The goal of my lesson is to introduce students to the concept of financial analysis.

I'll ask students the following: "Is it a problem that Company X's Accounts Receivable balance grew from $300,000 in 2012 to $500,000 in 2013?" I expect that most students will say yes because $500,000 is higher than $300,000. They will assume that the company's credit policy needs to be tightened. This will be the context for a discussion on the difference between absolute and relative numbers.

I'll explain that more analysis is needed before we reach a conclusion. While a growing accounts receivable balance could be indicative of a failure to collect balances owed by customers from credit sales, it could also be a product of healthy business growth (more sales usually lead to higher A/R balances). This will lead to a discussion of calculating a percentage share (a relative number) and why the percentage share may form the basis of a more competent judgment than an absolute number. We will practice computing relative numbers using information from the income statement and balance sheet.

To illustrate, I will ask my students to consider a scenario in which sales were $1,000,000 in 2012 and $1,800,000 in 2013. As a percentage of sales, Accounts Receivable decreased year over year from 30.0% to 27.8%. The analysis indicates that robust sales growth may be responsible the accounts receivable increase rather than a collections problem. Students will see that quantitative analysis can correct the "fast thinking" that lead them to their initial conclusion that their was a collections problem.

Knowledge and Conceptual Understanding

Define absolute and relative numbers.

Thinking and Other Skills

Calculate a relative number (percentage share) using information found on the income statement and balance sheet.

Attitudes, Values, Dispositions and Habits of Mind

Use the relative number as the basis of an informed opinion. Exhibit a readiness to use quantitative analysis (specifically financial analysis) as a tool to make judgments in "real world" situations.