23BAT605-FINANCIAL STATEMENT ANALYSIS

Uses of Financial Statements

1. **Investment Decision-Making:**
    - Investors use financial statements to assess the financial health and performance of a company before making investment decisions.
2. **Credit Analysis:**
    - Creditors, such as banks and suppliers, analyze financial statements to evaluate a company's creditworthiness before extending credit.
3. **Management Decision-Making:**
    - Management uses financial statements for strategic planning, budgeting, and overall decision-making to achieve organizational goals.
4. **Performance Evaluation:**
    - Financial statements serve as a basis for evaluating the performance of managers and the efficiency of various business units within the organization.
5. **Strategic Planning:**
    - Companies use financial statements to formulate and implement strategic plans, allocating resources effectively and setting realistic goals.
6. **Forecasting and Budgeting:**
    - Financial statements aid in financial forecasting and budgeting, helping companies plan for future activities and allocate resources efficiently.
7. **Shareholder Communication:**
    - Financial statements are a key communication tool to keep shareholders informed about the company's financial position and performance.
8. **Dividend Decisions:**
    - Shareholders assess financial statements to make decisions related to dividends, as the ability to pay dividends is reflected in the company's financial health.
9. **Market and Industry Analysis:**
    - Financial statements are used for analyzing market trends and comparing a company's performance with industry benchmarks.

10. **Regulatory Compliance:**
    - Companies use financial statements to comply with legal and regulatory requirements, ensuring accurate reporting to government agencies and stock exchanges.
11. **Negotiations and Contracts:**
    - Financial statements are crucial in negotiations, mergers, and acquisitions, providing a basis for valuations and contractual agreements.
12. **Benchmarking:**
    - Financial statements allow for benchmarking against industry standards and competitors, aiding in identifying areas for improvement.

Limitations of Financial Statements

1. **Historical Information:**
    - Financial statements provide historical information and may not accurately reflect a company's current market value or future potential.
2. **Qualitative Factors Ignored:**
    - Financial statements focus on quantitative data, ignoring qualitative factors such as management quality, employee satisfaction, and brand reputation.
3. **Dependence on Accounting Policies:**
    - Different accounting policies can lead to variations in financial statements, making it challenging to compare companies accurately.
4. **Subjectivity in Estimates:**
    - Financial statements often involve estimates and judgments, such as the estimation of useful lives for depreciation, introducing subjectivity.
5. **Does Not Reflect Market Changes:**
    - Financial statements may not capture rapid market changes or events that occur after the reporting date.
6. **Limited to Monetary Aspects:**
    - Non-monetary assets, such as employee skills and brand reputation, are not adequately reflected in financial statements.
7. **Complex Accounting Standards:**
    - Compliance with complex accounting standards may make financial statements difficult for some users to understand.

8. **Potential for Manipulation:**
    - Companies can manipulate financial statements through creative accounting practices, impacting the reliability of the information.
9. **Not Comprehensive:**
    - Financial statements provide a limited view of a company's overall performance and do not encompass all aspects of its operations.
10. **Lack of Future Predictions:**
    - Financial statements do not predict the future and may not capture emerging trends or potential risks.
11. **No Measurement of Non-financial Performance:**
    - Financial statements do not measure non-financial performance indicators, such as customer satisfaction or employee engagement.
12. **Assumes Going Concern:**
    - Financial statements assume that the company will continue as a going concern, and potential bankruptcy or significant disruptions may not be reflected.

Despite these limitations, financial statements remain indispensable tools for decision-making, and users need to consider these factors while interpreting and analyzing the information they provide. Supplementary information, such as management discussions and analyst reports, can enhance the understanding of a company's overall performance and prospects.