

# Applying Ind AS: A closer look at Ind AS 118

March 2026



The better the question.  
The better the answer.  
The better the world works.



Shape the future  
with confidence

# Contents



1

Introduction

2

Statement of profit and loss: General requirements

3

Statement of profit and loss: Requirements for specific entities

4

Items to be presented in the statement of profit and loss

5

Management-defined performance measures (MPM)

6

Aggregation and labelling

7

Consequential amendments to other standards

8

Transition

# Foreword

Financial reporting continues to evolve as the expectations of investors, regulators and other stakeholders grow in both scale and complexity. Today, financial statements are expected not only to present numbers accurately but also to communicate a clear and coherent narrative of an organization's financial performance. In this context, the introduction of Ind AS 118\* marks a significant step forward in strengthening the way financial information is presented and understood.

Ind AS 118 introduces a more structured approach to the presentation of financial performance, particularly within the statement of profit and loss. By establishing clearer categories, introducing defined subtotals and enhancing disclosure requirements, the standard aims to improve the consistency, comparability and transparency of financial reporting across entities. Importantly, it also brings greater discipline to the use of management-defined performance measures, thereby providing stakeholders with a clearer understanding of how management interprets and communicates performance.

While the effective date of the standard allows organizations time to prepare, the transition to Ind AS 118 will require thoughtful planning and early engagement. Entities will need to evaluate the implications for their reporting frameworks, internal systems and governance processes to ensure that the enhanced presentation and disclosure requirements are implemented effectively. In doing so, organizations will have an opportunity not only to comply with new reporting expectations but also to strengthen the overall quality of their financial communication.

This publication has been developed to support stakeholders in understanding the key principles and practical implications of Ind AS 118. We hope it serves as a valuable guide for finance professionals, preparers and users of financial statements as they navigate this important development in financial reporting.

As financial reporting standards continue to evolve, maintaining clarity, transparency and trust in corporate reporting remains paramount. Ind AS 118 is an important milestone in that journey.



## Vishal Bansal

Partner with an Indian member firm of EY Global,  
India Corporate Reporting Services Leader

*\* Ind AS 118 has been issued by ICAI as an Exposure Draft and is yet to be notified by the Ministry of Corporate Affairs (MCA). The final notified standard may differ from the Exposure Draft and, accordingly, the contents of this publication may be subject to change. NFRA has recommended that Ind AS 118 be made applicable for annual reporting periods beginning on or after 1 April 2027.*

# What you need to know

- Once notified, Ind AS 118 will replace Ind AS 1 *Presentation of Financial Statements*.
- Ind AS 118 responds to investor demand for better information about an entity's financial performance.
- Ind AS 118 sets out general and specific requirements for the presentation of financial statements and for disclosures in the notes.
- The key new requirements of the standard include:
  - Required totals, subtotals and new categories for all income and expenses included in the statement of profit and loss.
  - Disclosure of management-defined performance measures (MPMs) in a single note to the financial statements.
  - Enhanced guidance on the grouping (aggregation and disaggregation), description (labelling) and location of information.
  - Limited, but widely applicable, amendments have been made to other Ind AS, most notably Ind AS 7, Ind AS 33 and Ind AS 34.
  - Some requirements previously included in Ind AS 1 have been moved to Ind AS 8, and that standard has been renamed.
- Ind AS 118, and the consequential amendments to other standards, are expected to be effective for reporting periods beginning on or after 1 April 2027. For entities following the calendar year as financial year, early adoption from 1 January 2027 is recommended.
- Retrospective application is required in both annual and interim financial statements along with specified reconciliations for certain comparative periods.
- The format of Statement of Profit and Loss (P&L) prescribed under *Ind AS compliant Schedule III to the Companies Act, 2013* (as amended) and the *Securities and Exchange Board of India (SEBI) Listing Obligations and Disclosure Requirements, 2015* (as amended) ['LODR'] are also proposed to be changed.
- Although the impact of the new requirements may vary between entities, Ind AS 118 is expected to impact all entities, across all industries.

## How we see it

The adoption of the new standard provides an opportunity for entities reporting under Ind AS to revisit their communication strategy in the financial statements in general and especially for financial performance. We expect that the new requirements will improve both comparability and transparency of financial statements prepared in accordance with Ind AS.

To implement Ind AS 118, it is likely that entities will need to update their financial statement close process and make changes to their information systems. Management needs to plan ahead as the transition process could require considerable time.

It is likely that identifying management-defined performance measures, and providing the required disclosure, will necessitate significantly more collaboration between the entity's financial reporting, and legal and investor relations teams, among others, than is currently the norm in practice.

*This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither Ernst & Young Associate LLP nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.*



# 01

---

## Introduction



1.1 Objective and scope

---

1.2 Key new concepts



In April 2024, the International Accounting Standards Board (IASB) published a new IFRS accounting standard, viz., IFRS 18, dealing with presentation and disclosure in financial statements. IFRS 18 marks the culmination of the IASB's Primary Financial Statements project, running since 2014, whose objective was to improve communication in financial statements.

To align the requirements of *Indian Accounting Standards (Ind AS) notified under the Companies (Indian Accounting Standards) Rules, 2015* (as amended), the Institute of Chartered Accountants of India (ICAI), in January 2025, issued the Exposure Draft of Ind AS 118, *Presentation and Disclosure in Financial Statements*, for public comment. The Exposure Draft has since been finalized.

The National Financial Reporting Authority (NFRA) has recently recommended Ind AS 118 to the central government for notification. In accordance with the recommendations of NFRA, Ind AS 118 will be applicable for annual reporting periods beginning on or after 1 April 2027. NFRA has also recommended that entities preparing financial statements on a calendar-year basis may be allowed to early adopt Ind AS 118 for periods beginning on or after 1 January 2027. This would help subsidiaries of foreign companies avoid misalignment with their parent entities' reporting timelines under IFRS 18 since IFRS 18 is also applicable from annual reporting periods beginning 1 January 2027.

Along with Ind AS 118, the NFRA has recommended that the Ministry of Corporate Affairs (MCA) could consider making consequential amendments to Schedule III of the Companies Act, 2013 (as amended). The NFRA has also recommended that the Securities and Exchange Board of India (SEBI) could also consider making changes to its circulars and/ or guidance, to align the same with Ind AS 118 requirements. In our view, the SEBI needs to revise Format prescribed for preparation and presentation of financial results as required under Clause 33 of the *SEBI (Listing Obligations and Disclosure Requirements) Regulations, 2015* (as amended) (SEBI LODR).

Once effective, the new standard will replace Ind AS 1, *Presentation of Financial Statements*. While Ind AS 118 represents a major overhaul of the requirements relating to the presentation and disclosure of information in financial statements, many of the existing requirements in Ind AS 1 are carried forward substantially unchanged. This is because Ind AS 118 primarily focuses on targeted improvements designed to address three key concerns expressed by the users of financial statements (hereafter 'users'):

- a) Subtotals in the statement of profit and loss are not sufficiently comparable across reporting entities,
- b) The transparency and understandability of non-GAAP measures need to be improved, and
- c) The aggregation and disaggregation requirements had not been consistently understood or applied, leading to the omission of information that users need and material information being obscured.

Considering the above, many of the existing requirements in Ind AS 1 will be carried forward substantially unchanged. Some requirements currently included within Ind AS 1 will be moved to Ind AS 8 (which will also be renamed as '*Basis of Preparation of Financial Statements*') and to a much lesser extent, Ind AS 107 *Financial Instruments: Disclosures*. Narrow scope consequential amendments have also been made to other Ind AS including:

- Ind AS 7 *Statement of Cash Flows*
- Ind AS 33 *Earnings per Share*
- Ind AS 34 *Interim Financial Reporting*

Ind AS 118 and consequential amendments to other Ind AS will be effective from the date stated above.



**Adarsh Ranka**

*"Ind AS 118 is not only a change in presentation but also a catalyst for strengthening the underlying financial reporting infrastructure. The revised structure of the profit and loss statement and the new disclosure expectations will require organizations to reassess data flows, reporting systems, and internal controls. For many entities, the transition will present an opportunity to modernize reporting processes and build a more robust foundation for high-quality financial reporting."*



## ➤ Key new requirements in Ind AS 118 include:

- Mandatory subtotals and categories of income and expense in the statement of profit and loss, as well as new requirements for the disclosure of operating expenses
- Disclosures about management-defined performance measures (or MPMs) in the financial statements
- Enhanced requirements for the aggregation, disaggregation and location of information presented in the primary financial statements and disclosed in the notes, as well as guidance on providing informative labels

Retrospective application is required in both annual and interim financial statements along with specified reconciliations for certain comparative periods.

The requirements in Ind AS 118 apply to both separate financial statements (SFS) and consolidated financial statements (CFS). However, Ind AS 118 will generally not apply to the presentation and disclosure of information in the condensed interim financial statements prepared in accordance with Ind AS 34. To address changes required in the condensed interim financial statements prepared in accordance with Ind AS 34, changes have been made to Ind AS 34 and are discussed in later parts of this publication. With regard to interim financial results prepared in accordance with the requirements of the SEBI LODR, the changes are pending and, therefore, it is unclear at this stage the extent to which changes in presentation and related disclosures will be required.

Using the Exposure Draft published by the Accounting Standards Board (ASB) of the ICAI, this publication deals with key new requirements in Ind AS 118 and key consequential amendments in other Ind AS that could impact the financial statements for most reporting entities. The focus of this publication is on the new requirements. The requirements which are carried forward from Ind AS 1 and there are no substantial changes, will only be addressed if necessary to explain the context of the new requirements.

### How we see it

While there might appear to be ample time before the effective date of Ind AS 118, entities are strongly encouraged to determine the impact of the new requirements. Management needs to plan in advance as the transition process could require considerable time and involve a combination of resources and process alignment.

Although the impact of the new requirements might vary between entities, Ind AS 118 is expected to impact all entities, across all industries and to affect other areas of the financial statements, and not just the statement of profit and loss.

The changes may also have business implications for entities. For example, it is possible that changes require entities to revisit their remuneration policies and debt covenants linked to profit or loss metrics.





## 1.1 Objective and scope

---

The objective of Ind AS 118 is the same as that of its predecessor, viz., to help ensure that general purpose financial statements (hereafter 'financial statements') provide users with relevant information that faithfully represents the reporting entity's assets, liabilities, equity, income and expenses. The standard must be applied by all entities that prepare financial statements in accordance with Ind AS.

Ind AS 118 sets out general requirements for financial statements and general principles for aggregation and disaggregation. It includes specific requirements for the presentation of information in the statement of profit and loss, the balance sheet and the statement of changes in equity as well as for the disclosure of information in the notes to financial statements.

Ind AS 118 also includes requirements for the descriptions (or labels) of line items presented in the financial statements or items disclosed in the notes. Furthermore, Ind AS 118 introduces requirements to classify all income and expenses, included in the statement of profit and loss, into categories and to present certain mandatory subtotals. Ind AS 118 also requires disclosures about certain non-GAAP measures ('management-defined performance measures') to be included in a single note to the financial statements.

The presentation and disclosure requirements for information in the statement of cash flows are still contained in Ind AS 7. However, Ind AS 118 is now explicit that the general requirements for financial statements, the principles of aggregation and disaggregation and some requirements relating to disclosures in the notes in Ind AS 118 also apply to the statement of cash flows. Furthermore, some narrow scope amendments have been made to Ind AS 7. The requirements in Ind AS 118 apply to consolidated and separate financial statements, but they are not generally applicable to the presentation and disclosure of information in condensed interim financial statements prepared in accordance with Ind AS 34. However, the principles of aggregation and disaggregation, as well as the requirements relating to MPMS, do apply to such interim condensed financial statements.

## 1.2 Key new concepts

---

Ind AS 118 introduces the concept of 'primary financial statements', encompassing:

- The statement of profit and loss
- The balance sheet
- The statement of changes in equity, and
- The statement of cash flows

A complete set of financial statements, therefore, comprises the primary financial statements and the notes.

Another key change is that Ind AS 118 differentiates between 'presentation' and 'disclosure.' It explains that "an entity presents information in the primary financial statements and discloses information in the notes". This is in contrast to Ind AS 1, which mostly used the terms interchangeably.



# 02

---

## Statement of profit and loss: General requirements





The application of Ind AS 118 will likely result in significant changes to how most entities currently prepare and present their statement of profit and loss. In particular, the application of Ind AS 118 will require entities to:

1. Classify income and expenses included in the statement of profit and loss in one of the five categories, viz., (i) the operating category, (ii) the investing category, (iii) the financing category, (iv) the income taxes category, and (e) the discontinued operations category.
2. Present expenses classified in the operating category either by the “function” or by the “nature” method, or by a combination of both, based on what provides the most useful structured summary of operating expenses.
3. Present at a minimum two new subtotals, viz., (i) operating profit or loss, and (ii) profit or loss before financing and income tax, in addition to total profit or loss.

Currently, Ind AS 1 read with Schedule III do not require classification of income and expense into operating, investing and financial categories. Also, they do not allow expense classification using the function method or mixed approach. Thus, the application of Ind AS 118 will be significant change for most entities.

## 2.1 General requirements for classification of income and expense

The classification requirements prescribed in Ind AS 118 are based on the information needs of users with regard to the statement of profit and loss. These requirements are likely to be different for other primary financial statements. For example, information requirements with regard to the statement of cash flows prepared in accordance with Ind AS 7 are different vis-à-vis the statement of profit and loss. Also, the purpose of those primary statements is different. As a result, despite using the same or similar terminology, there is no alignment between the categories used in the two statements. For example, ‘investing activities’ as defined in Ind AS 7 is intentionally different from the investing category in the statement of profit and loss.

The information requirements of users with regard to the statement of profit and loss are different vis-à-vis those for the statement of cash flow. Also, the purpose of these two statements is different. Consequently, despite using similar terminology, there is no alignment between the categories used in the two statements.

While it may be self-evident, it is worth noting that the classification requirements only apply to income and expenses included in profit or loss for the period, as a result of applying Ind AS and would, therefore, not apply to expenses that were capitalized to an asset, or are included in the other comprehensive income (OCI) for the year/ period. That said, the classification requirements will apply to ‘reclassification adjustments’ which are items recognized in profit or loss which were previously recognized in other comprehensive income (commonly referred to as ‘recycling’).

Classification of income and expense into operating, investing and financing categories depends on main business activities of the entities. For example, classification is likely to be different for manufacturing and/ or services companies vis-à-vis banking, insurance and investment companies. To address these differences, Ind AS 118 has developed two different requirements for classification of income and expense. The first requirement (referred to as ‘General model’) is developed considering information requirements of a corporate entity (typically, non-financial institution).

Ind AS 118 requires all entities to classify their income and expenses included in profit or loss into one of five categories:

- (a) Operating
- (b) Investing
- (c) Financing
- (d) Income taxes, and
- (e) Discontinued operations

To reflect an accurate picture of entity's operating profit for entities engaged in particular type of activities, Ind AS 118 requires an entity to assess whether it has 'specified main business activity' of either investing in particular types of assets (e.g., investment property companies), and/ or providing financing to customers (e.g., banks and other lending institutions). If this is the case, then as an exception to the general requirements, Ind AS 118 requires entities with a 'specified main business activity' to classify some of their income and expenses in the operating category that would otherwise have been included in investing or financing. Classification requirements for an entity having specified main business activity are discussed separately in Chapter 3.

This chapter deals with classification requirements applicable to entities which do not have specified main business activity and are, therefore, covered under the General model.

Given here is a typical format of the statement of profit and loss likely to be used by an entity, which does not specify main business activity of investing in types of assets and/ or providing financing to customers, under Ind AS 118 scenario using a nature-based classification. For the function-based classification format, reference is drawn to Appendix A to this publication.

**Figure 2-1: Presentation of the statement of profit and loss example**

**Statement of profit and loss**

Revenue from contracts with customers		Operating
Other operating revenue		
<b>Total revenue</b>		
<b>Operating expenses</b>		
Changes in inventories of finished goods and work in progress		
Raw material used		
Employee benefits		
Depreciation, amortisation and impairment		
Other operating expenses		
<b>Operating profit</b>		
Share of the profit from associates and joint ventures		Investing
Gains on disposals of associates and joint ventures		
<b>Profit before financing and income tax</b>		
Interest expense on borrowings and lease liabilities		Financing
Interest expense on pension liabilities		
<b>Profit before income tax</b>		
Income tax expense		Income Taxes
<b>Profit from continuing operations</b>		Discontinued operations
Loss from discontinued operations		
<b>Profit for the year</b>		

New items

Required items

**How we see it**

All entities will need to carefully reconsider the structure of their statement of profit and loss, in light of the new categories and subtotals required by Ind AS 118. Classifying income and expenses into the relevant profit or loss categories might require the use of judgment.



## ➤ 2.1.1 Investing category

Many users analyze returns from an entity's investments separately from its operations. Thus, the introduction of an investing category enables those users to identify returns which are not part of the entity's main business activities. The investing category typically includes income and expenses arising from:

- Assets that generate a return individually and largely independently of other resources held by an entity, for example, rental income from investment property
- Interest income and fair value changes of financial assets
- Dividends and fair value changes of financial instrument investments
- Investments in unconsolidated subsidiaries, associates and joint ventures, and
- Cash and cash equivalents

There is no requirement to insert a heading for the 'investing category' and the standard permits an entity to present additional subtotals within that category, if this contributes to a useful structured summary.

### How we see it

We believe that the ability to present additional subtotals within the investing category will enable many entities to communicate information which reflects the relevance of different investments to their business and thus contribute to providing a useful structured summary.

### Assets generating return individually and largely independently of other resources

The standard provides examples of assets which generate a return individually and largely independently of the entity's other resources and the types of income and expense which could arise from:

- Debt or equity instruments, generating interest income or dividends
- Investment properties, generating rental income, depreciation, impairment losses and reversals as well as income and expenses from derecognition
- Receivables for rent generated by those investment properties

To further clarify, the standard provides examples of assets that are typically used in combination to produce or supply goods or services, and which, therefore, do not generate returns individually or largely independently of the entity's other resources. Such assets include but are not limited to:

- Property, plant and equipment
- Assets such as receivables, which arise from the production or supply of goods and services and for which the income and expenses are classified in the operating category
- Loans to customers, when the entity provides financing to customers

Other examples of assets that are typically used in combination to produce or supply goods or services, and which, therefore, do not generate returns individually or largely independently of the entity's other resources include intangible assets, contract assets and inventories.

Explanatory examples are given of the types of income and expenses that could arise from the above assets, and which would not be classified in the investing category, include:

- Revenue for goods and services produced or supplied using a combination of assets
- Interest income on trade receivables, contract assets, etc.
- Depreciation and amortisation
- Impairment losses on PPE and reversals thereof



- Income and expenses from derecognition of the asset
- Income and expenses from an asset's classification and measurement as held for sale
- Income and expenses arising on a business combination that includes assets, which will give rise to income and expenses that will be classified in the operating category, such as, remeasurement of contingent consideration

Business combinations represent the underlying assets acquired and liabilities assumed and, thus, the returns from a business combination (for example, remeasurement of contingent consideration) are not individual or largely independent of the entity's other resources.

### **Income and expenses to be classified as investing activity**

In accordance with Ind AS 118, the following income and expenses arising from the assets generating return individually and largely independently of other resources are classified as investing category:

- Income generated by those assets, e.g., interest revenue from debt investments, dividend income from equity instruments and rental income from investment properties
- Income and expenses that arise from the initial and subsequent measurement of the assets, including on derecognition of the asset e.g., depreciation, impairment losses and reversal of impairment losses on investment properties
- Incremental expenses directly attributable to the acquisition and disposal of the assets, e.g., transaction costs and costs to sell the assets

Ind AS 118 is clear that only the 'specified' income and expenses stated above are classified in the investing category. This implies that income and expenses other than those listed above arising from these assets are included in the operating category. For example, expenses on day-to-day operation and maintenance of these assets are classified in the operating category. This is because classifying all expenses directly related to such assets as investing would be too complex and costly in practice. For instance, investment-related expenses may include allocations of employee benefits where employees are engaged in both investment and other activities. Limiting the investing category to 'specified' income and expense avoids the need for complex allocation of such cost across categories.



**Jigar Parikh**

*"For many organizations, the implementation of Ind AS 118 will extend beyond external financial reporting and may prompt a broader review of internal reporting frameworks. Aligning internal management reporting with external financial statements will be important to ensure consistency in how performance is communicated. At the same time, the increased role of judgment in presentation choices will place greater emphasis on strong governance, clear documentation, and effective oversight."*



## Frequently asked questions

**Question 2-1: How is rental income from property, plant and equipment (PPE) given on an operating lease classified in the statement of profit and loss (P&L) by a lessor?**

Applying Ind AS 116, a lessor might classify a lease of PPE as an operating lease and recognize rental income in P&L. In classifying such lease income, the entity needs to consider whether the PPE can generate returns individually and largely independently of the entity's other resources.

Although Ind AS 118 gives PPE as an example of assets used in combination for operations and not generating independent returns, the standard assumes the asset is used in the entity's own operations. If the lessor leases out an individual asset not used in its operations, the asset could generate returns individually and largely independently. In that case, the operating lease income is classified in the investing category, unless the entity meets specific main business activity criteria for classification in the operating category.

**Question 2-2: How is finance income on the net investment in a finance lease classified in P&L?**

A lessor with an asset held under the finance lease will recognize finance income on the net investment in the lease in P&L. A net investment asset does not generate returns in conjunction with other resources of the entity. Therefore, the net investment asset meets the criterion of generating a return individually and largely independently of the entity's other resources. Thus, the finance income, being income arising from the subsequent measurement of the net investment asset, is classified in the investing category, unless the entity meets specific main business activity criteria for classification in the operating category.

**Question 2-3: How are expenses related to holding investment property classified in profit or loss?**

As noted above, the standard only requires specific expenses occurring in defined circumstances to be classified in the investing category. Therefore, other expenses that arise from holding the investment - for example, maintenance expenses or rates and taxes levied on an investment property, salaries to employees that manage the investment property, investment management fees paid to a third party - will be classified in the operating category since this type of expenditure does not fall within the categories of expenditure required to be classified in the investing category. Given here is classification of various income and expenses arising from investment property for an entity who does not have main business activity of investing in such assets:

Income/ expense	Classification
Expenses incurred on acquisition	Capitalized
Rental income	Investing category
Depreciation on investment property	Investing category
Maintenance cost and property taxes	Operating category
Employee compensation of staff working on operations and maintenance of investment property including staff monitoring performance (full time/ shared staff)	Operating category
Transaction cost on sale of investment property	Investing category (unless to be classified as discontinued operation)
Gain/loss on sale of investment property	

## Income and expense arising from investments in subsidiaries, associates and joint ventures

*Investments in subsidiaries, associates and joint ventures in separate financial statements*

In their separate financial statements, parent/ investor entities need to account for their investments in subsidiaries, associates and/or joint ventures either at cost less impairment or at fair value in accordance with Ind AS 109. In such cases, such income and expenses arising from the investment are also classified in the investing category, unless those entities have a main business activity of investing in such assets.



### *Equity method investees in consolidated financial statements (CFS)*

All entities irrespective of their main business activity are required to classify their share of profit or loss and other income and expenses arising from an equity accounted investees in the investing category in their consolidated financial statements (CFS).

All entities, irrespective of whether they invest in equity accounted investments as a main business activity or not, are required to classify their share of profit or loss and other income and expenses (e.g., an impairment loss) arising from an equity accounted investment in associates and joint ventures in the investing category in their CFS.

This view is supported by the key considerations below:

- (i) Both types of entities, viz., entities which invest in such assets as a main business activity and entities which do not, do not control the activities of its associates and joint ventures.
- (ii) Many users analyze equity method accounted income and expenses separately, therefore, classifying them in the operating category would disrupt analyses of both operating margin and the investments themselves.
- (iii) The approach reflects the fact that returns of equity accounted investments are not closely related to an entity's main business activities and are instead generated individually and largely independently of its other resources.

As the standard does not specify the location of the equity accounted investments line item within the investing category, it is possible for entities to present this as the first line after operating profit subtotal and insert an additional subtotal for operating profit and income and expenses from equity accounted investments.

#### **How we see it**

An entity has the option to present income and expenses from equity accounted investments as the first line after operating profit subtotal and insert an additional subtotal for operating profit and income and expenses from equity accounted investments.

### *Classification of Investments in subsidiaries in CFS*

With regard to investment in subsidiaries, it may be noted that in standalone financial statements (SFS), subsidiaries are not consolidated. Hence, as stated above, entities (which do not have specified main business of making such investment) classify income and expense from investment in subsidiaries as investing activity in SFS. In contrast, in CFS, most entities except investment entities will consolidate subsidiaries in accordance with Ind AS 110. Consequently, classification at CFS level will be based on principles explained above and considering the group as a single reporting entity.

### **Classification of incremental acquisition and disposal expenses**

Incremental expenses directly attributable to the acquisition and disposal of investments are required to be classified in the investing category. Such incremental costs, directly attributable to acquisition and disposal, are typically easily identifiable external costs and do not include internal expenses such as employee costs, which may involve complex and arbitrary allocation of expenses. Similarly, not all incremental expenses are classified in the investing category, but only those directly attributable to the acquisition. Thus, ongoing expenses related to the investment, such as investment management fees paid to a third party, are excluded from the investing category and classified in the operating category.



## Frequently asked questions

### Question 2-4: How are transaction costs incurred in acquiring investments in other entities classified in profit or loss?

Entities that acquire investments in subsidiaries, associates, joint ventures or other equity investments typically incur transaction costs relating to these acquisitions. Transaction costs relating to such acquisitions are either capitalized or expensed, depending on the nature of the transaction. For example, in consolidated financial statements, under Ind AS 103 *Business Combinations*, transaction costs relating to the acquisition of a subsidiary which meets the definition of business are expensed in the statement of profit and loss, whereas under Ind AS 28 *Investments in Associates and Joint Ventures*, transaction costs relating to the acquisition of an associate or joint venture are capitalized as part of the equity accounted cost of that investment rather than being recognized in the statement of profit and loss. In contrast, in separate financial statements, under Ind AS 27 *Separate Financial Statements*, transaction costs relating to the acquisition of a subsidiary, an associate or a joint venture are capitalized as part of the cost of that investment rather than being recognized in the statement of profit and loss.

For those expenses recognized in profit or loss, Ind AS 118 specifies that incremental expenses directly attributable to the acquisition of assets for which the income is included in the investing category are also classified in the investing category, while the costs to acquire assets which generate income classified in the operating category will also be classified in the operating category.

The following table summarizes classification of such incremental acquisition costs recognized in P&L for an entity that does not have a specified main business activity of investing in such assets:

Incremental cost incurred on acquisition of	Treatment in SFS	Treatment in CFS
Subsidiary constituting business in accordance with Ind AS 103 and includes assets not generating return individually and largely independently	Capitalized	Charged to P&L and classified as operating category
Equity investment in associate or joint venture accounted for using the equity method	Capitalized	Capitalized
Equity investment, without control, joint control or significant influence, accounted for as at fair value through profit or loss (FVTPL) in accordance with Ind AS 109	Charged to P&L and classified in investing category	Charged to P&L and classified in investing category

## Cash and cash equivalents

To make the structure of the statement of profit and loss easier to understand, and because cash and cash equivalents are assets which generate returns individually and largely independently of an entity's other resources, income and expenses from cash and cash equivalents are classified in the investing category. There are limited exceptions to this requirement for entities with a main business activity of investing in financial assets or providing financing to customers.

This requirement means that for entities that do not have a main business activity of investing in financial assets or providing financing to customers, there is no correlation between the purpose for which the cash is held or the manner of receipt and the classification within profit or loss.



## Frequently asked questions

**Question 2-5: How is interest income on cash and cash equivalents that is received as an advanced payment from a customer classified in profit or loss?**

If an entity receives cash advances from a customer under a revenue contract with a significant financing component, any interest earned on those cash advances is still classified in the investing category. The entity is not permitted to classify the interest income earned on the cash as part of its operating profit.

## ➤ 2.1.2 Financing

To determine income and expenses to be classified in the financing category, Ind AS 118 requires an entity to differentiate all its liabilities between two types. We have labelled these two types as below and will use these labels throughout the publication:

1. **Type 1:** Liabilities that arise from transactions that involve only the raising of finance, and
2. **Type 2:** All other liabilities (i.e., liabilities other than those under Type 1)

The financing category will include:

- All income and expenses from Type 1 liabilities, i.e., liabilities arising from transactions that involve only the raising of financing (for example, income and expenses from bank loans)
- Interest expense and the effects of interest rate changes recognized in P&L while applying Ind AS to Type 2 liabilities (for example, interest expenses recognized on a lease liability under Ind AS 116 *Leases* or the unwinding of discounting on a long-term provision under Ind AS 37)

Note that, for Type 2 liabilities, only interest income and expense and the effects of interest rate changes are classified in the financing category; all other changes, such as the re-measurement of a provision, are classified in the operating category.

There are specific requirements relating to income and expenses from hybrid contracts containing a host that is a financial liability and gains on losses arising on derivatives, including derivatives designated as hedging instruments. These requirements are dealt with in later parts of this Chapter.

### Type 1 liabilities

Liabilities arising from transactions involving only the raising of finance (i.e., Type 1 liabilities) are liabilities where the entity:

- (a) Receives finance in the form of cash, or an extinguishment of a financial liability, or receipt of its own equity instruments, and
- (b) At a later date, will return in exchange of cash or its own equity instruments.

Given below is a non-exhaustive list of examples of Type 1 liabilities:

- A debt instrument that will be settled in cash, such as debentures, loans, notes, corporate bonds and mortgages
- A liability under a supplier finance arrangement when the payable is derecognized, i.e., where the entity derecognizes the original trade payable and recognizes a new liability
- A bond settled through delivery of the entity's own shares, i.e., convertible debentures or preference shares treated as financial liability under Ind AS 32
- An obligation for an entity to purchase its own equity instruments



Income and expenses arising from the initial recognition and subsequent measurement, including derecognition, of Type 1 liabilities are required to be classified in the financing category. For example:

- Interest expense on a debt instrument issued
- Fair value gains and losses on a liability designated at fair value through profit or loss
- Dividends on issued shares classified as liabilities
- Remeasurements recognized on the extinguishment of a debt instrument

Incremental expenses directly attributable to the issue and extinguishment of such liabilities, for example transaction costs, are also required to be classified in the financing category.

## **Type 2 liabilities**

Type 2 liabilities are all liabilities that are not Type 1 liabilities. The following are examples of Type 2 liabilities in accordance with Ind AS 118:

- Payables for goods and services including payables with an extended payment terms
- Contract liabilities, i.e., advance received for sale of goods and services
- Lease liabilities
- Defined benefit liabilities
- Decommissioning provisions
- Provisions for litigation

The above list is not exhaustive and other types of liabilities may also get included here if they do not meet criteria for classification as Type 1 liability.

For Type 2 liabilities, interest income and expenses, including any income and expenses arising from changes in interest rates, recognized in profit or loss, will be classified in the financing category if these income and expenses arise as a result of applying other Ind AS. The latter part of this requirement is important, as not all Ind AS require an entity to disaggregate income and expenses arising from changes in the carrying amount into separate amounts for interest income and expenses and other types of income and expenses. An example of this is the changes in the fair value arising from a share-based payment transaction accounted for under Ind AS 102 *Share-based Payments*. Under Ind AS 102, there is no requirement to identify an interest element separately from the other fair value movements. Consequently, the interest element inherent in the fair value movement is not split out and classified within the financing category; rather, the whole fair value movement is classified within the operating category.

The standard provides the following examples of the types of interest income and expenses, including from changes in interest rates, on Type 2 liabilities that will be classified in the financing category:

- Interest expenses on trade payables recognized under Ind AS 109
- Interest expenses recognized on contract liabilities with a significant financing component, under Ind AS 115 *Revenue from Contracts with Customers*
- Interest expenses on lease liabilities recognized under Ind AS 116
- Net interest expense (or income) on a net defined benefit liability (or asset) recognized under Ind AS 19 *Employee Benefits*
- Unwinding of a discount on a provision recognized under Ind AS 37

Taking a long-term provision, recognized under Ind AS 37, as an example, an entity could recognize three types of changes to the provision:

1. Periodic unwinding of the discount
2. Effects of changes in the discount rate
3. Effects of changes in the best estimate of the expenditure required to settle the liability



Only the first two would be classified in the financing category, because they are financing in nature, while the third would need to be classified in the operating category.

For the avoidance of doubt, the standard also outlines income and expenses that are not interest income or expenses arising as a result of applying Ind AS and that will therefore be classified in the operating category, for example:

- Expenses recognized for the consumption of purchased goods or services
- Current and past service costs from Ind AS 19 defined benefit plan, and
- Fair value remeasurements of a contingent consideration liability recognized applying Ind AS 103

### Classification of loan commitment fees

Fees could be paid by a borrower to obtain a term loan, a line of credit, or a revolving debt arrangement and these fees are either included in the effective interest rate of the resulting loan or charged to P&L over the commitment period depending on whether:

- It is probable (more likely than not) at inception that the loan commitment will be utilized in whole or in part, and
- Once utilized, the loan commitment expires (that is, if the loan is repaid no further amount can be drawn)

Under Ind AS 118, the classification of loan commitment fees paid and charged to P&L of the borrower needs to reflect the underlying accounting, i.e., the classification depends on whether a liability is recognized or not. Unless the resulting expense is part of a specified expense that the entity must classify in the financing category, it is included in the operating category. This can be explained with the following examples:

1. The entity enters into loan agreement to obtain a five-year loan, with a set repayment schedule. The entity draws down in full on day one, resulting in the recognition of loan liability.  
In this case, commitment fee forms part of effective interest rate on the resulting liability and is recognized as part of the interest expense over the loan term. The interest expense (including commitment fees forming part of it) is classified as financing activity.
2. The entity enters into loan agreement and pays commitment fees for a fixed term loan. At the inception, it is probable that the entity will draw down only 60% of the sanctioned loan amount and leave the rest unused.  
In this case, commitment fee is apportioned pro-rata to the 60% of the loan likely to be drawn down and treated in the same manner (including categorization) as 1 above. The remaining portion of the commitment fee is expensed straight line over the commitment period and classified as the operating activity.
3. The entity enters into agreement for a revolving credit facility and makes payment of loan commitment fees. The entity can draw down and repay the funds numerous times during the life of the facility.  
In this case, loan commitment fee does not relate to a specific borrowing. Hence, it cannot be included as part of Effective Interest Rate under Ind AS 109. Rather, the commitment fee is expensed straight line over the commitment period. Consequently, the amount recognized in P&L is classified as operating activity.



**Dr. Devesh Prakash**

*"Ind AS 118 represents a significant evolution in financial reporting, shifting the emphasis from merely presenting numbers to communicating financial performance more effectively. By introducing structured categories and clearly defined subtotals within the statement of profit and loss, the standard provides a more coherent framework for presenting financial results. This enhanced structure is expected to improve transparency and comparability across entities, enabling stakeholders to better understand the underlying drivers of business performance."*



## Frequently asked questions

**Question 2-6: How is the interest expense on a contract liability (with a significant financing component) classified in the statement of profit and loss?**

Contract liability recognized as per Ind AS 115 is an example of a Type 2 liability in Ind AS 118, as it does not involve only the raising of finance, but also relates to the provision of goods or services. If, under a customer contract within the scope of Ind AS 115, the entity receives a significant benefit of financing the transfer of the goods or services, an interest expense may need to be recognized in P&L. The interest expense recognized on a contract liability with a significant financing component is given as an example of an expense arising from a Type 2 liability that must be classified in the financing category.

**Question 2-7: Is it acceptable to disaggregate the 'time value' element from the remeasurement of a Type 2 liability for the purpose of determining the appropriate category?**

Some measurements, such as fair value, implicitly include a time value element, but the accounting under the related Ind AS does not require this to be recognized separately. An example of this is the changes in the fair value arising from a share-based payment transaction accounted for under Ind AS 102. This inherently includes a time value of money element, but it is not split out under Ind AS 102 accounting. Consequently, the entire change in fair value of share-based payment transaction is included in the Operating Category.

The standard is clear that only the interest income or expense, including from changes in interest rates, on a Type 2 liability that an entity identifies for the purposes of applying another Ind AS is included in the financing category.

## How we see it

We believe that, unless an Ind AS permits or requires interest income or expenses to be recognized, it is not acceptable for an entity to disaggregate income and expenses relating to the time element to classify them separately in the financing category, even for the measurement of a liability which implicitly includes a time value element.

## Hybrid contracts containing a host liability

Some contracts in the scope of Ind AS 109 are hybrid contracts containing a financial liability and an embedded derivative, for example, a bank loan with a prepayment option. Classification of income and expenses of a hybrid contract with a host liability will depend on whether the embedded derivative is separated from the host contract.

### *Host and embedded derivative are separated*

If embedded derivative is separated, income and expenses arising from the host liability will be classified in accordance with the same requirements as for classifying a similar liability that is not a host in a hybrid contract. In other words, an entity will follow the guidance outlined above, i.e., assess whether it is a Type 1 or Type 2 liability and follow the appropriate requirements. Specific requirements applicable for entities with a main business activity of providing financing to customers are discussed in a separate section.

The separated embedded derivative is classified in accordance with the requirements for similar stand-alone derivatives, which are addressed in section 2.1.6 later.



## Embedded derivative is not separated

In cases where the embedded derivative is not separated, Ind AS 109 treats the hybrid instrument as a single unit of account and measures the combined liability in its entirety. In such cases, the following principles will apply for classification of income and expense recognized in P&L depending on whether the hybrid liability is a Type 1 or a Type 2 hybrid liability:

- Type 1 hybrid liability: Is treated entirely as a financial liability. Accordingly, all income and expenses will be classified in the financing category, despite the presence of the embedded derivative.
- For Type 2 hybrid liability, the following applies:
  - (a) For a hybrid contract with a host liability accounted for under Ind AS 109 and measured at amortised cost, all income and expenses arising from the hybrid contract will be classified in the financing category - essentially the hybrid instrument measured at amortised cost is treated as a Type 1 liability.

An example of such a Type 2 liability hybrid is a trade payable with extended credit terms and an early prepayment option. This gives rise to interest income and expenses related to the extended credit terms, but also potentially income and expenses from remeasurement, triggered by changes in expectations in future cash flows, as expectations about the use of the prepayment option change.

- (b) For a hybrid insurance contract in the scope of Ind AS 117, all income and expenses, including insurance finance income and expenses, will be classified in the operating category.
- (c) For all other Type 2 liability hybrid contracts, interest income and expenses and income and expense from interest rate changes identified for the purposes of applying other Ind AS, will be classified in the financing category. If the income and expenses are not interest income and expenses, they will be classified as operating.

### ➤ 2.1.3 Operating

Ind AS 118 defines the operating category as the residual category that includes all items of income and expense not classified in either the investing, financing, income taxes or discontinued operation categories. As a result, all items of income and expense arising from an entity's operations are classified as operating, including not only its main business activities but also supporting activities that do not directly generate revenue as well as items of income and expense which are not classified within the other four categories. This requirement is apparently based on key assumption that all items of income and expense included in the statement of profit and loss, which do not relate to another category, arise from an entity's operations.

The operating category also includes volatile, unusual or non-recurring items. For example, impairment expenses as well as depreciation expenses relating to an item of equipment are classified in operating to give a complete picture of the results from the operations for the period. Omitting either of those expenses would not depict the operating decisions to buy and deploy the equipment, nor how those decisions had given rise to income and expenses.

This residual approach is intended to work for different business models and ensure that all items of income and expenses from an entity's main business activities are included in operating category. The only exception relates to entities which consider their equity accounted investments (viz., investment in associate and joint ventures in their consolidated financial statements) to be their main business activity. Ind AS 118 requires that any income or loss from investments accounted for using the equity method are included in the investing category. This is despite the fact that the management considers these to be part of the entity's main business activities.

#### How we see it

We believe that the use of the operating category as the 'default' category thereby ensuring that all income and expenses from an entity's main business activities, whether volatile or not, are presented in the same category, will facilitate comparability between entities.



## Frequently asked questions

**Question 2-8: Where is interest income on a contract asset (with a significant financing component) classified in profit or loss?**

A contract with a customer under Ind AS 115 may result in the recognition of a contract asset and related interest income, if the contract terms provide the customer with a significant benefit of financing the transfer of goods or services. Similar to a receivable arising from a revenue contract, such contract assets arise from the production or supply of goods and services and, consequently, do not generate a return individually and largely independently of the entity's other resources. Consequently, if a significant financing component is recognized on a contract asset under Ind AS 115, the interest income is classified in the operating category.

The above classification may, at first glance, seem counterintuitive, as interest expense on a contract liability (i.e., a Type 2 liability) is classified in the financing category. However, in this case, the entity is not raising finance but providing finance to the customer and the standard is clear that different classification rules apply to assets and liabilities.

### How we see it

For assets, income and expenses are classified in operating or investing category, depending on whether the asset generates returns independently and largely independently of other resources. If it does not, all income and expenses arising from the asset are classified under the operating category.

**Question 2-9: Where is interest income on a financial asset arising from a service concession arrangement classified in profit or loss?**

Interest income on a financial asset arising from a service concession arrangement in the scope of Appendix D to Ind AS 115 *Service Concession Arrangements* is treated in the same way as a receivable arising under Ind AS 115, since it also arises from the production or supply of goods and services, for which the income and expenses are classified in the operating category. That is to say, the interest income is classified in the operating category.

**Question 2-10: Where are gains and losses arising from the remeasurement of contingent consideration in a business combination classified?**

The gains or losses recognized in profit or loss on the subsequent remeasurement of contingent consideration in a business combination under Ind AS 103 are classified in the operating category, provided that the related business combination includes assets that will give rise to income and expenses classified in the operating category.

### How we see it

In our view, the specific guidance on contingent consideration in Ind AS 118 applies to all types of contingent consideration, including those meeting the definition of a derivative, despite the general requirements for classification of income and expenses from derivatives also provided in Ind AS 118.



### Question 2-11: How is income from government grants classified?

Ind AS 20 *Accounting for Government Grants and Disclosure of Government Assistance* permits income from government grants included in P&L to be presented 'gross' or 'net' of the related expense. In our view, the classification will depend on gross or net approach adopted by the entity:

1. Entities which choose to present the income from government grants 'gross' within the P&L would follow the general classification requirements of Ind AS 118. Government grant income generally does not arise from an asset which generates returns individually and largely independently of an entity's other resources, nor from a liability which involves only the raising of finance (i.e., a Type 1 liability). Government grant income also does not represent interest income (including from interest rate changes) recognized on other liabilities (i.e., Type 2 liabilities) as a result of applying other Ind AS. Consequently, government grant income presented gross will generally be classified in the default category, i.e., the operating category.
2. In contrast, government grant income netted against the related income, expense, asset or liability when applying Ind AS 20 would, in principle, follow the Ind AS 118 classification of the related item against which it is netted.

This means that, in certain cases, government grant income presented gross in P&L applying Ind AS 20 could be classified in a different category from government grant income presented net under Ind AS 20. To illustrate, assume that the entity receives a government grant to reimburse it for interest expense incurred on its loan arrangement with a Bank. The government grant income is received in full on the same date the loan is taken out. The entity recognizes grant income as deferred income in the balance sheet and releases it to P&L as the interest on the bank loan is charged to P&L.

- If the entity has a policy of presenting government grant income as gross in P&L, it may be noted that the income is not arising from an asset which generates returns individually and largely independently, nor does it arise from a Type 1 liability, as it is not part of the initial or subsequent accounting for the amortised cost of the loan arrangement with the bank. It also does not represent interest income recognized on a Type 2 liability for the purposes of applying other Ind AS. As a result, in this case, it is appropriate for the entity to classify government grant income in the operating category.
- In contrast, if the entity has an accounting policy of presenting the government grant income net in P&L (i.e., setting it off against the interest charged), it would have presented a reduced interest expense on its Type 1 liability to the bank and this reduced interest expense would have been classified in the financing category.

#### How we see it

We believe it is generally appropriate to classify government grant income which is presented 'gross' in the statement of profit and loss under Ind AS 20, within the default category - i.e., within the operating category. However, practice might develop on this matter and needs to be monitored. If it does not, all income and expenses arising from the asset are classified under the operating

## ➤ 2.1.4 Income taxes

An entity is required to classify tax expense or tax income that are included in the statement of profit and loss applying Ind AS 12, and any related foreign exchange differences, in the income taxes category. Income and expenses classified in the income tax category are not subject to the requirements for classifying income and expense in the operating, investing and financing categories. The presentation of income and expenses related to income tax in that category complies with the presentation requirements of Ind AS 12. Although this category does not result in a required subtotal, generally entities present profit before income taxes as a subtotal when it is applicable.



## ➤ 2.1.5 Discontinued operations

An entity is required to classify in the discontinued operations category income and expenses from discontinued operations as required by Ind AS 105. Income and expenses classified in the discontinued operations category are not subject to the requirements for classifying income and expense in the operating, investing and financing categories. The presentation of income and expenses related to discontinued operations in that category complies with the presentation requirements of Ind AS 105. Although this category does not result in a required subtotal, generally entities present profit before discontinued operations as a subtotal when it is applicable.

## ➤ 2.1.6 Classification of specific income and expense

The requirement to classify all income and expense into one of the five categories above can be difficult for certain items of income and expense. Therefore, Ind AS 118 provides guidance for classifying some specific types of income and expense, viz., the following:

- Foreign exchange differences
- Gains and losses on derivatives and designated hedging instruments
- Hybrid contracts accounted for under Ind AS 109
- Changes in classification and derecognition

### Foreign exchange differences

The basic principle for classifying foreign exchange differences is that they follow the category in which the related income and expenses from the item giving rise to the foreign exchange difference have been classified, unless doing so involves undue cost or effort. If the latter is the case, all such differences are classified in the operating category. For example, foreign exchange differences on a trade receivable denominated in a foreign currency will be classified in the operating category. Whereas foreign exchange differences arising from a Type 1 liability (for example, a debt instrument liability denominated in a foreign currency) will be classified in the financing category, if the related interest expense on that liability is classified in the financing category.

In some cases, the requirement to classify foreign exchange differences in the same category as the income or expense that gave rise to them could impose large implementation costs on preparers, as many systems are currently configured to capture all foreign exchange differences in aggregate as a single amount. To address this, Ind AS 118 gives an exemption based on undue cost or effort. The exemption, requiring exchange differences to be classified in operating, is only applicable to the subset of differences that cannot be classified without undue cost or effort.

### How we see it

The undue cost and effort exemption, resulting in the classification of particular foreign exchange differences in the operating category, is a pragmatic solution which could involve significant judgment.

In some cases, income and expenses from a Type 2 liability might be classified in two different categories, as the transactions involve financing and another activity. For example, purchased services denominated in a foreign currency with extended credit terms could give rise to an operating expense for the purchase of the services and a financing expense for the interest on the payable. In this instance, judgment is required to determine to which of the two amounts the foreign exchange difference relates. The foreign exchange gain or loss will then be allocated in its entirety to the relevant category. Note that disaggregation of the foreign exchange difference arising on a Type 2 liability into more than one category is prohibited. Therefore, the judgment is made about the difference as a whole.



## Frequently asked questions

**Question 2-12: How are foreign exchange differences on intercompany loans, eliminated on consolidation, classified in profit or loss?**

Within a multinational group, the parent commonly has a different functional currency from its subsidiaries. For any intercompany balance between a parent and its subsidiaries, which do not form part of the net investment in a foreign operation, and which have been eliminated on consolidation applying Ind AS 110, the foreign exchange differences will not be eliminated and will remain in the consolidated profit or loss.

Applying the basic principle for classifying foreign exchange differences (i.e., classifying in the same category in which the related income and expenses from the underlying item have been classified) to such cases is problematic. This is because, from the consolidated group's perspective, the underlying intercompany balances that gave rise to the foreign exchange differences do not exist (i.e., they have been eliminated under Ind AS 110). Therefore, there does not appear to be 'related income and expenses' that the foreign exchange differences can 'follow'

### How we see it

In our view, the classification is performed from the group's perspective as a single reporting entity and at a consolidated level there is no underlying loan transaction giving rise to the foreign exchange gain or loss. As a result, we believe it is acceptable to classify these gains and losses within the default category of operating within the consolidated statement of profit and loss. However, considering that Ind AS 118 is silent on the matter, other categories cannot necessarily be ruled out and practice needs to be monitored, as it develops

At the time of writing, the IFRS IC was considering a submission on this issue.

## Gains and losses on derivatives and designated hedging instruments

Specific requirements are set out for the classification of gains and losses on financial instruments designated as hedging instruments, to the extent these are recognized in profit or loss. The basic principle is that all gains and losses must be classified in the same category as the income and expenses (or assets or liabilities) affected by the risk the financial instrument is used to manage. However, in the event this would lead to the grossing up of gains and losses, all gains and losses on the hedging instrument or derivative must be classified in the operating category. The same requirements apply to gains and losses on a derivative that is not designated as a hedging instrument, but is used to manage identified risks, unless it involves undue cost or effort, in which case the gain or loss is classified in the operating category. Thus, the gains and losses are classified as follows:

### (a) Financial instruments designated as hedging instruments

To the extent the gain or loss on the derivative/other financial instrument designated as hedging instrument is recognized in P&L, gains and losses are classified in the same category as the income and expenses exposed to the risks that the derivative/financial instrument is covering, unless this would require grossing up of those gains and losses. If the latter is the case, an entity will classify all gains and losses on the derivative in the operating category.

### (b) Derivatives not designated as hedging instruments, but used to manage exposure to identified risks

The gains and losses on derivatives are classified in the same category as the income and expenses affected by the risks that the derivative is managing, unless this requires either undue cost or effort, or the grossing up of the gains and losses. If one of the latter two is applicable, an entity classifies all gains and losses on the derivative in the operating category.



**c) Income and expenses on non-derivative financial instruments used to manage risk, but not designated as hedging instruments**

An entity may use a non-derivative financial instrument to manage exposure to identified risks, without designating it as a hedging instrument. The entity classifies the income and expenses on such non-derivative financial instruments in the operating, investing or financing categories, applying the general classification requirements of Ind AS 118. For example, a debt instrument denominated in a foreign currency can have two functions: to provide financing; and to manage the entity's foreign currency risk exposure. The debt instrument is a Type 1 liability and, in accordance with general requirements of Ind AS 118, the entity classifies income and expense on the same in financing category.

**d) Income and expenses arising on derivatives not used to manage exposure to identified risks**

The classification of derivatives that are not used to manage identified risk depends on whether they relate to transactions that involve only the raising of financing. If the derivative **relates to a transaction that involves only the raising of finance**, gains or losses are classified in the financing category. If this is not the case, all gains or losses are classified in the operating category.

**Figure 2-2: Classification of gain or loss on derivatives and non-derivative financial instruments**

Classification of gain or losses on		
	Derivatives	Non-derivative financial instruments
Designated as a hedging instrument	In the same category as the underlying income and expense affected by the risk. However, if doing so involves grossing up of gains and losses, the entity should classify all such gains and losses in the operating category.	
Not designated as a hedging instrument		
Used to manage exposure to identified risk	Same category as the underlying income and expense affected by the risk. However, if such classification requires grossing up of gains or losses or involve undue cost or effort, then the entire gain or loss is classified in the operating category.	In the operating, investing or financing category by applying the general classification requirements of Ind AS 118.
Not used to manage exposure to identified risk	<ul style="list-style-type: none"> <li>▪ Related to transaction involving only raising of finance - Financing category.</li> <li>▪ Not related to transactions involving only raising finance - Operating category.</li> </ul>	

**Changes in classification and derecognition**

Some transactions result in a change to the category in which an entity classifies income and expenses. For example, a non-financial asset might be derecognized or classified as held for sale or might be reclassified from one category to another in the balance sheet.

The question arises as to whether such gains or losses arising from these transactions should be classified according to the 'old' or 'new' classification of income and expenses. Ind AS 118 specifically requires an entity to classify income and expenses arising from the derecognition or change in classification of an asset or liability in the same way as any other expenses arising from the asset or liability immediately before the derecognition or change in classification, i.e., in the 'old' way.

An entity is required to classify income and expenses arising from the derecognition or change in classification of an asset or liability in the same way as any other expenses previously arising from the asset or liability, i.e., in the 'old' way.



The following Illustration shows examples to explain this.

#### Illustration 2-1 Gain or loss on disposal of selected assets

The following illustrates how this applies in three common situations:

- **Property, plant and equipment (PPE):** Assume an entity sells an item of PPE that it used in its own operations. Since depreciation on the item was classified in the operating category, the gain or loss on disposal of PPE is also classified in the operating category.
- **Investment property:** Assume an entity sells one of its investment properties, for which the income as well as depreciation was previously classified in the investing category. The gain or loss on the disposal of the investment property is also classified in the investing category.
- **Step acquisition of a subsidiary:** Assume an entity with an equity accounted associate engages in a step acquisition to obtain a controlling stake. Before the execution of the step acquisition, the acquirer had classified income and expenses from the associate in the investing category. Therefore, on remeasurement of the associate to fair value immediately before the step acquisition as required by Ind AS 103, the entity classifies any gain or loss on the pre-acquisition remeasurement in the investing category.
- **Factoring of trade receivables:** Assume entity X has entered into a factoring arrangement for its trade receivables arising from sale of goods/rendering of services and paid factoring fees. The factoring arrangement involves transfer of receivables to the bank without any recourse. The entity evaluates the factoring arrangement as per Ind AS 109 and concludes that the arrangement meets criteria for derecognition of trade receivables. In this case, the factoring fee paid is an expense related to derecognition of trade receivables. Therefore, any gain or loss on derecognition including factoring fees is classified in the same category as income or expenses from those receivables prior to derecognition. Since revenue from sale of goods/ rendering of services resulting on recognition of trade receivables was classified in the operating category, the gain/ loss of derecognition is also classified in the operating category.

Conversely, if the factoring arrangement is with recourse and all the significant risk and rewards of trade receivables are retained by the entity, trade receivables will not meet derecognition criteria under Ind AS 109. Rather, the entity will recognize the amount received from the bank as a separate borrowing/ financial liability in the financial statements. In this scenario, the factoring is not related to derecognition of trade receivables. Rather, it is likely to be treated as transaction cost incurred for origination of borrowing/ financial liability. If the factoring fee is included in the effective interest rate (EIR) computation, it would be classified in the financing category as an interest expense.

The standard explains that the requirement to classify income and expense from the asset in the 'old' category also applies to an individual asset classified as held for sale under Ind AS 105. This would include the income and expenses from:

- An impairment loss arising on classification as held for sale
- Any subsequent remeasurement while held for sale, and
- The gain or loss upon ultimate disposal

#### Change in use of an asset

Sometimes an entity might reclassify an asset without derecognizing it; for example, it might reclassify an item of property, plant and equipment to investment property. In such a case, the entity classifies any income or expenses, recognized in the statement of profit and loss and arising from the accounting for the change in use of the asset, in the same category as it classified income and expenses from that asset immediately before the transfer. As a result, any decrease in the carrying amount of the property not included in a revaluation surplus or any increase which reverses a previous impairment of the item of property, plant and equipment is classified in the operating category.





## Derecognition of liabilities

When derecognizing a liability, an entity is required to apply the same classification requirements to classify the income and expense on derecognition as it would when recognizing a liability. Therefore, the entity first needs to assess whether it is a Type 1 or Type 2 liability and follow the appropriate guidance. For example, any gain or loss on the prepayment of a Type 1 liability, for which income and expenses were previously included in the financing category, are also classified in the financing category. In contrast, income and expenses from the derecognition of a Type 2 liability such as a payable (for goods received) as part of a supplier finance arrangement, and the recognition of a new financial liability, is classified in the operating category.

## Derecognition of groups of assets (and liabilities)

A single transaction could result in derecognition, classification as held for sale, or a change in use of a whole group of assets (or a group of assets and liabilities). Income and expenses arising from these assets (or assets and liabilities) might have previously been classified in different categories immediately before the transaction. The standard introduces a 'tainting' concept, whereby the presence in a group of a single asset whose related income and expenses were classified in the operating category requires the income and expenses for the whole of that group to be classified in the operating category. Therefore, an entity classifies income and expense from such a transaction:

- In investing, only if all the assets in the group previously generated income and expenses classified solely as investing (any income tax assets in the group are disregarded for this purpose)
- In operating, in all other cases (or groups of assets and liabilities)

This is explained further with the following example.

### Illustration 2-2- Classification

Entity A, a conglomerate, has disposed of three subsidiaries in the current period, resulting in a gain or loss on disposal for each. The following table illustrates the different classifications of the gain or loss on disposal of each subsidiary in the CFS of the entity.

Type of subsidiary	Profit or loss category
Subsidiary B held assets which generated income and expenses previously classified in both the operating and investing categories within Entity A's CFS. The sale of Subsidiary B does not constitute discontinued operation under Ind AS 105.	Operating
Subsidiary C held only an investment property (and related income tax asset). The income and expenses from the investment property were previously classified in the investing category.	Investing
Subsidiary D held the Group's entire manufacturing operations. The sale of Subsidiary D constitutes a discontinued operation under Ind AS 105.	Discontinued operations

Note that foreign exchange differences reclassified from equity (e.g., from the foreign currency translation reserve) as part of the disposal of a foreign operation will form part of the gains or losses and, therefore, will also be included in the appropriate category, i.e., the same category as gain or loss on disposal.



## ➤ 2.1.7 Sub-totals

Ind AS 118 requires entities to present at a minimum two new subtotals, viz., (i) operating profit or loss, and (ii) profit or loss before financing and income tax, in addition to total profit or loss. The first subtotal is intended to give a relevant representation of an entity's operations, while the second is intended to allow users to analyze the performance of an entity before the effect of its financing decisions.

Certain entities already present an operating profit measure as additional information at the bottom of the statement of profit and loss, but the content of operating profit measures can vary quite significantly across entities, and these are often not comparable from one entity to the next.

### Operating profit or loss subtotal

The standard specifies that an entity must present a subtotal representing operating profit or loss, which comprises all income and expenses classified in the operating category. This is new requirement for many entities; however, there are few entities which already present an operating profit measure as an additional information at the bottom of the statement of profit and loss. For the latter entities, the content of operating profit measures can vary quite significantly.

It is expected that mandating all entities to present an 'operating profit' subtotal, which comprises all income and expenses not included in the investing or financing categories, will provide a consistent starting point for the analysis by users, reduce diversity in reporting and achieve comparability between entities. Additionally, entities can utilize other mechanisms to provide additional information about aspects of its financial performance such as:

- Presentation of additional line items or subtotals (see section 6.1)
- Further disaggregation (see section 6.3), and
- Presentation of management-defined performance measures (see Chapter 5). For example, the presentation of an MPM showing operating profit excluding expenses regarded as non-recurring or unusual could be disclosed.

### How we see it

At present, Ind AS 1 read with Schedule III does not allow entities to present 'operating profit or loss' as subtotal in the statement of profit and loss. Hence, the requirement to present 'operating profit or loss' is new for most entities.

There may be few entities who present operating profit or loss as additional information in the statement of profit and loss. These entities should not presume that the classification of income and expenses to the operating category will not change. For example, many entities currently present 'share of the profit or loss of associates and joint ventures accounted for using the equity method' in their consolidated financial statements in the operating profit or loss measure, which is not permissible under Ind AS 118.





## Frequently asked questions

**Question 2-13: Can an entity use alternative labels such as 'operating result,' 'net operating income' or 'Operating income' for the required subtotal 'operating profit or loss'?**

The standard makes it clear that an entity may use other terms to label the required totals, subtotals and line items, as long as they are labeled in a way that faithfully represents the characteristics of the items. In addition, Ind AS 118.11 uses the example of the term 'net income' as an allowable alternative label for 'profit or loss'. However, the label 'Operating income' may in some cases not faithfully represent the characteristics of the subtotal since the subtotal is made up of both income and expenses rather than only income.

While Ind AS 118 permits the use of alternative labels for the required totals, subtotals and line items, the entities should exercise caution as the permissibility of such labels will also depend on the requirements prescribed under the revised Schedule III once issued.

### How we see it

Since Ind AS 118 allows for alternative labels for the required totals, subtotals and line items, one may argue that 'operating result' and 'net operating income' may be acceptable alternative labels for 'operating profit.' However, it is to be noted that the revised Schedule III to be applicable in Ind AS 118 scenario is yet to be notified and the use of alternative labels may be subject to the requirements of revised Schedule III.



**Ayush Agrawal**

*"Strengthening the quality of financial communication with investors and stakeholders lies at the heart of Ind AS 118. Through refined presentation principles and enhanced disclosure requirements, the standard aims to provide clearer insights into how companies generate and present financial performance. In doing so, it supports more informed decision-making and reinforces confidence in corporate financial reporting."*

## Profit or loss before financing and income tax subtotal

The 'profit or loss before financing and income tax' subtotal is introduced as a mandatory subtotal by Ind AS 118 and comprises operating profit or loss and all income and expenses classified in the investing category. There are limited exceptions to this requirement for entities with a main business activity of providing financing to customers as discussed in section 3.7 later. The role of this subtotal is to facilitate an analysis of an entity's performance, independently of how it is financed and to improve comparability between entities.

Note that even if the profit or loss before financing and income tax subtotal is the same as the operating profit subtotal, both must still be presented.

# 03

## Statement of profit and loss: Requirements for specific entities

- 
- 3.1 Entities with specified main business activities
  - 3.2 Specified main business activities disclosures
  - 3.3 Investing in assets
  - 3.4 Providing financing to customers
  - 3.5 Classification of specific income and expenses
  - 3.6 Change in main business activity
  - 3.7 Subtotal: Profit or loss before financing and income tax subtotal



For certain entities, applying the general requirements would result in classification of income and expenses from their main business activities in categories outside the operating category. Therefore, as an exception to the general requirements, the standard requires entities with a 'specified main business' activity to classify some of their income and expenses in the operating category that would otherwise have been included in investing or financing.

The standard also provides certain exclusions from classification in the financing category for specific issuers of insurance contracts within the scope of Ind AS 117 and investment contracts with participation features in the scope of Ind AS 109. In particular, Ind AS 118 requires insurance finance income and expenses arising from insurance contracts and investment contracts with direct participation features accounted for by applying Ind AS 117 to be classified in the operating category.

It is important to note that these specific requirements only apply to the income and expenses set out below while the rest of an entity's income and expenses are still subject to the general requirements. Therefore, these specific entities will be required to consider both the general requirements and the relevant specific requirements discussed further in this section.

It is important to note that determination of main business activity impacts classification of only certain items of income and expense. The rest of an entity's income and expenses are still classified in accordance with general requirements of Ind AS 118.

## 3.1 Entities with specified main business activities

Ind AS 118 introduces a new concept of a 'specified main business activity'. When classifying its income and expenses, an entity is required to assess whether it has one or both specified main business activities of:

- (a) Investing in particular types of assets (referred to as 'investing in assets' hereafter), and/ or
- (b) Providing finance to customers

The identification of main business activities is limited to these two types as there are specific classification requirements for entities with either or both of those specified main business activities. However, it is not necessary to identify all the main business activities of the entity.

It is important to note that an entity's operations include, but are not limited to, its main business activities and that an entity could have just one, or more than one, main business activity; for example, an entity might manufacture a product and also provide financing to customers to buy that product. Both activities might be determined to be main business activities.

Ind AS 118 introduces a new concept of the 'specified main business activity'. When classifying its income and expenses, an entity will be required to assess whether it has one or both specified main business activity of:

- a) Investing in particular types of assets, and/ or
- b) Providing finance to customers



Examples of the types of entities that might fall into these categories:

**a) Investing in assets:**

- Investment entities (as per Ind AS 110 *Consolidated Financial Statements*),
- Investment property companies, and
- Insurers/ insurance companies.

**b) Provide financing to customers:**

- Banks and other lending institutions,
- Entities which provide financing to customers to enable those customers to buy the entity's products, and
- Lessors which provide financing to customers in finance leases.

Ind AS 118 is clear that whether an entity invests in assets or provides financing to customers as a main business activity is a matter of fact and not merely an assertion. The entity will need to use judgment to make this assessment, and such exercise of judgment must be evidence-based. The standard points out that a key determinant of whether an entity has a main business activity of investing in assets or providing financing to customers is:

- Whether it uses a subtotal such as gross profit as an important indicator of performance in external explanations of operating performance (such as investor presentations) or for internal assessment or monitoring, and
- Whether that subtotal includes items that would otherwise be classified in investing or financing, where the main business activities are not identified as investing in assets or providing financing to customers.

For example, a bank might use net interest income as an important indicator of performance. That subtotal typically includes interest earned from interest-bearing assets such as loans to customers and interest expenses from interest-bearing liabilities such as deposits. Were the bank unable to identify a main business activity of providing financing to customers, it would be required to present the interest expenses in the financing section. This classification would not provide a useful structured summary of the bank's operations.

In accordance with Ind AS 118, segment information under Ind AS 108 *Operating Segment* can also provide evidence of whether an entity's main business activities are investing in assets or providing financing to customers:

- If a reportable segment comprises a single business activity of investing in assets or providing financing to customers, this indicates that the performance of the reportable segment is an important indicator of the entity's performance. Consequently, the business activity of that reportable segment is a main business activity of the entity.
- If the performance of a single operating segment (which is not a reportable segment) is an important indicator of the entity's performance and if the segment comprises a single business activity, this indicates that the activity could be a main business activity. For example, when a reportable segment comprises several operating segments and one of the operating segments contains a single main business activity, the entity might determine that business activity included in that reportable segment, relating to the single operating segment, is a main business activity.

Ind AS 118 requires an entity to make the assessment of main business activities for the reporting entity as a whole. Thus, it is possible for a reporting entity that is a consolidated group and a reporting entity that is a subsidiary within that group, to have differing conclusions about its main business activities. As a result, the classification of income and expenses for the subsidiary could differ from that of the group.

The same applies to a parent entity, which may be a holding company, while one of its subsidiaries provides financing to customers; thus, the main business activity for the consolidated financial statements and the parent's separate financial statements could differ.



## Frequently asked questions

**Question 3-1: In separate financial statements, where does a parent classify the income and expenses from its investments in subsidiaries accounted for at cost?**

Parent entities may be pure holding companies while others have their own operations, alongside their holdings of investments in subsidiaries. Regardless of whether they have their own operations or not, it is reasonable to state that investments in subsidiaries accounted for at cost in a parent's financial statements constitute assets which generate a return individually and largely independently of the other resources of the entity, in the form of dividends. As a result, it would be appropriate to classify the income and expenses in the investing category.

However, there may be situations in which, depending on the facts and circumstances, a parent might assess that investing in such assets is a main business activity. As noted above, Ind AS 118 includes two indicators to help with this assessment. However, evidence that a parent entity uses a subtotal similar to gross profit to explain an entity's operating performance externally and information about its segments may not necessarily be relevant for its separate financial statements. Therefore, it is necessary to consider other evidence to make the assessment and such evidence might include:

- Use of a subtotal similar to gross profit used internally to monitor operating performance
- Assessment of the purpose of the entity, i.e., was the entity established to:
  - Shape the composition of the group by acquiring, managing and selling investments in subsidiaries, to realize the group's business strategy
  - Primarily carry out its own activities

If the entity does assess that it has a main business activity of investing in assets, classification of income and expenses arising from investments in subsidiaries accounted for at cost in the operating category would be appropriate.

## How we see it

We believe that in separate financial statements, classification of income and expenses arising from investments in subsidiaries, associates and joint ventures measured at cost in the operating or the investing category will depend on the facts and circumstances of each case and the entity's assessment of its main business activities.

From consolidated financial statements perspective, subsidiaries get consolidated and classification of income and expense is decided considering the group as single reporting entity and requirements of Ind AS 118. However, income and expense from equity accounted investment in associates and joint ventures are classified under the investing category only.

The identification of a main business activity is a relatively high bar and judgment is required. Not all activities which an entity conducts on a regular basis are necessarily main business activities, as some may constitute ancillary activities. Although the standard provides some indicators of when an activity is a 'main business activity', the list is not exhaustive. Other factors could therefore be relevant, depending on an entity's specific circumstances.

## How we see it

The requirements of the standard and accompanying guidance suggest that the threshold for identifying a specified main business activity is higher than some might intuitively think and that 'main' is a key element of the term 'main business activity'. Therefore, ancillary or incidental activities do not meet the definition of a 'main business activity'.



## 3.2 Specified main business activities disclosures

Entities with a specified main business activity must make certain disclosures to enable users to understand the assessment of their main business activity, as follows:

- a. If an entity invests in assets as a main business activity, it will disclose that fact.
- b. If an entity provides financing to customers as a main business activity, it will disclose that fact.
- c. If an entity identifies a different outcome from its assessment of whether it invests in assets or provides financing to customers as a main business activity, it will disclose:
  - i. The fact the outcome of the assessment has changed and the date of the change.
  - ii. The amount and classification of items of income and expense before and after the date of the change in the outcome of the assessment in the current period and the amount and classification in the prior period for the items for which the classification has changed because of the changed outcome of the assessment, unless it is impracticable to do so. If an entity does not disclose the information because it is impracticable to do so, the entity shall disclose that fact.

## 3.3 Investing in assets

If an entity invests as a main business activity in assets that generate a return (either positive or negative) individually and largely independently of the entity's other resources, it is required to classify specified income and expenses in the operating category that otherwise would have been included in the investing category. For example, real estate companies will need to present rental income in the operating category. Assets such as debt and equity instruments can also generate individual and largely independent returns. If the entity invests in such assets as a main business activity, it is also required to classify the income and expenses from those assets in the operating category. The type of income and expenses to be classified in the operating category in such cases include rental income, interest, dividends, depreciation, impairment losses and their reversal, fair value gains and losses and income and expenses from the derecognition of the asset or from its classification and remeasurement as held for sale.

The requirement to classify income and expenses in the operating category is only relevant for assets in which the entity invests as a main business activity. An entity that invests in investment property as a main business activity might have other investments such as financial assets that do not constitute a main business activity; therefore, income and expenses from those other investments will be classified in the investing category.

If an entity has a specified main business activity of investing in financial assets that generate a return individually and largely independently of the entity's other resources, it is required to classify the income and expenses from those financial assets as well as cash and cash equivalents in the operating category.

### **Investments in other entities not accounted for applying the equity method**

Entities which are assessed as having a specified main business activity of investing in associates, joint ventures and unconsolidated subsidiaries which are not equity accounted, are required to classify specified income and expenses in the operating category, as follows:

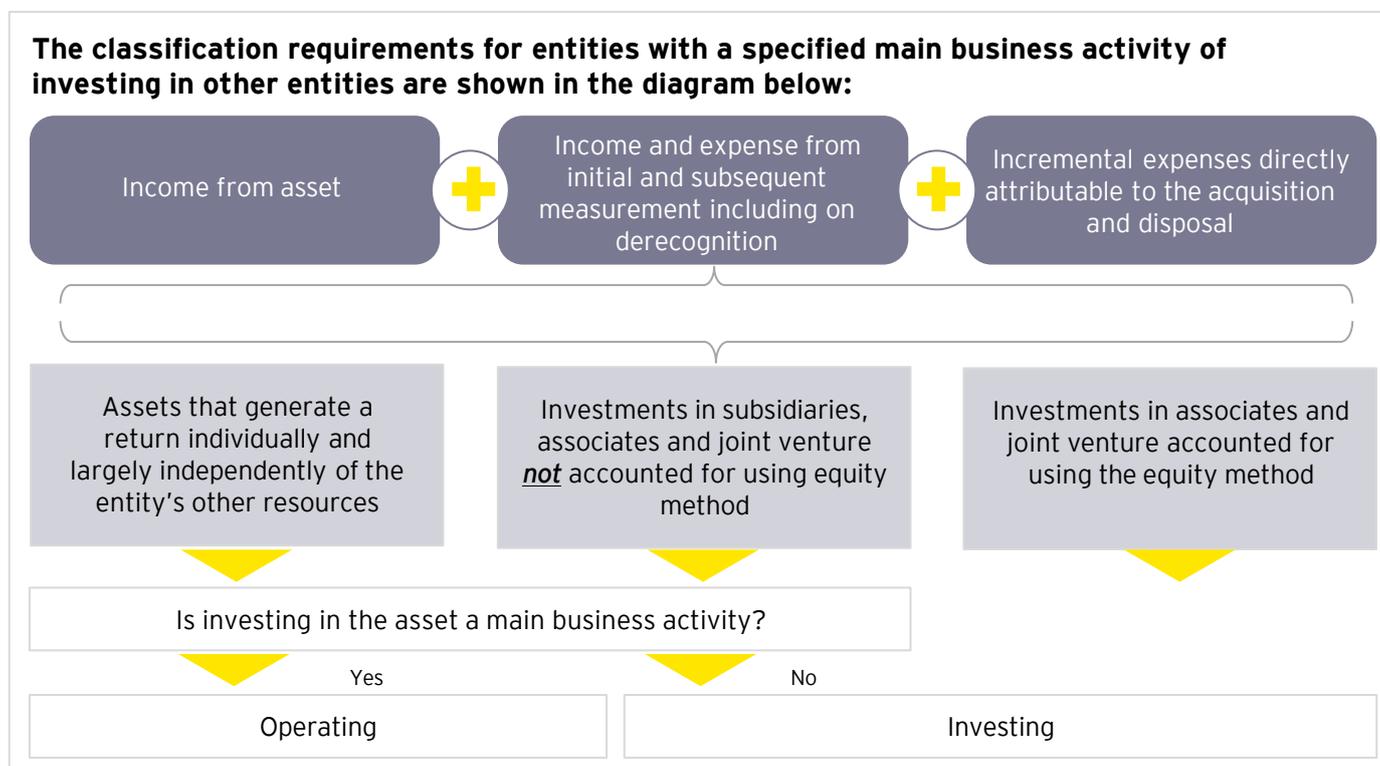
- Income generated by the assets, e.g., dividend income from equity instruments
- Income and expenses that arise from the initial and subsequent measurement of the assets, e.g., impairment losses and reversals
- Incremental expenses directly attributable to the acquisition and disposal of the assets, e.g., transaction costs and costs to sell the assets



The standard defines 'unconsolidated subsidiaries' as investments in subsidiaries:

1. Held by an investment entity and measured at fair value through profit or loss
2. Accounted for at cost or in accordance with Ind AS 109 in separate financial statements

Income and expenses from equity accounted associates and joint ventures are required to be classified in the investing category.



### Frequently asked questions

**Question 3-2: How is rental income from property, plant and equipment held on an operating lease classified in profit or loss by a lessor?**

Refer to Question 2-1 in section 2.2.1 above. While a lessor without a specified main business activity would classify this type of income or expense in the investing category if the leased asset generated a return individually and largely independently of the entity's other operations, a lessor with a specified main business activity of investing in such assets will classify the rental income in the operating category.

**Question 3-3: How is finance income on the net investment in a finance lease classified in profit or loss?**

Refer to Question 2-2 in section 2.2.1 above. While the net investment in a lease is able to produce returns individually and largely independently of the lessor's other resources, if the lessor invests in such an asset as a main business activity (e.g., the lessor is a leasing company), then the finance income on the net investment in the lease will be classified in the operating category.

**Question 3-4: Where is the selling profit or loss on investment property arising on recognition of a net investment in a finance lease classified?**

Applying Ind AS 116, on entering into a finance lease, a lessor derecognizes the asset (investment property), which is the subject of the lease, recognizes the net investment in the lease, and records the resulting selling profit or loss. Ind AS 118 requires the profit or loss on disposal of an item to be classified in the same category as the income and expenses arising on that item directly before derecognition. Therefore, if a lessor, with a main business activity of investing in investment properties, entered into a finance lease over one of its investment properties, it would recognize the selling profit or loss in the operating category.



**Question 3-5: How are transaction costs incurred in acquiring an equity investment (without control, joint control or significant influence) in other entities classified in profit or loss?**

An entity that acquires an equity investment (without control, joint control or significant influence) may incur transaction costs which are included in profit or loss. In such a case, an entity that has a main business activity of investing in the equity instruments classifies the transaction costs relating to that acquisition in the operating category.

**Question 3-6: How are expenses related to holding investment property classified in profit or loss?**

See the response to Question 2-3 in section 2.1.1 above.

Expenses that arise from holding the investment, for example, salaries to employees that manage the investment property, investment management fees paid to a third party, maintenance expenses or rates and taxes levied on an investment property, are classified in the operating category.

## 3.4 Providing financing to customers

There are specific requirements for the classification of income and expenses for entities which provide financing to customers as a main business activity which are summarized in the following table:

**Figure 3-1: Classification of income and expenses related to liabilities for an entity with a specific main business activity of providing finance to customers:**

Type of liability	Income and expense	Is liability related to providing finance to customers?	Presentation category
Type 1 liabilities <sup>1</sup>	Incremental expenses directly attributable to the issue and extinguishment Income and expenses from initial and subsequent measurement, including derecognition	Yes	Operating category
		No	Accounting policy choice <sup>2</sup> to classify specified income and expenses either as operating or financing category
Type 2 liabilities	Interest income and expenses identified for the purpose of applying other standards Income and expenses from changes in interest rates identified for the purpose of applying other standards	Not relevant	Financing category
Type 2 liabilities	Other income and expenses	Not relevant	Operating category

1. If the entity is unable to distinguish between its Type 1 liabilities that are related to providing financing to customers and those that are not, it must apply the accounting policy 'choice' to classify income and expenses from all such liabilities in the operating category.
2. The choice of accounting policy must be consistent (where applicable) with that made for the classification of income and expenses from cash and cash equivalents (see section 3.5).



### Illustration 3-1: Determining which Type 1 liabilities are in the scope of the accounting policy choice in Ind AS 118.65

Bank B, with a main business activity of providing financing to customers, entered into three Type 1 liabilities in the current period:

- Loan 1 - Entered into specifically to on-lend that financing to customers.
- Loan 2 - Taken out to fund the bank's own operations (e.g., to finance a business acquisition) as opposed to providing financing to customers.
- Loan 3 - A general purpose fixed rate loan entered into by the central treasury function of the bank. These funds have been intermingled with the bank's own excess cash and can be used by any part of the bank's business, including the lending operations. As a result, the bank cannot identify whether the liability solely relates to the provision of financing to customers.

The bank applies the accounting policy choice stated above to loan 2 only. This is because the accounting policy only applies to liabilities unrelated to providing financing to customers. The income and expenses from loan 1 and 3 must be classified in the operating category since:

- Income and expenses from liabilities that relate to a main business activity of providing financing to customers (i.e., loan 1) are always classified in the operating category, and
- When an entity cannot identify whether the liability relates solely to its main business activity of providing financing to customers (i.e., loan 3), the entity needs to 'choose' an operating classification, effectively removing the accounting policy choice.
- Therefore, there is no optionality for these two loans.

### How we see it

The policy choices available to entities whose main business activity is providing financing to customers provide a practical option for preparers who are unable to distinguish easily between income and expenses that relate to the provision of finance to customers.

However, the availability of a policy choice is likely to create diversity in practice, which will result in some loss of comparability between similar entities.





**The following illustration shows the appropriate classification of income and expenses arising from a range of liabilities for an entity with a main business activity of providing financing to customers.**

### **Illustration 3-2: Example of classification for an entity with a main business activity of providing financing to customers**

Entity A, an automotive retailer, provides financing to customers to enable them to buy Entity A's products, as a main business activity. This is evidenced by the fact that Entity A discloses the gross profit on this activity in its analyst presentations to reflect the performance of the entity as a whole.

Entity A borrows from the bank to finance the loans it provides and on-lends to its customers on deferred terms. Entity A also has the following liabilities:

- Lease liabilities (relating to its showrooms)
- A provision for litigation (which it expects to settle in three years and for which the discounting under Ind AS 37 is material)
- A liability for contingent consideration (relating to a business acquisition made in the prior year and payable in two years)
- A separate bank borrowing (to fund the business acquisition it made in the prior year)

#### **Bank borrowings related to providing financing to customers**

The bank borrowings related to the provision of financing to customers would be classified as a Type 1 liability (since Entity A receives finance in the form of cash and will return cash in exchange at a later date). As Entity A has a main business activity of providing financing to customers and these liabilities relate to the main business activity of providing financing to customers, the interest payable on those loans would be classified in the operating category.

#### **Lease liabilities**

The lease liabilities are Type 2 liabilities and Entity A will record interest expense on its lease liabilities as a result of applying Ind AS 116. This expense will be classified in the financing category.

#### **Provision for litigation**

The litigation provision is a Type 2 liability. Entity A has discounted the provision in accordance with Ind AS 37, therefore, the unwinding of the discount will be classified in the financing category. Remeasurements of the provision under Ind AS 37 will, however, be classified in the operating category.

#### **Contingent consideration**

The contingent consideration liability is a Type 2 liability (since Entity A receives assets and liabilities, not finance from the transaction). The remeasurement of the fair value of the liability is neither 'interest income or expense', nor does it result from a change in interest rates. Therefore, this remeasurement will be classified in the operating category.

#### **Bank borrowing for business acquisition**

The loan for the business acquisition is a Type 1 liability (since Entity A receives finance in the form of cash and will return cash at a later date in exchange), unrelated to the provision of financing to customers. Therefore, the entity has an accounting policy choice and can classify the income and expenses either in the operating or in the financing category. The choice must be consistent with the choice made for classifying income and expenses from cash and cash equivalents.



## 3.5 Classification of specific income and expenses

As stated in Chapter 2, Ind AS 118 provides specific guidance for classifying some specific types of income and expense. In many cases, the guidance states that the classification depends on the category where other income and expense from the same item are classified. It is clear that the above changes in classification of income and expense depending on specified main business activity may impact classification of other linked items of income and expense.

The following paragraphs discuss classification of certain specific income and expense for entities having specified main business activity of either investing in the specific assets or providing finance to customers or both.

### Foreign exchange differences

The basic principle for classifying foreign exchange differences (i.e., that they follow the category in which the related income and expenses have been classified) equally applies to entities that invest in specific assets and/ or provide financing to customers as a main business activity, including the undue cost or effort exemption. For example, foreign exchange differences arising from a Type 1 debt instrument liability, which is denominated in a foreign currency and is related to providing financing to customers, will also be classified in the operating category.

### Derecognition

When derecognizing a liability, an entity must apply the same classification requirements to classify income and expense from derecognition as it would when recognizing a liability. Therefore, an entity with a main business activity of providing financing to customers will need to determine if it is a Type 1 or Type 2 liability and apply the guidance discussed above. For example, such an entity will classify any gain or loss on the prepayment of a Type 1 loan, related to providing financing to customers, in the operating category. However, income and expenses from the derecognition of a Type 1 loan not related to providing financing to customers will be classified according to the accounting policy choice the entity has made, and thus may be classified in either the operating or the financing category.

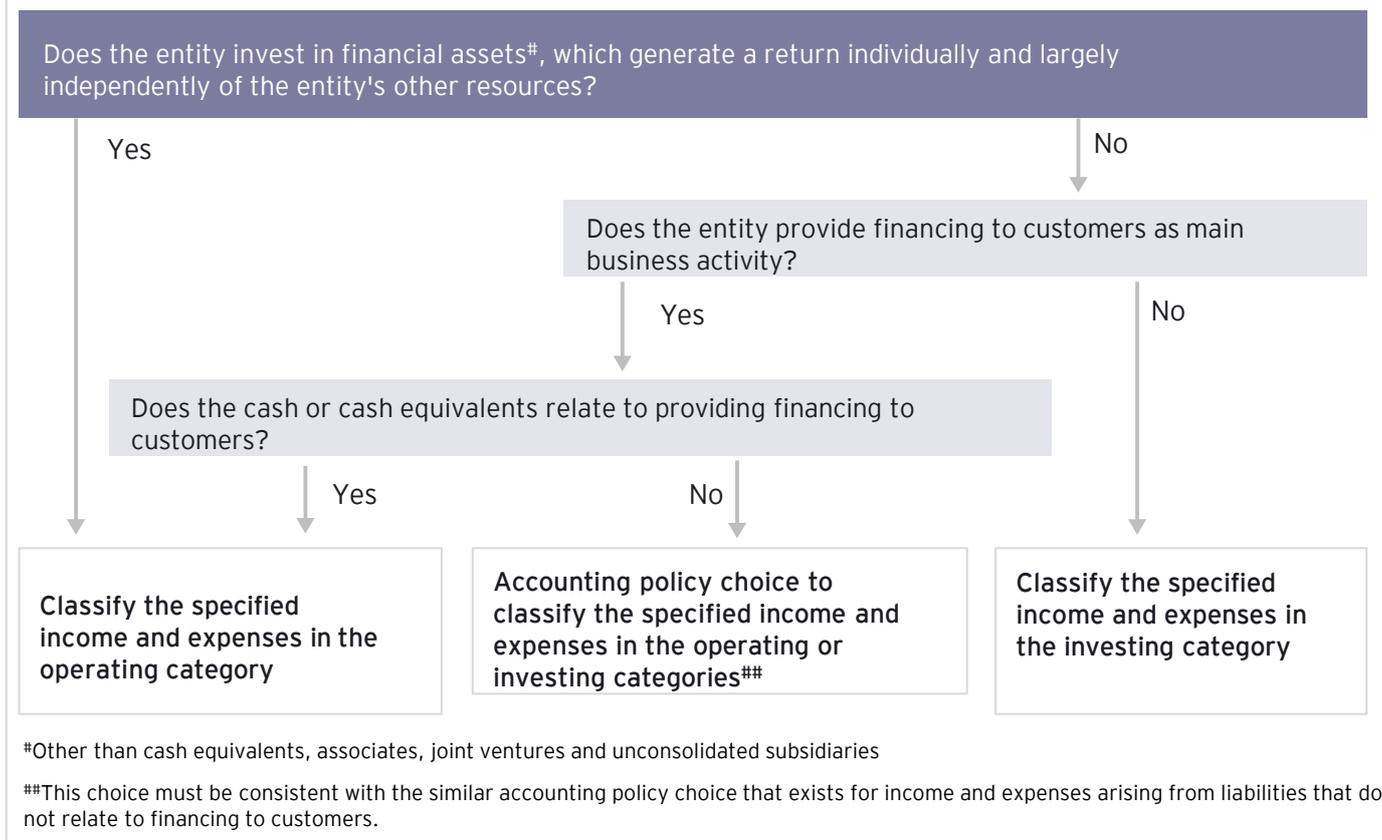
### Income and expenses from cash and cash equivalents

Most entities do not need to assess whether they invest in cash and cash equivalents as a main business activity, as the standard requires income and expenses from cash and cash equivalents to be classified in the investing category. However, for entities with specified main business activities of investing in financial assets other than cash and cash equivalents, associates, joint ventures and unconsolidated subsidiaries or providing finance to customers, the requirements are different. The diagram below, sets out the various permutations.





**Figure 3-2: Classification of income and expenses from cash and cash equivalents**



#### *Investing in financial assets as a main business activity*

If an entity invests as a main business activity in financial assets (other than cash and cash equivalents, associates, joint ventures and unconsolidated subsidiaries) which generate a return individually and largely independently of the entity's other resources, such as debt instruments, it is required to classify the income and expenses from cash and cash equivalents in the operating category.

#### *Cash and cash equivalents related to providing financing to customers*

If an entity provides financing to customers as a main business activity and the cash and cash equivalents relate to the provision of finance (for example, cash held for regulatory purposes), it classifies income and expenses from the cash and cash equivalents in the operating category.

#### *Cash and cash equivalents unrelated to providing financing to customers*

If an entity provides financing to customers as a main business activity and the cash and cash equivalents do not relate to the provision of finance, the entity has an accounting policy choice to classify the income and expenses arising from cash and cash equivalents in the operating or investing categories. This choice must be consistent with the similar accounting policy choice that exists for income and expenses arising from liabilities that do not relate to financing to customers.

If a reporting entity cannot distinguish between income and expenses from cash and cash equivalents related to providing finance to customers and from that unrelated, it is required to classify income and expenses from all its cash and cash equivalents in the operating category.

### **How we see it**

In our view, where a main business activity of investing in financial assets has been identified, the income and expenses from all cash and cash equivalents held by the reporting entity must be classified in the operating category.



## Hybrid contracts containing a host liability

There are specific requirements for hybrid contracts held by entities with a main business activity of providing financing to customers and classification depends on whether the embedded derivative is separated from the host contract.

### *Embedded derivative is separated*

If the embedded derivative is separated, income and expenses arising from the host liability will be classified in accordance with the requirements for classifying a similar liability that is not a host in a hybrid contract. Refer to the discussion earlier regarding classification of income and expense arising from Type 1 and 2 liabilities. The separated embedded derivative is classified in accordance with the requirements for similar stand-alone derivatives.

### *Embedded derivative is not separated*

In cases where the embedded derivative is not separated, Ind AS 109 treats the hybrid instrument as a single unit of account and measures the combined liability in its entirety. In such cases, classification is also assessed for the instrument as a whole, despite the presence of the embedded derivative suggesting that there is another activity present.

A hybrid contract (no separation) that arises from a transaction that involves only the raising of finance (i.e., a Type 1 liability hybrid) is essentially treated as a Type 1 liability in its entirety and related classification requirement will apply. Refer to the earlier discussion regarding classification of income and expense arising from Type 1 and 2 liabilities.

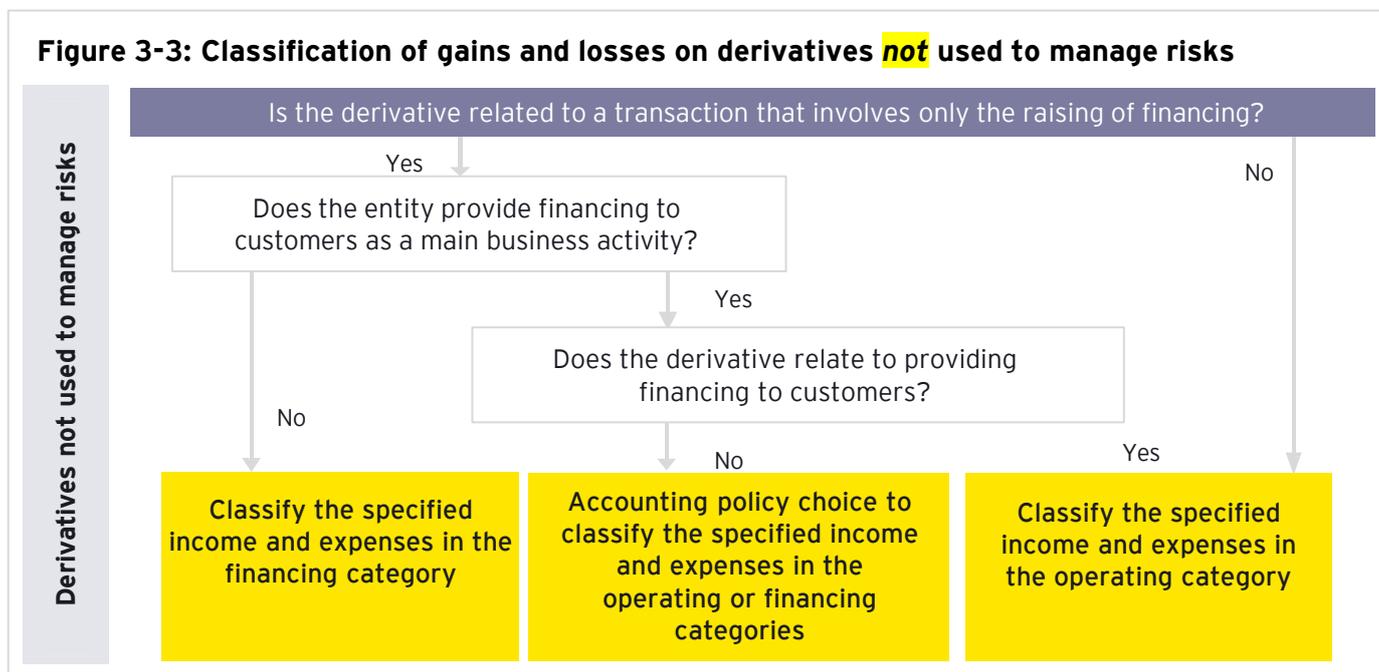
The classification of the income and expenses on a hybrid contract (no separation) which does not arise from a transaction that involves only the raising of finance (i.e., a Type 2 liability hybrid), depends on the type of contract:

- (a) If Type 2 hybrid contract has a host liability in the scope of Ind AS 109 which is measured at amortised cost, the standard requires that all income and expenses arising from the initial recognition and subsequent measurement, including on derecognition, of such a hybrid contract are classified in the financing category.
- (b) For a hybrid insurance contract in the scope of Ind AS 117, insurance finance income and expenses will be classified in the operating category.
- (c) For all other Type 2 liability hybrid contracts, interest income and expenses and income and expense from interest rate changes identified for the purposes of applying other Ind AS, are classified in the financing category. If the income and expenses are not interest income and expenses, they will be classified as operating. This is consistent with the treatment of non-hybrid Type 2 liabilities.



## Income and expenses on derivatives not used to manage exposure to identified risks

The following diagram summarizes the requirements for classifying derivatives not used to manage exposure to identified risks when entity has a main business activity of providing financing to customers.



**Darshan Varma**

*“The introduction of disclosures around management-defined performance measures is one of the most notable features of Ind AS 118. While many organizations already use such metrics in their communication with stakeholders, the new framework introduces greater transparency and discipline in how these measures are presented. By requiring reconciliation to standardized subtotals and clearer disclosures, the standard will allow users of financial statements to better understand management’s perspective on performance.”*

## 3.6 Change in main business activity

The assessment regarding main business activities mentioned above is carried out at a point in time, based on facts at that time. This means that if, at a later date, there is a different outcome to the assessment, it will be based on new facts at that moment in time. As a result, any change is treated as a prospective adjustment from the date of the reassessment and there is no need to reclassify comparative amounts. However, to provide useful information to a user, disclosure of the amount and classification of items of income and expense immediately before and after the date of change in the current period is required, as well as information about the amount and classification in the prior period.



## 3.7 Subtotal: Profit or loss before financing and income tax subtotal

As noted in section 2.1.7 above, profit or loss before financing and income tax is the second subtotal introduced by Ind AS 118 and comprises operating profit or loss and all income and expenses classified in the investing category. Its role is to facilitate an analysis of an entity's performance, independently of how it is financed and to improve comparability between entities.

An entity which provides financing to customers as a main business activity is prohibited from presenting this subtotal if, as an accounting policy choice, it classifies in the operating category all income and expenses from Type 1 liabilities (see section 3.4 above) that do not relate to the provision of financing to customers.

Nevertheless, such entities may consider whether they should give an additional subtotal after the investing category and before the financing category for providing a useful structured summary of an entity's income and expenses. If an entity were to present an additional subtotal, it must label the subtotal with a name that accurately describes it. For example, the label 'profit before financing' would be misleading in the case described above, as there could be financing income and expenses, unrelated to providing financing to customers, included in operating profit, and is consequently prohibited by Ind AS 118.

### How we see it

The standard requires precision in the labeling of subtotals and totals but does not restrict the number of subtotals which can be presented, provided that they contribute to a useful structured summary. Entities need to carefully consider their choice of label for any additional subtotal presented, to faithfully represent the items included in that subtotal.





# 04

## Items to be presented in the statement of profit and loss

- 4.1 Items to be presented in the statement of profit and loss
- 4.2 Presentation and disclosure of expenses classified in the operating category
- 4.3 Separate presentation of "non-recurring" items



Like Ind AS 1, Ind AS 118 specifies line items to be presented in the statement of profit and loss, though those line items are no longer described as 'minimum' line items. Ind AS 118 provides guidance to determine when additional line items are required and situations in which the specified line items may not be required.

Ind AS 118 also introduces new requirements relating to the presentation of expenses classified in the operating category. Operating expenses will now be presented either by "function" or by "nature", and additional disclosure requirements have also been added for entities choosing to present these items by function. These new requirements are discussed below.

## 4.1 Items to be presented in the statement of profit and loss

The standard specifies the below line items to be presented separately in the statement of profit and loss:

- Revenue, presenting separately
  - Interest revenue calculated using the effective interest rate method, and
  - Insurance revenue
- Operating expenses, presenting separate line items using one or both of the characteristics of:
  - The nature of the expenses, or
  - The function of the expenses within the entity
- Cost of sales, if the entity classifies some of its operating expenses in functions that include a cost of sales function
- Insurance service expenses from contracts issued within the scope of Ind AS 117
- Income or expenses from reinsurance contracts held
- Impairment losses (including reversals of impairment losses or impairment gains) determined in accordance with Ind AS 109
- Gains and losses arising from the derecognition of financial assets measured at amortised cost
- Any gain or loss arising from the difference between the fair value and the previous amortised cost of a financial asset reclassified from amortised cost to fair value through profit or loss
- Any cumulative gain or loss previously recognized in other comprehensive income, reclassified to profit or loss relating to the reclassification of a financial asset from fair value through other comprehensive income to fair value through profit or loss.
- Insurance finance income or expenses from contracts issued within the scope of Ind AS 117
- Finance income or expenses from reinsurance contracts held
- Share of the profit or loss of associates and joint ventures accounted for using the equity method
- Income tax expense or income, and
- A single amount for the total of discontinued operations.

However, despite this requirement for specified line items, Ind AS 118 introduces a two-step approach to determine which of these line items to present:

**Step 1:** Assess which required line items are material

**Step 2:** Assess whether presentation of the material required line items (i.e., separate presentation in the primary financial statements) is necessary to present a useful structured summary



The outcome of this is that an entity is required to present the line items listed above, unless the line item is not necessary for the P&L to fulfil its role of providing a useful structured summary. If a line item is omitted on the grounds that it is unnecessary for providing a useful structured summary, it is disclosed in the notes, if it provides material information.

Following the introduction of the categories within the statement of profit and loss, an entity might need to present a required line item in more than one category. For example, impairment losses could arise on receivables for goods and services, as well as on financial assets that generate a return individually and largely independently of the entity's other resources. Such impairments recognized by an entity without a specified main business activity would be classified in the operating and investing categories, respectively. The standard requires any line item presented in more than one category to be described in a way that faithfully represents the characteristics of that item (which could be, for instance, 'expected credit losses on trade receivables balances' and 'expected credit losses on other financial assets' in the example above).

## 4.2 Presentation and disclosure of expenses classified in the operating category

An entity must use one, or both of the following characteristics to present its operating expenses in P&L:

- The nature of expenses
- The function of expenses within the entity

However, for some entities a mixture of both could provide the most useful structured summary.

Operating expenses are classified and presented consistently from one reporting period to another, unless the conditions set out below apply:

- (a) It is apparent, following a significant change in the nature of the entity's operations or a review of its financial statements, that another presentation, disclosure or classification would be more appropriate having regard to the criteria for selecting and applying accounting policies in Ind AS 8, or
- (b) An Ind AS requires a change in presentation, disclosure or classification.

For example, a goodwill impairment presented as a nature line item in one period must be presented as such in subsequent periods, unless the requirements above apply. An expense of nil in a subsequent period does not constitute a change in classification and presentation.

### Presentation of operating expenses by nature

As noted above, an entity can choose to present its operating expenses according to their nature (hereafter, "nature expenses" or "nature presentation"). A nature presentation provides information about operating expenses related to the nature of the economic resources consumed to execute the entity's activities. Such expenses do not refer to the activities in relation to which those resources were consumed. Examples of nature expenses include:

- Raw material expense
- Employee benefit expense
- Depreciation and amortisation

The amounts of nature expenses presented or disclosed in a period need not be the amounts recognized as an expense in that period, as certain amounts might have been capitalized as part of the carrying amount of an asset and will, therefore, be recognized as an expense in a future period. If an entity presents amounts that are not the same as the amounts recognized as an expense in the period, an additional line item must be presented for the change in the carrying amount of the affected assets. A common example of this is the presentation of a line item relating to the changes in inventories of finished goods and work in progress.



**Navneet Mehta**

*"Ind AS 118 marks a new dawn in financial reporting, ushering in sharper structure and greater transparency in how performance is communicated. By integrating management defined performance measures (MPMs) and establishing a more coherent, principle driven classification framework, it brings reporting practices closer to what users expect while reinforcing the discipline of accounting standards. Realizing its full potential, however, will require careful evaluation, strong system preparedness, and disciplined execution with CFOs and financial reporting teams expected to take proactive leadership in driving a smooth and effective transition."*



## Presentation of expenses by function

Entities can allocate and aggregate operating expenses according to the activity to which the consumed resource relates: this is classification by function. An example is cost of sales, which typically combines expenses relating to an entity's production or revenue-generating activities, such as raw material expense, employee benefit expense, depreciation and amortisation.

Adopting a function presentation results in the allocation of expenses relating to economic resources of the same nature across several function line items; for example, employee benefits might be allocated to cost of sales and research and development, whereas a single function line item might contain allocations of expenses relating to economic resources of several differing natures.

If an entity presents at least one or more line items of operating expense by function, it is required to:

- Present a separate line item for cost of sales, if its functions include a cost of sales function, which needs to include the total of inventory expense, described in paragraph 38 of Ind AS 2 *Inventories*.
- Disclose a qualitative description of the nature of expenses included in each function line item. The qualitative description of the nature of expenses included in each line item is expected to enhance the understandability of the composition of each line item.

Such entities must disclose the following in a single note:

- (a) Total for each of:
  - i. Depreciation, comprising the amounts required to be disclosed by Ind AS 16 *Property, Plant and Equipment*, Ind AS 40 *Investment Property* and Ind AS 116 *Leases*
  - ii. Amortisation, comprising the amount required to be disclosed by Ind AS 38 *Intangible Assets*
  - iii. Employee benefits, comprising the amount of employee benefit expenses recognized under Ind AS 19 *Employee Benefits* and the amount for services received from employees recognized under Ind AS 102 *Share-based Payment*
  - iv. Impairment losses and reversals of impairment losses, comprising the amounts required to be disclosed by Ind AS 36 *Impairment of Assets*, and
  - v. Write-downs and reversals of write-downs of inventories, comprising the amounts required to be disclosed by Ind AS 2, and
- (b) For each total listed in (a)(i)-(v):
  - i. The amount related to each line item in the operating category, and
  - ii. A list of any line items outside the operating category that also include amounts relating to the total.

Note that the disclosure requirement is limited to the five specified nature expenses and must be presented in a single note. However, entities are not exempted from applying the specific disclosure requirements relating to those expenses contained in other Ind AS.

The amounts disclosed by nature may differ from expenses recognized in the period because some costs are capitalized and expensed in future periods. When this occurs, the entity must provide a qualitative explanation, including identification of the related assets.

### How we see it

Currently, considering the requirements of Ind AS 1 and Schedule III, most Indian companies use nature-wise classification to present expenses in their statement of profit and loss. The possibility of presenting function-wise classification is new for most entities and may require system changes. Further, entities using function-wise classification also need to ensure that they have necessary information to make nature-wise disclosure in the notes.



The following example shows an example of the disclosure of the five specified expenses discussed above.

### Note 1—Specified expenses by nature

This table shows the totals of depreciation, amortisation, employee benefits, impairment losses and write-down of inventories and the amounts related to each line item in the operating category of XYZ Group's statement of profit and loss.

	(in INR thousands)	
	20X2	20X1
<b>Depreciation</b>		
Cost of sales	23,710	21,990
Research and development expenses	2,515	2,590
General and administrative expenses	4,975	4,750
Total depreciation	<b>31,200</b>	<b>29,330</b>
<b>Amortisation</b>		
Research and development expenses	13,840	12,690
Total amortisation	<b>13,840</b>	<b>12,690</b>
<b>Employee benefits</b>		
Cost of sales	61,640	57,175
Selling expenses	7,515	7,110
Research and development expenses	6,545	6,750
General and administrative expenses	8,920	5,825
Total employee benefits	<b>84,620</b>	<b>76,860</b>
<b>Impairment losses(a)</b>		
Research and development expenses	1,600	1,500
Goodwill impairment loss	4,500	—
Total impairment losses	<b>6,100</b>	<b>1,500</b>
<b>Write-down of inventories(a)</b>		
Cost of sales	2,775	2,625
Total write-down of inventories	<b>2,775</b>	<b>2,625</b>

a) The amounts disclosed represent the total of impairment losses and reversals of impairment losses and the total of write-down of inventories and reversals of write-down of inventories.

### How we see it

Ind AS 118 does not contain a definition of the term 'cost of sales' and, therefore, its scope is likely to be judgmental. Entities will, therefore, need to consider facts and circumstances when considering whether to classify, for instance, shipping and handling costs, and write-offs on items such as inventory and property, plant and equipment within the 'cost of sales' line item.



## Assessing which presentation provides the most useful structured summary

Any individual line item in P&L can only contain expenses aggregated on the basis of either nature or function. However, a mixed presentation within the operating category as a whole is permitted. To make the determination of which presentation provides the most useful structured summary, an entity is required to consider the following:

- Which line items provide the most useful information about the main components or drivers of the entity's profitability
- Which line items most closely represent the way the business is managed and the entity's internal reporting
- Standard industry practice to enhance comparability
- Whether the allocation of particular expenses to functions would be arbitrary to the extent that the line items would not provide a faithful representation of the functions

### Mixed presentation

An outcome of considering the factors stated above may be that an entity may conclude that a mixed presentation, i.e., classifying some expenses by function and others by nature, provides the most useful structured summary. This might be the case for entities with two different types of main business activity or for particular expenses, whose allocation to a function would be arbitrary. This, however, does not mean that an entity has a free choice to present a mixed presentation, as it is constrained by the requirement to present P&L, in the manner which results in the most useful structured summary.

If an entity adopts a mixed presentation, it labels the line items in a manner that allows users to clearly identify which expenses are included in each line item. For example, if some employee benefits are included in cost of sales and others in a nature line item, the nature line item must clearly identify that not all employee benefits are contained within, for example, 'employee benefits other than those included in cost of sales.'

## 4.3 Separate presentation of "non-recurring" items

Under current (Ind AS 1 and Schedule III) practice, some entities present material 'non-recurring' or 'unusual' items (often referred to as "exceptional items") separately on the face of P&L. This raises the question of whether entities are permitted to continue this practice, particularly when they adopt a 'by function' method of presentation, since disclosing 'non-recurring' or 'unusual items' on the face of P&L typically follows a nature-based presentation.

In our view, separate presentation of 'non-recurring' items in P&L raises several questions. These questions and our perspective thereon are given here:

### a) Does Ind AS 118 prohibit separate presentation of 'non-recurring' items?

An entity is required to present disaggregated line items in the primary financial statements if it contributes to a useful structured summary. Ind AS 118 mentions that 'non-recurring income and expenses' might have sufficiently dissimilar characteristics that presentation (i.e., in a separate line item) in P&L may be necessary to provide a useful structured summary. Further to this, Ind AS 118 indicates persistence as a characteristic which could be sufficiently dissimilar to warrant separate presentation on the face of P&L.

The Basis for Conclusion to IFRS 18 indicates that information about unusual income and expenses is useful to users of financial statements and provides an example of separate presentation of restructuring costs due to a lack of persistence.

From the above, it is apparent that Ind AS 118 does not prohibit separate presentation of 'non-recurring' items and could, in fact, require the same in certain cases to provide a useful structured summary.



**b) What is considered to be 'non-recurring' and does such an item lack persistence?**

The absence of 'persistence' is typically the characteristic which drives the presentation of a 'non-recurring' or 'unusual' item. However, what is considered 'non-recurring' or 'unusual' is inherently judgmental and will be specific to the particular facts and circumstances of the reporting entity.

**How we see it**

Determining whether an item of income or expense is truly 'non-recurring' (i.e., lacks persistence) is an inherently judgmental assessment and will depend on the entity-specific facts and circumstances.

We expect that the revised Ind AS Compliant Schedule III to be applicable in Ind AS 118 Scenario and the ICAI Guidance Note thereon (both of which are pending issuance) may contain additional requirements/ guidance on the matter.

**c) Is disaggregation based on persistence permissible in a 'by function' presentation?**

If an entity presents separately a 'non-recurring' item separately on the basis of an absence of persistence in an otherwise 'by function' presentation, the item may become essentially a 'by nature' item. This raises the question whether this overrides its previous conclusion to use 'by function' presentation and show 'non-recurring' item separately.

Ind AS 118 is clear that it is possible to present line items in P&L using both a 'by nature' and a 'by function' presentation, if that presentation is necessary to provide a useful structured summary. The standard also clarifies that if the allocation of some expenses to a function would be arbitrary, presentation of a nature line item is permitted, provided the line items are faithfully labelled.

Therefore, an entity must apply judgment to assess which presentation achieves the most useful structured summary and, in doing so, must consider disaggregating items on the basis of dissimilar characteristics, including persistence.

**How we see it**

In certain circumstances, to provide a useful structured summary, it may be necessary to disaggregate a required 'by function' line item and present a non-recurring measure separately in the statement of profit and loss, but this will be a highly judgmental assessment based on an entity's individual facts and circumstances.

Entities must also consider the regulatory perspective while making such presentation.

**d) Can an entity present an additional subtotal when disaggregating certain items based on persistence?**

If an entity disaggregates items on the basis of persistence, as discussed above, it might well consider it necessary to also provide an additional subtotal of income and expenses that excludes non-recurring items. However, any such additional subtotal must comply with all the requirements set out in Ind AS 118 and may also meet the definition of a management-defined performance measure.

**How we see it**

It may be appropriate in some cases to present an additional subtotal, but only if it is necessary to provide a useful structured summary and if such a subtotal meets the requirements for additional subtotals in Ind AS 118.

In such cases, presentation of the unadjusted subtotal may also be necessary to achieve a useful structured summary.

# 05

## Management-defined performance measures (MPM)



- 5.1 Overview of the new requirements
- 5.2 Identification of MPMs
- 5.3 Information to be disclosed
- 5.4 Changes to MPMs
- 5.5 Presentation of MPMs in the statement of profit and loss



## 5.1 Overview of the new requirements

Ind AS 118 introduces the concept of a management-defined performance measure. It defines an MPM as a subtotal of income and expenses that an entity uses in public communications outside financial statements to communicate to users management's view of an aspect of the financial performance of the entity as a whole. However, MPMs do not include subtotals of income and expense required by an Ind AS, including Ind AS 118 itself. MPMs also do not include other subtotals of income and expense listed in Ind AS 118, e.g., "gross profit or loss (revenue minus cost of sales) and similar subtotals listed in Ind AS 118 are not MPMs.

To improve the transparency around these measures, Ind AS 118 requires an entity to disclose information about all its MPMs in a single note to the financial statements. The standard requires several disclosures including:

- How the measure is calculated
- How it provides useful information, and
- A reconciliation to the most comparable subtotal specified by Ind AS 118 or another Ind AS.

### How we see it

We believe that the required disclosures around MPMs will improve transparency for users and since MPMs are required to be included in the financial statements, they will generally also be subject to audit.

It is likely that the required disclosures will elevate the prominence of MPMs and result in increased scrutiny from regulators.

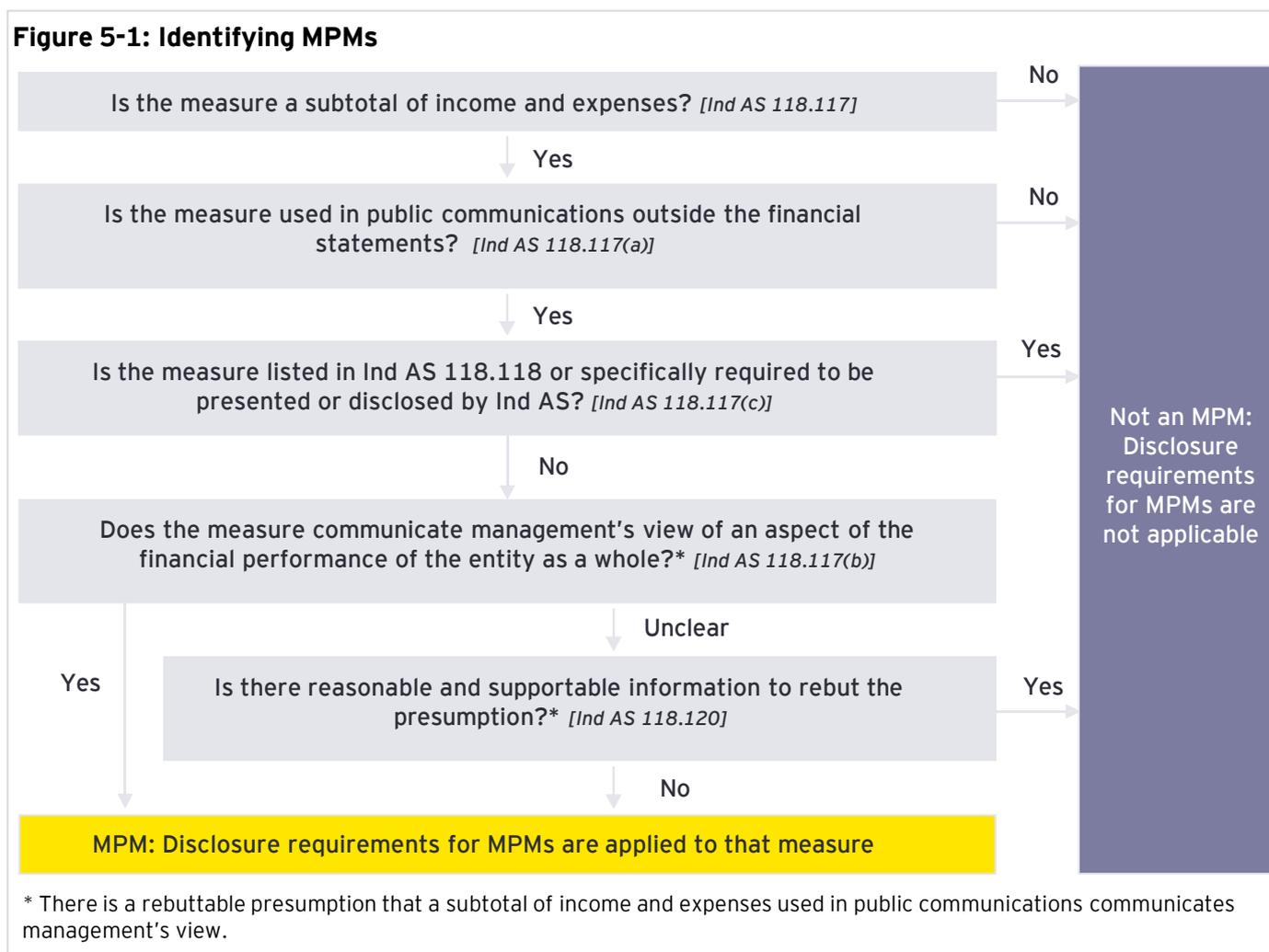
## 5.2 Identification of MPMs

In accordance with Ind AS 118, management-defined performance measure is a subtotal of income and expenses that:

- a) An entity uses in public communications outside financial statements,
- b) An entity uses to communicate to users of financial statements management's view of an aspect of the financial performance of the entity as a whole, and
- c) Is not listed in paragraph 118 of Ind AS 118, or specifically required to be presented or disclosed by Ind AS.

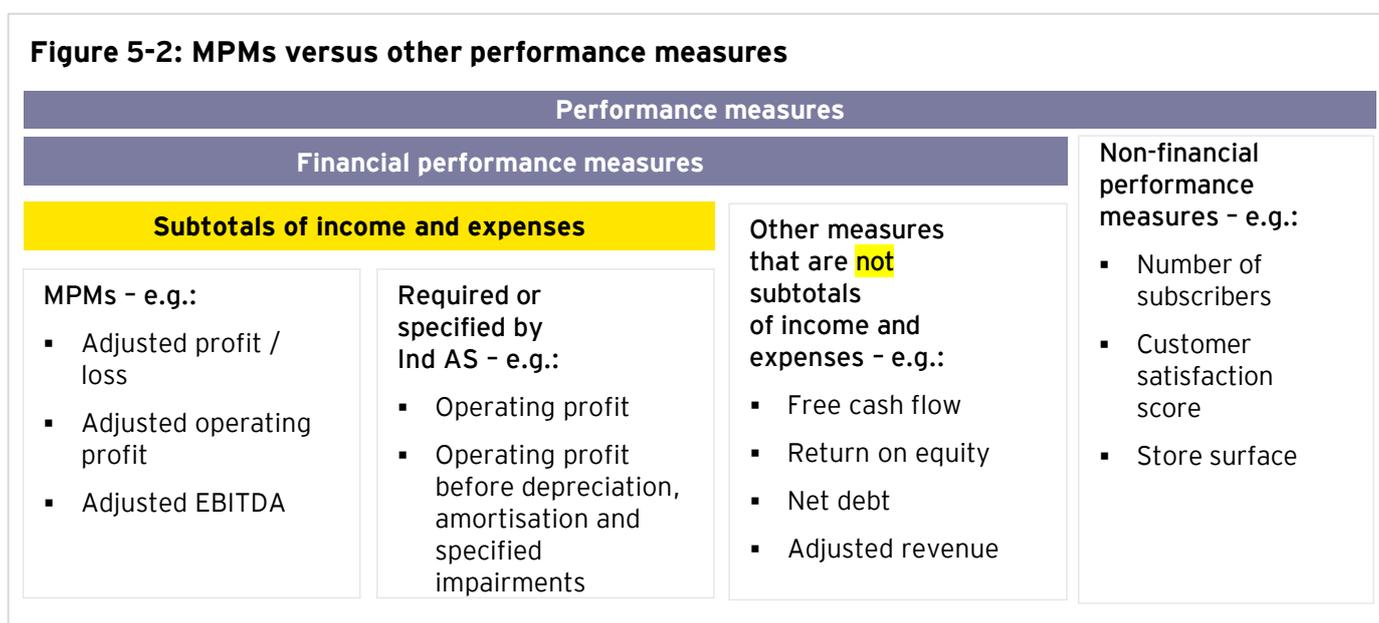


The following figure provides an overview of how an entity identifies an MPM:



### Subtotals of income and expenses

Ind AS 118 intentionally limits the definition of MPMs to subtotals of income and expenses. This narrow definition results in MPMs being a subset of other performance measures (e.g., alternative performance measures), as illustrated in the following diagram:





The following measures would not be MPMs since they are not subtotals of income and expenses:

- (a) **Subtotals of only income or only expenses**  
For example, a stand-alone measure of adjusted revenue.
- (b) **Measures of assets, liabilities, equity or combinations of these elements**  
For example, net current operating assets.
- (c) **Financial ratios**  
For example, return on assets. However, the numerator or denominator of a financial ratio could be an MPM (see **Question 5-1** below).
- (d) **Measures of liquidity or cash flows**  
For example, free cash flow, or
- (e) **Non-financial performance measures**  
For example, customer satisfaction score

A subtotal of income and expenses that meets the definition of an MPM does not need to be presented in the statement of profit and loss in order for it to be an MPM. For instance, an entity might present an adjusted operating profit measure outside the financial statements, without the same subtotal being included in the statement of profit and loss. In such a case, this subtotal could be an MPM, provided that it meets the other elements of the MPM definition.

A financial ratio cannot be an MPM since it is not a subtotal of income and expenses. However, the numerator or denominator of a financial ratio could be an MPM if it represents a subtotal of income and expense that would meet the definition of an MPM, had it not been part of a ratio.

### How we see it

MPMs, as defined in Ind AS 118, are a subset of alternative performance measures; many entities currently use alternative performance measures, which do not constitute MPMs, in their communications with capital markets outside the financial statements. Entities that plan to include alternative performance measures that are not also MPMs within the notes to the financial statements must consider whether this is appropriate. This assessment will require significant judgment, and such inclusion might not be appropriate in many instances since all information included within the financial statements needs to meet the overall 'true and fair view' requirement set out in Ind AS 8.

### Frequently asked questions

**Question 5-1: Can the numerator of a ratio be an MPM, even if the numerator is never communicated by itself outside the financial statements?**

Many entities use an adjusted earnings ratio (e.g., adjusted operating profit divided by capital employed) as a key performance indicator in their public communications outside the financial statements. However, the value of the numerator is not always specifically indicated in public communications as some entities just disclose the formula used to derive the overall ratio.

Ind AS 118 is clear that while a financial ratio is not an MPM (as it does not represent a subtotal of income or expense) the numerator or denominator in such a ratio could be an MPM if it had met the definition of an MPM had it not been used in a ratio.

Thus, an entity is required to assess the numerator against the definition of an MPM and can ignore the requirement that the numerator is used by itself in public communications outside the financial statements. It is sufficient that the ratio in which the numerator is included is used in public communications outside the financial statements to communicate management's view of an aspect of the entity as a whole.

If an entity concludes such a subtotal meets the definition of an MPM, the disclosure requirements will apply to the numerator rather than the financial ratio itself.



An entity might decide to replicate its statement of profit and loss in a public communication (for example, in a presentation to users). Where the replicated statement of profit and loss includes an additional subtotal not listed in the standard or not specifically required by Ind AS, that subtotal would meet the definition of an MPM, unless the entity rebuts the presumption.

An entity might have no MPMs, just one, or multiple MPMs. For example, an entity that only uses totals and subtotals required by Ind AS to communicate publicly its financial performance to users does not have any MPMs.

## Frequently asked questions

**Question 5-2: Are industry specific (e.g., insurance) alternative performance measures (APMs) aligned with the definition of MPMs?**

Entities within certain industry sectors typically use a range of alternative performance measures, but only some of these measures will fall into the narrowly-defined subset of MPMs. For example, measures used by some insurers such as 'adjusted equity' (combination of equity and liabilities), 'combined ratio' (financial ratio) or 'embedded value' (measure of cash flows) will not meet the definition of an MPM as they are not subtotals of income and expenses. However, as stated above, numerator or denominator in the financial ratio can be an MPM.

**Question 5-3: Can a 'what if' income and expense based alternative performance measure be an MPM?**

Some entities use alternative performance measures, which adjust a subtotal for items that are not measured or recognized in accordance with Ind AS, as key performance indicators in public communications outside the financial statements. They typically reflect the entity's performance had certain accounting requirements not applied (i.e., a 'what if' type of alternative performance measure). An example of that might be operating profit without the effects of Ind AS 116.

The definition of an MPM refers to a 'subtotal of income and expense' which some could read as referring to only subtotals of 'income' and 'expenses' as defined within Ind AS. However, it is clear that MPMs are defined by management and, therefore, by definition are not a measure required by Ind AS.

The disclosure requirements for MPMs also suggest that MPMs include measures calculated using a 'non-Ind AS' basis as it requires an entity to disclose when the calculation of the measure "differs from accounting policies required or permitted by Ind AS". Rather than prohibiting such measures, Ind AS 118 requires accurate labelling and MPMs to be described in a clear and understandable manner to ensure such measures are not misleading.

Therefore, if a subtotal which meets the definition of an MPM in Ind AS 118 is used in public communication outside the financial statements, the MPM disclosures within the notes to the financial statements are required, even if the management defined measure includes adjustments which are not in accordance with Ind AS.

### How we see it

While the inclusion of disclosure about 'what if' alternative performance measures used by management is not optional if these measures meet the definition of an MPM, regulators might object to the use of certain measures, if they consider these to be misleading or lack neutrality.

If a regulator prohibits the use of a particular measure within public communications and requires its removal, such a measure would no longer meet the definition of an MPM (as it is no longer 'used in public communications').



## Meaning of 'public communications'

A subtotal only meets the definition of an MPM if it is used by an entity in public communications outside the financial statements.

Public communications include:

- Management commentary
- Press releases
- Investor presentations

However, for the purpose of defining MPMs, public communication excludes:

- Oral communications
- Written transcripts of oral communications
- Social media posts

For the purpose of defining MPMs, public communication excludes oral communications, written transcripts of oral communications, and social media posts.

## Frequently asked questions

### Question 5-4 - Whether MPM requirements apply to private entities as well?

The MPM requirements apply to all entities applying Ind AS and, if a private entity covered under Ind AS application communicates subtotals that meet the definition of MPMs, that entity would be subject to the MPM requirements.

Ind AS 118 is clear that MPMs relate to the same reporting period as the financial statements. Specifically:

- (a) A subtotal that relates to the interim financial statements, but not to the annual financial statements, is only an MPM in the interim financial statements, and
- (b) A subtotal that relates to the annual financial statements, but not to interim financial statements, is only an MPM in the annual financial statements

While it is common for entities to issue public communications, such as press releases, before or at the date the financial statements are approved for issue, some public communications (for example, investor presentations) might not be made available until after the financial statements are approved for issue. Ind AS 118 requires an entity that routinely issues public communications containing performance measures after the financial statements are approved for issue to consider what measures it included in the previous period's public communications when identifying MPMs for the current period. However, an entity is not required to include a measure identified in the prior period as an MPM where evidence indicates it will no longer be included in the public communications to be issued for the current reporting period. When a measure was previously disclosed as an MPM but is not identified as an MPM for the current reporting period, the disclosure requirements for a change to, or cessation of, an MPM will apply.

## How we see it

While MPM disclosure is also required in interim financial statements, the subtotals that are considered MPMs could differ between the interim and annual financial statements.



## Management's view

MPMs are limited to those measures that communicate management's view of an aspect of the financial performance of the entity as a whole.

### *Management's view versus management's performance*

The focus of MPMs is on communicating an aspect of an entity's performance rather than communicating management's performance. As a result, a subtotal only used to measure management's performance (for example, a measure used internally for the purpose of management remuneration but not used externally to communicate management's view of an aspect of an entity's performance) would not meet the definition of an MPM. However, in some cases, a measure used externally to communicate management's view of an aspect of the entity's performance might be used for the purpose of assessing management's performance, and thus the two could overlap.

### *Entity as a whole*

To meet the definition of an MPM, the measure must communicate management's view of an aspect of the financial performance of the entity *as a whole* to users. For example, a subtotal of income and expenses related to a reportable segment (disclosed in accordance with Ind AS 108) that does not provide information about an aspect of the financial performance of the entity as a whole, does not meet the definition of an MPM. However, in some cases, a subtotal of income and expenses related to a reportable segment could provide information about an aspect of the financial performance of the entity as a whole and, therefore, meet the definition of an MPM. An indicator of this is where a reportable segment contains a single main business activity of an entity and a subtotal of income and expenses relating to that segment is presented in the statement of profit and loss.

## How we see it

Since the definition of an MPM refers to the entity as a whole, the focus is at an entity-level (for individual or stand-alone financial statements) or at group level (for consolidated financial statements), rather than just at part of the entity or group. Therefore, a measure used by a listed subsidiary in its public communications that meets the definition of an MPM at the subsidiary level would not necessarily meet the definition of an MPM at the consolidated group level.





## Frequently asked questions

**Question 5-5:** When would a segment profit measure represent 'an aspect of the financial performance of the entity as a whole'?

Reportable segment profit measures are not excluded from the definition of an MPM. However, to be identified as an MPM, segment profit measure must reflect management's view of an aspect of the performance of the *entity as a whole*. Since an operating segment is defined as a 'component' of an entity, it appears that in many cases, information about a segment may not reflect the performance of the *entity as a whole*.

Nevertheless, it is clear that a segment profit measure could, in certain circumstances, reflect the management's view of an aspect of the performance of *the entity as a whole* and, therefore, meet the definition of an MPM. But since there is limited guidance in the standard, an entity needs to apply judgment in making the assessment of whether such a segment profit measure is also an MPM.

### How we see it

An entity needs to apply judgment, based on its particular facts and circumstances, to assess whether a segment profit measure used outside the financial statements is also an MPM.

If a segment profit measure is also an MPM, the disclosure requirements for MPMs will apply, including the requirement to provide all disclosure about MPMs within a single note.

The following situations may indicate that a segment profit measure represents an aspect of the financial performance of the entity as a whole:

- a. The statement of profit and loss presents a subtotal related to a segment that contains a single main business activity of the entity,
- b. The measure represents the total of all segments combined,
- c. The entity only has one segment, or
- d. The measure is unique to only one of the entity's segments.

### Rebuttable presumption

The standard contains a *rebuttable presumption* that a subtotal of income and expenses used in public communications outside the entity's financial statements communicates to users management's view of an aspect of the financial performance of the entity as a whole.

An entity can only rebut this presumption (i.e., assert that a subtotal does not communicate management's view of an aspect of the financial performance of the entity as a whole) if it is able to demonstrate, using reasonable and supportable information that:

1. The subtotal does not communicate management's view of an aspect of the financial performance of the entity as a whole, and
2. There is a reason for using the subtotal in the entity's public communications other than communicating management's view of an aspect of the financial performance of the entity as a whole.



### Akshay Jalan

*"Although Ind AS 118 will become effective in the coming years, organizations should start preparing early. The transition to the revised presentation framework will require companies to reassess their existing reporting structures, evaluate the availability of relevant data, and ensure their systems and processes can support the new requirements. Proactive planning and timely impact assessment will be essential for smooth transition."*



The rebuttable presumption applies to the subtotal as a whole and not to individual items of income and expense that make up that subtotal. Therefore, an entity cannot rebut the presumption based on information indicating that an individual item (or items) of income or expense within the subtotal does not represent management's view.

Instead of specifying types of measures for which it would be appropriate to rebut the presumption, examples of reasonable and supportable information have been provided which could support rebutting the presumption that the subtotal communicates management's view of an aspect of the financial performance of an entity as a whole:

- (i) The subtotal is communicated without prominence.
- (ii) The subtotal is not used internally to assess or monitor the entity's financial performance.

Ind AS 118 also includes examples of 'reasonable and supportable information' that indicate the entity has a reason, other than to communicate management's view, for using a subtotal in its public communications:

- (a) The subtotal is required to be included in public communication by law or regulation.
- (b) The subtotal communicates performance related to financial statements prepared under another accounting framework (i.e., other than Ind AS).
- (c) The subtotal is used in public communication on the request of an external party.
- (d) The subtotal is used to communicate information other than financial performance.

In practice, an entity may include a measure in its public communications as a result of a regulatory requirement or on the request of investors (examples (a) and (c) above). However, in some cases, these measures also communicate management's view despite originally being included for regulatory reasons or at the request of investors and, in these instances, the assumption cannot be rebutted.

### Subtotals - Whether MPMs or not?

Ind AS 118 explicitly notes that subtotals required by an Ind AS, including Ind AS 118 itself, are not MPMs and Ind AS 118 also lists other subtotals that are not MPMs.

Category	Description	Can this be MPM?
Required Subtotals	Subtotals that must be presented in the statement of profit and loss as prescribed by an Ind AS including Ind AS 118.	No
Common Subtotals	Widely used subtotals that are not mandatory, but commonly presented, if relevant. Ind AS 118 includes a list of such sub-totals and sub-total is covered in the list.	No
Additional Subtotals	Other sub-totals of income and expense including subtotals presented to provide a useful structured summary to the primary financial statements, if necessary.	Yes

#### *Subtotals specifically required by Ind AS*

Ind AS 118 excludes subtotals specifically required by an Ind AS from the definition of an MPM. Since these subtotals are required by Ind AS, they are by definition not 'management-defined'. Such subtotals include those required by Ind AS 118:

- Operating profit or loss
- Profit or loss before financing and income taxes
- Profit or loss



## Frequently asked questions

### Question 5-6: Can additional subtotals included in profit or loss applying Ind AS 118.24, meet the definition of an MPM?

Ind AS 118 requires an entity to present an additional subtotal within profit or loss, if such a subtotal is necessary for the statement of profit and loss to present a useful structured summary.

Since Ind AS 118 excludes from the definition of an MPM, subtotals of income and expenses that are specifically required by Ind AS, some could read this as including additional subtotals required by Ind AS 118.24. However, Ind AS 118.24 indicates that when an entity presents additional subtotals, these additional subtotals must “be displayed no more prominently than the totals and subtotals required by Ind AS” suggesting that such additional subtotals are separate from those specifically required by Ind AS.

Accordingly, in our view, an additional subtotal that is considered necessary for the statement of profit and loss to provide a useful structured summary, while required generally by Ind AS 118.24, is not a ‘specifically’ required subtotal. Such subtotal will, therefore, meet the definition of an MPM, if it complies with the other elements of the definition.

### ***Subtotals specifically excluded***

Some subtotals are not required or defined by Ind AS, but are commonly used by entities in their financial statements and are well understood by users (for example, a gross profit subtotal). Providing the management-defined performance measures disclosures for such measures may not provide useful information because their purpose and relationship to totals or subtotals defined by Ind AS are well understood or would usually be apparent from their presentation in the statement of profit and loss. Therefore, the standard includes a list of such subtotals and these subtotals are specifically excluded from the definition of an MPM:

- (a) Gross profit or loss (revenue minus cost of sales) and similar subtotals
- (b) Operating profit or loss before depreciation, amortisation and impairments within the scope of Ind AS 36
- (c) Operating profit or loss and income and expenses from all investments accounted for using the equity method
- (d) For an entity that applies the accounting policy choice to present income and expense from liabilities that do not relate to the provision of financing to customers in the operating category, a subtotal comprising operating profit or loss and all income and expenses classified in the investing category
- (e) Profit or loss before income taxes
- (f) Profit or loss from continuing operations

### ***Subtotals similar to gross profit***

As noted above, subtotals similar to gross profit are not MPMs. A subtotal is similar to gross profit when it represents the difference between a type of revenue and the directly related expenses incurred in generating that revenue. The standard provides the following, non-exhaustive, list as examples of such subtotals:

- (a) Net interest income,
- (b) Net fee and commission income,
- (c) Insurance service result,
- (d) Net financial result (investment income minus insurance finance income and expenses), and
- (e) Net rental income.



### **Earnings before interest, tax, depreciation and amortisation (EBITDA)**

The 'earnings before interest, tax, depreciation and amortisation' (EBITDA) is one of the most commonly used alternative performance measures; although, it is not used in some industries (such as banking and insurance). Also, there is no consensus in practice on what EBITDA represents. Accordingly, the standard does not specifically deal with whether EBITDA will be treated as commonly used sub-total (which is excluded from MPM definition) or it will be treated as an MPM. Rather, it will be decided based on specific facts.

It may be noted that a measure calculated as 'operating profit before depreciation, amortisation and impairments within the scope of Ind AS 36' would provide similar information to many of the EBITDA measures currently used in practice. However, this might not always be the case. For example, under Ind AS 118 'operating profit' excludes income and expenses classified in the investing category and, therefore, might exclude income that some consider to be 'earnings.' However, the label 'EBITDA' could be an accurate description of the corresponding measure if, for example, all of an entity's earnings are included in operating profit, since it has no income and expenses that are required to be included in the investing category. In such cases, the standard would not prevent an entity from labelling the subtotal 'operating profit before depreciation, amortisation and specified impairments within the scope of Ind AS 36' as 'EBITDA'.

Whether EBITDA is treated as commonly used sub-total and therefore excluded from MPM definition or it treated as an MPM will be decided based on specific facts of each case.

### **Additional subtotals**

Refer to section 6.1, *The roles of the primary financial statements and the notes*, for the criteria to be evaluated for inclusion of an additional subtotals in the statement of profit and loss.

## **5.3 Information to be disclosed**

Ind AS 118 requires an entity to disclose information about all its MPMs in a single note to the financial statements and requires that this note includes a statement that MPMs provide management's view and are not comparable to MPMs of other entities.

The standard requires that each MPM is labelled and described in a clear and understandable manner and specifically requires the entity to make the following disclosures for each MPM:

- (a) A description of the aspect of the entity's financial performance that, in management's view, is communicated by the MPM, including an explanation of why management believes that the MPM provides useful information about the entity's financial performance.
- (b) How the MPM is calculated.
- (c) A reconciliation to the most directly comparable total or subtotal specifically required by Ind AS or one of the common subtotals listed in Ind AS 118 (i.e., those which are not required, or defined, by Ind AS but which are commonly used by entities and well understood by users).
- (d) The income tax effect and the effect on non-controlling interests for each reconciling item disclosed in the reconciliation required by (c) above.
- (e) A description of how the entity determined the income tax effect required by (d) above

Comparative numbers are also required for all MPM disclosures.

Any changes in MPMs need to be explained and comparative information must be restated to reflect these changes, unless it is impracticable to do so.



## Management's statement on the use of MPMs

An entity is required to include, in its MPM note, a statement that MPMs provide management's view of an aspect of the financial performance of the entity as a whole and are not necessarily comparable with measures provided by other entities that have a similar label or description.

## Labeling MPMs

An entity is required to label and describe each MPM in a clear and understandable manner that does not mislead users. To meet this requirement, an entity needs to disclose information that enables users to understand which items of income or expense are included in, and which are excluded from, the particular subtotal. For example, using the label 'operating profit before non-recurring expenses' for a subtotal will be appropriate only if it in fact excludes all expenses identified as non-recurring by the entity. Also, to explain the aspect of financial performance being communicated, the entity should explain how it defines 'non-recurring expenses' in its specific circumstances.

The standard requires that each MPM is labeled and described in a clear and understandable manner.

If the calculation of the MPM differs from the accounting policies the entity uses for the items in its statement of profit and loss, it is required to state that fact and disclose the calculations it used for the MPM. Additionally, where the calculation of the MPM also differs from accounting policies permitted or required by Ind AS, the entity must state that fact and where necessary explain the meaning of the terms used in calculating the MPM.

## Reconciliation

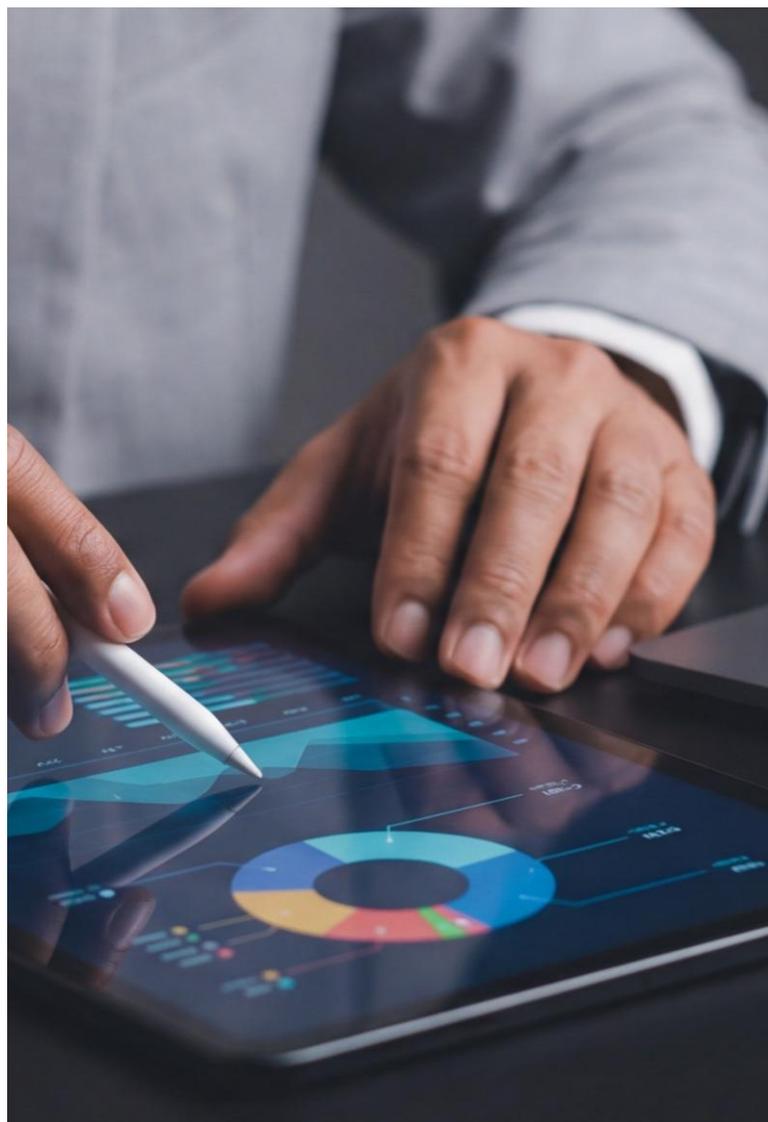
Ind AS 118 requires an entity to provide a reconciliation of each MPM to the most directly comparable total or subtotal specifically required by an Ind AS or a subtotal listed in Ind AS 118.118. For example, an entity that discloses in the notes an MPM of 'adjusted operating profit or loss' will be required to reconcile that measure to the 'operating profit or loss' total required to be presented under Ind AS 118.

An entity applies the normal principles of aggregation and disaggregation to the reconciling items in order to decide the level of detail required.

For each reconciling item, an entity is required to disclose:

- (a) The line item presented in the statement of profit and loss that includes the amount(s) making up the reconciling item
- (b) A description of how the item:
  - (i) Is calculated, and
  - (ii) Contributes to the MPM providing useful information (see below)

Depending on specific facts, the disclosure stated at (b) above may be required, for each reconciling item. For example, an entity could exclude several items of expense from an MPM, some because they are considered outside management's control and others because they are considered non-recurring. In order to explain how the MPM provides useful information in such a case, the disclosure would need to distinguish which items contribute to which type of adjustment.





## Income tax effect and the effect on non-controlling interests

An entity is required to disclose the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation between an MPM and the most directly comparable total or subtotal specifically required by an Ind AS, or one of the subtotals listed in Ind AS 118.118. This disclosure is required for each reconciling item because it gives users the necessary information to calculate their own adjusted earnings per share measure based on only the adjustments they want to consider in their analyses.

The following approaches are possible to calculate income-tax effect of each reconciling item:

- Simplified approach: By using the statutory tax rate(s) applicable to the particular transaction(s) in the relevant tax jurisdiction(s).
- Alternative approach 1: Based on a reasonable pro rata allocation of the entity's current and deferred tax in the relevant tax jurisdiction(s), or
- Alternative approach 2: Using another method, provided it achieves a more appropriate allocation in the circumstances.

### Example of a reconciliation

The illustration below shows XYZ Group's disclosures for its MPM. In the interest of brevity, the comparative table has not been provided in the illustration below, but comparative numbers are required for all MPM disclosures.

For the purpose of this illustration, assume that XYZ Group has disclosed a statement stating that adjusted operating profit provides management's view of XYZ Group's operating profit and such adjusted operating profit is not necessarily comparable with measures sharing similar labels or descriptions provided by other entities.

#### Illustration 5-1: MPMs note

##### XYZ Group's management-defined performance measures

XYZ Group uses the management-defined performance measure adjusted operating profit in its public communications. This measure is not specified by Ind AS. Therefore, it might not be comparable to apparently similar measures used by other entities. To provide management's view of XYZ Group's financial performance, operating profit has been adjusted for items of income or expense that XYZ Group does not expect to arise for several future annual reporting periods. XYZ Group's management believes adjusting operating profit for such items provides information that is helpful in understanding trends in XYZ Group's underlying profitability.

XYZ Group generally adjusts for these items of income or expense:

- Impairment losses (or reversals thereof) of property, plant and equipment (including right-of-use assets) and intangible assets (for information related to impairments, refer to Note X Property, plant and equipment, Note Y Intangible assets and Note Z Research and development expenses)
- Restructuring expenses (for information related to restructuring expenses, refer to Note U Employee benefits and Note V General and administrative expenses)
- Non-recurring litigation expenses (for information related to litigation expenses, refer to Note W Provisions and Note V General and administrative expenses)
- Gains or losses on disposal of property, plant and equipment and of intangible assets (for information related to disposal of property, plant and equipment and intangible assets, refer to Note X Property, plant and equipment, Note Y Intangible assets and Note T Other operating income)
- Gains or losses on disposal of subsidiaries, associates and joint ventures

XYZ Group assesses non-recurrence of litigation expenses on a case-by-case basis. XYZ Group generally categorizes litigation expenses arising from intellectual property disputes, regulatory violations and employee claims as 'non-recurring'. This classification is based on XYZ Group's proactive approach of having in place measures designed to prevent such events from occurring.



### Management-defined performance measures 20X4-20X5

(in thousands of CU)		Income tax expense	Profit attributable to NCI
<b>Operating profit (Ind AS-specified)</b>	<b>57,000</b>		
Gains on disposal of property, plant and equipment (included in 'Other operating income')	(1,800)	297	-
Impairment losses:	6,100	-	305
▪ Included in 'Research and development expenses'	1,600		
▪ Included in 'Goodwill impairment loss'	4,500		
Restructuring expense (included in 'General and administrative expenses')	3,800	(589)	161
<b>Adjusted operating profit (MPM)</b>	<b>65,100</b>		

Impairment losses	Impairment losses incurred in 20X4-20X5 did not yield any tax benefits because they were not eligible for tax deductions in Country A and Country B.
Restructuring expenses	The restructuring expenses in 20X4-20X5 are related to XYZ Group's restructuring program. These expenses include redundancy expenses, employee retraining expenses and relocation expenses, all related to the closure of several factories in Country C. The tax effect of these restructuring expenses is calculated based on the statutory tax rate applicable in Country C at the end of 20X4-20X5, which was 15.5%.
Gains on disposal of property, plant and equipment	The tax effect of gains on disposal of property, plant and equipment is calculated based on the statutory tax rate applicable in Country D at the end of 20X4-20X5, which was 16.5%.

### All required MPM disclosures in a single note

The standard does not prohibit an entity from including additional information in the note on MPMs; in fact, Ind AS requires disclosure of additional information when compliance with the specific requirements in Ind AS is insufficient to enable users to understand the effect of transactions and other events and conditions on the entity's financial position and financial performance. However, it is important to separately identify the required information about MPMs from other information included in the financial statements, so that it is clear which measures are subject to the MPM requirements.

The standard requires that an entity includes all the required information about MPMs in a single note to the financial statements.





## 5.4 Changes to MPMs

When an entity changes how it calculates an MPM, starts using a new MPM, stops using a previously disclosed MPM, or changes how it determines the income tax effects of any items disclosed in the reconciliation required for each MPM, it must disclose:

- (a) An explanation enabling users to understand the change, addition or cessation and its related effects
- (b) The reasons for the change, addition or cessation, and
- (c) Restated comparative information reflecting the change, addition or cessation unless it is impracticable to restate comparatives

If an entity is not able to disclose the restated comparative information because it is impracticable to do so, the entity must disclose that fact.

## 5.5 Presentation of MPMs in the statement of profit and loss

Ind AS 118 requires an entity to present line items and subtotals (including line items and subtotals not specifically required by an Ind AS) in the statement of profit and loss, if they are necessary to provide a 'useful structured summary' of the entity's income and expenses. Considering this requirement, an entity may present MPMs on the face of the statement of profit and loss

An entity presenting an MPM on the face of the statement of profit and loss still needs to comply with MPM related disclosure requirements for additional subtotals presented in the statement of profit and loss.



# 06

## Aggregation and labelling

- 6.1 The roles of the primary financial statements and the notes
- 6.2 Aggregation and disaggregation
- 6.3 Description of items



In accordance with Ind AS 118, the objective of financial statements is to provide financial information about a reporting entity's assets, liabilities, equity, income and expenses that are useful to users of financial statements in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources.

To achieve this objective, the primary financial statements and the notes have distinct and complementary roles in providing financial information to users. For such information to be useful, it needs to be appropriately aggregated and labelled, without obscuring material information.

Ind AS 118 differentiates between 'presenting' information in the primary financial statements and 'disclosing' it in the notes and introduces a principle for determining the location of information based on identified 'roles' of the primary financial statements and the notes.

The standard is clear that the materiality requirements apply equally to all requirements to present or disclose information. Information is either material (and, therefore, contributes to the objective of financial statements) or it is not material (and, therefore, is not required). As such, the materiality requirements set out whether information is required to be provided by an entity, not where in the financial statements to include that information.

Ind AS 118 requires an entity to aggregate and disaggregate information with reference to similar and dissimilar characteristics while keeping in mind the roles of the primary financial statements and the notes.

To represent an item faithfully, an entity is required to provide all the descriptions and explanations necessary for a user to understand the item. It also includes guidance on determining informative labels in order to provide useful information. For example, the use of the term "other" is generally not considered to provide useful information.

## 6.1 The roles of the primary financial statements and the notes

The users pay more attention to information presented in the primary financial statements and use it more often compared to information disclosed in the notes. Therefore, in order to meet the objective of financial statements, an entity 'presents' summarized (or aggregated) information in the primary financial statements and 'discloses' more detailed (or disaggregated) information in the notes. That said, an entity is only required to present or disclose material information, as Ind AS do not apply to immaterial items. However, certain information is required to be presented or disclosed by the applicable statute and entities should present/ disclose such information as per the applicable requirements in the financial statements, irrespective of materiality assessment.

### Information presented in the primary financial statements

An entity needs to assess what material information to present in its primary financial statements to meet their role of providing a useful structured summary.

Ind AS 118 distinguishes between:

An **'item'** is an asset, liability, equity instrument or reserve, income, expense or cash flow or any aggregation or disaggregation of such assets, liabilities, equity, income, expenses or cash flows.

And

A **'line item'** is an item that is presented separately in the primary financial statements.

All material information cannot be presented in (or on the face of) the primary financial statements as too many line items would clutter the primary financial statements. An entity is required to consider its specific facts and circumstances to determine what information will provide an understandable overview to users, while avoiding clutter. This can be shown by the following illustration:

Ind AS 118 distinguishes between an 'item', a 'line item' and other material information about items and line items.



### Illustration 6-1: Determining whether or not to present a line item based on the aspects of the role of the primary financial statements

Assume an entity undertakes a major restructuring during the reporting period and concludes that information about that restructuring is material.

In determining whether to present a line item for 'restructuring expenses' in the statement of profit and loss, the entity needs to consider whether such a line item contributes to a 'useful structured summary' by helping users to:

- (a) **Obtain an understandable overview of the entity's expenses for the period:** Separate presentation of the restructuring expenses could help users understand an increase in total operating expenses for the current period.
- (b) **Make comparisons between entities or between reporting periods:** Separately presenting the restructuring expenses, since they lack persistence, could make other line items more comparable to the amounts presented by this entity in prior periods as well as to amounts presented by other entities, thereby aiding trend analysis by users.
- (c) **Identify items or areas about which users might wish to seek additional information in the notes:** When the notes include additional information about restructuring expenses, presenting these expenses separately on the face of the primary financial statements (and including a cross-reference to the related note) could draw users' attention to that additional information.



**Sandeep Gupta**

*"Ind AS 118 represents a significant step forward in enhancing clarity and quality of financial reporting. By re-defining the presentation of profit and loss statement and expanding disclosure obligations around management-defined performance measures, the standard pushes companies to present financial information with greater transparency, consistency, and usefulness for investor's decision-making."*

#### Minimum line items

An entity should present in the balance sheet line items for:

- a. Property, plant and equipment
- b. Investment property
- c. Intangible assets
- d. Goodwill
- e. Financial assets (excluding amounts shown under (g), (j) and (k))
- f. Portfolios of contracts within the scope of Ind AS 117 that are assets, disaggregated as required by paragraph 78 of Ind AS 117
- g. Investments accounted for using the equity method
- h. Biological assets within the scope of Ind AS 41 *Agriculture*
- i. Inventories
- j. Trade and other receivables
- k. Cash and cash equivalents
- l. The total of assets classified as held for sale and assets included in disposal groups classified as held for sale in accordance with Ind AS 105
- m. Trade and other payables
- n. Provisions
- o. Financial liabilities (excluding amounts shown under (m) and (n))
- p. Portfolios of contracts within the scope of Ind AS 117 that are liabilities, disaggregated as required by paragraph 78 of Ind AS 117



- q. Liabilities and assets for current tax, as defined in Ind AS 12,
- r. Deferred tax liabilities and deferred tax assets, as defined in Ind AS 12, and
- s. Liabilities included in disposal groups classified as held for sale in accordance with Ind AS 105

Some Ind AS, including Ind AS 118, require specific line items to be presented separately in the primary financial statements. An entity is not required to present such line items in one of the primary financial statements, if those line items are not necessary for that statement to provide a useful structured summary. This applies even where an Ind AS describes the presentation of the line item as a minimum requirement. However, certain information is required to be presented or disclosed by the applicable statute and entities should present/ disclose such information as per the applicable requirements in the financial statements, irrespective of materiality assessment and/ or assessment related to useful structured summary.

Despite the requirement for specified line items, Ind AS 118 has effectively introduced a two-step approach for determining which of these line items to present:

**Step 1:** Assess which required line items are material.

**Step 2:** Assess whether presentation of the material required line items is necessary to present a useful structured summary.

However, if an entity concludes it does not need to present a line item specifically required by Ind AS separately in the primary financial statements, it still needs to disclose that item in the notes, unless it is immaterial. For example, if an entity concludes that presenting 'impairment losses' determined under Ind AS 109 *Financial Instruments* is not necessary to provide a useful structured summary of the entity's income and expenses, the entity is still required to disclose those losses in the notes, unless that information is immaterial.

## How we see it

The interaction between the minimum line item requirements, materiality and the useful structure summary concept involves some key nuances that might not always be easy to reflect in practice. Thus, determining whether to present or disclose information in, or to exclude information from, the financial statements will, in some cases, involve difficult judgments.

## Additional line items and additional subtotals

The standard specifies that an entity presents additional subtotals and line items if they are necessary to provide a useful structured summary in the primary financial statements. However, the standard restricts the type of additional line items or subtotals by stating that additional line items and subtotals should:

- (a) Comprise amounts recognized and measured in accordance with Ind AS
- (b) Be compatible with the statement structure created by the requirements listed in the standard
- (c) Be consistent from period to period, and
- (d) Be displayed no more prominently than the totals and subtotals required by Ind AS.

In any case entities will need to evaluate whether these additional subtotals will be considered as MPMs under Ind AS 118 (*refer section 5.2 Identification of MPMs*).



## Information disclosed in the notes

An entity is required to provide, in the notes, the information necessary for users to understand the line items presented on the face of the primary financial statements. Ind AS 118 provides the following examples of such information:

- (a) Disaggregation of the line items presented in the primary financial statements
- (b) Descriptions of the characteristics of the line items presented in the primary financial statements, and
- (c) Information about the methods, assumptions and judgments used to recognize, measure and present the items included in the primary financial statements

The notes to the primary financial statements will also include:

- (a) The information specifically required by an Ind AS. For example:
  - (i) Information about an entity's unrecognized contingent assets and contingent liabilities required by Ind AS 37 *Provisions, Contingent Liabilities and Contingent Assets*, and
  - (ii) Information about an entity's exposure to the various types of risks, such as credit risk, liquidity risk and market risk required by Ind AS 107, and
- (b) Additional information required for a user's understanding. Ind AS 118 requires an entity to consider whether additional information needs to be provided when specific requirements in Ind AS are insufficient to enable users to understand the effect of transactions and other events and conditions on the entity's financial position and financial performance.

However, an entity is not required to present a specific line item or make a disclosure required by an Ind AS if that information is not material.

## Cross references between the primary financial statements and the notes

Ind AS 118 requires an entity to cross-reference each item in the primary financial statements to any related information in the notes. However, an amount disclosed in a note is often included in one, or more, line items in the primary financial statements. In such cases, Ind AS 118 adds a requirement to disclose in that note the line item(s) in the primary financial statements in which the amounts are included.

### How we see it

We believe that the new requirement to cross refer from the notes to the primary financial statements, when amounts disclosed in the notes are included in one or more lines in the primary financial statements, will improve the transparency of financial statements for users and make it easier for them to understand how amounts disclosed in the notes link to those presented in the primary financial statements.

## 6.2 Aggregation and disaggregation

Ind AS 118 requires an entity to aggregate and disaggregate information with reference to similar and dissimilar characteristics. The application guidance sets out that items aggregated and presented as line items in the primary financial statements must have "at least one similar characteristic other than meeting the definition of assets, liabilities, equity, income, expenses, or cash flows." However, since the role of the primary financial statements is to provide a useful structured summary, the line items in the primary financial statements will, by design, aggregate items that have sufficiently dissimilar characteristics, such that disaggregated information about the aggregated items is likely to be material and will, therefore, need to be disclosed in the notes.

Aggregation and disaggregation of information requires an entity to avoid both:

- Omitting useful information by providing insufficient detail, and
- Obscuring information by providing too much detail



## Principles of aggregation and disaggregation

Unless it overrides specific aggregation or disaggregation requirements in Ind AS, an entity is required to:

- (a) Classify and aggregate assets, liabilities, equity, income, expenses or cash flows into items based on shared characteristics,
- (b) Disaggregate items based on dissimilar characteristics,
- (c) Aggregate or disaggregate items into line items that are presented in the primary financial statements so that they provide useful structured summaries,
- (d) Aggregate or disaggregate items in order to disclose material information in the notes, and
- (e) Ensure that the aggregation and disaggregation of information in the financial statements do not obscure material information

Applying the principles above, an entity should disaggregate items whenever the resulting information is material. However, the application of (c) above may result in an entity not presenting material information in the primary financial statements. If so, the entity should disclose material information in the notes.

### How we see it

While Ind AS 118 includes more guidance on aggregation and disaggregation, including the guidance on the principles of aggregation and disaggregation above, it remains a difficult balance to strike. Entities will need to apply judgment to determine how much detail is necessary to provide useful information, without obscuring material information.

## Basis of aggregation and disaggregation

To apply the requirements above, an entity is required to aggregate items with similar characteristics and disaggregate items with dissimilar characteristics. To do this, an entity must:

- (a) Identify the assets, liabilities, equity, income, expenses and cash flows that arise from individual transactions or other events
- (b) Classify and aggregate the identified assets, liabilities, equity, income, expenses and cash flows into 'items' based on their shared characteristics so that the 'line items' presented in the primary financial statements and the 'items' disclosed in the notes have at least one similar characteristic, in addition to the shared characteristic of meeting the definition of assets, liabilities, equity, income, expenses, or cash flows
- (c) Disaggregate items based on dissimilar characteristics:
  - (i) In the primary financial statements, so that the primary financial statements provide useful structured summaries, and
  - (ii) In the notes, so that the notes disclose material information

Applying the principles of aggregation and disaggregation, an entity must disaggregate items with dissimilar characteristics when the disaggregated information is material. In certain cases, a single dissimilar characteristic could result in disaggregated information about an item being material. This is shown in the following example:



### Illustration 6-2: Determining line items and disaggregation in the notes

An entity presents its financial assets, comprising equity investments and debt investments, separately from its non-financial assets in its balance sheet. In addition to being dissimilar to non-financial assets, these financial assets have dissimilar characteristics when compared to each other because of their different measurement bases (i.e., some are measured at fair value through profit or loss and others at amortised cost).

Assume the entity determined that presenting separate line items for the financial assets based on those measurement bases provides a useful structured summary. This disaggregation results in:

- A line item for equity and debt investments measured at fair value through profit or loss, and
- A line item for debt investments measured at amortised cost

However, while the equity and debt investments are both measured at fair value, these two types of investments are also dissimilar because equity investments expose the entity to different risks compared to debt investments. The entity would therefore need to assess whether further disaggregation of the financial assets measured at fair value through profit or loss (i.e., into equity investments and debt investments) is needed for the balance sheet to provide a useful structured summary.

If the entity concludes this further disaggregation is not necessary to fulfil the role of the primary financial statements, it then needs to consider if the disaggregated information is material, and if so, must disclose that disaggregated information in the notes. If the equity investments, in turn, have other dissimilar characteristics, the entity will need to further disaggregate those equity investments in the notes if the disaggregated information is material.





## Examples of similar and dissimilar characteristics

The application guidance in Ind AS 118 sets out characteristics an entity considers in making judgments for aggregation and disaggregation. The following table provides examples of those characteristics.

Characteristics	Examples
<b>Examples relating to both transactions and balances:</b>	
Nature	Transactions: <ul style="list-style-type: none"> <li>▪ Depreciation of property, plant and equipment</li> <li>▪ Staff costs</li> </ul> Balances: <ul style="list-style-type: none"> <li>▪ Equity investments</li> <li>▪ Debt investments</li> </ul>
Function (or role) within the activities of the entity	<ul style="list-style-type: none"> <li>▪ Selling expenses</li> <li>▪ Distribution expenses</li> <li>▪ Administrative expenses</li> <li>▪ Investment property</li> </ul>
Measurement basis	<ul style="list-style-type: none"> <li>▪ Fair value through profit or loss</li> <li>▪ Amortised cost</li> </ul>
Measurement uncertainty, outcome uncertainty or other risks associated with the items	Measurement uncertainty: <ul style="list-style-type: none"> <li>▪ Estimates, e.g., recoverable amount under Ind AS 36 <i>Impairment of Assets</i>, lifetime expected credit losses under Ind AS 109.</li> </ul> Outcome uncertainty: <ul style="list-style-type: none"> <li>▪ Provision for a legal dispute</li> <li>▪ Variable consideration</li> </ul>
Geographical location or regulatory environment	<ul style="list-style-type: none"> <li>▪ Property, plant and equipment located in volatile jurisdictions</li> <li>▪ Jurisdictional requirements for employee benefits</li> </ul>
Tax effects	<ul style="list-style-type: none"> <li>▪ Where different tax rates apply to the items</li> <li>▪ Where assets or liabilities have a different tax base</li> </ul>
<b>Examples relating to income and expenses (i.e., related only to transactions):</b>	
Persistence	<ul style="list-style-type: none"> <li>▪ How frequently the item of income or expense occurs</li> <li>▪ Whether the item is recurring or non-recurring</li> </ul>
Timing of recognition	Income or expenses arising: <ul style="list-style-type: none"> <li>▪ On initial recognition of an item</li> <li>▪ From a subsequent change in an estimate relating to the item</li> </ul>
<b>Examples relating to assets, liabilities and items of equity (i.e., related only to balances):</b>	
Duration and timing of recovery or settlement	<ul style="list-style-type: none"> <li>▪ Whether the item is classified as current or non-current</li> <li>▪ Whether the item's recovery or settlement forms part of the entity's operating cycle</li> </ul>
Liquidity	<ul style="list-style-type: none"> <li>▪ Cash</li> <li>▪ Receivables</li> <li>▪ Long-term fixed deposits</li> </ul>
Type	<ul style="list-style-type: none"> <li>▪ Type of good</li> <li>▪ Type of service</li> <li>▪ Type of customer</li> </ul>
Restrictions on the use or transferability of the item	<ul style="list-style-type: none"> <li>▪ Restricted cash</li> <li>▪ Ring fenced assets</li> </ul>



### Examples of items that have sufficiently dissimilar characteristics

The application guidance in Ind AS 118 also sets out examples of income, expenses, assets, liabilities and items of equity that may have sufficiently dissimilar characteristics to warrant separate presentation in the statement of profit and loss or balance sheet, or separate disclosure in the notes.

Examples of items of income and expenses that may require separate presentation in the statement of profit and loss or disclosure in the notes include:

- (a) Write-downs of inventories, as well as reversals of such write-downs
- (b) Impairment losses for property, plant and equipment, as well as reversals of such impairment losses
- (c) Income and expenses from restructurings of an entity's activities and reversals of any provisions for restructuring
- (d) Income and expenses from disposals of property, plant and equipment
- (e) Income and expenses from disposals of investments
- (f) Income and expenses from litigation settlements
- (g) Reversals of provisions, and
- (h) Non-recurring income and expenses not included above.

Examples of assets, liabilities and items of equity that may require separate presentation in the balance sheet or a disclosure in the notes include:

- (a) Property, plant and equipment disaggregated into classes in accordance with Ind AS 16
- (b) Receivables disaggregated into amounts receivable from trade customers, amounts receivable from related parties, prepayments and other amounts
- (c) Inventories disaggregated, applying Ind AS 2, into items such as merchandise, production supplies, materials, work in progress and finished goods
- (d) Trade payables disaggregated, applying Ind AS 7, to provide separately the amounts of those payables that are part of supplier finance arrangements,
- (e) Provisions disaggregated according to their nature, such as, provisions for employee benefits, decommissioning liabilities, or other items, and
- (f) Equity capital and reserves disaggregated into various classes, such as paid-in capital, share premium and reserves.

## 6.3 Description of items

Ind AS 118 includes requirements for the description of line items presented in the primary financial statements and items disclosed in the notes. This is to ensure that the descriptions used by entities are complete. To achieve this and faithful presentation, an entity may need to include the meaning of the terms used by the entity in the descriptions and explanations and disclose information about how it has aggregated or disaggregated assets, liabilities, equity, income, expenses and cash flows. For example, if an entity described some items of income or expense as 'unusual', it would need to disclose its definition of 'unusual' items.

The standard also requires an entity to label and describe the items presented in the primary financial statements or disclosed in the notes in a way that faithfully represents the characteristics of those items. Such items are often aggregations of individual items arising from transactions or other events. These aggregated items could be made up of individual items for which the information is material, individual items for which the information is immaterial, or a mix of both:



- (a) A material item is aggregated with other material items

Such an aggregation could be provided to summarize material information. However, the entity would be required to disclose disaggregated information about each material item.

- (b) A material item is aggregated with immaterial items

In this case, an entity would only need to provide disaggregated information about the material item.

- (c) Immaterial items are aggregated with other immaterial items

An entity might provide such an aggregation of immaterial items in order to complete a list of items, or a subtotal. Since items are immaterial, no disaggregated information would be required, subject to the guidance on using the label 'other' discussed below.

### Using the label 'other'

Currently, some entities present or disclose a large amount of 'other' income or expenses without explaining what those 'other' items include; this is a matter of concern for users. To address this concern, the standard contains application guidance which is likely to help entities determine a more informative label and provide more useful information.

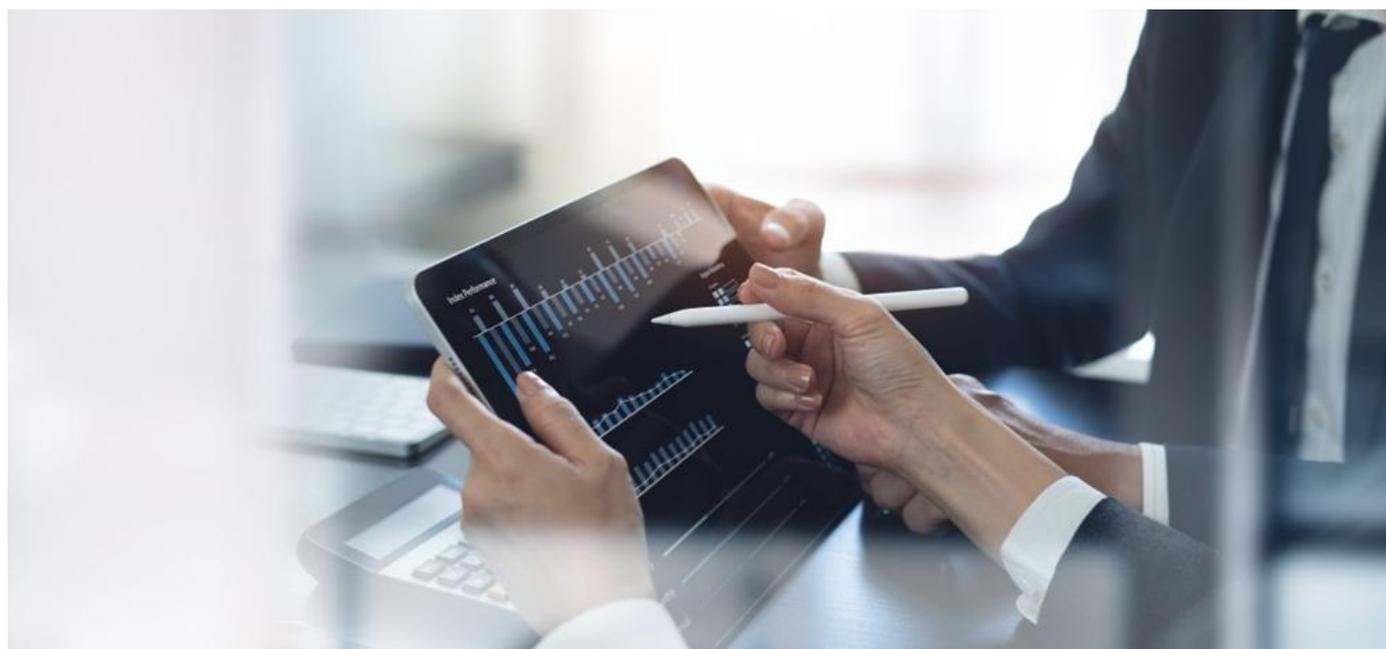
If an entity cannot find a more informative label than 'other':

- (a) For any aggregation

The entity needs to use a label which describes the aggregated item as precisely as possible (for example, 'other operating expenses' or 'other finance expenses').

- (b) For an aggregation comprising only immaterial items

An entity could aggregate immaterial items despite them having dissimilar characteristics, resulting in an aggregated item that is cumulatively large. Where that is the case, the entity needs to consider whether the aggregated amount is large enough that users may reasonably question whether it includes material items. If so, the information needed to resolve that question is itself material information. In such a situation, an entity is required to disclose further information. For example, the entity may consider including an explanation that the aggregated amount comprises several immaterial items, along with an indication of the nature and amount of the largest item.





# 07

## Consequential amendments to other standards

- 7.1 *Ind AS 7 Statement of Cash Flows*
- 7.2 *Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors*
- 7.3 *Ind AS 33 Earnings per share*
- 7.4 *Ind AS 34 Interim Financial Reporting*



Ind AS 118 introduced consequential amendments to other Ind AS. An entity is required to apply these consequential amendments when it applies Ind AS 118.

## 7.1 Ind AS 7 Statement of Cash Flows

Globally, IAS 7 is amended to remove presentation alternatives which were previously existing for cash flows related to interest and dividends paid and received. However, Ind AS 7 did not contain similar presentation alternatives. Thus, there is no removal of presentation alternatives from Ind AS 7. However, in the exposure draft issued by ICAI, the language used in Ind AS 7 is proposed to be aligned with IAS 7. It is proposed to amend Ind AS 7 to:

- Require all entities to use the operating profit subtotal as the starting point for the indirect method of reporting cash flows from operating activities.
- Require entities that do not have a specified main business activity of investing in assets or providing finance to customers to classify interest paid as financing activities, and interest and dividends received as cash flows from investing activities.
- Require entities that have a specified main business activity of investing in assets or providing finance to customers to classify cash flows from dividends received, interest paid and interest received as cash flows from operating activities.

This means that entities will determine how to classify dividends received, interest received, and interest paid in the statement of cash flows by referring to how the related dividend income, interest income and interest expenses are classified in the statement of profit and loss.

## 7.2 Ind AS 8 Accounting Policies, Changes in Accounting Estimates and Errors

The amendments, once effective, will change the scope and title of Ind AS 8, due to certain sections previously included within Ind AS 1 being moved to Ind AS 8.

The requirements moved are:

- (a) The concepts of 'true and fair view' and compliance with Ind AS
- (b) Whether an entity is a going concern
- (c) The accrual basis of accounting
- (d) Disclosure of an entity's selection and application of accounting policies
- (e) Disclosure of judgments and sources of estimation uncertainty

These relocated requirements are in addition to the guidance currently included in Ind AS 8 on accounting policies, changes in estimates and errors. The title of the amended Ind AS 8 would be changed to *Basis of Preparation of Financial Statements* to better reflect the updated content of Ind AS 8.

### How we see it

Although the consequential amendments to Ind AS 8 might seem significant in terms of volume, since these requirements are carried over from Ind AS 1 mostly unchanged, we do not expect any significant impact on current practice



## 7.3 Ind AS 33 Earnings per share

Ind AS 33 requires entities to report basic and diluted earnings per share. The amended Ind AS 33, once effective, will permit entities to disclose additional amounts per share, if the numerator used in the calculation meets specified criteria.

The amended standard permits entities to disclose additional amounts per share, if the numerator used in the calculation meets specified criteria.

Therefore, an entity can only use additional numerators that are amounts attributable to ordinary equity holders of the parent entity of:

- A total or subtotal identified in Ind AS 118, or
- A management-defined performance measure as defined by Ind AS 118.

Once amended Ind AS 33 becomes effective, an entity will not be allowed to disclose an additional earnings per share measure based on a numerator that does not comply with the above requirements. This is because Ind AS 33 has specific requirements for presenting additional earnings per share measures and indicates that only those numerators that meet the above criteria can be used for additional earnings per share measures.

The amended standard explicitly states that the additional amount per share cannot be presented in the primary financial statements and can only be disclosed in the notes.

### How we see it

Many entities currently use adjusted earnings ratios as key performance indicators in their public communications outside their financial statements. Despite the restrictions on the permitted numerators for additional per share measures, entities will be able to disclose such adjusted earnings ratios in the financial statements, if the numerator used is a subtotal that itself meets the definition of an MPM.

This includes subtotals only used as the numerator within a ratio (i.e., the subtotals are not separately used in communications as a standalone MPM), if the subtotals meet the MPM definition in their own right.

## 7.4 Ind AS 34 Interim Financial Reporting

Ind AS 118, once effective, will impact the disclosure requirements for interim financial reporting. Under Ind AS 34 (as amended), an entity will be required to make disclosures about its MPMs, as defined in Ind AS 118, in the notes to the condensed interim financial statements. The scope of these disclosures in the condensed interim financial statements is the same as that required in an entity's complete set of financial statements.

Consistent with the objective of condensed interim financial reports, an entity does not need to repeat previously reported information about MPMs, for example, information about why an entity's management considers that an MPM communicates aspects of the entity's performance.

It is worth noting that, because MPMs relate to performance for the same reporting period as the financial statements, a subtotal that relates to the annual financial statements, but not to interim financial statements, is only an MPM in the annual financial statements.

### How we see it

Generally, the disclosure requirements in Ind AS 34 are less prescriptive for condensed interim financial statements compared to complete financial statements. The fact that it was decided that the same level of prescriptiveness is required for disclosure about MPMs in condensed interim financial statements highlights that more detailed information about MPMs is also decision-useful in combination with otherwise condensed financial information.



08

---

# Transition





Ind AS 118 supersedes Ind AS 1 and is likely to be effective, together with the consequential amendments to other standards, for reporting periods beginning on or after 1 April 2027.

Ind AS 118 supersedes Ind AS 1 and is likely to be effective for reporting periods beginning on or after 1 April 2027. For entities preparing financial statements on a calendar-year basis, NFRA also recommended early adoption for annual periods beginning on or after 1 January 2027. The standard applies retrospectively. An entity is required to apply the consequential amendments to other Ind AS when it applies Ind AS 118.

In its annual financial statements, an entity must disclose, for the comparative period immediately preceding the period in which Ind AS 118 is first applied, a reconciliation for each item in the statement of profit and loss between:

- The restated amounts presented in accordance with Ind AS 118, and
- The amounts previously presented applying Ind AS 1

An entity is permitted, but not required, to provide the reconciliation for:

- The reporting period in which Ind AS 118 is first applied, and/ or
- Earlier comparative periods

However, an entity is not required to present the quantitative information specified in Ind AS 8.28(f) (i.e., the adjustment for each financial statement line item affected and the related effect on basic and diluted earnings per share, for the current period and each prior period presented).

### How we see it

While there might appear to be ample time before the effective date of Ind AS 118, entities are strongly encouraged to determine the impact of the new requirements on their particular business. Many entities will need to identify and collect information, which in some cases, could necessitate changes to their internal information systems and their financial statement close process.

Management needs to plan ahead as the transition process could require considerable time and involve the combination of resources from financial reporting, legal and investor relations, among others.

In addition, there could be impacts on remuneration agreements and covenants. Entities are advised to monitor practice as it develops, with a focus on the specific developments in their particular industry.

## 8.1 Interim financial reporting

If an entity prepares condensed interim financial statements in accordance with Ind AS 34, in the first year of applying Ind AS 118, it presents each heading it expects to use and the subtotals required in Ind AS 118 in its condensed interim financial statements.

As part of the information required by Ind AS 34.16A(a) (i.e., where accounting policies have changed since the last annual period, a description of the nature and effect of these changes), an entity that applies Ind AS 34 to prepare interim financial statements, in the first year of applying Ind AS 118, discloses a reconciliation, for each line item presented in the statement of profit and loss for the comparative periods immediately preceding the current periods, between:

- a) The restated amounts applying Ind AS 118 to the comparative period and the cumulative comparative period, and
- b) The amounts previously presented applying Ind AS 1 to the comparative period and cumulative comparative period



An entity can voluntarily provide additional reconciliations between the Ind AS 1 and Ind AS 118 presentation for:

- The current interim period (and the cumulative current interim period), and/or
- An earlier interim period in addition to those immediately preceding the current period as required above.

The SEBI LODR requires listed entities to publish quarterly financial statements. It requires format of statement of profit and loss and balance sheet should be as per Schedule III to the Companies Act, 2013. Further, recognition and measurement principles of Ind AS 34 need to be followed. It is expected that Schedule III will undergo a change pursuant to Ind AS 118 application. It is also expected that the SEBI may change format of quarterly financial results to comply with Ind AS 118 disclosure requirements. Accordingly, it is expected that in the first year of transition to Ind AS 118, listed entities will need to align their quarterly results and comparative information for comparative periods with the presentation prescribed under Ind AS 118.

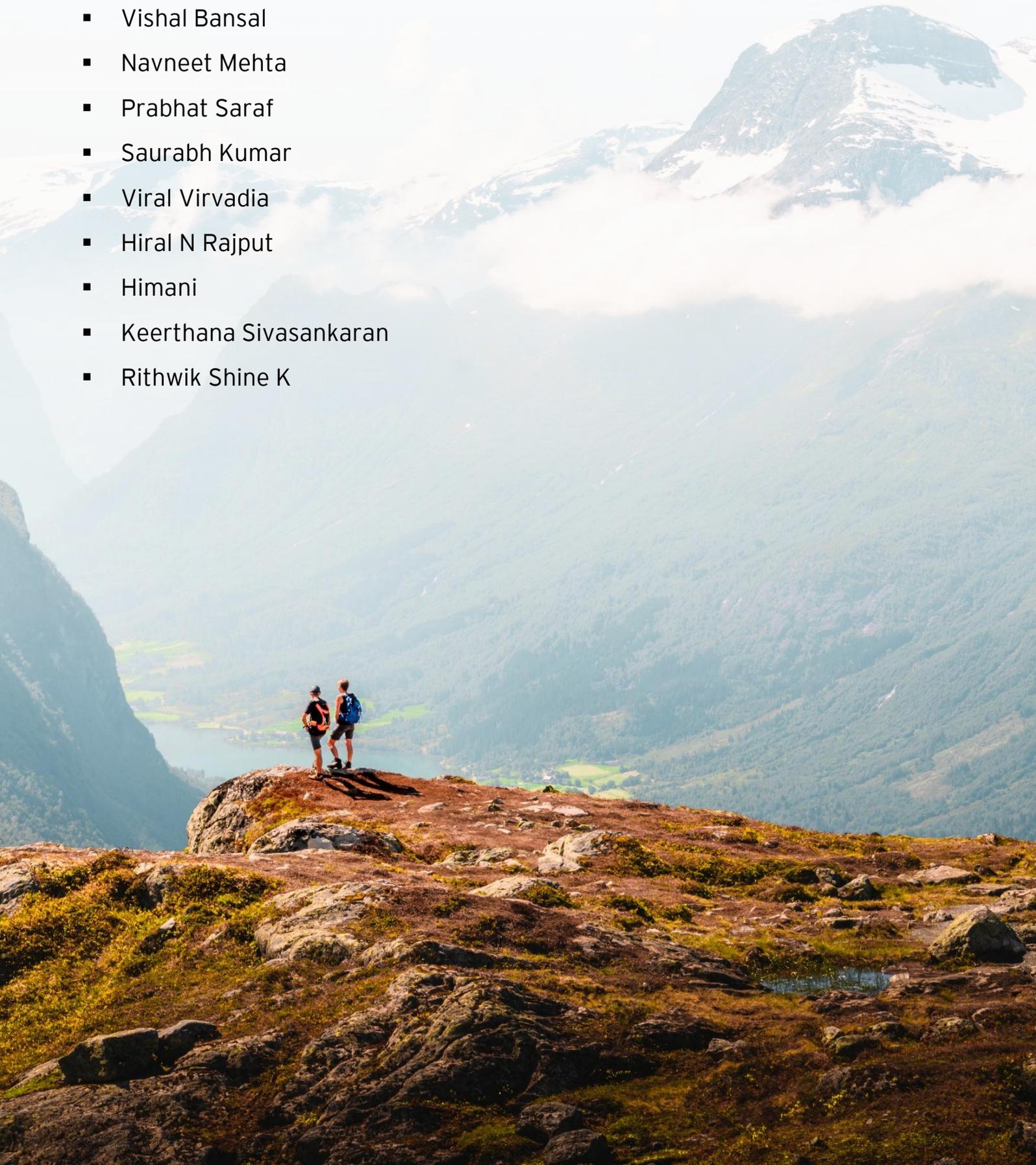
## Concluding remarks

Ind AS 118 represents a fundamental evolution in financial statement presentation rather than a mere re-labelling exercise. The standard is expected to significantly enhance comparability, transparency and discipline in the presentation of financial performance. Its implementation will require entities to look beyond statutory formats and reassess how performance is defined, measured and communicated. The standard is also likely to drive changes in transaction systems, reporting processes and internal controls to ensure consistent classification and robust disclosures. For listed entities and IPO-bound companies in particular, early preparedness will be critical to manage regulatory expectations and investor scrutiny.



# Acknowledgement

- Dr. Devesh Prakash
- Vishal Bansal
- Navneet Mehta
- Prabhat Saraf
- Saurabh Kumar
- Viral Virvadia
- Hiral N Rajput
- Himani
- Keerthana Sivasankaran
- Rithwik Shine K





# Our Offices

## Ahmedabad

22nd Floor, B Wing, Privilon  
Ambli BRT Road, Behind Iskcon Temple  
Off SG Highway, Ahmedabad - 380 059  
Tel: + 91 79 6608 3800

## Gandhinagar

8th Floor, Building No. 14A  
Block 14, Zone 1  
Brigade International Financial Centre  
GIFT City SEZ  
Gandhinagar - 382 355, Gujarat  
Tel: + 91 79 6608 3800

## Bengaluru

12th & 13th Floor  
"UB City", Canberra Block  
No.24 Vittal Mallya Road  
Bengaluru - 560 001  
Tel: + 91 80 6727 5000

Ground & 1st Floor  
# 11, 'A' wing  
Divyasree Chambers  
Langford Town  
Bengaluru - 560 025  
Tel: + 91 80 6727 5000

3rd & 4th Floor  
MARKSQUARE  
#61, St. Mark's Road  
Shantala Nagar  
Bengaluru - 560 001  
Tel: + 91 80 6727 5000

1st & 8th Floor, Tower A  
Prestige Shantiniketan  
Mahadevapura Post  
Whitefield, Bengaluru - 560 048  
Tel: + 91 80 6727 5000

Ecospace  
1st Floor, Campus 1C  
Ecospace Business Park  
Outer Ring Road,  
Bellandur - Sarjapura Area, Varthur Hobli,  
Bengaluru Urban - 560103

## Bhubaneswar

8th Floor, O-Hub, Tower A  
Chandaka SEZ, Bhubaneswar  
Odisha - 751024  
Tel: + 91 674 274 4490

## Chandigarh

Elante offices, Unit No. B-613 & 614  
6th Floor, Plot No- 178-178A  
Industrial & Business Park, Phase-I  
Chandigarh - 160 002  
Tel: + 91 172 6717800

## Chennai

6th & 7th Floor, A Block,  
Tidel Park, No.4, Rajiv Gandhi Salai  
Taramani, Chennai - 600 113  
Tel: + 91 44 6654 8100

## Delhi NCR

Aikyam  
Ground Floor  
67, Institutional Area  
Sector 44, Gurugram - 122 003  
Haryana  
Tel: + 91 124 443 4000

3rd & 6th Floor, Worldmark-1  
IGI Airport Hospitality District  
Aerocity, New Delhi - 110 037  
Tel: + 91 11 4731 8000

4th & 5th Floor, Plot No 2B  
Tower 2, Sector 126  
Gautam Budh Nagar, U.P.  
Noida - 201 304  
Tel: + 91 120 671 7000

## Hyderabad

THE SKYVIEW 10  
18th Floor, "SOUTH LOBBY"  
Survey No 83/1, Raidurgam  
Hyderabad - 500 032  
Tel: + 91 40 6736 2000

THE SKYVIEW 20  
2nd Floor, 201 & 202  
Right Wing, Survey No 83/1  
Raidurgam, Hyderabad - 500 032  
Tel: + 91 40 6736 2000

## Jaipur

9th floor, Jewel of India  
Horizon Tower, JLN Marg  
Opp Jaipur Stock Exchange  
Jaipur, Rajasthan - 302018

## Kochi

9th Floor, ABAD Nucleus  
NH-49, Maradu PO  
Kochi - 682 304  
Tel: + 91 484 433 4000

## Kolkata

22 Camac Street  
3rd Floor, Block 'C'  
Kolkata - 700 016  
Tel: + 91 33 6615 3400

6th floor, Sector V,  
Building Omega, Bengal Intelligent  
Park, Salt Lake Electronics  
Complex, Bidhan Nagar  
Kolkata - 700 091  
Tel: + 91 33 6615 3400

## Mumbai

14th Floor, The Ruby  
29 Senapati Bapat Marg  
Dadar (W), Mumbai - 400 028  
Tel: + 91 22 6192 0000

5th Floor, Block B-2  
Nirlon Knowledge Park  
Off. Western Express Highway  
Goregaon (E)  
Mumbai - 400 063  
Tel: + 91 22 6192 0000

3rd Floor, Unit No.301  
Building No.1, Mindspace-Gigaplex  
IT Park, MIDC, Plot No. IT-5  
Airoli Knowledge Park  
Airoli West, Navi Mumbai - 400 708  
Tel: + 91 22 6192 0003

18th Floor, Altimus  
Pandurang Budhkar Marg  
Worli, Mumbai - 400 018  
Tel: + 91 22 6192 0503

## Pune

C-401, 4th Floor  
Panchshil Tech Park, Yerwada  
(Near Don Bosco School)  
Pune - 411 006  
Tel: + 91 20 4912 6000

10th Floor, Smartworks  
M-Agile, Pan Card Club Road  
Baner, Pune - 411 045  
Tel: + 91 20 4912 6800



## Ernst & Young Associates LLP

### **EY | Building a better working world**

EY is building a better working world by creating new value for clients, people, society and the planet, while building trust in capital markets.

Enabled by data, AI and advanced technology, EY teams help clients shape the future with confidence and develop answers for the most pressing issues of today and tomorrow.

EY teams work across a full spectrum of services in assurance, consulting, tax, strategy and transactions. Fueled by sector insights, a globally connected, multi-disciplinary network and diverse ecosystem partners, EY teams can provide services in more than 150 countries and territories.

### **All in to shape the future with confidence.**

EY refers to the global organization, and may refer to one or more, of the member firms of Ernst & Young Global Limited, each of which is a separate legal entity. Ernst & Young Global Limited, a UK company limited by guarantee, does not provide services to clients. Information about how EY collects and uses personal data and a description of the rights individuals have under data protection legislation are available via [ey.com/privacy](https://ey.com/privacy). EYG member firms do not practice law where prohibited by local laws. For more information about our organization, please visit [ey.com](https://ey.com).

Ernst & Young Associates LLP is one of the Indian client serving member firms of EYGM Limited. For more information about our organization, please visit [www.ey.com/en\\_in](https://www.ey.com/en_in).

Ernst & Young Associates LLP is a Limited Liability Partnership, registered under the Limited Liability Partnership Act, 2008 in India, having its registered office at 6th Floor, Worldmark-1, Asset Area 11, Hospitality District, Indira Gandhi International Airport, New Delhi-110037, India.

© 2026 Ernst & Young Associates LLP. Published in India.  
All Rights Reserved.

EYIN2603-026  
ED none

This publication contains information in summary form and is therefore intended for general guidance only. It is not intended to be a substitute for detailed research or the exercise of professional judgment. Neither EYGM Limited nor any other member of the global Ernst & Young organization can accept any responsibility for loss occasioned to any person acting or refraining from action as a result of any material in this publication. On any specific matter, reference should be made to the appropriate advisor.

[ey.com/en\\_in](https://ey.com/en_in)

