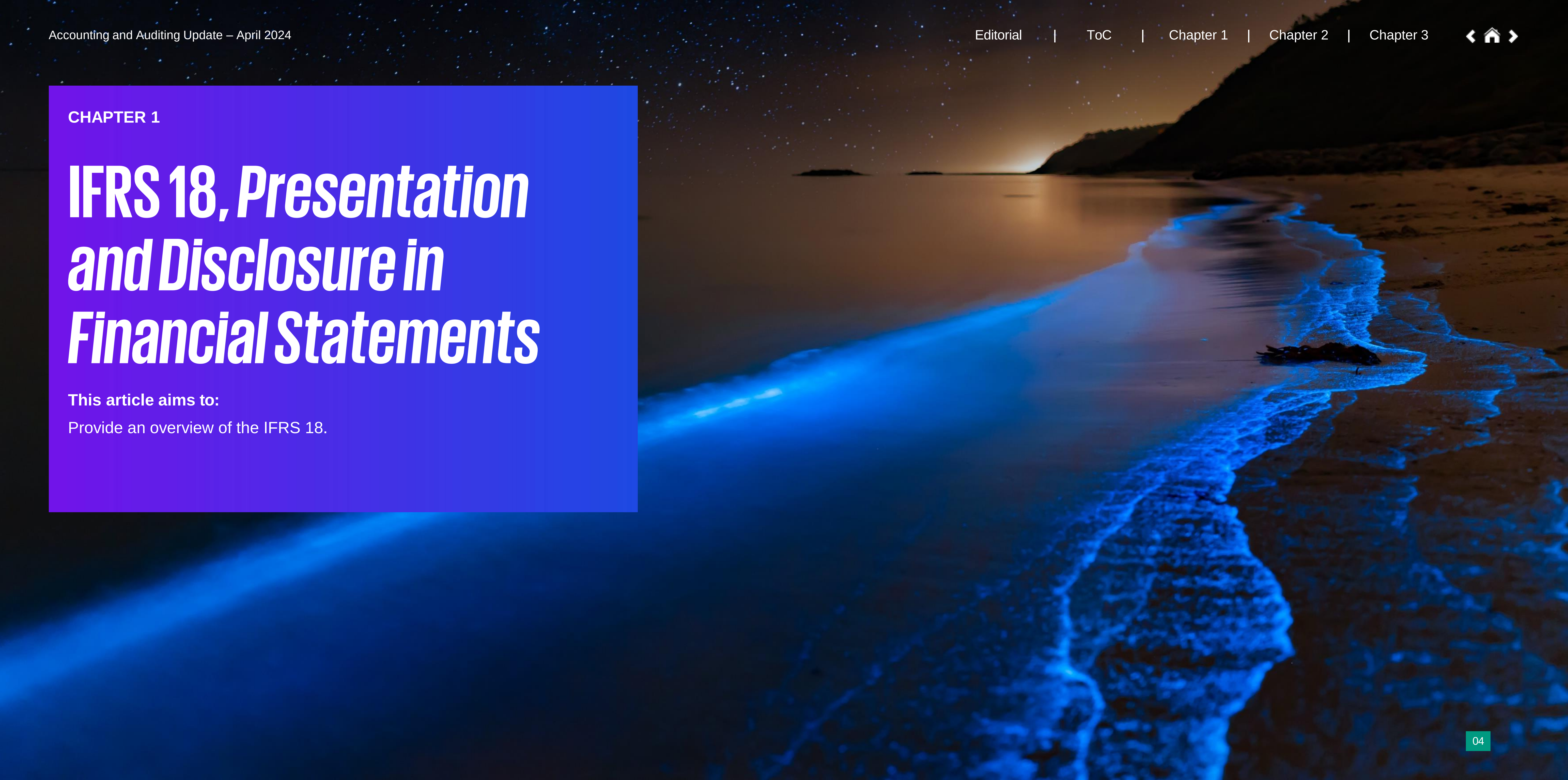

CHAPTER 1

IFRS 18, *Presentation and Disclosure in Financial Statements*

This article aims to:

Provide an overview of the IFRS 18.

Introduction

On 9 April 2024 the International Accounting Standards Board (IASB) issued IFRS 18 *Presentation and Disclosure in Financial Statements*. IFRS 18 replaces IAS 1 *Presentation of Financial Statements* with effect from accounting periods beginning on or after 1 January 2027. The requirements in IAS 1 that are unchanged have been transferred to IFRS 18 and other Standards. Companies will be required to apply the new requirements in interim financial statements in the initial year of application, and to restate comparative information for the prior year ('apply IFRS 18 retrospectively') in accordance with IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*.

The objective of IFRS 18 is to improve communication of financial information in the financial statements, particularly the statement of profit or loss.

Essentially, companies' net profit will not change. What will change is how they present their results on the face of the income statement and disclose information in the notes to the financial statements.

Investors wanted comparable subtotals and more disaggregation of information to better understand a company's performance and enable greater comparability between companies. IASB noted that while some companies present an "operating profit or loss" subtotal today, it is calculated differently, and this diversity made it challenging for investors to compare across companies. In response to investors' calls for more relevant, transparent and comparable information IFRS 18 have been introduced.

IFRS 18 will affect companies across all industries that prepare financial statements under IFRS Accounting Standards.

Overview of IFRS 18

Some of the key changes brought in by IFRS 18 are introduction of three categories of income and expenses, two income statement subtotals and one single note on management performance measures. These, combined with enhanced disaggregation guidance, will set the stage for better and more consistent information for users – and will affect all companies.

IFRS 18 affects the complete set of financial statements, including:

Primary financial statements

- **statement of financial position** (balance sheet)
- **statement of profit or loss** (income statement)
- **statement presenting comprehensive income**
- **statement of changes in equity**
- **statement of cash flows** (cash flow statement)
- **and the notes to the financial statements**

Legend:

Major changes

Some changes

Minimal changes

Requirements on grouping of information will affect the complete set of financial statements.

(Source: Project Summary of IFRS 18 issued by IASB, April 2024)

Major impact on the Statement of Profit or Loss (income statement)

IFRS 18 have introduced subtotals in the statement of profit or loss where a company will classify income and expenses into **operating**, **investing** and **financing** categories plus **income taxes** and **discontinued operations**; and will present two new defined subtotals:

a. Operating profit and

b. Profit before financing and income taxes in the statement of profit or loss.

The standard further requires companies to analyse the operating profit either by nature, by function or using mixed presentation. If any operating expenses are presented by function or using mixed presentation, then new disclosures will apply.

This information is likely to provide investors a breakup of operating profit and profit before investing and financing activities where operating profit is used as a comparable measure of financial performance and a starting point for forecasting future cash flows.

How will the income statement look now?

Income statement
Companies without specified main business activities

Operating*	Revenue	X
	Operating expenses (analysed by nature, function or both as appropriate)	(X)
	Operating profit	**X**
Investing*	**Share of profit or loss of equity-accounted investees**	X
	Income from other investments	X
	Interest income from cash and cash equivalents	X
	Profit or loss before financing and income tax*	**X**
Financing*	Interest expense on borrowings and lease liabilities	(X)
	Interest expense on pension liabilities	(X)
	Profit before tax	**X**
	Income tax	(X)
	Profit for the year	**X**

* The operating, investing and financing categories are not aligned with those for the cash flow statement.

* Companies providing financing to customers as a main business activity (e.g. banks) typically do not present this subtotal.

(Source: How companies communicate financial performance is changing, KPMG IFRG Limited's publication, April 2024)

Major impact in the notes to financial statements

a. MPMs to be disclosed in the notes to financial statements.

Non-GAAP measures that are a subtotal of income and expenses i.e. Management-defined Performance Measures ("MPM") (other than those listed by IFRS 18 or specifically required by IFRS Accounting Standards) which are used in public communications outside financial statements and are used to communicate to investors management's view of an aspect of the financial performance of the company as a whole will be reported now as a part of noted in the financial statements and subject to audit.

Companies often use these MPMs to explain their financial performance because it allows them to tell their own story and provides investors with useful insight into a company's performance.

IFRS 18 now requires the companies to identify and disclose these MPMs in the financial statements. For each MPM presented, companies will need to explain in a single note to the financial statements why the measure provides useful information, how it is calculated and reconcile it to an amount determined under IFRS Accounting Standards including tax and non - controlling interest effects for each reconciling item.

Making certain non-GAAP measures part of audited financial statements will bring more credibility to management's key performance indicators.

Some of the examples of MPMs are "adjusted profit", "adjusted operating profit" or "Adjusted earnings before interest, tax, depreciation and amortisation".

b. Enhanced requirements for grouping (aggregation and disaggregation) of information

IFRS 18 sets out requirements to help companies determine whether information about items should be in the primary financial statements or in the notes and provides principles for determining the level of detail needed for the information. Under more aggregated information the companies in its primary financial statements will be required to provide **'useful structured summary'** of the company's assets liabilities, equity, income, expense and cash flows. Under more disaggregated information the companies in its notes will be required to provide 'additional **material** information'.

IFRS 18 also includes requirements for the presentation of operating expenses in the statement of profit or loss, disclosure of specified expenses by nature. Companies are discouraged from labelling items as 'other' and will now be required to disclose more information if they continue to do so.

There are certain clarifications provided in the standard with regard to:

- **Operating Category**

  The standard states that the operating category is a default category and will include all income and expenses arising from a company's operations, regardless of whether they are volatile or unusual in some way. It will also include, but will not be limited to, income and expenses from a company's main business activities which means that income and expenses from other business activities, such as income and expenses from additional activities, will also be classified in the operating category if those income and expenses do not meet the requirements to be classified in any of the other categories.

- **Investing Category**

  This will include income and expenses from assets that generate returns separately from a company's business activities—for example, a company might collect rentals from an investment property or dividends from shares in other companies and; income and expenses from cash and cash equivalents and investments in associates and joint ventures—for example, a company might earn its share of profits from an associate.

- **Financing Category**

  This will include income and expenses on liabilities such as bank loans and bonds (liabilities arising from pure financing transactions); and interest expenses on any other liability, for example, lease and pension liabilities. Therefore, the financing category includes interest expenses on all liabilities.

- **Classification of foreign exchange differences**

  Foreign exchange differences are classified in the same category of the statement of profit or loss as the income and expenses from the items that gave rise to the foreign exchange differences. For example, foreign exchange differences on bank loans are classified in the financing category.

- **Nature of business that may impact in the classification**

  Some companies invest in assets or provide financing to customers as a main business activity—for example, banks and insurers. Income and expenses that would otherwise be classified in the investing or financing categories by most companies would form part of the operating result for such companies. IFRS 18 therefore requires these income and expenses to be classified in the operating category.

Changes introduced to other IFRS Standards

IFRS 18 has also introduced changes to other IFRS Accounting Standards, the most important include:

IAS 7, *Statement of Cash Flows*

- Operating Profit will be the starting point for the indirect method
- The option for classifying interest and dividend cash flows as operating activities has been eliminated[1].

IAS 34, *Interim Financial reporting*

IAS 34 was amended to require companies to disclose information about MPMs in interim financial statements. Some of the other changes (including those about subtotals) also apply to condensed financial statements in interim reports.

1. Classifying interest and dividends will differ for companies with specified main business

Our Comments

IFRS 18 marks a step towards more connected reporting. It will significantly update the requirements for presentation and disclosures in the financial statements, with a particular focus on improving the reporting of financial performance.

The major impact will extend to statement of profit or loss and notes to financial statements with some minor changes to statement of cash flows and balance sheet.

Statement of profit or loss

- All Companies will need to carefully assess which income and expenses belong in each category. Classification will vary depending on whether a company has specified main business activities.
- Companies with multiple main business activities that include specified main business activities may find it onerous to classify income and expense in the income statement.
- Presentation by function and mixed presentation of operating expenses would represent a significant change to Ind AS 1. This is because Ind AS 1 currently mandates presentation of income and expenses by nature only in the statement of profit and loss.

Notes to financial statements

- Certain 'non-GAAP' measures that meet the definition of MPMs will now be reported in the financial statements and subject to audit. As a result, companies may need to decide to revisit the purpose and relevance of existing 'non-GAAP' measures communicated outside of the financial statements.
- The reconciliation under MPMs may involve additional effort. For instance, a company may need to develop an appropriate method to calculate income tax effect for each reconciling item in the note.

Next Steps

The new standard is effective from 1 January 2027 and applies retrospectively. It is also available for early adoption.

The companies will also have to carefully assess and evaluate the impact of requirements of the new standard in its financial statements and need to plan in advance and invest time as the standard will apply retrospectively. In addition to the presentation and disclosures changes due to IFRS 18, companies will also have to assess their strategy to explain the impact of change to their stakeholders such as investors and analysts. Additionally, this would also require changes to systems and processes including, IT systems, internal controls, etc.

Ind AS is converged to IFRS and IFRS 18 would be adopted in due course. The changes brought in by IFRS 18 would also need to be incorporated in the Schedule III to the Companies Act, 2013.

Certain amendments have also been made in other standards like IAS 7, IAS 33 and IAS 34 to align with the requirements of IFRS 18 which the companies will have to monitor and track the impact in its financial statements.