INTERNATIONAL FINANCIAL REPORTING STANDARDS PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

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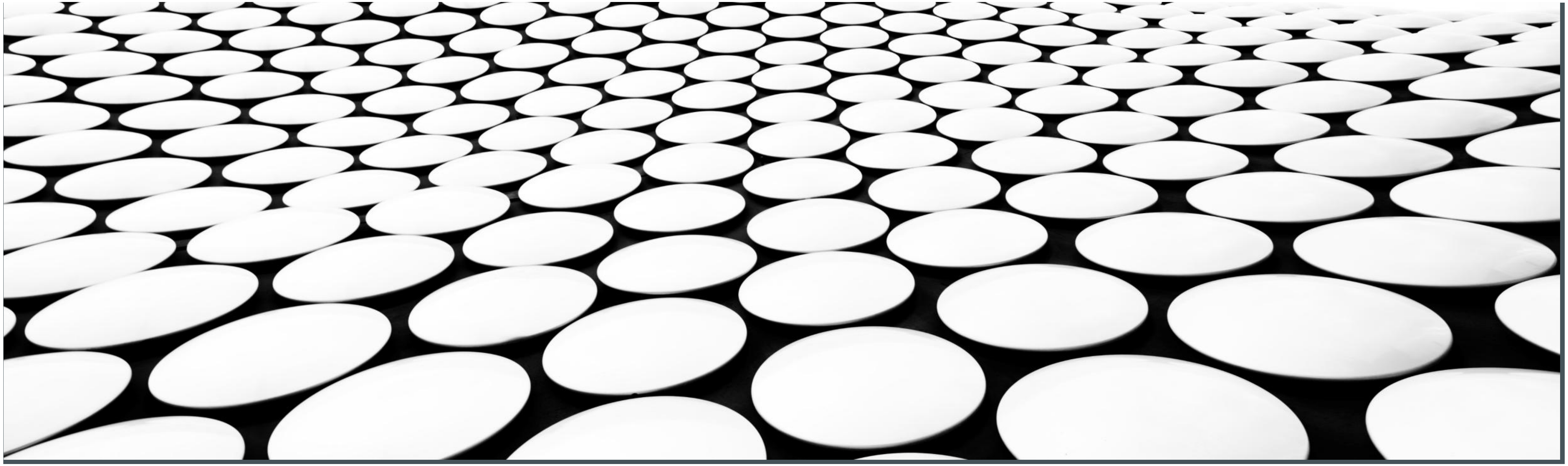

INTERNATIONAL FINANCIAL REPORTING STANDARDS
PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

INTRODUCTION

- IFRS 18 seeks to address investors' demands by requiring more structured income statements and disaggregation of financial information.
- It also considers management-defined performance measures as part of the audited Financial Statements.
- The idea is to give certain key performance indicators more credibility.

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

OBJECTIVE

The objective of IFRS 18 is to:

a) Enhance clarity and consistency in presenting information about an entity's financial performance.

b) Improve investor understanding and comparability between different companies.

c) Establish new requirements, including clearly defined subtotals such as operating profit, to facilitate effective analysis of financial statements.

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

SCOPE

- The new standard, IFRS 18, replaces IAS 1 Presentation of Financial Statements while carrying forward many of the requirements in IAS 1.
- IFRS 18 introduces new requirements to:
  - Present specified categories and defined subtotals in the statement of profit or loss
  - Provide disclosures on management-defined performance measures (MPMs) in the notes to the financial statements
  - Improve aggregation and disaggregation.

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

SCOPE (Continued)

- Some of the requirements in IAS 1 are moved to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors and IFRS 7 Financial Instruments: Disclosures.
- The IASB also makes minor amendments to IAS 7 Statement of Cash Flows and IAS 33 Earnings per Share.
- IFRS 18 requires retrospective application with specific transition provisions.
- An entity is required to apply IFRS 18 for annual reporting periods beginning on or after 1 January 2027 with earlier application permitted.

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

HOW DOES IFRS 18 ENHANCE THE INCOME STATEMENT STRUCTURE

❑ IFRS 18 enhances the income statement structure by:

- Defining and requiring clear categorization into operating, investing, and financing activities.
- Establishing mandatory subtotals such as operating profit, aiding better analysis and comparability.
- Facilitating clearer identification and analysis of recurring versus non-recurring items.
- Improving overall readability and user-friendliness of financial performance statements.

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HOW DOES IFRS 18 HELP INVESTORS AND STAKEHOLDERS

- Benefits of IFRS 18 for investors and stakeholders include:
  - a) Improved ability to analyze and compare company performance across different entities and industries.
  - b) Clearer understanding of operational efficiency and financial health through structured and standardized reporting.
  - c) Enhanced transparency through detailed expense disclosure, aiding investment decisions.

WHAT ARE THE PROPOSED CHANGES IN IFRS 18 COMPARED TO IAS 1?

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STRUCTURED CATEGORIES IN THE INCOME STATEMENT

IAS 1	IFRS 18
❑ Under IAS 1, companies had flexibility in presenting their income statements. ❑ This often led to inconsistencies in how companies reported operating results, which could make comparisons between companies challenging.	❑ The new standard mandates specific income statement categories – **operating, investing, and Financing**—each with clearly defined boundaries. ❑ The key requirement is that all companies present an operating profit subtotal, including revenue, costs directly related to operations, and other income and expenses directly related to operations. ❑ This structured approach improves comparability across companies by standardizing how key metrics are calculated and presented.

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MANAGEMENT DEFINED PERFORMANCE MEASURES

IAS 1	IFRS 18
❑ Previously, companies often reported performance measures that were not defined by IFRS (like “adjusted EBITDA”) without clear guidance on how these measures should be disclosed.	❑ Companies now have to identify any MPMs they use and provide detailed disclosures about these measures. ❑ This includes a clear explanation of why these measures are used, how they are calculated, and how they reconcile with the totals and subtotals required by IFRS. ❑ The aim is to help investors understand these measures and compare them across different companies.

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DISAGGREGATION OF INFORMATION

IAS 1	IFRS 18
❑ IAS 1 allowed for significant flexibility in how items were grouped together in financial statements, often resulting in a lack of clarity or useful detail.	❑ There is now a stronger emphasis on disaggregating information in the financial statements. ❑ Companies are required to break down large, aggregated numbers into more detailed components, particularly in relation to operating expenses. ❑ This helps users of financial statements to better understand the nature of these expenses and how they relate to the company's operations.

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CHANGES TO THE STATEMENT OF CASH FLOWS

IAS 1	IFRS 18
❑ The existing cash flow statement under IAS 1 did not mandate a specific breakdown of cash flows into operating, investing, and financing activities, leading to inconsistencies in how companies reported cash flows.	❑ While the changes to the cash flow statement are relatively narrow, the new standard still requires a more consistent classification of cash flows, aligning with the categories used in the income statement. ❑ This alignment helps users of the financial statements to better link cash flows with the operating, investing, and financing activities reported in the income statement.

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MANDATORY SUB-TOTALS AND STANDARDIZED HEADINGS

IAS 1	IFRS 18
❑ Subtotals were often left to the discretion of the entity, which could choose whether or not to present certain key performance indicators as subtotals in the statement of profit or loss.	❑ This Standard introduces mandatory subtotals, such as "Operating Profit" and "Profit Before Financing and Income Tax," which all entities must present. ❑ This helps ensure that certain key financial metrics are consistently reported across all entities, thereby improving comparability.

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ENHANCED NOTES AND DISCLOSURES

IAS 1	IFRS 18
❑ While notes and disclosures were required, there was often inconsistency in how much detail was provided.	❑ The new standard provides more detailed guidance on what should be included in the notes to the financial statements. ❑ This includes more rigorous requirements for explaining accounting policies, disclosing management judgments, and providing detailed information about the components of key line items. ❑ Additionally, there is now a requirement to disclose any information that might be relevant to understanding the financial performance and position of the company, even if it is not explicitly required by IFRS.

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IMPROVED COMPARABILITY AND TRANSPARENCY

- ❑ Overall, the changes are designed to enhance the comparability of financial statements across different entities and industries.
- ❑ By standardizing how certain key metrics are reported, the IASB aims to provide clearer, more consistent, and more useful information to investors and other stakeholders.
- ❑ These changes are expected to lead to more detailed, transparent, and comparable financial statements, helping users make better-informed decisions.

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COMPARATIVE ANALYSIS WITH IAS 1

Item	IAS 1 (Old Standard)	IFRS 18 (New Standard)
Structure of Profit or Loss	Flexible, companies could define their own format	Standardized categories: Operating, Investing, Financing
Subtotals	No mandatory subtotals like 'Operating Profit'	Introduces key subtotals: Operating Profit, Profit before Financing & Tax
Presentation of Expenses	Could use 'function' (e.g., COGS, admin) or 'nature' (e.g., depreciation, salaries)	Encourages clearer classification using mandatory categories
Management Performance Measures (MPMs)	Not specifically required	Must be disclosed separately with explanations and reconciliations
Classification of Interest & Dividends	Could be mixed in operating, investing, or financing	Standardized: Interest expense in financing, interest income in investing
Aggregation & Disaggregation	Flexible, leading to inconsistent reporting	More structured guidance to avoid excessive aggregation or unnecessary details
Flexibility	Allowed different formats, reducing comparability	Strict format ensures better comparability between companies

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ILLUSTRATION : COMPARATIVE ANALYSIS WITH IAS 1

Income Statement	IAS 1 Format	IFRS 18 Format
Revenue	1,000,000	1,000,000
Cost of Sales	(600,000)	(600,000) (Operating)
Gross Profit	400,000	-
Operating Expenses (Selling/Admin)	(120,000)	(120,000) (Operating)
Operating Profit	280,000	280,000
Interest Income	10,000	10,000 (Investing)
Profit Before Tax	260,000	-
Interest Expense	(30,000)	(30,000) (Financing)
Profit Before Financing & Tax	-	290,000
Profit Before Tax	260,000	260,000
Income Tax	(60,000)	(60,000)
Net Profit	200,000	200,000

WHAT ARE THE CATEGORIES OF CLASSIFICATION OF INCOME AND EXPENSES IN STATEMENT OF PROFIT AND LOSS?

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OPERATING CATEGORY

- The "Operating" category includes all income and expenses directly related to the company’s core business activities. This category is intended to reflect the results of the entity's principal revenue-generating activities.

- **Components:**
  - Revenue: Income generated from the sale of goods and services.
  - Cost of Sales: Direct costs attributable to the production of goods sold or services rendered.
  - Operating Expenses: Other expenses directly associated with the operations, such as selling, general, and administrative expenses.
  - Other Operating Income and Expenses: Income and expenses are not directly tied to primary operations but are still related to the company's core business activities.

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INVESTING CATEGORY

❑ The "Investing" category includes income and expenses related to the entity's investments and long-term asset management. It reflects the financial performance from non-core business activities that are expected to generate returns.

❑ Components:

- Income from Investments: Dividends, interest income, and gains or losses from the sale of investments.
- Expenses related to Investments: Costs associated with maintaining and managing investments, including impairment losses on financial assets.

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FINANCING CATEGORY

❑ The "Financing" category captures income and expenses associated with the entity's capital structure and borrowing activities.

❑ Components:

- Finance Costs: Interest expense on borrowings, finance charges related to leases, and other costs related to obtaining finance.
- Finance Income: Interest income from financing activities, such as interest earned on loans provided to third parties.
- Gains or Losses on Debt Instruments: Includes gains or losses from the revaluation or sale of financial liabilities or other financing instruments.

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KEY POINTS OF REPORTING THESE CATEGORIES

- ❑ Mandatory Subtotals: Within these categories, IFRS 18 requires certain mandatory subtotals to be presented, such as "Operating Profit" and "Profit Before Financing and Income Tax."
- ❑ These subtotals ensure consistency and comparability across different entities' financial statements.
- ❑ Management-Defined Performance Measures (MPMs): Companies are required to disclose any alternative performance measures they use and reconcile them to the IFRS-defined subtotals.

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MANAGEMENT DEFINED PERFORMANCE MEASURES

- **Management-defined performance Measures (MPMs)**
  - These are financial metrics or performance indicators that companies develop internally to provide additional insight into their financial performance beyond the measures prescribed by IFRS standards.
  - These measures are often tailored to reflect the specific operational realities or strategic goals of the business.

- **Non-IFRS Measures:**
- MPMs are not defined by IFRS. They can include metrics such as Adjusted EBITDA, Core Earnings, Free Cash Flow, and others that management believes better reflect the company's performance.

- **Customization:**
- Management often customizes MPMs to reflect items like adjustments for non-recurring events, changes in accounting policies, or sector-specific factors.
- These measures aim to present a view of financial performance that is more aligned with how management views and runs the business.

CASE STUDY

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CASE STUDY

❑ **Background**

- Company ABC Ltd., a manufacturing firm, prepares financial statements under IAS 1 (old standard). The company reports revenue, expenses, and profits in a flexible format. However, with the adoption of IFRS 18, it must comply with the new categorization and structured format.

- This case study illustrates the differences in treatment between IAS 1 and IFRS 18, focusing on how the company reports its Statement of Profit or Loss.

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CASE STUDY

- The Financial Data of ABC Limited is as follows:

Particulars	Amount in USD
Revenue:	5,000,000
Cost of Sales:	(3,000,000)
Selling & Admin Expenses:	(500,000)
Interest Income:	20,000
Interest Expense:	(100,000)
Income Tax:	(300,000)

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CASE STUDY

- Step one: **Financial Statement Under IAS 1 (Old Standard).**
- ABC Ltd. prepares its statement **flexibly** under IAS 1:

Income Statement (IAS 1)	Amount ($)
Revenue	5,000,000
Cost of Sales	(3,000,000)
Gross Profit	2,000,000
Selling & Admin Expenses	(500,000)
Operating Profit	1,500,000
Interest Income	20,000
Interest Expense	(100,000)
Profit Before Tax	1,420,000
Income Tax	(300,000)
Net Profit	1,120,000

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CASE STUDY

- Step two: **Financial Statement Under IFRS 18 (New Standard)** Under **IFRS 18**, ABC Ltd. must **restructure** its statement into the required **Operating, Investing, and Financing** categories:

Income Statement (IFRS 18)	Amount ($)
Revenue	5,000,000
Operating Category:	
- Cost of Sales	(3,000,000)
- Selling & Admin Expenses	(500,000)
Operating Profit	1,500,000
Investing Category:	
- Interest Income	20,000
Profit Before Financing & Tax	1,520,000
Financing Category:	
- Interest Expense	(100,000)
Profit Before Tax	1,420,000
Income Tax	(300,000)
Net Profit	1,120,000

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

CASE STUDY

- **Key Differences in presentation**

Aspect	IAS 1 (Old Standard)	IFRS 18 (New Standard)
Structure	Flexible format	Standardized categories: Operating, Investing, Financing
Subtotals	No specific subtotals	Introduces "Profit Before Financing & Tax"
Interest Income & Expense	Mixed in the statement, reducing clarity	Interest Income → Investing, Interest Expense → Financing
Expense Categorization	Broad grouping of expenses	More detailed and clearly categorized expenses
Comparability	Different companies could present statements differently	Enforces consistency across industries

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

CASE STUDY: TRANSITION TO IFRS 18 (Effective January 2027)

Key Changes Reflected:

(1) Structured Categories:

The income statement now clearly separates operating, investing, and Financing activities. The subtotal "Operating Profit" is mandatory, and "Profit Before Financing and Income Tax" is introduced, providing a more structured and consistent presentation.

(2) Mandatory Subtotals:

The income statement includes new subtotals, such as "Profit Before Financing and Income Tax," that were not previously required under IAS 1, enhancing comparability across entities.

(3) Disaggregation:

Operating expenses are disaggregated and grouped under a specific category, providing more detailed information about the nature of expenses, which helps users better understand the company's cost structure.

(4) Management-Defined Performance Measures (MPMs):

The company provides a detailed explanation of the MPM (Adjusted EBITDA), including its calculation and relevance. The reconciliation between the MPM and the IFRS-defined figure (Operating Profit) is clearly presented, offering transparency and improving investor understanding.

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DISCLOSURE REQUIREMENTS

- ❑ Reconciliation: IFRS 18 requires companies to reconcile MPMs with the most directly comparable IFRS measures. For example, if a company reports Adjusted EBITDA as an MPM, it must also show how this figure reconciles with Operating Profit, the closest IFRS measure.

- ❑ Explanation: Companies must clearly explain why they use MPMs, how these measures are calculated, and why they believe these measures provide useful information to investors.

- ❑ Consistency: The standard requires consistent presentation of MPMs over time, with any changes in the definition or calculation of these measures being clearly disclosed and justified.

HOW SHOULD COMPANIES IMPLEMENT THE TRANSITION TO IFRS 18

❑ Transitioning to IFRS 18 would require:

- Comprehensive review of current income statement presentation practices.
- Clearly redefining and categorizing all income and expenses according to IFRS 18 categories.
- Ensuring internal systems and processes capture and present required data effectively.
- Providing comparative prior-period information restated according to IFRS 18 criteria, with clear disclosures about the nature and impact of changes.

PRESENTATION AND DISCLOSURE OF FINANCIAL STATEMENTS – IFRS 18

WHAT ARE THE PRACTICAL IMPLICATIONS OF IFRS 18 FOR PREPARERS OF FINANCIAL STATEMENTS

❑ Practical implications of IFRS 18 include:

- Potential revisions to internal accounting systems and reporting processes.
- Increased demand for granular financial data, especially expense disclosures by nature.
- Additional training for accounting staff and clear internal communication regarding the new standards.
- Potentially increased transparency but also additional preparation effort, especially during the initial implementation phase.

THANK YOU!