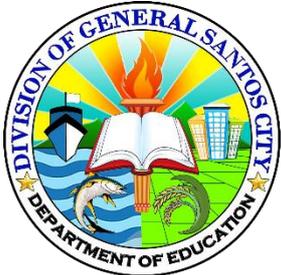
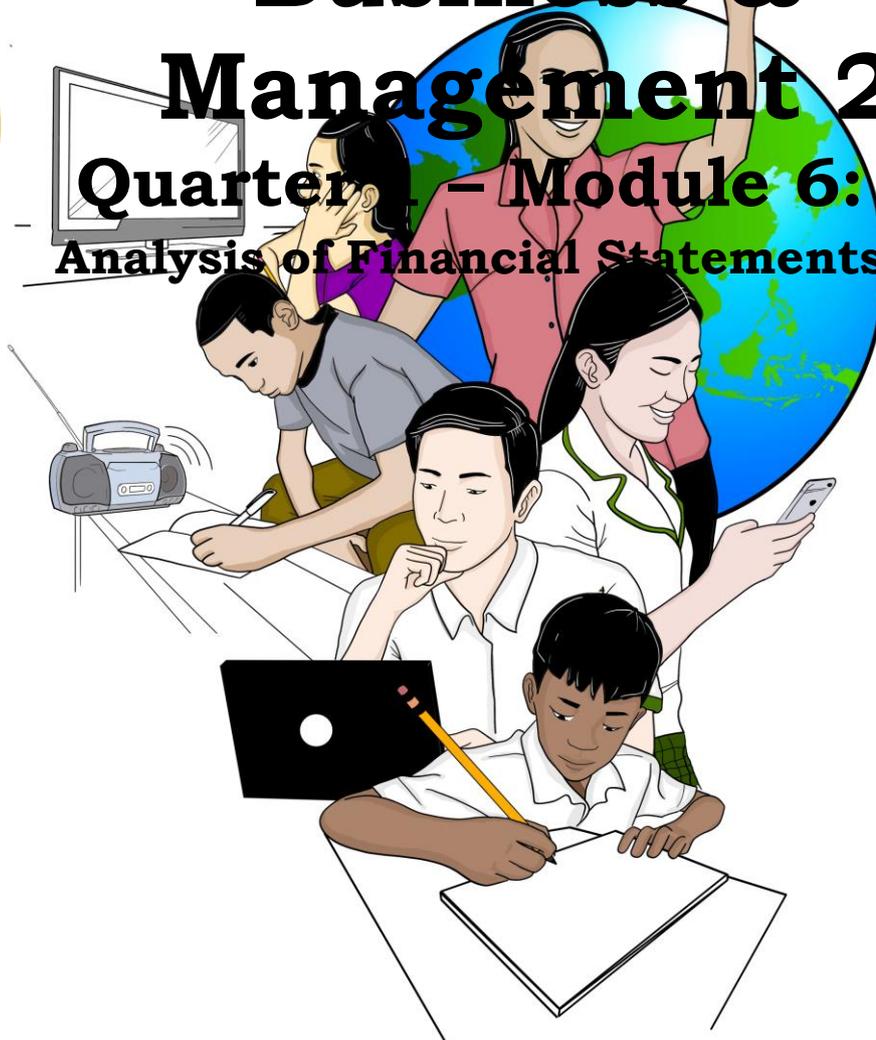


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# Fundamentals of Accountancy, Business & Management 2 Quarter – Module 6: Analysis of Financial Statements



**SELF-LEARNING MODULE**



DIVISION OF GENERAL SANTOS CITY

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## SELF-LEARNING MODULE



DIVISION OF GENERAL SANTOS CITY

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**Fundamentals of Accountancy, Business & Management 2 for Grade 12**  
**Self-Learning Module (SLM)**  
**Quarter 1 – Module 6: Analysis of Financial Statements**  
**First Edition, 2020**

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# **Fundamentals of Accountancy, Business & Management 2**

## **Quarter 1 – Module 6: Analysis of Financial Statements**



# Introductory Message

For the facilitator:

Welcome to the Fundamentals of Accountancy, Business & Management 2 Self-Learning Module (SLM) on Analysis of Financial Statements!

This module was collaboratively designed, developed and reviewed by educators both from public and private institutions to assist you, the teacher or facilitator in helping the learners meet the standards set by the K to 12 Curriculum while overcoming their personal, social, and economic constraints in schooling.

This learning resource hopes to engage the learners into guided and independent learning activities at their own pace and time. Furthermore, this also aims to help learners acquire the needed 21st century skills while taking into consideration their needs and circumstances.

In addition to the material in the main text, you will also see this box in the body of the module:



### ***Notes to the Teacher***

This contains helpful tips or strategies that will help you in guiding the learners.

As a facilitator you are expected to orient the learners on how to use this module. You also need to keep track of the learners' progress while allowing them to manage their own learning. Furthermore, you are expected to encourage and assist the learners as they do the tasks included in the module.

For the learner:

Welcome to the Fundamentals of Accountancy, Business & Management 2 – Grade 12 Self-Learning Module (SLM) on Analysis of Financial Statements!

The hand is one of the most symbolized part of the human body. It is often used to depict skill, action and purpose. Through our hands we may learn, create and accomplish. Hence, the hand in this learning resource signifies that you as a learner is capable and empowered to successfully achieve the relevant competencies and skills at your own pace and time. Your academic success lies in your own hands!

This module was designed to provide you with fun and meaningful opportunities for guided and independent learning at your own pace and time. You will be enabled to process the contents of the learning resource while being an active learner.

This module has the following parts and corresponding icons:



***What I  
Need to  
Know***

This will give you an idea of the skills or competencies you are expected to learn in the module.



***What I  
Know***

This part includes an activity that aims to check what you already know about the lesson to take. If you get all the answers correct (100%), you may decide to skip this module.



***What's In***

This is a brief drill or review to help you link the current lesson with the previous one.



***What's New***

In this portion, the new lesson will be introduced to you in various ways such as a story, a song, a poem, a problem opener, an activity or a situation.



***What is It***

This section provides a brief discussion of the lesson. This aims to help you discover and understand new concepts and skills.



***What's  
More***

This comprises activities for independent practice to solidify your understanding and skills of the topic. You may check the answers to the exercises using the Answer Key at the end of the module.



***What I  
Have  
Learned***

This includes questions or blank sentence/paragraph to be filled in to

process what you learned from the lesson.



***What I Can Do***

This section provides an activity which will help you transfer your new knowledge or skill into real life situations or concerns.



***Assessment***

This is a task which aims to evaluate your level of mastery in achieving the learning competency.



***Additional Activities***

In this portion, another activity will be given to you to enrich your knowledge or skill of the lesson learned. This also tends retention of learned concepts.



***Answer Key***

This contains answers to all activities in the module.

***References***

This is a list of all sources used in developing this module.

The following are some reminders in using this module:

1. Use the module with care. Do not put unnecessary mark/s on any part of the module. Use a separate sheet of paper in answering the exercises.
2. Don't forget to answer *What I Know* before moving on to the other activities included in the module.
3. Read the instruction carefully before doing each task.
4. Observe honesty and integrity in doing the tasks and checking your answers.
5. Finish the task at hand before proceeding to the next.
6. Return this module to your teacher/facilitator once you are through with it.

If you encounter any difficulty in answering the tasks in this module, do not hesitate to consult your teacher or facilitator. Always bear in mind that you are not alone.

We hope that through this material, you will experience meaningful learning and gain deep understanding of the relevant competencies. You can do it!



## ***What I Need to Know***

This module was designed and written with you in mind. It is here to help you master the **Analysis of Financial Statements**. The scope of this module permits it to be used in many different learning situations. The language used recognizes the diverse vocabulary level of students. The lessons are arranged to follow the standard sequence of the course. But the order in which you read them can be changed to correspond with the textbook you are now using.

The module discusses the topic on:

- Lesson 5 – Analysis of Financial Statements

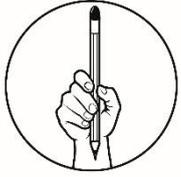
After going through this module, you are expected to:

- 1. define the measurement levels, namely; liquidity, solvency and profitability; (ABM\_FABM12- Ig-h-12)**
- 2. perform vertical and horizontal analyses of financial statements of a single proprietorship; and, (ABM\_FABM12- Ig-h-13)**
- 3. compute and interpret financial ratios such as current ratio, working capital, gross profit ratio, net profit ratio, receivable turnover, inventory turnover, debt-to-equity ratio, and the like. (ABM\_FABM12- Ig-h-14)**

Note: At the start of the module, you are to take the pre-assessment test to see how much background information and knowledge you stored for the new lesson.

This module is self-instructional. You can read, analyze concepts and ideas presented and reflect on them. The activities will help you assess your progress as you go through in this module.

Now, just fasten your seatbelts because we are now about to begin this journey...



## ***What I Know***

Let's begin with challenging our minds about analysis of financial statements. Are you ready now?

### ***Let's answer this!***

Instruction: Read the questions and encircle the letter of your answer.

1. It is the capability of a company to pay its current obligations.  
a. liquidity      b. solvency      c. profitability      d. stability
2. This ratio measures the capability of a company to pay its current obligations.  
a. liquidity ratio      b. solvency ratio      c. profitability ratio      d. stability ratio
3. The following ratios are used in measuring liquidity position of a company, except  
a. quick ratio      b. acid-test ratio      c. current ratio      d. gross profit ratio
4. If current asset is P 10,000 and current liability is P 5,000, the current ratio is  
a. 2:1      b. P 2,000      c. 1:2      d. P 5,000
5. It is the capability of a company to pay non-current liabilities as they fall due.  
a. liquidity      b. solvency      c. profitability      d. agility
6. This ratio measures the capability of a company to pay non-current liabilities as they fall due.  
a. liquidity ratio      b. solvency ratio      c. profitability ratio      d. stability ratio
7. Which financial ratios are used in financial statement analysis?  
a. liquidity ratios      b. solvency ratios      c. profitability ratios      d. all of these except stability
8. It is a common-size statement analysis or proportional analysis of a financial statements.  
a. vertical analysis      b. diagonal analysis      c. horizontal analysis      d. ratio analysis
9. It is the comparison of two or more financial statements over the time.  
a. vertical analysis      b. diagonal analysis      c. horizontal analysis      d. ratio analysis
10. If current assets is P 200,000 and total assets is P 800,000, what percentage of total assets is current assets?  
a. 2.5%      b. 25%      c. 250%      d. 23%
11. A firm has liabilities of P 30,000 and owner's capital of P 70,000. The percentage of total liabilities to total assets is  
a. 20%      b. 25%      c. 30%      d. 43%
12. A firm had owner's capital of ₱125,000 in 2018 and ₱150,500 in 2019. The increase in owner's capital from 2018 to 2019 is  
a. 20%      b. 21%      c. 16%      d. 17%
13. Which of the following is not included in computing acid-test ratio?  
a. cash      b. notes receivable      c. accounts payable      d. merchandise inventory
14. Which of the following is not included in computing current ratio?  
a. land      b. notes payable      c. accounts receivable      d. merchandise inventory
15. The difference between current assets and current liabilities is called  
a. current ratio      b. working capital      c. acid-test ratio      d. both a and b

## Lesson

# 6

# Analysis of Financial Statements

Can you tell a person having a fever by just looking at it? Can you tell a person happy by just looking at her/his face? Some of you would answer yes. We can tell a person is happy when there's a spark in their eyes, a smile on their face and etc. Same with business. As detectives, we can tell that a business is healthy or not by just looking thoroughly at financial statements.

This module would assist you as Senior High School learner **to define the measurement levels, perform vertical and horizontal analyses of financial statements of a single proprietorship; and compute and interpret financial ratios.**



## What's In

In order to proceed with the next topic, let's recall your understanding about the different financial statements. Can you recall?

### Activity 1: Just Do It!

Instruction:

A. Classify the following account titles as to Assets, Liabilities and Owner's Equity. Use "check mark" (/) on the space provided.

<u>EQUITY</u>	<u>ASSET</u>	<u>LIABILITY</u>	<u>OWNER'S</u>
1. Cash in Bank	_____	_____	_____
2. Notes Receivable	_____	_____	_____
3. Accounts Payable	_____	_____	_____
4. Corona Covid, Capital	_____	_____	_____
5. Office Equipment	_____	_____	_____
6. Professional Income	_____	_____	_____
7. Building	_____	_____	_____
8. Notes Payable	_____	_____	_____
9. Taxes and Licenses	_____	_____	_____
10. Salaries and Wages	_____	_____	_____

B. Encircle the letter of the correct answer in each question.

11. Which of the following is not a component of Cost of Sales?
  - a. freight-in
  - b. sales discounts
  - c. purchase discount
  - d. merchandise inventory
12. Which of the following is an expense account?
  - a. freight-in
  - b. freight-out
  - c. sales discounts
  - d. purchase discount
13. A balance sheet which is presented in horizontal format
  - a. report form
  - b. account form
  - c. natural form
  - d. standard form
14. Which of the following is included in making a head of cash flow statement?
  - a. title of the report
  - b. name of the business
  - c. period covered
  - d. all of these except place of the business
15. Which of the account titles that is differently classified from others?
  - a. rent expense
  - b. supplies expense
  - c. taxes and licenses
  - d. drawing



### ***Notes to the Teacher***

***Teacher facilitates an activity that enables learners to use previously taught lesson.***



## ***What's New***

How are you coping with our lesson? Are you now ready and excited to do the activities we will cover in this module? So, let's begin...

***Let's warm up!***

### **Activity 2: "Novice Stage"**

Instruction: Read the following scenes, then, solve the scenes by writing it in the space provided below.

Scene 1. Assume that you want a new cellphone. Since you don't have enough money, you tend to borrow some from your parents. Are you capable of paying your parents with what you have right now? If yes, how?

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Scene 2. Assume you have a P 50.00 allowance for a day. List down what comprises for that allowance. You can add components or change the amount of your daily allowance.

Example:

Food	P	20.00	
Fare		<u>10.00</u>	
Total	P	<u><u>30.00</u></u>	

Scene 3. Using your grade from previous year, complete the table.

Subjects	First Quarter	Second Quarter
Physical Education & Health		
Oral Communication		
Komunikasyon at Pananaliksik sa Wika at Kulturang Pilipino		

Processing Questions:

Instruction: Write your answers on the space provided.

1. How did you find the activity?  


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2. In scene two (2), what component is the largest and smallest?  


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3. In scene three (3), what is your observation in your grades?  


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## ***What is It***

In the previous lesson, that we tackled, we focused on the different financial statements being prepared by an entity. By this time, let us discuss about the measurement levels worth analyzing for in a business and I will explain to you further what you missed to answer in the previous activities. In our review, you are asked to answer a pretest in order to pre-assess your prior knowledge about our new lesson. And followed by completing the novice stage to know how far your knowledge is. This is purposely to gear up your mind because we are going to mug up the different measurement levels.

Financial Statements are tools in decision making process. It contains financial information of how the business runs throughout its life. To make use of it, accountant shows his analytical capabilities to analyze and interpret such figures

found in financial statements to help in decision making. Not only accountants are interested in it but also other users of financial statements such as investors, employees, lenders, suppliers and many more.

The purpose of statement analysis is to evaluate the performance of the business in the past as basis for future operations. Usually, financial statement analysis focuses on these three aspects of the business.

1. Liquidity – it is the company’s ability to pay its short-term obligations. A good liquidity position would encourage banks or financial institutions to lend. Short term obligation is a liability will be paid back within 12 months.
  - a. Current Ratio
  - b. Quick or Acid-Test Ratio
2. Solvency – it is the company’s capability to pay its long-term obligations as they fall due. Long-term obligation is defined as liability that will be paid back after 12 months.
  - a. Debt to Total Assets Ratio
  - b. Owner’s Equity to Total Assets Ratio
3. Profitability – it is the company’s ability to generate higher profit.
  - a. Rate of Return on Total Assets
  - b. Rate of Return on Sales
  - c. Gross Profit Ratio
  - d. Rate of Return on Investment

### **Comparison Standards**

Comparability is one of the key qualities which accounting information must have. Accounting information is comparable when accounting standards and policies are applied and consistently from one period to another. This comparability principle is important because it allow us to compare a set of financial statements with those previous periods and with other companies.

The following are the comparison standards that can be used by entities:

**a. Intracomparability.** The company’s financial statements for the current period are being compared with the financial statements of the past periods. It would point out areas for improvements and may be used as performance evaluation for sound decision making.

- The total net income of XYZ Company for the current year 2019 is being compared with the total net income of XYZ Company for the year 2018 and 2017.
- The total assets of XYZ Company for the current year 2019 is being compared with the total assets of XYZ Company for the year 2018 and 2017.

**b. Intercomparability.** The company’s financial statements are being compared against a direct competitor. It could show if our entity underperformed or overachieved against our direct competitor’s financial statements.

- The financial statements of *Lechonan 1* are being compared with the financial statements of *Lechonan 2*.
- The financial statements of Coffee Shop A are being compared with the financial statements of Coffee Shop B.

**c. Industry Standard.** The company’s financial statements are being compared within the industry. It helps the company on where does it stand financially and evaluate its financial performance. It could lead to benchmarking.

- The financial statements of *Lechonan 1* are being compared with the industry standard for the food and beverage industry.
- The financial statements of Smart Telecom are being compared with the industry standard for the telecom industry.

## METHODS USED IN STATEMENT ANALYSIS

The most common method of statement analysis employed by accountants as financial analyst are as follows:

1. Presentation of statement showing the component percentages;
2. By using trends by means of percentages;
3. Using ratio to establish the relationship between certain item in the Statement of Financial Position and Statement of Comprehensive Income.

## COMPONENT PERCENTAGES

The analytical technique used in this method is the Vertical Analysis. Vertical Analysis is a common size statement analysis or proportional analysis of a financial statement. This means, each line item of the statement of comprehensive income is stated as a percentage of net sales. On the other hand, each line item of the statement of financial position is stated as percentage of total assets. Doing this analysis can see the relative proportions of account balance and any relative changes in accounts over the time.

Go Company  
Statement of Comprehensive Income  
For the year March 31, 2018

		<u>Percent</u>
Sales	P 42,000	102.54%
Less: Sales Returns & Allow.	P 240	
Sales Discounts	<u>800</u>	<u>2.54%</u>
Net Sales	P 40,960	100%
Less: Cost of Goods Sold	<u>28,500</u>	<u>69.58%</u>
Gross Profit	P 12,460	30.42%
Less: Operating Expenses	<u>4,600</u>	<u>11.23%</u>
Net Income	<u>P 7,860</u>	<u>19.19%</u>

Sales	P 42,000
Net Sales	<u>÷ 40,960</u>
% of increase	<u>P 102.54%</u>

*(Net Sales is used as a common base)*

The above common-size Statement of Comprehensive Income shows that every P1 peso of your sales, seventy centavos cover the cost of goods sold, eleven centavos for the operating expenses and nineteen centavos represents profit. Go Company can consider this in decision making by reducing the cost of goods sold to increase net income.

## TRENDS BY MEANS OF PERCENTAGES

The analytical technique used in this method is the Horizontal Analysis. Horizontal Analysis is the comparison of two or more financial statements over the time. It helps to see if there are changes whether it is high or low that may lead for further investigation of the reason for changes.

Go Company  
Statement of Comprehensive Income  
For the year March 31, 2018

	<u>2018</u>	<u>2017</u>	Amount of Increase (Decrease)	% of Increase (Decrease)
Sales	P 42,000	P 35,000	P 7,000	20%
Less: Sales Returns & Allow.	P 240	P 155	P 85	55%
Sales Discounts	800	1,600	(800)	(50%)
Total	<u>P 1,040</u>	<u>P 1,755</u>	<u>P (715)</u>	<u>(41%)</u>
Net Sales	P 40,960	P 33,245	P 7,715	23%
Less: Cost of Goods Sold	28,500	29,000	(500)	(1.72%)
Gross Profit	P 12,460	P 4,245	P 8,215	193.52%
Less: Operating Expenses	4,600	2,500	2,100	84%
Net Income	<u>P 7,860</u>	<u>P 1,745</u>	<u>P 6,115</u>	<u>350.43%</u>

Sales of 2018 or Year 2	P 42,000	P 7,000/P 35,000 = 0.2
Sales of 2017 or Year 1	- <u>35,000</u>	or 20% (% of increase)
Amount of Increase	<u>P 7,000</u>	

Analysis/Interpretation:

1. Sales has increased by 20%. From P 35,000 to P42,000. Sales rate is higher than cost of goods sold (20% vs. 1.72%). It means more sales were done which increased in sales at a minimal increase in cost.
2. Sales Returns & Allowances has increased by 55%. It means more items/merchandise has been returned due to bad conditions upon shipment/delivery.
3. Sales Discounts has decreased by 50%. It means that customers cannot pay their accounts within the discount term due to its short discount term. Also, maybe the discount rate is too low that customers losing interest to pay within discount term.
4. Operating expense has increased by 84%. It is much higher than the increase in sales.

## RATIO ANALYSIS

Ratio analysis is a method of financial evaluation whereby the relationship between the items found in the Statement of Financial Position, Statement of Comprehensive Income or both are being established.

1. Liquidity Ratios. These ratios are very important to the short-term creditors of a company.
  - a. *Current Ratio* – it measures the ability of the business to pay its current obligations arising from operations. As much as possible, 1 or more current ratio is preferred.

Formula: Current Ratio = Current Assets/Current Liabilities

Example: Current Assets	1,000,000	
Current Liabilities	÷ <u>400,000</u>	
Current Ratio	2.5 or 2.5:1	

The current ratio of 2.5:1 indicates that for every one peso of current liability, there is P 2.5 of current asset to pay. This is a high indicative of its liability to pay the currently maturing obligation since it's more than 1.

The Current Ratio is also called Working Capital Ratio because the difference between current assets and current liabilities is called working capital.

Current Assets	1,000,000
Current Liabilities	- <u>400,000</u>
Working Capital	600,000

- b. *Acid-Test or Quick Ratio* – is a stricter test or measurement of the liability of the business to remove its non-cash current assets such as inventory and prepaid expenses in payment of its current obligations. As much as possible, 1 or more quick ratio is preferred.

Formula: Quick Ratio = (Current Assets-Inventories-Prepaid Expenses/Current Liabilities)

Example:

Quick Assets	800,000
Current Liabilities	÷ <u>400,000</u>
Quick Ratio	2 or 2:1

The quick ratio of 2.5:1 indicates that P 2.00 is used to pay the obligation of P 1.00. The business is very solvent.

## 2. Inventory Ratios

- a. *Rate of Inventory Turnover* – this ratio measures the number of times the company was able to sell its entire inventory to customers during the year. A high rate turnover ratio indicates a great demand of the commodities. The higher the better.

Formula: Rate of Inventory Turnover = Cost of Sales/Average Inventory

Example:

Merchandise Inventory, beginning	P 35,000
Add: Purchases	<u>130,000</u>
Cost of Goods Sold Available for Sale	P 165,000
Less: Merchandise Inventory, End	<u>15,000</u>
Cost of Sales	<u>P 150,000</u>
Merchandise Inventory, beginning	P 30,000
Merchandise Inventory, end	+ <u>20,000</u>
Total	P 50,000
	÷ <u>2</u>
Average Inventory	<u>P 25,000</u>

Rate of Inventory Turnover = Cost of Sales/Average Inventory  
6 times = P 150,000/P 25,000

- b. *Number of Days Sales in Inventory* – it indicates the length of time it takes to acquire, sell and replace the merchandise inventory.

Formula: Number of Days Sales in Inventory =  $\frac{\text{Number of Days in a Year or 365}}{\text{Rate of Inventory Turnover}}$   
60 days = 365 days/ 6 times

It takes 2 months to buy, sell and replace merchandise.

\*Inventory turnover is a measure of how efficiently a company can control its merchandise, so it is important to have a high turnover.

c. *Accounts Receivable Turnover* – it indicates the number of times the Accounts Receivable were collected from its customers.

Formula:  $\text{Accounts Receivable Turnover} = \text{Credit Sales} / \text{Average Receivable}$

Example:

Accounts Receivable, Jan. 1	P 25,000
Accounts Receivable, Dec. 31	15,000
Cash Sales	40,000
Credit Sales	160,000

Accounts Receivable, Jan. 1	P 25,000
Accounts Receivable, Dec. 31	+ 15,000
Total	P 40,000
	<u>÷ 2</u>
Average Accounts Receivable	<u>P 20,000</u>

$\text{Accounts Receivable Turnover} = \text{Credit Sales} / \text{Average Receivable}$   
8 times = P 160,000 / P 20,000

d. *Average Collection Period* – it indicates the number of days it takes to collect the customer's accounts.

Formula:  $\text{Average Collection Period} = \frac{\text{Number of Days in a Year or 365}}{\text{Accounts Receivable Turnover}}$

45 days = 365 days / 8 times

It takes 45 days to collect receivable.

3. Profitability Ratios. These ratios are used to select right investment opportunities.

a. *Rate of Return on Total Assets* – it measures the business' efficiency in utilizing its assets to generate profits. A higher return on assets is better.

Formula:  $\text{Rate of Return on Total Assets} = \frac{\text{Profit} + \text{Interest Expense}}{\text{Average Total Assets}}$

Example:

Profit for the Year	P 50,000
Interest Expense	10,000
Average Total Assets	200,000

$\text{Rate of Return on Total Assets} = \frac{\text{Profit} + \text{Interest Expense}}{\text{Average Total Assets}}$   
30 or 30% = P60,000 / P 200,000

The business earned an average of 30% for every peso of asset invested.

b. *Gross Profit Ratio* – it measures how profitable a company sells its product.

Formula:  $\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}}$

Example:

Net Sales	P 1,000,000
Cost of Sales	<u>500,000</u>
Gross Profit	<u>P 500,000</u>

$\text{Gross Profit Ratio} = \frac{\text{Gross Profit}}{\text{Net Sales}}$   
 50% = P 500,000 / P 1,000,000

The company has 50% of the sales revenue to cover operating expenses.

c. *Rate of Return on Investments* – it measures the profit's percentage generated by investment by owners.

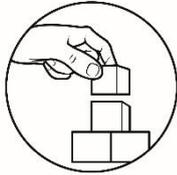
Formula:  $\text{Rate of Return on Investments} = \frac{\text{Profit}}{\text{Average Investment (Owner's Equity)}}$

Example:

Profit	P 7,000
Owner's equity, beginning	15,000

Owner's equity, end 20,000  
 Rate of Return on Investments = Profit/ Average Investment (Owner's Equity)  
 0.4 or 40% = P 7,000/ P 17,500

In every peso of investment, it earned 40 centavos profit. In other words, there is 40% return on their investment.



## What's More

Now, let us practice what you have learned from the topic discussed. Challenge your memory (if you still remember what you have learned from the discussion) by doing this activity.

Let's try this!

### Activity 3. "Medium Stage"

A.

Current Assets		Current Liabilities	
Year A	P 100,000	Year A	P 50,000
Year B	130,000	Year B	20,000

- The amount of increase (decrease) in the Current Assets is \_\_\_\_\_.
- The percent of increase (decrease) in the Current Assets is \_\_\_\_\_.
- The amount of increase (decrease) in the Current Liabilities is \_\_\_\_\_.
- The percent of increase (decrease) in the Current Liabilities is \_\_\_\_\_.
- The current ratio for Year A is \_\_\_\_\_. For year B is \_\_\_\_\_.

B. Make a vertical analysis.

Sales	P 73,000	_____
Less: Sales Returns & Allowances	<u>3,000</u>	_____
Net Sales	P 70,000	_____
Less: Cost of Sales	<u>55,000</u>	_____
Gross Profit	P 15,000	_____
Less: Operating Expense	<u>12,000</u>	_____
Profit	<u>P 3,000</u>	_____

C. Inventories		Sales		Accounts Receivable	
Beginning	P 80,000	Credit Sales	P 220,000	Beginning	P 50,000
Ending	60,000	Cost of Sales	210,000	Ending	90,000

Assume 365 days in a year.

- Inventory Turn-over \_\_\_\_\_
- Average age of Inventory \_\_\_\_\_
- Receivable Turn-over \_\_\_\_\_
- Average Collection Period \_\_\_\_\_



## ***What I Have Learned***

**Great Job!** You did well in your previous activity. Now, let us check your understanding of the lesson by underlining the highlighted word/s that complete the thought of each sentence. (10 points)

1. Liquidity is the company's ability to pay its (**short, long**) term obligations.
2. (**Liquidity, Solvency, Profitability**) is the company's capability to pay its long-term obligations as they fall due.
3. The base year in the comparative statements is the (**previous, current**) year.
4. The trend used in performing the Horizontal Analysis is the (**comparative, common-size**) statements.
5. Merchandise Inventory is (**included, excluded**) in determining the Acid-Test Ratio because it takes time to be converted into cash.
6. The current ratio of 4:1 is interpreted that every peso of your (**asset, liability**), you have P4 to pay.
7. A high rate on rate of inventory turn-over indicates a (**great, poor**) demand of the commodities.
8. Working capital is computed by (**deducting, adding, multiplying**) the current liabilities from the current assets.
9. Prepaid expenses are (**included, excluded**) in computing quick ratio.
10. A (**high, low**) rate of accounts receivable turn-over indicates efficiency in collecting the customer's account.



## ***What I Can Do***

**Wow!** It's good to know that are you are almost done. I hope you now have a deeper understanding and appreciation of analyzing financial statements. Are you now ready to apply what you have learned in this module in real life applications? If yes, do the next activity.

### **Activity 4: Last Stage**

Company A and Company B were competitors and both engaged in buying and selling the same products. Their Balance Sheet after operation is shown below.

	Company A	Company B
Current Assets:		
Cash in Bank	P 110,000	P 105,000

Accounts Receivable	85,000	65,000
Merchandise Inventory	125,000	75,000
Prepaid Expenses	20,000	6,000
Current Liabilities:		
Accounts Payable	40,000	35,000
Accrued Expense	20,000	--
Notes Payable	--	15,000

1. Determine the working capital of each company. \_\_\_\_\_
2. Which of the two companies has a better liquid position? Compute and interpret their respective current ratio.

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3. Which of the two companies was more liquid in terms of paying debts right away. Compute and interpret their respective acid-test ratio.

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## Assessment

**Congratulations!** You are now about to test what you have learned from this module.

Instruction: Read each question carefully and encircle the letter of your answer.

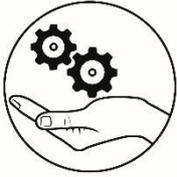
1. It is the capability of a company to pay its current obligations.
  - a. liquidity
  - b. solvency
  - c. profitability
  - d. none of these
2. This ratio measures the capability of a company to pay its current obligations.
  - a. liquidity ratio
  - b. solvency ratio
  - c. profitability ratio
  - d. none of these
3. The following ratios are used in measuring liquidity position of a company, except
  - a. quick ratio
  - b. acid-test ratio
  - c. current ratio
  - d. gross profit ratio
4. If current asset is P 10,000 and current liability is P 5,000, the current ratio is
  - a. two is to one
  - b. P 2,000
  - c. one is to two
  - d. none of these
5. It is the capability of a company to pay non-current liabilities as they fall due.
  - a. liquidity
  - b. solvency
  - c. profitability
  - d. agility
6. This ratio measures the capability of a company to pay non-current liabilities as they fall due.
  - a. liquidity ratio
  - b. solvency ratio
  - c. profitability ratio
  - d. none of these
7. Which financial ratios are used in financial statement analysis?
  - a. liquidity ratios
  - b. solvency ratios
  - c. profitability ratios
  - d. all of these
8. It is a common-size statement analysis or proportional analysis of a financial statements.
  - a. vertical analysis
  - b. diagonal analysis
  - c. horizontal analysis
  - d. ratio analysis

9. It is the comparison of two or more financial statements over the time.  
 a. vertical analysis b. diagonal analysis c. horizontal analysis d. ratio analysis
10. If current assets is P 200,000 and total assets is P 800,000, what percentage of total assets is current assets?  
 a. 2.5 percent b. 25 percent c. 250 percent d. none of these
11. A firm has liabilities of P 30,000 and owner's capital of P 70,000. The percentage of total liabilities to total assets is  
 a. 20 percent b. 25 percent c. 30 percent d. 43 percent
12. A firm had owner's capital of P125,000 in 2018 and P150,500 in 2019. The increase in owner's capital from 2018 to 2019 is  
 a. 20 percent b. 21 percent c. 16 percent d. 17 percent
13. The cost of goods sold and operating expenses excluding depreciation in 2018 amounted to  
 a. P 4,287,500 b. P 5,022,500 c. P 6,022,500 d. P 12,050,000

14. Selected information from Musang Company's accounting records is as follows:

Cost of good sold- 2019	P 1, 200, 000.00
Inventories January 1, 2019	350,000.00
Inventories – December 31, 2019	310,000.00

- Assuming a business year consisting of 360 days, what was the number of days' sales in average inventories for 2019?
- a. 82.5 days b. 99 days c. 100 days d. 77.5 days
15. Mindanao Electronics registered accelerated increases in its net income, earning P 437, 500.00 to P 1,260,000.00 in 2019. Rate of return on current assets increased from 25% in 2018 to 30% in 2019. Current asset turnover on the other hand, went up to 2. 67 turnovers in 2019 from 2.45 turnovers in 2018?
- The average investment in current assets for the company in 1991 was
- a. P 1,607,500 b. P 4,200,000 c. P 1, 750,000 d. P 5, 040,000



## ***Additional Activities***

I hope you have a learned a lot from the activities in this module. This additional activity is expected to enrich your knowledge about the analysis of financial statements.

### A. The balance sheet data of Malaya Company

Balance Sheet	2018	2019
Cash	P 30, 000.00	P 52, 000.00
Marketable security	170, 000.00	200, 000.00
Accounts Receivable, Net	100, 000.00	200, 000.00
Inventory	150, 000.00	100, 000.00
Machinery and Equipment	340, 000.00	300, 000.00
Land and Building, Net	110, 000.00	100, 000.00
Goodwill	80, 000.00	80, 000.00
Deferred Charges	20, 000.00	18, 000.00
Notes Payable, Trade	20, 000.00	30, 000.00
Accounts Payable, Trade	122, 000.00	158, 000.00
Expense Payable	8, 000.00	12, 000.00
Long term Note due 2031	500, 000.00	450, 000.00
15% Preferred Stock, P100 par	100, 000.00	100, 000.00
Common Stock, P10 par	200, 000.00	200, 000.00
Retained Earnings	50, 000.00	100, 000.00

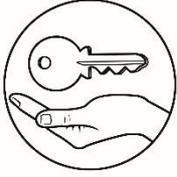
Prepare Comparative Balance Sheets for 2018 and 2019 shown peso and percentage increase of decrease (Horizontal Analysis)

### B. The income statement data of Malaya Company:

#### 2019 Income Statement Accounts

Sales	P 1,050,000.00
Sales Returns and Allowances	50, 000.00
Inventory December 31, 2019	100, 000.00
Inventory December 31, 2018	150, 000.00
Purchases	550, 000.00
Selling Expenses	80, 000.00
Administrative Expenses	120, 000.00
Interest on long Term Notes	50, 000.00
Income Taxes 35%	52, 500.00

Prepare income statement for the year ended December 31, 2019 with common – size percentages (Vertical Analysis)



# Answer Key

**What's More**

A.  
 1. P30,000 2. 30%  
 3. (P30,000) 4. (60%)  
 5. 2:1 and 6.5:1

B.  
 1. 104.29% 2. 4.29%  
 3. 100% 4. 78.58%  
 5. 21.43% 6. 17.14%  
 7. 4.29%

C.  
 1. 3 times 2. 121.67  
 3. 3.14 times 4. 116.24

**What's In**

1. A 11. b  
 2. A 12. b  
 3. L 13. b  
 4. OE 14. d  
 5. A 15. d  
 6. OE  
 7. A  
 8. L  
 9. OE  
 10. OE

**What I Know**

1. a 11. c  
 2. a 12. a  
 3. d 13. d  
 4. a 14. a  
 5. b 15. d  
 6. b  
 7. d  
 8. a  
 9. c  
 10. b

**Assessment**

1. a 11. c  
 2. a 12. a  
 3. d 13. a  
 4. a 14. c  
 5. b 15. b  
 6. b  
 7. d  
 8. a  
 9. c  
 10. b

**What I Can Do**

1. P280,000; P 201,000  
 2. Company A has a better liquid position.  
 5.67:1; 5.02:1  
 In every peso of Company's A current liability, there is P 5 of current asset to pay.  
 3. Company A was more liquid in terms of paying debts right away.  
 3.52:1; 3.4:1

**What I Have Learned**

1. short  
 2. Solvency  
 3. previous  
 4. comparative  
 5. excluded  
 6. asset  
 7. great  
 8. deducting  
 9. excluded  
 10. high

## ***Additional Activities***

MALAYA COMPANY  
CASH FLOW STATEMENT  
FOR THE YEAR ENDED DECEMBER 31, 2019  
(With Common – Size Percentages)

	<u>Amount</u>	<u>Percent</u>
Sales	P 1,050,000	100
Less: Sales Returns and Allowances	50,000	5
Net Sales	<u>P 1,000,000</u>	<u>100</u>
Cost of Goods Sold		
Inventory December 31, 2018	P 150,000	15
Add: Purchases	550,000	55
Total Goods Available for Sale	<u>700,000</u>	<u>70</u>
Less: Inventory December 31, 2019	100,000	10
Cost of Goods Sold	<u>600,000</u>	<u>60</u>
Gross Margin on Sales	<u>400,000</u>	<u>40</u>
Selling and Administrative Expenses		
Selling Expenses	80,000	8
Administrative Expenses	120,000	12
Less: Total Selling and Administrative Expenses	<u>200,000</u>	<u>20</u>
Net Operating Income	<u>200,000</u>	<u>20</u>
Net Operating Income	200,000	20
Less: Interest on long Term Notes	50,000	5
Net Income before Income Taxes	<u>150,000</u>	<u>15</u>
Less: Provision for income Tax 35%	52,500	5.2
NET INCOME	<u><u>97,500</u></u>	<u><u>9.8</u></u>

# ***References***

## **Book:**

Rafael M. Lopez, Jr. (2017) Fundamentals of Accountancy, Business and Management 2

## **DISCLAIMER**

This Self-learning Module (SLM) was developed by DepEd – Division of General Santos City with the primary objective of preparing for and addressing the new normal. Contents of this module were based on DepEd’s Most Essential Learning Competencies (MELC). This is a supplementary material to be used by all learners in General Santos City in all public schools beginning SY 2020-2021. The process of LR development was observed in the production of this module. This is version 1.0. We highly encourage feedback, comments, and recommendations.

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