Difference Between Financial and Managerial Accounting (Financial Accounting Vs Managerial Accounting):

Learning objectives of this article:

- Compare and contrast financial and managerial accounting.
- What is difference between financial and managerial accounting?

Financial accounting reports are prepared for the use of external parties such asshareholders and creditors, whereas managerial accounting reports are prepared for managers inside the organization.

This contrast in basic orientation results in a number of major differences between financial and managerial accounting, even though both financial and managerial accounting often rely on the same underlying financial data. In addition to the to the differences in who the reports are prepared for, financial and managerial accounting also differ in their emphasis between the past and the future, in the type of data provided to users, and in several other ways. These differences are discussed in the following paragraphs.

Emphasis on the Future:

Since planning is such an important part of the manager's job, managerial accounting has a strong future orientation. In contrast, financial accounting primarily provides summaries of past financial transactions. These summaries may be useful in planning, but only to a point. The future is not simply a reflection of what has happened in the past. Changes are constantly taking place in economic conditions, and so on. All of these changes demand that the manager's planning be based in large part on estimates of what will happen rather than on summaries of what has already happened.

Relevance of Data:

Financial accounting data are expected to be objective and verifiable. However, for internal use the manager wants information that is relevant even if it is not completely objective or verifiable. By relevant, we mean appropriate for the problem at hand. For example, it is difficult to verify estimated sales volumes for a proposed new store at good Vibrations, Inc., but this is exactly the type of information that is most useful to managers in their decision making. The managerial accounting information system should be flexible enough to provide whatever data are relevant for a particular decision.

Less Emphasis on Precision:

Timeliness is often more important than precision to managers. If a decision must be made, a manager would rather have a good estimate now than wait a week for a more precise answer. A decision involving tens of millions of dollars does not have to be based on estimates that are precise down to the penny, or even to the dollar. In fact, one authoritative source recommends that, "as a general rule, no one needs more than three significant digits., this means, for example, that if a company's sales are in the hundreds of millions of dollars, than nothing on an income statement needs to be more accurate than the nearest million dollars. Estimates that accurate to the nearest million dollars may be precise enough to make a good decision. Since precision is costly in terms of both time and resources, managerial accounting places less emphasis on precision than does financial accounting. In addition, managerial accounting places considerable weight on non monitory data, for example, information about customer satisfaction is tremendous importance even though it would be difficult to express such data in monitory form.

Segments of an Organization:

Financial accounting is primarily concerned with reporting for the company as a whole. By contrast, managerial accounting forces much more on the parts, or segments, of a company. These segments may be product lines, sales territories divisions, departments, or any other categorizations of the company's activities that management finds useful. Financial accounting does require breakdowns of revenues and cost by major segments in external reports, but this is secondary emphasis. In managerial accounting segment reporting is the primary emphasis.

Generally Accepted Accounting Principles (GAAP):

Financial accounting statements prepared for external users must be prepared in accordance with generally accepted accounting principles (GAAP). External users must have some assurance that the reports have been prepared in accordance with some common set of ground rules. These common ground rules enhance comparability and help reduce fraud and misrepresentations, but they do not necessarily lead to the type of reports that would be most useful in internal decision making. For example, GAAP requires that land be stated at its historical cost on financial reports. However if, management is considering moving a store to a new location and then selling the land the store currently sits on, management would like to know the current market value of the land, a vital piece of information that is ignored under generally accepted accounting principles (GAAP).

Managerial Accounting □ Not Mandatory:

Financial accounting is mandatory; that is, it must be done. Various out side parties such as Securities and exchange commission (SEC) and the tax authorities require periodic financial statements. Managerial accounting, on the other hand, is not mandatory. A company is completely free to do as much or as little as it wishes . No regularity bodies or other outside agencies specify what is to be done, for that matter, weather anything is to be done at all. Since managerial accounting is completely optional, the important question is always, "Is the information useful?" rather than, "Is the information required?"

Summary:

Financial Accounting	Managerial Accounting
• Reports to those outside the organization owners, lenders, tax authorities and regulators.	• Reports to those inside the organization for planning, directing and motivating, controlling and performance evaluation.
• Emphasis is on summaries of financial consequences of past activities.	• Emphasis is on decisions affecting the future.
• Objectivity and verifiability of data are emphasized.	• Relevance of items relating to decision making is emphasized.
• Precision of information is required.	• Timeliness of information is required.
• Only summarized data for the entire organization is prepared.	• Detailed segment reports about departments, products, customers, and employees are prepared.
• Must follow Generally Accepted Accounting Principles (GAAP).	• Need not follow Generally Accepted Accounting Principles (GAAP).
• Mandatory for external reports.	• Not mandatory.