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Ind AS 118 and the Changing Face of Income Statement Reporting

From income statement structure to management performance measures businesses should be evaluating today.

The accounting profession does not often witness changes in financial statement presentation that have the potential to affect virtually every reporting entity. The proposed introduction of Ind AS 118, based on IFRS 18 *Presentation and Disclosure in Financial Statements*, is one such development. While the standard does not change recognition or measurement principles, it could significantly influence how financial performance is presented, analyzed, and communicated. Through changes to the structure of the Statement of Profit and Loss, enhanced guidance on presentation and disclosure, and new requirements relating to management-defined performance measures, the standard seeks to bring greater comparability and transparency to financial reporting. With IFRS 18 becoming effective globally from 1 January 2027 and Ind AS 118 proposed to apply in India from 1 April 2027, organizations may already need to start evaluating the practical implications of transition.

Why Was IFRS 18 Introduced?

For more than two decades, IAS 1 *Presentation of Financial Statements* provided a principles-based framework for presentation of financial statements under IFRS. However, the flexibility embedded within IAS 1 resulted in considerable diversity in how entities presented their income statement. Investors and analysts increasingly sought greater consistency in the reporting of financial performance, particularly because IAS 1 income statements varied in structure and content. Measures tracked by investors such as Earnings Before Interest and Taxes (EBIT), Earnings Before Interest, Taxes, Depreciation and Amortization (EBITDA), and adjusted earnings often occupied a central role in performance discussions, particularly within management commentary, Management Discussion and Analysis (MD&A), investor presentations and earnings communications, but lacked a consistent reporting framework. IFRS 18 has been developed against this backdrop, with the objective of improving comparability, transparency and discipline in financial performance reporting through a more structured income statement, enhanced guidance on aggregation and disaggregation of information, and specific disclosure requirements for management-defined performance measures.

The Indian Context

In India, presentation requirements are currently governed by Ind AS 1 together with Schedule III to the Companies Act, 2013. While Ind AS 1 has largely converged with IAS 1, one notable area of difference relates to the presentation of operating expenses. Unlike IAS 1, which allows classification of expenses by nature or function depending on which approach provides more relevant information, Ind AS 1 requires presentation of expenses by nature. Consequently, Indian companies have traditionally followed a nature-based presentation of expenses, with operating costs typically reported under captions such as employee benefits, depreciation and finance costs. The proposed Ind AS 118 does not retain this distinction and instead aligns with the IFRS 18 framework, requiring entities to assess whether presentation by nature, function or a mixed approach provides the most useful information to users of financial statements. This shift places greater emphasis on judgments and could lead to a re-evaluation of long-standing reporting conventions across sectors, including whether subtotals such as gross profit become more prevalent in financial reporting.

Structure of Statement of Profit or Loss

Under Ind AS 118, income and expenses reported in the Statement of Profit and Loss will be classified into five categories—operating, investing, financing, income taxes, and discontinued operations. Although income taxes and discontinued operations are not new to financial reporting, the introduction of mandatory operating, investing, and financing categories brings greater structure to the presentation of financial performance. This structured classification framework is one of the central mechanisms through which the standard seeks to improve comparability across reporting entities. In addition, entities will be required to present two defined subtotals — operating profit and profit before financing and income taxes. Together, these requirements are intended to establish a more consistent foundation for analyzing financial performance across entities and industries.

Attention is likely to be directed towards the operating category. Unlike existing practice, operating profit will become a clearly defined subtotal within the financial statements. The category is intended to provide a comprehensive view of the entity's business activities and therefore functions as an important indicator of core performance. However, the standard recognizes that business models differ. Accordingly, certain entities whose core business activities involve investing in assets or providing financing may classify income and expenses that would ordinarily fall within investing or financing categories as part of operating activities. For example, interest income may form part of operating performance for banks and lending institutions, while investment returns may be operating in businesses whose core activities involve managing investments. The classification therefore requires a careful assessment of business substance rather than a mechanical application of rules.

Gross Profit: A Potentially Significant Change for Indian Reporting

Another noteworthy implication of Ind AS 118 in the Indian context relates to the possible emergence of gross profit as a reported subtotal within the Statement of Profit and Loss. Globally, gross profit has long been a commonly reported performance measure under both IFRS and US GAAP, particularly where entities present expenses by function and separately identify cost of sales. In contrast, Indian companies have not typically reported a gross profit subtotal in their financial statements.

This position has largely been driven by two factors. First, the existing carve-out in Ind AS 1 resulted in operating expenses being presented by nature rather than by function. Second, the format prescribed under Schedule III does not require presentation of a gross profit subtotal. Consequently, while investors and analysts may often compute gross profit and gross margin metrics, these measures have generally not appeared on the face of the financial statements.

The position could evolve under Ind AS 118. Where an entity concludes that presentation of expenses by function provides more useful information to users, and therefore separately presents cost of sales, the reporting of gross profit may become both relevant and meaningful. For some sectors, particularly manufacturing, consumer products and retail businesses, this could represent one of the more visible changes in financial reporting arising from the new standard.

An interesting distinction should also be noted. Many companies currently compute and report gross profit while preparing tax audit documentation. However, that figure is determined in accordance with the methodology prescribed by the ICAI's Guidance Note on Tax Audit and serves a different purpose. Any gross profit subtotal reported under Ind AS 118 would emerge from the financial statement presentation framework and should therefore not be assumed to be directly comparable with figures reported for tax audit purposes.

Aggregation and Disaggregation

While requirements relating to aggregation and disaggregation were not entirely absent under the existing reporting framework, they have received significantly greater prominence under Ind AS 118. One of the concerns highlighted by investors was that material information could be obscured when items with different characteristics were grouped together within broad captions, while excessive detail in other areas often detracted from the information that was most relevant to understanding financial performance.

Ind AS 118 responds to this concern by introducing a more structured framework for grouping and presenting information. The emphasis is not on providing more disclosures, but on ensuring that material information is communicated in a manner that faithfully reflects the underlying characteristics of transactions. As a result, entities may need to reassess long-standing captions such as 'other income' and 'other expenses', together with related note disclosures, to evaluate whether the presentation appropriately conveys the key drivers of financial performance.

Management Performance Measures

Perhaps the most debated feature of the new standard is the introduction of disclosures relating to Management Performance Measures (MPMs). An MPM is a subtotal of income and expenses that is used in public communications outside the financial statements and reflects management's view of an aspect of the entity's financial performance but is not specified by accounting standards. Measures such as EBIT and EBITDA will fall within this definition when communicated publicly, for example through management commentary or the MD&A. Certain information communicated orally, such as statements made during analyst or investor calls without being included in public written communications, may fall outside the scope of the definition.

The significance of the new requirements lies in bringing these measures within the audited financial reporting framework. Where an entity presents an MPM, the financial statements will be required to include disclosures explaining the measure, why management believes it is useful, and a reconciliation to the most directly comparable subtotal specified by accounting standards. As a result, metrics that historically appeared primarily in management commentary or the MD&A, may now receive a significantly greater degree of scrutiny from management, audit committees and auditors.

The Remapping Exercise May Be More Extensive Than It Appears

Although much of the discussion surrounding Ind AS 118 has focused on presentation, implementation will extend well beyond the face of the financial statements. Companies will need to analyze existing income and expense streams and determine how they should be classified under the new framework. Interest expense, for example, would typically form part of the financing category, while interest income, investment gains and treasury-related transactions may need to be reassessed depending on the entity's business model.

The exercise becomes even more nuanced in areas such as foreign exchange gains and losses. Under Ind AS 118, the classification of foreign exchange differences generally follows the classification of the underlying transaction. Consequently, foreign exchange gains or losses arising from trade receivables and payables would form part of the operating category, while those relating to borrowings or investments would be classified within financing or investing categories, respectively. Companies that currently accumulate all foreign exchange gains and losses within a single general ledger or reporting line may therefore need to revisit their chart of accounts, reporting structures and data capture processes to enable the required classification.

Existing management reporting metrics may also need to be mapped and evaluated against the requirements applicable to MPMs. This exercise is likely to reveal that implementation is not simply a disclosure project but a broader financial reporting transformation initiative.

Early Preparation Will Matter

The implementation effort should not be underestimated. Many organizations may need changes to chart-of-account structures, reporting hierarchies, consolidation systems, management reporting frameworks and internal controls. Information technology teams may need to support new data capture and reporting requirements, while finance teams may have to establish revised review and governance processes around classification judgment and MPM disclosures. In addition, the standard requires retrospective application, meaning comparative information will need to be restated. Consequently, entities that defer assessment activities until the year of adoption could find themselves facing compressed timelines and avoidable implementation challenges.

The Schedule III Dimension and the Emerging Expense Classification Debate

The Indian implementation journey is likely to involve considerations extending beyond the accounting standard itself. Corresponding amendments to Schedule III and alignment of other regulatory reporting frameworks will be necessary to facilitate smooth adoption. To reiterate, one of the more interesting questions arising from Ind AS 118 concerns the presentation of operating expenses.

Historically, the Indian reporting landscape has been characterized by nature-based presentation of expenses. The proposed Ind AS 118 does not carry forward the existing Indian carve-out in this area and instead aligns with the IFRS 18 framework, requiring entities to assess whether presentation by nature, function or a mixed approach provides the most useful information to users of financial statements. For many companies, this assessment may involve significantly more judgment than has traditionally been required in this area.

Indeed, for some sectors, the more significant debate may not be around operating profit or management performance measures, but whether a functional presentation better explains business performance than a traditional nature-based presentation. The decision could also influence whether gross profit emerges as a meaningful reported subtotal within the financial statements, something that has historically been uncommon in Indian corporate reporting. This is unlikely to be merely a company-specific decision. Over time, industry practices may begin to emerge, with early adopters potentially setting benchmarks for their peers. In that sense, one of the more interesting questions may be which sectors, and which companies within those sectors, choose to lead the transition towards a functional presentation of expenses.

Concluding Thoughts

Ind AS 118 will not change an entity's profit after tax. What could change, however, is the way financial performance is presented, analyzed, and understood. While Indian companies are already accustomed to a structured Statement of Profit and Loss under Schedule III, the new requirements relating to operating, investing and financing categories, management performance measures, aggregation and disaggregation of information and the potential move towards function-based expense presentation are likely to introduce new judgments and reporting considerations. For some entities, this could also result in the emergence of subtotals such as gross profit that have traditionally not been reported in Indian financial statements.

For many organizations, the transition may extend well beyond a technical accounting exercise. It could require reassessment of reporting structures, expense classification methodologies, management performance metrics, systems, controls and governance processes. In certain areas, particularly the presentation of expenses by nature, function or a mixed approach, market practice may continue to evolve over the coming years, and industry conventions may only emerge gradually.

Although the proposed effective date may appear distant, the implementation effort should not be underestimated, especially given the requirement to restate comparative information. The organizations that begin evaluating the implications early are likely to be better placed not only to manage the transition efficiently, but also to communicate financial performance more effectively in an increasingly focused reporting environment.

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