Grant Thornton

Get ready for MFRS 18

The new financial statements presentation and disclosure standard

Management-defined performance measures

Given the prevalence and usefulness of alternative performance measures (APMs), MFRS 18 introduces new disclosure requirements in relation to the use of a narrowly defined set of APMs, referred to as 'management-defined performance measures' (MPMs).

While the use of APMs is subject to regulation in most jurisdictions, MFRS 18's objective is to increase transparency and discipline, by making MPMs subject to the same disclosure requirements regardless of the entity's jurisdiction. To meet this objective MFRS 18 requires entities to pull into a single financial statement note, all disclosures concerning measures identified by management as 'management-defined performance measures'. For these newly defined MPMs, MFRS 18 requires the disclosure of the income tax effect, as well as the effect on non-controlling interests, for each item disclosed in the reconciliation of MPMs to Malaysian Financial Reporting Standards subtotals or totals. This represents a new requirement, even for most jurisdictions with existing regulations on APMs.

The process of applying MFRS 18, from first identifying MPMs, to subsequently complying with MFRS 18's detailed disclosure requirements, should not be underestimated. Considerable judgement will be required in applying MFRS 18's new MPM disclosure requirements and it may necessitate significant changes to existing systems and processes, and/or new systems and processes.

Early investor communication will be key, given some of MFRS 18's disclosure requirements will be new, even for those entities in jurisdictions that are currently subject to regulation regarding APMs.

Practical insight

MPMs will be subject to audit. Given MFRS 18 requires MPMs to be disclosed in the financial statements, the MPM disclosures will be subject to the financial statement audit requirements in accordance with ISA 200 'Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing', as opposed to simply falling within the scope of ISA 720 'The Auditor's Responsibilities Relating to Other Information'. The audit requirement means that the MPM disclosures will be subject to a higher level of scrutiny, with more onus being placed on management to ensure that MPMs are labelled and described in a clear and understandable manner that does not mislead the users of the financial statements.

Challenges with the definition of MPMs

An MPM is defined by MFRS 18 as:

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 MFRS 18, or specifically required to be presented or disclosed by Malaysian Financial Reporting Standards

Although this definition may seem narrow, there is a significant amount of application guidance which needs to be considered to determine whether an APM meets the definition of an MPM and therefore whether disclosures are required. There are a number of areas that can confuse entities when making these assessments.

What comprises a subtotal?

A subtotal must include items of both income and expense. Therefore a 'total income' subtotal comprising the sum of operating, investing and financing income, but none of the expenses, is not considered a valid subtotal for an MPM. A financial ratio is also not considered an MPM, however if a total used as a numerator or denominator for a ratio would meet the definition if it were not part of a ratio, this can be considered an MPM, provided the rest of the definition is met.

What constitutes ‘public communications’?

Public communications are more broadly defined and can include things like management commentary, press releases and investor presentations. If it is communicating financial information to the public outside of financial statements, it may be considered a public communication. Although the definition can be broad, oral communications (including written transcripts of oral communications) and social media posts are specifically excluded. Entities only need to consider public communications related to the reporting period when identifying MPMs, therefore the list of MPMs reported on each reporting period may change. There are specific requirements when reported MPMs change, which are detailed in the what could go wrong section below.

Practical insight

There is an exception to the rule that an entity should only consider the current reporting period when identifying public communications. When an entity routinely issues public communications after the date of issue of its financial statements as part of its financial reporting process, then they must also consider public communications related to the previous reporting period when identifying MPMs.

An aspect of performance of the entity as a whole

MPMs cannot just reflect the performance of part of an entity. For example, a subtotal relating to one geographic location of a worldwide business is unlikely to represent the whole entity, so would not be considered an MPM. Determining whether a measure relates to an aspect of the financial performance of the entity as a whole may require significant judgement. For example, in some cases, a subtotal related to a reportable segment as defined by MFRS 8 ‘Operating Segments’ will not be an MPM. However, if the reportable segment contains a single main business activity of the entity, and a subtotal of income and expenses from that segment is presented in the statement of profit or loss, that could suggest that it does provide information about an aspect of performance of the entity as a whole, and therefore is an MPM. Entities will need to carefully consider each performance measure that they are reporting to assess whether it will meet this aspect of the definition of an MPM.

Specifically excluded subtotals

MFRS 18 lists specific subtotals that are not considered MPMs. This includes profit or loss before income taxes, operating profit or loss before depreciation, amortisation and impairments within the scope of MFRS 136 ‘Impairment of Assets’, profit or loss from continuing operations and gross profit or loss or similar subtotals (for the full list please refer to the Standard). In relation to gross profit or similar, MFRS 18 specifies that a subtotal which consists only of one type of revenue and directly related expenses, such as gross profit or net interest income, are not considered MPMs.

Practical insight

Identifying subtotals that may meet the definition of an MPM may be complex and differences can be subtle. For example, if an entity were to define a measure of earnings before interest, taxes, depreciation and amortisation (EBITDA) as operating profit or loss before depreciation, amortisation and impairments, as noted in MFRS 18, this would not be an MPM. However if the earnings measure used as the starting point of that subtotal also included items of income and expenses that were classified in the investing category, then it could meet the definition of an MPM. Management need to carefully assess each subtotal that is being considered to determine if it meets the definition.

Any APM that meets the definition is considered an MPM, whether or not it is presented in the profit or loss

An entity needs to consider all communications and subtotals presented to identify MPMs.

If entities do not fully consider the application guidance and correctly identify MPMs, there are multiple issues that can arise. An entity may miss MPMs that need to be reported, causing a completeness issue with their disclosures. They may needlessly prepare disclosures for APMs that do not meet the definition of MPMs, creating more workload for annual reporting. They may also inadvertently create MPMs by communicating with the market without the appropriate governance measures in place.

MPMs are therefore a key area that will need to be given detailed consideration when planning for initial application of the Standard.

MFRS 18's rebuttable presumption on MPMs

When assessing whether a communicated subtotal meets the definition of an MPM, MFRS 18 presumes that a subtotal of income and expenses used in public communications outside its financial statements communicates management's view of an aspect of the financial performance of the entity as a whole. If management want to rebut this presumption they are required to have 'reasonable and supportable information' to demonstrate the basis for the rebuttal.

This rebuttal requires management to have some reasonable and supportable information, but does not require them to consider **all** available reasonable and supportable information. Therefore this may prove useful for management and provide some relief from making additional disclosures.

MFRS 18 includes extensive application guidance for the use of this rebuttable presumption. Management must be able to demonstrate that a subtotal does not communicate management's view of an aspect of the financial performance of the entity as a whole, and that the entity has another reason for using this subtotal in its public communications other than communicating management's view.

For example, if a subtotal is only included in a public communication due to a requirement of law or regulation or at the request of another external party, management do not use the measure internally to assess or monitor performance, and the subtotal is included without prominence, there may be reasonable and supportable information that would allow management to rebut the presumption, and the particular measure would not be identified as an MPM. For example, this may be the case if few references are made to the subtotal, the subtotal is not used to support management analysis of financial performance, and management commentary explains that the subtotal does not communicate management's view and is only included in response to the requirement of law or regulation or at the request of certain users.

Significant judgement may be required when applying this rebuttal, and conclusions may change over time. As we have previously discussed, monitoring and reporting on MPMs will be an ongoing exercise, and entities applying the rebuttal will have to reassess this at each reporting date to ensure there is compliance with MFRS 18's requirements.

Challenges with the disclosure of MPMs

MFRS 18 requires that reporting entities bring together all of their MPMs, and provide disclosures in a single note to the financial statements. For each MPM that an entity has identified, they are required to disclose:

1. A description of the aspect of financial performance that the MPM communicates, along with an explanation of why management believe that the MPM provides useful information about the entity's financial performance
2. How the MPM is calculated
3. A reconciliation between the MPM and the most directly comparable subtotal required by MFRS 18, a subtotal listed in the Standard, or another total or subtotal specifically required by another alaysian Financial Reporting Standards.
4. The income tax effect (along with a description of how this is determined) and the effect on non-controlling interest of each reconciling item identified above.
5. If the MPM is reconciled to a total or subtotal that is not presented in the statement(s) of financial performance, that total or subtotal must in turn be reconciled to the most directly comparable total or subtotal in the statement(s) of financial performance (note disclosure of the income tax and non-controlling interest (NCI) impact of reconciling items in this 'secondary' reconciliation is not required).

These disclosure requirements are demonstrated by the illustrative example provided by the MASB below.

Example MPM disclosures (as included in MASB Illustrative Examples – Part 1, Note 2)

XYZ Group's management-defined performance measures

XYZ Group uses the management-defined performance measures adjusted operating profit and adjusted profit from continuing operations in its public communications. These measures are not specified by MFRS Accounting Standards and therefore might not be comparable to apparently similar measures used by other entities.

1 To provide management's view of XYZ Group's financial performance, operating profit and profit from continuing operations have 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 and profit from continuing operations for such items provides information that is helpful in understanding trends in XYZ Group's underlying profitability.

2 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 X Intangible assets and Note X Research and development expenses)
- restructuring expenses (for information related to restructuring expenses refer to Note X Employee benefits and Note X General and administrative expenses)
- non-recurring litigation expenses (for information related to litigation expenses refer to Note X Provisions and Note X 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 X Intangible assets and Note X Other operating income), and
- 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 categorises 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 20X2 (in thousands of CU)

3	MFRS	Adjusting items: Impairment issues	Restructuring expenses	Gains on disposal of property, plant and equipment	Management-defined performance measure
Other operating income		–	–	(1,800)	
Research and development expenses		1,600	–	–	
General and administrative expenses		–	3,800	–	
Goodwill impairment loss		4,500	–	–	
Operating profit/Adjusted operating profit	**57,000**	**6,100**	**3,800**	**(1,800)**	**65,100**
4 Income tax expense		–	(589)	297	
Profit from continuing operations/ Adjusted profit from continuing operations	**32,100**	**6,100**	**3,211**	**(1,503)**	**39,908**
Profit attributable to non-controlling interests		305	161	–	

Impairment losses	Impairment losses incurred in 20X2 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 20X2 are related to XYZ Group's restructuring programme 'Apollo 20X2'. 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 20X2, 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 20X2, which was 16.5%.

What could go wrong?

- **Cross-referencing** – MFRS 18 requires that MPM information is presented in a single note. The MASB decided not to allow management-defined performance measure disclosure requirements to be met by cross-referencing to another document (although it does not explicitly prohibit it in the text of the Standard). Entities should therefore exercise caution before cross-referring to information contained elsewhere. Given MFRS 18's overarching objective to provide transparency and discipline when reporting MPMs, and the requirement to report information in a single note, these requirements are likely to be interpreted strictly by regulators.
- **Interaction with MFRS 8** – For entities applying MFRS 8, when reportable segment information contains an MPM, management may disclose the information required by MFRS 18 in the same note as the rest of the segmental reporting. If this is done, the requirement to present all MPM disclosures in a single note can either be met by including disclosures for all MPMs in the segmental reporting note, clearly distinguished information required under MFRS 18 from information required under MFRS 8, or alternatively all information about MPMs (including any MPMs reported in the segmental reporting) can be presented in a separate note. Management may wish to carefully consider their financial reporting processes to avoid or minimise the duplication of disclosures. More detailed disclosure on MPMs may also lead to more scrutiny over segmental information. Management will need to be aware of this greater level of information being presented and ensure that their financial reporting as a whole is communicating a consistent message about the entity's performance.
- **Comparison with current APM jurisdictions** – As previously mentioned, there are jurisdictions globally that currently require some level of disclosure on APMs. However, complying with the requirements of MFRS 18 is likely to require a significant increase in the level of information being disclosed. Management should therefore be careful not to assume that any existing disclosures they have will be sufficient.
- **Changing MPMs over time** – If an entity reports a new MPM, stops using an MPM, or changes how it calculates a previously reported MPM or the income tax effects of reconciling items, disclosures are required explaining the change and the reason for the change, and restated comparative information reflecting the change must be disclosed. Management may need to consider the requirements of MFRS 108 'Accounting Policies, Changes in Accounting Estimates and Errors' to assess whether restatement is impracticable, and if it is, this must also be disclosed. We note that the existing threshold for justifying impracticability is under MFRS 108 is very high.

It is important to note that the MFRS 18 disclosures on MPMs are required for both annual and interim financial statements (if prepared). The MPM requirements relate to the period covered by the relevant financial statements and therefore MPMs included only in annual public communications would not require disclosure in interim financial statements.

How to ease transition

MFRS 18 must be applied for the first time for annual reporting periods beginning on or after 1 January 2027, so in order to make a smooth transition to using the new MPM disclosures, management should consider prioritising:

- Early identification of APMs that are expected to meet the definition of MPMs and require disclosure in the first annual reporting period in which MFRS 18 is applied
- Assessing whether existing systems and processes are sufficient to appropriately identify MPMs and gather the information that will be required for disclosures
- Whether and when to make changes to the information that is currently provided to investors. Given MFRS 18's focus on public communications for identifying MPMs, regular communications may need to be altered to avoid creating a greater reporting burden.

What is next?

In our next series, we will be looking at **New and enhanced guidance on aggregation and disaggregation of information in the financial statements** in MFRS 18.

How we can help

We hope you find the information in this article helpful in giving you some insight into aspects of MFRS 18. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact.

Grant Thornton

grantthornton.com.my