How is accounting used in business?

It might seem obvious, but in managing a business, it's important to understand how the business makes a profit. A company needs a good business model and a good profit model. A business sells products or services and earns a certain amount of margin on each unit sold. The number of units sold is the sales volume during the reporting period. The business subtracts the amount of fixed expenses for the period, which gives them the operating profit before interest and income tax.

It's important not to confuse profit with cash flow. Profit equals sales revenue minus expenses. A business manager shouldn't assume that sales revenue equals cash inflow and that expenses equal cash outflows. In recording sales revenue, cash or another asset is increased. The asset accounts receivable is increased in recording revenue for sales made on credit. Many expenses are recorded by decreasing an asset other than cash. For example, cost of goods sold is recorded with a decrease to the inventory asset and depreciation expense is recorded with a decrease to the book value of fixed assets. Also, some expenses are recorded with an increase in the accounts payable liability or an increase in the accrued expenses payable liability.

Remember that some budgeting is better than none. Budgeting provides important advantages, like understanding the profit dynamics and the financial structure of the business. It also helps for planning for changes in the upcoming reporting period. Budgeting forces a business manager to focus on the factors that need to be improved to increase profit. A well-designed management profit and loss report provides the essential framework for budgeting profit. It's always a good idea to look ahead to the coming year. If nothing else, at least plug the numbers in your profit report for sales volume, sales prices, product costs and other expense and see how your projected profit looks for the coming year.