Takin' Care of Business

Mr. Breitsprecher's Edition | February 2018 | www.myBusinessEd.com

Accounting Cycle: Service vrs Merchandising Firms

Companies follow a standard schedule for recognizing financial transactions and the impact of those transactions. This schedule is called the accounting cycle.

The accounting cycle involves several steps, which include identifying each financial transaction, recording the financial transactions, analyzing and adjusting financial accounts, creating financial statements and setting up each financial account to start the new period.

The accounting cycle for service companies and merchandising companies experiences some similarities and some differences.

Service Company

A service company uses its employees to provide a service for the customer. These services can include lawn care, carpet cleaning or childcare.

Some service companies purchase expensive equipment to provide the service, such as a vehicle. Other service companies rely on human labor more than equipment and only purchase a minimal amount of assets.

The typical financial transactions recorded for a service company include collecting a deposit from the customer, providing the service and receiving payment. These activities may occur in the same accounting cycle or in several cycles.

Merchandising Company

A merchandising company purchases inventory items to resell to customers. The company buys from several vendors and provides a central purchasing point where customers can purchase everything in one stop. The customer benefits by making one convenient stop.

Inventory represents the primary asset of a merchandising company. The typical financial transactions of a merchandising company include purchasing inventory, storing the inventory and selling the inventory to customers. These activities may occur in one or more accounting cycles.

Similarities

The accounting cycle for service companies and merchandising companies includes similar processes. For example, the accounting cycle for both companies follows the same basic structure of recording transactions and reporting financial results.

The accountants in both types of companies review the account balances and identify any necessary adjustments. Adjustments refer to transactions that occurred during the month but did not create an entry in the financial records. The adjusting entry records the entry.

Differences

Several differences exist in the accounting cycle between service companies and merchandising companies. These include recognition of revenue and the format of the financial statements. Service companies recognize revenue when the company performs the service for the customer.

In most cases, the company bills the customer on a future date to request payment. Merchandising companies generally collect payment from customers when the customer takes the merchandise from the store.

The merchandising company recognizes revenue on the date of sale. The income statement formats vary between service companies and merchandising companies.

The income statement for the service company subtracts the operating expenses from the revenues to arrive at net income. The merchandising company subtracts the cost of merchandising from the revenue to arrive at gross profit. It then subtracts all other operating expenses to arrive at net income.

by Kathy Adams McIntosh
http://smallbusiness.chron.com