Get ready for MFRS 18

The new financial statements presentation and disclosure standard

New and enhanced guidance on aggregation and disaggregation of information in the financial statements

While MFRS 101 contained principles for the aggregation and disaggregation of information in the financial statements, when applying MFRS 18 significant judgement may be required to ensure that the primary financial statements fulfil their new role of providing 'useful structured summaries' to give users more useful information.

Challenges with presenting the primary financial statements as 'useful structured summaries'

The concept that the primary financial statements (ie the statements of financial performance, financial position, changes in equity and cash flows) are 'structured summaries' is not new, as it is a concept in the Conceptual Framework for Financial Reporting. However, MFRS 18 takes this concept to a new level, which for some entities may take time to embed in their financial statement preparation process, and for other entities, may require significant changes to existing systems and processes, and/or new systems and processes. Below are a few key areas that entities should be aware of.

- **Specifying that the role of primary financial statements is to provide 'useful structured summaries'** – MFRS 18 adds the word useful in this definition. Appendix A of the standard clarifies that a useful structured summary will provide an understandable overview of the entity's recognised assets, liabilities, income, expenses, equity and cash flows and allow users to make comparisons between entities and between reporting periods for the same entity and identify key areas where they might want to get more information from the notes. This definition underpins MFRS 18's objective in presenting primary financial statements so preparers need to be aware of this.
- **Clarifying the role of the notes** – MFRS 18 states that the notes are there to provide material information which is necessary for a user of the financial statements to understand the line items presented in the primary statements, and to supplement the primary statements with additional information in order to achieve the objective of the financial statements (ie to provide users with information to allow them to assess the prospects for future net cash inflows to the entity and assess management's stewardship of the entity's economic resources).
- **New and enhanced application guidance for determining what should be included** – MFRS 18 provides detailed application guidance to help preparers apply their judgement in determining what information must be disclosed on the face of the financial statements or in the notes. Some key areas of guidance include:

  An entity does not need to separately present a line item in primary financial statements if doing so is not necessary to provide a 'useful structured summary'. This is the case even if a line item is specifically required by Malaysian Financial Reporting Standards. However, if any line items required by MFRS 18 are not disclosed in the relevant primary financial statement, they must be disclosed in the notes unless the resulting information is considered immaterial. The general requirements for the structure of primary financial statements must also always be complied with when applying this judgement.

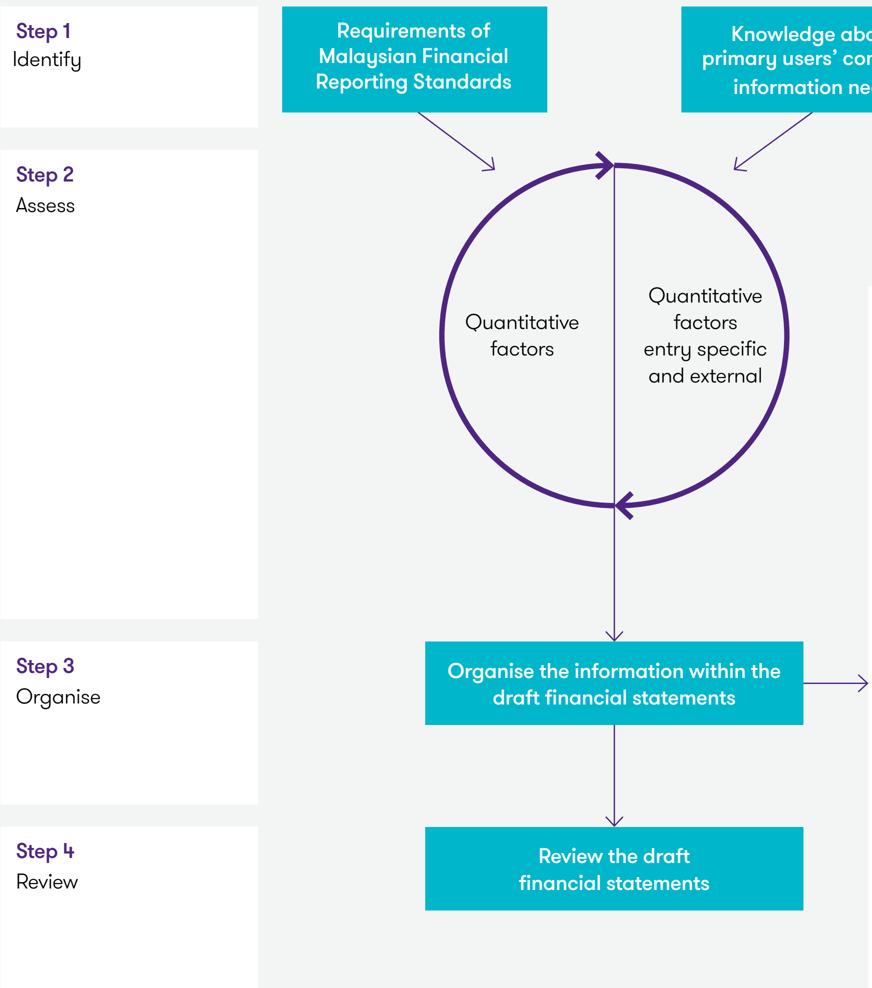
  The Standard makes it clear that an entity must also present additional line items and subtotals if they are necessary for a primary financial statement to provide a 'useful structured summary'. These additional items must be measured in accordance with Malaysian Financial Reporting Standards, they must be compatible with the overall structure required for financial statements, they must be presented consistently from period to period, and they must not be given more prominence than totals and subtotals required by Malaysian Financial Reporting Standards.

  Additional line items can be a disaggregation of required line items. MFRS 18 includes guidance on the type of characteristics which could be shared or not shared, and result in a conclusion to disaggregate information and present an additional line item. These characteristics include things like the nature of the item, its function within the entity's business activities, the measurement basis, geographic location etc.

Challenges with the interaction of the concept of materiality and presenting useful structured summaries

MFRS Practice Statement 2 'Making Materiality Judgements' contains useful guidance on making materiality judgements, and may help to decide whether an item should be presented separately in the primary financial statements, aggregated with other similar information, or disclosed in the notes. It states that an entity should consider the different roles of primary financial statements and notes.

Diagram 1 – the four-step materiality process



In Step 3 of the materiality process, to organise the **material information** identified in Step 2 within the draft financial statements:

- an entity exercises judgement when deciding how to communicate information clearly and concisely; and
- an entity would consider the different **roles of primary financial statements and notes** in deciding whether to present an item of information separately in the financial statements, to aggregate it with other information or to disclose the information in the notes.

MFRS 18 states that:

- the role of the primary financial statements is to provide **useful structured summaries** of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows, and
- the role of the notes is to provide **material information** necessary to understand the line items presented in the primary financial statements and to supplement the financial statements.

An entity cannot include **all** material information in the primary statements. The role of primary statements is to provide 'useful structured summaries', and this will provide a basis for determining what material information should be included on the face of the primary statements and what should be included in the notes. The definitions help to clarify that information in the primary statements should be a useful summary, and additional information should be included in the notes, as long as that additional information is material.

Practical insight

To help illustrate this we can use the example of an entity that has undergone a major restructuring, and concluded that information about that restructuring is material. In order to decide whether to present a line item for restructuring expenses in the statement of financial performance, the entity needs to consider whether it contributes to a useful structured summary. The entity may consider that presenting a separate line item for restructuring expenses will help users of the financial statements to understand the increase in total operating expenses for the period. By presenting a separate line item this may also result in the other expense balances being more comparable to previous periods, enabling users to make more useful comparisons between periods. The entity could also conclude that the separate line item will help users to identify restructuring as an area that they may wish to seek more information about in the notes.

Challenges with aggregation and disaggregation of information

While MFRS 101 included high level principles of aggregation and disaggregation of information in the financial statements, MFRS 18 introduces new specific principles for aggregating and disaggregating information in the financial statements, along with detailed application guidance. As such, for some entities the application of MFRS 18 may require changes to existing systems and processes, given an entity is required by MFRS 18 to comply with the following (unless doing so would override specific aggregation or disaggregation requirements in Malaysian Financial Reporting Standards):

- Classify and aggregate assets, liabilities, equity, income, expenses or cash flows into items based on shared characteristics such as the nature of the item, its function within the entity's business activities, the measurement basis, or another characteristic such as liquidity, geographical location, persistence, size etc.
- Disaggregate items based on characteristics that are not shared
- Aggregate or disaggregate items to present line items in primary statements that fulfil the role of providing 'useful structured summaries'
- Aggregate or disaggregate items to disclose material information in the notes
- Ensure that aggregation and disaggregation in the financial statements does not obscure material information.

If an entity does not present material information in the primary financial statements, it must disclose this in the notes.

As was also the case with MFRS 101, MFRS 18 makes it clear that when applying these principles an entity must disaggregate items which have dissimilar characteristics where the resulting information is material. Some examples given in the Standard of information that might need to be disaggregated include PPE disaggregated into classes as set out in MFRS 116 'Property, Plant and Equipment', inventories disaggregated into items such as merchandise, production supplied, materials, work in progress etc. and trade payables disaggregating those which are part of supplier finance arrangements.

Aggregating and disaggregating information based on shared or dissimilar characteristics will require management judgement. MFRS 18 includes examples of characteristics that may be considered when making this judgment. Although there are multiple factors to consider, MFRS 18 is clear that just one dissimilar characteristic could result in information being disaggregated, if that resulting information is material. For example, an entity would not be able to argue that a set of information has more similar characteristics than dissimilar, and therefore not disaggregate, if information about the dissimilar characteristic is material.

Practical insight

In order to illustrate this concept, MFRS 18 uses financial assets (debt and equity instruments) as an example. Financial assets may have dissimilar characteristics based on the different measurement bases used (ie some are held at amortised cost and some at fair value). An entity may conclude that to provide a useful structured summary, it is necessary to disaggregate the information into two line items, being financial assets measured at amortised cost, and financial assets measured at fair value. Further to this initial disaggregation, financial assets measured at fair value may also have dissimilar characteristics, as some may be debt instruments and some may be classed as equity. The entity could then further conclude that as debt and equity instruments expose the entity to different risks, that it is necessary to further disaggregate the information into separate line items for debt and equity instruments in order to provide a useful structured summary. However, if the entity was to conclude that disaggregation of debt and equity instruments was not required to provide a useful structured summary, but the disaggregated information is still material, then they would need to disclose this information in the notes to the financial statements.

Challenges with the use of descriptive labels

MFRS 18 specifies that items presented in the primary financial statements, or disclosed in the notes should be described in a way that faithfully represents the characteristics of the item, and to do this an entity must include all descriptions and explanations necessary to allow a user of the financial statements to understand the item.

MFRS 18 includes specific guidance and disclosure requirements for labelling aggregated items depending on whether the aggregated material is material and/or immaterial. It also limits the use of the non-descriptive label 'Other' when presenting information. Labelling aggregated information as 'Other' is only allowed when an entity is unable to find a more informative label. To support this MFRS 18 includes examples of how an entity might find a more informative label, application guidance around the labels that must be used if there is not a more informative label than 'Other', and additional disclosure requirements around aggregated information for specific circumstances.

An item for which information is:		Other items for which information is:	Disclosure requirements:
Material	Could be aggregated with	Material	Disclose information about each item
Material		Not material	Disclose information about disaggregated items only if immaterial information would obscure material information
Not material		Not material	Not required to disclose information about disaggregated items, but must consider if the balance is sufficiently large, whether a user of financial statements could reasonably question if it includes material information

How might an entity find a more informative label than 'other'?

- If an item for which information is material is aggregated with items for which information is not material, find a label that describes the item for which information is material
- If items for which information is not material are aggregated, find a label based on the similar or dissimilar characteristics upon which the aggregation is based

When there is no more informative label than 'other' an entity must use a label that describes the aggregated item in as useful a way as possible (eg 'other operating expenses'). Importantly, if an entity is describing an aggregation comprising of only items for which information is material, they must consider if the aggregated amount is sufficiently large that users of the financial statements could reasonably question whether it includes material information.

Practical insight

In providing a description or explanation of an item in the financial statements, it may be necessary for management to include definitions or meanings for specific terms used, as well as information about how they have aggregated or disaggregated assets, liabilities, equity, income, expenses and cash flows. This may be especially relevant if items are labelled or described in a way that is highly specific to the entity in question. Therefore entities with highly specialised or unique business activities should ensure they properly assess whether items are adequately labelled and described, such that they are properly understandable for users of the financial statements.

Challenges with the requirements in relation to operating expenses

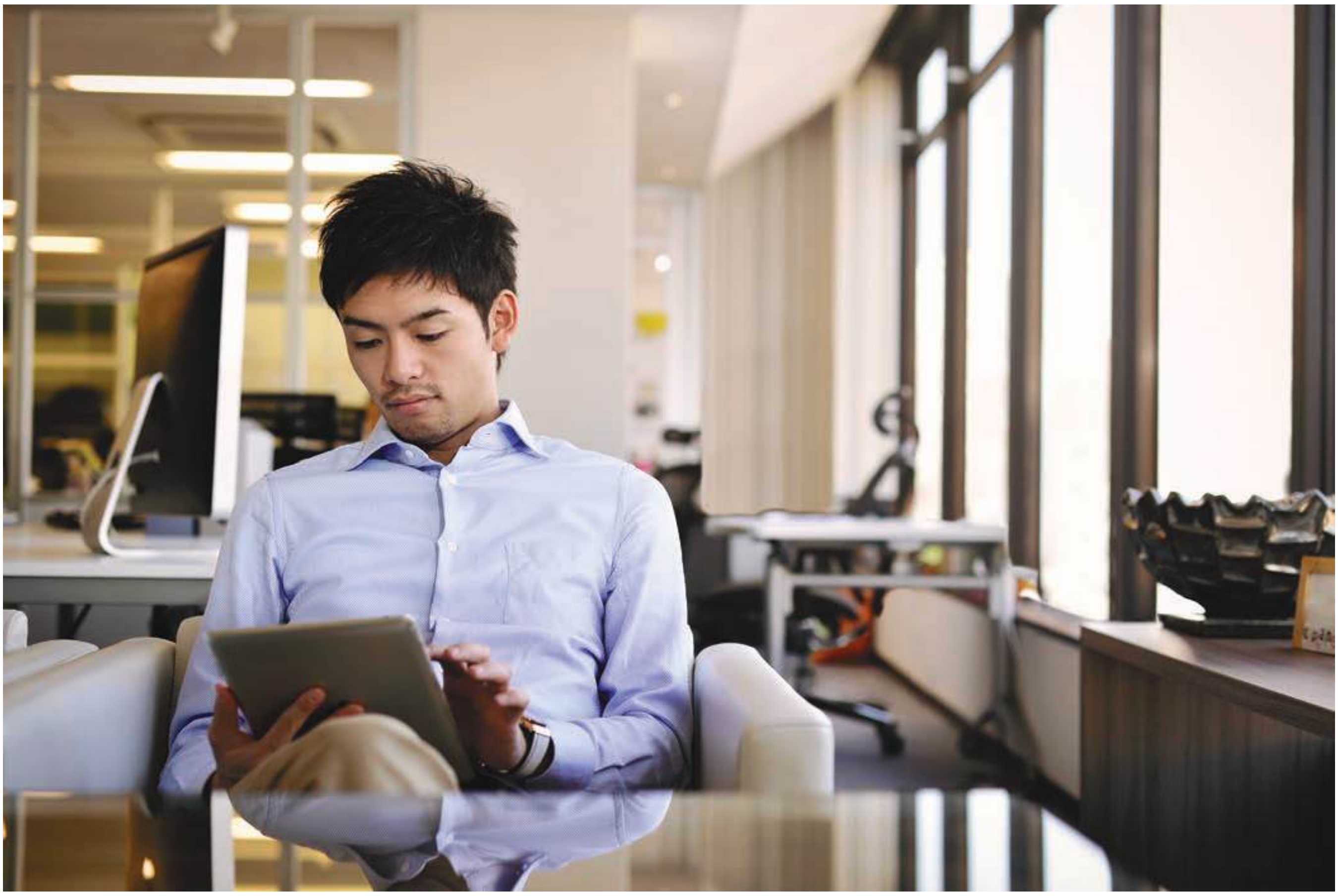
In contrast to MFRS 101, MFRS 18 now allows entities to classify and present operating expenses in the operating category of the statement of profit or loss, using the characteristics of the nature **and/or** the function of the expenses. This allows entities to use a hybrid approach where some expenses can be categorised by nature, and others by function.

While many may welcome this change, judgement is required in applying MFRS 18's detailed requirements and application guidance in relation to operating expenses. This may take some entities time to embed in their financial statement preparation process and for other entities, may require changes to existing systems and processes. Some key areas of challenge arising from the new requirements are:

- MFRS 18 does not permit expenses to be classified and presented using an arbitrary mixture of the characteristics of the nature and function of the expenses. Individual line items must comprise operating expenses aggregated only by nature or only by function. However, the same characteristic does not have to be used as the aggregation basis for all line items – some line items could be based on aggregating expenses of a similar nature, and others by aggregating expenses of a similar function. This may be the most appropriate solution in situations where an entity has two different main business activities. An entity must consider what level of aggregation for operating expenses provides the most useful structured summary. For example, whether aggregating expenses for resources consumed in administrative activities, such as human resources, information technology, legal and accounting and presenting them in a line item labelled as 'administrative expenses' would provide the most useful structured.
- MFRS 18 includes detailed principles around classifying and presenting operating expenses using the nature of the expenses, for example, raw material expense ('nature expenses') and/or the function of the expense, for example cost of sales. It provides much more detailed guidance around the use of nature versus function than MFRS 101 did previously, with the focus being providing the most useful structured summaries. It also requires that each line item is clearly labelled to identify what expenses are included.

- When an entity presents expenses classified by function, MFRS 18 include detailed requirements for disaggregation and labelling of this information.
  - When providing a cost of sale line item, MFRS 18 requires that this includes the total of inventory expenses as described in MFRS 102 'Inventories'.
  - When classifying expenses by function, entities must disclose a qualitative description of the nature of expenses included in each function line item.
  - Entities classifying one or more line items by function must also disclose in a **single** note the **total** for each of five **specified** expenses by nature. MFRS 101 required disclosure of three of these, namely depreciation, amortisation and employee benefits, but MFRS 18 now also requires disclosure of impairment losses (and reversals thereof) and write-downs of inventories (and reversals thereof). The amounts presented or disclosed do not necessarily have to be recognised as an expense in the period ie part, or all of the amounts could have been recognised as part of the carrying amount of an asset.
  - For each of the five specified expenses by nature, an entity needs to disclose the amount related to each line item in the operating category as well as a list of any items outside of the operating category which include amounts relating to the total. They must also give a qualitative explanation of amounts included in the carrying amount of assets.
  - When an entity classifies expenses by function and discloses the five totals of expenses by nature as described above, they are exempt from disclosing:
    - in relation to function line items presented in the operating category of the statement of profit or loss—disaggregated information about the amounts of nature expenses included in each line item beyond the information on the five specific items listed above.
    - in relation to nature expenses specifically required by an Malaysian Financial Reporting Standards to be disclosed in the notes—disaggregated information about the amounts of the expenses included in each function line item presented in the operating category of the statement of profit or loss beyond the information on the five specific items listed above.

  This exemption only relates to the disaggregation of operating expenses, and as such it does not exempt an entity from applying specific disclosure requirements relating to those expenses in other Malaysian Financial Reporting Standards.



What is next?

In our next series, we will be looking at **Consequential amendments to other MFRS Accounting Standards** 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.