Financial Merchandise Management

Dr. Swagato Chatterjee

VGSOM, IITKGP

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Financial Merchandise Management

- A retailer specifies which products are purchased, when products are purchased, and how many products are purchased
- **Dollar control** involves planning and monitoring a retailer's investment in merchandise over a stated period.
- **Unit control** relates to the quantities of goods a retailer handles during a stated period.

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Financial Merchandise Management
(2 of 2)

- Four aspects covered:
  - Methods of accounting (inventory valuation)
  - Merchandise forecasting and budgeting
  - Unit control systems
  - Financial inventory control

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Benefits of Financial Merchandise Plans (1 of 2)

- The value and amount of inventory in each department and/or store unit during a given period are delineated.
- Open to buy, the amount of merchandise a buyer can purchase during a given period can be calculated.
- The inventory investment in relation to planned and actual revenues is studied.
- The retailer's space requirements are partly determined by estimating beginning-of-month and end-of-month inventory levels.

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Benefits of Financial Merchandise Plans (2 of 2)

- A buyer's performance is rated. Measures may be used to set standards.
- Stock shortages are determined and bookkeeping errors and pilferage are uncovered.
- Slow-moving items are classified, leading to increased sales efforts or markdowns.
- A proper balance between inventory and out-of-stock conditions is maintained.

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Inventory Accounting Systems

- The cost accounting system values merchandise at cost plus inbound transportation charges
- The retail accounting system values merchandise at current retail prices

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ABC Hardware Store Profit-and-Loss Statement, January 1, 2016-June 30, 2016

Sales		**$ 417,460**
Less cost of goods sold:		
Beginning inventory (at cost)	$ 44,620	
Purchase (at cost)	289,400	
Transportation charges	2,600	
Merchandise available for sale	$ 336,620	
Ending inventory (at cost)	90,500	
Cost of goods sold		246,120
Gross profit		$ 171,340
Less operating expenses:		
Salaries	$ 70,000	
Advertising	25,000	
Rental	16,000	
Other	26,000	
Total operating expenses		137,000
Net profit before taxes		$34,340

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Physical Inventory System

- Ending inventory – recorded at cost. Is measured by counting the merchandise in stock at the close of a selling period.
- Gross profit is not computed until ending inventory is valued.
- Gross profit is derived during full merchandise count.

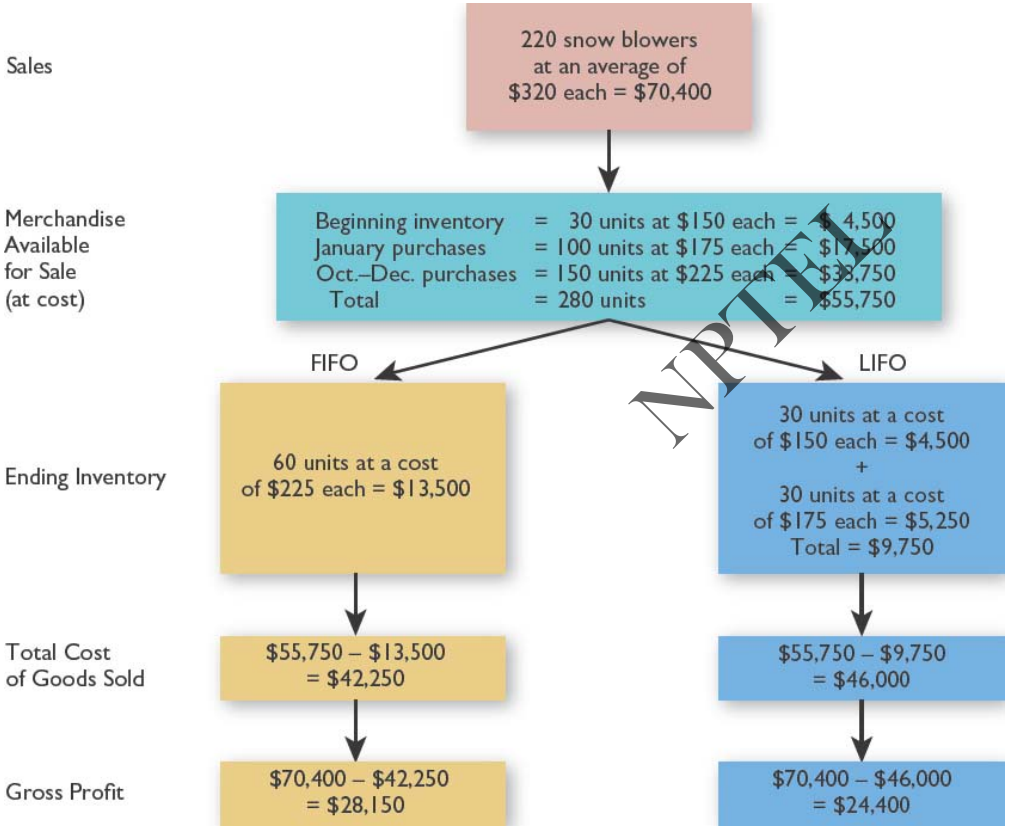
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Cost Method of Accounting

- The cost to the retailer of each item is recorded on an accounting sheet and/or is coded on a price tag or merchandise container.
- Can be used with physical or book inventories:
  - Physical inventory – actual merchandise count
  - Book inventory – recordkeeping

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Applying FIFO and LIFO Inventory Methods to ABC Hardware, January 1, 2016–December 31, 2016



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Advantages of Cost-Based Inventory Systems

- Keeps a running total of the value of all inventory on hand and at cost at any given time.
- End-of-month inventory values can be more easily computed without the need for a physical inventory.
- Frequent financial statements can be prepared.

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Disadvantages of Cost-Based Inventory Systems

- They require that a cost be assigned to each item in stock
- Do not adjust inventory values to reflect style changes, end-of-season markdowns, or sudden surges of demand

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ABC Hardware Store Perpetual Inventory System, July 1, 2016-December 31, 2016*

Date	Beginning-of-Month Inventory (at cost)	+	Net Monthly Purchases (at cost)	–	Monthly Sales (at cost)	=	End-of-Month inventory (at cost)
7/1/16	$ 90,500	+	$ 40,000	–	$ 62,400	=	$ 68,100
8/1/16	68,100	+	28,000	–	38,400	=	57,700
9/1/16	57,700	+	27,600	–	28,800	=	56,500
10/1/16	56,500	+	44,000	–	28,800	=	71,700
11/1/16	71,700	+	50,400	–	40,800	=	81,300
12/1/16	81,300	+	15,900	–	61,200	=	36,000
		Total	$ 205,900		$260,400		(as of 12/31/16)

* Transportation charges are not included in computing inventory value in this table

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The Retail Method

- Closing inventory is determined by calculating the average relationship between the cost and retail values of merchandise available for sale during a period. This is called the cost complement.
- The cost complement is also used in open-to-buy calculations

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Advantages of the Retail Method (1 of 2)

- Costs do not have to be decoded when conducting a physical inventory
- Profit and loss statements can be prepared based on retail inventory values which are then converted into costs
- The retail method is acceptable for insurance claims

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Determining Ending Inventory Value

- Calculating the cost complement
- Calculating deductions from retail value
- Converting retail inventory value to cost

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ABC Hardware Store, Calculating Merchandise Available for Sale at Cost and at Retail, July 1, 2016-December 31, 2016

	At Cost	At Retail
Beginning inventory	$ 90,500	$ 139,200
Net purchases	205,900	340,526
Additional markups	—	16,400
Transportation charges	3,492	—
Total merchandise available for sale	$ 299,892	$ 496,126

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Calculation of Cost Complement

$$\text{Cost Complement} = \frac{\text{Total Cost Valuation}}{\text{Total Retail Valuation}}$$

$$= \frac{\$299{,}286}{\$496{,}126}$$

$$= 0.6045$$

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On average, 60.45 cents of every sales dollar was used to pay for merchandise

ABC Hardware Store, Computing Ending Retail Book Value, as of December 31, 2016

Merchandise available for sale (at retail)		$ 496,126
Less deductions:		
Sales	$ 422,540	
Markdowns	11,634	
Employee discounts	2,400	
Total deductions		436,574
Ending retail book value of inventory		$ 59,552

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ABC Hardware Store, Computing Stock Shortages and Adjusting Retail Book Value, as of December 31, 2016

Ending retail book value of inventory	$ 59,552
Physical inventory (at retail)	56,470
Stock shortages (at retail)	3,082
Adjusted ending retail book value of inventory	$ 56,470

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Convert Retail Inventory Value to Cost Basis

Ending Inventory value at retail (net of stock shortages at retail value based on physical inventory) × Cost Complement

($59,552 − stock shortages of $3,083) × 0.6045 = $34,136

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Shortage Calculation

Shortages can be due to:

- Employee theft
- Customer theft
- Accounting errors
  - Not reducing inventory valuations due to markdowns, employee discounts, etc.

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ABC Hardware Store Profit-and-Loss Statement, July 1, 2016-December 31, 2016

Sales		$ 422,540
Less cost of goods sold:		
Total merchandise available for sale (at cost)	$ 299,892	
Adjusted ending inventory (at cost)*	34,136	
Cost of goods sold		265,756
Gross profit		$ 156,784
Less operating expenses:		
Salaries	$ 70,000	
Advertising	25,000	
Rental	16,000	
Other	28,000	
Total operating expenses		139,000
Net profit before taxes		$ 17,784

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Advantages of the Retail Method (2 of 2)

- Valuation errors are reduced when conducting a physical inventory since merchandise value is recorded at retail and costs do not have to be decoded.
- Because the process is simpler, a physical inventory can be completed more often.
- Profit-and-loss statement can be based on book inventory.
- Method gives an estimate of inventory throughout the year and is accepted in insurance claims.

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Limitations of the Retail Method

- Bookkeeping burden
- Ending book inventory is correctly computed only if the following are accurate:
  - Value of beginning inventory
  - Purchases
  - Shipping charges
  - Markups
  - Markdowns
  - Employee discounts
  - Merchandise transfers to other stores
  - Merchandise returns
  - Sales

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--Cost complement is an average based on the total cost of merchandise available for sale and total retail value.

Thank You

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