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DISADVANTAGES OF THE METHODOLOGY AND PRACTICE OF ANALYSIS OF THE FINANCIAL STATUS OF THE ENTERPRISE: CAUSES, CONSEQUENCES, WAYS OF ELIMINATION

Abstract: Today, businesses operate in conditions of significant competition and a high level of unpredictability of changes in the environment. Therefore, for each company even more important is the importance of making optimal management decisions. A significant number of decisions are made based on the results of the analysis of the financial condition of the enterprise. However, the existing methodology and practice of financial analysis have many different types of shortcomings that significantly distort the results of the analysis. The main shortcomings can be grouped into the following groups: organizational, methodological, technical, legislative, conceptual, informational. As a result of their presence, many users of financial information form incorrect conclusions and make suboptimal management decisions, which negatively affects the future results of the enterprise, related entities and the economy in general. Therefore, the purpose of scientific work is to study the shortcomings of the methodology and practice of financial analysis, and to find ways to address these shortcomings. The article examines foreign and domestic experience in analysing the financial condition of enterprises; identified and grouped the shortcomings of the methodology and practice of this type of analysis; the importance of taking into account the factors of its internal and external

environments during the analysis of the financial condition of the enterprise is substantiated; recommendations for eliminating a number of shortcomings of the analysis of the financial condition of enterprises are offered. The results of the study will help to obtain much more reliable results of financial analysis, which will improve the quality of management decisions of operational, tactical and strategic nature.

Key words: analysis methodology; financial condition of the enterprise; shortcomings and ways to eliminate them; practice of financial condition analysis; financial indicators; subjects of financial analysis.

Formulation of the problem

Today, businesses operate in conditions of significant competition, which further increases the importance of making optimal management decisions on which depends the efficiency of each enterprise. A significant number of decisions are made based on the results of the analysis of the financial condition of the enterprise. The existing methodology and practice of analysing the financial condition of the enterprise contains a number of shortcomings (Fig. 1), which significantly distort the

results of the analysis and as a result lead to the formation of incorrect conclusions, assumptions and management decisions of operational, tactical and strategic nature.

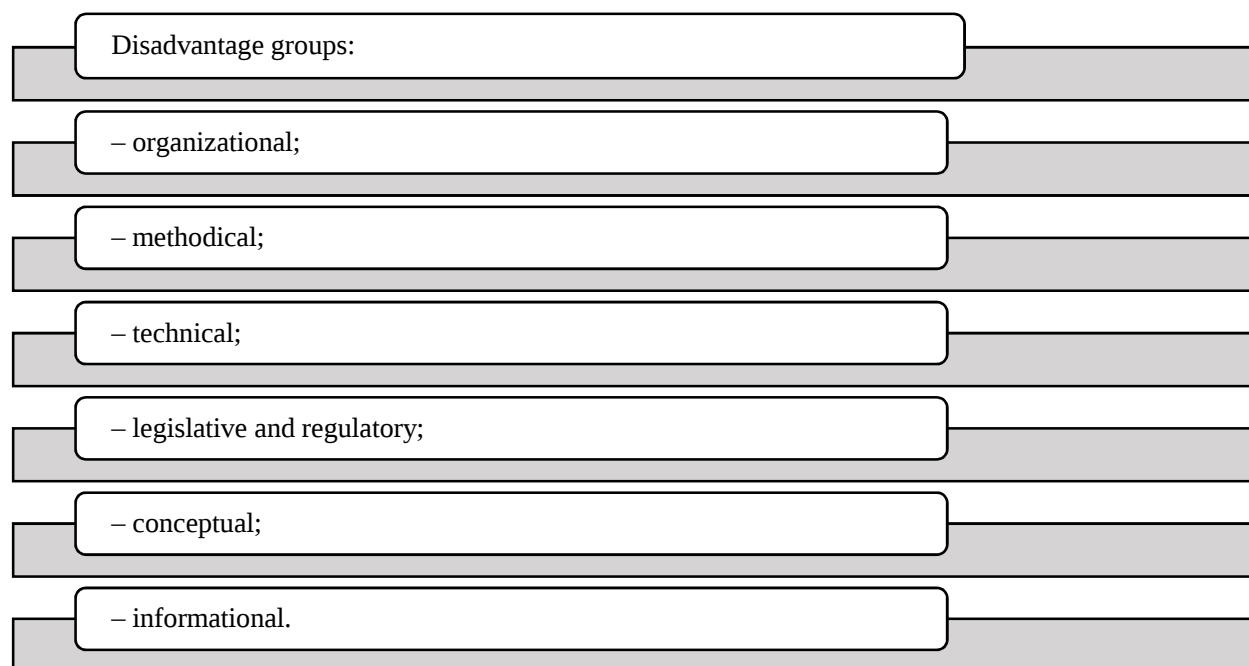


Fig. 1. Groups of shortcomings related to the methodology and practice of analysing the financial condition of enterprises

Organizational shortcomings in particular include the often incorrect organization of financial analysts, and in particular their failure to identify (before analysing the financial condition of the enterprise) problems and distortions that have arisen at different stages of transformation of information needed for analysis. Methodological shortcomings in particular are the lack of detailed tables of interdependence of changes in various financial indicators, disregard in the analysis of the financial condition of important industry features of the enterprise, insufficient consideration in domestic methods of analysis of modern foreign practice. Technical – the use of outdated computer programs for financial analysis or the use of any relevant information systems. Legislative and regulatory – differences in the regulatory framework for the calculation formulas and regulatory values of the same indicators, the lack of justification of the established level of regulatory values, in particular in terms of different activities. Conceptual – the obsolescence of approaches to the analysis of

financial condition, which are still not adapted to modern conditions of enterprises, the need to take into account during this analysis of dozens of factors of internal and external environment, including non-financial quality indicators. Information shortcomings are in particular the lack of prompt and complete information for the analysis of the financial condition of the enterprise, the low informativeness of domestic Internet resources, which contain information about enterprises (for example, the annual financial reporting appear on them in 4–5 months after the end of the reporting period), lack of reliable, comprehensive and operational statistical information, etc.

Relevance of the research topic

The above shortcomings of the methodology and practice of financial condition analysis affect not only the management decisions of the management of enterprises, but also a significant number of different groups of entities shown in Fig. 2.

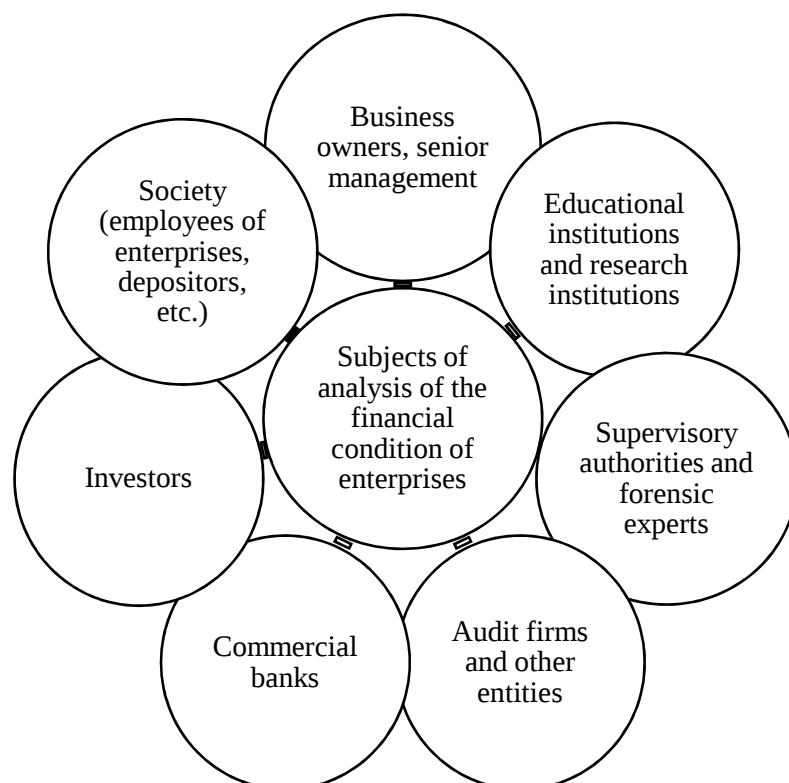


Fig. 2. Groups of entities whose conclusions and decisions are affected by the shortcomings of the methodology and practice of analysing the financial condition of enterprises

These shortcomings have a different essentially negative impact, in particular, on:

- business owners and senior management (deficiencies in particular lead to incorrect management decisions due to the use of unreliable results of the analysis of the financial condition of enterprises);
- supervisory authorities (deficiencies lead to the formation of incorrect conclusions about the suspicion of bringing the company to bankruptcy or concealment of bankruptcy, etc.);
- audit firms (shortcomings in particular lead to the provision of inappropriate audit opinion on the possibility of ensuring the principle of continuity of the enterprise, and may lead to failure to detect certain fraudulent actions, aimed at distorting the financial condition of the enterprise);
- commercial banks (deficiencies lead to incorrect assessment of the financial condition of the debtor or potential borrower);
- investors (shortcomings in particular often lead to incorrect decisions on the feasibility of investing in the company, joining the co-founders, acquisition of the company, etc.);
- society in general, including citizens who may be in particular in the status of employees of

enterprises, depositors (shortcomings in particular lead to incorrect decisions on the choice of place of work, the bank for the deposit, which further leads to financial losses of members of society);

- educational institutions (shortcomings lead to a decrease in the level of training of future financial analysts due to the use in the educational process of imperfect methods of financial analysis, etc.).

That is, the correctness of the methodology and practice of analysing the financial condition of enterprises is important for many groups of entities – both internal and external. Therefore, a very important issue is to improve the methodology of analysis of financial condition, taking into account in domestic practice adapted to our realities of foreign experience of this type of analysis.

Analysis of recent research and publications

Researchers are exploring various aspects of financial analysis. Ivchenko L. V. and Lezhnenko L. I. [1] considered the problems at the stage of formation of financial statements, which will affect in the future and the analysis of the financial condition of the enterprise. Sobchenko T. S. and Soskida Yu. M.

[2] investigated the peculiarities of the analysis of the reporting of small business entities. Soroka Y. J. [3], Torshin E. A. [4] studied foreign experience in assessing the financial condition of enterprises in modern business conditions. Fesenko V. V., Zagorelska T. Yu. [5], Bezverkhy K. V. [6] investigated accounting distortions and their impact on financial statements, manipulation of financial results. Klebanova T. S., Dymchenko O. V., Rudachenko O. O. [7] emphasized the importance of preventing the crisis of enterprises. Legenchuk S. F.,

Polishchuk I. R., Brokhun N. S. [8] investigated the mechanism of disclosure of financial and non-financial indicators in integrated reporting. Azarova A. A. [9] stressed the importance of using the coefficient method for the analysis of financial condition, as it will allow to take into account the influence of both internal and external factors.

Most often in domestic and foreign literature sources, the analysis of the financial condition of enterprises is proposed to be carried out in the areas presented in Fig. 3.

Directions of analysis of the financial condition of the enterprise		
1. Analysis of absolute indicators of financial statements (net income and profit, equity, asset value, etc.).	2. Analysis of individual ratios and other indicators for the following groups: – indicators of solvency of the enterprise and its liquidity; – indicators of business activity; – indicators of financial stability; – profitability indicators; – indicators related to the profitability of shares, dividends per share, the ratio of the market price of one share to the net profit attributable to it.	3. Analysis of complex indicators (integrated indicators).

Fig. 3. Directions of analysis of the financial condition of the enterprise

The first direction of analysis, in particular, involves horizontal and vertical analysis of reporting, analysis of trends in absolute financial performance of the enterprise for recent reporting periods. The second direction – involves the calculation of individual coefficients and other indicators in terms of several groups. The third direction – involves the calculation of integrated indicators (for example, determining the level of threat of bankruptcy). Based on the results of the analysis in these areas, information users form their conclusions and make decisions. However, today is characterized by a large number of approaches to calculate the same indicators, which can lead to incorrect comparison of the results of the analysis of the financial condition of different enterprises and creates opportunities for companies to manipulate the results of the analysis in their own interests.

The purpose and objectives of the study

The aim is a comprehensive study of the shortcomings of the methodology and practice of the financial condition of the enterprise for further development of recommendations on ways to correct existing problems of financial analysis. The tasks are: research of foreign and domestic experience of analysis of the financial condition of enterprises, in particular approaches to determining indicators; identifying and grouping the shortcomings of the methodology and practice of this type of analysis; substantiation of the importance of taking into account during the analysis of the financial condition of the enterprise the factors of micro-, meso-, macro- and global environments of the enterprise; development of recommendations for eliminating a number of shortcomings of the analysis of the financial condition of enterprises. The results of the study will help to obtain much more reliable results of the analysis of the financial condition of enterprises,

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which will improve the quality of management decisions of operational, tactical and strategic nature.

Presentation of the main material of the study and the results obtained

In Ukraine, various entities (auditors, employees of commercial banks, specialists of supervisory

authorities, forensic experts, etc.) use different regulations [10–12], which regulate the definition of indicators of financial condition of enterprises. In the Table 1 shows the approaches to the calculation of the most common indicators of financial condition in domestic and foreign practices.

Table 1

Approaches to determining some key indicators of the financial condition of the enterprise

Domestic practice			Foreign practice [13]
1			2
Resolution of the Board of the National Bank of Ukraine No. 351 [10]	Methodical recommendations of the Audit Chamber of Ukraine No. 99 [11]	Methodical recommendations of the Ministry of Economy of Ukraine No. 14 [12]	
Analysis of solvency and liquidity of the enterprise			
<i>Current ratio</i> = CA / CLC, where: CA – current assets; CLC – current liabilities and collateral	<i>Coverage ratio (total liquidity)**</i> = CA / CL where: CL – current liabilities	<i>Current (overall) liquidity ratio**</i> = CA / BC, where: BC – borrowed capital (long-term and current liabilities of the enterprise).	<i>Current liquidity ratio</i> = CA / CL
<i>Total liquidity ratio</i> = CA* / CLC		<i>Coverage ratio**</i> = CA/CL	
Analysis of business activity			
<i>Inventory turnover ratio</i> = = 365 × EIBA / COGS where: IBA – the value of stocks and current biological assets at the end of the year; COGS – cost of goods sold (goods, works, services) for the year	<i>Inventories turnover ratio***</i> $TR_i = COGS / ((BI_i + EI_i) / 2)$, where: I – inventories; letters “B” and “E”. indicate the value of indicators at the beginning and end of the period, respectively <i>Term of turnover of inventories</i> = T / TR_i where: T – the duration of the period (is usually taken for 365 days)	<i>Inventory turnover ratio</i> = 360 / TR_i	<i>Inventory turnover ratio</i> = = 365 × ((BI + EI) / 2) / COGS
<i>The turnover of accounts receivables****</i> = 365 × EAR / NI, where: AR – receivables for products, goods, works, services; NI – net income from sales of products (goods, works, services) for the year	<i>Accounts receivables turnover ratio</i> $TR_{CAR} = NI / ((BCAR_i + ECAR_i) / 2)$, where: CAR – current receivables <i>Maturity of receivables</i> = T / TR_{CAR}	<i>Turnover of funds in the calculations</i> $TR_{TAR} = In / ((BTAR + ETAR) / 2)$, where: In – income from sales of products (goods, works, services); TAR – long-term and current accounts receivables <i>Turnover time of funds in calculations</i> = 360 / TR_{TAR}	<i>Accounts receivable turnover ratio</i> = = 365 × ((BAR + EAR) / 2) / NI _c , where: NI _c – net income arising from the sale of goods, works, services on a post-payment basis

Continuation of Table 1

1			2
<i>The turnover of accounts payable</i> = $365 \times \text{EAP} / \text{COGS}$, where: AP – current accounts payable for goods, works, services	<i>Accounts payable turnover ratio</i> $\text{TR}_{\text{CAP}} = \text{NI} / ((\text{BCAP} + \text{ECAP}) / 2)$, where: CAP – current accounts payable without taking into account debts on short-term bank loans, current debts on long-term liabilities, without taking into account the item “Other current liabilities”, current collateral and deferred income	<i>Turnover time of accounts payable**</i> = $360 \times ((\text{BBC} + \text{EBC}) / 2) / \text{COGS}$	<i>Accounts payable turnover ratio</i> = $= 365 \times ((\text{BAP} + \text{EAP}) / 2) / \text{NCP}$, where: NCP – net credit purchases
	<i>Maturity of accounts payable</i> = $\text{T} / \text{TR}_{\text{CAP}}$		
Analysis of financial stability			
<i>Capital ratio</i> = SE / TC, where: SE – shareholder’s equity; TC – total capital (total assets of the balance sheet)	<i>Solvency ratio (autonomy)</i> = $= \text{SE} / \text{TC}$	<i>Coefficient of financial autonomy</i> = SE / TC	<i>Equity ratio</i> = $= \text{SE} / \text{TA}$, where: TA – total assets
–	<i>Funding ratio*****</i> = $= \text{BC} / \text{SE}$	<i>Financial leverage ratio</i> = $(\text{TC} - \text{SE}) / \text{SE}$	<i>Debt equity ratio</i> = $= \text{BC} / \text{SE}$
Analysis of financial results and profitability of the enterprise			
<i>Operating return on assets *****</i> = FR_0 / ETA, where: FR_0 – financial results from operating activities	<i>Return on assets</i> = $= \text{NP} / (\text{BTA} + \text{ETA}) / 2$, where: NP – net profit	<i>Return on assets</i> = $= 100 \% \times \text{NP} / (\text{BTA} + \text{ETA}) / 2$	<i>Return on assets ratio</i> = $= \text{NP} / (\text{BTA} + \text{ETA}) / 2$
<i>Return on assets before tax *****</i> = FR_b / ETA, where: FR_b – financial results before tax			

Notes:

* – current assets are taken into account for calculation only in the part of stocks, biological assets, receivables for products, goods, works, services, as well as cash and cash equivalents.

** – for the calculation take the obligations given in the formula, but without taking into account the collateral and deferred income; for calculation take current assets without taking into account the costs of future periods.

*** – stocks in the formula include production stocks, animals for breeding and fattening, work in progress, finished products, goods.

**** – as amended on November 7, 2019, the receivables turnover ratio was removed from Table 3 of Annex 7 to Regulation No. 351.

***** – BC for this formula is defined as the sum of long-term liabilities, current liabilities, collateral for subsequent expenses and payments, deferred income.

***** – in the wording of November 7, 2019, the indicators of return on assets were removed from Table 3 of Annex 7 to Regulation No. 351.

As you can see from Table 1, there are different approaches to the calculation of the same name indicators (for example, the turnover ratios of receivables and payables) in different domestic

regulations and foreign practice. This is a problem, because it creates difficulties in comparing the published indicators of different companies, if you do not know what method is used by each of them.

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Also, there is a problem when the same company is analysed using different regulations of different groups of entities. Another problem is the different names of indicators with the same formulas for their calculation. For example, according to Resolution No. 351 we have – capital ratio, according to Methodical recommendations No. 99 – solvency ratio (autonomy), according to Methodological recommendations No. 14 – financial autonomy ratio, and in foreign practice – equity ratio. In the Table. 2 shows the calculation of indicators of financial condition, the formulas for determining which there are differences in various domestic regulations, on the example of PJSC “Kyivstar” [14].

The results of the analysis of the financial condition and activities of PJSC “Kyivstar” for 2020 confirm our statement about obtaining different results, using the approaches given in various domestic regulations and approaches used

in foreign practice. Consequently, this will lead to significant differences in the conclusions of various subjects of analysis (including domestic and foreign investors, auditors, supervisors, forensic experts, employees of commercial banks and many other users of the results of financial analysis). Therefore, the urgent task at the state level is to eliminate differences between domestic regulations and take into account foreign experience in calculating the relevant financial indicators.

In foreign practice (Table 3) widely used indicators EBITDA (Earnings before Interest, Tax, Depreciation and Amortization), EBIT (Earnings before Interest and Tax), EBT (Earnings before Tax) to analyze the profitability of companies, to compare companies with their competitors, enterprises that have the same owner, but which operate in different areas or countries, or with other companies that are somehow related to the analyzed.

Table 2

Some indicators of the financial condition of PJSC “Kyivstar” for 2020

Domestic practice			Foreign practice [13]
Resolution of the Board of the National Bank of Ukraine No. 351 [10]	Methodical recommendations of the Audit Chamber of Ukraine No. 99 [11]	Resolution of the Board of the National Bank of Ukraine No. 351 [12]	
<i>Current ratio</i> = 0.27	<i>Coverage ratio (total liquidity)</i> = 0.29	<i>Current (overall) liquidity ratio</i> = 0.15	<i>Current liquidity ratio</i> = 0.27
<i>Total liquidity ratio</i> = 0.24		<i>Coverage ratio</i> = 0.29	
<i>The turnover of accounts receivables</i> = 9.67 days	<i>Maturity of receivables</i> = 12.21 days	<i>Turnover time of funds in calculations</i> = 10.04 days	<i>Accounts receivable turnover ratio*</i> = 83.95 days
<i>The turnover of accounts payable</i> = 61.9 days	<i>Maturity of accounts payable</i> = 91.87 days	<i>Turnover time of accounts payable</i> = 516.15 days	<i>Accounts payable turnover ratio</i> = 55.69 days

* Note. Assume that only 80 % of NP were on post-payment terms

Table 3

General characteristics of EBITDA, EBIT and EBT and advantages of their use

Name and calculation of the indicator	Advantages of application
<i>EBITDA (Earnings before interest, taxes, net of depreciation)</i> = EBT + I + DA where: EBT – pre-tax profit; I – interest payable in this period; DA – depreciation of non-current assets	Ability to compare companies with different accounting policies in terms of period and depreciation method.
<i>EBIT (Profit before interest and taxes)</i> = EBT + I	Ability to compare the financial results of competing companies operating in the same industry, but which attract borrowed capital at different loan rates, terms of interest payment
<i>EBT (Profit before tax)</i>	Ability to compare companies with different tax burdens

Source: [15]

Aside from the benefits of using EBITDA, there are issues that are hard not to notice. This is the lack of a single approach to the calculation of EBITDA without the risk of distortion of results due to disregard for the specifics of the activities of a particular enterprise in different countries. Therefore, the calculation of normalized (adjusted) EBITDA is popular among public companies, which is adjusted in particular for certain types of costs and revenues that are specific to the activities of a particular enterprise, or the adjustment of which is necessary due to certain events. In particular, due to the COVID-19 pandemic, the normalized EBITDA can be adjusted for lost sales revenue due to supply disruptions, operational inefficiencies, unforeseen changes in the cost structure, termination of contracts due to the pandemic, and so on.

Scientists have different attitudes to the use of normalized EBITDA. Some experts justify the benefits of using this indicator, while others, on the contrary – consider the existence of individually adjusted costs and revenues a significant problem. Some authors argue that EBIT and EBITDA, which are calculated in a way other than the classical way, cannot be called so. Therefore, companies that use a non-conventional classical formula for one reason or another, call these indicators differently, often adding the word “adjusted” [15]. Different calculation methods lead to incomparability of indicators of different enterprises and create opportunities for manipulation of these indicators in an effort to improve their value.

In Ukraine, EBITDA is mostly calculated only by those companies that are subsidiaries of foreign companies or which also operate in foreign markets. The practice of calculating this indicator should be introduced into the activities of Ukrainian companies, as it will allow to more correctly compare the company with domestic and foreign competitors with different differences in depreciation policy, lending conditions and tax rates.

We believe that for a correct analysis of the results of any enterprise still need to consider the normalized EBITDA, while trying to prevent manipulation of its calculation. This will allow to take into account the impact of atypical transactions

or events that occurred during the analysed period, namely: extraordinary (non-operating) income and expenses (for example, the sale of all stocks due to production stoppage); significant exchange rate differences; costs of sale (disposal) of non-current assets; impairment losses on various groups of assets, including goodwill; shares of financial result in associates and joint ventures and operations; accrual of reserves for various needs.

Another obstacle to comparing the results of domestic enterprises with foreign ones is the different approaches to defining and ensuring the operating cycle, which, in turn, is associated not only with the specifics of the enterprise (including technical and technological features), but also with established practice. relationships with their counterparties, in particular regarding the terms of settlements, etc. In addition, the quality of current assets management and the efficiency of financial and economic activities of the enterprise as a whole directly affect the duration of the operating cycle [16]. On the other hand, in addition to various micro- and meso-environments of Ukrainian and foreign enterprises, the macro-environment also has an impact on the duration of the operating cycle, the factors of which are: the state of the economy, inflation, credit relations, products, the tax system in the country, legislation and regulations, etc. It should be noted that an individual enterprise is largely unable to influence the factors of the macro-environment, and therefore it adapts to their influence, in particular, on the operating cycle. Also, it is important to take into account the influence of the above factors when analysing the causes of deterioration of the financial condition of the enterprise.

Today, in the process of analysing the financial condition, it is necessary to understand the conditions in which enterprises operate, and what trends are occurring in the markets of individual countries, regions and the global market in general. For this purpose, in foreign countries (in particular in the USA) Purchasing Managers' Index (PMI) is widely used. PMI calculates and publishes the Institute for Supply Management on a monthly basis. PMI – ranges from 0 to 100. If the index is above 50, it indicates an improvement in operating conditions compared to the previous month. If below 50, then, accordingly, the deterioration of

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conditions. When the index value is 50 – no change. Figure 4 shows the dynamics of changes

in global PMI, starting from April 2018 until March 2021.

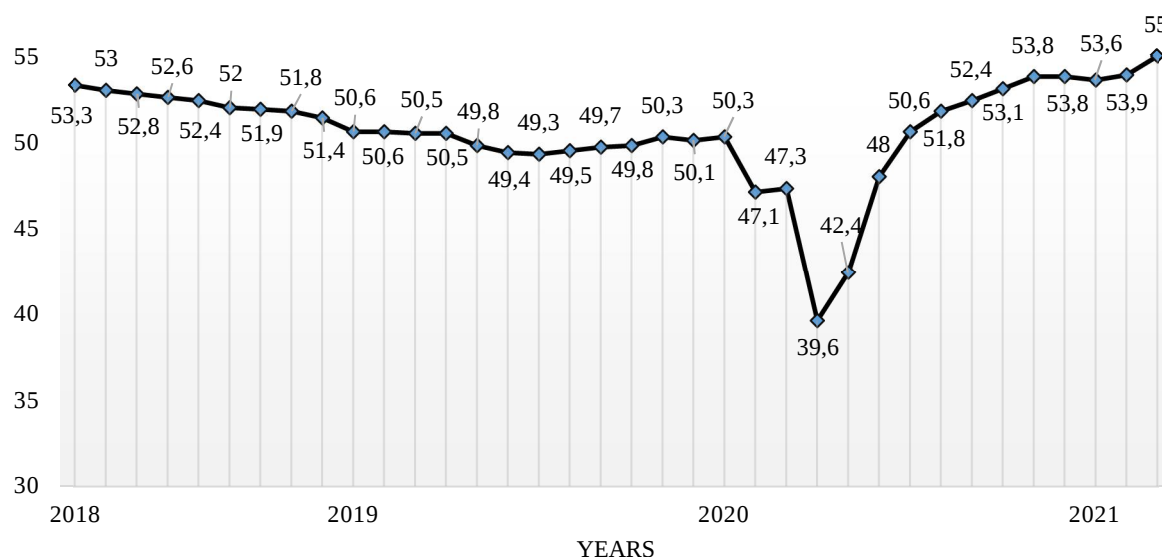


Fig. 4. Dynamics of global PMI change from April 2018 until March 2021. [17]

As we can see from the schedule of changes in the global RMI in recent years, the conditions of business are not stable. During the analyzed period, the lowest level of RMI was 39.6 in April 2020 (the period of strict quarantine, closure of borders in connection with the COVID-19 pandemic, etc.), and the highest – 55 in March 2021. Therefore, the study of methodology and practice of analysis of

the financial condition of the enterprise must be carried out taking into account the conditions of the external environment.

To carry out a comprehensive analysis of the financial condition of enterprises, it is necessary to have enough reliable financial and non-financial information (Table 4) for several reporting periods.

Table 4

General characteristics of domestic and foreign sites of generally available information about enterprises

Ukrainian sites	Foreign sites
smida.gov.ua – contains regular and irregular information about issuers of securities; you can find information about registrars, securities traders, depositories, etc.; contains all the facts of offenses committed on the stock market by issuers of securities, etc.	bloomberg.com/markets – available data on futures, commodities, bonds and currencies of companies, current and future economic announcements, etc.
stockmarket.gov.ua – is a publicly available information database of the National Securities and Stock Market Commission about the securities market, in particular in terms of types of participants – issuers of securities, exchanges, traders, rating agencies. In particular, it contains information on transactions on exchanges and off-exchange, etc.	sec.gov/edgar – the US Securities and Exchange Commission's Electronic Data Collection, Analysis and Search (EDGAR) database provides free public access to corporate information, including registration applications, prospectuses and periodic reports submitted on 10-K forms (verified annual financial statements) and 10-Q (unaudited quarterly financial statements) etc.
clarity-project.info – contains basic information about companies, including their licenses, related parties, inspections, intellectual property, enforcement proceedings, documents, etc.	seekingalpha.com – contains information on financial markets, articles and research covering a wide range of stocks, asset classes etc.
ZAKUPKI.PROM.UA – detailed information about auctions, commercial and government procurement, etc.	finviz.com – contains in particular information about the participants of stock exchanges.

It is worth noting that there are many more foreign sites with publicly available information about companies. One of their advantages is the availability of up-to-date information on the financial and economic condition of enterprises for a specific day, month, quarter, year (depending on the types of indicators), and not only the data of annual financial statements provided on domestic sites. Also on a number of foreign sites you can see the dynamics of various financial indicators (including graphically presented), as well as grouped financial and economic information for any of the last 12 months and comparative previous periods. Monitoring this information is useful for different groups of users related to a particular company, including creditors, investors, competitors, auditors, buyers, shareholders, and so on. At any time, they can analyse the required indicators of the financial condition of the enterprise. This prompt presentation of information by enterprises once again confirms their transparent conduct of business. In Ukraine, it is necessary to create Internet sites with up-to-date open financial and economic information of enterprises for external and internal users by analogy with foreign sites listed in Table. 4.

Conclusions and prospects for further research

As a result of the study, the shortcomings of the methodology and practice of analysing the financial condition of the enterprise were identified, the impact of these shortcomings on management decisions of users of relevant analytical information, analysed foreign experience in financial analysis, and proposed recommendations to improve the quality of this analysis. In particular, on the example of a real enterprise, differences in approaches to the calculation of the same indicators by name, but regulated by different domestic regulations, as well as a comparison with the approaches that exist in foreign practice. This situation allows different entities to manipulate the results of the analysis of financial condition. In order to solve it, it is necessary at the state level to eliminate differences between domestic regulations that regulate the financial situation, and are used by investors, business owners, regulators, creditors, including commercial banks and more. It is also justified to determine the normalized

EBITDA, as this approach will eliminate the impact of atypical transactions or emergencies on the financial result. This will make it possible to more accurately compare the performance of the enterprise for different years.

Among the prospects for further research is the development of recommendations for improving the methodology and practice of analysing the financial condition of enterprises, and in particular taking into account the introduction in Ukraine of taxonomy of financial reporting under IFRS and improving integrated reporting of enterprises and more.

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