

Differences between financial accounting and management accounting

[Business](#), [Management](#)



The purpose of this report is to discuss principles of and similarities and differences between financial and management accounting and to highlight how management accounting could be used to improve TVD's performance. In particular, one of the management accounting techniques, benchmarking, is used as an example of how MA can help a business to run successfully.

Today, accounting is an important aspect of business. The primary idea is to present financial and non-financial information so that the company can make good decisions and succeed financially. In other words, for a business or organisation to be able to communicate and exist there is a demand of accounting.

There are two main types of accounting: financial accounting and management accounting.

Purpose of financial accounting

The main purpose of financial accounting is to record and summarize all transactions made over a particular period of time (usually a year) and to arrange these facts into a financial statement that can be communicated and analyzed. This information plays an important role for shareholders, who want to know how the business is performing and whether it makes profit or loss. The financial accounting is also of interest to other external users who are interested in organization's performance, such as creditors, banks, potential investors, customers, tax inspectors and employees.

Purpose of management accounting

In contrast, management accounting is used for internal control, for example: planning, forecasting, performance measurement and decision-making. In other words, management accounting provides information for people inside the organisation, e. g. managers, to help them control the business and make decisions for the future.

Similarities between financial and management accounting

Although there is a difference in the type of information presented, financial and management accounting have some common characteristics. According to Upchurch (2002, pp. 25) “ they are both predominantly quantitative, they share certain data sources, there is limited common usage, they are key elements in the Management Information System (MIS) and may be integrated”.

Differences between financial accounting and management accounting

However, there are also a number of differences in the preparation and use of the two types of accounting.

There is a legal requirement to produce annual financial information taken from the organisation’s financial accounting records, whereas management accounting information is collected for the advantage of the company and is not strictly a necessity. In addition, financial accounts are required by law to follow the Generally Accepted Accounting Principles (GAAP). These principles “ are set by professional bodies in each country such as the Accounting Standards Board (ASB) in the UK, Financial Accounting Standards Boards (FASB) in the USA and International Accounting Standards Board” (Drury,

2004, p. 7). The purpose of these principles is to ensure that external users can trust that the provided information is correct and complete. On the other hand, there is no legal requirement for management accounting to follow the GAAP, since the information is only for internal users who have greater opportunity to ensure themselves of the reliability of the information.

The advantage of not being bound to the GAAP is that management accounting can be adapted to the organisation's needs. While financial accounting results in annual or quarterly reports, management accounting can provide information whenever it is required, for example daily, weekly or monthly. In addition, financial accounting usually concentrates on the company as a single unit. Management accounting can give attention to specific areas of an organisation's activities, for instance to separate business locations or individual products.

A final difference is that while financial accounting is concerned only with what has happened in the past, management accounting focuses both on past and future events as a basis for organisational planning. As a result, management accounting incorporates forward-looking elements such as sales budgets and cash-flow forecasts to facilitate forecasting and the decision-making process. The disadvantage of this is that management accounting must often resort to estimates about future outcomes. In comparison, financial accounting is exclusively based on information about past events, which are verifiable. Consequently, it can be more accurate and precise than management accounting.

Description of management accounting technique: Benchmarking

As described above, management accounting has many advantages as a complement to the financial accounting system. Therefore, it is recommended that TVD adopt more management accounting techniques to improve its chances of success. In this report, benchmarking will be used as an example of how these techniques could help to improve TVD's performance. Although still unfamiliar to many people, benchmarking is one of the most powerful techniques within management accounting. It is also particularly relevant in the context of TVD's business concept.

The main idea behind benchmarking is to make comparisons between the own company and other organizations that have a high performance rating. This provides a chance to study the "best practice" and adopt ideas for how to improve performance and increase profit. According to Drury (2008, p. 14) it "represents the ideal way of moving forward and achieving high competitive standards".

How Benchmarking will benefit TVD

One way that TVD would benefit from adopting another company's best practices is by improving customer service and increasing the quality of our food to keep the customers happy and keep them coming back. This is the key to success in the catering business.

Currently, TVD offers up-market fast food with average service and not a very high quality of food. To achieve a higher standard of performance, TVD should look at one of the most successful restaurants throughout the UK according to customers' feedback - Nando's. In twelve years, Nando's has grown rapidly to operate more than 120 restaurants within the UK. The main

reason for Nando's success is their high quality of food and customer service. By analyzing the reasons for their success, TVD could learn from an organisation that is at the "leading edge".

A few potential success factors to study further are that Nando's ingredients are delivered fresh rather than frozen, that they reduce the fat content of their food and that the food contains no preservatives or artificial flavours which make it attractive to health conscious customers. In addition, Nando's aims to offer speedy and friendly service and guarantees that a customer will not have to wait longer than 15 minutes to get their food.

Although it would increase costs to implement changes in these areas, for example by using fresh ingredients and employing more skilled and experienced staff, benchmarking could help TVD identify the factors that contribute the most to customer satisfaction and increased revenues. As a result, increased revenues due to returning customers and an improved reputation would balance the costs and lead to a higher profit.

Conclusion

In conclusion, financial accounting and management accounting serve different purposes. While financial accounting helps communicate the organisation's past performance to external users, management accounting is a tool to help the management to plan for the future and identify ways to improve future profits. One example is benchmarking, which allows an organisation to learn from its competitors to achieve continual improvements. Therefore, it is recommended that TVD makes a greater use

of management accounting as a means to find new ways to improve our performance.