



Department of Education
SCHOOLS DIVISION OF CITY OF MEYCAUAYAN
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Senior High School

12

Activity Sheet **in** **Fundamentals of** **Accountancy, Business** **and Management 2**

Financial Analysis, Horizontal and
Vertical Analysis

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FINANCIAL ANALYSIS, HORIZONTAL & VERTICAL ANALYSIS



LET US KNOW

An accountant's work does not end by just preparing the financial statement correctly. The user needs financial data in making economic decisions and we can only achieve it if the management can interpret the information. Accounting is more than just a number; it is a language that speaks with relevance to the firm's operation. In this lesson, we will obtain the skill of interpreting financial data and solve exercises and problems that require computation and interpretation using horizontal and vertical financial analysis technique for financial statement.



LET US REVIEW

Enumerate the following concept ask and explain each concept based on your own understanding .Write your answer on separate sheet of paper.

1. Enumerate the five financial statements prepared by an entity and explain the report function of each statement.

Enumerate

Explain

2. Enumerate the elements of Statement of Financial Position, Statement of Comprehensive Income, Statement of Changes in Equity and Statement of Cash Flow. Explain the purpose of each elements in coordination with the report.

Enumerate

Explain



LET US STUDY

Financial Statements, one of its qualitative characteristics is **comparability**. The financial user can determine their right action to improve entity's operation by comparing previous financial data to the current data prepared. They can evaluate the effectivity of their strategy seeing an improvement through numbers presented on the financial report. Identification of similarities and difference of financial information plays a vital role that leads an entity in making a sound economic decision. Comparability of financial statement can also be used as for entities major competitor in the industry. This help them to be a major player and compete with high regards to its customer service and branding. Comparability help an entity to benchmark entity to the current trend of its market.

COMPARISON STANDARDS		
Type of Comparison	Definition	Example
Intra-comparability	The company's financial statement for current are being compared with the financial statements of prior or earlier periods.	The net income of ABC company for current year 2016 is compared to net income of ABC company in 2015.
Inter-comparability	Deals with comparative analysis of the company's financial statements against a direct competitor. This is valuable for companies that do not have the monopoly of the market.	Financial Statement of Jollibee food corporation compared to the financial statement of its major competitor Mc. Donald's.
Industry standard	It refers to the wide range of major players in the industry. It compares company financial statements with the standard average for that industry.	The financial statements of Smart are compared to the industry standard of telecom industry.

Horizontal vs. Vertical Analysis	
Horizontal (Trend Analysis)	Vertical Analysis (Common Size)
<ul style="list-style-type: none"> Use to evaluate firms risk factors, performance, financial condition, and financial projection. Company will compare their own financial statement for the current period (2019) with 	<ul style="list-style-type: none"> Express items of a certain financial statement as a percentage of a given base amount.

their financial statement prior (2018).	
<ul style="list-style-type: none"> Prior period is the starting point of comparison. 	<ul style="list-style-type: none"> Statement of Financial Position Base amount is the total assets of the company in the given year. Statement of comprehensive income base amount is the net sales of the given accounting period.
<ul style="list-style-type: none"> Increases and decrease are measured in percentages and monetary value. 	

Example. Horizontal Analysis comparing JPIA Company Statement of Financial Position of 2018 to Statement of Financial Position of 2019.

Horizontal analysis or trend analysis is an analysis that involves the comparable prior year of business to the current year of business. It is an evaluation or an intra comparison of an entity to measure the firm's performance acknowledged the emerging risk in the business trend and justify strategic plans for management.

Peso Change = Balance of Current Year- Balance of Prior Year

Percentage change = $\frac{\text{Variance}}{\text{Balance of Prior Year}}$

Statement of Comprehensive Income Horizontal Analysis

JPIA Company					
Statement of Comprehensive Income Comparative Analysis					
As of December 31					
	Accounts	2019	2018	Variance	Percentage Change
	Net Sales	₱1,000,000.00	₱750,000.00	₱250,000.00	33%
Less	Cost Of Goods Sold	120,000.00	100,000.00	₱20,000.00	20%
	Gross Profit	₱880,000.00	₱650,000.00	₱230,000.00	35.4%
Less	Operating Expenses	120,000.00	100,000.00	20,000.00	20%
	Operating Income	₱760,000.00	₱550,000.00	₱210,000.00	38%
Less	Interest Expense	125,000.00	115,000.00	10,000.00	9%
	Net Income Before Tax	₱635,000.00	₱435,000.00	₱200,000.00	46%
Less	Income Tax Expense	100,000.00	85,000.00	15,000.00	18%
	Net Income After Tax	₱535,000.00	₱350,000.00	₱185,000.00	53%

Figure 1. Statement of Comprehensive Income

Interpretation of Statement of Comprehensive 2019 Horizontal Analysis

- Sales have increased at a higher rate, cost of goods sold has a minimal increase it means more sales activities were undertaken which causes the sales to increase.
- The increase in sales is directly proportional to the operating expense and income of the company. An increase sale is an increase in its gross profit, operating expenses, and operating income.
- The profitability of the business has been improved with an increase of 53% in net income after tax.

Statement of Financial Position Horizontal Analysis

Assets	Year 2019	Year 2018	Variance	Percentage Change
Cash	P1,250,000.00	P800,000.00	P450,000.00	56%
Account Receivable	25,000.00	20,000.00	5,000.00	25%
Inventory	100,000.00	75,000.00	25,000.00	33%
Land	165,000.00	150,000.00	15,000.00	10%
Patent	200,000.00	170,000.00	30,000.00	18%
Total Assets	P1,740,000.00	P1,215,000.00	P525,000.00	43%
Liabilities				
Accounts Payable	P155,000.00	P215,000.00	-P60,000.00	-28%
Notes Payable	P85,000.00	P100,000.00	-P15,000.00	-15%
Total Liabilities	P240,000.00	P315,000.00	P75,000.00	24%
Owners Equity				
JPIA, Capital	P1,500,000.00	P900,000.00	P600,000.00	67%
Total Liabilities & Owners Equity	P1,740,000.00	P1,215,000.00	P675,000.00	56%

Figure 1. Statement of Financial Position

Interpretation of Statement of Financial Position 2019 Horizontal Analysis

- The liquidity of the operation has improved in 2019 there is an increased in the total current assets a decrease in total current liabilities there is a minimal increase in account receivable turnover yet management must exert an effort to collect the accounts receivable, to avoid a doubtful account expense. There is an increase of inventory, probably these are the old stocks that needed to be sold before it will result in losses.
- Solvency of the business has improved as reflected in the notes payable of the entity it committed to paying their obligations.

- The main source of business financing in 2018 is capital and increase in their equity probably came from the profits which is a very significant, it means that the company is performing and doing well in managing their overall business operation.

Vertical Analysis of JPIA Company Statement of Financial Position and Statement of Comprehensive income.

Vertical Analysis (common size financial statement) is a proportional analysis of each line item on a financial statement in percentage form. It is commonly used within a financial statement for a single period to attain relative proportion of financial information and used for time series analysis (Guzman, 2019).

Statement of Comprehensive Income Vertical Analysis

JPIA COMPANY							
Statement of Comprehensive Income Vertical Analysis							
As of December 31							
		2019	%	2018	%		
	Net Sales	₱1,000,000.00	100%	₱750,000.00	100%		
Less	Cost Of Goods Sold	120,000.00	12%	100,000.00	13%		
	Gross Profit	₱880,000.00	88%	₱650,000.00	87%		
Less	Operating Expenses	120,000.00	12%	100,000.00	13%		
	Operating Income	₱760,000.00	76%	₱550,000.00	73%		
	Interest Expense	125,000.00	13%	115,000.00	15%		
	Net Income Before Tax	₱635,000.00	64%	₱435,000.00	58%		
Less	Income Tax Expense	100,000.00	10%	85,000.00	11%		
	Net Income After Tax	₱535,000.00	54%	₱350,000.00	47%		

Figure 3. Statement of Comprehensive Income

Interpretation of Statement of Comprehensive Income Year 2019 Vertical Analysis

The company managed to increase its sales despite the minimal increase in its cost of goods sold. The current cost of goods sold is at 12%, which means that for every ₱1 sales, ₱.12 centavos represent the cost of good. A total of ₱.35 centavos is allocated to expenses such as, operating expenses, interest expense and tax expenses. A good management of expenses and cost of goods sold resulted to increase the profit from ₱.47 centavos of the prior year to the current year of ₱.54 centavos in every ₱1 sales. . This is a good indication that the business is performing and following its strict control policies in managing its expenses and inventories.

Statement of Financial Position Vertical Analysis

JPIA Company				
Statement of Financial Position Vertical Analysis				
As of December 31				
Assets	Year 2019	%	Year 2018	%
Cash	₱1,250,000.00	72%	₱800,000.00	66%
Account Receivable	25,000.00	1%	20,000.00	2%
Inventory	100,000.00	6%	75,000.00	6%
Land	165,000.00	9%	150,000.00	12%
Patent	200,000.00	11%	170,000.00	14%
Total Assets	₱1,740,000.00	100%	₱1,215,000.00	100%
Liabilities				
Accounts Payable	155,000.00	9%	215,000.00	18%
Notes Payable	85,000.00	5%	100,000.00	8%
Total Liabilities	₱240,000.00	14%	₱315,000.00	26%
Owners Equity				
JPIA, Capital	1,500,000.00	86%	900,000.00	74%
Total Liabilities & Owner's Equity	₱1,740,000.00	100%	₱1,215,000.00	100%

Figure 4. Statement of Financial Position**Interpretation of Statement of Financial Position 2019 Vertical Analysis**

Looking at the financial position of JPIA company, it is a highly liquid company with a 72% total cash asset. It has a good account receivable collection policy with a fast-moving inventory turnover. A decrease of 18% to 9% company's current liabilities denotes that it manages to pay its current maturing liabilities and a significant decrease in its long-term debt from 8% to 5% measures its solvency. JPIA Company also increases its equity which shows that the company truly perform on the year 2019.



LET US PRACTICE

Read and analyze the given problem .Develop a horizontal and vertical analysis for 2019 and 2018 Statement of Financial Position and Statement of Comprehensive Income of Alahas ATBP. Interpret the outcome of the analysis. Write your answer on separate sheet of paper.

Alahas ATBP					
Statement of Financial Position					
As of December 31					
				12/31/2019	12/31/2018
Current Assets				₱5,000,000.00	₱3,500,000.00
Property Plant and Equipment				₱1,000,000.00	₱700,000.00
Current Liabilities				₱3,000,000.00	₱1,200,000.00
Long Term Liabilities				₱1,000,000.00	₱1,500,000.00
Owners Capital				₱2,000,000.00	₱1,500,000.00

Alahas ATBP					
Statement of Comprehensive Income					
For the year ended					
				12/31/2019	12/31/2018
Net Sales				₱4,500,000.00	₱2,250,000.00
Cost of Goods Sold				1,500,000.00	750,000.00
Gross Profit				₱3,000,000.00	₱1,500,000.00
Selling Expense				350,000.00	100,000.00
Administrative Expense				120,000.00	85,000.00
Net Operating Income				₱2,530,000.00	₱1,315,000.00
Interest Expense				200,000.00	100,000.00
Net Income				₱2,330,000.00	₱1,215,000.00



LET US REMEMBER

1. **Financial statement analysis** a process of evaluating risk, performance, financial condition, and future projection of a business. It is an analytical technique with an objective of making sound decision.
2. **Horizontal analysis or trend analysis** is an analysis that involves the comparable prior year of business to the current year of business. It is an evaluation or an intra comparison of an entity to measure the firms' performance, acknowledged the emerging risk in the business trend and justify strategic plans for management.
3. **Vertical Analysis (common size financial statement)** is an analysis that expresses the elements of financial statement as a percentage of the base amount such as the total assets and total liabilities and owner's equity for statement of financial position and net sales for statement of comprehensive income. It shows standardized or relative amounts that enable users to make a comparison of companies.



LET US APPRECIATE

On the matrix below write the advantage of performing the following financial analysis technique in the financial statements of business operation. What is the effect of financial analysis on the business? Write your answer on separate sheet of paper.

Advantage of Horizontal Analysis	Advantage of Vertical Analysis



LET US PRACTICE MORE

Perform a financial statement analysis (Horizontal and Vertical Analysis) for “Intoy’s Goodies” on their prior and current year of operation. Use the M.S. excel application in presenting your report. Interpret the outcome of the analysis.

Intoy's Goodies			
Statement of Financial Position			
As of the year ended December 31			
Assets	2019	2018	
Current Assets	₱584,000.00	₱400,000.00	
Property Plant & Equipment	544,500.00	495,000.00	
Intangible Assets	148,500.00	220,000.00	
Total Assets	₱1,277,000.00	₱1,115,000.00	
Liabilities & Owners Equity			
Current Liabilities	₱245,000.00	₱115,000.00	
Long Term Liabilities	532,000.00	200,000.00	
Owners capital	500,000.00	800,000.00	
Total Liabilities & Owner's Equity	₱1,277,000.00	₱1,115,000.00	

Intoy's Goodies						
Statement of Comprehensive Income						
For the year ended December 31						
				2019		2018
Sales				₱2,250,000.00		₱1,550,000.00
Cost of Goods Sold				900,000.00		750,000.00
Gross Profit				₱1,350,000.00		₱800,000.00
Operating Expenses				250,000.00		175,000.00
Net Income				₱1,100,000.00		₱625,000.00



EVALUATION

Read each sentence carefully and determine, whether the statement is True or False. Write your answers on separate sheet of paper.

1. _____ Financial statement analysis uses computational and analytical techniques to evaluate the company's risks, performance and financial condition and future projections.
2. _____ Horizontal Analysis is also known as common size financial statements.
3. _____ Vertical analysis compares the balances of account from prior period to current period.
4. _____ The common size statement of comprehensive income shows that cost of goods sold at 25% means that cost of goods sold is 25% of sales.
5. _____ Financial Statement of I love Milk tea compared to the financial statement of its major competitor Macao imperial is an example inter comparability standards.
6. _____ Industry standards compares company financial statements with the standard average for that industry.
7. _____ Horizontal analysis maybe used for projecting financial statements.
8. _____ Vertical Analysis an analysis that expresses the elements of financial statement as a percentage of the base amount such as the total assets and total liabilities and owners' equity for statement of financial position and net sales for statement of comprehensive income.
9. _____ You can use horizontal analysis if you want to see the trend of an entity from the prior year of operation to the current year.
10. _____ The net income of DEF company for current year 2014 is compared to net income of DEF company in 2013 is an example of intra - comparability standards.



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