DIFFERENCES BETWEEN FINANCIAL REPORTING AND MANAGERIAL ACCOUNTING INFORMATION

Financial Reporting (FR) involves the analysis and interpretation of financial statements to reveal the financial position of a business over a given period. It helps to determine the overall performance of the organization, its efficiency in resource utilization, solvency and weaknesses (Mitra, 2009, 12). Management Accounting (MA) on the other end of the spectrum entails the “identification measurement, accumulation, analysis, preparation, interpretation, and communication of financial information, which is used by management to plan, evaluate, and control operations within an organization.” (Siegel & Shim, 2006, 81). Consequently, there are several differences between the information provided by FR and MA.

Perhaps the major difference between FR and MA information is that FR information is meant for external users, while MA information is meant internal users, especially the management. The later mainly relates to the operating, investing and financing activities and facilitates future strategic decision making while the former dwells on historical data (Needles et al., 2011, 7). Other than that, FR information usually covers one fiscal period and is therefore provided annually, semiannually or quarterly, depending on company policy. On the other hand, MA information is made available more frequently depending on management’s needs. Moreover, FR information should be published and as such, has to be presented according to predetermined formats prescribed by accounting standards such as the Generally Accepted Accounting Principles (GAAP), while the presentation of MA information does not follow any guidelines because it is not published. Additionally FR information is governed by the Companies Act and has to be audited while MA information is governed by the needs of the management and is not subject to any statutory audit. Finally, while FR information covers the entire organization, MA information might cover only a section of the organization.
Cost–Volume–Profit (CVP)
Cost–volume–profit (CVP) analysis can be defined as “a method of examining the relationship between changes in activity (i.e. output) and changes in total sales revenue, expenses and net profit.” (Drury, 2006, 241). This method is used to determine the impact of fluctuations in specific levels of activity or volume on the financial performance of a firm. Information obtained from the analysis is very vital to the management of a firm because it facilitates the determination of the optimum level of output that maximizes total sales revenue and minimizes total cost, hence maximizing the profitability of the firm. CVP analysis can therefore be used for both planning and control (Needles et al., 2011, 935). It is used to establish the relationship between volume, sales revenue, costs and profit in the short-run, that is, a period of one year or less. Despite being a powerful decision making tool, CVP analysis is characterized by simplification of real-life situations, which obscures the reality. It is also subject to several assumptions and limitations.
Benefits
CVR analysis is used to evaluate the financial implication of a wide range of strategic and operational decisions for instance product mix, pricing, and product process improvement (Kee, 2007, 478). Furthermore, it is used to measure the sensitivity of a specific product’s profitability to the fluctuation of the different parameters that influence its production. Finally, it can be used to determine the trade-off in risk and profitability for different production possibilities and product designs. CVP analysis is essentially used to determine efficient allocation of resources and is therefore a vital tool for budgeting, strategic planning and controlling production costs (Needles et al., 2011, 935). Apart from its technical capabilities, research has also shown that the method is favored by managers because of its simplicity.
Limitations
As afore mentioned, CVP analysis uses simplified assumptions, which include deterministic linear revenue and cost functions (Kee, 2007, 478). Other limitations of the model include the fact that it is single product oriented and focuses on single period analysis. Even though non-linear and stochastic models involving multiple stages, variables, products and periods have been incorporated in CVP analysis over the years, they are highly complex and result the loss of simplicity, which is a major advantage of the model (Yunker, 2001, 127). Kee also pointed out CVP analysis, like most managerial accounting techniques overlooks the cost of capital and assumes a zero that the cost of capital (479).
Recommendations
It would be strongly advisable for the entrepreneur to take the accountants offer. Even though he complies with the statutory accounting requirements, which mainly entail financial reporting, the entrepreneur does carry out any managerial accounting. This is one of the factors contributing to the poor performance of the business. Managerial accounting would entail among other things, CVP, which would facilitate profit maximization through cost minimization and sales revenue maximization. CVP will enable the entrepreneur to determine the optimum level output and identify those product lines that are most profitable in the businesses. This will in turn increase efficiency because he will be in a position engage in highly profitable production activities and avoid those activities that generate negligible profit and losses. Ultimately, CVP will facilitate better budgeting, strategic planning and control of production costs. The entrepreneur should however beware of the limitation of CVP and take necessary measures to address these limitations.
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