

CHAPTER 9 – JOURNALIZING PURCHASES AND CASH PAYMENTS

In this section of accounting, we will be working with a corporation. Businesses might organize as a corporation because two or more owners can provide the capital required to operate the business. A corporation exists independent of its owners.

I. Business Structures

- Forming a Corporation – many businesses need amounts of capital that cannot be easily provided by a proprietorship
- An organization with the legal rights of a person and which many persons can own is called a corporation
- A corp. is formed by receiving approval from a state or federal agency.
- Each unit of ownership in a corp. is called a share of stock
- Total shares of ownership in a corporation are called capital stock
- An owner of one or more shares of a corp. is called a stockholder
- A corp. can own property, incur liabilities, and enter into contracts in its own name
- A corp. may also sell ownership in itself
- The main difference between the accounting of a proprietorship and corporation is in the capital accounts (prop. have a single capital and drawing account for the owner)
- A corp. has separate capital accounts for the stock issued and for the earnings kept in the business
- Information in a corporations accounting system is kept separate from the personal records of its owners (Concept: business entity)
- Periodic financial statements must be sent to the stockholders of the corp. to report the financial activities of the business

9-1 Journalizing Purchases using a Purchases Journal

- I. TechKnow Consulting sold a service for a fee. This is called a service business. Many businesses purchase goods to sell
 - A. **Merchandising business** – A business that purchases and sells goods.
A merchandising business has additional accounts on the balance sheet and income statement to account for the purchase and sale of merchandise
 - B. **Retail merchandising business** – A merchandising business that sells to those who use or consumer the goods.
 - C. **Merchandise** – Goods that a merchandising business purchases to sell.
 1. In this section of the book we'll be looking at Hobby Shack, which is a retail merchandising business organized as a corporation.
 2. The business was started by Janice Kellogg and the help of a small group of investors. Each stockholder received a number of shares of stock based on the amount invested. The business purchases and sells a wide variety of art and hobby supplies to individuals, schools, and businesses.

- D. **Wholesale merchandising business** – A business that buys and resells merchandise to retail merchandising businesses.
- II. Hobby Shack rents the building in which the business is located as well as the equipment used for operation and employ other individuals. Hobby Shack expects to make money and continue in business indefinitely (CONCEPT: Going Concern). Janice intends to give her shares of stock to her children.
- III. Using Special Journals
- A. Hobby Shack could use the same journal as TechKnow Consulting. However, there would be many General Debit and Credit column entries because of the large number of transactions.
- B. Therefore, Hobby Shack will be using a Special Journal, which is a journal used to record only one kind of transaction
- C. Hobby Shack uses five journals to record daily transactions:
1. Purchases Journal – for all purchases of merchandise on account
 2. Cash Payments Journal – for all cash payments
 3. Sales Journal – for all sales of merchandise on account
 4. Cash Receipts Journal – for all cash receipts
 5. General Journal – for all other transactions
- IV. Purchasing Merchandise
- Merchandise is recorded in a purchases account – which is a cost account
 - In the chart of accounts the location of Purchases is in the Cost of Merchandise section of the income statement accounts
 - Businesses add markup to the cost of merchandise to establish selling prices.
 - Markup must cover all expenses of the business plus enough extra to earn a net income
 - If the markup is too high, sales may be lost to competitors with lower prices
 - Look on the Chart of Accounts for the location of the Cost of Merchandise section
 - Businesses may also purchase other items, such as supplies, but these are not recorded in Purchases; only goods that are purchased for resale – merchandise – are recorded in the purchases account
- A. **Cost of merchandise** – the price a business pays for goods it purchases to sell.
- B. The selling price of merchandise must be greater than the cost of merchandise for a business to make a profit.
- C. **Markup** – The amount added to the cost of merchandise to establish the selling price.
- D. Revenue earned from the sale of merchandise includes both the cost of merchandise and markup. Only the markup increases capital. Accounts for the cost of merchandise are kept in a separate division of the general ledger.
- E. In addition to purchasing merchandise to sell, a merchandising business also buys supplies and other assets for use in the business.

- F. **Vendor** – A business from which merchandise is purchased or supplies or other assets are bought.
- G. **Purchases** – The account used for recording the cost of merchandise.
- H. **Purchase on account** – a transaction in which the merchandise purchased is to be paid for later
- I. Purchases are classified as a cost account because it is in the cost of merchandise division in the chart of accounts. Purchases are a temporary account. Because Purchases reduces Capital, it has a normal debit balance. Purchases are used only to record the cost of merchandise purchases and is recorded in the Purchases Journal. All other items bought, such as supplies, are recorded in the General Debit column of the General Journal.

V. Purchases Journal – a special journal used only to record purchases of merchandise on account

- The amount column has two account titles in the heading: Purchases Debit and Accounts Payable Credit (this is a special amount column)
- Using special journals eliminates writing general ledger account titles in the Account Title column. Recording entries in a journal with special amount columns saves time.
- Remember – all purchase on account transactions are recorded in the purchases journal. If a purchase is made for cash, the transaction is NOT recorded in the purchases journal.
- Remember – “Purchases Merchandise” always means that Purchases is debited. “Bought Supplies” always means that Supplies is debited.

Receiving a Purchase Invoice

- When a vendor sells merchandise to a buyer, a form is prepared showing what has been sold.
- A form describing the goods sold, the quantity, and the price is called an invoice
- An invoice used as a source document for recording a purchase on account transaction is called a purchase invoice

Steps when receiving a purchase invoice

1. Stamp the date received and purchase invoice number in upper right corner of invoice
2. Place a check mark by each of the amounts in the total column to show that the items have been received and that amounts have been checked and are correct
3. The person who checked the invoice should initial below the total amount in the total column
4. Review the vendor’s terms. An agreement between a buyer and a seller about payment for merchandise is called the “terms of sale”. The terms could be 15 days, 30 days, 60 days, etc. This means the payment is due within that many of days from the vendor’s date on the invoice. Weekends and holidays are not excluded.

Purchasing Merchandise on Account

A purchase on account increases the amount owed to a vendor – Accounts Payable increased and purchases are increased (purchases are debited and A/P are credited – both are increased)

Steps when journalizing a purchase of merchandise on account

1. Write the date in the date columns
2. write the vendor name in the account credited column
3. Write the purchase invoice number in the Purchase No. column
4. Write the amount of the invoice in the special amount column. This single amount is both a debit to purchases and a credit to accounts payable. Therefore, it is not necessary to write the title of either general ledger account.

Totaling and ruling a purchases journal

Hobby Shack always rules its purchases journal at the end of each month, even if the page is not full.

Steps in totaling and ruling a purchases journal

1. Rule a single line across the amount column under the last entry
2. Write the date in the date column (last day of that month)
3. Write the word Total in the account credited column
4. Add the amount column – verify the total by re-adding the column in reverse order
5. Write the total directly below the single line in the amount column
6. Rule double lines across the amount column directly below the total amount to show that the total has been verified as correct

9-2 Journalizing Purchases of Merchandise on Account and Buying Supplies

Journalizing Purchases of Merchandise on Account

- A. Many times merchandise (and other assets) is purchased on account, to be paid for later. This is called a purchase on account.
- B. When a vendor sells merchandise to a buyer, the vendor prepares a form showing what has been sold.
- C. Invoice – A form describing the goods sold, the quantity, and the price.
- D. **Purchase Invoice** – An invoice used as a source document for recording a purchase on account transaction.
- E. **Terms of sale** – An agreement between a buyer and a seller about payment for merchandise

Journalizing Buying Supplies

- A. When supplies are purchased, they are not recorded in the purchases account because supplies are not meant for sale. The business will consume them itself. Cash register tape and price tags are examples of supplies used in a merchandising business.
- B. Besides buying supplies for cash, a business may also buy them on account. Because the invoice received for the purchase of supplies is similar to the purchase invoice received when merchandise is purchased, a memorandum is attached to the invoice, noting that the invoice is for supplies and not for purchases.

9-3 Journalizing Cash Payments and Other Transactions

Cash Payments and Other Transactions

- A. Cash Payments on Account
 1. Payments to vendors are made according to the terms of sale on the purchases invoices.
 2. Accounts Payable is debited and the vendor name is written in the Account Title column. Cash is credited.

B. Payment of an Expense

1. Omni usually pays for an expense at the time the transaction occurs.
2. The name of the expense is debited and cash is credited.

C. Replenishing Petty Cash

1. Omni deposits all cash in a bank. Some cash, however, is kept in a petty cash fund for making cash payments. Omni has a petty cash fund of \$300 and is replenished whenever the petty cash on hand drops below \$100.
2. Each account title affected (Supplies, Expenses, etc.) are debited. Cash is credited

– **Remember, Petty Cash is used only when establishing the petty cash account, never when replenishing it.**

D. Withdrawals

1. Assets taken out of a business for the personal use of an owner are known as withdrawals. Cash, supplies, and merchandise are most often taken out.
2. Withdrawals reduce the amount of a businesses' capital; however, the amount is not written directly into the capital account. The drawing account is used for this.
3. The name of the partner, Drawing is debited. Cash, Supplies, or Purchases is credited.