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THE ROLE OF ANALYTICAL REVIEW ON COMPANY'S PERFORMANCE ASSESSMENT

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ABSTRACT

The objective of this study is to determine the role of analytical review on companies' performance assessment. This work is both empirical (where respondents were issued questionnaires) and conceptual one (where related literatures were reviewed and suggestions were made on how companies' performance can be improved through analytical review of financial statements). The research therefore recommends that financial statements must be prepared without window dressing to give room for an objective review of financial statements. Also, stakeholder should always engage financial experts to interpret financial statements for before taking investment decisions.

KEYWORDS: *Analytical review, Performance assessment, Window dressing, Stakeholders, Financial experts.*

INTRODUCTION

The board of directors, management, existing and prospective shareholders, the tax authorities of government, competing companies, loan providers, the press and the general public are always interested in the performance of companies. These stakeholders' interest in the financial statements and the analysis of ratios by financial experts range from being able to take informed decisions on planning and control decisions (by management) to investment decisions (by shareholders). The financial statement indicates a summarized presentation of activities of a company in a particular period and an implied management assertion that the financial statements show a true and fair view.

Financial statements are formal and comprehensive documents describing financial activities of a business organization such as financial institutions. For such a business entity, financial statement is a statement that reports all relevant financial information, presented in a structured manner and in a form easy to understand for managerial use for prompt and informed decision making relating to investment (IASB, 2007a) and also to decision making pertaining to cost planning, investment planning, expected returns and performance evaluation. The financial statements comprise of statement of financial position, statement of profit and loss and other comprehensive income, statement of changes in equity, cash flow statements and notes to the accounts.

Although, these statements are often complex and may include extensive set of notes to the financial statements and explanation of financial policies and management discussions and analysis (IASB, 2007b), the notes typically describes each item on the statement of financial position, income statement and cash flow statement in further details.

Audited financial statements are usually a confirmation of by an independent expert's opinion attesting to and confirming management's assertion that the financial statements of a company shows a true and fair view of the state of affairs of the company as at the financial year end and the profit or loss and statement of cash flow of the company for the year ended.

STATEMENT OF PROBLEMS

The increasing need to make informed decisions using the financial statements of companies coupled with the fact that not all stakeholders are accountants makes analysis by financial experts necessary. These analyses are not only useful in making investment decisions but are also used to measure performance, compare performance, analyse trends and forecast future outcomes.

The fact that not all investors understand the language of finances and the activities in the corporate world necessitates the needs for them to seek guidance from experts. This study is set to investigate:

How analytical review of companies' financial statements by experts measure the performance of companies.

How analytical review impact on investment decisions by stakeholders.

The impact the new International Financial Reporting Standards have made to the review process (analysis of ratio).

RESEARCH HYPOTHESIS

Ho: Analytical reviews of companies' financial statements do not portray an adequate measurement of performance of companies.

Ho: Analytical reviews of companies' financial statements do not affect the investment decisions of stakeholders.

Ho: The new International Financial Reporting Standards (IFRS) has no effect on the analytical reviews of companies' financial statements.

REVIEW OF RELATED LITERATURE

The accounting profession defines analytical review as the 'evaluations of financial information through the analysis of plausible relationships among both financial and non-financial data'. It is one of the techniques of substantive audit test-confirming the correctness of a balance in a general ledger account. It helps the Auditor in deciding the critical audit areas that requires special attention. According to Ayozie, K.N (2013), Techniques of obtaining audit evidence could either be manually based or computer based.

The manual base includes:

INSPECTION: This provides evidence of varying degrees of reliability depending on their nature and source.

COMPUTATION: Checking the arithmetical accuracy of accounting records or performing independent calculations.

OBSERVATION: Looking at an operation or procedure being performed by others with a view to determining the manner of its performance only at that time, but not any other time. E.g attendance at a company's stock counts exercise.

ENQUIRY: Seeking relevant information from knowledgeable persons or corporate entities either within or outside the company been audited either formally or informally, orally or in writing. E.g. Bank circularization replies.

ANALYTICAL REVIEW PROCEDURES: This involves the review of relationships between one financial data and another or between one financial data and a non-financial data in other to determine material unusual variations between them that may need to be investigated further. e.g ratio analysis.

Hence, it is obvious that ratio analysis and analytical review are one and the same and could be used interchangeably.

Furthermore, the Institute of Chartered Accountants of Nigeria (ICAN) study text on Financial Reporting (2014) posited that financial statements are used to make decisions… The financial statements contain a large number of figures, but the figures themselves do not necessarily have much meaning to a user of financial statements.

However, the figures can be analysed and interpreted by calculating financial ratios. Financial ratios can help the users of financial statement to access:

The financial position of the entity, and

Its financial performance

Achebe, A.S (2017) opines that one of the roles of analytical review in auditing is that of an early warning system. It may be used early in an audit to identify specific audit risks, thus leading to better audit planning. It may also be used as a substantive test of an account balance later in the audit. In this role, it may even provide sufficient audit assurance that the account does not contain material error, as to make other direct tests of the account balance unnecessary.

In the view of Innocent, O (2005), a ratio is one number expressed in terms of another to show the relationship between them. In financial accounting and reporting, it is generally agreed that there are certain relationships between items shown in the profit and loss accounts (now also known as statement of profit or loss and other comprehensive income) and those in the balance sheet (now known as the statement of financial position) as well as between items in these statements. Ratios are used as a means of expressing these relationships.

Interpretation of the calculated ratios is another important thing that must be known. All these have been taken into consideration in our classifications of ratios.

CLASSIFICATION OF RATIOS

Ratios are broadly classified into the following:

Short – term solvency and liquidity

Profitability and efficiency

Long – term solvency/stability

Investor's Ratio

For this study, the focus will be more on profitability and efficiency. As Peavler (2018) rightly puts it, profitability ratios show a company's overall efficiency and performance.

Profitability ratios are divided into two types: margins and returns. Ratios that show margins represent the firm's ability to translate sales dollars (or any currency) into profits at various stages of measurement. Ratios that show returns represent the firm's ability to measure the overall efficiency of the firm in generating returns for its shareholders.

PROFITABILITY AND EFFICIENCY

a) Net profit percentage

$$\frac{\text{Net profit (before tax)}}{\text{Sales}} \times 100\%$$

Indicates the net margin due to the business after taking into account all revenue expenses. The higher the percentage, the more efficient the enterprise will be deemed to be in control of its revenue expenses.

b) Gross profit percentage

$$\frac{\text{Gross profit}}{\text{Sales}} \times 100\%$$

Indicates the gross margin achieved by the enterprise on its sales of goods. The higher the percentage, the more profit the enterprise will be expected to make. However, this will not be the case if there is more than proportionate fall in sales volume or quantity. As such, care should be taken when interpreting this ratio.

c) Operating profit percentage or profit margin

$$\frac{\text{Operating profit (PBIT)}}{\text{Sales}} \times 100\%$$

Indicates the net margin due to the enterprise after taking into account all operational expenses before interest charges. It is a measure of the relative efficiency of the enterprise in managing operational expenses before interest charges.

d) Asset Turnover

$$\frac{\text{Sales}}{\text{Capital employed}}$$

The ICAN study pack has it as:

Asset turnover ratio =

$$\frac{\text{Sales}}{\text{Share capital + reserves + long term debt}} \times 100$$

Indicates the efficiency of the enterprise in the utilization of capital employed (or oganisation's or individual's asset) to generate income.

e) Return on capital employed

$$\frac{\text{Profit}}{\text{Capital employed}} \times 100\%$$

Indicates the overall profitability of the business. The profit to be used depends on the definition of capital employed. It is profit before tax where capital employed is defined as shareholders fund and profit before interest and tax where capital employed is defined as shareholders fund plus long term liabilities. The higher the percentage, the more profitable the enterprise will deemed to be.

For the ICAN study text, Return on capital employed is =

$$\frac{\text{Profit before interest and taxes}}{\text{(Share capital and reserves + long-term debt capital + Preference share capital)}} \times 100\%$$

SOURCE OF DATA

Data was mainly collected from both primary and secondary sources. This will be used to arrive at conclusions for the first and second hypothesis, except for the third hypothesis, on which there is a consensus opinion of a positive impact of the IFRS on the analytical review of companies' financial statements.

Primary source of data collection brings about, as Institute of Chartered Accountants of Nigeria (ICAN) Study Text (2009) puts it, 'firsthand information'.

The primary source of data used to derive information is the questionnaire, which was framed and administered to a sample of 20 employees of each of the 5 selected companies making a total of 100. It was independently filled and submitted by the respondents.

METHODOLOGY

The data analyses method used in the research were editing, grouping and tabulation.

The Z – test and percentage after scoring and editing stage was to check the questionnaires for completeness to ensure uniform and accurate interpretation of response.

The group stage of the analysis was to classify responses according to how answers were given to specific questions. The statistical interpretation was arrived at using Z – test at 0.05 level of significance for the researcher to compare and make descriptive analysis of collected data. The results of this procedures form the basis for this study's discussion.

Explaining the rationale for choosing the 0.05 level of significance for the T- test or Z – test, the institute of Chartered Accountants of Nigeria Study Text for Research Methodology (2009) states that the 0.01 (1%) level of significance is a more rigorous test of significance than 0.05 (5%) level of significance…

The 0.05 alpha level is often used as a standard for rejecting Ho. Rejecting Ho at 0.05 alpha level implies that differences in mean as large as that found between the sample groups would have resulted from either sampling error or faulty hypothesis or even significant error. That is the difference due to experimental treatment in less than 5 out of every 100 replication of the investigation.

From the Institute of Chartered of Accountants of Nigeria Study Text (2009), the equation for the test of independent sample proportion of unequal sample sizes is –

$$Z = \frac{|p_1 - p_2|}{\sqrt{(SP)^2}} \quad \text{OR} \quad \frac{p_1 - p_2}{\sqrt{Pq.\ 1/N_1 + 1/N_2}}$$

For independent samples, which are of the same size; where $N_1 = N_2 = N$

$$Z = \frac{|P_1 - P_2|}{\sqrt{\frac{2Pq}{N}}}$$

where $P = ½ (P_1 + P_2)$

where P_1 and P_2 are the proportions of independent sample 1 and 2 respectively.

SP is the standard deviation for the weighted mean (P) of the same proportion:

P is further explained below

If let us say there is n_1 successes (with respect to a given event) observed in a sample of size N_1, the proportion (percentage/probability) of success (P_1) of that event – Lagos, in the sample is $P_1 = n_1/N_1$ while the proportion of failure (q_1) of that event is $q_1 = 1 – P_1$

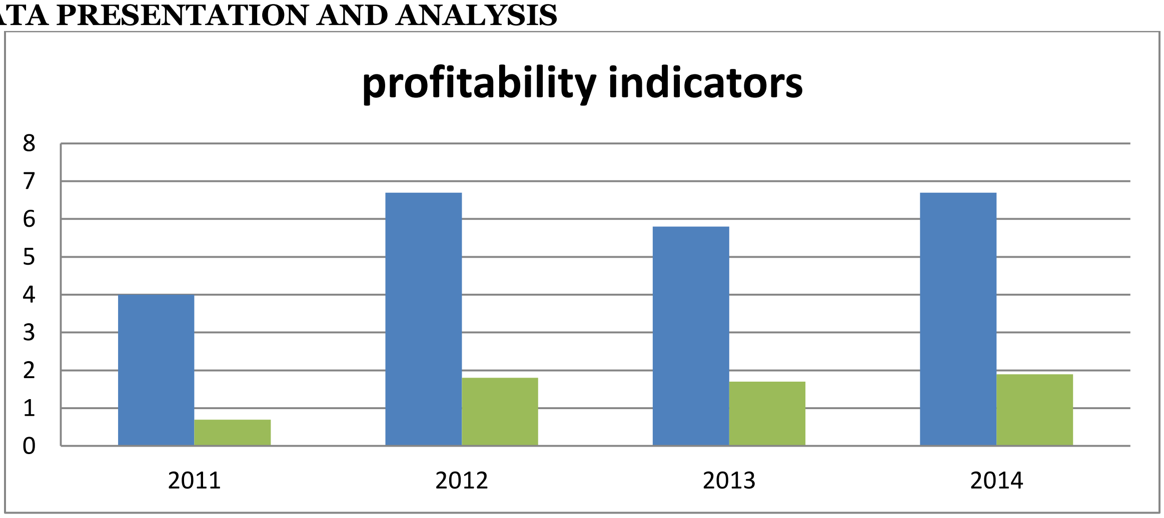
Similarly, if there are n_2 observed successes in another sample (Abuja) of size N_2, P_2 will be:

$P_2 = n_2/N_2$

While the proportion of failure (q_2) of the event is

$q_2 = 1- P_2$

DATA PRESENTATION AND ANALYSIS



(Source: Global Credit Rating Co. – First Bank of Nigeria, August 2015)

Scale:
Y-axis Represents Revenue (N'bn)
X-axis represents the period in years
On the Y-axis, Let 1 unit = N 50 billion
Blue = Turnover on Investment
Green = Pre-tax profit

A total of 100 questionnaires were administered to employees of 5 companies for the purpose of this research. Out of the 100 questionnaires, eighty eight (88) were returned and these represented eighty eight (88) percent. The number of questionnaires collected was used as a basis for calculations and analysis as shown below.

COPIES OF QUESTIONNAIRES ADMINISTERED

RESPONSES	NUMBER OF QUESTIONNAIRE	PERCENTAGE
Distributed	100	100%
Returned	88	88%

SEX DISTRIBUTION OF RESPONDENTS ACCORDING TO GENDER

RESPONSES	NUMBER	PERCENTAGES
Male	42	48
Female	46	52

DISTRIBUTION OF RESPONDENTS ACCORDING TO THEIR EMPLOYER

RESPONSES	NUMBER	PERCENTAGES
First Bank - Auchi	18	20.5
United Bank for Africa – Ekpoma	19	21.6
Bisaj Engineering Ltd - Osogbo	17	19.3
Obat Aluminium Company – Akure	17	19.3
Anemode Construction Company - Benin	17	19.3

DOES ANALYTICAL REVIEW OF A COMPANY'S FINANCIAL STATEMENT SATISFACTORILY MEASURES ITS PERFORMANCE AND IMPACTS POSITIVELY ON ITS RESULTS?

RESPONSES	NUMBER	PERCENTAGES
Yes	74	84
No	14	16

DOES THE ANALYTICAL REVIEW OF FINANCIAL STATEMENTS INFLUENCE THE INVESTMENT DECISIONS OF STAKEHOLDERS?

RESPONSES	NUMBER	PERCENTAGES
Yes	59	67
No	29	33

HAS THE INTERNATIONAL FINANCIAL REPORTING STANDARDS IMPACTED POSITIVELY ON THE ANALYTICAL REVIEW OF FINANCIAL STATEMENTS?

RESPONSES	NUMBER	PERCENTAGES
Yes	72	82
No	16	18

In other to objectively direct this research work into determining the effect of analytical review on the companies' financial statements, hypotheses were formulated paramount among which are:

Ho: Analytical reviews of companies' financial statements do not portray an adequate measurement of performance of companies.

If my calculated Z is lower than Z-critical critical value (on the Z-table) at the 0.05 level of significance, the null hypothesis will be accepted and the alternative hypothesis rejected.

However, where the Z-calculated is found to be higher than the Z-critical value, the alternative hypothesis accepted while the null hypothesis is rejected.

From the above, it is clear that the value of 'Z' must be calculated and compared with the theoretical value of 'Z' table (or as could be found in some materials, 'T' table).

To test whether there is a positive effect of analytical review on the performance of companies or not, a table is designed below with inference. This was done for ease and conformity with the procedure for calculations using the Z-test.

RESPONSES	Males	Females
Population	34	38
Sample	29	35
Proportion	0.853	0.921

Source: Deduced from field Survey 2018

From the table above, Let:

N_1 Represent the population for male respondents.

N_2 Represent the population for female respondents.

n_1 Represent the sample from the population of the male respondents that agree (successes) that analytical review on companies financial statement improves performance of the companies.

n_2 Represents the sample from the population of female respondents that agree (successes) that analytical review on companies financial statements improve performance of the companies.

P_1 Represents the proportion of male who agree, to the entire population of male. i.e. n_1/N_1.

P_2 Represents proportion of females who agree, to the entire population of females. i.e. n_2/N_2.

P Represents the average of the sum of the proportions of successes (those that agree) of both males and females.

Q Represents averages of the sum of the proportions of failures (those that do not agree) of both males and females.

Hence $P_1 = 29/34 = 0.853$

$P_2 = 35/38 = 0.921$

$P = ½ (P_1 + P_2) = ½ (0.853 + 0.921)$

$P = 1.774/2 = 0.887$

$q = 1 – 0.887 = 0.113$

$$\text{Then } Z, 0.05 = \frac{|P_1 - P_2|}{\sqrt{P \times q\,(1/N_1 + 1/N_2)}} = \frac{0.853 - 0.921}{\sqrt{0.887 \times 0.113\,(1/34 + 1/38)}}$$

$$= \frac{|0.853 - 0.921|}{0.01763} = 3.8636$$

From the computations above, the calculated Z is higher than the critical value of Z-tabulated value. The calculated Z gives us 3.8636 while the critical value of Z $\pm$ 1.96.

This will lead us to rejecting the null hypothesis which is, analytical review of financial statements has no positive effect on the performance of companies.

From the last table analysed above, the views of the respondents concerning the effects of analytical review on the companies' performance indicates that the majority of respondents are of the opinion that the analytical review on financial statements is good for accessing current profitability/ Performance and also in planning for the future.

At this point, it is also important to take a look at the extract of financial ratios analysed on a four year trend.

RATIO ANALYSIS (%)
PROFITABILITY

	2011	2012	2013	2014
Net income/Total Capital (Avg.)	n.a	25.1	13.8	17.5
Net income/Total Asset (Avg.)	n.a	3.3	1.7	2.3
Net interest margin	9.0	10.0	8.8	8.1
Interest income + Com. Fees/ Earnings Asset + guarantees (a/avg)	5.7	8.0	6.9	6.4
Non-interest Income/Total operating Income	20.0	22.4	20.0	29.3
Non-interest Income/Total operating Expense (or burden ratio)	31.5	34.5	32.4	45.4
Cost Ratio	63.5	64.8	61.7	64.5
OEaA (overhead Ratio)	5.4	6.2	5.1	5.6
ROaE	5.5	18.9	17.1	20.2
ROaA	0.7	2.5	2.0	2.2

SUMMARY OF FINDINGS

Based on the analysis of the study, the following major findings were drawn;

Analytical reviews of companies' financial statements portray an adequate measurement of performance of companies.

Analytical reviews of companies' financial statements affect the investment decisions of stakeholders.

The new International Financial Reporting Standards (IFRS) has a positive effect on the analytical reviews of companies' financial statements. It has improved the process of analyzing financial statements.

CONCLUSION

Hence, we can conclude that analytical review has a positive impact on companies' performance as interpretation of the results of the financial statements reviewed is used to assess past and current performances with the aim of mitigating losses and maximizing profits in future. It also helps the companies in scheming for future competition for the share of the market.

RECOMMENDATIONS

Financial statements must be prepared without window dressing to give room for an objective review of financial statements.

Stakeholder should always engage financial experts to interpret financial statements for before taking investment decisions.

Every company should adopt the IFRS in preparing financial statements to allow for global uniformity.

Auditors should avoid been used by clients to compromise fraudulent records and reports.

Auditors should not only make efforts to remain independent, but must also make efforts to be seen to be independent.

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