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## Financial Statement Analysis

# LEARNING OBJECTIVES

- Complete a horizontal analysis
- Complete a vertical analysis
- Prepare common-size financial statements
- Calculate various financial ratios

# Benchmarks

Figures against which current period account balances may be compared:

- Prior performance
- Competitor's balances
- Industry standards

# Horizontal Analysis

- This type of analysis is typically performed on the income statement and/or balance sheet.
- Dollar changes for each account are calculated by subtracting the earlier year figure from the later year figure.

**Percent Change = Dollar Change ÷ Base Year**

# Horizontal Analysis--Example

## Horizontal Analysis Income Statement

Wileson Legal Advisors Comparative Income Statement For the Years Ended June 30, 2026 and June 30, 2027				
	2027	2026	Dollar Change	Percent Change
<b>Revenues:</b>				
Sales Revenue	\$ 48,750	\$ 39,000	\$ 9,750	25.00%
Interest Revenue	1,350	1,425	(75)	-5.26%
Total Revenue	50,100	40,425	9,675	23.93%
<b>Expenses:</b>				
Rent Expense	14,250	14,250	-	0.00%
Insurance Expense	8,750	7,200	1,550	21.53%
Depreciation Exp. - Truck	3,550	3,550	-	0.00%
Utilities Expense	1,875	1,220	655	53.69%
Supplies Expense	1,530	1,620	(90)	-5.56%
Telephone Expense	1,300	740	560	75.68%
Miscellaneous Expense	475	500	(25)	-5.00%
Total Expenses	31,730	29,080	2,650	9.11%
<b>Net Income</b>	<b>\$ 18,370</b>	<b>\$ 11,345</b>	<b>\$ 7,025</b>	<b>61.92%</b>

# Vertical Analysis

- This type of analysis is typically performed on the income statement and/or balance sheet.
- The percentage for each account is calculated by dividing its balance by the base figure in the balance sheet.
  - The base figure on an income statement is commonly total revenue.
  - The base figures on a balance sheet are total assets and total liabilities and owner's equity.

# Vertical Analysis--Example

## Vertical Analysis Income Statement

Nathan's Donut School Income Statement For the Month Ended March 31, 2027		
	Dollar Amount	Percentage
<b>Revenues:</b>		
Service Revenue	\$ 3,500	100.00%
<b>Expenses:</b>		
Rent Expense	1,700	48.57%
Wages Expense	750	21.43%
Supplies Expense	315	9.00%
Advertising Expense	250	7.14%
Total Expenses	3,015	86.14%
<b>Net Income</b>	<u>\$ 485</u>	<u>13.86%</u>

# Liquidity Ratios

These indicate how quickly a company can convert assets to cash.

- Current ratio
- Quick ratio

**Current Ratio = Current Assets ÷ Current Liabilities**

**Quick Ratio =  $\frac{\text{Cash} + \text{Short-Term Investments} + \text{A/R}}{\text{Current Liabilities}}$**

# Solvency Ratios

These gauge a company's ability to meet long-term obligations.

- Debt ratio
- Equity ratio
- Debt-to-equity ratio

**Debt Ratio = Total Liabilities ÷ Total Assets**

**Equity Ratio = Total Equity ÷ Total Assets**

**Debt-to-Equity Ratio = Total Liabilities ÷ Total Equity**

# Profitability Ratios

These provide insight into a company's ability to effectively generate income.

- Profit margin
- Return on assets

**Profit Margin = Net Income ÷ Revenue**

**Return on Assets = Net Income ÷ Avg. Total Assets**