Financial accounting and managerial accounting systems

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Executive Summary

Though, financial accounting and managerial accounting systems prepare and analyze the same financial data, they also differ in some aspects. For example the users of the information are different. Also the procedures for their preparations differ including the time frames. Cost accounting is another sphere of accounting that deals with the analysis of costs of products and activities in an organization. It forms a substantial part of managerial accounting since through it, the management can also make decisions. This paper analyzes the similarities a swell as differences between the two.

Introduction

Management accounting is and accounting system that provides the management with techniques that provide of an organization with information for purposes of internal use like decision making and effective control of the organization’s resources. According to Enotes website (2010), procedures in management accounting provide information for decision makers in a company. Contrary, financial accounting procedures provide information to external users like the shareholders of a firm, government agencies, and creditors to the firm. Management accounting reports are usually generated anytime; daily, weekly, monthly, or quarterly. While individuals in an organization decide management accounting methods, financial accounting techniques must conform to external standards like the international financial accounting standards developed by financial accounting standards board (FASB). Cost accounting is often confused with management accounting. Cost accounting involves determining the cost of an activity while management accounting goes beyond to combine multiple management disciplines that contain financial information for internal decision making. Therefore cost accounting can be said to a necessary component of management accounting (Enotes website, 2010).

Characteristics of management accounting procedures

According to netTOM website (2010), management accounting procedures should posses the following procedures. They should be; Relevant for the purpose, complete, accurate, clear and precise to the manager, timely, communicated through the appropriate channel, less costly to provide and the volume should be manageable.

The role of management accounting

Management accounting plays the following roles within an organization:

Planning:

the information provided by management accounting procedures is vital in planning and budgeting processes. This is because such information contains various costs like pricing, product costs and capital expenditures.

Control:

the management is in a position to see which activities are not conforming to the plan from the reports provided by the management accounting (netTOM website, 2010).

Organization:

the management accountant can reinforce the organizational framework of the organization by tailoring the accounting structure to the organizational structure.

Motivation:

the managers and other staff are always motivated by the budgets prepared by the management accountant.

Decision making:

this is one of the major functions of management accounting procedures. Through the collection and analysis of data, the reports he or she presents to the managers assist in decision making (netTOM website, 2010).

Similarities between financial accounting and management accounting

Despite the two fields having numerous differences, there also many areas of similarities as specified below;

- Certification: both fields emphasize on certification. For one to be certified, he/she must pass the exams that are concerned in each field of specialization. Certifications come in form of certified management accounting and certified public accounting (Ehoh website, 2010).
- Review of historical data: both systems prepare reports basing on historical data review. In financial accounting, this is for comparison purposes of the business between the present and the past, while for management accounting, it is for determining the current performance of the organization and to come up with a business financial forecast of the future (ehow website, 2010).

- Measurement of the currency: the unit of measurement in generation of reports in the two systems is the currency. The reports generated are thereafter used to give tangible information to business owners or show the financial state of the business. They can also be used to plan and generate the budget for the business (ehow website, 2010).
- Terminology used: both systems of accounting use similar accounting terminology. E. g. debits and credits are used in both systems to describe the money that goes out and the money that go in to the business respectively (ehow website, 2010).
- Techniques: the accounting techniques employed by both the systems are basically the same. E. g. the technique that is used to determine the actual cost of the product (ehow website, 2010).

Differences between Financial and managerial accounting

Although both financial accounting and management accounting provide information to the user for decision making, there are various differences between the two as summarized in the table below.

Financial accounting

Management accounting

Information from Financial accounting system is used by external parties to the organization like the creditors, shareholders etc

Information from management accounting procedures is for internal use by the organizational management.

Financial accounting reports provide information on financial performance of an organization over a given period of time and the state of affairs for the organization at the end of the period.

Management accounting reports are for planning and control activities and also for decision making in an organization.

It is compulsory according to the law for limited companies to prepare financial statements.

Management accounting reports have no legal requirement.

Financial accounting statements are an end to themselves as they dwell mainly on the whole organization aggregating costs and revenues from different departments.

Management accounting information can not be an end to a product but rather aid in decision making. Also management accounting may give focus to specific areas and not every department.

Essentially, a historical picture of a past operation is presented by financial accounting procedures.

In management accounting, both the historical past of the immediate past and a future tool for planning is given.

Financial accounting records should be provided for at least a period of 12 months.

There is no time limit for management accounting records.

The international accounting standards must be followed in the preparation of accounting statement (financial accounts of various companies can be compared). I. e. Generally accepted Accounting Principles must be followed (GAAP).

There are no strict rules to govern management accounting record preparation (no need to follow GAAP). The records are used by managers of the organization and therefore there is no need for comparison.

A specific format specified by the IAS is to be followed in the preparation for financial statements.

There is no specified management accounting format and therefore no specific statements should be produced.

The nature of financial statements most often is of financial nature.

Management accounting information not necessarily money related. It can also be non-monetary.

(NetTOM website, 2010)

Types of management accounting reports

Since management accounting is a vital part of the planning tool kit, you can find the following managerial reports within SAC:

– Variance analysis:

this usually determines the standard, projections and actual costs of an activity. One key element to the company's benchmark is the difference between the actual and the standard costs, i. e. how much it can cost to produce the same computer chip by two different computer manufacturers. The organization can analyze its planning processes using the projections or estimate variance analysis. Through variance analysis, there is a special field called bottleneck accounting that examines the relative costs and the variances created through production bottlenecks (lovetoknow website, 2010).

– Cost analysis:

this is a type of managerial accounting that analyzes the exact cost of a product. This usually starts with finding out the cost of direct expenses like materials and labor. There are other sophisticated management accounting techniques that include analysis of indirect expenses. They include cost projection accounting, calculating opportunity costs and facility overheads. These techniques essentially analyze alternative ways in which the company could have invested the funds (lovetoknow website, 2010).

Activity based costing:

this type of costing technique analyzes the cost of activities basing on their cost rather than the product. Its advantage is that it allows for deeper analysis of the company's interconnected parts. This method divides products into;

- Unit- level activities (production of one unit).

- Batch level activities (cost per batch).
- Product sustaining activities.
- Facility sustaining activities.

The above report indicates Normal Costing System Per Unite Costs Retrieved from: http://ivythesis. typepad. com/term_paper_topics/management_accounting_report/

Accounting reports prepared on profit performance for a company may also indicate some of the expected managerial accounting duties. The example below was drawn from ABC System Profit Performance. The example that follows indicates normal costing system profit performance.

ABC System Profit Performance report retrieved from: http://ivythesis. typepad. com/term_paper_topics/management_accounting_report/

Normal Costing System Profit Performance report retrieved from http://ivythesis. typepad. com/term_paper_topics/management_accounting_report/

A business process like research development can be examined by either total cost analysis and/or cycle cost analysis. This is because both methods analyze the total expenses involved in a business activity. Therefore the two methods are very important n determining the company’s profitability (lovetoknow website, 2010).

Return on investment: this is a type of cost analysis that includes cost analysis naturally while measuring the direct returns as well as calculating the ratio (lovetoknow website, 2010).

Projections: this include future estimate of the organization such as; demand, sales, expenses, necessary resources and the number of required employees. Projections form one of the most complicated areas of managerial accounting because of the difficulty ion predictions caused by inflation, consumer demand and material prices. Therefore, they are built on extensive modeling.

Balanced scorecard: this usually includes standard financial measures. These measures include on perspectives of the customer on satisfaction, business process, innovation and perspective on learning (lovetoknow website, 2010).

Digital dashboards: these are applications that are designed in the form of a car's dashboard to display critical business information. They provide needed information fat just at a glance. Through them, the manager is able to see the latest data about the company in the company's business contexts (lovetoknow website, 2010).

Conclusion

Management accounting and financial accounting are two major accounting systems used by various organizations. Despite their use, they are totally different. Whereas financial accounting is prepared after a certain period of time and used by external users, managerial accounting is prepared by the management accountant for internal use of the management and it has no specific format to be used hence no need for comparison with other organizations. The similarities of the two range from mandatory certifications, use of currency, terminology used to similar technology. Examples of managerial accounting reports available are the variance analysis, cost analysis, return on investment, projections and digital dash boards.

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