External and internal financial accounting term paper example

Business, Company

Introduction

There are certain differences between internal and external financial accounting. Internal financial accounting is also known as managerial accounting. The main differences between the two activities are the users of the financial statements, the types of information, the frequency of preparing the statements and the regulatory oversight of the accounts. The external financial information is a summary of the historical data of the company and it is mandatory for the accountants to prepare these statements. On the other hand internal financial accounting is detailed in nature and tends to be futuristic in terms of projections, budgets and estimations. It is also not mandatory for the company to prepare these management accounts.

The Users of the Information

The users of the financial accounting statements are external users such as the stockholders, the government, potential investors and creditors (Tiffany, 2009). The financial accountants prepare the financial statements that form part of the company's annual reports. The potential investors are interested to know how the company is performing over the years. Is it a viable investment? The creditors are eager to ensure that their interest is secured. How is the financial health of the company? How is the cash flow of the company? They want to know the gearing or leverage ratios of the company. A company that is highly geared with liquidity problems is not a good sign. Inability to pay debts will destroy their credibility or reputation in the market.

The stockholders or owners of the company are interested to know whether the value of their stock or investment is increasing.

Ratios such as the operating profit margin, sales revenue and the return on capital

employed are very important to them. The company's performance affects the earnings and the dividends per share (Kugel, 2011). The government acts as an overseer and ensures the general accounting standards have been used and the necessary disclosures have been given. It acts to protect the interests of the other stockholders against management creative accounting or fraud.

The users of the internal financial accounting are the management of the company. Management accounts are prepared to show the trends and variances of the direct and indirect costs, overhead expenses and the sales figures. The company usually prepares the budgeted figures for the revenues and the expenses every financial year or quarter. It is therefore interested to know the costs and revenues of each product. Those products that are unable to break even or consistently make losses may be discontinued. Activity based costing assists the company to know the value adding and non-value activities in the company.

The company is interested in reducing the non-value adding activities and their related costs. In management by exception, the management scrutinises the adverse variances in the materials, labour and overhead costs. To minimise the adverse variances the management works towards labour efficiency, acquiring quality materials and reducing wastes and defective products in the manufacturing process.

Regulatory Oversight

It is mandatory for companies to publish their financial statements. External financial accounting is regulated by different bodies in different countries. Any delays or refusal to submit the financial statements is considered a criminal offence. It is a regulatory requirement. If the management is found to be fraudulent with the intention of false misrepresentation of the company's financial statement will result to fines and damages. The company's management will also be arrested for fraud.

When it comes to the management accounting, it is not mandatory for the company to prepare the management accounts. There is also no regulatory body that oversees the preparation of these management accounts. The board will be interested to ensure that the management is preparing accounts for internal controls and performance management however the management cannot be arrested for failing to do so.

Frequency of Reporting

External financial accounting reports information that is historical in nature. The information is reported periodically, quarterly, semi-annually and annually. It usually covers one financial period which is usually a calendar year. The various stakeholders are interested to know what happened in that specific financial year. What were the capital investments undertaken? Did the company invest in any fixed assets or investment securities during the year? The company highlights the long-debt instruments and shares that were issued in that particular year. There is also information on the cash or stock dividends that were given to the owners of the company. Most of the information given is historical in nature.

Managerial information on the other hand tends to be futuristic in nature (McIntosh, 2011). There are budgets that are prepared by the accountant to show what the company intends to sell and the associated costs to be incurred. There are projected cash flow, income statements and balance sheets prepared in order for the staff to know the goals and the future direction of the company.

It uses a combination of both the past and future accounting data. The information is also prepared continuously. The manager can get the current status of the performance any

time when it comes to the preparation of management accounts. There is flexibility in retrieving any data that the manager wants.

While the focus on external financial accounting is that the information should be precise, in management accounting, the concern is that the information should be timely and relevant (Tiffany, 2009). It involves the use of enterprise reporting systems and information technology for the needed information to be accessed in a timely manner in order to make strategic decisions well. If the information is not timely, it can cause the company many lost opportunities or cause it to lose its competitive edge. In financial accounting, there has to be objectivity of the figures reported. The figures should have been verified by the external auditors. The focus in managerial accounting however is on the relevance of the information provided on the decision that the management wants to make.

Types of Information

The information that is reported in external financial accounting and managerial accounting is very different. The information in the annual reports of a company is summarized for the whole company. The investors are interested in knowing what the sales and profits were for the whole organization. On the other hand, managerial accounting is concerned with the segments of the organization in terms of the different departments and units. The management is interested to know the costs and profits generated by the different departments (Kugel, 2011).

Managerial accounting is more detailed in nature. The management is interested in the

inner details so that it can take corrective actions where necessary to increase the company's profit margins. The accountant provides to the management the profits and expenses incurred

in the production of all the goods and services provided by the company. It helps the company know the products that are bringing in the highest profits for the company and those that are lagging behind. In external financial statements there is also a lot of focus on the quantitative data of the company. These are the figures for the sales, the profits and the earnings per share of the company.

Without detailed management reports, the company will not know which products they should be focusing. The company needs to focus on its strengths so that it can have a competitive advantage. A lot of resources could be going to products and activities that do not increase the profit of the company.

On the other hand managerial accountants are also concerned with the qualitative data in the company that eventually affects the quantitative data of the company whether positively or negatively. The management are interested in such data such as the employee morale, customer service standards, leadership, empowerment of the staff and the company's community image. It will be difficult to quantify the soft data into figures.

Conclusion

Companies generally operate with the two sets of accounting data. It enables them to comply with the law and inform the different stakeholders the financial position and health of the company. The accountants also prepare the internal financial statements to assist in the management in planning, controlling, directing and evaluating the financial health of the organization. The company should take advantage of the benefits that are gained when a company invests in managerial accounting concepts such as activity based and job costing. It will help the company reduce duplication and waste. It will also assist in ensuring that in every successive accounting period, the performance goes higher and higher.

References

Kugel. R. (2011). Automating External and Internal Financial Reporting.

Retrieved

from http://businessfinancemag. com/article/automating-external-and-internal-financial-reporting-1031

McIntosh. K (2011). Managerial Accounting Vs. Financial Accounting.

Retrieved from

http://www. ehow. com/info_7737521_managerial-accounting-vs-financial-accounting. html

Tiffany. A., (2009). Who Are the Internal and External Users of Accounting Information? Retrieved from

http://bizcovering. com/accounting/who-are-the-internal-and-external-users-of-accounting-information/