Lesson no. 2 – Types of Business Accounting

Although accounting and finance are both vital to the healthy functioning of a business, they have different meanings and accomplish different goals. Accounting, for example, refers to how a business acquires its money and how much it distributes outward to cover expenses. The term finance refers to the way a business makes its financing and business decisions to ensure the ongoing survival and growth of the company.

A finance department can't operate without input from accounting, and accounting professionals require the assistance of financial experts to create accounting information readily understood by a general audience. A business must use three separate types of accounting to track its income and expenses most efficiently. These include cost, managerial, and financial accounting, each of which we explore below.

The Three Types of Accounting and Why They Matter to Your Business

1. Cost Accounting
2. Managerial Accounting
3. Finance Accounting

1. **Cost Accounting:** Disagreement exists within the accounting and finance world about whether cost and managerial accounting are the same or two separate entities. Whatever you're feeling about it, these two areas of accounting certainly do overlap. The primary function of cost accounting is for a business to determine its production costs by considering how much it spends to purchase the supplies and labor needed to create its products.

   When managers receive these figures, they compare the cost of the production of goods against the profit the company earned by selling them. This helps them to establish a budget for future projects of a similar nature.

2. **Managerial Accounting**: This area of a company's accounting department concerns itself with obtaining and preparing financial documents for management and other higher-level staff. The documents prepared by managerial accountants remain within the organization

only. Managers use the financial documents they receive from this department to help them make the most appropriate business decisions and manage costs.

A key difference with managerial accounting is that those receiving the documents use it for forecasting purposes rather than as historical evidence of financial progress. Some specific techniques used by this area of accounting include cost-volume-profit analysis, risk management, and variance analysis.

3. **Finance Accounting:** Also called financial accounting, this area of a company focuses on external companies that have expressed interest in the business. Employees create several financial statements to provide to investors. The most common ones include the balance sheet, income statement, and statement of cash flows. These documents help investors understand the financial strength of the company to decide whether they want to follow through with making an investment or not.

Businesses considering whether to extend credit to a company also care about its financial statements. This helps them to determine the risk of loaning money to the company. The creditor may request collateral, a down payment, a personal guarantee, or another method of ensuring payment if the business doesn't have strong financial documents but still shows promise. On the other hand, companies that consistently post a loss or demonstrate proof of poor money management may not have credit extended at all. Companies with the strongest financial documents receive the best interest rates and other favorable terms.