Financial Accounting as Compared to Managerial Accounting

by Sophia

WHAT'S COVERED

What do you think are the different roles that financial managers perform in their day-to-day operation? We've discussed what a financial manager is and what they do, but what are some of the roles they take on in a business? This tutorial will cover the differences between financial accounting and managerial accounting. Our discussion breaks down as follows:

1. Financial Managers

Financial managers have to balance the need to borrow versus the needs of production. They need to make sure that they've gotten the best deal possible to borrow the money and ensure that the money is being used carefully within the organizations and not wasted on things that the organization doesn't need.

IN CONTEXT

Suppose a company wants to install solar in their plant or at their headquarters. A financial manager might look at the needs for funding, including how much it's going to cost and the potential return on investment. They'll also consider how long and when they'll be able to recoup those funds and get ahead.

On one hand, it may be a very smart idea to put the solar panels on, because the company will save a lot of money upfront on its electrical bills. It will also be able to pay back the money that was borrowed to install the panels in the first place fairly quickly.

On the other hand, if the company isn't garnering savings in its anticipated electrical bills and it will take a very long time to pay that money back—with the interest continuing to accrue in the financial reports—a financial manager may want to rethink the solar panels as an option.

2. Responsibilities of Financial Managers

A financial manager has four main responsibilities:

- *Determining long-term investments:* What are those things that we want to invest in long-term that will bring us money several years from now?
- *Getting the funds for these investments:* What are the things that we want to buy that we're going to use for a long time? And how do we get the money to acquire these things?
- *Overseeing the day-to-day operations of the financial activities:* Financial managers ensure that the money is controlled and that it's spent where it needs to be spent, and conversely, that it's not spent inefficiently in places where it will be wasteful for the company.
- *Helping manage risks:* This involves looking at the payoff, for example--how long does it take to make this money back? Or, if we invest in a certain product or improvement, will it actually help make the money back? If it's not benefiting the company, it probably shouldn't be done.

3. Types of Financial Managers

There are several different types of financial managers.

Types of Financial Managers	Description
Certified Public Accountant (CPA)	A CPA is licensed to work by the state, and they work with something called Generally Accepted Accounting Practices, or GAAP. This is the standard that accountants use so that everyone's books look basically the same, that what appears in one financial record will translate directly to a financial record in another company. They are generally involved in the tax part of the business, as well as financial auditing, to ensure that things are going smoothly.
Chief Financial Officer (CFO)	A CFO is involved in the big picture, 30,000-foot view of financial planning. They are considered part of executive management. They are the overseers of the entire financial department, so everything that happens from a financial standpoint in the whole company is their responsibility. That sounds like a pretty big job, doesn't it?
Chief Accounting Officer	A chief accounting officer oversees accounting operations only, but it's the accounting for the entire firm. Again, they are considered a part of higher management, though not necessarily executive management. Chief Accounting Officers report directly to the Chief Financial Officer.

Now, a CPA can perform any one of these roles, and these roles differ quite a bit in how they are organized in a business, based on the size of the organization. For instance, in a small business, you may have one person that is both the CFO and the CPA. Or, a company may outsource the CPA, and not have a CFO at all. Therefore, depending on the size of the business, these roles can vary dramatically.

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4. Financial vs. Managerial Accounting

Now let's take a look at how financial accounting and managerial accounting differ from each other.

4a. Financial Accounting

Financial accounting is the sphere of accountancy that is focused on the creation of financial statements for stakeholders outside the organization. These are the folks who prepare the financial statements for the people who are outside looking in--the shareholders and perhaps the owners of the company.

Financial accounting is focused on the external user. These could be stockholders, unions, creditors, the government, or possibly even suppliers. Financial accounting is responsible for preparing income statements and balance sheets, which we'll discuss in a different tutorial. Typically, these reports are filed annually, such as the annual report to the shareholders, which is also sent to the government through the Securities and Exchange Commission, or the SEC.

TERM TO KNOW

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4b. Managerial Accounting

Managerial accounting is the sphere of accountancy that is focused on the creation of financial statements to assist organizational managers in making decisions. It is a little different because it is internally focused and not necessarily meant for the people that are outside of the business.

These are the managers that are making decisions and running the business every day, and they can be used to help set performance goals. Where do we want to be? How well are we doing in getting there?

They want to make sure that they're filing the reports, but there is no release set schedule. The reports can be filed in a variety of time frames, such as weekly, monthly, biweekly, every two or three months, or semiannually—whatever it takes to make sure that the business is staying on top of its performance goals.

The area of managerial accounting also monitors trends or predictions, forecasting where a business wants to be in the future, based on the trends seen within the finances.

HINT

Now, managers in all departments need to have some type of managerial accounting skills for their department. If you're going to work in business—especially if you're going to be a manager—it's important that you understand the numbers so that you can participate in the conversation. If you have no idea what the numbers mean, it doesn't do you a lot of good to see them, and they can really help drive your department and the business toward success.

TERM TO KNOW

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The sphere of accountancy that is focused on the creation of financial statements to assist organizational managers in making decisions.

SUMMARY

Today we learned about **financial managers**. We explored the four main **responsibilities of financial managers** as well as the **types of financial managers**: the CFO, the CPA, and the Chief Accounting Officer. Lastly, we looked at **financial accounting vs. managerial accounting** to see how they compare to each other regarding who the intended user is for these two types of accounting.

Good luck!

Source: adapted from sophia instructor james howard

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