I. Service Company

1. Operations

As the name implies, service companies provide specific services to their customers. These services can range from professional consulting, such as from doctors and attorneys, to household chores, such as carpet cleaning and child care. Service companies can provide these services as a one-time offer or on a continuing basis. They can also choose to bill the customer by the service provided, by the hour or by a billing scheme of their own.

2. Service Company Accounting Cycle

A service company determines its net income by subtracting its operating expenses from its revenues. The accounting cycle for service companies starts when the customer pays for the service. However, service companies can often expect to wait several weeks or months between the time they invoice the customer and the time they receive payment. The unpaid balance on these invoices represent "accounts receivable".

II. Merchandising

1. Company Operations

A merchandising company buys items to stock its shelves from one or more suppliers to resell to customers. These customers can either be retail buyers or wholesalers. Merchandising companies must record transactions on both the purchases and sales of their inventory items. The accurate recording of inventory transactions determines whether or not the merchandising company has made a profit, so the steps in the accounting cycle process act as a guide to calculating the company's profits.

2. Merchandising Company Accounting Cycle

A merchandising company determines its net income by subtracting both its operating expenses and its costs of goods sold from its revenue. While service companies can wait for months to see the revenues from their transactions [Cash basis], most merchandising companies realize their revenues immediately during the transaction [Accrual basis]. The transactions begin when customers pay for their items and the merchandising company delivers those items. This process enables merchandising companies to record transactions and start the accounting cycle without delay.

Accrual Accounting

Definition: Accounting method that records revenues and expenses when they are incurred, regardless of when cash is exchanged. The term "accrual" refers to any individual entry recording revenue or expense in the absence of a cash transaction. Most businesses typically use one of two basic accounting methods in their bookkeeping systems: **cash basis or accrual basis**. While most businesses use the accrual basis, the most appropriate method for your company depends on your sales volume, whether or not you sell on credit and your business structure.

The **cash method** is the most **simple** in that the books are kept based on the actual flow of cash in and out of the business. Income is recorded when it's received, and expenses are reported when they're actually paid. The cash method is used by many sole proprietors and businesses with no inventory. From a tax standpoint, it is sometimes advantageous for a new business to use the cash method of accounting. That way, recording income can be put off until the next tax year, while expenses are counted right away.

With the **accrual method**, income and expenses are recorded as they occur, regardless of whether or not cash has actually changed hands. An excellent example is a sale on credit. The sale is entered into the books when the invoice is generated rather than when the cash is collected. Likewise, an expense occurs when materials are ordered or when a workday has been logged in by an employee, not when the check is actually written. The downside of this method is that you pay income taxes on revenue before you've actually received it.

Should you use the cash or accrual method in your business? The accrual method is required if your business's annual sales exceed $5 million and your venture is structured as a corporation. In addition, businesses with inventory must also use the accrual method. It's also highly recommended for any business that sells on credit, as it more accurately matches income and expenses during a given time period.

The cash method may be appropriate for a small, cash-based business or a small service company. You should consult your accountant when deciding on an accounting method.