

Financial statement analysis as a tool for investment decisions and assessment of companies' performance

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Abstract

Purpose: Financial Statement Analysis (FSA) and Interpretation is a vital instruments for good management decision-making in business. The main objective of this study is therefore to determine how firms could use FSA and its interpretation to aid funding and investment decisions and to avert low profitability or low investment returns.

Research methodology: Data from the annual report of Nestlé Nigeria Plc are utilized for the Analysis and Interpretation of the financial ratio using descriptive statistical analytical tools for presentations.

Result: The study concludes that analysis of FSs is adequate for effective decision making and that firms should pay great attention to the use of FSA to properly equip themselves with this tool and also a combination of different ratios should be used in analyzing a firm's financial performance. Proper use of FSA should be made not only in investment but also in other areas of decision-making.

Limitations: The study is limited to FSs published by Nestlé Nigeria plc between the years 2014 to 2019.

Contribution: The paper serves as an aid to different categories of investors when making critical investment decisions.

Keywords: *Decision, Financial statement, Financial reporting, Investment, Regulatory bodies*

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1. Introduction

Financial statement analysis (FSA) is a process that examines past and current financial data to evaluate performance and estimate future risks and potential. According to [Auwalu and Ibrahim \(2017\)](#), financial statements (FSs) present information about the financial position, performance, and changes of an entity in a standardized and accurate form to investors, regulators, financial analysts, and other users in making economic decisions. FSA is used by potential investors, proprietors, creditors, security analysts, leading houses, managers, Government regulatory agencies and tax authorities, trade unions, customers, and many other stakeholders who rely on financial data for making both financial and economic decisions about a firm.

Analysis of FSs focuses primarily on data provided in the firm's annual reports which contained the FS and other supplementary information. Significant changes or turning points in patterns, amounts, SWOT, and other relationships were identified during the analysis. Therefore FSs are merely summaries of detailed financial information that can only be a piece of meaningful information when analyzed and interpret. Different categories of financial information users are concerned in getting access to the Firm's FS, chiefly among them are the investors and creditors than other internal and external users, though they might have distinct objectives sometimes but more often related objectives. Nevertheless, the basic models, techniques, and tools of FSs can be effectively put into

practice by all the categories of users. To this end, FSA can assist investors, creditors, and other users in the discovery of the sort of data they needed settling on an ideal choice relating to funding, credit facilities, or other interests in a particular firm.

Accountants, auditors, financial analysts, and other financial advisors have utmost interest in the tools and techniques of FSA since they have the same basic information from FSs like their principal, employer, investors, leasers, or creditors as it relates to their customers and expected customers. For that reason, they use FSA tools and techniques on current financial data to evaluate performance and estimate future risks and potential of the firm and thereafter interpret the outcome to their clients. Financial analysts frequently do adjust the FSs drawn up by the client firm's accountants for things they don't consider noteworthy or for things they consider critical however which don't show up on the FS.

[Securities and Exchange Commission \(SEC\) \(2000\)](#), stated categorically that, when investors decided on the merits and comparability of an investment opportunity through FSA, allocation of financial resources is made easier and investor reliance is nurtured. The usefulness of comparable FSs is under cored in the financial accounting standard board (FASB). [FASB \(2000\)](#) affirmed that funding, investing and lending decision prerequisites, involve analysis and evaluations of alternative opportunities and they cannot be carryout rationally if comparative information is not obtainable. Textbooks on FSA as well, emphasize the importance of comparability across FSs in judging a firm's performance using ratios analysis.

The firm's accounting year-end annual reports and FSs are the main documents that are expected to be produced by registered business entities at the end of every twelve calendar months. The financial ratio analysis (FRA) is considered an important tool for the organization to evaluate its financial situation, competitiveness, liquidity, solvency, risk, Operational effectiveness, productivity, and appropriate use of funds ([Asrizal, Linzzy & Shinta, 2018](#)).

[Suryanto and Thalassions \(2017\)](#) expressed that the FSs are an open wellspring of data, and their content, structure presentation, and approval are bound together by fundamental guidelines so as provide details, timely, accurate, and reliable information content that is of great value to the users. Among those values is the ability to use the firms' FSs to predict the performance of firms. For effective decision-making, to this end information contained in the FSs cannot be overemphasized. The information depicted in the FS for the firm past and current financial transactions enhances decision-making. Hence, it can safely be concluded that FSA is not the conclusion in itself but a means to a conclusion i.e. decision-making to improve firm performance ([Susan, Innocent & Philip 2018](#)).

Decision-making is not the fundamental goal of each financial or venture activity, the decision is a choice from a set of identifies alternatives. However, the achievement of financial or investment goals and objectives depends on the proper implementation of meaningful decisions, on the contrary execution of wrong decisions emphatically leads to financial or investment disappointment. The definitive target of each operation in every investment are cost minimization, profit augmentation, and wealth growth, subsequently, to achieve the aforementioned objectives it becomes necessary that capital structure and other financial decisions about the firm or investment opportunities have to be made and implemented. All the significant information required with regard to investment opportunity is mainly concerned with the financial aspect and the record that contains those financial aspects is the FS while FSA is a process that analyzes the financial statement (FS).

The focus of this research work examines the FSs of a firm as a tool for evaluating a firm's value, funding, or investment decisions, the researcher will base her analysis on FSs published by Nestlé Nigeria plc. Nestlé Nigeria plc is a top-ranking consumer goods firm in Nigeria and one of the biggest food companies in Africa. Nestlé Nigeria plc began trading operations in Nigeria in 1961 and got listed on the floor of the Nigerian Stock Exchange on April 20, 1979. Nestlé Nigeria plc establish its

first factory at Agbara, Ogun State Nigeria in 1982. [Securities and Exchange Commission \(SEC\) \(2000\)](#) proclaims that, when investors judge the benefits of investments and equivalency of investment, proficient distribution of capital is facilitated and investor certainty sustained. The functionality of equivalent FSs is under cored in the financial accounting standard board (FASB). [FASB \(2000\)](#) proclaims that "contributing, funding and lending choice basically include assessments of alternative opportunities and they can't be made rationally if comparative information is not available". FSA textbooks also stress the importance of comparability across FSs in judging a firm's performance using financial ratios.

Corporate yearly reports and FSs is a specific report that is expected to be delivered by all business entities at regular interval. The financial ratio analysis is considered an important tool for the organization to evaluate its financial situation, competitiveness, liquidity, solvency, risk, operational effectiveness, productivity, and appropriate use of funds ([Asrizal, Linzzy & Shinta, 2018](#)). [Suryanto and Thalassions \(2017\)](#) expressed that the FSs are an open wellspring of financial data, which their structure, content, and presentation forms are bound together by fundamental rules and parameters to generate financial information content that has prominent value to the users. Part of this prominent value is the ability of the user to use the FS to predict the performance of a firm or an investment. For effective decision making, FS information depicted cannot be overemphasized, as that information enhances decision making. Hence, it can safely be concluded that FSA is not the conclusion in itself but a means to an optimal conclusion i.e. decision-making to improve firm performance ([Susan, Innocent & Philip 2018](#)).

A decision is a choice between at least two other alternatives, though it isn't the center of each investment activity, yet the execution of meaningful choices gives way to the accomplishment of investment aims and purposes while the execution of erroneous decisions positively gives a lead to investment disappointment or non-performance. The paramount aims and objectives for investments are profit maximization and wealth growth, consequently, it becomes fundamental that capital structure and investment funding decisions must be made and carried out to accomplish the previously mentioned targets objectives. Among the prime information required with regards to an investment opportunity is concerned with the aspect of financial data and the book of records that contains the financial aspect of an investment for analysis is what is referred to as the financial statement (FS).

This research work is based on the FSA as a tool for investment or funding decisions through evaluating a firm's performance and the analysis will be based on FSs published by Nestlé Nigeria plc. Nestlé Nigeria plc is in the consumer goods industry in Nigeria and is one of the biggest food manufacturing firms in Africa. Nestlé Nigeria plc began trading merchandise activities in Nigeria in early 1961 and was listed on the floor of the Nigerian Stock Exchange for the stock market on April 20, 1979. Nestlé Nigeria plc commissioned its first factory at Agbara, Ogun State Nigeria In 1982.

Problem statements

The achievement of financial or investment goals and objectives depends on a proper understanding of such investment opportunities ([Aniefor & Oboro 2015](#)). However, many potential investors are known to have adventured into an investment opportunity without appropriate apprehension of such investment opportunity, thus settling on and executing erroneous decisions effectually the investment will collapse when the going demonstrated unfeasibly. In some instances, the investment ventures may become to pass, but the aim for such investment may not be realized. [Kapellas and Siougile \(2018\)](#) debated that the principal driver of the stock exchange market is information depicted in the FSs and with proper analysis of investment opportunities derived from FSs, adverse selection or moral hazard will be reduced drastically.

Fortunately, numerous investments are done without emphasis laid on those indexes that show such investments would be solvency and effective to generate great returns, in the long run, so likewise the danger implied and the advantages to be derived whenever set out on such investment with the limited financial resources and the resultant effect of non-performance. According to [Conteh and Akuntansi \(2021\)](#), for an effective and efficient investment decision, FSA is an important process needed to be

carryout by potential investors, if the investors fail to carryout FSA on the financial data of investment opportunity, such an investment is at higher risk of surviving and meet its targeted objectives. All the aforementioned problems emerge due to erroneous financial decisions making hence, this review will, therefore, point out the means through which meaningful financial and investment decisions can be inferred with the aid of FSA to enhance the changes available for investment opportunities or firms' financial activities through analyzing financial information concerning such investment opportunities. This study will be centered on the FS presented to the stakeholders by Nestlé Nigeria plc and also available to potential investors and stockholders as a means of getting information for efficient and effective decision-making using financial ratio analysis (FRA) tools and techniques.

The objectives of the study

The general objective of this study is to ascertain the role of FSs in investment decision-making in Nestlé Nigeria plc in particular while the definite objectives go as follows:

- i. To undersee how FSs as prescribed analytics tools succor anticipated proprietors when evaluating the financial status of the firm.
- ii. To commend the fundamental use of FS information, in supplying relevant financial information for investment decision-making.
- iii. To examine the task accomplishment of a firm for making choices from a set of identified alternatives investment from FS outlook.

Research questions

The research questions are:

- i. How can analysis of FSs be used as tools to succor investment decisions?
- ii. To what stretch does the FS information empower the users in acquiring the required knowledge for investment decision-making?
- iii. Are FSs useful for projecting a firm's achievement?

Significance of the study

The paper will make the case study (Nestlé Nigeria plc) to value the prominence of sound FSs in the provision of knowledge needed for decision making. The paper will augment greater benefit, by serving as an aid to different categories of stakeholders or potential investors when making a critical decision on an investment opportunity that will improve their firms' performance, firms value, and also additional knowledge will be acquired on the use of the FS when making choices among investment opportunities. Stakeholders like financial analysts, investors, creditors, and other financial organizations. Furthermore, the paper will similarly serve as a reference to students in the various institution and other researchers who may be interested to embark on further research.

2. Literature review

Proprietary and residual (prospective) equity theory

The basic conceptual structure provides the concept of FSA concerning the models and theories on a financial statement (FS), most commonly used theories are proprietary & residual equity theory and DuPont mean-variance of portfolio investment theory. Proprietary & residual equity theory debated that the accounting procedures of an enterprise imperatively be managed from the shareholders' outlook. The Residual equity theory which was developed by [Staubus \(1959\)](#), deliberated that the accounting procedure of a business needed to be fashionable from the vista of the prospective equity shareholders, simultaneously for the accounting concept of a going concern concurs with that of the capital stockholders. Though the theory of residual equity on the other hand is a more hypothetical form of proprietary theory, however, in the proprietary theory, transactions and events are accounted for, recorded, and analyzed as to their immediate effect on the proprietors' outlook. Financial statements (FSs) are prepared from the outlook of the proprietors and are meant to value and analyses their net worth expressed by the accounting expressions:

- 1) Total equity, proprietorship or net worth = Total assets - Total liabilities

In the proprietary theory assumption, the total assets are regarded as the proprietors' total assets, and the total liabilities are the proprietors' total liabilities. [Newslove and Garner \(1951\)](#) debated beneath the proprietary theory, "liabilities described as assets minus proprietorship,

and they ought to be delineated and differentiated in the accounting records procedures." The higher the revenues the higher the proprietorship equity while expenses shrink proprietorship equity. Gross profit is the excess of sales over the cost of sales while net profits on the other hand are the excess of Gross profit overall expenditure, which accrues directly or indirectly to the income of equity stockholders, therefore it is an increase in the wealth of the equity shareholders. [Staubus \(1959\)](#) contracted the concept of owners/proprietors to ordinary equity shareholders, while preferred ordinary or preference shareholders are considered as liability shareholders and that distinguishes the two is very important in the estimation of the firm future solvency. To this end, the accounting expressions is modified as:

- 2) Residual Equity = Total Assets – Total liabilities & Specific Equities (Liabilities + Preferred Stock)

The proprietary and prospective equity model assumption is a principal and agent relationship theory assumption that the main responsibility of the enterprise agent/management is to organize the firm accounting process and procedure in the best interests of the proprietors/owners ([Nkuhi, 2015](#)). Furthermore, beneath both the proprietary and prospective theories and approaches to income valuation, equity shareholders' interests must be carefully distinguished from the interests of the debts' providers. The approach will enable the measurement of the increase in net assets.

DuPont mean-variance of portfolio investment theory

[Adebimpe \(2009\)](#) espoused the DuPont equation in his research work and concluded that the DuPont equation is an equality expression that splits return on equity (ROE) into three categories. DuPont mean-variance originated from the DuPont Corporation, DuPont Corporation designed and practiced this mean-variance formula into its enterprise's transformation in the years 1920s. However, the DuPont mean-variance theory of DuPont Corporation was adapted from Markowitz's Mean-Variance Portfolio, the theory postulated that the profit or loss of a firm is a mapping of turnover, fixed & current assets, shareholder funds (equity), and total liabilities (debts). This model is also referring to has Strategic profit model; DuPont identity model; the DuPont method/model or the DuPont analysis. Under DuPont analysis, ROE is equal to the profit margin multiplied by asset turnover multiplied by financial leverage. Nonetheless splitting ROE (return on equity) into three parts, enable firms to easily understand changes in their ROE over time. The components of the DuPont Equation are Profit Margin, Asset Turnover, and Financial Leverage.

The profitability and efficiency of firms are measured by profit margin. A firm's profit margin depicts the efficiency of a firm's pricing policy and how well the firm commands its operating costs and expenses. To derive the firm's profit margin the proportion of net profit is taken as a percentage of the total revenue. The attribute of the DuPont equation is that the higher the profit margin the higher the profit generated from every sale making the firm more solvency and resulting in a higher overall ROE.

To determine how the firm proficiently make uses its assets to generate turnover or sales income for the firm, the asset turnover ratio is applied. This financial ratio is another constituent of the DuPont equation but slightly differs from the profit margin assumption because, firms that recorded low-profit margins tend to experience high asset turnover, while those with high profit margins tend to record low asset turnover. However, similar to profit margin, if asset turnover rises, a firm will generate more turnover per asset owned making the firm more solvency and once again resulting in a higher overall ROE.

Financial leverage is another component of the DuPont equation that is used in calculating the proportion of the total (liabilities) debt that a firm utilizes in financing its business operations, as compared with the amount of owner's equity that the firm utilizes. Similar to the case of asset turnover and profit margin rise in leverage (debt) will also lead to a higher overall ROE. Simply because, an increase in the use of debt as a means of financing though will make the firm have a higher interest obligation to meet, however, those interests are tax-deductible, while dividend

payments are not tax-deductible. Therefore maintaining a high percentage of debt in a firm's capital structure leads to a higher ROE.

Decision making

This is a complex, cognitive intellectual way of making choices out of identifying alternatives, which outcome might produce an action, an opinion, or a recommendation. The act of remaining neutral or doing nothing is normally amidst the set of alternatives that one selected from a set of identifies alternatives and selecting that choice is the outcome of a decision. [Omodero \(2019\)](#) debated that, the most important financial information needed in the process of investment decision comes from FSs. Financial information analysts desire to analyze and evaluate firms earning capability make future projections and make comparisons. Furthermore, the financial information derived from FS will as well aid in the firm's economic activities, investment, and financing decision-making process. Analyzing an investment and making a decision thereafter has to do with an efficient allocation of financial resources and the structure of firm capital ([Pandeg, 2005](#)). It also involves the choice of allocating the firm's financial resources to the procurement of long-term fixed assets and servicing long-term leverages. Making such decisions are valuable choices and are important to the value of the firm since a firm tends to determine its value size by influencing its growth, profitability index and stability. The financial information of an enterprise required for making the decision is contained in the FS.

Financial Statements (FSs)

Records of financial transactions, events, and performances of an enterprise serve as a yardstick for making choices from a set of identified alternatives if the decisions are to be realistic. The FSs disclosed vital information concerning past and recent financial activities, outcomes of management activities on the profitability of the firm, and the firm's financial status. Diverse users of FSs such as proprietors/owners, local and foreign investors, trade creditors, lending house management, etc., need to analyze FSs to make appropriate choices. According to [Ige and Adewumi \(2020\)](#), the micro determinants of firms' profitability are entrenched in the FS, therefore, FSs is the wherewithal of conveying to interested users both insiders and outsiders of the firm, a succinct reality of the profitability index and financial status of the firm. FSs is the summary report of the firm's financial transactions, status, and accounting procedures for twelve months accounting period which provides succinct financial transactions of the period after the financial year is concluded. FSs provide the statement disclosing profit or loss for the period covered and the statement of the financial position of a firm at the same period. FSs are the financial year-end accounts records prepared to convey the profit or loss, the financial status, and cash flow position of the firm on a particular date. Data provided by FSs convey the past and current financial activities of the firm.

A financial statement (FS) according to [Mercy \(2014\)](#) can be described as a computation statement that reviews periodically the financial health of a firm for a disclosed period. Included in FS is a statement of income portraying the profit or loss and its appropriation including retained profit transfer to revenue reserve, a cash flow statement showing the flow of liquidity, and a balance sheet that discloses the financial status of the firm. Academic of organization Dictionary also described FS as a document that disclosed the equity, assets, liability, income, and expenses of a firm to allow the interested party to evaluate the firm's financial health.

Features of Financial Statements (FSs)

- a) FSs of an enterprise should be prepared in such a way that comparison could be made with the other firms' FSs in the same industry or with past FSs of the same firm.
- b) FSs are those statements that disclose historic data, meaning that FSs disclose transaction that has already happened, however, they do not reveal anything about the future.
- c) FSs do not reveal qualitative factors such as the satisfactory level of the firm's workers or no financial contributions of the proprietor of the enterprise etcetera. Such factors are not included in the FSs.

- d) FSs are explicitly in monetary value, incomes and appropriation statement show the profitability of the enterprises, the statement of an affair or the statement of financial condition reveal the financial health of the enterprise and the statement of fund flow or cash flow display the cash position or solvency of the enterprises.
- e) FSs should reveal all financial transactions within the stated period and is not expected to conceal any information which materially capable to alters the decision of the users who are reading that FS for deciding on the firm. For example, prospective shareholders looked at FSs before deciding on an investment opportunity.

Objectives of Financial Statements (FSs)

The FSs of a firm or an enterprise are the outcomes of management activities. Information reveals in the FSs is the result of the accounting process and procedures. FSs depict the solvency and how profit-wise a firm is to the public. The primary goals of the FSs are as follows:

- a) To furnish the general public with the required financial information about the firm.
- b) To generate useful information for the process of making financial choices.
- c) To disclose the profitability, stability, solvency etcetera of the firm.
- d) To aid in evaluating management efficiency and firm financial health

Distinctive of Financial Statements (FSs)

- a) Pertinence: The information generated from FSs must be pertinent to the desire of the users. This may entail reporting particularly pertinent information or information whose omission or misstatement could influence the economic decisions of users.
- b) Dependability: The information reveals in the FS needs to be substantive error and prejudice-free, and must not be a piece of misleading information. Thus, it has to reliably portray financial transactions and other financial engagement, and prudently present investment projections, estimates, and uncertainties through proper revelation.
- c) Equivalence: The information must be comparable to the financial information disclosed for similar accounting periods, this will enable the users to identify trends in the performance and financial position of the reporting firm.
- d) Comprehend potentiality: The information disclosed needs to be easily comprehensible to users of the FSs. An indication that information needs to be presented together with further information to be provided in the supporting footnotes that will aid in unbundling some facts and figures.

Financial Statement Analysis (FSA)

Both external and internal users of FSs will get further insight into the financial SWOT (strengths, weaknesses, opportunities, and threats) of the firm if the information disclosed in the FSs is properly analyzed. To this end, financial statement analysis (FSA) is the task or set of the program of identifying the financial SWOT of a firm through establishing relationships between the items depicted in the FSs, [Francis and Schipper \(1999\)](#) argued that to enhance the acceptance and promote the usage of financial data extracted from FSs in the purpose of decision-making procedure, FSA of those data in the FSs presented should be done. From that point of view, the FSA can be depicted as the procedure/process where financial facts and figures transform from FSs into usable information for a firm's quality measurement and evaluation by using a series of analytical tools and techniques. The task of FSA to a great extent vital in the process of rational administration and business management. To this end, knowing the prevailing level of business entity status, value and financial health is an important instrument in the context of future firm management and stakeholders, because the management of every enterprise tries to ensure the relevance and existence of the firm in the market environment. Furthermore, FSA comes before the management planning process which is the component of the management process.

Financial planning is very vital for good investment management. A good financial plan has to reflect on all the firm's SWOT. The task of FSA is to recognize the strength and opportunities of a firm, so that management could use most of those strengths and opportunities for the firm's financial planning, similarly the firm's weaknesses and threats were also recognized to take corrective measures. To that

end, we can say that firm's management is the most significant user of FSA. In carrying out FSA on FS presented, it is feasible to use a series of methods, instruments & procedures. For instance, the horizontal analysis model is used when considering comparative FSs, and then use the vertical analysis model for structural FSs. The horizontal analysis that forms based form comparative FSs, tries to observe the trend and dynamics of changes in specific basic FSs positions. The firm effectiveness, efficiency, and security are appraised based on observed changes. The foundation for vertical analysis on the other hand is the structural FSs which allows insight into FSs structure. FSs structure is very noteworthy in the context of firm financial stability and firm value, however, FSs which does not depict the accurate financial condition of a firm is capable of misleading investors in making funding decision ([Sanyaolu, Odunayo, Akintan & Ogunmefun 2020](#)).

Internal users

Individuals who have a direct bearing on the business of the firm are referred to as internal users. Categories of internal users are as follows:

- a) Agent and proprietors: The managers who manage the affairs of the firm and the proprietors who are the owners and equity contributors of the needed financial reports essential to make financial and economic decisions. In the process of formulating contractual terms and agreements between the firm and other organizations FS is used by managers and owners. The outcome from FSA like the current or working capital ratio which is the proportion of current assets to current liabilities is very significant in deciding the ability of the firm to meet its short-term obligations, as they fall due out of its short-term assets. The FSs of other firms in the same business environment and industry can also project investment solutions to different firms in the industry. In some instances, deciding on the right investment to which scarce resources may be a channel can be difficult. In a situation like this, the FSs of other firms provide felicitous guidelines.
- b) Employees: The outcome from FSA that was derived from FSs is of immense importance to the workers of the firm for making a contractual agreement. Matters relating to workers' salary increases and other remuneration packages, welfare, promotion, and ranking are discussed with the aid of information derived from the FSA.

External users

These categories of users comprise:

- a) Potential Investors: This categories of external users make use of FSA outcomes to appraise the financial SWOT of a firm. FSA aid these categories to make reasonable funding or investment decisions.
- b) Government/Regulatory Agency: The FSs of different firms are also used by the government agency like the Board of Inland Revenue to scrutinize whether the breakdown of company tax paid by those firms is precise and is in line with the financial status of the firms.
- c) Lend house/Financial Institutions: Other categories of users of FSs for FSA are different financial institutions like banks insurance and other lending institutions who decide whether to provide the firm with working capital, debenture, or to issue other bonds security to it.
- d) Creditors: The creditors who intend to provide credit facilities to the firm require FSs to assess the creditworthiness of the firm ([Jennins, 2004](#)).

Financial Statement Components

Cash Flow Statement (CFS): In making investment decisions, the statement of cash flows also refers to as the statement of fund flows also figure out useful information. It shows the solvency and the net change in the firm's liquidity status during a particular period. Stable or growing cash flow portrays that the firm is solvency and can cover its short-term debt payments and expenses on demand and also keep up with any long-term debt obligations. The structure of the cash flow also discloses how much cash is generated from operating activities when compared with the financing and investments resource. A situation where cash from the operating profit routine outweighs net income is a good solvency situation for the firm. Normally, an effective liquidity status of a firm is pleasing in investment because it shows the relative amount of assets in cash or which can be quickly converted into cash, available to meet short-term liabilities. Effective liquidity is an indication that the firm is

less at risk of loan defaults or bankruptcy. Liquid assets consist of cash and bank balance, debtors, and marketable securities.

Statement of Comprehensive Income (SCI): The statement of comprehensive income is often known as the statement of profit and loss. This statement disclosed the profit or loss a firm has earned during a given accounting period. The statement contained financial data for gross profit calculation, operating and non-operating income data, and other special sources of revenue and expense data. Calculation of gross profit is based on the difference between total revenue and the total cost of making the commodities or render services that a firm trade often known as the cost of goods sold. SCI discloses the overall profitability of the firm and how efficiently the firm generates profit from its trading activities. Net profit or operating profit on the other hand reflects many other operating costs and expenses in the computations together with the cost of commodities sold, like depreciation on machinery and equipment and other overhead expenses. This is necessary for evaluating the real profitability of the firm, particularly when compared to the firm SCI for the preceding periods or to the SCI of other firms in the same industries and business environment. An increase in operating profit is a good sign of the firm profitability and relevance.

Statements of Financial Position (SFP): This component of FS also known as the balance sheet is prepared under the basic accounting equation (Total assets represent the total owners' equity and the total liabilities). The difference between the value of a firm's total assets and the total liabilities is referred to as the equity or net worth of the firm. If the owners' equity is higher when expressed as a proportion of total assets, and compared with preceding records with other firms in the same industry. A firm with a high net worth may indicate that the firm is relatively leverage-free and also the degree to which unsecured creditors are protected against loss in the event of liquidation of the firm can be computed from the SFP.

Statement of Owners' Equity (SOE): This statement isolates the owner's equity section of the balance sheet. The primary purpose of SOE is to disclose firm potentiality and actual growth, as also the trend in retained earnings and reserves for the firm. Accumulated profits not paid out in dividends constitute the retained earnings and reserves. The data provided in the SOE is useful in earnings management and other investment-related decisions because the higher revenue reserve and the retained earnings of the current accounting year ending compared to currently proposed dividends, the lower the dividend income received. This can be translated that the firm holding onto its revenue reserve and profit for reinvestment instead of paying it out as they were earned.

Notes on the accounts: Series of supplemental notes that are included in the published the FSs of firms are referred to as Noted on the accounts. The notes are numbers, and they disclose further, the detailed assumptions made by the management when preparing the firm's FSs. The numbers are important and they should not be underestimated when analyzing FS data. Information in the FSs is incomplete if there are no Notes on the account, therefore investors who depend solely on the monetary values disclosed on the FS and pay no attention to the notes are likely to find themselves deluded.

Statement of Accounting Policies (SAP): This component consists of unique cooperative governance policies and procedures adopted by a firm in compiling its FSs. These incorporate any frameworks, techniques, methods, measurements, and strategies for divulgences and presentation. These is varying from accounting standards in that the standard is the principle while the approaches are a firm's methods of holding fast to the guidelines.

The function of statutory auditors has become increasingly crucial ever since auditing of FSs was first made mandatory under CAMA 2004 (The Nigeria Companies and Allied matters Act as amended). Like wisely, the director's report should not be underestimated, the director's report depicted certain genuine information that identifies with the year under the survey which is mandatory by law to be disclosed. Furthermore, the value-added statement (VAS) is another important component of FS, its relevance depends upon its value to potential users. [Akinsonyime \(1990\)](#) says that information in the

value-added statements (VASS) is vital information that provides a sound base to a viable and more practical and realistic decision-making process.

Financial Statement Analysis (FSA) in Investment Decision

Investment analysis and decisions focus on the structure and an efficient allocation of financial resources ([Pandeg, 2005](#)). An FS aims to provide financial information about a firm to interested stakeholders for efficient allocation of the firm's financial and economic resources. The investigation, analysis, and understanding of FS and decision-making thereafter unveil the significant features of FSs as the significant possessor of financial information essential for any venture or funding choices. Therefore, the information provided by the FS can only become valuable with the aid of financial interpretations obtained from the analysis of the FS.

The major tool for analyzing FSs to make investment or funding decisions is ratio analysis (RA). Ratio analysis in this context refers to as Financial Ratio Analysis (FRA), is the judgmental procedure that was intended to assess the current and past financial condition and the status of a firm with the primary aim of discovering the best feasible prediction. [Elliot and Elliot \(2004\)](#) stated that FRA established a quick diagnostic expression of a firm's financial condition and triggers off subsequent investment, financial, and performance analysis. However, data and figures that are utilized in the FRA are being generated from the financial statements (FS) which thusly inspire our funding, financial performance, and investment decisions.

Financial Ratio Analysis (FRA) according to [Gavtan \(2005\)](#) is a procedure for determining and interpreting the relationship between the data generated in the FS to build up a valuable comprehension of the productivity, liquidity, dissolvability, and profitability of a firm. Moreover, for the ratio to be relevant and a guide for investment decisions, it has to be compared with preceding accounting periods of the firm to show the patterns or contrasted and comparable firms in the industry to ascertain its SWOT. Ideally, a comparison has to be made within the industrial average. With the aid of FSA, the management of the firm gets familiarized with the firm's operational standards.

According to [Bragg \(2012\)](#), in the context of computing and evaluating business operational standards based on FSs, the most noteworthy FRA derived from basic FSs should be used, they are divided into five fundamental categories, and these are as follows:

- a) Short-term Solvency and Liquidity Ratio: The solvency ratio measures the ability of the firm to provide for its rippling short-term (current) obligations or liabilities as at when due.
- b) Long-term Solvency and Stability Ratio: This ratio measures the capital structure of the firm, which is the extent of the obligation to value in the financing of the firm's assets.
- c) Efficiency Ratio (ER): The efficiency Ratio indicates the overall profitability of the investment, it measures how productively and viably the firm's management is using its scant financial and economic resources. The overall effectiveness is depicted by the profit/benefit created by turnovers and investment.
- d) Potential and Actual Growth Ratio: This ratio indicates potential returns of investment, it estimates the firm's potential to keep up with its financial and economic status in the development of the economy and business climate ([Ratu & Yoga 2021](#)).
- e) Performance Ratio (PR): The performance ratio is the most complete evaluation of a firm's performance, this ratio mirrors the danger and returns ratio. PRs are vital in FRA since they are connected straightforwardly to the objective of a firm's value expansion and shareholders' wealth. The list of ratios is not exhaustive here, however, the types of FRA to be used need to be tailored to the ideal nature of the problem, which it is expected to help in answering.

Empirical literature review

[Otley \(2012\)](#) proclaims that FS is an important part of the firms' framework and needed to be judged, analysis and interpreted in their wider managerial, entity and environmental context. [Otley \(2012\)](#)

argues further that the effectiveness of an FS doesn't just rely upon the objectives of such a firm, it additionally relies upon the possible elements of each firm. When the information generated and depicted by FS widely meets the requirements of users, such FS is said to be effective. Effective FS should consistently depict information that has a prospective effect on investment, financial, and management decision-making by the management and potential & prospective investors. The above finding from previous pieces of literature has demonstrated clearly that FSs play a prime role in funding or investment decision-making. However, they abstain from demonstrating how prospective investors will concentrate, analyze, and comprehend the information contained in FS for an appropriate funding choice.

[Mercy \(2014\)](#) argues that FSs are practically important for forecasting a firm's performance. They made the conclusion based on findings that FSs play a vital role in funding decision-making and recommend that the firm's FS should be strongly considered before any funding or financial decision would be taken.

[Adebayo, Idowo, Yusuf, and Bolarinwa \(2013\)](#) look into the significance of accounting information provided in FS in aiding the firms in making sound and productive financial, economic, or funding decisions. The paramount wellspring of data for their study was primary data through the administration of questionnaires. Regression was analyzed and Karl pear son's correlation was utilized for data analysis. Their discoveries show that accounting information in the firms' FS is an exceptional tool in business management choice-making in today's unrest business environment. However, they advised firms' stakeholders to put resources in information technology (IT) tools to improve their productivity, viability, and their general business execution.

Conceptual Frame Work (CFW)

A conceptual framework (CRW) is described as an analytical tool that is used to get the comprehensive meaning of a concept that the researcher will use to understand and realize his study goals. The figure below illustrates the frame of reference that guides funding decisions. Thus, FSs do sway greatly in funding or investment decisions by informing stockholders or investors regarding the investment opportunities, firm's financial status, and firm's efficiency and performance.

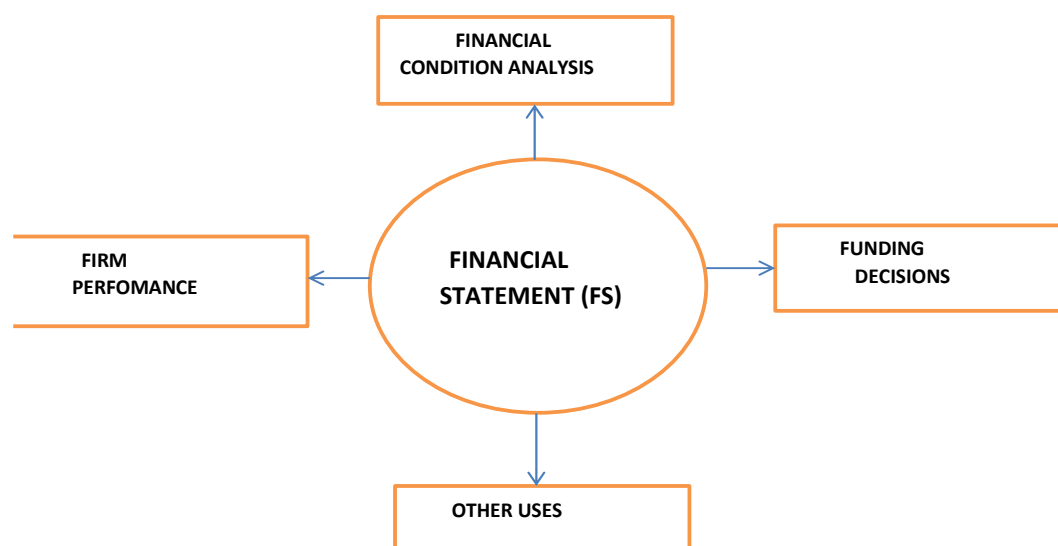


Figure 1. Illustration of the Conceptual Framework

The CFWs above illustrate literarily the major parts of how the research will depict the role of FSs in investment/venture decision-making. Venture decisions to accept or reject a project are made from FRA by looking at the information provided in the FSs that help in the computation of the net present values of a project and other profitability indexes. This is made possible because, from the FS we can

be able to calculate the firm's financial status, investment profitability prediction, firm's performance and also understand the firm's financial condition as far as asset and liability differentiation from the preceding FS of a similar accounting period.

Another important aspects of the conceptual framework are Investment profitability projects. From the analysis of the FSs, the firm's stakeholders or potential investors can choose which investment opportunities to target since FSs depict distinctly the drift of performance of investment projects. Furthermore, FSs dictate the capital structure and mode of funding that should be adopted by a firm to arrive at an optimal capital structure. When FSs are analyzed, the firm's capital structure can be determined and thereafter ascertain the funding options in the pursuit of identifying financing alternatives. This is the basis of obtaining the firm's financial position which is depicted by the firm's FSs.

Finally, FSs information has various figures and facts that if properly analyzed can influence a firm's financial performance through timely and objective investment decisions. Capital and financial market information depicted in the FS can lead to trends in the value of stock market variables and economic growth index and also greatly influence funding or investment decisions. This is because such information established through FSs depicts the performance of the firm and its value in the stock market.

3. Research methodology

The research method adopted for this project is quantitative, as quantitative research methodology seeks to quantify the data, and typically, applies a form of statistical analysis ([Malhotra, 2007](#)). Thus, the Financial Statement Analysis was applied since the study is to examine the role of financial statement analysis as a tool for evaluating the performance of companies and investment decisions. The information regarding the individual firm's income statement, cash-flow statement, and balance sheet was obtained through the firms' annual report, the Nigeria Stock Exchange factbook, and the handbook of the Nigeria Stock Exchange.

Research design

A research design/method is simply the structure, framework, or plan for the study, which is used as the modus operandi for collecting appropriate records and data. In this study, the financial ratio analysis method is espoused with particular concentration on the financial statement data. This is preferred to others given the identity of the study, concerning the effect of FSA and its interpretation as a tool for funding, investment, and management decisions and also firm's performance evaluation.

Sources and method of data collection

The leading sources and methods of data collection used in the study are secondary sources. This includes Nestlé Nigeria plc Annual Reports, textbooks, journals, and experts' schools of thought on the subject. The secondary source provides the theoretical structure and analysis data for the study.

Research instrument

A research instrument is a measuring device constructed for the recording of measuring data. It is the means for generating appropriate information to be used for solving the research questions and issues ([Olakunori, 1997](#)) to this end, in order to obtain valuable records and data for analysis, interpretation, and answering research questions raised at the introduction of this study, data related to the information needed for series of financial ratio analyzes were extracted from Nestlé Nigeria plc annual report from 2014 to 2019.

4. Results and discussion

Method of data analysis

Descriptive statistical analytical tools (Tables and figures) were used in preparing and analyzing the data generated for this study.

Financial ratio (business ratios) analysis method

To assist these various groups, creditors, bankers, investors and management, and to facilitate financial control, a Financial Ratio Analysis of the organization's financial records is required. Usually, this consist of determining groups of specific ratios from selected items of the balance sheet and profit and loss account for several consecutive years. In this manner, trends are ascertained and it may even be possible through the introduction of additional data to make comparisons with external industry standards and with the internal goals and budgets of the organization.

In most circumstances, if the analyst is to gain a complete picture of the financial condition of the firm, he must know the characteristics of the business, its seasonality and trade customs and in addition, he must utilize several different ratios. Moreover, if the data are to be fully comparable the term must be adequately defined.

Classification of financial ratios used in this study:

- 1) Potential, Actual Growth and Profitability Ratios.
- 2) Efficiency and Activity Ratios.
- 3) Long term Solvency, Stability Leverage Ratios.
- 4) Short-term Solvency and Liquidity Ratios.

Potential, Actual Growth and Profitability Ratios:

- a) Gross Profit Margin = Gross Profit / Sales
- b) Net profit margin = Profit After Tax / Sales
- c) Return on Capital Employed (ROCE) = Profit Before Tax / Capital employed
- d) Return on Equity (ROE) = Profit After Tax / Equity
- e) Earnings Per Share

Efficiency and Activity Ratios:

- a) Debtors Turnover = Sales / Debtors
- b) Current Assets turnover = Sales / Current Assets
- c) Total Assets Turnover: = Sales / Total Assets

Long term Solvency, Stability Leverage Ratios

- a) Debt Ratio = Total Debt (TD) / Total Assets (TA)
- b) Debt –Equity Ratio = Total debt / Equity

Short-term Solvency and Liquidity Ratios

- a) Current ratio = Current Assets / Current liabilities
- b) Quick Ratio = Current Assets – (Inventories + Prepaid) / Current liabilities

For quantitative data analysis in social science, the appropriate analytical tools rely upon the kind of estimation scales utilized and the variables being scrutinized ([Kothari, 2004](#)). The study stockpiled data that can be used for Financial Ratio Analysis (FRA) from the firm's FS.

Data generated will be analyzed and interpreted using FRA which involves a comparison of one figure against another to show the relationship between the firm's operation results. FRA is useful in the determination of the following:

- 1) The efficiency with which the company is utilizing its various assets in generating sales revenue.
- 2) The overall operating efficiency and performance of the company.
- 3) Company's ability to meet its current obligations.
- 4) The extent to which the company has used its long-term solvency by borrowing funds.

To enhance good understanding, easy appreciation, and interpretation of accounts, the ratios analysis will be grouped into four categories namely:

- 1) Efficiency and profitability
- 2) Potential and growth
- 3) Short-term solvency and liquidity
- 4) Long-term solvency and liquidity

Table 1. Data Extracted

S/N	Particulars	2019	2018	2017	2016	2015	2014
1	Sales	284,035,255	226,274,621	244,151,411	181,910,977	151,271,526	143,328,987
2	Gross Profit	128146782	113,920,176	100,871,151	75,327,592	67,345,569	61,229,931
3	Profit/Loss Before Tax	71123824	59,750,846	46,828,682	21,548,408	29,322,477	24,445,978
4	Profit/Loss After Tax	45683113	43,008,026	33,723,730	7,924,968	23,736,777	22,235,640
5	EPS	57.63	54.26	42.55	10.00	29.95	28.05
6	Trade and other receivable	65820188	42,175,062	31,430,450	24,035,411	24,445,995	22,330,813
7	Current Assets	107037314	82,734,317	72,270,783	97,736,155	48,714,656	37,389,330
8	Total Asset	193374314	162,334,422	146,804,128	169,585,932	119,215,053	106,062,067
9	Share Capital Employed	396,328	396,328	396,328	396,328	396,328	396,328
9	Equity	45557630	50,220,486	44,878,177	30,878,075	38,007,074	35,939,643
10	Current Liability	125535430	92,117,501	79,680,495	121,033,434	59,731,857	44,638,052
11	Total Liability	147816685	112,113,936	101,925,951	138,707,857	81,207,979	70,122,424

Source: Nestlé Nigeria plc annual report from 2014 to 2019

Table 2. Descriptive Analysis

	Range	Minimum	Maximum	Mean	Std. Deviation
Sales	140706268.00	143328987.00	284035255.00	205162129.5000	55596802.14717
Gross profit	66916851.00	61229931.00	128146782.00	91140200.1667	27180702.90882
PBT	49575416.00	21548408.00	71123824.00	42170035.8333	20364494.82788
PAT	37758145.00	7924968.00	45683113.00	29385375.6667	14237897.64559
EPS	47.63	10.00	57.63	37.0733	17.96151
Debtors	43489375.00	22330813.00	65820188.00	35039653.1667	16770302.85201
Inventories	22464984.00	10813960.00	33278944.00	20453497.8333	8564229.95514
Current Assets	69647984.00	37389330.00	107037314.00	74313759.1667	27251593.58851
Total Assets	87312247.00	106062067.00	193374314.00	149562652.6667	32571148.86877
Capital Employed	.00	396328.00	396328.00	396328.0000	.00000
Equity	19342411.00	30878075.00	50220486.00	40913514.1667	7180569.83887
Current Liability	80597378.00	44638052.00	125235430.00	87072797.8333	32366773.67076
Total Liability	77694261.00	70122424.00	147816685.00	108649138.6667	30764116.41324

Source: SPSS data computation from data extracted

Potential, Actual Growth, and Profitability Ratios

To measure the potential, actual growth, and profitability of the company:

1. Gross Profit Margin: It indicates the average spread between the cost of goods sold and the sales revenue.
2. Net Profit Margin: This ratio indicates management's efficiency in manufacturing, administering, and selling of products.
3. Return on Capital Employed (ROCE): ROCE designates the firm's earning power.
4. Return on Equity: ROE on the other hand indicates how well the firm has used the resources of its owners.
5. Earnings Per Share

Table 3. Potential, Actual Growth and Profitability Ratios

	Gross Profit Margin	Net Profit Margin	ROCE	ROE	EPS
2014	0.43	0.16	61.68	0.62	28.05
2015	0.45	0.16	73.99	0.62	29.95
2016	0.41	0.04	54.37	0.26	10
2017	0.41	0.14	118.16	0.75	42.55
2018	0.50	0.19	150.76	0.86	54.26
2019	0.45	0.16	179.46	1.00	57.63
Min	0.41	0.04	54.37	0.26	10.00
Max	0.50	0.19	179.46	1.00	57.63
Average	0.44	0.14	106.40	0.69	37.07

Source: Processed data

These ratios convey how well Nestlé Nigeria plc generate profit from its operations between 2014 to 2019

Efficiency and Activity Ratios:

To measure the Efficiency and Activity Ratios of the company:

1. Debtor (Account Receivable) Turnover: It specifies the number of times debtors turnover within an accounting period.
2. Total and Current Assets Turnover: It measures the preparedness of the firm to efficiently make use of its total and current assets discretely.

Table 4. Efficiency and Activity Ratios

	Debtor Turnover	Current Asset Turnover	Total Asset Turnover
2014	6.42	3.83	1.35
2015	6.19	3.11	1.27
2016	7.57	1.86	1.07
2017	7.77	3.38	1.66
2018	5.37	2.73	1.39
2019	4.32	2.65	1.47
Min	4.32	1.86	1.07
Max	7.77	3.83	1.66
Average	6.27	2.93	1.37

Source: Processed data

How Efficiently Nestlé Nigeria plc used its assets and liabilities to generate sales and maximize profit during the accounting periods 2014 to 2019 is shown in Table 4

Long-term Solvency, Stability Leverage Ratios

To measure Long term Solvency and Stability Leverage of the company:

1. Debt Ratio: This ratio is used to compute the proportion of the firm's total assets which are financed by both long and short-term debt. It is calculated as Total Debt (TD) / Total Assets (TA).
2. Debt – Equity Ratio: DER on the other hand is used to compute the direct proportion of debt to owners' equity. It is indirectly computed by dividing total debt by net worth. That is total debt/equity. Debt –Equity Ratio = Total debt / Equity.

Table 5. Long-term Solvency, Stability Leverage Ratios

	Debt- Equity	Debt Ratio
2014	1.95	0.66
2015	2.14	0.68
2016	4.49	0.82
2017	2.27	0.69
2018	2.23	0.69
2019	3.24	0.76
Min	1.95	0.66
Max	4.49	0.82
Average	2.72	0.72

Source: Processed data

These ratios measure how well Nestlé Nigeria plc used long-term debt during the study period

Short-term Solvency and Liquidity Ratios

To measure the short-term solvency of the company;

Current ratio = Current Assets / Current liabilities

Quick Ratio = Current Assets – (Inventories + Prepaid) / Current liabilities

Table 6. Short-term Solvency and Liquidity Ratios

	Current Ratio	Quick Ratio
2014	0.84	0.59
2015	0.82	0.63
2016	0.81	0.64
2017	0.91	0.61
2018	0.90	0.65
2019	0.85	0.59
Min	0.81	0.59
Max	0.91	0.65
Average	0.85	0.62

Source: Processed data

The ratio tells us Nestlé Nigeria plc's ability to meet its short-term financial obligations.

Findings

All the financial data used in the computation of the ratio analysis above were derived from the financial statement of Nestlé Nigeria plc annual report from 2014 to 2019, which confirms the argument of [Omodero \(2019\)](#) that, the most important financial information needed in the process of investment decision comes from FSs. Similarly, [Ige and Adewumi \(2020\)](#), argue that the micro determinants of firms' profitability are entrenched in the FS, which were also ascertained in this analysis. Using FSs, periodical reviews of the firm's financial health were also described here is in line with [Mercy's \(2014\)](#) argument A financial statement (FS) according can be described as a computation statement that reviews periodically the financial health of a firm for a disclosed period. Therefore, the finding concluded that FSs are documents that disclosed the equity, assets, liability, income, and expenses of a firm to allow the interested party to evaluate the firm's financial health, firm's economic activities, investment, and financing decision-making process.

5. Conclusion

The role of FSs in making choices from a set of identified investment or funding alternatives seems to be ideally censorious even so dependent on a few situations. This study has debated whether potential investment stakeholders are confident about FSs in funding or investment decision making. This is

largely for the fact that it was established that in general, the FSs are adequate for effective funding or investment decision-making. Expressly, the key variables referenced to aid investment decision-making included; Efficiency and profitability ratio, Potential and growth ratio, Short-term solvency and liquidity ratio, and Long-term solvency and liquidity ratio.

Recommendations

From the findings of this research work as presented, analyzed, and interpreted, the following recommendations were considered imperative by the researcher:

- 1) There should be a sufficient period for the collection of FSs data and preparation for their analysis.
- 2) FSs should be accurately and adequately explicated and should be made to reflect contemporary accounting and transaction costs to reduce the adverse consequences of the historical cost principle on FS's decisions.
- 3) The consequence of inflation on FSs results ought to be observed to reduce the inflation risk.
- 4) The adequacy of financial information should be accentuated, as it will give enough fundamental subtleties for investment speculation and management choice.
- 5) A mixture of non-identical ratios ought to be used to analyze a firm's financial and/or operating performance.
- 6) Lastly, the stakeholders of the selected firm should make proper use of FSA in other decision areas of the firm's administration and management not only in the funding or investment decision.

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