



## FINANCIAL STATEMENT ANALYSIS: MODERN APPROACH

Rakhimov Matnazar Yusupovich  
Professor of Tashkent State University of Economics  
raximovmy@mail.ru

<b>ABSTRACT</b>	<b>KEYWORDS</b>
<p>Financial statement analysis is important for assessing a company’s performance, determining its financial stability, solvency, and profitability. However, in practice, various problematic aspects arise during financial statement analysis. These problems can negatively impact the reliability of the analysis results.</p>	<p>Financial statements, financial statement analysis, financial condition, financial stability, financial results, business activity, insolvency.</p>

### **Introduction**

The different forms of financial reporting in different countries are explained by a number of objective factors:

The economic system of the country (market economy, mixed or strictly regulated by the state) cannot but directly affect the content and purpose of financial reporting.

For example:

- in countries with a developed market economy, reports are intended more for investors and shareholders.

- in countries with a high role of the state, reports serve mainly for tax and control purposes.

In many countries, accounting (financial) reporting is closely related to tax reporting. Therefore, there are cases of different interpretations of financial results in order to reduce the tax burden.

In countries with high inflation rates, approaches such as revaluation and indexation are used in financial reporting. This changes the interpretation of financial indicators.

The attitude towards accounting, risk and transparency is different in each country. This aspect also led to the formation of national accounting traditions.

### **Research Methodology**

In this study, the use of comparative, logical, regulatory and systematic analysis methods allows drawing scientifically based conclusions. Complex use of methods increases the practical and theoretical significance of research.

## **Review of literature on the subject**

Different interpretation of financial statements in different countries. Foreign R. Nobes, K. Parker, Ch. Horngren's works are studied in detail. In their research, the main factors influencing national accounting systems are: legal system, tax policy, level of development of the financial market. The differences between the Anglo-Saxon and continental accounting models are also scientifically substantiated [1].

The literature on IFRS (International Financial Reporting Standards) (D. Alexander, E. Britton, J. Georgescu) substantiates the need for international harmonization of financial reporting. In these sources, such principles as the concept of fair value, the primacy of content over form, transparency and comparability are indicated as important aspects that distinguish national accounting systems [2]. The literature on financial reporting analysis (I. Blank, V. Kovalev, E. Stoyanova) discusses the reliability of reporting data and the problems of their interpretation in different countries. The authors emphasize the need to take into account: differences in accounting policies, the impact of inflation, and non-financial factors in reporting analysis [3].

## **Analysis and Results**

We can structure the analysis of financial statements and its problematic aspects in the following directions.

### **1. Information quality.**

Information quality - reflects the extent to which the information presented in financial statements meets the needs of users and is useful in making decisions. The main criteria for information quality include:

- the ability of information to influence economic decisions;
- the ability to make predictions and estimates.

Financial statements are a set of official documents that reflect reliable and systematized information about the financial position, financial results and cash flows of an enterprise (organization) for a certain period.

The main purpose of financial statements:

- providing users (investors, creditors, government agencies, management) with the information necessary for making decisions;
- assessing the financial stability and profitability of the enterprise.

One of the main problems in the analysis of financial statements is the completeness, accuracy and reliability of the reporting data. In some enterprises, accounting data is submitted late or errors are made in accounting. This leads to incorrect conclusions in the analysis results.

Information completeness means that all important information necessary for the user to make the right economic decision is fully and sufficiently reflected in the financial statements. The following are the main characteristics of information completeness:

- all important transactions are reflected in the report;
- assets, liabilities, income and expenses are not hidden;
- accounting policies and significant changes are disclosed in the notes;
- the need to provide additional information.

Information accuracy is the absence of errors and inaccuracies in the information provided in the financial statements, the calculations were made correctly and truthfully reflect the real situation. The main characteristics of information accuracy are:

- the absence of arithmetic errors in the calculations;
- the information is supported by documents;
- assets and liabilities are correctly valued;
- the absence of vague expressions and ambiguities that lead to misinterpretation.

Information reliability - the fact that the information presented in the financial statements accurately reflects the true, fair and real economic situation, that is, the user can make decisions based on it

In terms of factors determining the reliability of information, it is recommended that:

- its accuracy;
- its completeness;
- its objectivity.

**Table 1 Financial reporting information quality comparison table**

<b>№</b>	<b>Information quality</b>	<b>Brief definition</b>	<b>Basic requirement</b>
1	Compatibility	The ability of information to influence decision-making	Economic significance
2	Reliability	The accuracy and impartiality of information	Complete, without distortion
3	Completeness	All relevant information is provided	Omission of important information
4	Clarity	The information is accurate and free from errors	Absence of errors in calculations
5	Comparability	Comparability across periods or companies	Usage of uniform calculation methods
6	Auditability	The information can be independently verified	Substantiation with documents
7	Timeliness	Timely presentation of information	Presentation of reports without delay
8	Understandability	Simple and clear presentation of information	Absence of complex expressions

**2. Failure to take into account the impact of inflation.**

In most cases, financial statements are not restated in the face of inflation. As a result, assets, liabilities, and income do not reflect their true value. This problem, especially in conditions of high inflation, reduces the objectivity of the analysis.

In information analysis, failure to take into account the impact of inflation means that financial statements and economic indicators are analyzed in nominal values, without taking into account the decrease in the value of money (inflation). In conditions of inflation, the purchasing power of money decreases.

If inflation is not taken into account in the analysis:

- income appears to have increased, but in fact real income has not changed;
- the value of assets is underestimated;

- expenses and income are incorrectly compared;
- erroneous conclusions about the financial situation can be drawn.

The negative consequences of the impact of inflation are summarized in the following points.

1) Incorrect dynamics analysis:

- when comparing indicators of different years;
- if inflation is not taken into account, artificial growth appears.

2) The real level of profit is distorted:

- there is a nominal profit, but there is no real profit.

3) The true value of assets is not reflected:

- long-term assets (buildings, equipment) are recorded at old prices.

4 Mistakes of investors and creditors:

- although the enterprise looks good financially, the real situation may be weak.

As methods of reducing the problem, the following actions are performed: bringing the indicators to real values, using inflation coefficients, applying revaluation (indexation) methods, and choosing the same base year in comparative analysis.

**Table 2 Effect of not accounting for the effect of inflation on the analysis**

№	Direction of analysis	If the effect of inflation is not taken into account	The resulting incorrect conclusion
1	Income analysis	Nominal growth is taken as real growth	The wrong idea is made that profits have increased
2	Profit rate	Profits are not shown to have decreased in real terms	The company is assessed as efficient
3	Asset value	Long-term assets remain at old prices	The amount of assets is undervalued
4	Comparison of periods	Different years are directly compared	Artificial growth occurs
5	Cost analysis	Real increases in costs are hidden	Efficiency is incorrectly assessed
6	Investment grade	Real income is not calculated	Investors make wrong decisions
7	Financial situation	Currency depreciation is not taken into account	The wrong conclusion is made that the company is in a stable state

If the effect of inflation is not taken into account, financial indicators are not estimated in real terms, but in nominal terms, and the results of the analysis become unreliable.

### 3. Differences in accounting policies.

The accounting policies used by enterprises may vary. Differences in depreciation methods, valuation of reserves, or rules for recognizing income make it difficult to conduct a comparative analysis of enterprises.

Accounting policies are a set of rules and methods that an enterprise uses in preparing its financial statements.

It determines the following: the method of valuing assets and liabilities (cost, depreciation, reserves); the method of accounting for income and expenses; the way to reflect inflation, exchange rates, and loan terms; accounting methods (nominal, real value, FIFO/LIFO, types of depreciation).

Each enterprise has freedom in its accounting policy, but its choice directly affects the analysis of financial indicators.

**Table 3 Differences in accounting policies and implications for analysis**

Nº	Difference in accounting policy	Financial indicator that affects	Consequences in the analysis
1	Depreciation method (straight or limited or accelerated)	Depreciation expense, asset value	Accelerated depreciation reduces profit, the value of the asset decreases quickly; the analysis may incorrectly compare cost and profit
2	Inventory cost (FIFO, LIFO, AVECO)	Sell expenses, profit	If LIFO is used, expenses are overstated in inflationary conditions and profit is reduced; FIFO shows profit as high
3	Asset valuation method (nominal, revaluation)	Balance sheet, asset value	When assets are revalued, the balance sheet value increases; the analysis shows the company as financially stable
4	Revenue recognition method (cash or accrual)	Revenue, profit	In the cash method, income is recorded at the latest; the analysis shows profit as decreased
5	Debt and liability valuation (nominal or real value)	Liability value, profit	If debt is not shown at fair value, profit is misinterpreted
6	Property and investment valuation (revaluation or historical value)	Balance sheet, capital	If it differs from fair value, the analysis may artificially inflate the company's value

Accounting policy is an important signal to management, auditors and investors. Differences in accounting policies are a key factor in the analysis of financial performance for management and analysts. Therefore, the accounting policy must be clear and stable in the analysis, and its changes must be indicated in the notes.

**4. Relying only on past data in the analysis.**

Financial statement analysis relies mainly on historical data. This does not allow a full assessment of the company's future development prospects. This is a serious limitation when making strategic decisions.

**Table 4 The main problems in the analysis**

Nº	Problem	Result
1	Incompatibility with real time	Profit, revenue, and expense ratios do not reflect the current economic situation; the analysis is based on historical data
2	Market and economic changes are not taken into account	Inflation, interest rates, exchange rates, or potential competition are not reflected in the analysis
3	The wrong outcome of strategic decisions	Investors and management may develop incorrect strategies based on profit or debt analysis
4	Misinterpretation of the real value of benefits and costs	Nominal profits may appear to have increased, but in reality, their real value may have decreased
5	Past trends cannot predict the future	Analysis based solely on historical data does not adequately reflect future opportunities and risks
6	Delay in economic decisions	Important financial decisions (investment, borrowing, asset disposal) may be delayed or made incorrectly

**5. Failure to take into account non-financial factors in the analysis.**

The analysis process often focuses only on numerical indicators. Non-financial factors such as management quality, the level of competition in the market, and technological development are not sufficiently taken into account. This makes the overall assessment one-sided.

Non-financial factors are factors that affect the activities and financial indicators of the enterprise, but are not directly reflected in the numbers in accounting.

These include:

- qualification and efficiency of the workforce;
- quality of relations with customers and suppliers;
- brand value and level of competitiveness;
- social and political conditions (tax policies, licenses, sanctions);
- scientific and technical and innovation capabilities.

That is, even if the numbers are shown in the financial statements, non-financial factors do not fully reveal their meaning.

**Table 5 Consequences of not taking into account non-financial factors in the analysis**

<b>№</b>	<b>Problem</b>	<b>Effect on the analysis</b>
1	Misconception in economic decisions	Even if financial indicators are good, lagging behind the competition or low employee productivity may be misjudged
2	Strategic and investment risks	If innovation and technological capabilities are not taken into account, the effectiveness of new projects is misjudged
3	Weakness in customer and market relationship analysis	Real revenue and profit are misrepresented due to the lack of brand equity and customer loyalty analysis
4	Ignoring the social and political impact	Tax, licensing procedures, or political risks may not have an overriding impact on financial indicators
5	Incorrect assessment of competition	Even if financial indicators are high, the analysis does not show that competitive advantage is low

The importance of taking into account non-financial factors can be classified according to the following units of influence.

Assessment of real profit and efficiency:

-based on the numbers in the accounts alone, the enterprise may look good, but the efficiency of employees may be low.

Improving the quality of strategic decisions:

-when investments, projects and development strategies are evaluated using non-financial factors, accurate and reliable decisions are made.

Identifying risks:

-analysis of the brand, license, market or social conditions reveals risks for investors and management.

Relying only on financial figures makes the analysis short-sighted and does not reflect real efficiency and risks. If non-financial factors (from the quality of the workforce to the market and brand value) are

included in the analysis, the true economic and strategic state of the enterprise becomes more clearly visible.

**6. Limitations of analytical methods.**

In practice, sometimes one is limited to only classical analytical methods. In modern economic conditions, the use of complex, scenario and forecast analysis methods is required.

Financial statement analysis methods - a set of various methods and techniques used to assess the financial condition of an enterprise and make decisions.

By limitation, the methods used in the analysis are related to financial statement figures, but they do not take into account all factors and context. That is:

- conclusions are drawn only on the basis of financial figures;
- non-financial, strategic, market and macroeconomic factors are not taken into account;
- only certain indicators are relied on for decision-making.

**Table 6 Problematic aspects of limitation in financial statement analysis**

№	The problem	Cause of the limited methods	Consequences
1	Relying on nominal numbers only	Analysis based on trends, ratios and industry standards	Incorrect assessment of real benefits and value; inflation, currencies and market changes are not taken into account
2	Non-financial factors are not taken into account	The quality of the equipment, brand, customers and workforce are not shown in the analysis	Efficiency, competitiveness and strategic advantage are underestimated
3	Economic and strategic analysis is limited	Only debt and profit figures are used	Long-term investment, projects and strategy analysis will go wrong
4	Comparative analysis becomes difficult	These methods do not fully reflect differences between companies and periods	Artificial indicators may appear in the comparison
5	Risks and trends are not adequately assessed	Information other than financial ratios and profits is not taken	Investors and management may come to the wrong conclusions

The following directions can be formulated as ways to improve the analysis of limited methods.

Analysis with non-financial factors:

- labor efficiency, brand value, customers and market trends.

Taking into account real value and inflation:

- revaluing nominal profits and assets to real value.

Taking into account the strategic and macroeconomic context:

- tax policy, exchange rate, market conditions and level of competition.

Using several methods:

- coefficients, trend analysis, horizontal and vertical analysis, forecast and scenario analysis.

## Conclusion

Problematic aspects of financial statement analysis affect the accuracy and reliability of the analysis results. To eliminate these problems, it is necessary to improve the quality of reporting, take into account inflation, include non-financial factors, and use modern analysis methods. Only then will financial statement analysis become an effective tool for making management decisions.

If financial statement analysis is carried out solely on the basis of numbers, it will not fully reflect the real economic situation, strategic opportunities, and risks. For effective analysis, it is necessary to combine historical data with real values, non-financial factors, and the macroeconomic context.

In particular, the lack of a modern, unified analytical approach to financial statement analysis and the prevention of its shortcomings also does not allow for a correct assessment of the situation.

Unfortunately, approaches to establishing a modern form of conducting an in-depth analysis of the financial situation with clearly defined reliability criteria remain the most pressing issue in analysis. In this regard, the need to bring the national and international segments of financial analysis into a single system for a wide range of managers and interested parties requires a restructuring of the methodological basis of analysis.

In order to achieve a unified approach to the methodological basis, it is necessary to establish a clear classification of its research units, a system of indicators, and assessment indicators. At present, hundreds of approaches and differences can be observed in world practice. True, it is natural that there are differences in some sense. However, these differences should not lead to different interpretations. In particular, the different advantages of economic entities in the developed Western world and the national economy in determining regulatory requirements for analytical indicators should not affect the correct interpretation of the object.

The methodological basis is also largely associated with problems in determining legal norms in the field. The fact that the requirements for the assessment of important performance indicators of joint-stock companies, defined by legal norms, and the determination of different methods and procedures in different enterprises are excessive and have no effect, is also a proof of our opinion.

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