

IFRS 18: Transforming the Presentation of Financial Statements - A Way Forward & Its Implementation Issues in Global and Indian Context

Debjyoti Dey

Assistant Professor (Finance & Accounting), School of Business Management,
Narsee Monjee Institute of Management Studies (NMIMS), Mumbai

debjyoti.dey1@gmail.com

and

Sapana Dey

Assistant Professor, Department of Commerce (Accounting & Finance), Smt. P N
Doshi Women's College, SNDT Women's University, Mumbai

sapanamishra875@gmail.com

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ABSTRACT

IFRS 18, which was introduced in April 2024 and is set to take effect from January 1, 2027, aims to enhance the clarity and comparability of financial statements in response to the increasing demand from investors for more transparent information on financial performance. The objective of this paper is to highlight the changes that IFRS 18 (known as Ind AS 118 in the Indian context) will bring to the preparation of financial statements, both globally and within India, following its implementation in 2027.

The paper is entirely descriptive in nature and discusses the key amendments introduced by these accounting standards. This new standard, emerging from the IASB's Primary Financial Statements project, introduces a structured framework for the statement of profit or loss, mandating the inclusion of two pivotal subtotals: 'Operating Profit' and 'Profit Before Financing and Income Taxes.' By precisely defining these metrics, IFRS 18 aims to enhance stakeholders' understanding of a company's operational efficiency and its financial results prior to the influence of financing and tax considerations.

In addition, companies are required to disclose management-defined performance measures (MPMs) in a designated note, offering further insights into financial performance that extend beyond traditional GAAP metrics. Furthermore, the standard emphasizes the systematic aggregation and disaggregation of financial statement elements based on their nature, thereby enhancing the materiality and relevance of the disclosed information. Collectively, these requirements strive to promote greater transparency and informed decision-making among investors and analysts, ultimately improving the overall quality and utility of financial reporting across various entities.

Keywords: IAS 1, IFRS 18, Ind AS, Management-defined Performance Measures (MPM)

A. INTRODUCTION

IFRS 18 was introduced in April 2024 and is set to take effect on January 1, 2027. The delay in implementation is intended to provide companies sufficient time to prepare (Deloitte, 2024). However, companies have the option to voluntarily adopt IFRS 18 prior to this effective date. This new standard emerged from the IASB's efforts on the Primary Financial Statements (PFS) project and addresses investors' demands for enhanced information regarding companies' financial performance. The objective behind bringing a new accounting standard (i.e., IFRS 18) by replacing the IAS 1 is to communicate more relevant information in financial statements, thereby offering investors a more reliable foundation for analysing and comparing company performance (KPMG, 2024).

The recognition and measurement of financial statement components will remain unchanged under this accounting standard. Consequently, net income and shareholders' equity will stay consistent with previous reporting practices. Nonetheless, IFRS 18 will have a substantial effect on the way the financial statements are presented, particularly the income statement and its accompanying footnotes (Deller, A. 2024). In contrast to IAS 1, which did not establish predefined sub-totals and resulted in inconsistencies among companies, IFRS 18 is going to provide clarity by explicitly defining the sub-totals that should be presented on the face of the income statement as line items.

B. OBJECTIVE OF THE STUDY

The objective of this study is to examine how IFRS 18 will change the presentation of financial statements, with a particular focus on both global and Indian contexts. Given the limited number of research papers and academic articles currently available on this topic, the study aims to address this gap by exploring the key issues that may arise from the implementation of IFRS 18. These include *the new sets of requirements introduced*, *the revised classification of line items in the income statement*, and *the managerial implications associated with adopting the standard*.

Although major accounting and auditing firms such as KPMG, Deloitte, EY, and PwC have released some reports and preliminary analyses in this area, academic research remains limited, likely because IFRS 18 has not yet been fully implemented.

This paper therefore seeks to serve as a foundational contribution by sharing the proposed changes that IFRS 18 will bring, thereby a greater understanding and discussion within the academic community. The present study is not an analytical investigation; rather, it is a discussion paper that aims to conceptually explore the proposed changes under IFRS 18 and their potential implications.

The discussion in this paper is organized under the following broad sub-headings:

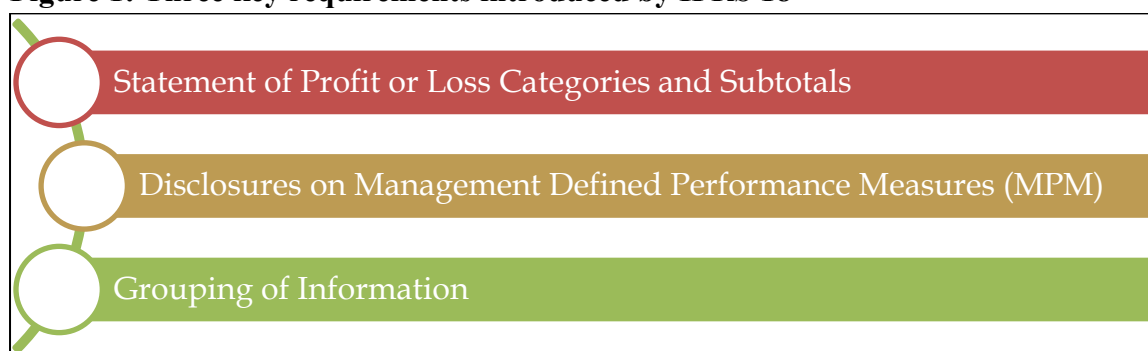
- a. Three Sets of Requirements Introduced by IFRS 18*
- b. Proposed Changes in the Categories and Subtotals of the Statement of Profit or Loss*
- c. Inclusion of Management-Defined Performance Measures (MPMs)*
- d. Grouping of Information: Principles of Aggregation and Disaggregation*
- e. Enhancing Investor Insights Through the Implementation of IFRS 18*
- f. Implementation Issues of Ind AS 118 (Corresponding to IFRS 18) in the Indian Context.*

C. DISCUSSION ON KEY ISSUES PERTAINING TO IFRS 18 IMPLEMENTATION

a. *Three sets of requirements introduced by IFRS 18*

- **First set of requirements:** In financial reporting, companies are now required to present a statement of profit or loss that incorporates two distinct subtotals: 'Operating Profit' and 'Profit Before Financing and Income Taxes'. This approach aims to enhance the consistency and comprehensiveness of financial statements, thereby improving understandability and comparability across different entities. By clearly delineating these key performance metrics, stakeholders can gain deeper insights into a company's operational efficiency and its financial performance before the impact of financing costs and tax obligations. This structured presentation fosters greater transparency and aids in informed decision-making for investors and analysts alike.
- **Second set of requirements:** IFRS 18 requires organizations to present non-GAAP metrics in a separate note within their financial reports. These metrics, known as management-defined performance measures (MPMs), aim to improve the information provided in the updated format of the profit or loss statement. They will provide insights into performance that are specific to the company.
- **Third set of requirements:** IFRS 18 necessitates that companies systematically aggregate and disaggregate the elements comprising their financial statements in accordance with their inherent nature and distinguishing characteristics. This methodology is pivotal in ensuring the materiality of the financial information presented, thereby enhancing the clarity of the data communicated to stakeholders. By adhering to this approach, organizations can foster greater transparency and facilitate informed decision-making among users of the financial statements.

Figure 1: Three key requirements introduced by IFRS 18



Source: Compiled by authors

These three sets of requirements are expected to enhance decision-making by improving information comparability, transparency, and usefulness.

b. **Proposed Changes in the Statement of Profit or Loss Categories and Subtotals**

The initial set of requirements focuses on the categorization and subtotals presented in the P&L statement. This aims to address investors' concerns regarding the difficulties in comparing financial performance due to the inconsistent line items and structure found in various

companies' P&L Statement.

Operating profit is commonly used as a very important indicator by the investors; however, its definition is not clearly established in any IFRS accounting standards. This creates an ambiguity which results in differing interpretations by companies for the same financial measure. With the introduction of IFRS 18, three new defined categories such as, operating, investing, and financing have been established in the P&L Statement to promote a consistent structure. Additionally, two new mandatory subtotals, *operating profit* and *profit before financing and income taxes*, have been included to enhance financial analysis.

▪ ***Operating Category***

This category contains the items that do not specifically fall under the classifications of investing or financing activities. This category serves as the default for recording the income and expenses, providing a clear picture of a company's day-to-day financial performance. It contains all transactions concerning company's primary business functions, such as revenue from sales, costs associated with distribution, and various administrative expenses necessary for operations.

In the context of financial institutions such as banks, NBFCs, and insurance companies the definition of operating activities is different. Here, income and expenses generated from financing and investing activities, including interest income or dividends earned from investments, are treated as operating activities. This is due to the fact that these financial activities form the cornerstone of their business model.

It is essential for companies to apply their best suited judgement in determining which activities should be classified as part of their core business operations. The aggregate result is designated as 'Operating Profit,' a key indicator of a company's operational efficiency and overall health.

▪ ***Investing Category***

Income and expenses associated with the investment in assets must be systematically recorded under this category. Specifically, this includes the initial investment costs as well as any subsequent profits or losses that arise from engaging in equity investments in subsidiaries, associates, or joint ventures. Moreover, it is imperative for companies to document variations in the fair value of financial assets and non-consolidated equity investments within this classification.

Similarly, income from investments such as dividends and rental income should also be categorised as investing activities for companies.

The total from this category should be labelled as 'Profit before Financing and Income Tax.' However, it's important to note that this total should not be included in the P&L Account of financial companies since in case of financial companies these income and expenses are considered under operating activity.

▪ ***Financing Category***

Income and expenses relating to procurement of finance such as interest expenses shall be recognized under the financing category. For instance, interest payment on bank loans or debt securities issued shall be classified as financing activity. However, for financing companies

such activities shall fall under operating activity.

c. Inclusion of Management Defined Performance Measures (MPMs)

Companies frequently employ non-GAAP measures, to convey management's perspective on performance to investors and other stakeholders. These measures are referred to as MPMs (PwC, 2024). Unlike the totals and subtotals found in financial statements, MPMs are not included in these statements and are only utilized in communications with stakeholders. This can create ambiguity surrounding the interpretation of MPMs, their calculations, and their tax implications.

For example, in India, SEBI mandates under the Issue of Capital and Disclosure Requirements Regulations, 2018, as amended in November 2022 that companies issuing shares to the public (known as Issuer Companies) must disclose Key Performance Indicators (KPIs) in their offer documents. These KPIs must continue to be disclosed for a minimum of one year after being listed or until the funds raised from the share issuance are fully utilized, in accordance with the disclosures made in the prospectus, whichever is later. Furthermore, these KPIs must be validated by a Chartered Accountant, Cost Accountant, or Statutory Auditor (SEBI, 2022)

With the implementation of IFRS 18, all companies will be required to disclose non-GAAP measures to enhance the transparency of their operations and decision-making processes. Incorporating the phrase "management's view of an aspect of the entity's financial performance" into the definition of MPM serves to align with the objective of delivering deeper insights into management's perspective. By doing so, it effectively narrows the requirements' scope, thereby enhancing the clarity and relevance of the information presented. This focus is essential for understanding how management interprets and evaluates financial performance, ultimately facilitating more informed decision-making and accountability within the organization (IASB, 2021). These measures will be included in a separate footnote within the financial statements, accompanied by a reconciliation of such measures to the metrics defined under IFRS. Frequently utilized metrics consist of adjusted EBITDA, adjusted operating income, adjusted EBIT, free cash flow, and return on equity. IFRS 18 requires businesses to reveal the methods used to calculate these measures and to include a distinct note outlining any alterations made to the measures. This change further emphasizes auditors' increased obligation to guarantee that financial reporting is clear and accurately represents the performance metrics of the entities. (BDO IFR Advisory Limited, 2024)

d. Grouping of Information - Aggregation and Disaggregation

Aggregation: This pertains to the categorization of different elements within financial statements, such as assets, liabilities, equity, income, expenses, and cash flows that share common traits. There are two key factors to keep in mind when aggregating items.

- **Labelling of aggregated items:** Meaningful labels to be used for aggregation, e.g., the term 'Other' is to be used only when no better term is available to explain or represent the items but, in that case, it should be represented by using some meaningful alternative which explains its characteristics like 'Other Operating Expenses' or 'Other Financing Income' and so on.

Emphasis should be placed on making the information provided in the financial Statement more significant for the investors. Companies need to use their best judgment to decide on using more informative labelling for the aggregated items presented in financial statements.

If companies are unable to identify a more suitable label for the combined items, they should aim to use a designation that offers users a clearer understanding of the characteristics of the items that have been aggregated and displayed in the financial statements.

- **Materiality of aggregated items:** When companies label their financial statements, they must reveal the importance of the combined items. In a similar way, it is essential to disclose materiality if the overall total of the combined items is substantial enough to potentially raise concerns among investors regarding their significance.

Companies need to provide qualitative explanations regarding those line items disclosed in the Statement of P&L, which includes some amount shown as carrying amount of assets, for example, depreciation, amortisation, specified impairments etc.

Disaggregation: It is an antonym of aggregation and therefore pertains to the procedure of ungrouping or separation of various components or items of financial statements due to differences in their nature or characteristics.

Table 1: Transition from IAS 1 to IFRS 18 / Ind AS 118 and its impact on the face of the income statement:

Statement of P&L as per IAS 1		Statement of P&L as per IFRS 18 / Ind AS 118		
CU		CU		
Revenue from operation	x	Revenue from operation	x	OPERATING
Cost of goods sold	(x)	Cost of goods sold	(x)	
Gross Profit	x	Gross profit	x	
Other operating income	x	Other operating income	x	
Selling expense	(x)	Selling expense	(x)	
General and administrative expenses	(x)	General and administrative expenses	(x)	
Research and development expense	(x)	Research and development expense	(x)	
Income and expenses from associates and joint ventures accounted for using equity method	x	Other operating expenses	(x)	
Other operating expenses	(x)	Operating profit or loss	x	
Operating profit or loss	x	Share of profit or loss from associates and joint ventures	x	INVESTING
Finance income	x	Other investment income	x	
Finance costs	(x)	Profit before financing and income taxes	x	
Profit or loss before tax	x	Interest expense on borrowings	x	FINANCING
Income tax expense	(x)	Interest expense on pension liabilities	x	
Profit or loss	x	Profit or loss before tax	x	
		Income tax expense	(x)	
		Profit or loss	x	

CU= Currency Units

Source: *Staff paper, Emerging Economies Group Meeting (October 2023.)*

e. Enhancing Investor Insights Through IFRS 18 Implementation

The newly implemented operating, investing, and financial structure, along with the introduction of updated sub-totals in the income statement, intends to offer investors more comparable information, thereby improving their capacity to perform thorough analysis. A key performance indicator that investors commonly reference in equity analysis is operating profit,

which holds significant importance in assessing enterprise value through Discounted Cash Flow (DCF) analysis. Having this metric readily available on the income statement will undoubtedly benefit investors. Furthermore, with the adoption of the classified structure in IFRS 18, analysts will no longer need to invest significant time and resources in calculating operating profit, as it will be clearly presented. Moreover, IFRS 18 mandates organizations to disclose MPMs, commonly referred to as non-GAAP measures. This requirement will enhance transparency about the company's activities, ultimately allowing investors to make more informed decisions.

f. Implementation Issues of Ind AS 118 (IFRS 18) In Indian Perspective

In India, the regulatory framework for accounting standards encompasses two primary sets tailored for distinct categories of entities: AS and Ind AS. Listed entities are mandated to adhere to Ind AS, while unlisted entities having net worth of more than INR 250 crore are likewise required to comply with Ind AS, barring certain exceptions for Banks, Regional Rural Banks (RRBs), and Insurance Companies.

The Companies Act of 2013 delineates the accounting framework through Schedule III, which comprises three divisions. Division I pertains to entities that follow Accounting Standards (AS) in the preparation and maintenance of financial statements. Division II is relevant for entities implementing Ind AS, with the exception of Non-Banking Financial Companies (NBFCs). Division III specifically addresses NBFCs that comply with Ind AS.

On January 6, 2025, the Accounting Standards Board (ASB) of the Institute of Chartered Accountants of India (ICAI) issued an exposure draft on Ind AS 118 - Presentation and Disclosure in Financial Statements, inviting feedback from various stakeholders. The notification further indicates that, globally, IFRS 18 will come into effect for annual reporting periods beginning on or after January 1, 2027. Given that Ind AS 118 has been aligned with IFRS 18, the intended effective date for this standard is proposed for annual reporting periods commencing on or after April 1, 2027.

This new standard is anticipated to incorporate certain carve-in and carve-out provisions and is set to replace the existing Ind AS 1 based on the feedback received from various stakeholders. Additionally, it is probable that it will result in significant alterations in how financial statements are presented and reported, requiring amendments to Divisions II and III of Schedule III of the Companies Act 2013.

One significant issue in the Indian context is the need for extensive training for accounting professionals and management to understand and apply these new principles effectively. Additionally, there could be initial resistance from organizations accustomed to traditional formats, necessitating a robust change management process.

Furthermore, as companies begin to synchronize their financial statements with international standards, there might be discrepancies in how different entities interpret and apply these guidelines. This could impact transparency and comparability among firms, which Ind AS 118 seeks to enhance.

D. CONCLUSION

The introduction of IFRS 18 marks a significant advancement in financial reporting by addressing long-standing concerns regarding the consistency, clarity, and comparability of financial statements across entities. The mandatory presentation of distinct subtotals—namely, 'Operating Profit' and 'Profit Before Financing and Income Taxes'—is expected to enhance the qualitative characteristics of financial information, thereby providing stakeholders with deeper insights into a company's operational efficiency and overall financial performance.

Moreover, the requirement for companies to disclose non-GAAP measures in a dedicated note allows for greater transparency and responsiveness to investor needs, while the systematic aggregation and disaggregation of financial statement components will further enhance the materiality and relevance of disclosed information. By delineating clear categories and guidelines for financial reporting, IFRS 18 is not only set to improve the decision-making process for investors and analysts but also aims to establish a more standardized framework that may ultimately foster greater trust and confidence in the financial reporting landscape. As organizations prepare for the implementation of this standard, it will be crucial to monitor its impact on financial practices and the overall utility of financial statements for all stakeholders involved.

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