Name ______________________ Date ______________________

CHAPTER 10 Accounting for a Merchandising Business

SECTION 10.1 REVIEW QUESTIONS (page 401)

1. *A service business sells a service to the general public but does not deal in merchandise. For example, a law firm is a service business.*
2. *A merchandising business buys goods and sells them at a profit. For example, a furniture store is a merchandising business.*
3. *A wholesaler buys goods that it sells to retailers. A retailer buys goods from wholesalers or manufacturers and sells them to the public.*
4. *The merchandise inventory of a drugstore is the goods for sale on the store shelves and in the storeroom.*
5. *Another name for merchandise inventory is stock-in-trade (stock for short).*
6. *The goods available for sale that are not on hand have been sold, lost, broken, or stolen.*
7. *Merchandise inventory is listed as a current asset on the balance sheet.*
8. *The cost of goods sold figure is important because it is the largest deduction from revenue for a merchandising business.*
9. *Gross profit is the difference between the cost price of the goods and their selling price, before deducting any operating expenses.*
10. *The periodic inventory system is used by businesses that have a large number of inventory items but choose to avoid the high cost of the perpetual system.*
11. *A small variety store would choose to use the periodic inventory system because is easy to manage and less expensive than the perpetual inventory system.*
12. *The four steps of the inventory cycle are as follows. One: There is inventory at the beginning of the accounting period. Two: Merchandise is sold and moves out during the period. Three: Merchandise is purchased to replace items sold. Four: The inventory at the end of the accounting period is approximately equal to the inventory at the beginning.*
13. *The cost of goods sold formula is: Cost of goods sold = Cost of beginning inventory + Cost of merchandise purchased – Cost of ending inventory.*
14. *It is necessary to take a physical inventory when using the periodic inventory system because the financial statements cannot be prepared without an accurate count and value of the ending inventory for an accounting period.*
15. *Gross margin is also called the gross profit.*
16. *Margin is a percentage of the selling price while markup is a percentage of the cost price.*
17. *A limitation of the periodic inventory system is that financial statements cannot be accurately prepared unless the inventory is counted and valued.*

Name ______________________ Date ______________________

SECTION 10.1 EXERCISES (page 402)

Exercise 1, p. 402

Selling Price	Cost Price	Gross Profit	Cost of Goods Sold as a % of Selling Price	Gross Profit as a % of Selling Price (Margin)	Gross Profit as a % of Cost Price (Markup)
$250	*$150*	$100	*60%*	*40%*	*67%*
$125	$ 85	$ 40	*68%*	*32%*	*47%*
$ 80	$ 56	*$ 24*	*70%*	*30%*	*43%*
$150	$ 75	$ 75	*50%*	*50%*	*100%*
$300	$195	*$105*	*65%*	*35%*	*54%*
$225	*$162*	$ 63	*72%*	*28%*	*39%*
$ 90	$ 54	*$ 36*	*60%*	40%	*67%*
$500	*$350*	*$150*	70%	*30%*	*43%*
$200	*$130*	*$ 70*	65%	*35%*	*54%*
$250	$120	*$130*	*48%*	52%	*108%*

Exercise 2, p. 402

A.

	Year 1	Year 2	Year 3
Beginning inventory	100 units	*300 units*	*200 units*
Merchandise purchased	*700 units*	900 units	*650 units*
Goods available for sale	800 units	*1200 units*	*850 units*
Merchandise sold	*500 units*	1 000 units	800 units
Ending inventory	300 units	*200 units*	50 units

B. Cost of Goods Sold

Beginning Inventory		*$1 000*
Purchases	+	*3 250*
Goods Available for Sale		*$4 250*
Ending Inventory	−	*250*
Cost of Goods Sold		*$4 000*

Name ______________________ Date ______________________

SECTION 10.1 EXERCISES (continued)

Exercise 3, p. 402

	Sales	Beginning Inventory	Purchases	Ending Inventory	Cost of Goods Sold ($)	Gross Profit ($)
1.	$125 000	32 000	74 250	33 500	72 750	52 250
2.	$750 585	85 600	410 360	88 300	407 660	342 925
3.	$288 635	65 550	110 357	60 548	115 359	173 276
4.	$174 000	33 800	82 640	33 500	82 940	91 060
5.	$255 324	48 500	150 650	50 300	148 850	106 474

Exercise 4, p. 403

Cost of Goods Sold

Beginning Inventory	$14 500
Purchases	+ 41 300
Goods Available for Sale	$55 800
Ending Inventory	− 15 600
Cost of Goods Sold	$40 200

Exercise 5, p. 403

LONDON RETAILERS

INCOME STATEMENT

MONTH ENDED JUNE 30, 20–

Revenue		
Sales		$55 325 –
Cost of Goods Sold		
Beginning inventory	$24 500 –	
Purchases	18 575 –	
Cost of Goods Available for Sale	$43 075 –	
Less Ending Inventory	25 350 –	
Cost of Goods Sold		17 725 –
Gross Profit		$37 600 –
Operating Expenses		
Advertising Expense	$ 500 –	
Car Expense	750 –	
Rent Expense	1 000 –	
Utilities Expense	900 –	
Wages Expense	4 750 –	
Total Operating Expenses		7 900 –
Net Income		$29 700 –

Name ______________________ Date ______________________

SECTION 10.2 REVIEW QUESTIONS (page 406)

1. *The final inventory figure is included on the balance sheet because it is an asset and all assets are included on the balance sheet.*

2. *The cost of goods sold figure is determined for inclusion on the income statements by using the cost of goods sold formula. This formula normally requires a count of inventory on hand.*

3. *The two accounts in the general ledger where merchandise inventory is recorded are Merchandise Inventory and Purchases.*

4. *During the fiscal period, the balance in the Merchandise Inventory account represents the value (at cost) of the inventory at the beginning of the fiscal period.*

5. *The merchandise inventory is valued at cost prices.*
6. *The full title of the Purchases account is Purchases of Merchandise for Resale account.*
7. *This is the accounting entry for the purchase of merchandise for resale on account.*

	Dr	Cr
Purchases	*$$$$*	
HST Recoverable	*$$$$*	
Accounts Payable		*$$$$*

8. *This is the accounting entry for the purchase of a delivery truck for cash.*

	Dr	Cr
Trucks	*$$$$*	
HST Recoverable	*$$$$*	
Bank		*$$$$*

9. *In the ledger of a merchandising business, the revenue account is usually called Sales.*
10. *If the periodic inventory system is used, the cost portion of a sale is ignored because there is no way to debit the Inventory account after each sale.*

11. *Transportation charges on incoming merchandise are recorded in the Freight-in account.*

Name ______________________ Date ______________________

SECTION 10.2 EXERCISES (page 406)
Exercise 1, p. 406

GENERAL JOURNAL

PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Dec.	1	Purchases		3045 –	
		HST Recoverable		395 85	
		A/P—Paramount Manufacturing			3440 85
		Purchase Invoice No. 435			
	2	Freight-in		435 –	
		HST Recoverable		56 55	
		A/P—Murray Transport			491 55
		Purchase Invoice No. B616			
	3	Supplies		236 –	
		HST Recoverable		30 68	
		A/P—Swiss Stationers			268 68
		Purchase Invoice No. 7042			
	4	A/R—W. Purbhoo		471 21	
		HST Payable			54 21
		Sales			417 –
		Invoice No. 789			
	5	Bank		103 96	
		HST Payable			11 96
		Sales			92 –
		Cash Sales Slip No. 143			
	6	Purchases		2678 –	
		HST Recoverable		348 14	
		A/P—Haniko Electric			3026 14
		Purchase Invoice No. 902			

Name ______________________________ Date ______________________________

SECTION 10.2 EXERCISES (continued)

Exercise 2, p. 407

A. The final inventory figure appears on the ___*balance sheet*___ and on the ___*income statement*___.

B. Neither the ___*inventory figure*___ nor the ___*cost of goods sold figure*___ is known during the accounting period.

C. The cost of goods sold figure is ___*calculated*___ using a ___*formula*___.

D. Merchandise inventory is kept in two accounts. These are ___*Merchandise Inventory account*___ and ___*Purchases account*___.

E. The ___*Merchandise Inventory account*___ normally shows the merchandise inventory figure as of the ___*beginning of the fiscal period*___.

F. At the fiscal year-end, the inventory is counted and valued at ___*cost prices*___.

G. The Merchandise Inventory account is adjusted ___*at the end of the fiscal period*___.

H. The ___*inventory adjustment*___ is the only accounting entry made to the Merchandise Inventory account.

I. Merchandise purchased during the fiscal period is debited to the ___*Purchases account*___.

J. The Purchases account is a short form of ___*purchases of merchandise for resale*___.

K. If merchandise is purchased on account, the account debited is ___*Purchases*___.

L. If a tire company purchases office supplies, the account debited is ___*Office Supplies*___.

M. For a merchandising business, the Sales account is the ___*Revenue account*___.

N. When a business using the periodic inventory system sells goods, there is no accounting entry to record the ___*decrease in inventory*___.

O. The Freight-in account is used to accumulate ___*transportation charges on incoming goods*___.

Exercise 3, p. 408

Opening Inventory	Purchases	Freight-in	Closing Inventory	Cost of Goods Sold
$20 000	40 000	5 000	25 000	*40 000*
$29 000	50 000	1 000	30 000	*50 000*
$12 000	*52 000*	1 000	15 000	50 000
$42 000	90 000	8 000	39 000	101 000
$50 000	100 000	*10 000*	60 000	100 000
$75 000	200 000	5 000	*80 000*	200 000

Name ______________________ Date ______________________

SECTION 10.3 REVIEW QUESTIONS (page 413)

1. *The three new accounts that appear on the worksheet of a merchandising company are Merchandise Inventory, Purchases, and Freight-in.*
2. *The trial balance figure for Merchandise Inventory represents the inventory figure at the beginning of the fiscal period.*
3. *The trial balance figure for Purchases represents the cost of merchandise purchased during the fiscal period.*
4. *A physical inventory must be taken and valued before the worksheet for a merchandising business can be completed.*
5. *To extend the Merchandise Inventory line, the trial balance figure for Merchandise Inventory is written in the Income Statement section, Debit column. Then the closing inventory figure is entered in two places: the Income Statement section, Credit column, and the Balance Sheet section, Debit column.*
6. *To extend the Purchases line, the trial balance figure for Purchases is written in the Income Statement section, Debit column.*
7. *To extend the Freight-in line, the trial balance figure for Freight-in is written in the Income Statement section, Debit column.*
8. *The figures for the Cost of Goods Sold section of the income statement are all found on the worksheet in the Income Statement section.*
9. *The Cost of Goods Sold section of the income statement is important because the cost of the goods sold is the largest deduction from revenue.*
10. *The closing entry process is theoretically the same as it was when first introduced. However, a common error at this stage is to forget to include the inventory figures.*
11. *When recording the first two closing entries, you must be careful to include the inventory figures.*
12. *As a result of processing the first two closing entries for a merchandising business, the Merchandise Inventory account is adjusted automatically.*
13. *All the information for the closing entries is found on the worksheet.*
14. *The total effect of all the closing entries is to adjust the Merchandise Inventory account, to close out all the nominal accounts in the equity section of the ledger, and to bring the Capital account up to date.*

Name ____________________ Date ____________________

SECTION 10.3 EXERCISES (page 414)

Exercise 1, p. 414

A.

Bok Trading Company — **Worksheet** — **Year Ended Dec. 31, 20–**

ACCOUNTS	TRIAL BALANCE Dr	TRIAL BALANCE Cr	ADJUSTMENTS Dr	ADJUSTMENTS Cr	INCOME STATEMENT Dr	INCOME STATEMENT Cr	BALANCE SHEET Dr	BALANCE SHEET Cr
Bank	500 –						500 –	
Accounts Receivable	17 910 –						17 910 –	
Merchandise Inventory	39 600 –				39 600 –	43 700 –	43 700 –	
Supplies	2 500 –			② 1 200 –			1 300 –	
Prepaid Insurance	1 800 –			③ 1 150 –			650 –	
Equipment	27 850 –						27 850 –	
Accum. Dep.—Equip.		5 200 –		④ 2 600 –				7 800 –
Accounts Payable		7 400 –		① 350 –				7 750 –
HST Payable		550 –						550 –
HST Recoverable	390 –						390 –	
R. Bok, Capital		63 712 –						63 712 –
R. Bok, Drawings	10 000 –						10 000 –	
Sales		94 938 –				94 938 –		
Purchases	41 500 –		① 300 –		41 800 –			
Freight-in	950 –				950 –			
Miscellaneous Expense	350 –		① 50 –		400 –			
Rent Expense	4 800 –				4 800 –			
Telephone Expense	1 500 –				1 500 –			
Utilities Expense	2 750 –				2 750 –			
Wages Expense	19 400 –				19 400 –			
	171 800 –	171 800 –						
Supplies Expense			② 1 200 –		1 200 –			
Insurance Expense			③ 1 150 –		1 150 –			
Dep. Exp.—Equip.			④ 2 600 –		2 600 –			
			5 300 –	5 300 –	116 150 –	138 638 –	102 300 –	79 812 –
Net Income					22 488 –			22 488 –
					138 638 –	138 638 –	102 300 –	102 300 –

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)
Exercise 1, p. 414 (continued)

B.

BOK TRADING COMPANY
INCOME STATEMENT
YEAR ENDED DECEMBER 31, 20–

Revenue		
Sales		*$94 938 –*
Cost of Goods Sold		
Merchandise Inventory, January 1	*$39 600 –*	
Purchases	*41 800 –*	
Freight-In	*950 –*	
Goods Available for Sale	*$82 350 –*	
Less Merchandise Inventory, December 31	*43 700 –*	
Cost of Goods Sold		*38 650 –*
Gross Profit		*$56 588 –*
Operating Expenses		
Depreciation Expense—Equipment	*$ 2 600 –*	
Insurance Expense	*1 150 –*	
Miscellaneous Expense	*400 –*	
Rent Expense	*4 800 –*	
Telephone Expense	*1 500 –*	
Utilities Expense	*2 750 –*	
Wages Expense	*19 400 –*	
Supplies Expense	*1 200 –*	
Total Operating Expenses		*33 800 –*
Net Income		*$22 488 –*

SECTION 10.3 EXERCISES (continued)

Exercise 1, p. 414 (continued)

C.

BOK TRADING COMPANY

BALANCE SHEET

DECEMBER 31, 20–

Assets			
Current Assets			
Bank		*$ 500 –*	
Accounts Receivable		*17 910 –*	
Merchandise Inventory		*43 700 –*	
Supplies		*1 300 –*	
Prepaid Insurance		*650 –*	*$64 060 –*
Long-Term Assets			
Equipment		*$27 850 –*	
Less Accumulated Depreciation		*7 800 –*	*20 050 –*
Total Assets			*$84 110 –*
Liabilities and Owner's Equity			
Current Liabilities			
Accounts Payable		*$ 7 750 –*	
HST Payable	*$ 550 –*		
Less HST Recoverable	*390 –*	*160 –*	*7 910 –*
R. Bok, Capital			
Balance, January 1		*$63 712 –*	
Net Income	*$22 488 –*		
Drawings	*10 000 –*		
Increase in Capital		*12 488 –*	
Balance, December 31			*76 200 –*
Total Liabilities and Equity			*$84 110 –*

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 1, p. 414 (continued)

D.

GENERAL JOURNAL

PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20–		Closing Entries			
Dec.	31	Sales		94 938 –	
		Merchandise Inventory		43 700 –	
		Income Summary			138 638 –
	31	Income Summary		116 150 –	
		Merchandise Inventory			39 600 –
		Purchases			41 800 –
		Freight-In			958 –
		Miscellaneous Expense			400 –
		Rent Expense			4 800 –
		Telephone Expense			1 500 –
		Utilities Expense			2 750 –
		Wages Expense			19 400 –
		Supplies Expense			1 200 –
		Insurance Expense			1 150 –
		Depreciaton Expense—Equipment			2 600 –
	31	Income Summary		22 488 –	
		R. Bok, Capital			22 488 –
	31	R. Bok, Capital		10 000 –	
		R. Bok, Drawings			10 000 –

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 2, p. 415

A.

Small Engine Sales and Service — **Worksheet** — **Year Ended Oct. 31, 20–**

ACCOUNTS	TRIAL BALANCE Dr	TRIAL BALANCE Cr	ADJUSTMENTS Dr	ADJUSTMENTS Cr	INCOME STATEMENT Dr	INCOME STATEMENT Cr	BALANCE SHEET Dr	BALANCE SHEET Cr
Bank	520 –						520 –	
Accounts Receivable	12 260 –						12 260 –	
Merchandise Inventory	36 050 –				36 050 –	35 651 –	35 651 –	
Supplies	1 975 –			① 1 625 –			350 –	
Parts and Materials	10 350 –			② 5 790 –			4 560 –	
Prepaid Insurance	1 150 –			③ 550 –			600 –	
Equipment	18 600 –						18 600 –	
Accum. Dep.—Equip.		12 505 –		④ 1 219 –				13 724 –
Truck	18 000 –						18 000 –	
Accum. Dep.—Truck		14 975 –		⑤ 908 –				15 883 –
Accounts Payable		5 360 –						5 360 –
HST Payable		1 830 –						1 830 –
HST Recoverable	420 –						420 –	
H. Rohr, Capital		29 010 –						29 010 –
H. Rohr, Drawings	25 000 –						25 000 –	
Revenue—Sales		80 362 –				80 362 –		
Revenue—Service		66 215 –				66 215 –		
Bank Charges	410 –				410 –			
Freight-in	862 –				862 –			
Miscellaneous Expense	650 –				650 –			
Purchases	52 795 –				52 795 –			
Rent Expense	3 600 –				3 600 –			
Telephone Expense	1 250 –				1 250 –			
Truck Expense	5 825 –				5 825 –			
Utilities Expense	2 240 –				2 240 –			
Wages Expense	18 300 –				18 300 –			
	210 257 –	210 257 –						
Supplies Expense			① 1 625 –		1 625 –			
Parts and Mat. Exp.			② 5 790 –		5 790 –			
Expense Insurance			③ 550 –		550 –			
Dep. Exp.— Equip.			④ 1 219 –		1 219 –			
Dep.—Truck			⑤ 908 –		908 –			
			10 092 –	10 092 –	132 074 –	182 228 –	115 961 –	65 807 –
Net Income					50 154 –			50 154 –
					182 228 –	182 228 –	115 961 –	115 961 –

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 2, p. 415 (continued)

B.

SMALL ENGINE SALES AND SERVICE

INCOME STATEMENT

YEAR ENDED DECEMBER 31, 20–

Revenue				
Sales	$80 362	–		
Service	66 215	–	$146 577	–
Cost of Goods Sold				
Merchandise Inventory, January 1	$36 050	–		
Purchase	52 795	–		
Freight-In	862	–		
Cost of Goods Available for Sale	$89 707	–		
Less Merchandise Inventory, December 31	35 651	–		
Cost of Goods Sold			54 056	–
Gross Profit			$ 92 521	–
Operating Expenses				
Bank Charges	$ 410	–		
Depreciation Expense—Equipment	1 219	–		
Depreciation—Truck	908	–		
Insurance Expense	550	–		
Miscellaneous Expense	650	–		
Parts and Materials Expense	5 790	–		
Rent Expense	3 600	–		
Supplies Expense	1 625	–		
Telephone Expense	1 250	–		
Truck Expense	5 825	–		
Utilities Expense	2 240	–		
Wages Expense	18 300	–	42 367	–
Net Income			$ 50 154	–

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 2, p. 415 (continued)

C.

SMALL ENGINE SALES AND SERVICE

BALANCE SHEET

DECEMBER 31, 20–

Assets			
Current Assets			
Bank		$ 520 –	
Accounts Receivable		12 260 –	
Merchandise Inventory		35 651 –	
Supplies		350 –	
Parts and Material		4 560 –	
Prepaid Insurance		600 –	$53 941 –
Long-Term Assets			
Equipment	$18 600 –		
Less Accumulated Depreciation	13 724 –	$ 4 876 –	
Truck	$18 000 –		
Less Accumulated Depreciation	15 883 –	2 117 –	6 993 –
Total Assets			$60 934 –
Liabilities and Owner's Equity			
Current Liabilities			
Accounts Payable		$ 5 360 –	
HST Payable	$ 1 830 –		
Less HST Recoverable	420 –	1 410 –	$ 6 770 –
H. Rohr. Capital			
Balance, January 1		$29 010 –	
Net Income	$50 154 –		
Drawings	25 000 –		
Increase in Capital		25 154 –	
Balance, December 31			54 164 –
Total Liabilities and Equity			$60 934 –

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 2, p. 415 (continued)

D.

GENERAL JOURNAL

PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20–		Adjusting Entries			
Dec.	31	Supplies Expense		1 625 –	
		Supplies			1 625 –
	31	Parts and Materials Expense		5 790 –	
		Parts and Materials			5 790 –
	31	Insurance Expense		550 –	
		Prepaid Insurance			550 –
	31	Depreciation—Equipment		1 219 –	
		Accumulated Depreciation—Equipment			1 219 –
	31	Depreciation—Truck		908 –	
		Accumulated Depreciation—Truck			908 –

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 2, p. 415 (continued)

D. (continued)

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20–		Closing Entries			
Dec.	31	Merchandise Inventory		35 651 –	
		Revenue—Sales		80 362 –	
		Revenue—Service		66 215 –	
		Income Summary			182 228 –
	31	Income Summary		132 074 –	
		Merchandise Inventory			36 050 –
		Bank Charges			410 –
		Freight-In			862 –
		Miscellaneous Expense			650 –
		Purchases			52 795 –
		Rent Expense			3 600 –
		Telephone Expense			1 250 –
		Truck Expense			5 825 –
		Utilities Expense			2 240 –
		Wages Expense			18 300 –
		Supplies Expense			1 625 –
		Parts and Materials Expense			5 790 –
		Insurance Expense			550 –
		Depreciation—Equipment			1 219 –
		Depreciation—Truck			908 –
	31	Income Summary		50 154 –	
		H. Rohr, Capital			50 154 –
	31	H. Rohr, Capital		25 000 –	
		H. Rohr, Drawings			25 000 –

Name ______________________________ Date ______________________________

SECTION 10.3 EXERCISES (continued)

Exercise 2, p. 415 (continued)

E.

GENERAL LEDGER

Bank

520	

Accounts Receivable

12 260	

Merchandise Inventory

36 050	36 050
35 651	
35 651	

Supplies

1 975	1 625
350	

Parts and Materials

10 350	5 790
4 560	

Prepaid Insurance

1 150	550
600	

Equipment

18 600	

Acc. Deprec.—Equip.

	12 505
	1 219
	13 724

Truck

18 000	

Acc. Deprec.—Truck

	14 975
	908
	15 883

Accounts Payable

	5 360

HST Payable

	1 830

HST Recoverable

420	

H. Rohr, Capital

25 000	29 010
	50 154
	54 164

H. Rohr, Drawings

25 000	25 000
0	

Revenue—Sales

80 362	80 362
0	

Revenue—Service

66 215	66 215
0	

Name ______________________________ Date ______________________________

SECTION 10.3 EXERCISES (continued)

Exercise 2, p. 415 (continued)

E. (continued)

Bank Charges

410	*410*
0	

Freight-in

862	*862*
0	

Miscellaneous Expense

650	*650*
0	

Purchases

52 795	*52 795*
0	

Rent Expense

3 600	*3 600*
0	

Telephone Expense

1 250	*1 250*
0	

Truck Expense

5 825	*5 825*
0	

Utilities Expense

2 240	*2 240*
0	

Wages Expense

18 300	*18 300*
0	

Supplies Expense

1 625	*1 625*
0	

Parts and Materials Expense

5 790	*5 790*
0	

Insurance Expense

550	*550*
0	

Depreciation—Equipment

1 219	*1 219*
0	

Depreciation—Truck

908	*908*
0	

Income Summary

132 074	*182 228*
50 154	
0	

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)
Exercise 2, p. 415 (continued)

F.

SMALL ENGINE SALES AND SERVICE
POST-CLOSING TRIAL BALANCE
DECEMBER 31, 20–

ACCOUNTS	DEBIT	CREDIT
Bank	520 –	
Accounts Receivable	12 260 –	
Merchandise Inventory	35 651 –	
Supplies	350 –	
Parts and Materials	4 560 –	
Prepaid Insurance	600 –	
Equipment	18 600 –	
Accumulated Depreciation—Equipment		13 724 –
Truck	18 000 –	
Accumulated Depreciation—Truck		15 883 –
Accounts Payable		5 360 –
HST Payable		1 830 –
HST Recoverable	420 –	
H. Rohr, Capital		54 164 –
	90 961 –	90 961 –

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 3, p. 416

A.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20–		Adjusting Entries			
Dec.	31	Advertising Expense		100 –	
		Freight-in		70 –	
		Miscellaneous Expense		25 –	
		Purchases		940 –	
		Accounts Payable			1135 –
	31	Supplies Expense		2104 –	
		Supplies			2104 –
	31	Insurance Expense		950 –	
		Prepaid Insurance			950 –
	31	Depreciation Expense—Building		3869 –	
		Accumulated Depreciation—Building			3869 –
	31	Depreciation Expense—Equipment		4375 –	
		Accumulated Depreciation—Equipment			4375 –
	31	Depreciation Expense—Truck		5474 –	
		Accumulated Depreciation—Truck			5474 –

SECTION 10.3 EXERCISES (continued)
Exercise 3, p. 416 (continued)

A. (continued)

GENERAL JOURNAL

PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20–		Closing Entries			
Dec.	31	Merchandise Inventory		40 500 –	
		Sales		232 250 –	
		Income Summary			272 750 –
	31	Income Summary		221 175 65	
		Merchandise Inventory			43 700 –
		Advertising Expense			2 670 –
		Freight-in			3 775 –
		Miscellaneous Expense			1 775 –
		Purchases			81 642 50
		Telephone Expense			1 250 –
		Utilities Expense			12 316 –
		Wages Expense			57 275 15
		Supplies Expense			2 104 –
		Insurance Expense			950 –
		Depreciation Expense—Building			3 869 –
		Depreciation Expense—Equipment			4 375 –
		Depreciation Expense—Trucks			5 474 –
	31	Income Summary		51 574 35	
		T. Barbini, Capital			51 574 35
	31	T. Barbini, Capital		36 000 –	
		T. Barbini, Drawings			36 000 –

SECTION 10.3 EXERCISES (continued)

Exercise 3, p. 416 (continued)

B.

GENERAL LEDGER

Bank

3 250.00	

Accounts Receivable

33 930.10	

Merchandise Inventory

43 700.00	*43 700.00*
40 500.00	
40 500.00	

Supplies

3 400.50	*2 104.00*
1 296.50	

Prepaid Insurance

2 090.00	*950.00*
1 140.00	

Land

35 000.00	

Building

95 000.00	

Accum. Deprec.—Building

	17 620.00
	3 869.00
	21 489.00

Equipment

53 400.00	

Accum. Deprec.—Equip.

	31 527.00
	4 375.00
	35 902.00

Truck

76 000.00	

Accum. Deprec.—Truck

	57 752.00
	5 474.00
	63 226.00

Accounts Payable

	40 820.20
	1 135.00
	41 955.20

HST Payable

	2 910.00

HST Recoverable

720.00	

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)
Exercise 3, p. 416 (continued)

B. (continued)

T. Barbini, Capital

36 000.00	159 180.05
	51 574.35
	174 754.40

T. Barbini, Drawings

36 000.00	36 000.00
0	

Sales

232 250.00	232 250.00
0	

Advertising Expense

2 570.00	2 670.00
100.00	
0	

Freight-in

3 705.00	3 775.00
70.00	
0	

Miscellaneous Expense

1 750.00	1 775.00
25.00	
0	

Purchases

80 702.50	81 642.50
940.00	
0	

Telephone Expense

1 250.00	1 250.00
0	

Utilities Expense

12 316.00	12 316.00
0	

Wages Expense

57 275.15	57 275.15
0	

Supplies Expense

2 104.00	2 104.00
0	

Insurance Expense

950.00	950.00
0	

Depreciation—Building

3 869.00	3 869.00
0	

Depreciation—Equipment

4 375.00	4 375.00
0	

Depreciation—Truck

5 474.00	5 474.00
0	

Income Summary

221 175.65	272 750.00
51 574.35	
0	

Name ______________________ Date ______________________

SECTION 10.3 EXERCISES (continued)

Exercise 3, p. 416 (continued)

C.

BARBINI STONE PRODUCTS

POST-CLOSING TRIAL BALANCE

DECEMBER 31, 20–

ACCOUNTS	DEBIT					CREDIT				
Bank	3	2	5	0	–					
Accounts Receivable	35	9	3	0	10					
Merchandise Inventory	40	5	0	0	–					
Supplies	1	2	9	6	50					
Prepaid Insurance	1	1	4	0	–					
Land	35	0	0	0	–					
Building	95	0	0	0	–					
Accumulated Depreciation—Building						21	4	8	9	–
Equipment	53	4	0	0	–					
Accumulated Depreciation—Equipment						35	9	0	2	–
Trucks	76	0	0	0	–					
Accumulated Depreciation—Truck						63	2	2	6	–
Accounts Payable						41	9	5	5	20
HST Payable						2	9	1	0	–
HST Recoverable		7	2	0	–					
T. Barbini, Capital						174	7	5	4	40
	340	2	3	6	60	340	2	3	6	60

SECTION 10.4 REVIEW QUESTIONS (page 424)

1. *When a sale is made on account, a sales invoice is issued.*
2. *When a sale is made on account and the customer is satisfied, the company expects the customer to send payment for the sales invoice by the specified due date.*
3. *When a customer is dissatisfied with the merchandise, the customer does not pay the sales invoice and returns the merchandise.*
4. *To adjust a customer's account downward, a credit invoice is issued.*
5. *A credit invoice is different from a regular invoice because it reduces the amount a customer owes on account. To distinguish it from a regular invoice, it is often printed in red and has the word Credit printed on it.*
6. *Another name for a credit invoice is a credit note.*

SECTION 10.4 REVIEW QUESTIONS (continued)

7. *Three reasons why companies issue credit invoices are if the goods are unsatisfactory and have been returned, the goods are unsatisfactory but the customer agrees to keep them for a lower price, or if the invoice amount is incorrect and needs to be reduced.*

8. *This is the accounting entry for issuing a credit note, ignoring tax.*

	Dr	*Cr*
Sales	*$$$$*	
Accounts Receivable		*$$$$*

9. *A cash refund is money paid back to a customer who has purchased merchandise with cash and then returned the merchandise as unsatisfactory.*

10. *This is the accounting entry for a cash refund, ignoring tax.*

	Dr	*Cr*
Sales	*$$$$*	
Bank		*$$$$*

11. *Some businesses keep returns and allowances accounts because they want their financial statements to show how much merchandise is being returned by their customers. This helps them identify and correct problems with the merchandise and increase sales.*

12. *A business that keeps a returns and allowances account has its sales data in two accounts, a Returns and Allowances account and a Sales account. A business without a returns and allowances account keeps all its sales data in the Sales account.*

13. *This is the accounting entry for a credit note of $100 for goods returned to the supplier, ignoring taxes.*

	Dr	*Cr*
Accounts Payable	*$100*	
Purchases		*$100*

14. *This is the accounting entry for a credit note of $100 for goods returned to the supplier who uses a returns and allowances account, ignoring taxes.*

	Dr	*Cr*
Accounts Payable	*$100*	
Purchases Returns and Allowances		*$100*

15. *On the income statement, Sales Returns and Allowances are deducted from Sales and Purchase Returns and Allowances are deducted from Purchases.*

Name ______________________ Date ______________________

SECTION 10.4 EXERCISES (page 424)

Exercise 1, p. 424

A. *From the point of view of Acadia Equipment and Supply, document 1 is a sales invoice.*

B. *From the point of view of Cornwallis Construction, document 1 is a purchase invoice.*

C. *Document 2 is a credit invoice.*

D. *Acadia Equipment and Supply is the sender of the documents.*

E. *Cornwallis Construction is the purchaser.*

F., G.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Sep.	14	Accounts Receivable		339 –	
		Sales			300 –
		HST Payable			39 –
		Sales		50 –	
		HST Payable		6 50	
		Accounts Receivable			56 50
Sep.	14	Purchases		300 –	
		HST Recoverable		39 –	
		Accounts Payable			339 –
		Accounts Payable		56 50	
		Purchases Returns and Allowances			50 –
		HST Recoverable			6 50

Name ______________________ Date ______________________

SECTION 10.4 EXERCISES (continued)

Exercise 2, p. 425

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– May	31	Bank		175 15	
		Sales			155 –
		HST Payable			20 15
		Cash Sales Slip No. 1060			
Jun.	4	Sales Returns and Allowances		155 –	
		HST Payable		20 15	
		Bank			175 15
		Cash Refund Slip No. 1075			

Exercise 3, p. 426

A. $376 462.09
C. $328 811.77
E. $27 356.04
B. $47 650.32
D. $186 235.32
F. $158 879.28

G. Separate returns and allowances accounts would help the management of this company track the amount of goods returned by its customers and sent back to its suppliers. If returns and allowances are excessive, management can identify and fix the problems with their merchandise and ordering policies. This will improve customer and supplier relations and increase profits.

Exercise 4, p. 426

Mr. Leif is correct that net sales have increased by 20% but according to data hidden in the Sales account, Sales Returns and Allowances have increased by 1078% (15 200 ÷ 1410). This indicates that his customers are unhappy with the merchandise they are purchasing and are returning 16.4% of it (249 468 ÷ 15 220). His company is not as successful as he thinks. He needs to address the high number of returns. Mr. Leif should adjust his accounting system by creating a Sales Returns and Allowances account. The amount of returns and allowances would then appear on the income statement and would be more open to analysis. Better business decisions would follow.

Name ____________________ Date ____________________

SECTION 10.4 EXERCISES (continued)

Exercise 5, p. 427

ISLAND TRADERS

PARTIAL INCOME STATEMENT

YEAR ENDED DECEMBER 31, 20–

Revenue															
Sales						$102	3	5	6	–					
Less Sales Returns and Allowances						4	6	9	8	23					
Net Sales											$97	6	5	7	77
Cost of Goods Sold															
Merchandise Inventory, January 1						$ 43	2	5	0	40					
Purchases	$60	2	5	8	20										
Less Purchases Returns and Allowances	9	5	6	2	45										
Net Purchases						50	6	9	5	75					
Freight-in						6	2	3	5	14					
Goods Available for Sale						$100	1	8	1	29					
Less Merchandise Inventory, December 31						48	9	0	1	25	51	2	8	0	04
Gross Profit											$46	3	7	7	73

SECTION 10.5 REVIEW QUESTIONS (page 432)

1. *A cash discount is a deduction that may be taken off the amount of a bill if payment is made on or before the discount date stated on the bill.*
2. *Terms of sale are the arrangements a company makes with its customers about when payment is due for its goods or services and whether it offers customers a cash discount for early payment.*
3. *A business would sell goods COD if it had doubts about the customer's ability to pay for the goods.*
4. *The buying firm would accept COD as the terms of sale if better terms were denied, perhaps because of a poor credit rating.*
5. *Net 30 means that the bill is expected to be paid within 30 days of the invoice date.*
6. *The term 2/10,n/30 means that the customer may take a 2% discount if payment is made within 10 days of the invoice date. If the discount is not taken, payment is expected in full within 30 days.*
7. *The customer would see the terms of sale for a transaction on the sales invoice.*
8. *A manager could see the terms of sale for any customer on the customer's account in the subsidiary ledger.*

Name ______________________ Date ______________________

SECTION 10.5 REVIEW QUESTIONS (continued)

9. *A business ensures that cash discounts are taken when available by having a designated employee check every purchase invoice to see if a discount is offered and pay the invoices with discounts within the discount period.*
10. *The Discounts Allowed account is associated with a sales transaction.*
11. *Another name for Discounts Allowed is Discount off Sales or Sales Discounts.*
12. *Another name for Discounts Earned is Discount off Purchases or Purchases Discounts.*
13. *A business would not have an account for Discounts Allowed if it does not offer cash discounts to its customers.*
14. *The discount is calculated on the net amount of the sale, the amount after the sales return. The discount period would begin from the date on the latest document related to the transaction, which is the document for the sales return.*
15. *Discounts Allowed appears on the income statement as a deduction from Sales.*
16. *Discounts Earned appears on the income statement as a deduction from Purchases.*

SECTION 10.5 EXERCISES (page 432)

Exercise 1, p. 432

Date of Invoice	Total of Invoice	Terms of Sale	Amount of Credit Note	Date of Credit Note	Date Payment Is Made	Amount of Payment Required
Mar. 12	$ 52.50	2/10,n/30	–	–	Mar. 20	*$ 51.45*
May 18	47.25	Net 30	–	–	May 27	*47.25*
Sep. 4	115.50	3/15,n/60	–	–	Oct. 10	*115.50*
Feb. 6	1 050.00	1/20,n/30	$126.00	Feb. 18	Mar. 6	*914.76*
Oct. 19	588.00	2/10,n/30	42.00	Nov. 5	Nov. 27	*546.00*
Aug. 27	882.00	2/15,n/30	168.00	Sep. 7	Sep. 10	*699.72*

Name ______________________________ Date ______________________________

SECTION 10.5 EXERCISES (continued)

Exercise 2, p. 433

Date of Invoice	Total of Invoice	Terms of Sale	Amount of Credit Note	Date of Credit Note	Date Payment Is Made	Amount of Payment Required
May 14	$147.00	2/10,n/30	–	–	*May 24*	*$144.06*
Apr. 15	315.00	3/20,n/60	$42.00	May 1	*May 21*	*264.81*
Jun. 3	220.05	2/10,n/30	78.75	Jun. 20	*Jun. 30*	*138.47*
Nov. 20	59.25	2/15,n/30	36.75	Dec. 2	*Dec. 17*	*22.05*

Exercise 3, p. 433

A., B.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Aug.	*3*	*A/R—Watson Construction*		*7 1 42*	
		Sales			*6 3 20*
		HST Payable			*8 22*
	12	*Bank*		*7 0 16*	
		Discounts Allowed		*1 26*	
		A/R—Watson Construction			*7 1 42*

C.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Aug.	*3*	*Small Tools and Supplies*		*6 3 20*	
		HST Recoverable		*8 22*	
		A/P—Circle Supply			*7 1 42*
	12	*A/P—Circle Supply*		*7 1 42*	
		Discounts Earned			*1 26*
		Bank			*7 0 16*

Name ______________________ Date ______________________

SECTION 10.5 EXERCISES (continued)

Exercise 4, p. 434

A. to C.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Sep.	3	A/R—Jackson and Jackson		113 –	
		Sales			100 –
		HST Payable			13 –
	9	Sales		10 –	
		HST Payable		1 30	
		A/R—Jackson and Jackson			11 30
	19	Bank		99 90	
		Discounts Allowed		1 80	
		A/R—Jackson and Jackson			101 70

D.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Sep.	3	Supplies		100 –	
		HST Recoverable		13 –	
		A/P—Circle Supply			113 –
	9	A/P—Circle Supply		11 30	
		HST Recoverable			1 30
		Supplies			10 –
	9	A/P—Circle Supply		101 70	
		Bank			99 90
		Discounts Earned*			1 80

*The assumption is that the discounts are taken on pre-tax totals.

Name ______________________ Date ______________________

SECTION 10.6 REVIEW QUESTIONS (page 440)

1. *A common-size income statement is an income statement with amounts expressed as percentages of net sales.*

2. *A common-size income statement shows you how many cents each item represents for every dollar of net sales. This makes it easy to understand how different items on the income statement compare to each other.*

3. *When working with spreadsheet formulas, it is sometimes necessary to make the divisor an absolute cell reference so that it will not change when a formula containing the divisor is copied to a number of different cells.*

4. *The formula for calculating the markup percentage is: Markup Percentage = Margin ÷ Cost of Goods Sold.*

5. *The markup multiplier is the factor you need to increase the cost values by to reach the sales (retail) values.*

6. *Three ways to calculate the markup multiplier are as follows. One: Divide the Sales (in dollars) by the Cost of Goods Sold (in dollars). Two: Divide the Sales percentage (always 100%) by the Cost of Goods Sold percentage. Three: Divide the Sales percentage (100%) by the complement of the Margin Percentage (100% – Margin Percentage).*

7. *Find the complement of the margin: 100% – 39.5% = 60.5%. If the gross margin is 39.5%, the cost percentage must be its complement, 60.5%.*

8. *Two complementary things together make up one whole. For example, the complement of 30% is 70%; and together, 30% and 70% make 100%.*

Name ______________________ Date ______________________

SECTION 10.6 EXERCISES (page 440)

Exercise 1, p. 440

This is a spreadsheet exercise.

A. to C.

pricingAnswersTimFormulas.xls

Inventory Pricing and Values

Desired Margin	Complement (Cost %)	Markup Multiplier
0.457	=1-B6	=1/C6

Stock No.	Quantity	Cost Price	Retail Price	Inventory at Cost	Inventory at Retail	Gross Profit
Product 235	500	4.32	=D10*D6	=C10*D10	=C10*E10	=G10-F10
Product 236	475	6.55	=D11*D6	=C11*D11	=C11*E11	=G11-F11
Product 237	200	7.33	=D12*D6	=C12*D12	=C12*E12	=G12-F12
Product 238	150	8.44	=D13*D6	=C13*D13	=C13*E13	=G13-F13
Product 239	125	8.79	=D14*D6	=C14*D14	=C14*E14	=G14-F14
Product 240	115	9.35	=D15*D6	=C15*D15	=C15*E15	=G15-F15
Product 241	140	9.45	=D16*D6	=C16*D16	=C16*E16	=G16-F16
			Totals	=SUM(F10:F16)	=SUM(G10:G16)	=SUM(H10:H16)

D. *The spreadsheet should match Figure 10.22 on page 439 of the student textbook.*

E. *The spreadsheet should match Figure 10.23 on page 439 of the student textbook.*

F., G.

pricing.xls

Inventory Pricing and Values

Desired Margin	Complement (Cost %)	Markup Multiplier
50.0%	50.0%	2.00

Stock No.	Quantity	Cost Price	Retail Price	Inventory at Cost	Inventory at Retail	Gross Profit
Product 235	500	4.32	8.64	2 160.00	4 320.00	2 160.00
Product 236	475	6.55	13.10	3 111.25	6 222.50	3 111.25
Product 237	200	7.33	14.66	1 466.00	2 932.00	1 466.00
Product 238	150	8.70	17.40	1 305.00	2 610.00	1 305.00
Product 239	125	8.79	17.58	1 098.75	2 197.50	1 098.75
Product 240	115	9.35	18.70	1 075.25	2 150.50	1 075.25
Product 241	140	9.45	18.90	1 323.00	2 646.00	1 323.00
			Totals	11 539.25	23 078.50	11 539.25

When the desired margin was 49%, the Total Gross Profit was $11 086.73. The change to 50% added another $452.52 to the Total Gross Profit.

SECTION 10.6 EXERCISES (continued)

Exercise 1, p. 440 (continued)

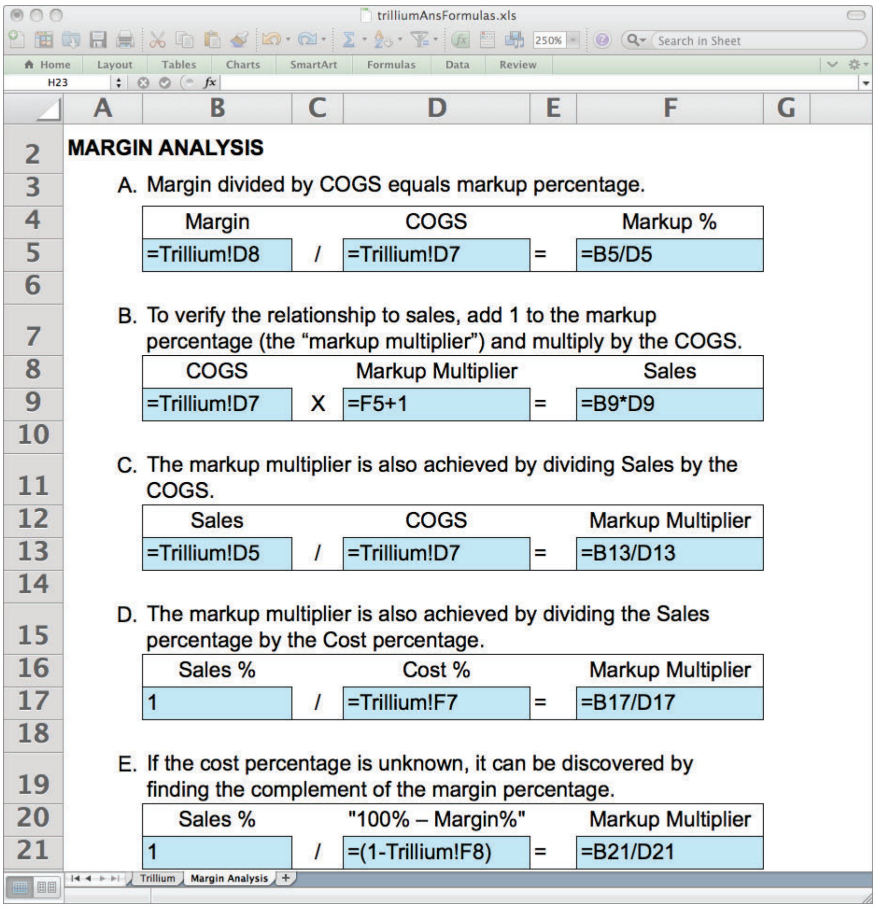
H. *The danger of increasing the desired margin too much is that the quantity sold will drop because consumers look for cheaper alternatives. This results in lower sales volume and a lower gross profit.*

I. *The retail price of an inventory item will change over time because of sales and other discounts. You could adapt the spreadsheet model by adding more columns for the various retail prices and quantities sold at each level. Since the calculation will be more involved, each product should be given its own sheet that uses cell references to link to the Inventory Pricing and Values sheet.*

Exercise 2, p. 441

This is a spreadsheet exercise.

A.



trilliumAnsFormulas.xls

MARGIN ANALYSIS

A. Margin divided by COGS equals markup percentage.

Margin		COGS		Markup %
=Trillium!D8	/	=Trillium!D7	=	=B5/D5

B. To verify the relationship to sales, add 1 to the markup percentage (the "markup multiplier") and multiply by the COGS.

COGS		Markup Multiplier		Sales
=Trillium!D7	X	=F5+1	=	=B9*D9

C. The markup multiplier is also achieved by dividing Sales by the COGS.

Sales		COGS		Markup Multiplier
=Trillium!D5	/	=Trillium!D7	=	=B13/D13

D. The markup multiplier is also achieved by dividing the Sales percentage by the Cost percentage.

Sales %		Cost %		Markup Multiplier
1	/	=Trillium!F7	=	=B17/D17

E. If the cost percentage is unknown, it can be discovered by finding the complement of the margin percentage.

Sales %		"100% – Margin%"		Markup Multiplier
1	/	=(1-Trillium!F8)	=	=B21/D21

Trillium | Margin Analysis

B. *When Net Sales is changed to $400 000, the markup multiplier increases from 184.1% to 195.0%.*

Name ______________________ Date ______________________

SECTION 10.7 REVIEW QUESTIONS (page 445)

1. *The perpetual inventory system is a system where the record of items in stock is kept up to date in detail on an ongoing basis.*
2. *Before the use of computers, a perpetual inventory system was recorded manually on file cards.*
3. *Only a few companies kept track of inventory on card files because it was very time consuming and expensive.*
4. *The source document for additions to inventory in a manual system is a receiving report.*
5. *The source document for deductions from inventory in a manual system is a shipping order.*
6. *Deductions from inventory after a sale in a department store are made through the point-of-sale terminal. The cashier enters the codes and quantities sold and the POS terminal automatically updates the inventory records.*
7. *It is not necessary to count the inventory when using a perpetual inventory system because the figures are always up to date. However, random checks of the inventory are made to ensure the merchandise had not been stolen or damaged, two reductions in inventory that the POS system cannot track. A physical count will also be done at the end of the fiscal year to ensure the accuracy of the inventory account in the ledger.*
8. *This is the entry for the cost portion of a sale when the perpetual inventory system is used.*

	Dr	*Cr*
Cost of Goods Sold	*$$$$*	
Merchandise Inventory		*$$$$*

9. *Switching from the periodic system to the perpetual inventory system adds the Cost of Goods Sold account to the general ledger and eliminates the Purchases account and the Purchases Returns and Allowances account.*
10. *Under both inventory systems, transportation charges are accumulated in a separate account, such as Freight-in.*
11. *If inventory were lost, stolen, or damaged under the perpetual inventory system, you would debit Inventory Shrinkage.*

SECTION 10.7 EXERCISES (page 445)

Exercise 1, p. 445

A. Additions to inventory are usually made from copies of *receiving reports*.

B. *Competition* forces department stores to use the perpetual inventory system.

C. In a computer inventory system, each inventory item is given a(n) *unique code*.

D. The *perpetual* inventory system produces up-to-the-minute information that cannot be produced by the *periodic* inventory system.

Name ______________________ Date ______________________

SECTION 10.7 EXERCISES (continued)

Exercise 1, p. 445 (continued)

E. Deductions from store inventory are made from copies of *shipping orders* or, more commonly, through *point-of-sale terminals*.

F. Any differences between the *book* figures and the actual figures require a(n) *adjustment* to the book figure.

G. Even in a computer inventory system, a(n) *count* of the stock is necessary.

H. A journal entry for a sale under the perpetual inventory system includes a debit to *Cost of Goods Sold* and a credit to *Merchandise Inventory*.

I. When buying inventory, the *Purchases* account is not used with the perpetual inventory system.

J. Spoiled merchandise forces a debit to the *Inventory Shrinkage* account.

Exercise 2, p. 446

INVENTORY CONTROL CARD

Stock Number 730-0320

Description SCHAEFER CHEEK BLOCK — Maximum 30

Location: Row 16 Bin 3 — Minimum 10

Date	Reference	Unit Cost	Quantity Received	Quantity Shipped	Balance on Hand
Feb. 20	Forward	15.50			28
26	S.O. 904			5	23
Mar. 1	*S.O. 921*			*5*	*18*
5	*S.O. 924*			*15*	*3*
19	*S.O. 928*			*2*	*1*
25	*R.R. 639*	*16.00*	*25*		*26*
30	*S.O. 930*			*12*	*14*

INVENTORY CONTROL CARD

Stock Number 713-3011

Description BARTON CAM CLEAT — Maximum 50

Location: Row 20 Bin 14 — Minimum 20

Date	Reference	Unit Cost	Quantity Received	Quantity Shipped	Balance on Hand
Feb. 24	Forward	9.20			37
26	S.O. 910			10	27
Mar. 1	*S.O. 922*			*6*	*21*
8	*S.O. 925*			*10*	*11*
15	*R.R. 636*	*9.40*	*35*		*46*
23	*S.O. 929*			*15*	*31*
31	*S.O. 931*			*20*	*11*

Name ______________________ Date ______________________

SECTION 10.7 EXERCISES (continued)

Exercise 2, p. 446 (continued)

B. *No. 730–0320: 14 × \$16.00 = \$224.00*

No. 713–3011: 11 × \$9.40 = \$103.40

The cost value of item No. 730–0320 is \$224.00 and item No. 713–3011 is \$103.40.

Exercise 3, p. 447

Bank

	40 000	10 000	1
2	11 000	3 000	4
3	15 000		
	53 000		

Sales

		11 000	2
		15 000	3
		26 000	

Merchandise Inventory

	50 000	6 000	2
1	10 000	9 000	3
4	3 000		
	48 000		

Cost of Goods Sold

2	6 000		
3	9 000		
	15 000		

Name ______________________ Date ______________________

SECTION 10.7 EXERCISES (continued)

Exercise 4, p. 448

A. Note: After the first printing, the May 22 transaction total was corrected to 423.47.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– May	3	*Merchandise Inventory*		*1 598 –*	
		HST Recoverable		*207 74*	
		Accounts Payable—Lau's Sports			*1 805 74*
		Purchased 40 pairs of shoes @ $39.95 each			
	7	*Accounts Payable—Lau's Sports*		*225 72*	
		HST Recoverable			*25 97*
		Merchandise Inventory			*199 75*
		Returned 5 pairs of defective shoes			
	12	*Accounts Payable—Lau's Sports*		*1 580 02*	
		Discounts Earned			*27 97*
		Bank			*1 552 05*
		Paid the full amount owing to Lau's			
	22	*Bank*		*423 47*	
		Cost of Goods Sold		*199 75*	
		Merchandise Inventory			*199 75*
		Sales			*374 75*
		HST Payable			*48 72*
		Sold five pairs of running shoes			
	29	*Sales Returns and Allowances*		*74 95*	
		HST Payable		*9 74*	
		Merchandise Inventory		*39 95*	
		Cost of Goods Sold			*39 95*
		Bank			*84 69*
		Customer returned defective runners			
	29	*Inventory Shrinkage*		*39 95*	
		Merchandise Inventory			*39 95*
		Returned shoes were discarded			

Name ______________________ Date ______________________

SECTION 10.7 EXERCISES (continued)

Exercise 4, p. 448 (continued)

B.

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– May	3	Accounts Receivable—Fleet Foot		1 805 74	
		Cost of Goods Sold		798 –	
		Merchandise Inventory			798 –
		Sales			1 598 –
		HST Payable			207 74
		Sold 40 pairs of shoes @ $39.95 each			
	7	Sales Returns and Allowances		199 75	
		HST Payable		25 97	
		Merchandise Inventory		99 75	
		Cost of Goods Sold			99 75
		Accounts Receivable—Fleet Foot			225 72
		Defective shoes returned—5 pairs @ $39.95 each			
	7	Inventory Shrinkage		99 75	
		Merchandise Inventory			99 75
		Defective shoes discarded			
	12	Bank		1 552 05	
		Discounts Allowed		27 97	
		Accounts Receivable—Fleet Foot			1 580 02
		Full payment of account			

Name ______________________ Date ______________________

SECTION 10.8 REVIEW QUESTIONS (page 452)

1. *The major expense that a merchandising business has that a service business does not is the cost of goods sold.*
2. *The essential difference between a merchandising business and a manufacturing business is that the merchandising business buys the goods it sells while the manufacturing business makes the goods it sells.*
3. *The differences in calculating the cost of goods sold for merchandising and manufacturing businesses is that merchandising business use the cost of goods purchased while manufacturing businesses have a more complex calculation to determine the cost of goods manufactured.*
4. *Cost accounting is a specialized area of accounting that concentrates on determining, controlling, and reporting the costs of doing business.*
5. *The calculation for the cost of goods manufactured is not normally shown on the income statement because it is a detailed calculation that deserves its own statement.*
6. *Another name for the manufacturing statement is the schedule of the cost of goods manufactured.*
7. *Three important costs that make up the manufacturing costs for a fiscal period are raw materials, direct labour, and factory overhead.*
8. *Direct labour represents the wages for those employees who have a specific role in making the finished goods. Indirect labour represents wages to workers who support the manufacturing process.*
9. *Goods in process are goods that have had some raw materials, direct labour, or factory overhead costs applied to them but which are not yet in their finished state.*
10. *Another name for goods in process is work in progress or unfinished goods.*
11. *To determine the cost of goods manufactured, use the formula: Cost of Goods Manufactured = Beginning Goods in Process + Total Manufacturing Costs – Ending Goods in Process.*
12. *Three inventory accounts that may appear on the balance sheet of a manufacturing firm are Merchandise Inventory, Raw Materials Inventory, and Goods in Process Inventory.*
13. *Understanding the cost of goods formula helps you with the calculation on the manufacturing statement because the two calculations are similar. The cost of goods formula uses inventory and purchases while the manufacturing statement uses the cost of goods in process and manufacturing costs.*

Name ______________________ Date ______________________

SECTION 10.8 EXERCISES (page 452)

Exercise 1, p. 452

CODLING COMPANY

PARTIAL INCOME STATEMENT

YEAR ENDED DECEMBER 31, 20–

Sales			*$512 600 –*
Cost of Goods Sold			
Beginning Finished Goods		*$ 24 900 –*	
Cost of Goods Manufactured		*312 000 –*	
Cost of Goods Available		*$336 900 –*	
Ending Inventory of Finished Goods		*27 800 –*	
Cost of Goods Sold			*309 100 –*
Gross Profit			*$203 500 –*

Exercise 2, p. 453

CULL'S NOVELTIES
MANUFACTURING STATEMENT
YEAR ENDED DECEMBER 31, 20–

Raw materials			
Opening inventory of raw materials		$ 42 500	
Raw materials purchased	$89 600		
Freight charges	6900		
Cost of raw materials purchased		1. *96 500*	
Raw materials available for use		2. $*139 000*	
Less: Ending inventory of raw materials		3. *13 700*	
Raw materials used			$ 125 300
Direct labour			109 800
Factory overhead			
Indirect labour		$ 37 000	
Factory supplies used		11 600	
Property taxes		11 800	
Depreciation of factory and equipment		18 900	
Utilities		19 500	
Maintenance		8 000	
Total factory overhead costs			4. *106 800*
Total manufacturing costs			5. $*341 900*
Add: Goods in process Inventory, January 1			22 000
Total goods in process during the year			6. $*363 900*
Deduct: Goods in process Inventory, December 31			7. *45 500*
Costs of goods manufactured			$ 318 400

Name ____________________ Date ____________________

SECTION 10.8 EXERCISES (continued)

Exercise 3, p. 453 (continued)

RYDER INDUSTRIES

MANUFACTURING STATEMENT

YEAR ENDED DECEMBER 31, 20–

Raw materials			
Opening inventory of raw materials		$17 600 –	
Raw materials purchased	$45 300 –		
Freight charges	2 900 –		
Cost of raw materials purchased		48 200 –	
Raw materials available for use		$65 800 –	
Less: Ending inventory of raw materials		20 600 –	
Raw materials used			$ 45 200 –
Direct labour			67 800 –
Factory overhead			
Indirect labour		$13 500 –	
Factory supplies used		6 800 –	
Property taxes		7 900 –	
Depreciation of small tools		500 –	
Depreciation of factory and equipment		11 000 –	
Utilities		13 600 –	
Maintenance and repair		12 500 –	
Total factory overhead costs			65 800 –
Total manufacturing costs			$178 800 –
Add: Goods in process inventory, January 1			13 300 –
Total goods in process during the year			$192 100 –
Deduct: Goods in process inventory, December 31			29 700 –
Costs of goods manufactured			$162 400 –

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (page 455)

Using Your Knowledge

Exercise 1, p. 455 *Account names will vary.*

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– May	1	A/R—Hewitt Construction		741.28	
		Sales			656.–
		HST Payable			85.28
		Sales Invoice No. 501			
	5	Purchases		1 072.14	
		HST Recoverable		139.38	
		A/P—EMJ Steel Inc.			1 211.52
		Purchase Invoice No. 702			
	8	A/P—Great Lakes Wood Products		661.05	
		Purchases			585.–
		HST Recoverable			76.05
		Credit Invoice received No. 702			
	9	A/R—Northern Contracting		955.98	
		Sales			846.–
		HST Payable			109.98
		Sales Invoice No. 502			
	15	Sales		600.–	
		HST Payable		78.00	
		A/P—Precision Instruments			678.–
		Credit Invoice issued No. 503			
	19	Bank		115.83	
		Sales			102.50
		HST Payable			13.33
		Cash Sales Slip No. 12520			
	26	Freight-In		896.50	
		HST Recoverable		116.55	
		A/P—Pacific Transport			1 013.05
		Purchase Invoice No. 371			

Name ____________________ Date ____________________

CHAPTER 10 REVIEW EXERCISES (continued)
Exercise 2, p. 456

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Jun.	4	A/R—KBM Television		398.89	
		Sales			353.–
		HST Payable			45.89
		Sales Invoice No. 14522			
	5	A/R—R. Willis		565.–	
		Sales			500.–
		HST Payable			65.–
		Sales Invoice No. 14523			
	9	Sales Returns and Allowances		450.–	
		HST Payable		58.50	
		A/R—Court St. Clinic			508.50
		Credit Invoice issued, No. 14524			
	11	Bank		480.25	
		Sales			425.–
		HST Payable			55.25
		Cash Sales Slip No. 5602			
	12	A/P—Toshiba Corporation		2800.14	
		Purchases Returns and Allowances			2478.–
		HST Recoverable			322.14
		Credit Invoice received, No. 7654			
	17	Freight-in		256.–	
		HST Recoverable		33.28	
		A/P—Harry's Trucking			289.28
		Purchase Invoice No. 442			

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)

Exercise 2, p. 456 (continued)

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Jun.	23	Sales Returns and Allowances		575 –	
		HST Payable		74 75	
		A/R—Northland Maintenance			649 75
		Credit Invoice issued, No. 14525			
	30	Purchases		530 –	
		Supplies		270 –	
		HST Recoverable		104 –	
		A/P—Imperial Supply			904 –
		Purchase Invoice No. 1205			

Exercise 3, p. 456

Indicate whether each of the following statements is true or false by entering a T or an F in the space provided. Explain the reason for each F response in the space provided.

A. A wholesaler is a merchandiser. Therefore, you can say that a merchandiser is a wholesaler. F

B. Some of the goods found in the inventory of a hardware store are also goods found in the inventory of a building supply store. T

C. Merchandise inventory is under Prepaid Expenses on the balance sheet. F

D. The cost of goods sold figure normally includes the cost of goods that are lost, stolen, or broken. T

E. The merchandise inventory of a drugstore is calculated by counting all the goods on hand and multiplying by the selling prices of the goods. F

F. An item that cost $40 and sold for $80 has a gross profit of 50% of the selling price. T

G. The difference between the selling price and the cost price of the goods for a fiscal period is also the net income figure before any operating expenses are deducted. F

H. The goods not sold represent the ending inventory. T

I. The goods sold at selling prices represent the revenue figure. T

J. The perpetual inventory system is not commonly used because of the work needed to keep track of the many items in the inventory. F

K. A used car business could easily use the perpetual inventory system because the number of items in its inventory is quite small. T

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)

Exercise 3, p. 456 (continued)

L. XYZ department store uses the periodic inventory system. It must take a physical inventory at least once a year. *T*

M. A perpetual inventory results in a "calculated" inventory figure. The inventory quantities shown on a perpetual inventory listing should be checked by inspecting the inventory from time to time. This would make clear whether or not any goods had been stolen. *T*

N. If the beginning inventory was 10 000 units and the ending inventory was 12 000 units, the business sold more units than it purchased. *F*

O. The merchandise inventory figure can be found during the fiscal period from the Merchandise Inventory account. *F*

P. The Purchases account is used to accumulate all purchases during the period. *T*

Q. When a business that uses the periodic inventory system sells goods, no accounting entry is made to reduce the merchandise inventory. If it were made, the entry would debit Cost of Goods Sold and credit Merchandise Inventory. *T*

R. The Freight-in account is used to accumulate all transportation charges during the fiscal period. *F*

S. Freight-in increases cost of the goods acquired. *T*

T. On the worksheet, the Purchases figure in the trial balance is extended to the Income Statement section, Debit column. *T*

U. On the worksheet, the Merchandise Inventory figure in the trial balance is extended to the Balance Sheet section, Debit column. *F*

V. Both the beginning and the ending inventory figures are shown on the income statement of a merchandising company. *T*

W. The Merchandise Inventory account is automatically adjusted by the closing entries. *T*

X. A credit invoice is issued by the vendor and received by the buyer. *T*

Y. The accounting entry for a credit note issued is either a. or b. below. Ignore taxes. *F*

	Dr	Cr
a. Accounts Receivable	$$$$	
Sales		$$$$

	Dr	Cr
b. Accounts Receivable	$$$$	
Sales Returns and Allowances		$$$$

Z. The best match for Merchandise Inventory on a balance sheet of a manufacturing company is Raw Materials Inventory. *F*

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)

Exercise 3, p. 456 (continued)

Explanations for F Responses

A. Many merchandisers, of course, sell to the public. These merchandisers are retailers, not wholesalers.

C. Merchandise Inventory is a current asset on the balance sheet.

E. Merchandise Inventory is calculated at cost.

G. The figure is called gross profit not net income. Also, items such as discounts, freight charges, and returns and allowances will affect the calculation.

J. Computer technology is making the perpetual system increasingly more common.

N. For an increase in inventory, the business purchased more than it sold.

O. During the fiscal period, the merchandise inventory figure becomes inexact when the periodic system is used. Even when the perpetual system is used, a physical count is needed to verify the accuracy of the ledger totals.

R. Freight-in is used only for the charges on transporting merchandise to the business for resale.

U. On the worksheet, the Merchandise Inventory figure in the trial balance is extended to the Income Statement section, Debit column.

Y. The correct accounting entries are:

	Dr	Cr
a. Sales	*$$$$*	
Accounts Receivable		*$$$$*
b. Sales Returns and Allowances	*$$$$*	
Accounts Receivable		*$$$$*

Z. Merchandise Inventory is similar to Finished Goods Inventory.

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)

Exercise 4, p. 458

MASTER SECURITY SYSTEMS

INCOME STATEMENT

YEAR ENDED DECEMBER 31, 20–

Revenue			
Sales		*$229 350.50*	
Less Sales Returns and Allowances		*4 092.–*	
Net Sales			*$225 258.50*
Cost of Goods Sold			
Merchandise Inventory, January 1		*$ 45 957.–*	
Purchases	*$75 316.20*		
Less Purchases Returns and Allowances	*7 621.90*		
Net Purchases		*67 694.30*	
Freight-in		*1 592.–*	
Cost of Goods Available for Sale		*$115 243.30*	
Less Merchandise Inventory, December 31		*43 500.–*	
Cost of Goods Sold			*71 743.30*
Gross Profit			*$153 515.20*
Operating Expenses			
Advertising Expense		*$ 1 585.–*	
Bank Charges Expense		*2 685.–*	
Car Expense		*8 356.–*	
Delivery Expense		*5 695.21*	
Depreciation Expense—Automobiles		*7 424.–*	
Depreciation Expense—Equipment		*6 086.–*	
General Expense		*1 632.25*	
Insurance Expense		*2 417.–*	
Rent Expense		*12 000.–*	
Supplies Expense		*2 563.–*	
Telephone Expense		*1 115.33*	
Utilities Expense		*3 875.25*	
Wages Expense		*47 256.32*	
Total Operating Expenses			*102 690.36*
Net Income			*$ 50 824.84*

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)

Exercise 5, p. 459

A.

GREEN'S GARDEN CENTRE
INCOME STATEMENT
YEARS ENDED DECEMBER 31, 20–1 AND 20–2

	20-1	20-2
Sales	$100 000	$120 000
Costs of Goods Sold		
Opening Inventory	$ 20 000	$ 25 000
Purchases	*40 000*	*38 000*
Goods Available for Sale	$ *60 000*	$ 63 000
Less Closing Inventory	25 000	*22 000*
Cost of Goods Sold	$ *35 000*	$ *41 000*
Gross Profit	$ 65 000	$ *79 000*
Expenses	$ *32 000*	$ 37 000
Net Income	$ 33 000	$ 42 000

B. *The net income for 20–2 would be understated by $4000 ($29 000 instead of $33 000).*

C. *The net income for 20–2 would be overstated by $4000 ($46 000 instead of $42 000).*

D. *The inventory on the 20–1 balance sheet would be understated by $4000.*

Exercise 6, p. 459

A.

	No. 460	No. 911
Quantity on hand to start	*32*	*25*
Receipts and shipments	*– 8*	*– 5*
	– 10	*– 8*
	– 2	*+ 40*
	+ 30	*– 15*
	– 15	*– 12*
Quantity on hand at end	*27*	*25*

B. *27 × $46 = $1 242*

The inventory value for item No. 460 is $1242.

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)

Exercise 7, p. 460

Gross profit is 40% of sales. Gross profit: $103 850 × 40% = $41 540.

Cost of Goods Sold = Sales – Gross Profit.

Cost of Good Sold: $103 850 – $41 540 = $62 310.

Cost of goods available for sale is calculated from ledger account data ($127 128). The difference between cost of goods available for sale and cost of goods sold is the “cost of goods not sold”, or in other words, the closing inventory.

Closing Inventory: $127 128 – $62 310 = $64 818.

SUTTON HARDWARE STORE

ESTIMATED INCOME STATEMENT

MONTH ENDED JANUARY 31, 20–

Revenue		
Sales		$103 850 –
Cost of Goods Sold		
Merchandise Inventory, January 1	$ 51 920 –	
Purchases	73 950 –	
Freight-in	1 258 –	
Cost of Goods Available for Sale	$127 128 –	
Less Merchandise Inventory, January 31	64 818 –	
Cost of Goods Sold		62 310 –
Gross Profit		$ 41 540 –
Operating Expenses		
Operating Expenses		22 357 –
Net Income		$ 19 183 –

Exercise 8, p. 460

Unaudited net income	$38 525
Add cost of new equipment	+ 4 200
Deduct depreciation on new equipment	– 840
No change to net income for the incorrect credit	0
Add overcharge on repairs to auto	+ 1 500
Deduct supplies used	– 2 010
Deduct inventory deduction	– 3 300
Adjusted net income figure	$38 075

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)

Exercise 9, p. 461

A. a. *Since inventory is lower than it should be, the cost of goods sold is higher than it should be by $10 000. This is because the overlooked inventory is assumed to be sold, which means the cost of selling is inflated.*

b. *The inflated and artificial cost of selling causes the gross profit to be understated by $10 000.*

c. *The net income also will be understated by $10 000.*

d. *The Merchandise Inventory account and the Capital account will both be understated by $10 000 because assets are less than what they should be, causing the owner to have a smaller claim.*

B. *If the inventory was overstated, the cost of goods sold would be understated by $10 000. The gross profit, net income, Merchandise Inventory account, and Capital account would all be overstated by $10 000.*

C. *To make the profit appear higher, you could consider inflating the ending inventory figure. This lowers the cost of goods sold and when you lower costs, profits go up.*

D. *To cheat on taxes, you might consider understating the ending inventory. This would result in a higher cost of goods sold figure. Increasing costs causes a lower profit on the income statement and a lower income tax bill.*

E. *No, your method in Part D would not save tax dollars over a two-year period. If the ending inventory is understated by $50 000, the cost of goods sold will be higher in that year by $50 000. However, this ending inventory becomes the beginning inventory in the new fiscal year. Since the cost of the beginning inventory is $50 000 lower than it should be, the overall costs in the new fiscal year will wind up being $50 000 less than they would have been. This results in an overstated net income in the new fiscal year and a larger tax bill. The scheme merely postpones the payment of taxes. The owner might still be tempted to cheat because they may think other business circumstances will arise in the new year that make the postponement of taxes advantageous such as (planned purchases of new equipment, an impending labour contract with employees, etc.), but hopefully sound morals, ethics, and a desire to build a solid business reputation will prevail.*

Name ______________________ Date ______________________

CHAPTER 10 REVIEW EXERCISES (continued)
Exercise 10, p. 461

GENERAL JOURNAL PAGE

DATE		PARTICULARS	P.R.	DEBIT	CREDIT
20– Aug.	9	A/R—G. Baker		234.81	
		Sales			207.80
		HST Payable			27.01
		Invoice No. 802			
	17	Sales Returns and Allowances		14.40	
		HST Payable		1.87	
		A/R—G. Baker			16.27
		Credit Invoice No. 851			
	26	Bank		214.17	
		Discounts Allowed		4.37	
		A/R—G. Baker			218.54
		Cheque received			

CHAPTER 10 REVIEW EXERCISES (continued)
Exercise 11, p. 462

SUPERIOR TRADING COMPANY

INCOME STATEMENT

YEAR ENDED DECEMBER 31, 20–

Revenue			
Sales		*$207 245 50*	
Less Sales Returns and Allowances	*$ 4 102 –*		
Discounts Allowed	*3 525 24*	*7 627 24*	
Net Sales			*$199 618 26*
Cost of Goods Sold			
Merchandise Inventory, January 1		*$ 44 323 40*	
Purchases	*$73 219 20*		
Less Purchases Ret. & Allow. $5 625.00			
Discounts Earned 1 023.65	*6 648 65*		
Net Purchases		*66 570 55*	
Freight-in		*1 501 –*	
Merchandise Available for Sale		*$112 394 95*	
Less Merchandise Inventory, December 31		*43 750 –*	*68 644 95*
Gross Profit			*$130 973 31*
Operating Expenses			
Advertising Expense		*$ 1 426 –*	
Bank Charges Expense		*2 247 –*	
Car Expense		*8 135 –*	
Delivery Expense		*5 535 –*	
Depreciation Expense—Automobiles		*3 600 –*	
Depreciation Expense—Equipment		*2 400 –*	
General Expense		*1 505 15*	
Insurance Used		*2 075 –*	
Rent Expense		*12 000 –*	
Supplies Used		*2 203 –*	
Telephone Expense		*1 052 25*	
Utilities Expense		*1 785 25*	
Wages Expense		*46 056 35*	*90 020 –*
Net Income			*$ 40 953 31*

CHAPTER 10 REVIEW EXERCISES (continued)

Questions for Further Thought, p. 463

1. *The inventories mentioned are not merchandise inventory because they are to be used and not resold. Therefore, they are not a factor in determining a figure for cost of goods sold. They represent materials used in the operation of the business and are treated in the accounts in the same way as supplies.*
2. *Yes, this conclusion is true. Merchandise that has been bought represents a cost to the company. If it is still on hand, it is an asset. If it is not still on hand, its cost must be included as a deduction from revenue to arrive at a correct gross profit. This is true regardless of how the inventory left the business. The cost of goods sold formula helps calculate gross profit in a straight-forward way, and this is acceptable accounting practice; however, the formula is unable to reveal the amount of inventory lost, broken, and stolen.*
3. *The value of merchandise listed on the balance sheet is determined by the units on hand multiplied by their cost price. The amount of Sales on the income statement is determined by the number of inventory units sold multiplied by their selling (retail) price.*
4. *The gross profit is shown separately on the income statement so that it is easy to see the amount of gross profit that is necessary to cover operating expenses and yield a net income. Also, the amount of gross profit can be easily converted to a percentage of sales, which gives business owners an idea of how much to mark up the cost price of their inventory items.*
5. *Computers constantly track levels of inventory and automate the re-ordering process. The advantages of carrying a smaller inventory are that less money is invested in inventory and the company can spend less on storage facilities. This frees up cash, reduces the need to borrow, and lowers interest charges as a result.*
6. *The merchandise sold is listed first as revenue at its selling price and then as the cost of goods sold at its cost price. It needs to be listed twice because the business pays a different price to buy the goods than it does to sell the goods.*
7. *Listing the closing inventory at its cost price is easy to calculate and gives readers of the balance sheet an objective and understandable figure to examine. When special market conditions arise, the value of inventory can be adjusted.*
8. *Freight-in is included in the cost of goods calculation because the cost of transporting the merchandise to the business is one of the logical costs of acquiring the merchandise.*
9. *A business might close down for a day or two in order to take inventory because the process of sorting and counting all the merchandise disrupts the business's normal operations. It is also difficult to count items accurately if they are being sold at the same time.*
10. *Businesses with a periodic inventory system take inventory even though they would rather not because it is a necessary step in determining cost of goods sold, gross profit, and net income.*

Name ____________________ Date ____________________

CHAPTER 10 REVIEW EXERCISES (continued)

Questions for Further Thought, p. 463 (continued)

11. *The method of handling the merchandise inventory on the worksheet records the opening inventory as a cost in the Income Statement, Debit column. It also records the ending inventory as a contra-cost in the Income Statement, Credit column, and as an asset in the Balance Sheet, Debit column. No adjustment is made to an existing figure; nothing is recorded in the adjustments columns.*
12. *Sound arguments can be made for all three major financial statements: the balance sheet, income statement, and cash flow statement. Yet, the income statement is probably of most interest to a banker because it shows the business's net income and operating expenses. If the business is making a profit and is projected to make a profit in the future, it will likely be able to cover the interest costs associated with additional bank loans.*
13. *The most common error made by students when doing the closing entries for a merchandising business is to forget to include the merchandise inventory figures in the closing entries.*
14. *The credit note got its name because it means the customer—specifically, an accounts receivable customer—is getting some type of allowance to reduce the amount owed. This means Accounts Receivable is decreasing and it does so with a credit entry not a debit entry.*
15. *In purchase transactions where returns and allowances are involved, there is no point in paying for a transaction until all the source documents are received and the final amount of the transaction is known.*
16. *Businesses that refuse to give a cash refund for returned merchandise offer a credit instead.*

Cases for Further Thought, p. 463

1. *Price is not the only consideration for Paula's customers. Her business offers a wide variety of products in one place, and it obviously provides outstanding customer service.*

CASE STUDIES (page 464)

Case 1 *Analyzing Income Statements for Two Merchandising Companies* (p. 464)

1. *From looking at the sales figures, Company A is likely a small company and Company B is likely a large company. From looking at the building maintenance, rent, and wages figures, Company A is physically smaller than Company B and has less office space and fewer employees. From looking at the advertising expense, Company B has a higher profile than Company A, which spends no money on advertising.*
2. *Company B has higher expenses than Company A but is able to earn more than twice the net income of Company A because it has a much higher amount of gross profit.*

Name ________________________ Date ________________________

CASE STUDIES (continued)

Case 1 *Analyzing Income Statements for Two Merchandising Companies* (continued)

3\. A. *$211 686 ÷ $415 072 = 51%*

For Company B, the cost of goods sold is 51% of sales.

B. *Cost of Good Sold (58% of Sales): $415 072 × 58% = 240 742*

Net income: $415 072 – $240 742 – $149 025 = $25 305

Difference in Net Income: $54 361 – $25 305 = $29 056

Company B's net income would decrease by $29 056 if its cost of good sold was 58% of sales.

Case 2 *Why Have Gross Profits Declined?* (p. 465)

1. *$110 000 × 50% = $55 000*

   The correct cost of goods sold figure should have been $55 000.

2. *The high cost of goods sold figure is likely a result of a loss of inventory due to theft. In this situation, it seems probable that the new manager, Jonathan Yeo, is responsible for the loss.*

3. Cost of Goods Sold

Beginning inventory		*$ 36 500*	
Purchases	+	*67 000*	
Goods Available for Sale		*$103 500*	
Ending Inventory	–	*48 500*	
Cost of Goods Sold		*$ 55 000*	*50*%

4. *Piran Trewin could prevent any irregularities in the inventory by starting a system where all inventory is carefully controlled for a specific time period. Then, any losses of inventory during this time could probably be traced to a specific cause and the weakness in the system could be eliminated. Also, it may be that Jonathan Yeo is not a good man for the job and a better person should be hired to replace him. Perhaps Piran Trewin should oversee his business more closely.*

Case 3 *Squeeze Play?* (p. 466)

1. *On the surface, Lequita is a sharp business person. She appears to be picking up easy discounts of sizable amounts. However, this might not always be to the company's advantage. Good reputations in business produce profits over the long term. Lequita's scheme will diminish goodwill with suppliers. At some point, they might respond by refusing to provide credit terms, increasing prices, delivering sub-standard materials, giving poor customer service, or complaining to the government officials who award contracts to Highway Construction.*

2. *No, Lequita's policy is not ethical because it is based on misrepresentation. She agrees to the supplier's terms of sale at purchase but does not honour these terms when she receives the bill. It is not illegal, she will not go to jail for it, but it will sour relations with her suppliers, which is a considerable hidden cost in the long run.*

CASE STUDIES (continued)

Case 3 *Squeeze Play?* (continued)

3. *$200 000 × 2% = $4000*
   The 2% discount is $4000.

4. *Whether Lequita's money-saving claim is true or false depends on how long she takes to pay the bank loan. Using the $200 000 invoice as an example, the timeframe might work like the scenario below.*
   - *The invoice is received. Highway Construction has no intention of paying it until 100 days have lapsed.*
   - *Highway Construction hears nothing from the supplier for the first 30 days because the invoice is not due. After 10 days of being overdue—and 40 days since the invoice was received—the supplier calls and agrees to Lequita's scheme.*
   - *Lequita was going to wait 100 days before paying $200 000, but will now pay $196 000 after 40 days. This forces her to borrow $196 000 for 60 days.*
   - *The cost of borrowing $196 000 for 60 days at 10% is $3222 ($196 000 × 10% × 60 ÷ 365). Therefore, Lequita's scheme saves $778 ($4000 – $3222).*
   - *But, there is a good chance that Lequita might not pay the bank loan at the end of 60 days, given her poor business attitude and the business's uncertain cash flow patterns. If she holds on to the loan for 90 days, for example, she actually costs the business $833 ($196 000 × 10% × 90 ÷ 365 = $4833).*

5. *If I were the accountant for Highway Construction, I would inform suppliers at the time of purchase of our cash flow situation and that they will have to wait a good length of time before receiving payment, perhaps up to 90 days, but no more. This way, they can plan for the delay. If the delay is not acceptable to them, and they would prefer to decline considerable sales revenue, then that is their choice. In a competitive market, though, they likely would still be happy for the business. Business people are willing to absorb some inconveniences if they are assured that they are dealing with straightforward and honest people.*

Name ______________________ Date ______________________

CASE STUDIES (continued)

Case 4: Challenge *A Scheme To Save Income Tax?* (p. 467)

1. *Yes, Vince is correct that the net income for the two years remains the same no matter how it is calculated.*
2. *Yes, Vince would be guilty of tax evasion. Tax laws do not leave room for cheating on this year's tax return on the premise that extra payments will be paid at some time in the future. Yes, he is violating accounting standards. The International Financial Reporting Standards require financial statements to be relevant and reliable. Vince's valuation of inventory is misleading.*
3. *Yes, the scheme offers the hidden benefit of saving Vince some interest charges because he will have an extra $7000 and will not need a bank loan in order to pay his tax bill. In essence, the government and taxpayers are lending him money free of charge.*
4. *The main danger of the scheme is that Vince could be charged with tax evasion, which could result in a large fine, jail time, or both. He is risking his reputation and his business. This type of scheme might also become a habit if he continues to lose in the stock market and take other financial risks, which will increase his chances of getting caught. The company accountant or a manager in charge of taking inventory is most likely to detect this scheme. Tax auditors at CRA might also notice a large drop in inventory, when compared to previous years. They would subsequently question why the extra inventory leaving the store did not produce a higher sales volume.*

CAREER

Evelin Wong, CA, CPA/Manager, Audit and Assurance Services/McGovern, Hurley, Cunningham, LLP, Toronto (page 469)

Discussion (p. 470)

1. *Evelin chose a career in accounting instead of science because of the wide range of job opportunities. As she says, every company has to deal with accounting but not every company has a science department.*
2. *The skills Evelin learned on the job that she did not learn in university were time management, working under pressure, communicating complex ideas, and multitasking.*
3. *Differences: The medium-sized firm has tighter deadlines, more complex accounting issues, and stricter reporting standards that the small accounting firm. Evelin worked alone in the small firm and in a team in the larger firm. Similarities: Both firms use the same format for the engagement forms and used the same accounting standards.*
4. *Positive aspects of Evelin's job are meeting interesting people, learning new things, and travelling to exotic locations. Negative aspects of Evelin's job are the long work hours, unexpected deadlines, and high levels of stress.*