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Crowe Chat

Vol.4 /2021

Accounting and Audit

How Will Financial Statements Look Like In the Future?

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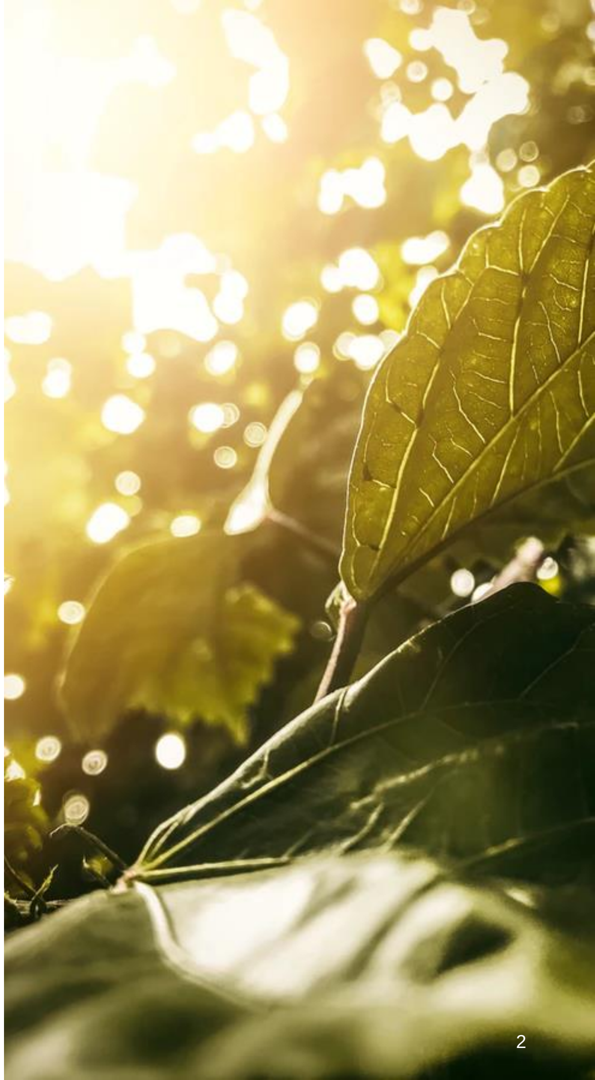


How Will Financial Statements Look Like In the Future?

Introduction

In response to concerns from financial statement users about the comparability and transparency of companies' performance reporting, the International Accounting Standards Board (IASB or the Board) published the Exposure Draft "General Presentation and Disclosures" in December 2019. The Exposure Draft, if finalised, would replace the existing IAS 1 "Presentation of Financial Statements". IAS 1 presently guides the types of general disclosures needed in a set of financial statements.

The said Exposure Draft carries forward many of the requirements of IAS 1 and sets out some new and revised presentation and disclosure requirements in the financial statements with a focus on the statement of profit or loss.

This article provides an overview of the key changes about the general presentation and disclosures (including consequential amendments to other IFRS Standards) in future financial statements.

How Will Financial Statements Look Like In the Future?

1. Key changes in the statement of profit or loss

The proposed changes are as follows:-

1.1 To Present 3 Defined Subtotals

An entity would have to provide the following mandatory subtotals:-

i. Operating profit (or loss)

ii. Operating profit (or loss) and income from integral associates and joint ventures

iii. Profit (or loss) before financing and income tax

Please see the example on the right as an illustration:-

	Revenue	347,000
	Operating expenses *(to present by function or by nature)*	(305,730)
i	Operating profit	41,270
	Share of profit or loss of integral associates and joint ventures	(600)
ii	Operating profit and income and expenses from integral associates and joint ventures	40,670
	Share of profit or loss of non-integral associates and joint ventures	3,380
	Dividend income	3,550
iii	Profit before financing and income tax	47,600
	Interest income from cash and cash equivalents	500
	Expenses from financing activities	(3,800)
	Unwinding of discount on pension liabilities and provisions	(3,000)
	Profit before taxation	**41,300**
	Income tax	(7,200)
	Profit for the financial year	**34,100**

Source: Exposure Draft "General Presentation and Disclosures" and the related IASB Snapshot

At present, the 'operating profit' subtotal is not defined by IFRS Standards.

With these additional subtotals, a consistent structure is created for the statement of profit or loss, which thereby improves comparability among companies.

How Will Financial Statements Look Like In the Future?

1. Key changes in the statement of profit or loss (cont'd)

1.2 To Categorise Income and Expenses into 4 Defined Categories

An entity would have to classify its income and expenses under the following categories and present the above 3 subtotals mentioned in item 1.1 between the categories:-

i. Operating

ii. Investing

iii. Financing

iv. Integral associates and joint ventures

Please see the example on the right as an illustration:-

	Revenue	347,000	Operating
	Operating expenses *(to present by function or by nature)*	(305,730)	Operating
i	Operating profit	41,270	
	Share of profit or loss of integral associates and joint ventures	(600)	Integral associates and joint ventures
ii	Operating profit and income and expenses from integral associates and joint ventures	40,670	
	Share of profit or loss of non-integral associates and joint ventures	3,380	Investing
	Dividend income	3,550	Investing
iii	Profit before financing and income tax	47,600	
	Interest income from cash and cash equivalents	500	Financing
	Expenses from financing activities	(3,800)	Financing
	Unwinding of discount on pension liabilities and provisions	(3,000)	Financing
	Profit before taxation	**41,300**	
	Income tax	(7,200)	
	Profit for the financial year	**34,100**	

Source: Exposure Draft "General Presentation and Disclosures" and the related IASB Snapshot

How Will Financial Statements Look Like In the Future?

1. Key changes in the statement of profit or loss (cont'd)

1.2 To Categorise Income and Expenses into 4 Defined Categories (cont'd)

Operating category	Income and expenses from the company's main business activities that are not classified in the other categories. In short, operating profit (or loss) is defined as a residual.
Investing category	Income and expenses from investments that are generated individually and largely independently of other resources held by the company.
Financing category	Income and expenses from assets and liabilities related to the company's financing decisions.
Integral associates and joint ventures	This category would include the share of profit or loss and related income and expenses from those associates and joint ventures whose activities are closely related to the company's main business activities. On the other hand, income and expenses from non-integral associates and joint ventures would be classified in the investing category.

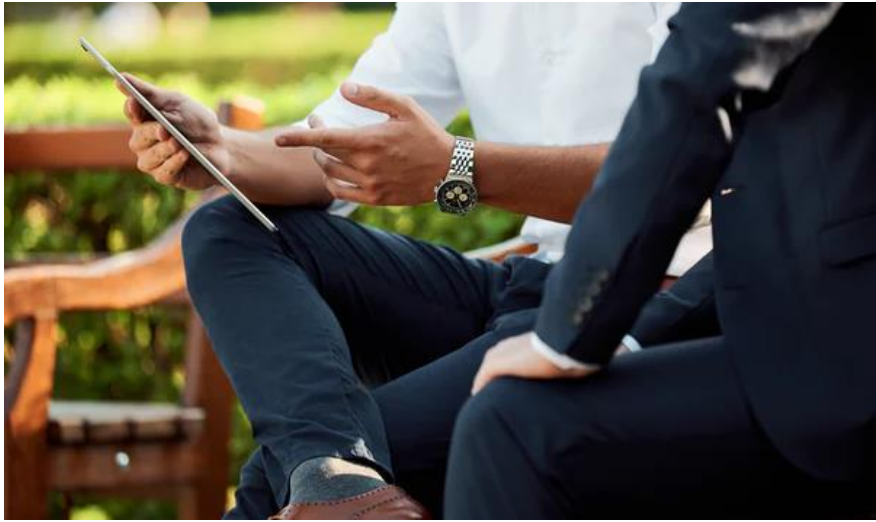
How Will Financial Statements Look Like In the Future?

1. Key changes in the statement of profit or loss (cont'd)

1.2 To Categorise Income and Expenses into 4 Defined Categories (cont'd)

Depending on the company's main business activities, some types of income or expenses would be categorised differently for different companies.

Although the categories (operating, investing and financing) have the same labels as those in the statement of cash flows, their definitions are not the same. As a result, the accounting requirements under both statements are also different. For example, cash flows from property, plant and equipment are included in the investing category in the statement of cash flows, but income and expenses from those assets would generally be included in the operating category in the statement of profit or loss.



How Will Financial Statements Look Like In the Future?

1. Key changes in the statement of profit or loss (cont'd)

1.3 To Analyse Operating Expenses by Nature or by Function

Currently, companies have an accounting choice to present their operating expenses either 'by nature' or 'by function'. Please see the example below as an illustration:-

Existing IAS 1 – Presentation by nature		Existing IAS 1 – Presentation by function	
Revenue	10,000	Revenue	10,000
Other income	500	Cost of sales	(6,500)
Changes in inventories of finished goods and work-in-progress	(3,700)	Gross profit	3,500
Raw materials and consumables used	(2,250)	Other income	500
Employee benefits expense	(850)	Distribution costs	(1,200)
Depreciation and amortisation expense	(1,150)	Administrative expenses	(800)
Other expense	(550)	**Profit before taxation**	**2,000**
Total expenses	(8,500)		
Profit before taxation	**2,000**		

In the future, an entity would have to select a method – by nature or by function – to present its operating expenses that provides the most useful information.

In short, the selection of the method is not a free choice. A list of indicators would be provided to help companies in assessing the method that provides the most useful information.

How Will Financial Statements Look Like In the Future?

2. Key changes in the statement of financial position
(previously known as balance sheet)

An entity would have to separately present (i) goodwill from intangible assets and (ii) integral and non-integral associates and joint ventures.

Non-integral associates and joint ventures are those where their activities have little or no effect on the company's main business activities and the share of their results under the equity method would be presented in the investing category in the statement of profit or loss. In short, these types of investments are able to generate a return individually and largely independently of the other assets of the company.

Please see the example below as an illustration:-

Existing IAS 1		Proposed presentation	
Non-Current Assets		**Non-Current Assets**	
Property, plant and equipment	3,000	Property, plant and equipment	3,000
Investments in associates	1,000	Investments in integral associates and joint ventures	1,200
Investments in joint venture	800	Investments in non-integral associates and joint ventures	600
Intangible assets	500	Intangible assets	400
		Goodwill	100

How Will Financial Statements Look Like In the Future?

3. Key changes in the statement of cash flows

An entity would no longer have a choice as to where to present cash flows from dividends and interest. Dividends and interest paid would be presented as cash flows from financing activities, while dividends and interest received would be presented as cash flows from investing activities.

Cash flow item	< --------------- Existing IAS 7 --------------- >			Proposed presentation
	Operating	Investing	Financing	
Interest paid	√		√	Depends on the classification of these income and expenses in the statement of profit or loss per the Exposure Draft
Interest received	√	√		
Dividends received	√	√		
Dividend paid	√		√	Financing only

How Will Financial Statements Look Like In the Future?

4. Disclosure of unusual income and expenses

In 2002, the IASB concluded that unusual items (commonly known as extraordinary items) do not warrant separate presentation and prohibited the presentation of extraordinary items on the face of a company's income statement.

At present, these unusual items are also not separately presented on the face of the statement of profit or loss. Instead, the unusual items are presented within the normal income and expenses in the statement of profit or loss according to their nature, function or other characteristics.

The Board acknowledges that information about income and expenses that are not expected to recur in the near future are useful to investors in predicting a company's future cash flows. However, the way companies provide this information varies significantly and it is often unclear how or why items have been identified as unusual.

How Will Financial Statements Look Like In the Future?

4. Disclosure of unusual income and expenses (cont'd)

Therefore, the Board proposes to introduce a definition of 'unusual income and expenses' and requires companies to disclose and explain any unusual income and expenses in a single note to the financial statements. Unusual income and expenses are defined as items that are not expected to recur in the near future. In other words, the definition is forward-looking rather than based on past occurrence.

This is an illustration of the disclosures in future:-

15. Unusual Income and Expenses

On 13 July 20X5, a fire occurred at the Group's main factory in Klang, Selangor Darul Ehsan. Consequently, certain property, plant and equipment and inventories of the Group have been written off during the current financial year.

The insurer has offered and the Group has accepted an insurance compensation as full and final settlement to the Group. The settlement could be deployed for recovery of the production facilities affected by the fire incident and the Group will still retain its rights to any recovery from insurance proceeds for business interruption arising from the fire incident.

	20X5 '000	**20X4** '000
Insurance claims (recognised in "Other Operating Income")	159,354	-
Inventories written off (recognised in "Cost of Sales")	6,908	-
Property, plant and equipment written off (recognised in "Other Expenses")	41,133	-

The above income and expenses are unusual in nature because the Group does not reasonably expect that income or expenses similar in type and amount will arise in any of several future annual reporting periods.

How Will Financial Statements Look Like In the Future?

5. Introduction of Management Performance Measures (MPM)

Many companies provide performance measures defined by management (such as adjusted operating profit and adjusted EBITDA) in their public communications with investors, especially in the annual reports and press releases. However, it is always not clear on how these measures are calculated and how to reconcile to the subtotals presented in the financial statements.

The Board proposes to define MPM and requires companies to disclose such measures and all related information (including a reconciliation between each measure and the related (sub)total presented in the financial statements) in a single note to the financial statements.
MPM are defined as subtotals of income and expenses that:-

i. are used in public communications outside financial statements;
ii. complement totals or subtotals specified by IFRS Standards; and
iii. communicate to users of financial statements management's view of an aspect of a company's financial performance.

Example of a reconciliation

Adjusted operating profit	52,870
– Restructuring in Country X	(5,400)
– Revenue adjustment	(6,200)
Operating profit per consolidated statement of profit or loss	**41,270**

Source: The IASB Snapshot "General Presentation and Disclosures"

Please note that the MPM are entity-specific and are not necessarily comparable with other entities.

Also, the subtotals specified by IFRS Standards are not MPM, such as the 3 new subtotals mentioned in item 1.1 above, 'profit before tax' and 'profit from continuing operations'.

How Will Financial Statements Look Like In the Future?

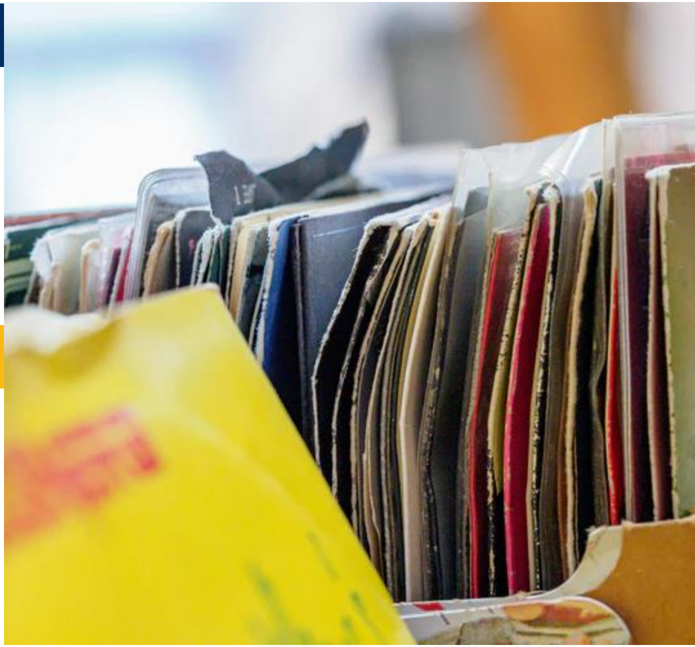
Effective Date

The Exposure Draft does not contain any proposed effective date as the Board will only decide on the effective date upon completion of its re-deliberation. However, the Board has proposed to set the effective date so that the new standard will become effective about 18 to 24 months after it is being issued.

Current developments

The comment period for the Exposure Draft ended on 30 September 2020 and the Board had received more than 200 comment letters.

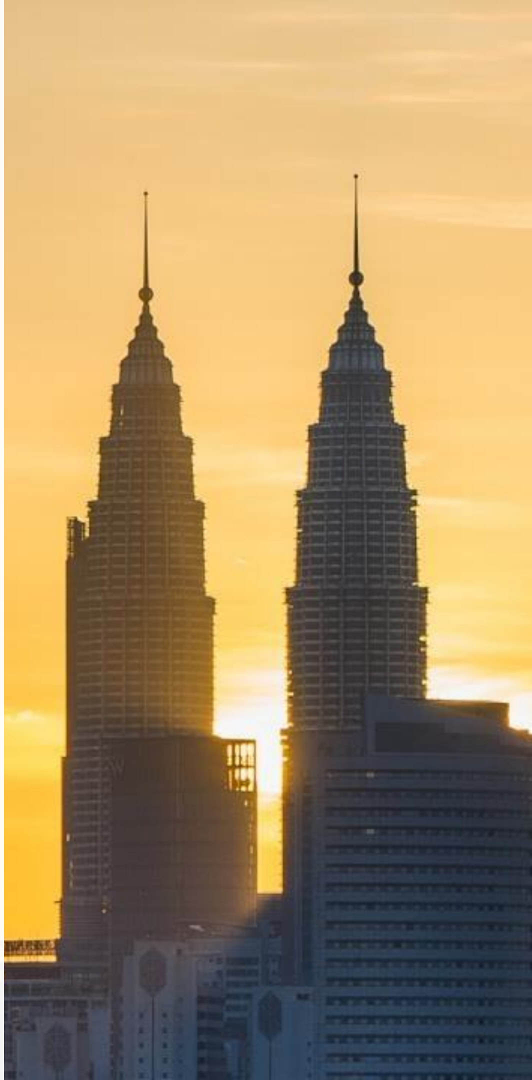
The Board has begun to re-deliberate proposals in the Exposure Draft in March 2021. At this juncture, the discussions are still ongoing and the Board will consider feedback received in developing its final requirements. You are therefore need to continue monitoring the developments at the IASB to see if any subsequent changes to the Exposure Draft are being made.



Start the conversation with us

James Chan
Partner, Audit
james.chan@crowe.my

Lee Kok Wai
Partner, Audit
kokwai.lee@crowe.my



Crowe

Our Offices (West Malaysia)

Kuala Lumpur
Level 16, Tower C,
Megan Avenue 2,
12 Jalan Yap Kwan Seng,
50450 Kuala Lumpur,
Malaysia

+603 2788 9999 Main
+603 2788 9899 Fax

Contact: Poon Yew Hoe
Email: yewhoe.poon@crowe.my

Penang
Level 6, Wisma Penang Garden,
42 Jalan Sultan Ahmad Shah,
10050 Penang, Malaysia

+604 227 7061 Main
+604 227 8011 Fax

Contact: Eddy Chan
Email: eddywaihun.chan@crowe.my

Melaka
52 Jalan Kota Laksamana 2/15,
Taman Kota Laksamana, Seksyen 2,
75200 Melaka, Malaysia

+606 282 5995 Main
+606 283 6449 Fax

Contact: Patrick Wong
Email: patrick.wong@crowe.my

Ipoh
A-2-16, 2nd Floor, Wisma MFCB
1, Persiaran Greentown 2
Greentown Business Centre
30450 Ipoh
Perak Darul Ridzuan
Malaysia

+605 238 0411 Main

Contact: Choong Kok Keong
Email: kokkeong.choong@crowe.my

Klang
Suite 50-3, Setia Avenue,
No. 2, Jalan Setia Prima SU13/S,
Setia Alam, Seksyen U13,
40170 Shah Alam,
Selangor, Malaysia

+603 3343 0730 Main
+603 3344 3036 Fax

Contact: Michael Ong
Email: michael.ong@crowe.my

Johor Bahru
E-2-3 Pusat Komersial Bayu Tasek,
Persiaran Southkey 1,
Kota Southkey, 80150 Johor Bahru,
Johor, Malaysia

+607 288 6627 Main
+607 338 4627 Fax

Contact: Patrick Wong
Email: patrick.wong@crowe.my

Muar
8, Jalan Pesta 1/1,
Taman Tun Dr. Ismail 1,
Jalan Bakri, 84000 Muar,
Johor, Malaysia

+606 952 4328 Main
+606 952 7328 Fax

Contact: Ng Kim Kiat
Email: kimkiat.ng@crowe.my

Our Offices (East Malaysia)

Kuching- iCom Square
2nd Floor, C378, Block C,
iCom Square,
Jalan Pending,
93450 Kuching, Sarawak, Malaysia

+6082 552 688 Main
+6082 266 987 Fax

Contact: Kenny Chong
Email: kenny.chong@crowe.my

Miri
Lot 2395, Block 4,
Bulatan Business Park,
Jalan Bulatan Park,
98000 Miri, Sarawak, Malaysia

+6085 658 835 Main
+6085 655 001 Fax

Contact: Matthew Wong
Email: matthew.wong@crowe.my

Sibu
1st & 2nd Floor, No. 1 Lorong
Pahlawan 7A2, Jalan Pahlawan,
96000 Sibu, Sarawak, Malaysia

+6084 211 777 Main
+6084 216 622 Fax

Contact: Morris Hii
Email: morris.hii@crowe.my

Labuan
Lot 36, Block D, Lazenda Centre,
Jalan OKK Abdullah, P.O. Box
81599, 87025, Labuan, Malaysia

+6087 417 128 Main
+6087 417 129 Fax

Contact: Christabel Chieng
Email: christabel.chieng@crowe.my

Kuching- Brighton Square
2nd Floor, Lots 11994 - 11996,
Brighton Square,
Jalan Song,
93350 Kuching, Sarawak, Malaysia

+6082 285 566 Main
+6082 285 533 Fax

Contact: Eddie Wee
Email: eddie.wee@crowe.my

Bintulu
1st floor, Lot 4542-4543,
Jalan Abang Galau Shophouse,
Kampung Masjid, 97000
Bintulu, Sarawak, Malaysia

+6086 333 328 Main
+6086 334 802 Fax

Contact: Lau Hin Siang
Email: hinsiang.lau@crowe.my

Sabah
Damai Plaza 3, 3rd Floor, C11,
Jalan Damai 88300, P.O. Box
11003,
88811 Kota Kinabalu, Sabah,
Malaysia

+6088 233 733 Main
+6088 238 955 Fax

Contact: Michael Tong
Email: michael.tong@crowe.my

Tawau
No.194, 2nd Floor, Block B,
Wisma DS, Jalan Bakau
91000 Tawau
Sabah, Malaysia

+6089 771 040 Main

Contact: Chong Ken Vun
Email: kenvun.chong@crowe.my

Contact us

Crowe Malaysia PLT
Level 16, Tower C
Megan Avenue 2
12, Jalan Yap Kwan Seng
50450 Kuala Lumpur
Malaysia

Tel. +603 2788 9999

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