December 2024

PKF INSIGHT

Newsletter of PKF-CAP LLP

THE LATEST FROM PKF INSIGHT:

IFRS 18 Presentation and Disclosure in Financial Statements supersedes IAS 1 Presentation of Financial Statements

IFRS 18

The International Accounting Standards Board (IASB) has issued IFRS 18, a new standard focusing on presentation and disclosure updates in financial statements, particularly the statement of profit or loss.

IFRS 18 was issued to enhance the quality and comparability of financial statements. The standard aims to provide investors and other financial statement users with a clearer and more comprehensive view of an entity's financial performance and position. Key objectives include improving the structure and content of primary financial statements, enhancing financial performance information, and simplifying the presentation of complex financial data. The goal is to reduce diversity in financial reporting, thereby helping investors understand the information and make better comparisons between entities.

IFRS 18 introduces key changes in three areas:

- **Statement of Profit or Loss Structure:** The standard defines a new structure for the income statement.
- **Management-Defined Performance Measures:** Companies must now disclose specific profit or loss metrics they report outside the financial statements.
- **Enhanced Aggregation and Disaggregation:** Improved principles govern how information is grouped and presented within the primary financial statements and notes.

IFRS 18 supersedes IAS 1 *Presentation of Financial Statements*. While retaining many existing principles from IAS 1 with modifications, IFRS 18 will not affect how companies recognise or measure financial statement items. However, it may influence the reported 'Operating profit or loss'.

Effective Date: IFRS 18 applies for reporting periods beginning on or after 1 January 2027, and also applies retrospectively. The changes in presentation and disclosure required by IFRS 18 might necessitate system and process changes for many entities, so early preparation for adoption is recommended.

IFRS 18 enhances transparency by mandating new disclosures for certain performance measures used by management but not formally included in financial statements.

WHAT'S NEW?

Comparability and transparency

Investors seeking improved comparability and transparency in financial reporting will welcome the new IFRS 18 standard. Issued by the IASB on 9 April 2024, IFRS 18 focuses on "Presentation and Disclosure in Financial Statements."

This new standard addresses' investor concerns by introducing requirements that will make it easier to compare the financial performance of similar entities. A key area of focus is how companies define "operating profit or loss." Additionally, IFRS 18 enhances transparency by mandating new disclosures for certain performance measures used by management but not formally included in financial statements.

KEY CHANGES

Statement of Profit or Loss

IFRS 18 introduces a standardised structure for the profit or loss statement, aiming to reduce reporting inconsistencies and improve comparability. This structure categorises income and expenses into five groups: operating, investing, financing, income taxes, and discontinued operations. IFRS 18 offers general classification guidance with flexibility for specific business models.

A key change is the mandatory inclusion of 'Operating profit or loss' alongside other required subtotals like profit or loss and profit before financing and taxes (exceptions may apply).

KEY CHANGES (CONT’D)

Here's a breakdown of the categories:

- **Operating:** This category captures the core results of an entity's main business activities (essentially the "bottom line" before other income and expenses).
- **Investing:** This category typically includes income and expenses from investments like associates, cash equivalents, and assets generating independent returns.
- **Financing:** This category includes income and expenses related to financing activities, such as interest expense and the impact of interest rate changes on liabilities.
- **Income Taxes:** This category encompasses all taxes payable on pre-tax profit.
- **Discontinued Operations:** This category includes income and expenses associated with discontinued business segments.

For entities with financing or investment as a core business activity (e.g., banks), IFRS 18 allows certain income and expenses to be presented in the operating category to better reflect their main business performance.

Statement of Profit or Loss - Disclosures

IFRS 18 introduces new disclosure requirements to enhance transparency in financial reporting.

- **Management-Defined Performance Measures (MPMs):** Companies can define their own performance metrics, often referred to as "non-GAAP measures." IFRS 18 requires disclosure of these MPMs, along with a reconciliation to the most similar standard subtotal defined by IFRS. This effectively brings some non-GAAP measures into the financial statements for better user understanding.
- **Disclosure of Expenses by Nature and Function:** Entities presenting statements by **function** must break down operating expenses by both nature (e.g., rent, salaries) and function (e.g., research and development, marketing). This offers a more granular analysis of a company's operating costs.

The revisions aim for improved clarity and conciseness while maintaining the core information.

KEY CHANGES (CONT'D)

→ AGGREGATION & DISAGGREGATION

IFRS 18 provides enhanced guidance on the principles of aggregation and disaggregation (impacting all primary financial statements and notes) which focus on grouping items based on their shared characteristics. These principles are applied across the financial statements, and they are used in defining which line items are presented in the primary financial statements and what information is disclosed in the notes.

→ THE IMPACT

IFRS 18 will enhance companies' storytelling capabilities through their financial statements. By standardising the presentation of income and cash flow statements and providing more detailed information, investors will benefit from greater consistency and transparency.

Integrating certain 'non-GAAP' measures into audited financial statements will bolster the credibility of management's key performance indicators. While companies' net profits will remain unaffected, the way they present results on the income statement and disclose information in the notes will change.

IFRS 18 represents a significant step towards more interconnected reporting.

→ OTHER CHANGES

IFRS 18 also introduces minor changes to cash flow statement presentation. It specifies 'operating profit or loss' as the starting point for reconciling cash flows from operating activities, and removes existing options for presenting interest and dividends paid and received.

→ EFFECTIVE DATE

As mentioned, IFRS 18 takes effect for annual reporting periods starting on or after 1 January 2027. This applies to both annual and interim financial statements. Companies must also retrospectively apply the standard, meaning they need to prepare comparative information under IFRS 18. In the first year of adoption, a reconciliation between the previous presentation under IAS 1 and the new IFRS 18 format is required for the statement of profit or loss. Similar reconciliation requirements apply to interim financial statements in that year.

STATEMENT OF PROFIT OR LOSS STRUCTURE

New required subtotals, from IFRS 18 effect analysis and Key message

Example for presentation of Statement of Profit or Loss

Statement of profit of loss	
Revenue	**Operating**
Costs of goods sold	
Gross profit	
Selling expenses	
General and administrative expenses	
Other operating expense	
Operating profit	Required subtotal
Gain on disposal of joint venture	**Investing**
Profit before financing and income tax	Required subtotal
Interest expense on borrowings	**Financing**
Profit before tax	
Income tax expense	
Profit from continuing operations	
Loss from discontinued operations	Discontinued operations
Profit for the year	Required subtotal

Note: (1) Operating profit presents a picture of a company's operations and (2) Profit before financing and income tax presents the company's performance before effect of financing.

What is classified in the operating, investing or financing category?

(1) The operating category includes all income and expenses in the statement of profit or loss **that are not classified in the investing, financing, income taxes or discontinued operations categories**. It comprises all income and expense arising from a company's operations (not limited to company's main activity).

(2) 'Income and expenses' related to investing category comprises income generated by the assets, income and expenses that arise from the initial and subsequent measurement of the assets, including on derecognition of the assets, and incremental expenses directly attributable to the acquisition and disposal of the assets. For example, dividends from equity instruments.

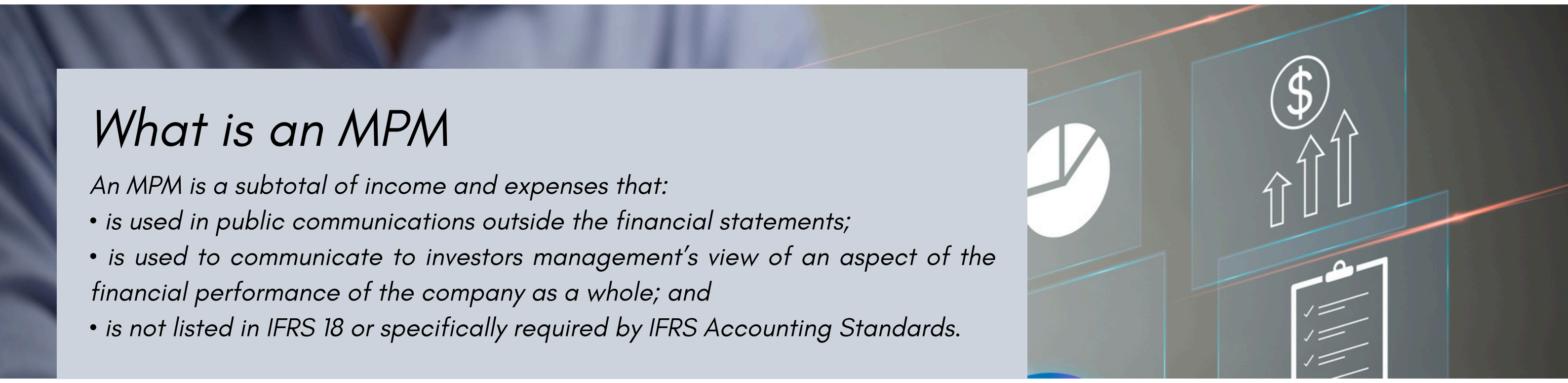
(3) 'Income and expenses' related to financing category comprises:

a) income and expenses from liabilities arising from transactions that involve only the raising of finance. For example, debt instruments settled in cash such as loans.

b) interest income and expenses and the effects of changes in interest rates from liabilities arising from transactions that do not involve only the raising of finance. For example, payables for goods and services.

MANAGEMENT-DEFINED PERFORMANCE MEASURES

MPM, from IFRS 18 effect analysis and Key message



What is an MPM

An MPM is a subtotal of income and expenses that:

- *is used in public communications outside the financial statements;*
- *is used to communicate to investors management's view of an aspect of the financial performance of the company as a whole; and*
- *is not listed in IFRS 18 or specifically required by IFRS Accounting Standards.*

Disclosure in a single note:
1) Statement that the MPM reflects management's view
2) Explain why the MPM is reported
3) Reconciliation of MPM to IFRS defined numbers
4) Explain any changes to the MPM

Criteria for MPMs (all must be met):
(1) Is a subtotal of income and expense
(2) Is used in public communications outside the financial statements.
(3) Is NOT included in the list of subtotals in IFRS 18 that are not MPMs or specifically required to be presented or disclosed by IFRS (e.g. Gross profit and profit before income taxes).
(4) Is to communicate the management's view. If not, is there reasonable and supportable information to rebut the presumption*?

* It is presumed that a subtotal of income and expenses used in public communications communicates management's view; a company is not required to consider whether to rebut the presumption.

Example of MPM (and reconciliation):

Operating profit	**S$10,000**
Impairment losses (Adjusting item)	**S$5,000**
Adjusted operating profit (MPM)	**S$15,000**

Company identified the MPM and provide the subtotal in its public communications hence disclosure is required.

Alternative Performance Measures (APMs)

Newly defined subtotals in IFRS 18 may lead to reduced usage of self-defined performance measures (i.e. APMs) by companies.

Companies using APMs without detailed information in financial statements must provide MPM disclosures for APMs meeting the IFRS 18 definition of MPMs. Companies already disclosing APM information may need to modify it to comply with IFRS 18 if the APMs meet the MPM definition.

AGGREGATION AND DISAGGREGATION

IFRS 18 provides a comprehensive framework for grouping assets, liabilities, equity, income, expenses, and cash flows within financial statements, ensuring that these statements are informative, relevant, and adhere to the fundamental principles of financial reporting. By carefully aggregating similar items and disaggregating dissimilar ones, entities can present data in a way that is both detailed and understandable without compromising the underlying principles of financial accounting.

Key steps in applying IFRS 18 include:

1. **Identifying individual transactions and events:** This involves a thorough examination of each transaction and event to determine its nature and characteristics.
2. **Grouping items based on shared characteristics:** Similar assets, liabilities, equity, income, expenses, or cash flows should be grouped together based on their common attributes, such as nature, function, or risk profile. This aggregation process helps to simplify the presentation of financial information and enhance its comparability.
3. **Separating items based on dissimilar characteristics:** Items that exhibit distinct characteristics should be presented separately to avoid obscuring material information. This disaggregation process ensures that users of financial statements have access to the necessary detail to make informed decisions.

Material information that is not presented in the primary financial statements should be disclosed in the notes. This includes any information that is relevant to users' understanding of the entity's financial position, performance, and cash flows, but does not meet the criteria for recognition in the primary statements. By providing this additional detail in the notes, entities can enhance the transparency and completeness of their financial reporting.

Adhering to the core principles of financial reporting while applying the guidance provided by IFRS 18 is essential for producing financial statements that are both informative and compliant. By following the steps outlined above and ensuring that the information presented in the financial statements is clear, relevant, and comparable, entities can meet the needs of their users and demonstrate their commitment to financial transparency.

Grouping items in financial statements requires careful judgement to determine whether they share similar or dissimilar characteristics. Factors to consider when making this assessment include:

Nature	*The underlying nature of the items, such as assets, liabilities, income, or expenses.*
Function	*The purpose or role of the items within the entity's operations.*
Measurement	*The method used to measure the items, such as historical cost or fair value.*
Size	*The relative size or materiality of the items.*
Geographical location	*The location where the items are related to or generated.*
Regulatory environment	*Applicable laws, regulations, and accounting standards that affect the items.*

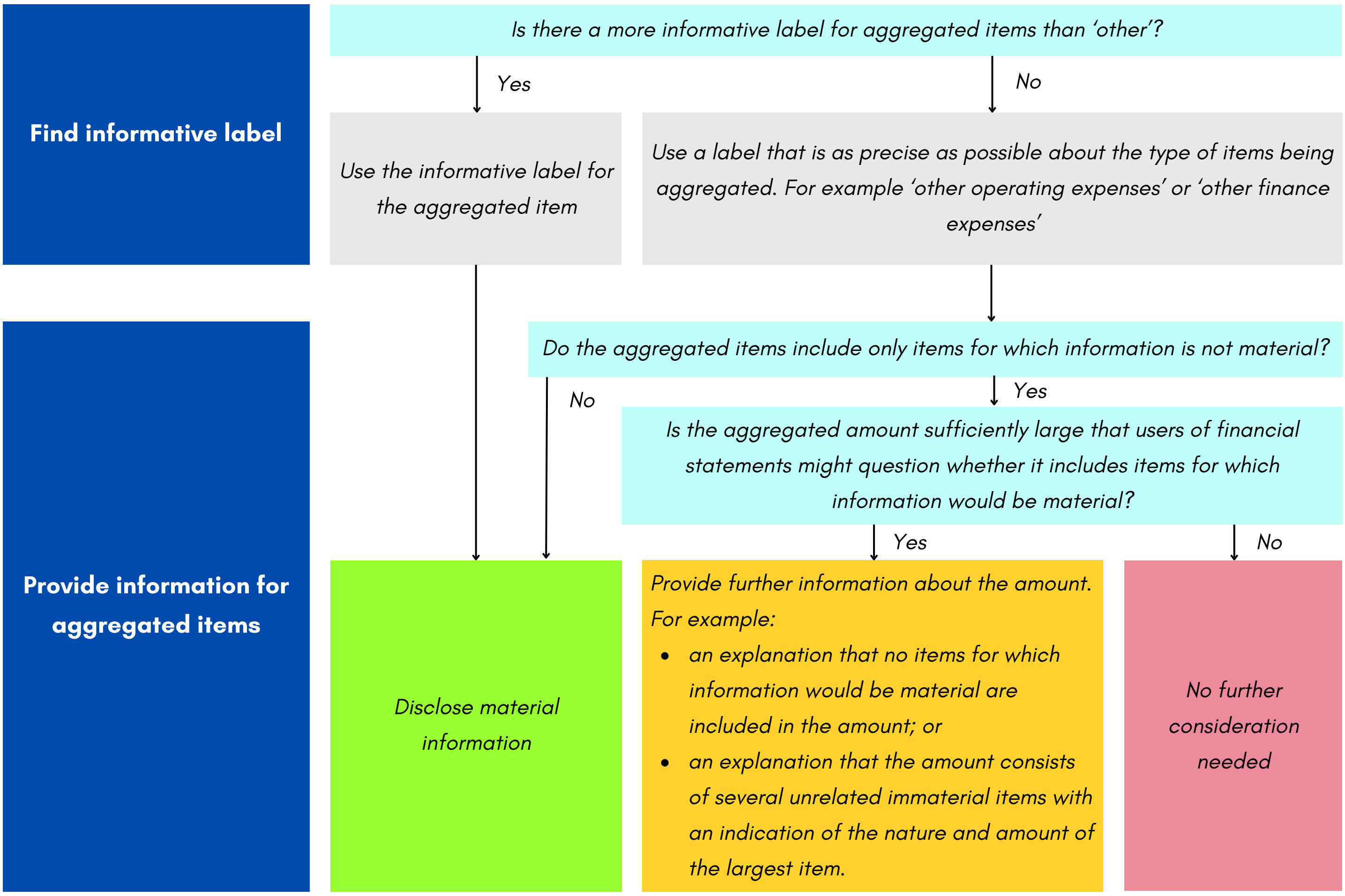
The greater the similarity between items, the more likely it is that aggregating them will fulfill the role of the primary financial statements or the notes. Conversely, if items exhibit significant differences in these characteristics, disaggregating them may be necessary to provide meaningful information.

AGGREGATION AND DISAGGREGATION (CONT'D)

Aggregating items and using meaningful labels

Under IFRS 18, when aggregating and disaggregating items in financial statements, entities are required to carefully select labels and descriptions that provide sufficient clarity and avoid obscuring material information. The use of broad terms like "other" should be minimised, and instead, entities should strive to use more specific labels that accurately describe the nature of the aggregated items, such as "other finance expenses." When a item is comprised of a material and other immaterial items, labelling then item by describing only the material items may result in an informative label. Where it is not possible to find a more precise label, and the aggregated group contains only immaterial items, entities should consider whether users of the financial statements might reasonably question the materiality of the items based on the size or significance of the total amount. In such cases, providing further explanatory information may be necessary to ensure faithful representation and transparency.

The following diagram, based on Figure 7 in the Illustrative Examples to IFRS 18, sets out how an entity can navigate the requirements above:



OTHER CHANGES

Other changes that apply to primary financial statements

Other changes - Statement of Cash Flows

The amended IAS 7 Statement of Cash Flows:

- to require all companies to use the **Operating Profit subtotal as the starting point for the indirect method** of reporting cash flows from operating activities; and
- to remove the presentation alternatives for cash flows related to interest and dividends paid and received, t**his means that the option for classifying interest and dividend cash flows as operating activities has been eliminated**.

Classification for interest received, interest paid and dividends received as cash flows from operating activities will need to change their classification to improve the comparability of the statement of cash flows, by considering whether the company has any specified main business activities.

Note: The categories in the statement of profit or loss and the statement of cash flows have different meanings.

Cash flows (general model) - Classifying interest and dividends will differ for companies with specified main business activities.

Financing	**Investing**
Dividends paid	Dividends received
Interest paid	Interest received

Other changes - Balance Sheet

Goodwill is presented as a new line item on the face of the balance sheet.

Property, plant and equipment	S$ 5,000,000
Goodwill	**S$ 2,500,000**
Intangible assets	S$ 3,000,000
Total non-current assets	**S$10,500,000**

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