Merchandising, Adjusting, and Closing

by Sophia

WHAT'S COVERED

This tutorial will cover the adjusting and closing process for a merchandising company.

Our discussion breaks down as follows:

1. Closing Entries: A Review

You may recall that a closing entry is an entry made at the end of an accounting period that is used to close out a temporary account. Closing entries are entered into the general journal, and then posted to the general ledger.

As mentioned in the definition, the accounts that get closed are the temporary accounts, which comprise revenues and expenses, as well as owner drawings. Within a merchandising company, there are some unique revenue accounts that are going to be closed and hence have closing entries. These are the sales discounts and sales returns and allowances, which will be closed in addition to the sales account.

On the expense side, there are purchases that need to be closed out, as well as purchase discounts, purchase returns and allowances, and freight-in. These are all of the accounts on the expense side, unique to a merchandising company, that will also be closed out with accompanying closing entries, in addition to operating expenses.

Revenue	Expenses
Sales Discounts Sales Returns and Allowances	Purchases Purchase Discounts Purchase Returns and Allowances Freight-In

The purpose of closing the accounting system is essentially to serve as a reset button. All of the temporary, period-based accounts are closed to ensure accurate reporting, so that a merchandiser can hit reset for the next period.

Closing the accounting system also allow a merchandiser to track activity for a specific period, and then transfer net income or loss into cumulative equity. Then, those temporary accounts are reopened for the following period, again, to report activity for that one specific period.

2. Closing Procedure: A Review

Temporary account groups are closed by processing netting journal entries on their unnatural balance side. Now, netting refers to looking at the total balance of the account, whether it's debit or credit, and recording a closing entry for that amount to the opposite side.

> ↱ EXAMPLE Suppose you have an account with a current debit balance. Through netting, you would book an entry for that same amount to the opposite side, credit, so that the account nets to zero.

The REDI method refers to the following process :

Revenues: First, close out the revenues.
Expenses: Next, close out the expenses.
Drawings: This is the other type of temporary account that needs to be closed out. Close the owner drawings accounts.
Income Summary: Close out the revenues, expenses, and drawings to the income summary, which in turn gets closed to the retained earnings.

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3. Closing Entries: Example

Now let's look at some closing entries specific to a merchandising company. Remember, these entries are in addition to the regular closing entries mentioned above--the revenues and operating expenses. These are the additional closing entries that a merchandising company would need to make: sales returns and allowances, as well as sales discounts.

General Journal J201

Date	Account Title	Ref	Debit	Credit
12/31/12	Income Summary	7999	10,000	
	Sales Returns & Allowances	7501		10,000
12/31/12	Income Summary	7999	5,500	
	Sales Discounts	7502		5,500
12/31/12	Income Summary	7999	25,000	
	Purchases	7600		25,000
12/31/12	Purchase Returns & Allowances	7601	1,000	
	Income Summary	7999		1,000
12/31/12	Purchase Discounts	7602	1,500	
	Income Summary	7999		1,500
12/31/12	Income Summary	7999	500	
	Freight-in	9501		500

- Sales returns and allowances and sales discounts must be closed out with a credit. This means that they have a natural debit balance, which makes sense because they are actually a reduction of sales, which has a natural credit balance.
- Purchases are closed out with a credit, because they are an expense, so naturally have a debit balance.
- Purchase returns and allowances, as well as purchase discounts, are closed out with debits, because they have a natural credit balance--again, because they reduce the purchases that were made.
- Freight-in in the last entry needed to close out. Freight-in, because it's an expense that is incurred, is closed out with a credit, because it has a natural debit balance.

SUMMARY

Today we covered a **review of closing entries**, specifically discussing those additional closing entries that are unique to a merchandising company. We **reviewed the closing procedure**, including the REDI method: revenues, expenses, and drawings are closed out, then the income summary is used to record the closeout of revenue and expenses. Lastly, we examined an **example of closing entries** that are unique to a merchandising company.

Source: Adapted from Sophia instructor Evan McLaughlin.