1. **Answer: C** – The cost of shipping merchandise to customers is a selling and administrative cost called transportation-out. Shipping paid to purchase inventory, as well as the cost of the merchandise itself, are product costs.

2. **Answer: D** – Netflix does not purchase goods and resell them to customers. It is a service company. The other companies all purchase goods and resell them.

3. **Answer: B** – Retail companies sell goods to end consumers. Wholesale companies are also merchandising companies, but sell goods to retailers.

4. **Answer: C** – Product costs are recognized as cost of goods sold on the income statement when the merchandise is sold.

5. **Answer: D** – Cost of goods sold is the expense account associated with merchandise.

6. **Answer: A** – At the time of the purchase, assets (inventory) and liabilities (accounts payable) will both increase by the full cost of the inventory. The discount will only be recognized if and when the company pays the invoice within the discount period.

7. **Answer: D** – When the invoice is paid, cash will decrease by $980, inventory will decrease by $20 (the amount of the discount), liabilities will decrease by $1,000 (the amount of the invoice).

8. **Answer: D** – The $100 paid to ship goods to customers will be recorded as a selling and administrative expense (transportation-out) and will be a cash outflow for operating activities.

9. **Answer: A** – Freight terms FOB shipping point mean that Madison Company, the buyer, pays for shipping. Transportation-in is a product cost, meaning that Madison will add the $200 cost to its inventory account.

10. **Answer: D** – When the sale is recorded, Sales and Accounts receivable both increase by $75. Cost of goods sold increases and Inventory decreases by $40. The net effect is:



11. **Answer: C** – The sale is recorded as a debit to cash and credit to sales for $80 (the selling price) and a debit to cost of goods sold and credit to inventory for $50 (the cost).

12. **Answer: C** – The purchase discount is recognized at the time the invoice is paid. The entry will debit (reduce) accounts payable by $500, credit (reduce) cash by the $495 paid after the discount, and credit (reduce) the inventory account by the amount of the discount, $5.

13. **Answer: B** – For both sales returns and sales allowances, sales and accounts receivable (or cash) are decreased. When a sales return is recorded, the inventory account is increased and cost of goods sold is decreased by the amount of the merchandise’s original cost because the merchandise is then returned to inventory. When a sales allowance is recorded, however, there is no merchandise returned, so only sales and accounts receivable (or cash) are decreased.

14. **Answer: D** – Purchasing merchandise on account increases both assets (inventory) and liabilities (accounts payable).

15. **Answer: B** – Returning merchandise to a vendor for credit decreases both assets (inventory) and liabilities (accounts payable).

16. **Answer: A** – If merchandise is sold for cash, there will be a net increase in assets (cash increases by $55 and inventory decreases by $30), revenue will increase by $55, cost of goods sold (an expense) will increase by $30, for an increase in net income of $25, and there will be a cash inflow of $55 for operating activities.

17. **Answer: D** – Freight terms FOB Destination means that the seller pays. Therefore a merchandising company will only pay for the freight if it is the seller. When a merchandising company pays transportation cost as a seller, it will never increase the inventory account. Instead, it will record the expense transportation-out.

18. **Answer: D** – Payment terms 2/10, n 30 (read two-ten, net 30) means that the buyer may take a 2% discount if the invoice is paid within 10 days; otherwise the invoice must be paid within 30 days.

19. **Answer: B** – When a company accepts a return from a customer, the inventory account will increase by the original cost of the merchandise and accounts receivable will decrease by the amount of the sale. In this example, therefore, there would be a net decrease in assets of $40. There is also a decrease in equity of $40 (sales decreases by $100 and cost of goods sold decreases by $60).

20. **Answer: D** – Recording a cash sale causes cash (an asset) and sales revenue (equity) to increase by the selling price. Inventory (an asset) decreases by the cost of the merchandise and the expense cost of goods sold decreases equity by the same amount. The net increase in assets is the difference between the selling price and the cost, which is the gross margin.