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A CRITICAL ANALYSIS ON THE USE OF FINANCIAL STATEMENTS IN ASSESSING THE PERFORMANCE OF AN ORGANIZATION

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ABSTRACT

The purpose of this research paper is to determine the use of financial statements as a final product of financial accounting and all the financial data available in analyzing and evaluating the performance of an organization to different stakeholders. The financial statements of an organization are examined internally by the management of the organization to study and improve its operations internally and externally by investors and creditors to make investment decisions. Income statement, Balance sheet, Cash flow statement and financial ratios are included in financial statements of an organization. Financial statement analysis can be used to determine an organization's liquidity position, long-term solvency, financial viability, and profitability. Therefore, this research paper explains in detail why financial statements are important and their uses for an organization.

Keywords: Financial analysis, Financial Accounting, Stakeholders, Financial statements, Balance sheet, Income statement.

Introduction

The focus of this study is to coincide financial accounting information with meaningful analysis of the available information to help an organization in its future operations and performance management; How Financial Information help in Financial Accounting process and how the Financial Statements created are turned into Financial Analysis.

The accounting system we have today often functions as an integrated registration and data system, delivering a trustworthy and transparent report on the organization’s property and financial situations and its financial results. According to polish balance sheet law, one of the most important parts of company accountability is the creation and, in some cases, examination and dissemination of financial statements(Osadchy et al.,2018).

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Financial analysis determines a firm's financial health by evaluating its stability, viability, and profitability.An essential goal of financial analysis is to discover changes in financial patterns that can track a company's progress and establish a relationship that can be used to accomplish the desired goals and objectives of the organization. Another important part of a financial study is comparing the company's performance to that of its competitors (Osadchy al,2018).

The analysis of financial statements by management is primarily focused on sections of the organization that allow management to plan, analyses, and regulate operations within the company. On the other hand, Investors and creditors examine the financial statements as a whole when deciding whether to invest in or extend credit to a company.

The income statement and the balance sheet are critical reports to examine while analyzing the company's overall financial condition because the income statement demonstrates performance, and the balance sheet shows the net worth of the organization.

Stakeholders involved with an organization

Financial statements are used to examine a company's strengths and shortcomings by connecting the many Components in accounting and financial statements. Any stakeholder, including business Owners, trading lenders, lenders, shareholders, labour unions, employees, analysts, and anybody with a stake, may undertake a financial statement analysis.

Use of Financial Statements by Different Stakeholders of an Organization

Businesses and other organizations must file tax returns and financial reports to tax officials at the end of each year, quarter, or as required by rule and governance. The financial statements include the balance sheet, income statement, cash flow statement, and notes that clarify the statement features. Financial statements summarize and Coverall corporate financial actions and transactions over a certain period and must be prepared with management disclaimers following global financial reporting standards (SZYDELKO, & BIADACZ, 2016).

The cash flow statement (CFS) depicts the amount of cash generated over a certain period, taking into account any transactions that contributed to or draws cash away from the organization. Cash flow is important because it shows how much money is available to meet short-term obligations, invest in the firm or pay dividends. Dividends are often cash payments paid to shareholders in exchange for their ownership of the company. Financial ratios assist investors in deciphering 'the huge amount of financial information offered by organizations. A ratio can only be used to analyze data and draw useful comparisons to other firms and re porting periods (Osadchy et al.,2018), Financial ratios analysis analyses numerous elements in.at organization's financial

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accounts to see how well they perform. All ratios influence profitability, debt, managerial efficiency, and operational excellence.

It is critical to recognize that investors frequently misinterpret the outcomes of financial ratios. Financial ratio analysis can provide knowledge to a company, but it must be coupled with other metrics and analyzed against the backdrop of the economy as a whole. Using return on equity and/or Return on Investment (ROE), various investors assess a company's ability to generate equity and/or investment revenues (SZYDELKO, & BIADACZ, 2016). Companies can collect money and then return it to the firm by issuing stocks. The amount returned to shareholders if the company's assets are distributed, and all debts are paid off is referred to as Shareholder equity. The greater the company's profitability, the greater the ROL because-it generated more cash per dollar invested.

Limitations of financial statements

Qualitative aspects are missing

The financial statement does not often address non-financial elements, such as the environmental sensitivity of the company or its good working relations with its surrounding employees. A corporation with strong financial performance in these fields could be a disaster. The financial statements are much more limited, so exhibitions and presentations on the changing international financial reporting guidelines and practices, on the changing side of company owners, and on the socially responsible cooperative part of business and ecosystems for various fiscal organizations and stake holders are necessary.

Based on Historical costs

The figures calculated in financial statements are not based on current costs, they are rather based on past data available. This limits the financial analysis in a way that the balance sheet value and the current market value of differ from each other significantly. As a result, relying entirely on historical costs makes the financial statement less trustworthy and misleading.

Not Self Explanatory

The terms and formats of financial statements are usually difficult for a layman to comprehend or understand, which limits the use of these statements to people with knowledge or Accounting and Financial matters. The decision of investment by investors is also a lot of times based on expert opinions, since not all investors are well equipped with accounting knowledge.

Changing business conditions

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The market is extremely unpredictable; market situations and circumstances can shift at any time, resulting in recession or favorable conditions in some cases. So, the market's condition could be different from the time financial statements were made, which might lead to incorrect analysis of these financial statements.

Conversion of financial statement figures into meaningful information to analyze the performance of an organization.

a) Ratios

Based on the data from the financial accounts, the calculation and analysis of the financial ratios are used to analyze the company's condition and performance. A percentage- based link between financial data vis a financial ratio, for example, current assets could be compared with current debts or asset sales, The ratios can then be compared across time (usually three to five years), A company ratio or industry averages can be compared with other companies within the Same industry. The ratio analysis is based on prior data and may not precisely estimate future financial performance (Al-Nasser, 2014). Ratios ate also crucial for existing and potential lenders who want to determine if the company can re pay its bonds and evaluate the company's financial health. Loan agreements frequently demand businesses to maintain specific ratio levels. Over time, both current and potential shareholders use ratio evaluations of the company's previous successes and trends, The current ratio is-calculated by dividing current assets by current liabilities. A ratio of one show that the company's current assets fall short of covering its current liabilities, A corporation with a ratio greater than one has more current assets than current liabilities; a company with a ratio less than one has more current liabilities than current assets (Al-Nasser, 2014), Investors frequently favor a lower current ratio since it shows that a company's assets are being used to build the business.

b) Income Statement

Many firms categorize revenue or sales to indicate how much each division made. Well- defined and independent revenue sources can substantially facilitate income statement analysis. It allows for a more accurate projection of future growth. The cost of goods sold (COGS) is the amount of money spent by a company to manufacture, create, or sell a product. It includes the cost of the raw material and the price of converting it into a completed product. The phrase "cost of goods sold" (COGS) can also refer to the cost of income or sales.

c) Balance Sheet

Assets and liabilities are included in the balance sheet. It at some time indicates the company's financial situation, The assets are usually given in order of liquidity or time to convert the assets

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into cash. First of all, it is cash that is liquid. Non-cash assets should in the future offer a cash flow but not the cash in hand nor the amount of cash available today when sold because the amount can be more or less than the book value.

How financial statements analyze organizational performance.

A corporation's financial statements contain financial data that may be used to assess financial performance by investment companies, Creditors, and analysts. The law or accounting standards necessitate a considerable part of the information in a financial report. Senior management might use your organization's financial records to discuss past and future victories (Hasanaj& Kugi,2019), The financial statement contains the highest quality financial data utilized in corporate performance management. It gives numerical data stated in monetary units that summarize the defined entity's property and financial condition and the results obtained, the financial statements reflect international business events associated with the company's business activities, converted. into numbers and placed into accounting records to produce the financial statements database (Hasanaj& Kuqi,2019). The mastery and-understanding of the information contained in the financial report provide a comprehensive picture of the organization.

Conclusion

To sum up, financial analysis is a method of determining a firm's financial health by evaluating its stability, viability, and profitability. An essential goal of financial analysis is to discover changes in financial patterns that can track a company's progress and establish a relationship that can be used to accomplish the desired goals. The analysis is an important part of the business because it shows whether the entity is growing. It contains the highest quality financial data utilized in corporate performance management. It gives numerical data stated in monetary units that summarize the defined entity's property and financial condition and the results obtained. The study leads to the conclusion on each aspect of financial information of an organization is helpful in interpreting the real condition of the organization and make better decisions in future based on past and predicted financial analysis.

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