

Apply Horizontal Analysis and Vertical Analysis To Financial Statements Based On IFRS

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Abstract

The purpose of this paper is to examine of the International Financial Reporting Standard (IFRS) apply horizontal analysis and vertical analysis to financial statements based on IFRS. On the content of the analysis of financial statements based IFRS the author shows that basic of financial statement analysis such as apply horizontal analysis and vertical analysis to financial statements. Every item reported in a financial statement has significance. Various analytical techniques are used to evaluate the significance of financial statement data. The analysis emphasizes the apply horizontal analysis and vertical analysis to financial statements based on IFRS on the content and composition of financial statement analysis today.

Keywords: Horizontal and Vertical Analysis, financial statements

1. Introduction

In the current era of globalization forcing every company to be able to compete and adapt in the global market in order to survive from competitors. Companies can expand their business and put the company in global competition. In this case the company must pay attention to the importance of financial statements for its survival in the market. This financial report will later be used to evaluate the policies that will be implemented and the policies that have been implemented in the company. According to Weygandt, Kimmel and Kieso (2013) there are two methods to analyze the financial statements of a company. First, horizontal analysis is a technique for evaluating a series of financial statement data over a certain period of time. Next, there is vertical analysis, which is a technique that reveals each financial statement item as a percentage of the basic amount.

2. Literature Review

The financial statements describe the financial condition and results the business of a company at a certain time or a certain period of time. Need for Comparative Analysis is every item reported in a financial statement has significance. Various analytical techniques are used to evaluate the significance of financial statement data.

International Financial Reporting Standards (IFRS) is a standard, interpretations, and frameworks adopted by accounting standard setting bodies international standard known as International Accounting Standards Board (IASB), the IASB is an independent organization headquartered in London, English (Ball, 2003). IFRS is the latest model of international accounting standard, which was previously a collection of several standards known as International Accounting Standards (IAS).

In countries that implement IFRS as a reporting method. There are several financial benefits that will be obtained. Impact of convergence IFRS are as follows:

1. Alignment of international accounting standards can improve the quality in financial statements
2. The adoption of IFRS can bring something positive, namely it can increase the comparability of information in financial statements at the level of international.
3. Financial reports can be more easily presented to global investors, and access international channel funding will be easier.
4. Financial statements will use more fair value (fair value)
5. The use of fair value will be used in the financial statements so that it will increasingly difficult to do income smoothing.

According to Kvaal and Nobes (2010) International Accounting Standards are becoming very important in developing countries, because IFRS convergence will be a cost cheaper than having to prepare their own accounting standards. Existence principles-based IFRS convergence has resulted in companies having to have professionals who have adequate skills. Likewise, because there IFRS convergence accountants must also have extensive knowledge in corporate business and economics before making a decision.

3. METHODS

Horizontal analysis, also called trend analysis, is a technique for evaluating a series of financial statement data over a period of time. The purpose is to determine the increase or decrease that has taken place. Commonly applied to the statement of financial position, income statement, and retained earnings statement. Horizontal Analysis, Comparative Analysis through comparison with budget (budget) and comparisons for two years, for example the 2021 financial statements, compared to the 2020 financial statements. And the 2022 financial statements compared to the 2021 financial statements.

The purpose of this comparative analysis is to find out changes in the form of an increase or decrease in financial statement accounts or data other in two or more periods being compared. Analytical techniques that can be used include: (http://www.EchoRosari, Methods and Techniques of Analysis Financial Report, Tuesday, March 15, 2011)

Vertical Analysis, which is the analysis used to find out relationship between certain items in the Balance Sheet or Profit/Loss Statement (Calculation Operating Results) either individually, or a combination of the two reports. Vertical analysis, also called common-size analysis, is a technique that expresses each financial statement item as a percent of a base amount.

- On an income statement, we might say that selling expenses are 16% of net sales.
- On a statement of financial position, we might say that current assets are 22% of total assets.

Vertical analysis is commonly applied to the statement of financial position and the income statement. Changes suggest that the company expanded its asset base during 2020 and financed this expansion primarily by retaining income rather than assuming additional long-term debt.

4. RESULT AND DISCUSSION

4.1. Result

Statement of Financial Position

Quality Department Store Condensed Statements of Financial Position December 31				
	202x	202x	Increase or (Decrease) during 2020	
			Amount	Percent
Assets				
Intangible assets	€ 15,000	€ 17,500	€ (2,500)	(14.3%)
Plant assets (net)	800,000	632,500	167,500	26.5%
Current Assets	1,020,000	945,000	75,000	7.9%
Total assets	€1,835,000	€1,595,000	€ 240,000	15.0%
Equity				
Share capital—ordinary, €1 par	€ 275,400	€ 270,000	€ 5,400	2.0%
Retained earnings	727,600	525,000	202,600	38.6%
Total equity	1,003,000	795,000	208,000	26.3%
Liabilities				
Non-current liabilities	€ 487,500	€ 497,000	€ (9,500)	(1.9%)
Current liabilities	344,500	303,000	41,500	13.7%
Total liabilities	832,000	800,000	32,000	4.0%
Total equity and liabilities	€1,835,000	€1,595,000	€ 240,000	15.0%

- In the assets section, plant assets (net) increased €167,500, or 26.5%.
- In the equity section, retained earnings increased €202,600, or 38.6%.
- In the liabilities section, current liabilities increased €41,500, or 13.7%.

Changes suggest that the company expanded its asset base during 2020 and financed this expansion primarily by retaining income rather than assuming additional long-term debt.

Income Statement

Quality Department Store Condensed Income Statements For the Years Ended December 31				
	2020	2019	Increase or (Decrease) during 2020	
			Amount	Percent
Sales revenue	€ 2,195,000	€ 1,960,000	€ 235,000	12.0%
Sales returns and allowances	98,000	123,000	(25,000)	(20.3%)
Net sales	2,097,000	1,837,000	260,000	14.2%
Cost of goods sold	1,281,000	1,140,000	141,000	12.4%
Gross profit	816,000	697,000	119,000	17.1%
Selling expenses	253,000	211,500	41,500	19.6%
Administrative expenses	104,000	108,500	(4,500)	(4.1%)
Total operating expenses	357,000	320,000	37,000	11.6%
Income from operations	459,000	377,000	82,000	21.8%
Other income and expense				
Interest and dividends	9,000	11,000	(2,000)	(18.2%)
Interest expense	36,000	40,500	(4,500)	(11.1%)
Income before income taxes	432,000	347,500	84,500	24.3%
Income tax expense	168,200	139,000	29,200	21.0%
Net income	€ 263,800	€ 208,500	€ 55,300	26.5%

Overall, gross profit and net income were up substantially. Gross profit increased 17.1%, and net income, 26.5%. Quality's profit trend appears favorable.

Retained Earnings Statement

Quality Department Store Retained Earnings Statements For the Years Ended December 31				
	2020	2019	Increase or (Decrease) during 2020	
			Amount	Percent
Retained earnings, Jan. 1	€ 525,000	€ 376,500	€ 148,500	39.4%
Add: Net income	263,800	208,500	55,300	26.5%
	788,800	585,000	203,800	
Deduct Dividends	61,200	60,000	1,200	2.0%
Retained Earnings, Dec. 31	€ 727,600	€ 525,000	€ 202,600	38.6%

In the horizontal analysis of the statement of financial position the ending retained earnings increased 38.6%. As indicated earlier, the company retained a significant portion of net income to finance additional plant facilities.

Statement of Financial Position

Quality Department Store Condensed Statements of Financial Position December 31				
	2020		2019	
	Amount	Percent	Amount	Percent
Assets				
Intangible assets	€ 15,000	0.8%	€ 17,500	1.1%
Plant assets (net)	800,000	43.6%	632,500	39.7%
Equity				
Share capital—ordinary, €1 per	€ 275,400	55.0%	€ 270,000	56.8%
Retained earnings	727,600	39.7%	525,000	32.9%
Total equity	1,003,000	54.7%	795,000	49.8%
Liabilities				
Non-current liabilities	€ 487,500	26.5%	€ 497,000	31.2%
Current liabilities	344,500	18.8%	303,000	19.0%
Total liabilities	832,000	45.2%	800,000	50.2%
Total equity and liabilities	€1,835,000	100.0%	€1,595,000	100.0%

- In the assets section, current assets decreased from 59.2% of total assets in 2019 to 55.6% in 2020.
- Plant assets (net) increased from 39.7% to 43.6% of total assets.
- Retained earnings increased from 32.9% to 39.7% of total equity and liabilities.
- These results reinforce the earlier observations that Quality is choosing to finance its growth through retention of earnings rather than through issuing additional debt.

Income Statement

Quality Department Store Condensed Income Statements For the Years Ended December 31				
	2020		2019	
	Amount	Percent	Amount	Percent
Sales revenue	€ 2,185,000	104.7%	€ 1,980,000	100.0%
Sales returns and allowances	98,000	4.7%	128,000	6.7%
Net sales	2,087,000	100.0%	1,852,000	100.0%
Cost of goods sold	1,281,000	61.2%	1,140,000	61.6%
Gross profit	806,000	38.8%	712,000	38.4%
Selling expenses	211,000	10.1%	211,500	11.5%
Administrative expenses	104,000	5.0%	108,500	5.8%
Total operating expenses	315,000	15.6%	320,000	17.4%
Income from operations	491,000	23.9%	392,000	21.2%
Other income and expense				
Interest and dividends	8,000	0.4%	11,000	0.6%
Interest expense	16,000	0.7%	40,500	2.2%
Income before income taxes	483,000	23.6%	362,500	19.6%
Income tax expense	188,200	9.0%	138,000	7.5%
Net income	€ 294,800	14.6%	€ 224,500	12.1%

Quality Department Store appears to be a profitable business that is becoming even more successful.

Income Statement

Condensed Income Statements For the Year Ended December 31, 2020 (in thousands)				
	Quality Department Store		Park Street	
	Amount	Percent	Amount	Percent
Net sales	€ 2,097	100.0%	€17,556,000	100.0%
Cost of goods sold	<u>1,281</u>	<u>61.1%</u>	<u>10,646,000</u>	<u>60.6%</u>
Gross profit	<u>816</u>	<u>38.9%</u>	<u>6,910,000</u>	<u>39.4%</u>
Selling and administrative expenses	<u>357</u>	<u>17.0%</u>	<u>6,247,000</u>	<u>35.6%</u>
Income from operations	459	21.9%	663,000	3.8%
Other income and expense (including income taxes)	<u>195</u>	<u>9.3%</u>	<u>412,000</u>	<u>2.4%</u>
Net income	<u>€ 264</u>	<u>12.6%</u>	<u>€ 251,000</u>	<u>1.4%</u>

Enables a comparison of companies of different sizes

4.2. Discussion

Horizontal analysis quality's profit trend appears favorable. Horizontal analysis is carried out by comparing the number of each current year's financial statement account with the same account in the previous period to determine the increase or decrease that occurred in that account. The increase or decrease is divided by the previous period's account and multiplied by one hundred percent to find out the percentage increase or decrease in the account and the increase or decrease in the number of items is calculated as a percentage increase or decrease.

Vertical analysis focuses on the financial relationship between financial statement items for one period. In a vertical analysis of the balance sheet, each asset item is expressed as a percent of total assets. Each liability and owner's equity item is expressed as a percent of total liabilities and owner's equity. In a vertical analysis of the income statement, each item is expressed as a percent of total revenue or income. From the horizontal analysis, the increase in sales revenue is a good trend which may be caused by additional investment. However, this was not offset by an increase in profit for the year, because operating expenses experienced a large percentage increase.

5. CONCLUSION

To analyze the financial statements, data is presented for at least the last 3 years so that growth data is obtained for the last 2 years. Financial statement analysis is useful for:

1. Knowing the financial strength and profitability in protecting creditors
2. Knowing the condition and performance of the company
3. Reflecting the condition and performance

Horizontal analysis is useful for knowing the growth trend of each forecast from time to time, so that the direction of business growth of the entity can be predicted. For analyze the fairness of the existing financial statements. For example: if a company's production costs are 1 billion, it will be a question if production costs increase rapidly without being followed by external factors that influence. Another example can be seen in the sales growth target every year. Deviations that occur from the targets that have been set need to be studied further to analyze their fairness

Vertical analysis emphasizes the analysis of each account/estimate against the specified reference account/estimate. For example, what is the value in % for the estimated credit given to total assets. What is the % of third party funds to total liabilities. how much % portion of interest income from loans. Vertical analysis is useful for knowing the concentration of assets, liabilities and income so that a conclusion can be drawn about the characteristics of the entity that presents the financial statements and see the effect if there are macroeconomic changes. Comparing one item to another in a financial statement period is made in percentage, where one comparison item is set as a benchmark. The goal is to find out the contribution of each post to the post that is used as a comparison. Both analysis techniques, both vertical and horizontal, are used together to provide a better and more comprehensive analysis.

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