

- main difference between perpetual and periodic - the time at which cost of goods sold is calculated
- revenues from sale of merchandise are recorded when sales are made
 - on the date of sale, cost of merchandise sold is **not** recorded in a periodic inventory system
- in a perpetual inventory system
 - merchandise inventory asset accounts are adjusted for each transaction affecting inventory (such as freight, discounts, etc)
 - merchandise inventory account on the trial balance shows the ending inventory balance
- in a periodic inventory system
 - different accounts are used for each transaction
 - accounts are temporary expense accounts rather than permanent asset accounts
 - merchandise inventory account on the trial balance represents the beginning inventory balance or ending balance from the previous period

	Perpetual Inventory System	Periodic Inventory System
Purchases of merchandise	Merchandise Inventory	Purchases
Freight costs paid by buyer	Merchandise Inventory	Freight In
Purchase returns and allowances	Merchandise Inventory	Purchase Returns and Allowances
Purchase discounts	Merchandise Inventory	Purchase Discounts

Recording Purchases of Merchandise

May 4	Purchases	3,800	
	Accounts Payable		3,800
	(To record goods purchased on account from PW Audio Supply, terms 2/10, n/30, FOB shipping point)		

- purchases are a temporary expense account reported on the income statement
- normal balance is a debit

Freight Costs

- FOB Shipping Point
 - debit freight in
 - credit cash

May 4	Freight In	150	
	Cash		150
	(To record payment of freight on goods purchased)		

- is a temporary expense account with a normal balance of a debit
- freight is part of the cost of goods purchased in a periodic inventory system
- cost of goods purchased includes freight charges incurred in bringing goods to the buyer

Purchase Returns and Allowances

May 8	Accounts Payable	300	
	Purchase Returns and Allowances		300
	(To record return of goods to PW Audio Supply)		

- purchase returns and allowances are a temporary account with a normal balance of a credit
- is a **contra expense account** whose balance is subtracted from the purchases account

Purchase Discounts

May 14	Accounts Payable (\$ 3,800 – \$ 300)	3,500	
	Cash		3,430
	Purchase Discounts (\$ 3,500 × 2%)		70
	(To record payment to PW Audio Supply within discount period)		

- purchase discounts are a temporary account with a normal balance of a credit
- is a contra expense account subtracted from the purchases account
- **NET PURCHASES = PURCHASES INVENTORY - PURCHASES RETURNS AND ALLOWANCE - PURCHASE DISCOUNTS**
- **NET PURCHASES + Freight (fob shipping point) = COST OF GOODS PURCHASED**

Purchases Inventory	-	Purchase Returns and Allowances	-	Purchase Discounts	=	Net Purchases	+	Freight (FOB shipping point)	=	Cost of Goods Purchased
\$3,800	-	\$300	-	\$70	=	\$3,430	+	\$150	=	\$3,580

Illustration 5A-1
Formula for cost of goods purchased

Recording Sales of Merchandise

- only one entry is needed to record for sales

May 4	Accounts Receivable	3,800	
	Sales		3,800
	(To record credit sale to Sauk Stereo, terms 2/10, n/30, FOB shipping point)		

Freight Costs

- freight costs incurred by the seller on outgoing merchandise are an **operating expense** to the seller
- costs are debited to the freight out or delivery expense account

Sales Returns and Allowances

May 8	Sales Returns and Allowances	300	
	Accounts Receivable		300
	(To record return of goods by Sauk Stereo)		

Sales Discounts

May 14	Cash	3,430	
	Sales Discounts (\$ 3,500 × 2%)	70	
	Accounts Receivable (\$ 3,800 – \$ 300)		3,500
	(To record collection from Sauk Stereo within discount period)		

Gross Sales	–	Sales Returns and Allowances	–	Sales Discounts	=	Net Sales
\$3,800	–	\$300	–	\$70	=	\$3,430

Perpetual Inventory System VS. Periodic Inventory System

ENTRIES ON SAUK STEREO'S BOOKS (BUYER)						
Transaction		Perpetual Inventory System			Periodic Inventory System	
May 4	Purchase of merchandise on credit	Merchandise Inventory	3,800	3,800	Purchases	3,800
		Accounts Payable			Accounts Payable	3,800
4	Freight costs on purchases	Merchandise Inventory	150	150	Freight In	150
		Cash			Cash	150
8	Purchase returns and allowances	Accounts Payable	300	300	Accounts Payable	300
		Merchandise Inventory			Purchase Returns and Allowances	300
14	Payment on account with a discount	Accounts Payable	3,500	3,430	Accounts Payable	3,500
		Cash		70	Cash	3,430
		Merchandise Inventory			Purchase Discounts	70

ENTRIES ON PW AUDIO SUPPLY'S BOOKS (SELLER)						
Transaction		Perpetual Inventory System			Periodic Inventory System	
May 4	Sale of merchandise on credit	Accounts Receivable	3,800	3,800	Accounts Receivable	3,800
		Sales			Sales	3,800
		Cost of Goods Sold	2,400	2,400	No entry	
		Merchandise Inventory				
8	Return of merchandise sold	Sales Returns and Allowances	300	300	Sales Returns and Allowances	300
		Accounts Receivable			Accounts Receivable	300
		Merchandise Inventory	140	140	No entry	
		Cost of Goods Sold				
14	Cash received on account with a discount	Cash	3,430	3,500	Cash	3,430
		Sales Discounts	70		Sales Discounts	70
		Accounts Receivable			Accounts Receivable	3,500

Calculating Cost of Goods Sold

- calculate cost of goods purchased
- determine the cost of goods on hand (ending inventory) at the end of the accounting period
- calculate the cost of goods sold

Cost of Goods Purchased

- purchases, freight in, purchase returns and allowances and purchase discounts all combine to determine the costs of goods purchased

Purchases		\$325,000
Less: Purchase returns and allowances	\$10,400	
Purchase discounts	6,800	17,200
Net purchases		307,800
Add: Freight in		12,200
Cost of goods purchased		320,000

Cost of Goods on Hand

- count the units on hand for each item of inventory
- apply unit costs to the total units on hand for each item
- total costs for each item of inventory -> determines total cost of goods on hand

Cost of Goods Sold

- add the costs of goods purchased to the cost of goods on hand at the

- beginning of the period (beginning inventory)
 - results in the cost of goods available for sale
- subtract the cost of goods on hand at the end of the period (ending inventory) from cost of goods available for sale
 - result: cost of goods sold

Merchandise inventory, January 1		\$ 36,000
Purchases		\$325,000
Less: Purchase returns and allowances	\$10,400	
Purchase discounts	6,800	17,200
Net purchases		307,800
Add: Freight in		12,200
Cost of goods purchased		320,000
Cost of goods available for sale		356,000
Merchandise inventory, December 31		40,000
Cost of goods sold		316,000

Beginning Inventory	+	Cost of Goods Purchased	=	Cost of Goods Available for Sale	-	Ending Inventory	=	Cost of Goods Sold
\$36,000		\$320,000		\$356,000		\$40,000		\$316,000

Illustration 5A-4
Formula for cost of goods sold

PW AUDIO SUPPLY, INC.
Income Statement
Year Ended December 31, 2012

Sales revenue		
Sales		\$480,000
Less: Sales returns and allowances	\$12,000	
Sales discounts	<u>8,000</u>	<u>20,000</u>
Net sales		460,000
Cost of goods sold		
Merchandise inventory, January 1	\$ 36,000	
Purchases	\$325,000	
Less: Purchase returns and allowances	10,400	
Purchase discounts	<u>6,800</u>	
Net purchases	307,800	
Add: Freight in	<u>12,200</u>	
Cost of goods purchased	<u>320,000</u>	
Cost of goods available for sale	356,000	
Merchandise inventory, December 31	<u>40,000</u>	
Cost of goods sold		<u>316,000</u>
Gross profit		144,000
Operating expenses		
Salaries expense	\$ 45,000	
Rent expense	19,000	
Utilities expense	17,000	
Advertising expense	16,000	
Depreciation expense	8,000	
Freight out	7,000	
Insurance expense	2,000	
Loss on sale of equipment	<u>200</u>	<u>114,200</u>
Profit from operations		29,800
Other revenues and gains		
Interest revenue	\$ 3,400	
Other expenses and losses		
Interest expense	<u>1,600</u>	<u>1,800</u>
Profit before income tax		31,600
Income tax expense		<u>6,300</u>
Profit		<u>\$ 25,300</u>