

Role of Financial Analysis in Organization Management System

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Abstract: This study considers methodological aspects of analyzing financial statements for internal users, objective peculiarities of analysis as a Cognition Method were discovered, its advantages and limitations were defined as well as the reasons of decrease of popularity of performing complex analysis at Russian enterprises; inter alia, the range of essential and conjectural reasons was named. We detached key tasks of performing analysis of accounting reports for internal users who take managerial decisions. We compared methods of decision-making on the base of financial information and key indicators of activity, we defined the possibilities and limitations of technology of taking managerial decisions based on KPI. Exemplified by real existing enterprise “Nizhnekamskmashina” OJSC and its financial statements, we suggested methodological variant for analyzing main financial indices for solving various tasks of enterprise management. It was demonstrated that at correct initial set of analytical task and identification of indices, the quality of total summary increases and the process of analysis becomes easier. Then, we demonstrated possibilities of express analysis for development and correction of financial policy and groundings for managerial decisions. Finally, we provide recommendations for performing analysis for the usage in organization.

Key words: Financial statements, analysis of financial statements, users of analysis’ results, financial indicators, balance sheet, annual report, integrated reporting, KPI-based management

INTRODUCTION

In modern market economy financial statements as well as results of its analysis are called for serving generally recognized cooperation between participants of economic activity. The main purpose of financial statements is transmission of information which is not a commercial secret to any interested users (Kovalev, 2004). Similar approach is provided by current legislation of the Russian Federation about accounting, namely that statements should provide information, needed by users of these statements for taking economic decisions (Article 13 of Accounting Law).

Financial statements are supported by long history it is invested with significant intellectual capital of many scientists and experts as well as the work of government establishments. Reports provide many analytical opportunities which may be used for taking various decisions (Karnach, 2015).

Importance of financial analysis: It is expected that analysis of statements should represent general instrument with the help of which external and internal subjects take managerial decisions, seeking to improve their quality and mitigate risks (Krylov, 2009).

However, in practice we often see low popularity of accounting analysis for taking particular business decisions. Thus, at taking decision about granting a credit, banks mainly give preference to quality of deposit, availability of warranties and credit history rather than contents and values in financial statements. Participants of security market at performing operations with assets are more interested in dynamics of stock pricing on the exchange, the volume of dividends paid and company’s plans than in financial statements. Counteragents at signing contracts are more interested in information about the company and its managers in business circles, previous relations and means of risks’ mitigation. Accounting information for all these people is a secondary one and it does not have any defining role. In our opinion such situation aggravates uncertainty in economic environment and increases outlays in decision-making.

Within the scope of this article, let us consider possibilities and peculiarities of accounting analysis for internal users. For management analytical information obtained on the base of reports should present four key possibilities:

- Timely detect reserves for increasing efficiency of business activity
- To assess efficiency of taken managerial decisions
- To eliminate defects in financial activity
- To find instruments for boosting company's attractiveness for investors and growth of enterprise cost in general

Surely, a good informational accounting systems and modern forms of accounting should provide terms exhaustive for all-round and objective solution of the tasks set (Yarygina, 2014).

However, just like external users, in practice managers use financial statements rather seldom, its full-fledged analysis is not performed at all or is performed with the usage of limited set of indices and methods. The quality of accounting and consecutively, the interconnection between taken decisions and efficient financial indices are monitored completely only by the companies, securities of which are traded at financial markets (Levitskaya, 2014).

Management that bases upon key performance indicators "management based on KPI" has become popular these days. The essence of this technology lies in selection of some amount of the most significant indicators (for separate subdivisions, business segments and company in general) setting of desired fluctuation limits, intermittent test of values, taking decisions in case of significant fluctuations of actual values from the given ones. Could this technology substitute financial analysis? Just to some extent-mainly for increasing effectiveness of staff incentive and creation of transparent mechanisms of distribution of remuneration for the labor.

The main peculiarities of "management based on KPI" which differs it from financial analysis: diversification and subjectivity of assessments; wide application of non-financial criteria; ambiguity of many methods of indicators' calculation.

In addition, the question of direction and power of KPI influence on total indices of enterprise's activity (profit, profitability, total equity etc.) remains unresolved, besides, internal KPI are not designated for transferring them to external users, since the banker is not interested in paces of growth of work performance and supplier is not interested in obtained economy on hospitality costs.

Limitations of financial analysis: We may mention two reasons of low significance of financial analysis:

- The ones that are conditioned by the essence of analysis, based on universal methods and indices

- The ones that are conditioned by modern condition of economic system

We may refer the following reasons to the first group: various methods of analysis contain many indices, diversification of which and various approaches to their calculation do not reveal real financial condition but only complicate detection of tendencies and definition of their possible reasons; results of analysis allow characterizing financial condition of the enterprise only in past time period, that's why, they may be used only partially for taking decisions in current period only data of external financial statements is used at the same time, stage of life cycle, size, industrial peculiarities are not taken into account. Thus, on the stage of growth the most topical tasks of analysis are assessment of financial results and return of investments and at crisis stage-provision of financial stability and deficit-free budget (Elakova, 2014).

Available methods are usually aimed at statement of separate fact and tendencies, interconnection between which is not defined categorically (Vakhrushina and Plaskova, 2007). For instance how one may assess efficiency of economic and financial activity at decreasing liquidity and growth of profitability? How growth of cash flow and decrease in working capital turnover would influence financial condition? And so on, the second group includes:

- Distortion of organization's financial indicators as a result of inflation or other reasons of changing prices even in the short-time period (2-3 years)
- Weakness or absence of stable traditions and culture of accounting analysis in Russia which is typical for Western business environment
- More severe susceptibility of Russian economy to crisis events; high volatility of markets
- Specific character of development of market relations in many segments of economy, for example, in the sphere of market of industrial estate and equipment, which doesn't allow expressively calculate market value of assets

MATERIALS AND METHODS

Let us consider possibilities of analysis of account statements for managerial aims as exemplified by "Nizhnekamskshina" OJSC (the Republic of Tatarstan, City of Nizhnekamensk), Table 1 presents the range of key financial indicators, taken from annual report for 2012-2014 Within the context of external

Table 1: Key financial indicators of “Nizhnekamskshina” OJSC millions of rubles

Indicators	Dates (31.12)		
	(2012)	(2013)	(2014)
Non-circulating assets	3672.10	4003.9	3841.3
Current assets	2590.70	2955.8	2086.3
Uncovered loss	1342.40	1282.7	1323.3
Capital and reserves	287.70	323.5	267.6
Long-term obligations	534.20	944.7	725.3
Short-term obligations	5440.80	5691.5	4934.6
Revenues (for the year)	17763.40	16256.3	13596.1
Administrative costs	782.00	821.7	584.7
Sales profit	635.00	440.8	240.6
Net profit (loss)	68.90	35.9	(55.8)

users, financial condition of the enterprise is critical which is evidenced by the following indices:

- Presence and growth of uncovered loss on the liabilities side
- Net loss per results of 2014
- Reduction of volume of proper capital; at the same time, its share by the end of the term in question equals only about 4.5%
- Unsatisfactory condition of liquidity during the whole period; liquidity coefficient equals about 0.5

However, against this background, the enterprise in correspondence with annual report owns the largest market share of tires in the Russian Federation, it improves manufacturing progress and has good investment perspectives, “Tatneft” OJSC also makes significant investment into provision of enterprise’s survivability.

Let us consider the possibilities of some analytical procedures for internal users, i.e. for management. Any analytical task implies its specification clear identification of the process, selection of indicators, calculation and further interpretation of result.

For solution of the first task of analysis detection of reserves one needs to define the source which may be located in both external environment (for example, market share) or in the internal one (as related to usage of resources). For assessment of external reserve’s influence one may compare dynamics of market of tires in 2014 with the change of profit from enterprise’s sales. Thus, sales of tires in Russia in 2014 dropped by 4.5% and enterprise’s revenues at 16.4%. This comparison points, on the one hand, onto presence of significant reserve as related to activation of sales policy and on the other hand, to ineffective solutions in the sphere of production and sales. For assessment of efficiency of managerial decisions one needs to keep a clear line of sight on decisions that had been taken in the past, about purposes

of these decisions and actual control mechanisms. It is clear that, it is not enough to operate only financial statement information; to the full extent these questions should be answered by management accounting system. Nevertheless, main decisions of industrial enterprise are quite typical and they include decisions in the sphere of supply, production and sales. Results of such decisions may be indirectly assessed through indicators of structure and turnover of assets, dynamics and relative share of reserves, work performance, condition of credit debts, dynamics of prime costs in comparison with earnings, etc. Let us consider some indicators: Share of current assets has an unstable dynamics 71, 74 and 54%, respectively per years. These fluctuations point at lack of expediency in financial policy as well as at decreasing of mobility of aggregate capital in 2014; marked deceleration of asset turnover 127, 154, 157 days, respectively-efficiency of resources’ usage drops. At the background of revenue drop in 2013, administrative costs increased and efficiency of management was negative; in 2014 these costs decreased by 29% and revenue increased by 16.45. This points at the fact that, the enterprise used reserves of cuts of administrative costs having achieved positive results in it. The main task for the future is preventing of quality degradation of managerial decisions.

Drop of sales profit (in 2014, it decreased almost twice in comparison with previous year) indicates at untenable structure of prime cost, particularly at high share of constant indirect costs. Share of short-term obligations fluctuates in the interval of 81-86% of total balance. On the one hand, this points at stability of cooperation with suppliers and creditors and on the other hand-at strong dependence on them and unreasonable decisions as related to formation of capital’s structure.

Disadvantages of financial activity are mainly connected with condition of balance, As a rule, indicators of “good” balance are the following ones:

- Total balance at the end of reporting period increased in comparison with the beginning
- Paces of growth of current assets are higher that growth rates of non-current assets
- Proper capital of organization exceeds borrowed capital; long-term capital exceeds short-term one
- Coefficient of current liquidity is >1.5%
- Supportability of enterprise with proper current capital is >0.1
- Absence of sharp changes in particular balance sheet items
- There are no “ill” items in balance sheet (like losses, past-due debt)

- Enterprise's resources do not exceed minimal value of sources of their formation (proper current assets and short-term credits and loans)

RESULTS AND DISCUSSION

There is almost no presence of these attributes at "Nizhnekamskshina" OJSC while disadvantages are the consequences of the complex of factors including the ones that are present in external environment.

Solution of the fourth task of internal analysis, finding ways of growth of investment attractiveness, implies development of complex program of financial activity. In our opinion, this program should be directed at achievement of the following goals (as prioritized):

- Reduction of costs at the account of constant indirect ones
- Activation of sales policy, avoidance of profit fall and occurrence of losses
- Strengthening of authorized capital stock, elimination of uncovered losses
- Change of structure of sources to increase long-term ones
- Increasing effectiveness of using non-current assets, primarily-fixed assets
- Increasing costs of remuneration for labor in strict compliance with growth of its productivity

For development of specific managerial decisions one needs to operate more full information about business situation at the enterprise as well as of internal environment. This information is not a prerogative of financial statement. For elimination of lack in necessary information an integrated statements exist which becomes more widespread in both countries with developed economy and in Russia (Solovyeva, 2013). Significant volume of data is included into annual report. Consideration of these questions is beyond the scope of this article.

Summary: One should avoid mechanical use of standard methods of analysis and large range of indicators which taken together often just obscure real financial situation. Besides, initiative of holding profound analysis should come not from accounts or financial department but from management. Apt and systematic conduction of analysis allow timely detecting problems, correcting managerial tasks and increase efficiency of managerial decisions.

CONCLUSION

Thus, efficiency of financial analysis significantly increases and labor complexity decreases if the following conditions are met:

- Clear goal-setting of the analysis which final information should be obtained after analyzing procedures
- Selection of methods and indicators which indicators to the fullest extent correspond to specific character of this enterprise
- Sequential interpretation of each calculated indicator which means its size and dynamics
- Formation of total conclusions which must include indication of reason and consequence of current situation
- Justification of managerial decisions

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