

Accounting Involves What Happened and Finance Focuses on What Will Happen

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People often confuse accounting and finance. However, there are rather significant differences in the two subjects, as all university students quickly realize, if they choose to study one or both. These two subjects also have some similarities.

Similarities

- * Both accounting and finance involve money management.
- * Both areas focus on representing results of company actions.
- * Both subjects convert actions into numerical monetary data.

The universal language of business around the globe involves numbers, which display the monetary effectiveness of operations and strategic plans. Internationally, the displayed numbers are converted to the country's currency, initially making them more difficult to compare with US dollars.

However, financial statements (accounting) and strategies (finance) still present a picture of the success (or lack thereof) with company operations, strengths and weaknesses, regardless of currency conversion. In most cases, this is where the significant similarities end.

Differences

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Students should learn the differences in accounting and finance early in their educational careers. Accounting and finance have two very important differences that separate one from the other.

1. Accounting displays what has already happened, while Finance affects what is happening or will happen in the future.
2. Accounting records historical numbers and results, while Finance attempts to plan for and predict the numbers that will result from certain action plans.

Accounting

This function involves the following responsibilities.

- * Recording daily results in a company's books and records. Using original documents, bank transactions and internally or externally generated reports, accountants post daily operating results.
- * Combining daily results into monthly summaries of operations.
- * Every 90 days (quarterly) putting together monthly data to indicate the results of operations.
- * Annually combining the operating results to show the yearly data for operations success or failure.
- * Monthly, quarterly and annually displaying the assets, liabilities and owner's equity in the organization at different points in time.

* Verifying that documents and reports are accurately recorded and support the financial statements that are created.

Finance

While accounting is a component of finance, the scope of finance is wider and more all-encompassing. Beyond evaluation of what has happened as presented by accounting, finance uses this historical data to interpret the organization's financial position, while providing the fuel for creating, modifying or dramatically changing current and/or future plans.

Finance involves managing a company's assets and resources to maximize their use and effectiveness. The future forecasts made by finance strongly influence the coming success or failure of management strategies to create revenue and organization value.

Analyzing accounting results, finance evaluates company performance, risks and returns on investment, all critical components of sustainable organizations. Finance analyzes accounting ratios to improve decision-making plans to improve a company's financial and operating position.

Even nonprofit organizations must have financial plans that balance revenue and expenses. Nonprofit companies must achieve break-even levels (where income is sufficient to meet all expenses). While the profit and return on investment goals are different with nonprofits, strong financial plans are still necessary to ensure the organization can sustain itself for the long-term.

Finance often involves SWOT (Strengths, Weaknesses, Opportunities and Threats) analysis. This classic financial and operating tool provides data that allows financial personnel and senior management to design strategies that enhance strengths, minimize

weaknesses, recognize opportunities to succeed and identify threats from competition, economies and other internal or external issues.

Accounting and Financial Tools

Accounting tools include Income Statements (sometimes called Profit & Loss Statements, Balance Sheets and Cash Flow Statements. These three documents are used internally by financial employees and externally by lenders and investors to evaluate the company. Profitability, available cash and owners' equity levels are vital for sustainability and company value.

Financial tools, including the accounting statements, involve performance reports, risk analyses, return on investment data and break-even statements. Finance uses these tools to plan for and predict future results. Designing or re-designing strategies that will maintain or improve monetary results and strength are prime objectives of finance.

When the components are broken down and identified, the difference between accounting and finance typically becomes clearer. Their few similarities are outweighed by their difference. However, both functions are necessary components of all organizations, whether for-profit or not-for-profit.

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