaining after covering the cost of merchandise sold that is available to cover operating expenses
- Separating Operating Expenses into selling expenses and administrative expenses to provide an additional level detail
- Income from Operations to report the profitability of the company's reason for being in business
- Other Income and Other Expense to identify the revenues and expenses not related to the company's reason for being in business

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- In real life, income tax expense would be reported between net other revenues and expenses and Net Income. It is excluded in this illustration and in the textbook for simplicity.

Gross Sales		\$500,000
- Sales Returns & allow.	\$5,000	
- Sales Discounts	<u>3,000</u>	<u>8,000</u>
Net Sales		492,000
Cost of Merchandise Sold		<u>294,000</u>
Gross Profit		198,000
Operating Expenses:		
Selling Expenses	50,000	
Admin Expense	<u>45,000</u>	
Total Operating Expenses		<u>95,000</u>
Income from Operations		103,000
Other Income:		
Interest Revenue	1,000	
Other Expenses:		
Interest Expense	<u>700</u>	<u>300</u>
Net Income		\$102,700

Practice Problem #3

Using the format for the multi-step income statement, compute the following:

- Calculate Net Sales and Gross Profit** if, Sales are \$375,000, Sales Returns and Allowances are \$32,000, Sales Discounts are \$12,000 and Cost of Merchandise Sold is \$255,000.
- Calculate Sales Returns and Allowances and Cost of Merchandise Sold** if, Sales are \$750,000, Sales Discounts are \$9,000, Net Sales are \$736,000 and Gross Profit is \$310,000.
- Calculate Sales and Net Sales** if, Sales Returns and Allowances are \$25,000, Sales Discounts are \$15,000, Cost of Merchandise Sold is \$620,000 and Gross Profit is \$185,000.

Practice Problem #4

Journalize the following related transactions.

- a) Purchased mdse on account from Blitzen Co., list price \$20,000, trade discount 25%, terms FOB shipping point, 2/10, n/30, with prepaid transportation costs of \$650 added to the invoice.
- b) Purchased merchandise on account from Cupid Co., \$8,000, terms FOB destination, 1/10, n/30.
- c) Sold merchandise on account to Donner Co., \$9,800, terms 2/10, n/30. The cost of the merchandise sold was \$5,800.
- d) Returned \$2,000 of merchandise purchased from Cupid Co. (b)
- e) Paid Blitzen Co. on account for purchase in (a) less discount.
- f) Received merchandise returned by Donner Co. from sale in (c), \$1,800. The cost of the merchandise returned was \$1,080.
- g) Paid Cupid Co. on account for purchase in (b) less return (d) and discount.
- h) Received cash on account from Donner Co. for sale in (c) less return (f) and discount.
- i) Perpetual inventory records indicate that \$85,000 of merchandise should be on hand. The physical inventory indicates that \$81,350 of merchandise is on hand.

SAMPLE MULTIPLE CHOICE QUESTIONS

1. The difference between net sales and cost of merchandise sold for a merchandising business is:
 - a) Sales
 - b) Net Sales
 - c) Gross Profit
 - d) Gross Sales

2. When purchases of merchandise are made on account, the transaction would be recorded with the following entry:
 - a) Debit Accounts Payable, credit Merchandise Inventory
 - b) Debit Merchandise Inventory, credit Accounts Payable
 - c) Debit Merchandise Inventory, credit Cash
 - d) Debit Cash, credit Merchandise Inventory

3. When a corporation sells merchandise and the terms are FOB shipping point and pays the shipping costs, the seller would record the transportation costs with the following entry:
 - a) Debit Cash, credit Accounts Receivable
 - b) Debit Accounts Receivable, credit Sales
 - c) Debit Accounts Receivable, credit Cash
 - d) Debit Merchandise Inventory, credit Accounts Payable

4. Multiple-step income statements:
 - a) Show gross profit but not income from operations
 - b) Show both gross profit and income from operations
 - c) Show neither gross profit nor income from operations
 - d) Show income from operations but not gross profit

5. Which of the following would be reported on the retained earnings statement for the current year?
 - a) Dividends for the current year
 - b) Sales
 - c) Cost of merchandise sold
 - d) Merchandise inventory

6. A sales invoice included the following information: merchandise price, \$12,000; transportation, \$500; terms 2/10, n/eom, FOB shipping point. Assuming that a credit for merchandise returned of \$600 is granted prior to payment, that the transportation is prepaid by the seller, and that the invoice is paid within the discount period, what is the amount of cash received by the seller?
 - a) \$11,662
 - b) \$11,672
 - c) \$12,250
 - d) \$11,172

7. An acid-test ratio of 1.5 means
 - a) Quick assets are 1.15 times as large as sales.
 - b) That every \$1.50 of quick assets generates \$1.00 in sales.
 - c) That every \$1.50 of sales generates \$1.00 of liabilities.
 - d) Quick assets are 1.5 times as large as total liabilities.

8. Merchandise with an invoice price of \$7,000 is purchased with terms of 2/10, n/30, FOB shipping point. Transportation costs paid by the seller were \$125. What is the cost of the merchandise purchased if payment is made during the discount period?
 - a) \$6,860.00
 - b) \$6,982.50
 - c) \$7,000.00
 - d) \$6,985.00

9. Cost of Merchandise Sold would be classified as:
 - a) Asset
 - b) Expense
 - c) Liability
 - d) Revenue

10. The discount period for credit terms of 1/10, n/30 is:
 - a) 1 day
 - b) 10 days
 - c) 20 days
 - d) 30 days

11. Freight costs incurred by the seller are recorded in the
 - a) Sales account
 - b) Cost of merchandise sold account
 - c) Transportation In account
 - d) Transportation Out account

12. Which of the following would be classified in an income statement as Other Income or Other Expense?
- a) Advertising Expense
 - b) Interest Expense
 - c) Transportation Out
 - d) Cost of merchandise sold
13. The sales discount is based on
- a) Invoice price plus transportation costs
 - b) Invoice price less discount
 - c) Invoice price plus transportation costs less returns and allowances
 - d) Invoice price less returns and allowances
14. Myers and Company sold \$1,800 of merchandise on account to Oscar, Inc. on March 1 with credit terms of 2/10, n/30. Oscar returned \$500 of the merchandise due to poor quality on March 3. If Oscar pays for the purchase on March 11, what entry does Myers make to record receipt of the payment?
- a) Debit Cash, \$1,764; credit A/R, \$1,764
 - b) Debit Cash, \$1,800; credit Sales Returns and allowances, \$500; credit A/R, \$1,300
 - c) Debit Cash, \$1,274; debit Sales Discounts \$26; credit A/R, \$1,300
 - d) Debit Cash, \$1,800; credit Sales Discounts \$36; credit A/R, \$1,764
15. In a perpetual inventory system, what accounts are credited when a customer returns merchandise to the seller?
- a. Sales Returns and Allowances and Accounts Receivable
 - b. Accounts Receivable and Cost of Merchandise Sold
 - c. Merchandise Inventory and Cost of Merchandise Sold
 - d. Sales Returns and Allowances and Merchandise Inventory
16. Assume that sales are \$450,000, sales discounts are \$10,000, net income is \$35,000, and cost of merchandise sold is \$320,000. Gross profit and operating expenses are, respectively
- a) \$130,000 and \$95,000
 - b) \$120,000 and \$95,000
 - c) \$130,000 and \$85,000
 - d) \$120,000 and \$85,000

17. Which of the following accounts is credited by the seller when merchandise purchases are paid for within the discount period?
- a) Merchandise Inventory
 - b) Accounts Payable
 - c) Accounts Receivable
 - d) Sales Discounts
18. A classified balance sheet reports merchandise inventory as:
- a) Plant asset
 - b) Long-term asset
 - c) Current asset
 - d) Current liability
19. Gross Margin is calculated as:
- a) Sales less cost of merchandise sold
 - b) Sales less merchandise inventory
 - c) Sales less expenses
 - d) Sales less operating expenses
20. Company A's gross profit ratio has been steadily declining for 5 years while the net profit ratio has remained constant. The most likely reason for this pattern is:
- a) Cost of merchandise sold and operating expenses have both increased each year
 - b) Selling price and operating expenses have both decreased each year
 - c) Cost of merchandise sold and operating expenses have both decreased each year
 - d) Selling price decreased and operating expenses increased each year

SOLUTIONS TO PRACTICE PROBLEMS

Practice Problem #1

a) Merchandise Inventory	4,200	
A/P		4,200
b) A/P	500	
Merchandise Inventory		500
c) A/P	3,700	
Cash		3,630
Merchandise Inventory		70

Sample True / False Questions

1. Trade discounts represent a discount offered to the purchasers for quick payment.
True False
2. When a company sells a \$100 service with a 20% trade discount, \$80 of revenue is recognized.
True False
3. A sales discount represents a reduction, not in the selling price of a product or service, but in the amount to be paid by a credit customer if payment is made within a specified period of time.
True False
4. A sale on account for \$1,000 offered with terms 2/10, n/30 means that the customers will get a \$2 discount if payment is made within 10 days; otherwise, full payment is due within 30 days.
True False
5. The Sales Discounts account is an expense account.
True False
6. A sales allowance is recorded as a debit to Accounts Receivable and a credit to Sales Allowances.
True False
7. The Sales Returns account is an expense account.
True False
8. If a company has total revenues of \$100,000, sales discounts of \$3,000, sales returns of \$4,000, and sales allowances of \$2,000, the income statement will report net revenues of \$91,000.
True False
9. Cost of goods sold is an asset reported in the balance sheet and inventory is an expense reported in the income statement.
True False

10. If a company has beginning inventory of \$15,000, purchases during the year of \$75,000, and ending inventory of \$20,000, cost of goods sold equals \$70,000.
True False
 11. For inventory that is shipped FOB destination, title transfers from the seller to the buyer once the seller ships the inventory.
True False
 12. For inventory that is shipped FOB shipping point, title transfers from the seller to the buyer once the seller ships the inventory.
True False
 13. Freight-in is included in the cost of inventory.
True False
 14. Gross profit equals net sales of inventory less cost of goods sold.
True False
 15. Sales revenue minus cost of goods sold is referred to as operating income.
True False
-
1. When a company sells a \$100 service with a 20% trade discount, \$80 of revenue is recognized.
True False
- Sales returns and allowances occur when the buyer returns the goods or the seller reduces the customer's balance owed.
True False
3. Inventory is usually reported as a long-term asset in the balance sheet.
True False
 4. Merchandising companies purchase inventories that are primarily in finished form for resale to customers.
True False
 5. Sales revenue minus cost of goods sold is referred to as operating income.
True False

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Income before income taxes equals operating income plus
nonoperating revenues less nonoperating expenses.

True False

Practice Problem #2

a)	Accounts Receivable/Jangle	5,200	
	Sales		5,000
	Cash		200
	Cost of Merchandise Sold	3,000	
	Merchandise Inventory		3,000
b)	Accounts Receivable/Comet	10,000	
	Sales		10,000
	Cost of Merchandise Sold	6,000	
	Merchandise Inventory		6,000
c)	Transportation Out	400	
	Cash		400
d)	Sales Returns & Allowances	2,000	
	Accounts Receivable/Comet		2,000
	Merchandise Inventory	1,200	
	Cost of Merchandise Sold		1,200
e)	Cash	5,100	
	Sales Discounts	100	
	Accounts Receivable/Jangle		5,200
	<i>\$5,000 sale * 2% = \$100 discount</i>		
	<i>\$5,200 owed (\$5,000 + \$200 shipping)</i>		
	<i>- \$100 discount = \$5,100 received</i>		
	Cash	7,920	
	Sales Discounts	80	
	Accounts Receivable/Comet		8,000
	<i>\$10,000 sale - \$2,000 return = \$8,000 owed</i>		
	<i>\$8,000 * 1% = \$80 discount</i>		
	<i>\$8,000 owed - \$80 discount = \$7,920 received</i>		

Practice Problem #3

a) Sales		\$375,000
- Sales Returns & Allowances	(32,000)	
- Sales Discounts	<u>(12,000)</u>	
Net Sales		331,000
-Cost of Merchandise Sold		<u>(255,000)</u>
Gross Profit		\$76,000

b) Sales	\$750,000	$750,000 - x - 9,000 = 736,000$
- Sales Returns & Allowances	x	$741,000 - x = 736,000$
- Sales Discounts	<u>(9,000)</u>	x = 5,000
Net Sales	736,000	$736,000 - y = 310,000$
- Cost of Merchandise Sold	y	y = 426,000
Gross Profit	\$310,000	

c) Sales	X	$x - 25,000 - 15,000 = y$
- Sales Returns & Allowances	(25,000)	
- Sales Discounts	<u>(15,000)</u>	$y - 620,000 = 185,000$
Net Sales	Y	y = 805,000
- Cost of Merchandise Sold	<u>(620,000)</u>	x = 845,000
Gross Profit	185,000	

Practice Problem #4

a.	Merchandise Inventory	15,650	
	Accounts Payable/Blitzen		15,650
	(20,000 * 25%) = \$5,000 discount		
	(20,000 – 5,000 + 650 shipping)		
b.	Merchandise Inventory	8,000	
	Accounts Payable/Cupid		8,000
c.	Accounts Receivable/Donner	9,800	
	Sales		9,800
	Cost of Merchandise Sold	5,800	
	Merchandise Inventory		5,800
d.	Accounts Payable/Cupid	2,000	
	Merchandise Inventory		2,000
e.	Accounts Payable/Blitzen	15,650	
	Cash		15,350
	Merchandise Inventory		300
	(15,000 mdse * 2% = \$300 disc.)		
f.	Sales Returns & Allowances	1,800	
	A/R – Donner		1,800
	Merchandise Inventory	1,080	
	Cost of Merchandise Sold		1,080
g.	Accounts Payable/Cupid	6,000	
	Cash		5,940
	Merchandise Inventory		60
	(8,000 – 2,000 return = 6,000 bal.)		
	(6,000 * 1% = \$60 discount)		
h.	Cash	7,840	
	Sales Discount	160	
	A/R – Donner		8,000
	(8,000 * 2% = \$160 discount)		
	(9,800 – 1,800 return = 8,000 bal.)		
i.	Cost of Merchandise Sold	3,650	
	Merchandise Inventory		3,650
	(85,000 – 81,350 = 3,650)		

SOLUTIONS TO MULTIPLE CHOICE QUESTIONS

1. C
2. B
3. C
4. B
5. A
6. B
7. A
8. D
9. B
10. B
11. D
12. B
13. D
14. C
15. B
16. D
17. C
18. C
19. A
20. B

SOLUTIONS TO TRUE / FALSE QUESTIONS

1. False - trade discounts represent a reduction in the listed price of a product or service.
2. True
3. True
4. False - 2/10 indicates a 2% discount (or \$20 in this example) if payment is made within 10 days.
5. False - sales Discounts is a contra revenue account.
6. False - a sales allowance is recorded as a debit to Sales Allowances and a credit to Accounts Receivable.
7. False - sales Returns is a contra revenue account.
8. True
9. False - cost of goods sold is an expense reported in the income statement and inventory is an asset reported in the balance sheet.
10. True
11. False - For FOB destination, title transfers once the inventory reaches the buyer (destination).
12. True
13. True
14. True
15. False - sales revenue minus cost of goods sold equals gross profit.
16. True
17. True
18. False - inventory is typically reported as a current asset because companies expect to convert it to cash in the near term.
19. True
20. False - sales revenue minus cost of goods sold equals gross profit.
21. True