

ANALYSIS AND INTERPRETATION OF FINANCIAL STATEMENT AS A MANAGERIAL TOOL FOR DECISION MAKING

**(A CASE STUDY OF NWOKEJI URBAN PLANNING AND
ARCHITECTURAL STUDIO [NUPAS])**

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Abstract

Financial Statement Analysis and Interpretation is a very vital instrument of good management decision-making in business enterprise. Good decisions ensure business survival, profitability and growth. Without financial statement analysis in investment decisions, an enterprise is likely to make decisions, which could spell its doom. Poor or lack of qualitative financial statement analysis could lead to investment returns, low profitability and even inability to identify viable investment opportunities. The main objective of this project is therefore, was to determine how firms could use financial statement analysis and interpretation to aid management decisions and to avert the problems highlighted above. Primary and secondary data are employed to broaden the scope of this study. Primary data are sourced from questionnaire responses. This provided data for the validation of the hypotheses tested with the use of chi-square (X^2). The test revealed as follows: (1) Significant difference between the returns of the financial statement in Analysis and Interpretation based on management decision. (2) Organizational profitability has relationship with financial statement analysis and interpretation based management decision but not significantly. The project concludes that companies should pay great attention to the use of financial statement analysis so as to properly equip themselves with this invaluable tool. The researcher recommends the following: (a) Accountants or financial analysts should not be rushed in collection, preparation, analysis and interpretation off financial statements. (b) Financial statements should be made to reflect current cost accounting to eliminate or reduce the effects to historical cost principle and inflation risk element. (c) A combination of different ratios should be used in analyzing a company's financial and/or operating performance. Proper use of financial statement analysis

should be made not only in investment but also in other areas of decision making.

CHAPTER ONE

1.0 INTRODUCTION

1.1 Background of the Study

The complex nature of today's business world and the transformation of the entire world into a global village have been of great concerns to managers of all forms of business organizations. According to Ojuigo (2001), the problems of managers are multi-varied because of inefficiency in management of poor decision outcomes of these organizations. Therefore, the managers are unable to achieve the organizational objective within a period of time.

As diverse as business is, its controllable and uncontrollable factors influence all decisions which ultimately lead to the realization of set objectives. To achieve this, management needs reliable, authentic and relevant information from the financial statements to efficiently facilitate decision making.

It must be noted that every business stores at making at least from investments "sustainable profits" so as to stay afloat and continue in business. Therefore, profit being the concern of every manager is a factor in business. To achieve this, available information from the financial statements of organizations must be analysed, interpreted and used as a basis for decision making (Needham and Dransfield 1991). Financial statement analysis is often considered as a vital tool used in evaluating a company's

performance and ensuring that decisions are based on facts rather than rule of thumb.

A financial analyst needs financial statements of companies to be able to identify operating and financial problems which may affect the companies (Mbat, 2001:60). Thus, any person who analyses the financial statements of firms should be able to identify the cause and effect of financial and operating problems of such firms.

Statement of the Problem

The principal aim of making investment decision is to get adequate returns from it. According to Needham and Dransfield (1991), “people as a rule will only tie up their money in a business if they are satisfied with the returns they get from it”.

In an attempt to achieve maximum returns from investment in production, services shares or stock and/or other securities outside the firm, a comprehensive analysis of the company which is intended to be invested in should be carried out using the company’s financial statements to ascertain both its explicit and implicit investment opportunities. However, organizations that do not use financial statement analysis in making investment decisions could be ill formed. As a result, the following problems may arise:

- (i) Inability to identify viable investment opportunities
- (ii) Decreasing returns from investments.
- (iii) Decline in organizational overall profitability.
- (iv) Increased investment risk: The organization might not achieve its corporate objective at the end of the period.

If the trend continues, it will likely lead to the failure of the organization. Therefore, there is a great need for organizations to

consider and analyse company's financial statements before investing in that company. These are the focus of this study.

1.3 Objectives of the Study

On noting that most investments made by firms end in failure, it is the overall objective of this study to determine how firms can use financial statement analysis and interpretation to aid management decisions. Specifically, the study is designed to:

- i) Find out how the use of financial statement analysis assists organizations in identifying investment opportunities.
- ii) Find out how increasing investment returns can be achieved using financial statement analysis.
- iii) Find out the extent to which a company's overall profitability can be hampered if it does not analyse another company's financial statement before investing in it.
- iv) Find out how business failures can be curbed or minimized and corporate objective achieved through successful investment.
- v) Identify alternative ways of minimizing investment risk.

1.4 Research Questions

The following questions are put forward for the purpose of the study.

- 1) Is financial statement analysis important/necessary in every organization?
- 2) Who are the users of financial statement?
- 3) How can a financial statement of an organization be interpreted?

- 4) How can its interpretation be used in making effective management decisions?

1.5 Hypotheses of the Study

To achieve the achievement of the desired objectives, the following hypothesis are formulated:

H₀: Represents Null hypothesis

H₁: Represents Alternative hypothesis

Research hypothesis No 1

H₀: There is no significant difference between the returns of a financial statement analysis and interpretation based on management decisions.

H₁: There is a significant difference between the returns of a financial statement analysis and interpretation based on management decisions.

Research hypothesis No 2

H₀: There is no significant relationship between a firm's profitability and financial statement analysis and interpretation based management decisions.

H₁: There is a significant relationship between a firm's profitability and financial statement analysis and integration based management decision.

1.6 Significance of the Study

The study of the use of financial statement analysis and interpretation in management decision is meant to contribute immensely to sustained business operations in selected firms south south region and general growth in business, be it private or public. The study shall be beneficial in the following ways:

- i) It will direct analysis and interpretation of the use of financial

- ii) It will inform management on the possible and available investment ratio, their functions and uses for a greater evaluation of a company's capabilities and profitability.
- iii) The work will also serve as a reference material to other persons who will conduct studies in similar areas both within and outside the university.

1.7 Scope of the Study

The study is conducted to cover selected firms both in South-South region.

However, this study is conducted to cover the use of financial statement which includes; (Balance sheet, income statement, statement of cash flow and statement of retained earnings) analysis civil interpretation management decision.

1.8 Limitation of the Study

The research work has some limitations due to some problems encountered from the sources of collecting useful materials also some unforeseen circumstances which posted as a threat during preparation of this research project includes:

- TIME: A research of this kind would require enough time to cover many areas of activity effectively, but since the researcher is a student with other classroom works to do, the time allocated for the study was limited.

- FINANCE: During the course of this research, another stumbling block. Judgment financial resources was encountered. The researcher has to make due with little financial provision available to achieve a qualitative and acceptable research finding.
- Health was also a limiting factor, for instance, the researcher falling ill in the cause of the study, which stopped the research for some time.
- TRANSPORTATION: The source of collecting useful material or information is far and the transport logistics expensive, in some cases, the journey was fruitless if the staff was not available.

1.9 Definition of Terms

- * RATIOS: A ratio is the relationship between two amounts that results from dividing one by the other. It is an accounting term used to describe the financial index which compares two financial variables such as current assets and current liabilities. Examples of ratios are quick ratio, and test etc.
- * ACCOUNTING RATIOS: “they are the relationship between figures expressed as ratios”
- * INVESTMENT DECISIONS: This relates to allocation of capital and involves decisions to commit funds to long term assets, which will yield benefits in future.
- * RATIO ANALYSIS:

It is an analytical tool designed to identify significant relationships between two financial statement amounts.

CHAPTER TWO

LITERATURE REVIEW

2.1 Introduction

The use of financial statement analysis and interpretation in investment decision has been addressed by a series of authors in one way or the other. In some instances, the sue of this analysis to determine profitability of a company and specifically returns on investment and optimal management decisions have been stated.

According to Pandey (2005), profitability is the ability of an entity to earn income. It can be assessed by computing various relevant measures including the ratio of net sales to assets, the rate earned on total assets etc.

Meigs and Meigs (2003) stated that the rate of return on investment (ROI) is a test of management's efficiency in using available resources. This review is organized under the following sub-heads for ease of comprehension.

1. What is financial statement?
2. Objective of financial statement analysis
3. Uses and users of financial statement analysis
4. Classification of financial statement
5. Techniques of financial statement analysis and interpretation.
6. Limitations of financial statement analysis
7. Features of a good management decision

8. Decision making environment
9. Impact of inflation on financial statement analysis

2.2 What is Financial Statement?

According to Meigs and Meigs (2003), financial statement are a structured representation of the financial position and financial performance of an entity. The objective of 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.

Financial statements also show the results of the management's stewardship of the resources entrusted to it. To meet these objectives, financial statements provide information about an entity's:

- i) Assets
- ii) Liabilities
- iii) Equity
- iv) Income and expenses, including gains and losses
- v) Contribution by and distribution to owners in their capacity as owners, and vi) cash flows

A complete set of financial statement comprises:

- 1) A statement of financial position as at the end of the period:
- 2) A statement of comprehensive income for the period;
- 3) A statement of changes in equity for the period:
- 4) A statement of cash flow for the period.

- 5) Notes of Account comprising a summary of significant accounting policies and other explanatory information; and
- 6) A statement of financial position as at the beginning of the earliest comparative period when an entity applies an accounting policy retrospectively or makes a retrospective restatement of items in its financial statements or when it reclassifies items in its financial statements.

2.2.1 Objective of a Financial Statement Analysis

Business decisions are made on the basis of the best available estimates of the outcome of such decisions. According to Meigs and Meigs (2003), the purpose of financial statement analysis is to provide information about a business unit for decision making purpose and such information need not to be limited to accounting data. While ratios and other relationships based on past performance may be helpful in predicating the future earnings performance and financial health of a company, we must be aware of the inherent limitations of such data.

According to Meigs and Meigs (2003), the key objectives of financial analysis are to determine the company's earnings performance and the soundness and liquidity of its financial position. We are essentially interested in financial analysis as a predictive tool.

Accordingly, we want to examine both quantitative and qualitative data in order to ascertain the quality of earnings and the quality and protection of assets. In periods of recession when business failures are common, the balance sheet takes on increase

importance because the question of liquidity is uppermost in the minds of many in the business community. However, when business conditions are good, the income statement receives more attention.

Nevertheless, a financial analyst has to grapple on the above complexities of using financial statement analysis to achieve a specific purpose.

2. 3 Vertical Analysis

According to Diamond (2006), vertical analysis is used to evaluate the relationships within a single financial statement. Essentially, the appropriate total figure in the financial statement is set to 100% and other items are expressed as a percentage of that figure, ibidi. For the balance, this figure usually is total assets or the total of liabilities plus stockholders equity. Net sale usually is the total figure used in the income statement.

Exhibit 2.8 and 2.9

24 Ratio Analysis

According to Diamond (2006), Ratio analysis is a method of expressing relations among various items in a company's financial statement. However, ratios are not substitutes for looking dipper into the financial position of the company. There is a danger that inexperienced financial statement analysts might use what is called a rule of the thumb analysis to make important decisions. However, according to Diamond, there are few rules of thumb that are adequate in today's complex financial world. It is important to keep that caveat in mind when performing ratio analysis.

of debtors turnover, the more efficient is the management of credit. Thus, debtors turnover can be calculated by dividing total sales by the year and balance of debtors (Pandey, 2005:526)

CHAPTER THREE

3.1 Research Design

A research design is simply the framework or plan for the study, which is used as the modus operandi of collecting pertinent data.

In this study, the quasi-experimental design is adopted with particular concentration on the descriptive method. This is preferred to others given the nature of the study, which is an exposition of selected companies with respect to the effect of financial statement analysis and interpretation as a tool for management decision and corporate performance evaluation.

3.2 Sources and Method of Data Collection

The main sources and methods of data collection used in the study are:

- a) Primary source and
- b) Secondary source

The primary source of data is the questionnaire and personal interview while the secondary sources include: textbooks, journal and opinions of experts on the subject.

The secondary source provide the theoretical framework for the study.

3.3 Research Instrument

A research instrument is any device constructed for recording of measuring data. It is the means for generating pertinent information to be used for solving the research problems (Olakunori 1997) therefore, in order to obtain valuable data for analysis, interpretations and appreciation of problems aforementioned, a set of questionnaire was designed and administered to employees of NUPAS Ltd.

The choice of questionnaire as research instrument for this study was based on the fact that, it permits the coverage of minimum expenses both in money and effort.

Again, because of greater impersonality attached to questionnaires, more objective data were obtainable in the set of questionnaire structured questions, multiple choice (close-ended) questions and open ended questions were used.

3.4 Reliability/Validity of Research Instrument

In order to forestall measurement errors, which occur when the research instrument is faulty, the reliability of the research instrument was ensured through its careful construction and pretest. Pretest was done by conducting a pilot survey, where in the research instruments (questionnaire) were administered to a part (sample) of the population with a view to finding possible fault and thereafter,

correction than before the full application of main sample for the study.

3.5 Population

Population here refers to the totality of targeted individuals that form the focus of this study. The objectives of the data collection process is to draw conclusions about the population. It is therefore imperative to have a clear picture of what constitutes the research population.

The population for this study consist of employees drawn from some vital departments or section of workers of the NUPAS Ltd.

Department	Population
Architecture	10
Accounting	15
Administration	20
Construction	5
Accounts & cleaning	50
Total	50

3.6 Sample Size and Technique

According to Egbu (1998), sampling involves the selection of a number of study units from a defined study population.

A sample is therefore, a small representatives of a large population. In drawing a small sample for the study, the researcher

considered how many people that are needed in the sample and their category first to be selected.

A sample size used is forty-four (44) staff selected from NUPAS Ltd using the formular by yaro yemmen method (1967)

$$n = \frac{N}{1+N(e)^2}$$

where

n = sample size

N = Population size (50)



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e = Level of significance (acceptable error/limit)

l = A constant number

For the purpose of this research works, our level of significance (2) = 5% or 0.05 that is a 95% confidence limit.

Since $n = ?$

$$N = 50$$

$$e = 0.05 \text{ or } 5\%$$

substituting the above value into the formular we have that,

$$n = \frac{50}{1 + 50 (0.05)^2}$$

$$n = \frac{50}{1 + 50 (0.0025)}$$

$$= \frac{50}{1+0.125}$$

$$= \frac{50}{1.125} = 44.44$$

Approximately $= 44$

$$n = 44$$

the sample size of the population is 44 and the researcher issue the same number of questionnaire to the staff of NUPAS Ltd, to the responses in this study.

CHAPTER FOUR

DATA PRESENTATION AND ANALYSIS

The previous data dealt with research methodology. In this chapter, the researcher present and analyze the data collected through the primary source to enable him read meaning into the responses to the questionnaire. The collected data presented in tables, with frequency of each variables calculated the analysis drawn depends largely on response from the data collected the set of questionnaire.

Furthermore, in this chapter, the formulated hypothesis are subjected to empirical test using the chi-square (χ^2) and correlation statistical technique. The essence of this test is to valiolate or otherwise disapprove the hypothesis.

The chapter is divided into two parts with one dealing with data presentation while the other deals with the test of hypothesis.

Table 4.1.1

QUESTIONNAIRE DISTRIBUTIONS AND RETRIEVAL

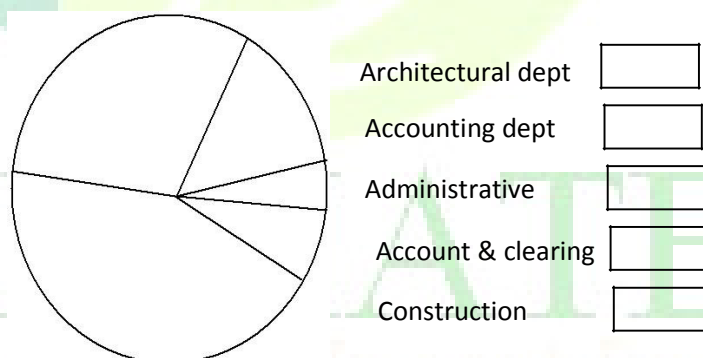
S/N	Department/Section of Worker	Total	Distribution and Returned	Percentage
1	Architecture	4	4	9
2	Accounting	13	13	30
3	Administration	18	18	41

4	Accounts & Clearing	5	5	11
5	Construction	4	4	9
	Total	44	44	100

Source: Field survey 2012

The above table shows that, a total of 44 questionnaire were distributed and returned from all the section of worker/department. 4 questionnaire representing 9% was distributed to Architecture dept and the same number were returned 13 questionnaire represented by 30% was issued to Accounting department and the same number were Returned after Filling them. 18 questionnaire representing 41% to Administration department and the same number were returned after filling them. 5 questionnaire representing 1% to Accounts and clearing dept and the same number were returned. 4 questionnaires representing 9% to construction department and the same number were also returned.

PIE CHART DISTRIBUTION/RETIRVAL OF QUESTIONNAIRES



CALCULATION OF THE PIE CHART

$$\text{Architectural Dept} = \frac{9}{100} \times 360^{\circ} = 32.4 = 32^{\circ}$$

$$\text{Accounting Dept} = \frac{30}{100} \times 360 = 108^{\circ}$$

$$\text{Administrative Dept} = \frac{41}{100} \times 360 = 147.8^{\circ}$$

$$\text{Accounts and clearing} = \frac{11}{100} \times 360 = 40^{\circ}$$

$$\text{Construction Dept} = \frac{9}{100} \times 360 = 32^{\circ}$$

$$\text{Total} = 360^{\circ}$$

4.1 Data Presentation

The researcher makes use of questionnaire for the data presentation. The data collected from the members of staff of NUPAS Ltd. The questionnaire was distributed randomly on all categories or section of workers in the accessible population.

The researcher desire to use only 44 questionnaire the researcher topic from the staffs of NUPAS Ltd. The 44 question were issued to the staff of NUPAS Ltd and the entire question issued were collected successfully for analysis is consequently based on the sample size of 44 which is the producing sample. The method of data analysis used is the sample percentage which is very easy to understand.

CHAPTER FIVE

SUMMARY OF FINDINGS, CONCLUSION AND RECOMMENDATIONS

5.1 Summary of Findings

This research work has identified how companies use financial statement analysis and interpretation in making effective management decisions. Overall organizational profitability and achievement of organizational objectives were discussed. Again the difference between the returns of a financial statement analysis and interpretation based on management decisions were also discussed.

Forty-four questionnaires were distributed to the top and executive level managers of the selected company and the use of percentage and chi-square distribution were also used in testing the formulated hypothesis.

From the results of the hypothesis tested, the null hypothesis was rejected in the first hypothesis and the alternative hypothesis was accepted. In other words, it was observed that there is a significant difference between the returns of a financial statement analysis and interpretation based on management decisions.

From the results of the second hypothesis tested, the null hypothesis was rejected and the alternative hypothesis was accepted. We also got to conclude that there is a significant relationship between a firm's profitability and financial statement analysis and interpretation based on management decisions.

5.2 Conclusion

The main objective of this study was to determine how firms could use financial statement analysis to aid investment and management decisions in the selected company.

It is of great importance to note that survey carried out shows that financial statement analysis is valuable in investment decision making of the company.

Consequently, the first and second hypothesis shows a positive result, all from the responses obtained from the questionnaires used in the analysis of the research work. Hence, from this point of view, it is necessary that business organizations should pay more attention to the use of financial statement analysis

5.3 Recommendations

Based on the findings of this study as presented, analysed and interpreted, the following recommendations were deemed necessary by the researcher:

- 1) Adequate time should always be allowed for collection of financial statement data and preparation for their analysis.
- 2) Financial statement should be properly interpreted and should be made to reflect current cost accounting to reduce the negative effects of historical cost principle on financial statement decisions.
- 3) The effects of inflation on financial statement result should be considered to reduce the inflation risk.

- 4) The adequacy of financial information need to be emphasized on, as it will provide enough and necessary details for investment and management decisions.
- 5) A combination of different ratios should be used to analyze a company's financial and/or operating performance.
- 6) Finally, the management of the selected company should make proper use of financial statement analysis in other decision areas of management not only in investment decision.
- 7)

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