The Relevance of Measuring Performance Using Financial Statements

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Abstract: When we evaluate the performance of companies that seek ways to measure the financial and economic aspects of decisions relating to investments, operations and finance. Our approach proposes an analysis of financial performance based on the financial summary. These are the most accessible source of data, although not the most "economic" way of presenting such data. We present also, and most important metrics that can contribute to financial performance. As we will see, there is a wide variety of solutions, and measurements of individual reports, some other purely financial and economic content. No indicator or measure will be considered predominant. We will focus on relationships and indicators, which allow measurement of past performance and estimating future performance, we emphasize the significance, and inherent limitations.

Keywords: performance measurement, indicators, financial statements, profitability

1 Introduction

Recent years are marked by the appearance of numerous concepts regarding definition, classification and highlighting ways of enhancing performance in an organization.

Enterprises increasingly emphasizes the importance of their relationship with external partners, customers, investors, the foundation of their success in business.

The way in which a company measures the financial performance affects the financial decisions of users (shareholders, managers, creditors). Performance indicators should serve to assessing the economic value of creating value and future earnings potential. Financial statement can contribute to more effective communication of opportunities and challenges of economic, environmental and social facing enterprise than simply reply to requests for information of interested partners. These goals are in line with the IASB approach to guide decisions in normalization.

Thus, it creates a bridge between financial statement and economic interpretation in terms of enterprise performance.

Why is the studied matter important?

Because there are many tools for measuring performance, we should note that different techniques often lead to very stringent assessment and as narrow a definition. Our system of evaluation and measurement of crumbling under the burden of rigidity, lack of relevance and reliability. But, surprisingly, conservative accounting is the first wake.

Methodological arsenal or be adopted to new requirements. Near them, or even at confluence, the imperatives of financial performance on an updated name.

Specialists in the field give their account of the crucial moment of the start and to put question (question we put them us): if company resources are used efficiently, if the profitability of the business is expected and if the financing options are chosen properly and prudently?

As we will see, there are a variety of solutions for individual measurements and reporting, some purely financial, while more economic content.

In this context, we believe that performance measurement and reporting of both the past and of the anticipated method of management is essential in today's interconnected world, "the world news 24 hours" in which it circulates with a maximum speed.

Based on the hypothesis according the which the interests of measuring performance, selected references, measuring instruments are located in close connection with the objectives of the company and its partners, we chose to build the discussion around the most important categories of users: managers, shareholders (investors) and creditors, and the way in which they are interested in business success, each from a particular point of view.

Our study result from a review of literature on the topic raised. This review has helped us to structure elements relating to: the way in which a performance measure, the selection of indicators of financial performance, performance evaluation based on the financial decisions of users of financial information.

Efforts conducted under the current trends and analysis of literature suggests that performance is a concept used in theoretical approaches and also a permanent concern in business practice; it is influenced by the economic and political modes of governance of an enterprise.

Perception is different depending on the specific interests of each user of financial accounting information, but also represents a direction of priority for international normalized accountants.

Currently, financial performance of companies know a degree of complexity, and for defining the content, you have to consider several sides of an enterprise activity.

In this context, we thought we build our vision of the three categories of users mentioned above, along with the most commonly used methods of measuring performance.

2 Literature review

An enterprise is a dynamic environment, which has as its principal objective of adding value. But it urges the study of performance through the effective management of resources.

You can approach this without a thought to have managed without enough to know the company, its structure and strategies.

In this sense, to develop this material were required to use the knowledge of accounting related areas such as economic and financial analysis, management and finance. Also, the materials studied in the literature, we have helped to structure the information required to prepare this article.

They relate mainly to those aspects of performance measurement and analysis that are subject to debate and approaches for which no set answer or solution to be accepted by scientific community or practice.

An analysis of the relevant subject (and also an interesting source of inspiration for us) was made by Stefan Bunea (2006) in "Monocromie si policromie in proiectarea politicilor contabile ale intreprinderilor" who will express their views on assessment relevant financial performance of enterprises.

View is that " *how a company measures the financial performance, affect the financial decisions of users the financial statements of users (shareholders, members of the administration, financial managers, or creditors) and the effectiveness of management systems influenced by the selection of performance indicators"* (S.Bunea, 2006, p.191).

Another source of inspiration for us was a work of Erich A. Helfert (2006) *"Tehnici de analiza financiara"* where, during a whole chapter done a comprehensive analysis of company performance. Presenting the most important categories of users of financial accounting information together with their fields of interest, he groups in a table. We thought the new approach interesting, therefore, we took the table in our paper.

Analysis of literature found that users of financial accounting information si presented descriptive, in a static vision. Supreme approach through the categories of users that should be used by beneficiaries for the decision.

Consider pertinent remark *"that very little was written about what users of financial accounting information deemed to be useful in practice and the reasons for their selection" (Dutescu, 2000, p.27).*

The size of the static presentation is outdated when the authors focus on the relationships are established between the various users of financial accounting information (eg. Minu, 2002).

In our turn, we preferred to present the dynamics in the three categories of users chosen, namely, dynamic relationship that is created between them.

To clarify issues of the chosen theme, we can remember and other authors and works of reference that we were really helpful in our development: *: N.Albu, C. Albu (2003) in "Instrumente de management al performantei", V.Avram (2003) in "Managementul crearii de valoare si guvernarea intreprinderii", Cohen E. (2000) in Analyse financiére et comptabilité, Encyclopédie de Comptabilité, Contrôle de Gestion et Audit, Ristea (2000) in "Metode si politici contabile de intreprindere".*

Other sources of documentation and have been online we have allowed the study of and publications in the field, such as: Business Week (www.businessweek.com), Virtual Finance Library, Ohio State University (www.cob.ohio_state.edu/dept/fin/overview.htm) , an excellent source of information about the views of specialists in the field.

Because our research is both a heuristic approach and one reason we try to seed answers or solutions to immediate problems of practice organization.

3 Tools for measuring the performance

By definition, a link to an indicator of economic value to another, possible combinations are limited only by the imagination of everyone. Each indicator or measure is useful only in relation to the starting point was a hypothesis and objectives. If there is such a correlation, the measurement may become a standard for comparison (N.Albu,C.Albu,2003:p.236).

Helfert (2006:p.111) says*:" moreover, indicators are not absolute criteria, but serve only to reflect the financial and operational performance for certain time periods compared with other similar businesses. The indicator help to illustrate trends and structure of these changes, in turn, may indicate a risk analysis or business opportunity."*

To sketch a structure consistent use of indicators, we will build the discussion around three major points of view of financial performance analysis. Although there are a number of individuals or groups interested in the success or failure of a business, the most important categories of users: managers, shareholders (investors) and creditors.

Areas of interest in the management, investors and creditors are listed on the table below, together with the most commonly used methods of measuring performance.

Table 1. Performance indicators and perspectives segment

Management		**Investors/Shareholders**	**Creditors**
Operational analysis		**ROI**	**Liquidity**
Gross margin Profit margin Value added Gross exploitation surplus The net result of exploitation Analysis of operational costs Structural analysis Operating leverage Comparative Analysis		Return on net assets Return on capital Profit per share Cash flow per share Increased stock shares Total return to shareholders	Liquidity Overview Acid test Liquidation value
Resource Management		**Taking profit**	**Financial indebtedness**
Rotation assets Capital management Stock rotation Rotation receivables Rotation suppliers		Dividend per share Dividend rate Rate distribution Degree coverage dividends Dividend/ Total assets	The degree of indebtedness Financial stability (Debt/Capitalization) Financial autonomy (Debt/Capital and reserves)
Profitability Economic profitability (net) Gross Return Return an net assets Economic value added Economic Profit Return on cash-flow map Free cash-flow		**Market Performance** PER Degree of multiplication of cash-flow map Market value/book value Relative movements of stock Vectors of value Company value	**Debt service** The degree of coverage of interest Coverage of debt Coverage of fixed costs Cash-flow analysis will

Source: Erich A. Helfert – "Tehnici de analiza financiara ", 2006 :p.113

3.1 Managerial perspective

Management has a dual interest in analyzing financial performance:

- to improve efficiency and profitability of operations;
- to assess the effectiveness of using company.

Interpretation of a business operations are conducted primarily through analysis of the Income Statement , while analyzing the efficiency of resource utilization is based on both the Balance Sheet and the Income Statement (Minu,2002:p.186).

In order to deliver economic judgments, it is often necessary to convert the financial data available to reflect the current economic conditions. An initial evaluation of the operational efficiency of the business is generally done through an analysis of the percentage of the Income Statement. Individual costs are normally related to sales, which means that gross revenues from sales are adjusted to returning any products or discounts offered. Nature of sales allow fair comparison between the costs of key sales from one period to another in a long time and the company's competitors or industry in which it belongs.

Operational Analysis

Two of the most common indicators are operational analysis for calculating the cost of goods sold and gross profit margin as a percentage of sales.

These indicators show, in fact, share the cost of goods purchased or produced or services rendered in connection with the sales and gross margin remaining to cover operational expenses and achieve profit.

A change of gross margin is due to changes in combination:

- the selling price of the product;
- the cost of manufacturing products;
- any variations in the mix of products.

Any changes in the cost of goods sold by a company or a margin gross obtained it in a period of time requires a thorough analysis of the causes which led to these changes.

The period envisaged for such a trend analysis depends on the nature of business. For example, many businesses have seasonal fluctuations normal, while other are affected by economic cycles lasting.

This indicator serves as a signal rather than the absolute measure, as most of those which we present below.

The relationship between net profit after tax (net profit) and sales value indicates the ability of management to drive the business profitability.

In this case, success means not only recovering the cost of goods sold or services rendered, the operating expenses (including depreciation) and cost of borrowing, but also maintaining a satisfactory margin of reward investors for placing their capital under risk.

The Net Profit/Sales actually expressed overall cost effectiveness value for the company's operations.

A variation of this indicator using the net profit before interest and tax (EBIT), in other words net operating profit (net to reduce depreciation) . This value is obtained operating profit before payment of any obligations to creditors of the company. It will also calculate the profit before tax due the state, which usually is based on an amount as profit, according to non-deductible expenses and non-taxable income.

This indicator gives a much clearer picture on operational efficiency, not distorted by the financial or the tax.

An indicator often used by financial analysts and is modified and adjusted EBIT of established provisions and depreciation recorded (Bunea,2006:p.196).

This is an attempt to reflect any profits tax free and no allocation of expenses recorded in the form of provisions and depreciation.

Niculescu (2003) make a solid argument can be made is that tax should be considered an expense of the course work. Thus, the formula may be adjusted EBIAT by using a net operating profit after tax, noted EBIAT, which requires an adjustment to the tax impact of interest expense. As an expression of the ability to create operating profit after-tax, becomes a night of calculating the economic value added – EVA.

Analysis of contribution

This type of analysis was used primarily as a internal management tool. It involves linking sales with margin contribution of individual products or product groups, form all company.

May exist significant differences between to contribution margins of different industries, due to variation needs capital investment required and the cost-volume involved. Even if a company namely, the different production lines may contribute differently to cover fixed costs and obtain profits (Bunea,2006:p.270).

Be noted that the indicator is sensitive to three key elements: volume, price and direct costs, which are combined in the management of company operations.

Contribution margins are derived from financial statements and are useful as a general but limited to understanding the risk characteristics of business.

Measure suggests the ability of management to use the price you have the ability to control costs in the different moments of the economic cycle.

Resource Management

At this stage we are interested in evaluating the effectiveness with which management has used the assets that they have been provided by the shareholders of the company. In a view of *Helfert (2006),* when analyzing a company's balance sheet, can make certain conclusions regarding the size, nature and value of existing assets, can analyze the relative proportions of assets and may determine the existence of a solid in terms of company assets. Indices, such a high level of accumulated depreciation from the value of entry, may suggest that there is an "aging" of the company's assets that my require investment. Similarly, a significant increase in the level of available cash may suggest a postponement of new investment and an accumulation of excess funds in cash. Increases of circulating active elements, such as stocks or claims may suggest the existence of problems in inventory management and credit policy promoted by the company.

A statement of cash flows provides a useful variation on the allocation of resources, which are induced by variations in the balance sheet items. (Feleaga,Malciu,2004:p.88).

In broader sense, there are a number of indicators that measure the general trend of resource use. These indicators essentially involves rotation evaluation of assets and reflection in various forms, the relative amount of capital used to support transactions.

Capital management

Indicators used in the analysis of key elements of working capital (stocks and claims) tend to express the relative efficiency with which stocks are managed and the company claims. These indicators help to detect the signals of deterioration or excessive accumulation of inventories or receivables.

Amounts included in the balance sheet are generally reported in the most general level of activity, such as turnover or cost of goods sold, assuming that there is a close relationship between the asset and that are reporting.

The stocks can not be accurately assessed only by a current measuring, a check and an estimate of current value.

The most appropriate is to report the accounting of stocks to turnover or cost of goods sold, to see if there is a change in this indicator over time.

Moreover, it is necessary to observe closely the methods of accounting records of inventories, such as LIFO (last-first came out), FIFO (first come-first out) or weight average cost of stocks, any change to these policies may affect the results analysis, the impact of these accounting policies on balance sheet are significant.

Although a simple relationship with the level of stocks, gives an overview on the performance management, usually more accurate reporting of stocks at the cost of goods sold.

Just as the two elements of the indicator are reported on a similar conceptual and economic.

Use turnover creates a distortion, because the value of sales also includes a profit margin of the company, no margin in the accounts and balance sheet stocks.

We need to have in mind that there are problems related to accounting measurements, as encountered, in using analytical methods, whereas the book value of stocks may be seriously affected by the method of assessment of their chosen company.

Electronic links and deliveries on "just-in-time" have significantly improved the management of stocks in recent years.

Claims analysis is based on sales.

The question to ask is whether the claims at the end of period approximates quite accurately the amount of sales on credit estimated to remain received within agreed trading terms. For example, a company that sells products with the value of the collection to 30 days, would expect that normally, the level of its claims to be equal to sales recorded in the previous month. If the value and values are not listed for 40 or 50 days means that there is a difficult of clients to pay maturing obligations or there is an abuse of trust from those customers.

There are certain situations is which sales are made under conditions of extended payment terms compared to normal.

An exact analysis of claims can be achieved only by examining the claim that the age recorded in the company.

Ranking claims by age, involves a classification of them in the time intervals of days 10.20.30.40, etc., attached this analysis and the terms applicable to commercial credit company said.

This analysis assumes access to detailed information on the analytical accounts of clients, will resort to an approximation using general balance sheet receivables and sales volume in determining the duration in days in claims against the company's customers.

The problem of interpreting the basic conditions for capital is related cash flow, believes (*Bunea, 2006:p.210).*

In time, all the capital is converted to cash and must assess the nature and quality of the conversion cycle of a company's cash. Excessive spread between debt and a steady increase in the level of stocks can significantly affect the normal cash conversion and lead to distortions of the financial system of the company.

Profitability

In the opinion of *Niculescu (2003) -The simplest form of analysis of profitability is to report net profits derived from the total assets in the balance sheet.*

Can be used and the net assets (total assets-current liabilities), noting that current liabilities are the company to involve virtually no cost of financing assets. This profit is directly affected by the proportion of debt in capital structure due to interest costs involved in this debt, expenses have been deducted from taxable profit.

A more significant result obtained if we remove both interest and tax of the net profit and use the result of exploitation.

This rate of return adjusted to reflect gross earnings capacity of capital invested, irrespective of the mode of financing of capital or income tax deducted by the tax authorities.

Another measure of profitability, is the concept of economic profit or economic value added – EVA. *(Bunea, 2006:p.194).*

Determination is based on the assumption that to create value for shareholders, the profits obtained from use of resources must be allocated to higher cost of capital to finance these resources.

To determine cost of capital, it is necessary to define the assets involved, which usually are not assets and to calculate the weighted average cost of capital invested. Then, the asset is multiplied by the weighted average cost of capital, cost of achieving the value of capital, which decreased net income operational resulting the economic benefits obtained by the company. If the value obtained is positive, to create value for shareholders, if the result is negative, the value has been destroyed, consumed.

In conclusion, the various indicators available to assess the performance operations, capital allocation efficiency and profitability from the exploitation of assets.

These measures are only affected in a particular way of uncertainties related to accounting methods and evaluation, but used together can provide relevant clues about a company's performance, while suggesting directions for future analysis.

3.2. Perspective of investors/shareholders

A second relevant perspective in analyzing company performance is the business owners. They are ones to which managers are responsible for the company . It is clear that managers must be fully responsive to the views of investors and their expectations in terms of time, obtain and evaluate operational results.

These elements are based on creating value for shareholders (Avram, 2006:p.62).

Similarly, managers must be responsive to the position and perspective of the creditors. Key point of interest to business owners is return on investment. We refer to the return obtained by the lead management, on the resources invested by owners.

Are planning a series of indicators reflecting the performance of the company in connection with the investment shareholders.

Two of these indicators, profitability and return on equity capital are measures of profitability total investment of shareholders, while the third, the profit per share, measure the proposition of each unit of investment in company profits in a given period.

Investors are also concerned and how the distribution of profits which they belong, that is what the profit is invested over the distributed as dividends or in some cases, the ransom of shares issued, investors are concerned about the company's results and future expectations concerning the market value of the investment especially in the case of companies listed on stock exchanges (eg.Malciu,1998:p.19).

In short, the indicators relevant to the perspective of investors on business performance are those that measure profitability form shareholders and distribution cash received by them in the form of dividend and expectations regarding future performance.

These results depend on the ability to profit of the company, management policies, decisions regarding the use and indebtedness reinvestment profits and exploitation vectors of creating value in the company.

After all, all management decisions affecting the economic value of capital invested by shareholders, a fact reflected in market prices of company shares.

3.3. Creditors' perspective

Although the managers and owners is the main orientation business continuity, it is necessary for creditors dual approach. Creditors are interested in financing a profitable company needs in terms of a performance.

At the same time, they should consider the option and the failure or liquidation of the company.

Choosing between not benefit from the success of the business and receive regular payments of interest and principal, creditors should evaluate carefully the risks involved in the recovery of capital advanced on loan, especially in the case of the lending period longer.

Part of this assessment is the liquidation of claims of creditors in the event of a failure of the business.

There are a number of indicators that are used to evaluated the protection of creditors, testing the liquidity of the business. Another set of indicators to assess the relative exposure of debt, called the degree of indebtedness of the company to determine the ratio between the position of shareholders and creditors of the company.

Finally, there are so called coverage indicators, which measure ability to meet debt service on the funds generated from continuing operations (www.cob.ohio_state.edu/dept/fin/overview.htm).

4 Conclusions

Since there are many tools for measuring economic performance, we should have
in mind that different techniques often lead to very stringent assessment and "narrow" as a way of defining. However, few correlations will yield information that analysts and managers need for substantiation decision.

In the performance analysis can not draw firm conclusions. Any inquiries can be made that are relative, as business conditions vary form company to company and from industry to industry.

Comparisons and standards based on past performance are difficult to interpret global. An example are companies with large field of activity in which information about a given activity is limited.

Performance evaluation based on the financial situations is a task oriented past; it is difficult to make extrapolations future. However, any decision is the result of such analysis of performance that can only affect the future, the past is unrepeatable (Ristea, 2000:p.121).

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Comparisons and standards based on past performance are difficult to interpret global. An example are companies with large field of activity in which information about a given activity is limited.

We tried, through this article, to present key aspects of the main financial statements as a basis for evaluating financial performance, although the process of creating real value for shareholders is based on cash-flow.

In this context, we demonstrated that the performance of the business makes sense only if viewed from the perspective of each particular group interested in the company.

We chose to focus on individual perspectives of the three categories of users – managers, shareholders, creditors – which are essential to the operation of business. . All groups are interested in basic business success, each from a particular point of view.

I understand that the present range of indicators, crucial test of the business is return of capital invested and its effect on capital owned by shareholders.

These indicators are best interpreted when tackling a correlation system, sensitive to managerial decisions, which involved the development of specific vectors of value creation.

Many indicators are individual in nature and only static elements can not be interpreted in context with rigor business dynamics.

Drawbacks are related to the limitations of traditional accounting principles.

In this sense, it emphasized the need for managers to adopt an economic perspective, based on cash-flows, for the substantiation and take decision, which long term will cause a performance – based accounting information.

In conclusion, we believe that there is no definitive and reliable method of balancing these issues of measurement, making the analysis of financial instruments comparison of actual economic performance.

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