Recording Purchases of Merchandise

Perpetual

- Purchases are recorded by <u>debiting</u> **Merchandise Inventory** and <u>crediting</u> **Cash or Accounts Payable.**
- Only the goods purchased to *sell to customers* are recorded in the Merchandise Inventory Account. → any assets such as supplies or equipment that the business uses, would be directed to those specific accounts.
- The Merchandise Inventory account is always kept up-to-date.
- Any *Purchase Returns and Allowances* or *Purchase Discounts* would result in a credit entry to Merchandise Inventory.

Periodic

- Four accounts – Purchases, Purchase Returns and Allowances, Purchase Discounts, and Freight In – are used to record the purchase of inventory.
- *Purchases* are recorded by <u>debiting</u> **Purchases** and <u>crediting</u> **Cash** or **Accounts Payable.**
- *Net Purchases* are calculated as follows:

Purchases	−	Purchase Returns and Allowances	−	Purchase Discounts	=	Net Purchases
$325,000	−	$10,400	−	$6,800	=	$307,800

- *Cost of Goods Purchased* is calculated as follows:

Net Purchases	+	Freight In	=	Cost of Goods Purchased
$307,800	+	$12,200	=	$320,000

Use FIRST HALF of Illustration 5A-2 on page 224 to help with transactions involving <u>PURCHASES</u>.

SUBSIDIARY INVENTORY RECORDS
Subsidiary Ledger

- A group of accounts that share a common characteristic (all inventory accounts, all accounts payable).
- Frees the General Ledger from the details of individual balances.
- The General Ledger account that summarizes the subsidiary info is called a **Control Account.**
- **Purchases** and sales of each item of merchandise are recorded and posted to the individual inventory subsidiary ledger accounts.
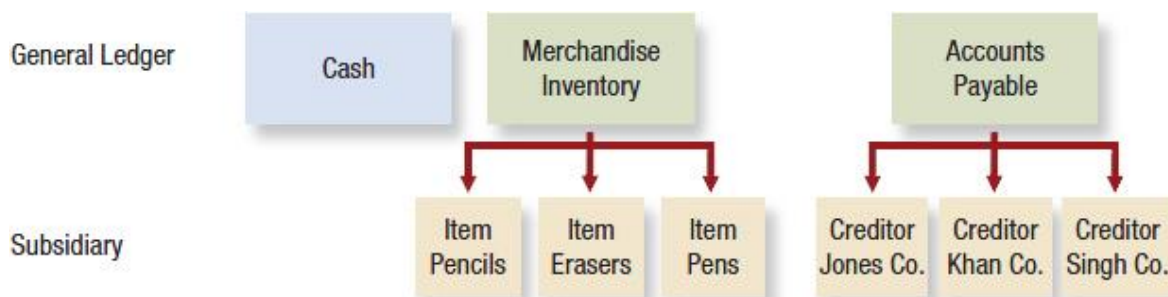
SALES TAXES

- In Ontario, we have the HST, which is a combination of the GST and the PST.
- Paid by merchandising companies of the goods that they purchase for resale.
- This cost is rarely part of the cost of the merchandise, because in most businesses, companies can get back any HST they pay on purchases by offsetting it against the HST they collect from customers or by filing a claim with the government.

FREIGHT COSTS

- The Sales/Purchase Invoice should indicate <u>WHEN the OWNERSHIP transfers</u> from the seller to the buyer.
    - o This may be at the shipping point, or the destination.

  ### FOB Shipping Point
    - o Ownership changes when the *goods are <u>placed</u> on the carrier* by the seller (the shipping point).
    - o The <u>buyer</u> pays the freight costs and is responsible for any damages.

  ### FOB Destination
    - o Ownership changes when the *goods are <u>delivered</u> by the carrier* to the *buyer's place of business* (the destination).
    - o The <u>seller</u> pays the freight costs and is responsible for any damages.
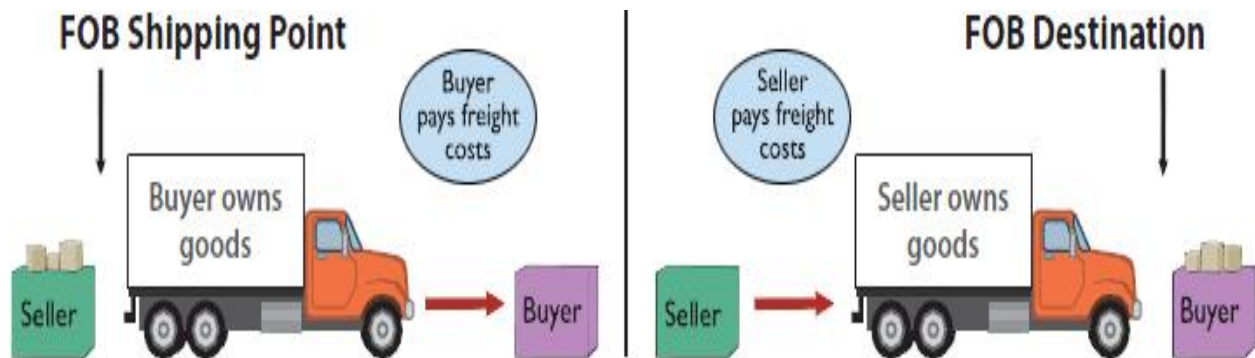
FOB stands for Free on Board. FOB (Free On Board) is a term specifying at what point the <u>seller</u> transfers ***ownership*** of the goods to the <u>buyer.</u>

PURCHASE RETURNS AND ALLOWANCES

Purchase Return - when a buyer returns the product because they are unsatisfied/do not need the product.

Purchase Allowance - alternatively, the purchaser may choose to keep the merchandise if the seller is willing to grant an allowance (deduction) from the purchase price.

DISCOUNTS

Quantity Discounts

- A deal for a bulk purchase.
- All accounting entries are based on the net price of purchase after the quantity discount has been subtracted
- Not recorded or accounted for separately.

Purchase Discounts

- A reward for prompt payment.
- Computed on the *net purchase amount* after the quantity discount.
- Noted on the invoice by the use of credit terms that specify the amount and the time period for the purchase discount.
- Ex.: 2/10 n/30 - if you pay within 10 days, you will receive 2% off, otherwise it is due within 30 days.

  - **Perpetual -** When an invoice is paid within the discount period, the **Merchandise Inventory account** will be reduced by the amount of the discount because <u>inventory is recorded at cost.</u>
  - **Periodic -** When an invoice is paid within the discount period, the **Purchase Discounts account** (a contra account) will be reduced by the amount of the discount because inventory is recorded at cost.