FINANCIAL REPORTING VS. MANAGERIAL REPORTING – A COMPARATIVE APPROACH

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***Abstract**: Financial reporting provide detailed information for external users, like as investors, lenders and creditors but it doesn't provide enough useful information for those decisions made concerning the daily activities of the business or regarding planning and controlling the companies' operations on a long term. Management reporting closely examines the process of converting consumed resources into results, allowing managers to set and permanently evaluate the fulfilment of business goals. This article considers a comparative approach between financial and management reporting, analyzing some important differences in terms of the objective of financial and managerial reporting, users of reports, purposes of reports and types of reports.*

***Keywords**: financial reporting, managerial reporting, users of reports, types of reports, focus of reports*.

***JEL Classification**: M41, M00*.

1. Introduction

Accounting is the system of recording and summarizing business and financial transactions and analyzing, verifying, and reporting the results. It provides information necessary to make choices among alternative uses of scarce resources in the conduct of business and economic activities. Accounting is often seen as a link between business activities and decision makers (Needles et al, 2014).

Every business has a financial side and a managerial one.

The financial side includes all the transactions which arise between: the firm and stockholders, or between partners; the firm and debtors and creditors; the income and expenditures of the company, its losses and gains, its assets and liabilities.

The managerial side of the business includes all transactions which arise between the various departments which produce or sell goods, including the cost of goods both as a whole and by departments, and the firm and its employees.

Thus, the separation of the two types of transactions determines the separation of the two sides of accounting, respectively financial and managerial accounting, best meeting the requirements of performing and managing the external and internal functions of the enterprise.

Financial accounting provides information intended mainly to the company's external partners in order to help them decide on the allocation of their resources. It provides information that gives a global and standardized view of the company, based on the answer to the question: "what is the consumption of resources and what are the results of the enterprise as a whole?" (Epuran et al., 1999)

Financial reporting provides a synthetic and retrospective picture of the company's financial position and performance.

Management accounting serves the managers inside the company, whose mission is to make decisions about transforming the resources entrusted to them to be managed and to achieve the surplus that ensures growth, without other external resources.

The comparison between financial and managerial reporting reveals important differences in terms of: the objective of financial reporting, users of reports, types and purposes of reports, focus of reports.

2. The objective of financial reporting and management reporting

The objective of general purpose financial reporting is to provide financial information about the reporting entity that is useful, mainly, to different categories of external users.

The management reporting provides information to different levels of management so as to allow assessing the effectiveness of their responsibility centres and become a base for taking corrective measures, if necessary. A fundamental objective of management reporting is to obtain the information about the operating results of the company in order to use them for further planning and control.

3. Users of reports

The information provided by financial reporting is used primarily by external users, like as the investors, creditors, tax authorities and regulators, competitors, customers, suppliers and others outside the company. The external users are relying on the financial statements to access information about a company in order to make more informed decisions.

According to IFRS Conceptual Framework for Financial Reporting, the users of financial reporting are existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity (Conceptual Framework, 2018, par. 1.2). These decisions relate to important economic aspects like as:

(a) buying, selling or holding equity and debt instruments;

(b) providing or settling loans and other forms of credit; or

(c) exercising rights to vote on, or otherwise influence, management's actions that affect the use of the entity's economic resources.

Management reports provide information about different aspects of the business to managers of different levels of the company, in order to help them make better-informed decisions. They basically show the worth of the business over a specific time period by disclosing operational information. Reporting for management provides insights on how the company is doing, empowering decision-makers to find the right path to increase operating efficiency and make pertinent decisions to remain competitive (Durcevic, 2020).

4. Purposes of reports; types of reports

The objective of general purpose financial statements is to provide information about the financial position, financial performance, and cash flows of an entity that is useful to a wide range of users in making economic decisions. To meet that objective, financial statements provide information about an entity's: assets, liabilities, equity, income and expenses, including gains and losses, contributions by and distributions to owners (in their capacity as owners), cash flows (IAS 1, par. 9).

That information, along with other information in the notes, assists users of financial statements in predicting the entity's future cash flows and, in particular, their timing and certainty.

A complete set of financial statements includes:

(a) a statement of financial position (balance sheet) at the end of the period

(b) a statement of profit or loss and other comprehensive income for the period

(c) a statement of changes in equity for the period

(d) a statement of cash flows for the period

(e) notes, comprising a summary of significant accounting policies and other explanatory notes (IAS 1, par. 10).

An example of a statement of profit or loss and other comprehensive income is presented in table no. 1.

Table no. 1. Example of a statement of profit or loss and other comprehensive income

	€	€
Revenue		
- Sales revenue	500,000	
- Services revenue	240,000	
- Changes in inventories of finished goods	60,000	
Total revenues		**800,000**
Expenses		
- Raw materials used	200,000	
- Employee benefits expense	250,000	
- Depreciation of plant and equipments	50,000	
- Utilities and rent	180,000	
- Other operating expenses	20,000	
Total expenses		**(700,000)**
Profit before taxes		**100,000**
Income tax expense		(20,000)
Profit for the year		**80,000**
Other comprehensive income		
- Gain on revaluation on land	30,000	
- Exchange differences on translating foreign operations	(22,000)	
Total comprehensive income net of tax		**8,000**
Total comprehensive income for the year		**88,000**
Profit attributable to owners		**100,000**
Total comprehensive income attributable to owners		**88,000**

The management accounting ensures, mainly, the recording of the operations regarding the collection and allocation of expenses by destinations, respectively by activities, manufacturing departments, cost centres, profit centres. It also ensures the calculation of the cost of inventories, cost of purchase, cost of conversion of inventories, and work-in-progress.

In Romania, according to Order No. 1826/2003 of the Ministry of Public Finances (par. 1), the purpose of management reporting is to provide:

- information related to the cost of goods and services, for companies carrying out production and service activities, as well as to the cost of goods sold for companies carrying out trade activity;
- information underlying the budgeting and control of the operating activity;
- information necessary for the financial analysis to substantiate the managerial decisions regarding the management of the internal activity;
- other information required by efficient management.

Managerial accounting information is communicated through reporting as well. The reports are more detailed and more specific and can be customized. Examples of managerial accounting reports are: budget analysis, job order cost sheets, cost of goods manufactured, and production reports.

Budget Report is a fundamental report in managerial accounting, helping business owners understand and control costs across the company. By evaluating expenses in prior years, it becomes possible to estimate budgets for the following year and find ways to reduce costs. In table no. 2 an example of budget report is presented.

Table no. 2. Example of Budget Report

Manufacturing Costs	Budget	Actual	Differences	
Variable Costs				
- Direct Materials	€25,100	€24,400	€700	Favourable
- Direct Labour	€28,300	€27,500	€800	Favourable
- Indirect Materials	€16,800	€17,200	€400	Unfavourable
- Indirect Labour	€12,500	€12,700	€200	Unfavourable
- Utilities	€10,300	€11,000	€700	Unfavourable
- Maintenance	€5,000	€5,000		
Total Variable	**€98,000**	**€97,800**	**€200**	**Favourable**
Fixed Costs				
- Rent	€6,100	€6,000	€100	Favourable
- Supervision	€4,000	€4,000		
- Depreciation	€5,500	€5,500		
Total Fixed	**€15,600**	**€15,500**	**€100**	**Favourable**
Total Costs	**€113,600**	**€113,300**	**€300**	**Favourable**

Job Cost Report provides information regarding the total cost accrued in a single product compared to the expected revenue from selling the product. This report helps managers evaluate the profitability of specific types of products and optimize their operations by focusing on the products or services that are the most profitable overall.

For example, product A ordered by client X passes through three manufacturing departments 1, 2 and 3. In table no. 3 an example of job cost report is presented.

Table no. 3. Example of Job Cost Report

	Manufacturing departments			
	MD 1	**MD 2**	**MD 3**	
Direct materials	€15,000	€2,000	€1,400	€18,400
Direct labour (hours for Product A)	2,000	1,000	3,000	
Rate of direct labour per hour	€2.00	€3.50	€1.50	
Total overheads for the departments	€12,000	€10,000	€15,000	€37,000
Total labour hours for the departments	15,000	15,000	20,000	
Job Cost Report				
Direct materials	€15,000	€2,000	€1,400	€18,400
Direct wages	€4,000	€3,500	€4,500	€12,000
Direct costs	**€19,000**	**€5,500**	**€5,900**	**€30,400**
Overheads*	€1,600	€667	€2,250	€4,517
Total Costs	**€20,600**	**€6,167**	**€8,150**	**€34,917**

***** Calculation of overhead allocated to Product A has been made as follows:

$$= \frac{\text{Total overheads for the department}}{\text{Total labour hours in the department}} \times \text{Labour hours in department for Product A}$$

Inventory and Manufacturing Report provides centralize data on inventory costs, labour, and other forms of overhead involved in the production process, providing raw data to optimize assembly or machining. An example is shown below:

Sales		€300,000
Cost of goods sold		
Merchandise inventory, beginning balance	€230,000	
Add net purchases	€170,000	
Cost of goods available for sale	€400,000	
Less merchandise inventory, ending balance	€210000	
Cost of goods sold		€190,000
Gross profit		**€110,000**
Less operating expenses		
Selling		€50,000
General and Administrative		€40,000
Operating profit		**€20,000**

Management reporting provides information that is relevant to planning and control decisions, for example, budgetary control information, relevant costs for one-off decisions, and profitability reports for profit monitoring. Also, management reporting is focused on segments of the business**.** By segmenting, the manager can get into the details and analyze the drivers of the business.

5. Focus of reports

Because financial accounting typically focuses on the company as a whole, external users of this information choose to invest or loan money to the entire company, not to a department or division within the company. Therefore, the global focus of financial accounting is understandable (Franklin et al., 2019).

Financial accounting is concerned with the principles and practices applied for recording transactions of a company and presenting financial information for use by the company's internal and external stakeholders. Presenting financial information in prescribed formats and under specific legal rules and regulations is a mandatory requirement of the law. Generally the topics covered include: accounting principles; bookkeeping rules, processes and formats; recognizing, measurement and presenting assets; recognizing, measurement and presenting liabilities; equity accounting; receivables and bad debts accounting; revenue recognition principles; taxation.

Managerial reporting is more focused on divisions, departments, or any component of a business, down to individuals. Managers need accounting reports that deal specifically with their division and their specific activities (Franklin et al., 2019). As an example, production managers are responsible for their specific area and the results within their division. Therefore, the company can be divided into segments based on what managers need; few examples of segmenting criteria are: geographic location, product line, customer demographics, or any other divisions.

That is why we conclude that managerial accountants perform a wider range of analyses than financial accountants do. Issues covered in management accounting include: product costing; cost behaviour; cost estimation; Cost-Volume-Profit analysis; flexible budgeting; strategic cost planning.

Detailed analysis may address the following issues:

- analyzing the profit resulting from different products or activities of a company and also the effect on the stakeholders' wealth of engaging in producing a certain product (through calculating profitability index, net present value, internal rate of return, payback period);

- the effect on profits of changing the company's cost structure (for example, replacing fixed expenses of sales wages with variable costs such as sales commissions);
- the minimum number of units that must be sold in order to achieve minimum 0 net operating profit (the "break-even point").

An advantage of using management reports is that there are no standard reporting formats that guide them, thus because managerial accounting reports are unique to a certain entity. Reports to management may be either summaries of past events, forecasts of the future, or a combination of the two. Additionally, they are generally not audited by an independent auditor because external users do not rely on them.

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