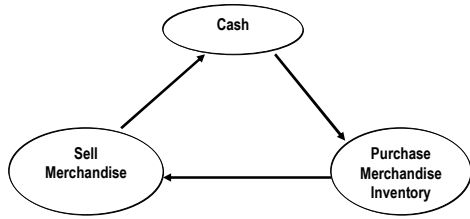
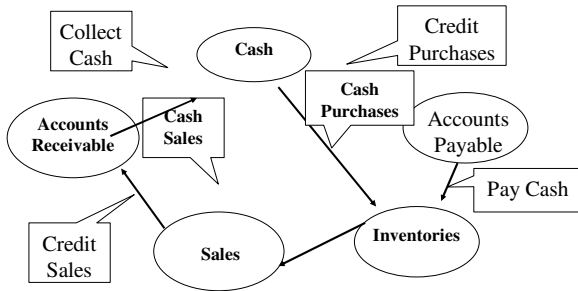


Operating Cycle



if a company has cash sales only, then the cycle is cash-inventories-sales-cash

Detailed Operating Cycle



The shorter the operating cycle, the more profitable the companies are

Accounting for Inventories

- The costs included in acquisition cost of manufactured inventory
- The valuation basis used for items in inventory
- The frequency of carrying out inventory computations -- periodically or perpetually
- The cost flow assumption used to trace the movement of costs into and out of inventory. The cost flow assumption need not parallel the physical movement of goods.

Inventory systems

- *perpetual* - a company maintains a running record of purchases and sales through (merchandise) inventory account
- *periodic* - record their purchases in a separate account called 'purchases'
 - decrease in inventory due to sale of goods is not recorded in the inventory account
 - After the physical count is completed at the end of the accounting period, the **cost of goods sold (in short COGS)** can be determined.
- cost of goods sold reflects the cost of inventories consumed in generating the revenue of the period
- Physical count - counting and valuing inventories on hand at the end of an accounting period

**COGS= Beginning Inventory
+ Purchases
- Ending Inventory (as determined by physical count)**

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How do we determine the Acquisition Cost of Purchased Inventory?

-Determine purchase price :

- ordering goods +
- receiving +
- inspecting +
- recording the purchase +

•Recorded when title passes to the firm.

-Adjust purchase price for:

- transportation (add)
- handling (add)
- customs and duties (add)
- cash discounts (deduction)
- returns (deduction)
 - to determine the acquisition cost

Cost of inventory should include all costs incurred to acquire goods and prepare them for sale.

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How do we record the adjustments to purchase price?

Depends on the recording system: Perpetual or Periodic

Perpetual Inventory System:

- A running record of purchases are kept through "**merchandise inventory**" account
- Purchases entries and Adjustments are made to the merchandise inventory account
- The amount of inventories at a point in time can be determined
- Cost of Goods sold is known during the period

Periodic Inventory System:

- Purchases of inventory are recorded in "**Purchases**" account
- Adjustments are made to separate accounts"
- Amount of inventories at a point can not be determined unless a physical count is made
- Cost of goods sold can be determined after physical count at the end of the period

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How do we determine the cost of goods that are sold -COGS?

Perpetual

- Accumulated in cost of goods sold account as sales are made
- Known during the period
- Physical count made at the end – helps to determine inventory shrinkage

Periodic

- Cost of goods sold can be determined after the physical count
- Beginning Inventory (from previous period) +
- Purchases (net) –
- Ending Inventory (physical count) =
- Cost of goods sold
- Cannot determine inventory shrinkage

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Merchandising Terms and Concepts

- **F.O.B. shipping point (free-on-board-shipping point)**: the ownership of the goods is transferred to the buyer when the goods are loaded for shipment
- **F.O.B. destination (free-on-board destination)**: in this case the ownership of goods is transferred to the buyer when the goods reach their final destination
- **bulk discounts** or **trade discounts**, and **cash discounts**
- For example, the terms of sales could state 2/10, n/30

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Accounting for Cash Discounts

➤ Gross Method

- Buyer (seller) assumes that they will not pay within the cash discount period

➤ Net Method

- Buyer (seller) assumes that they will pay within the discount period

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Accounting for Purchases- Periodic Inventory System

Giysi Giyim A.Ş. purchases sweaters and pants from a manufacturer for resale purposes. Each sweater costs TL 10, and that a pair of pants costs TL 15, and Giysi Giyim A.Ş. purchases 50 sweaters and 30 pairs of pants.

Entry for cash purchases:

Date	Account Title and Description	Debit	Credit
1 December 2007	Purchases	950	
	Cash		950
	Purchase of merchandise for cash		

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Accounting for purchases-periodic-credit

Date	Account Title and Description	Debit	Credit
1-Dec-07	Purchases	950	
	Accounts Payable		950
	Purchase of merchandise on credit		

Case 1: pays within the discount period

Date	Account Title and Description	Debit	Credit
9-Dec-07	Accounts Payable	950	
	Purchase Discounts		19
	Cash		931
	Payment of Accounts Payable; discount taken		

Case 2: pays after the discount period

Date	Account Title and Description	Debit	Credit
30-Dec-07	Accounts Payable	950	
	Cash		950
	Payment of Accounts Payable; no discount		

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Purchase Returns and Allowances- Periodic

- Goods may be returned or an allowance may be granted if the goods are defective, damaged or not in accordance with specifications
- Giysi Giyim A.Ş. decides to return TL 50 of merchandise to the manufacturer
- Giyim A.Ş. decides to keep it in exchange for a TL 5 reduction in price

Date	Account Title and Description	Debit	Credit
8-Dec-07	Accounts Payable or Cash	50	
	Purchase Returns and Allowances		50
	Return of merchandise		

Date	Account Title and Description	Debit	Credit
9-Dec-07	Accounts Payable or Cash	5	
	Purchase Returns and Allowances		5
	Received Purchase allowance		

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Transportation Costs

- **freight charges**
- buyer is responsible for the transportation costs, it is called the **freight-in**
- seller is responsible for transportation costs it is called **Delivery Expenses** or **Freight-out**
- for example, Giysi Giyim A.Ş. and the manufacturer agree on FOB shipping point, Giysi Giyim A.Ş. will pay for the transportation costs

Date	Account Title and Description	Debit	Credit
2-Dec-07	Freight- in	50	
	Cash		50
	Payment of transportation charges		

Total Cost of Merchandise

Purchases	TL950
Less: Purchase Returns and Allowances	55
Less: Purchase Discounts	<u>19</u>
Net Purchases	876
Plus: Freight-in	<u>50</u>
Total Cost of Merchandise	TL 926

Accounting for Purchases-Perpetual Inventory System

Recording of purchases for cash or credit:

Date	Account Title and Description	Debit	Credit
1-Dec-07	Merchandise Inventory	950	
	Accounts Payable or Cash		950
	Purchase of merchandise		

If the company pays within the discount period:

Date	Account Title and Description	Debit	Credit
9-Dec-07	Accounts Payable	950	
	Merchandise Inventory		19
	Cash		931
	Payment of Accounts Payable; discount taken		

If the company pays after the discount period:

Date	Account Title and Description	Debit	Credit
30-Dec-07	Accounts Payable	950	
	Cash		950
	Payment of Accounts Payable; discount not taken		

Purchase Returns and Allowances

Date	Account Title and Description	Debit	Credit
8-Dec-07	Accounts Payable or Cash	50	
	Merchandise Inventory		50
	Return of merchandise		

Date	Account Title and Description	Debit	Credit
9-Dec-07	Accounts Payable or Cash	5	
	Merchandise Inventory		5
	Received Purchase allowance		

Freight Cost - under the perpetual inventory system

Date	Account Title and Description	Debit	Credit
1-Dec-07	Merchandise Inventory	1.000	
	Accounts Payable		1.000
	Purchase of merchandise on credit-freight cost paid by the buyer –FOB shipping point		

Date	Account Title and Description	Debit	Credit
2-Dec-07	Account payable	50	
	Cash		50
	Payment of freight charges		

Selling Merchandise and Recording Cost of Goods Sold

- **Sales** or **Sales Revenue**
- cash or credit
- Sales Returns and Allowances
- Sales Discounts

Accounting for Sale of Merchandise - Periodic Inventory System

Gysi Giyim A.S. sold five sweaters for TL 25 each, receiving cash

Date	Account Title and Description	Debit	Credit
12-Dec-07	Cash	125	
	Sales		125
	Sale of merchandise for cash		

If the same sales is made on credit ?

Date	Account Title and Description	Debit	Credit
12-Dec-07	Accounts Receivable	125	
	Sales		125
	Sale of merchandise on credit		

Sales Returns and Allowances

If the customers returns one of the sweaters

Date	Account Title and Description	Debit	Credit
15-Dec-07	Sales Returns and Allowances	25	
	Cash or Accounts Receivable		25
	Merchandise returned		

Accounting for Cash Discounts – Sales-Periodic or Perpetual

Gysi Giyim A.S. sold TL 500 worth of merchandise to Okan Boutique with the terms 2/10, n/30.

Date	Account Title and Description	Debit	Credit
15-Dec-07	Accounts Receivable	500	
	Sales		500
	Sale of merchandise on credit 2/10, n/30		

Date	Account Title and Description	Debit	Credit
24-Dec-07	Cash	490	
	Sales Discount	10	
	Accounts Receivable		500
	Collection on account; discount taken		

How much will be collected after the discount period?

Partial Income Statement

Sales	TL 625
Less;Sales Returns and Allowances	40
Less:Sales Discounts	<u>10</u>
Net Sales	TL 575

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Accounting for Sale of Merchandise- Perpetual Inventory System

TWO ENTRIES ARE NECESSARY TO RECORD A SALE UNDER PERPETUAL INVENTORY SYSTEM

1. To record the sale transaction
2. To reflect the cost of the sales (cost of goods sold) made and deduct the cost of sales from the inventory

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Recording Sales-Perpetual

Giyisi Giyim A.S. sold five sweaters for TL 125 on credit. The cost of each sweater is TL 10.

1) Record sale

Date	Account Title and Description	Debit	Credit
12-Dec-07	Accounts Receivable	125	
	Sales		125
	Sale of merchandise on credit		

2) show the decrease in inventory and the corresponding increase in COGS

Date	Account Title and Description	Debit	Credit
12-Dec-07	COGS	50	
	Merchandise Inventory		50
	To record cost of goods sold		

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Accounting for Sales Returns- Perpetual System

When the customer returns one of the sweaters

Date	Account Title and Description	Debit	Credit
15-Dec-07	Sales Returns and Allowances	25	
	Cash or Accounts Receivable		25
	Merchandise returned		

Date	Account Title and Description	Debit	Credit
15-Dec-07	Merchandise Inventory	10	
	Cost of Goods Sold		10
	Returned goods to inventory		

Transaction	Periodic Inventory System	Perpetual Inventory System
Purchases Related		
- Purchase of Merchandise	Purchases	Merchandise Inventory
- Receive Cash Discount	Purchase Discounts	Merchandise Inventory
- Return of merchandise and /or receipt of price allowance	Purchase Returns and Allowances	Merchandise Inventory
- Transportation Costs-if born by the	Freight-in	Merchandise Inventory
Sales Related		
- Sale of Merchandise	Sales	Sales ; COGS and Merchandise
- Grant Cash Discount	Sales Discounts	Sales Discounts
- Return of merchandise by the customer	Sales Returns and Allowances	Sales Returns and Allowances / COGS and Merchandise Inventory
- Price allowance given to the customer	Sales Returns and Allowances	Sales Returns and Allowances
- Transportation Costs-if born by the	Freight-out (Delivery Expense)	Freight-out (Delivery Expense)

Gross Profit

**GROSS PROFIT =
NET SALES – COST OF GOODS SOLD**

**COST OF GOODS SOLD=
BEG INV + PURCHASES –END INV**

**GROSS PROFIT PERCENTAGE=
GROSS PROFIT/NET SALES**

COGS – Periodic Computation

Beginning Inventory:	TL 6.700
Plus: Purchases	14.800
Less: Pur.Disc	(300)
Pur.R&A	<u>(400)</u>
Net Purchases	14.100
Plus: Freight-in	<u>500</u>
Total Cost of Purh.	<u>14.600</u>
Cost of Goods Available for Sale	21.300
Less: Ending Inventory	<u>4.800</u>
<u>Cost of Goods Sold</u>	<u>TL 16.500</u>

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Closing entries in the Periodic Inventory System

1. Close the beginning balance of the Inventory by crediting the Inventory account and debiting the Income summary account
2. Enter the ending balance of the Inventory account as determined by the physical count at the end of the period by debiting the Inventory account and crediting the Income Summary account
3. Close Sales Returns and Allowances, Sales Discounts, Purchases, Freight-in and Delivery Expense accounts by debiting the Income Summary and crediting these accounts
4. Close Sales, Purchase Returns and Allowances, and Purchase Discounts accounts by crediting the Income Summary account and debiting these accounts
5. Close other revenue and expense accounts as usual
6. Close the Income Summary account to either the Retained Earnings or Capital account depending on the type of company
7. Close dividends (or owners' withdrawals) to Retained Earnings (or to Capital) account as appropriate depending on the form of the company

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Account Title	Debit	Credit
Cash	TL 2.570	
Accounts receivable	1.960	
MERCHANDISE INVENTORY	6.700	
Prepaid Insurance	480	
Equipment	12.480	
Accumulated Depreciation: equipment		TL 3.480
Accounts Payable		2.000
Notes Payable		1.640
Salaries Payable		150
Common Stock		10.000
Retained Earnings		4.720
Dividends paid	600	
Sales		30.700
Sales Discounts	500	
Sales Returns and Allowances	200	
Purchases	14.800	
Freight-in	500	
Purchases Discounts		300
Purchases Returns and Allowances		400
Rent Expense	1.500	
Salaries Expense	6.100	
Utilities Expense	1.100	
Delivery Expense	700	
Advertising Expense	1.300	
Depreciation Expense	1.000	
Insurance Expense	900	
Interest Expense	600	
Interest Revenue		400
Gain on Sale of Equipment		200
Total	TL 53.990	TL 53.990

Chapter 4

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Closing Entries-Periodic

Date	Account Title and Description	Debit	Credit
31.Dec.2007	Income Summary	35.900	
	INVENTORY Beg.Balance		6.700
	Sales Discounts		500
	Sales Returns and Allowances		200
	Purchases	14.800	
	Freight-in	500	
	Rent Expense	1.500	
	Salaries Expense	6.100	
	Utilities Expense	1.100	
	Delivery Expense	700	
	Advertising Expense	1.300	
	Depreciation Expense	1.000	
	Insurance Expense	900	
	Interest Expense	600	

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Mugan-Akman 2007

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Closing Entries-Periodic

Date	Account Title and Description	Debit	Credit
31.Dec.2007	INVENTORY (Ending Balance)	4.800	
	Sales	30.700	
	Purchases Discounts	300	
	Purchases Returns and Allowances	400	
	Interest Revenue	400	
	Gain on Sale of Equipment	200	
	Income Summary		36.800

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Closing Entries-Periodic

Income Summary			
31.12.2007	35.900	31.12.2007	36.800
			900
			net income before tax

Date	Account Title and Description	Debit	Credit
31-Dec-07	Income Summary	900	
	Retained Earnings		900
31-Dec-07	Retained Earnings	600	
	Dividends Paid		600

Chapter 4

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Closing Entries-Perpetual Inventory System

Account Title	Debit	Credit
Cash	2 570	
..		
Sales		30 700
Sales Discounts	500	
Sales Returns and Allowances	200	
COGS	16 300	
Rent Expense	1 500	
Salaries Expense	6 100	
.		
Inventory Shrinkage	200	
. Total	53 290	53 290

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Closing Entries-Perpetual Inventory System

Date	Account Title and Description	Debit	Credit
31-Dec-07	Inventory Shrinkage	200	
	Merchandise Inventory		200

Date	Account Title and Description	Debit	Credit
31-Dec-07	Sales		30.700
	Interest Revenue		400
	Gain on Sale of Equipment		200
	Income Summary		31.300

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Closing Entries-Perpetual Inventory System

Date	Account Title and Description	Debit	Credit
31-Dec-07	Income Summary	30.400	
	Sales Discounts		500
	Sales Returns and Allowances		200
	COGS		16.300
	Rent Expense		1.500
	Salaries Expense		6.100
	Utilities Expense		1.100
	Delivery Expense		700
	Advertising Expense		1.300
	Depreciation Expense		1.000
	Insurance Expense		900
	Inventory Shrinkage		200
	Interest Expense		600

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Closing Entries-Perpetual Inventory System

Date	Account Title and Description	Debit	Credit
31-Dec-07	Income Summary	900	
	Retained Earnings		900
31-Dec-07	Retained Earnings	600	
	Dividends Paid		600

Single Step Income Statement

- Deduct all expenses from the total of revenues without a distinction among the different sources of revenues or the causes of expenses

Giysi Giyim A.S. Income Statement For the Year Ended 31 December 2007

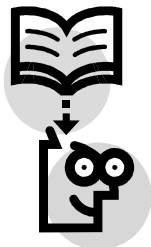
Revenues	
Net Sales	TL 30.000
Interest Revenue	400
Gain on Sale of Equipment	200
Total Revenues	30.600
Expenses	
Cost of Goods Sold	TL 16.500
Operating Expenses	12.600
Interest Expense	600
Income Before Tax	TL 900

Multiple Step Income Statement

- Discloses numerous parts or steps to determine net income, showing income from operating and non-operating activities

Giyisi Giyim A.Ş. Income Statement For the Year Ended 31 December 2007

		TL 30,700
Sales:	Sales Discounts	TL 500
	Sales Returns and Allowances	700
Net Sales		30,000
Cost of Goods Sold:		
	Merchandise Inventory, 1 January	6,700
	Purchases	TL 14,800
Less:	Purchase Returns and Allowances	TL 300
	Purchase Discounts	400 700
	Net Purchases	14,100
	Add: Freight-in	500
	Cost of Goods Purchased	14,600
	Cost of Goods Available for Sale	21,300
Less:	Inventory, 31 December	4,800
Cost of Goods Sold		16,500
Gross Profit		TL 13,500
Operating Expenses:		
Selling Expenses:		
	Salaries Expense	6,100
	Advertising Expense	1,300
	Delivery Expense	700
	Total Selling Expenses	8,100
Administrative Expenses:		
	Rent Expense	1,500
	Utilities Expense	1,100
	Depreciation Expense	1,000
	Insurance Expense	900
	Total Administrative Expenses	4,500
Total Operating Expenses		TL 12,600
Operating Income		TL 900
Other Revenues and Gains		
	Interest Revenue	400
	Gain on Sale of Equipment	200 600
Other Expenses and Losses		
	Interest Expense	(600) 0
Income Before Tax		TL 900



Are we done with Inventories? NO..... Wait 'till next chapter....
