TRANSITIONING TO IND AS 118

How different will your Income Statement look from **FY2027**?

PART 4: MANAGEMENT-DEFINED PERFORMANCE MEASURES

A BDO INDIA PUBLICATION
SEPTEMBER 2026

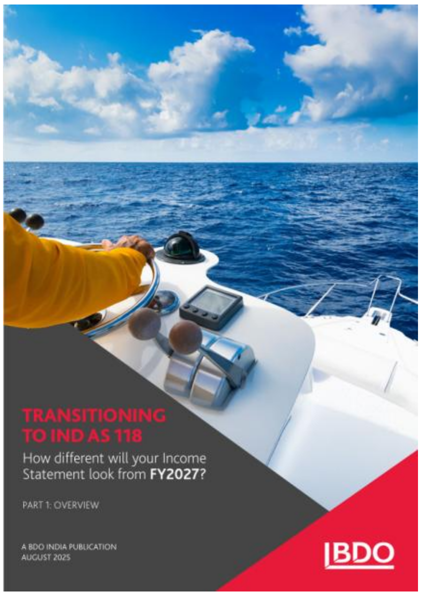
TABLE OF CONTENTS

COMMUNICATING PERFORMANCE BETTER

The Exposure Draft of *Ind AS 118, Presentation and Disclosure in Financial Statements* (Proposed Ind AS 118/ Exposure Draft) introduces a new, structured approach to presenting income and expenses, with the operating and financing categories being central to this change. Among its most significant changes are the requirements relating to Management-defined Performance Measures, which bring greater discipline to performance measures that have traditionally been communicated outside the financial statements.

Part 4 of our publication on the proposed Ind AS 118 series provides a practical and structured understanding of the proposed MPM requirements. It explores the key principles, areas requiring judgment, disclosure requirements and practical considerations for preparers, audit committees and other stakeholders. These requirements may require management to make new judgments, navigate complexities and oversee changes to systems and processes. Therefore, early engagement with stakeholders is critical for a smooth transition.

This publication would be particularly useful for the Board of Directors and C-Suite executives who understand the nuances of the proposed requirements. These insights must be read with the applicable requirements and the Exposure Draft. You can read the earlier issues of this publication series below.



Part 1 of the publication series gave a high-level overview of the proposed changes, including a worked example to understand key changes.

Part 2 of the publication series covered key proposals relevant for classifying transactions under the investing category.

Part 3 of the publication series covered key considerations relevant to classifying transactions under the financing and operating categories.

PROPOSALS AT A GLANCE

Ind AS 118 proposes to change existing requirements relating to the presentation and disclosure of information in financial statements. Ind AS 118 is proposed to supersede Ind AS 1, together with the consequential amendments to other standards, for reporting periods beginning on or after 1 April 2027. The most significant effects relate to the following topics:

KEY TOPICS	SUMMARY
Most requirements applicable to the preparation of primary financial statements other than the statement of profit and loss	Ind AS 118 does not significantly affect how the primary financial statements are prepared, other than the introduction of new aggregation and disaggregation requirements, with some exceptions, such as those noted above
Presentation of true and fair view and explicit and unreserved statement of compliance with Ind AS	Relocated to Ind AS 8 substantially unchanged
Going concern	Relocated to Ind AS 8 substantially unchanged
Offsetting	Substantially unchanged from Ind AS 1
Frequency of reporting	Substantially unchanged from Ind AS 1
Comparative information	Substantially unchanged from Ind AS 1
Consistency of presentation	Substantially unchanged from Ind AS 1
Structure of notes	Substantially unchanged from Ind AS 1
Disclosure of accounting policy information	Relocated to Ind AS 8 substantially unchanged
Disclosures about judgements and sources of significant estimation uncertainty	Relocated to Ind AS 8 substantially unchanged
Capital disclosures	Substantially unchanged from Ind AS 1
Disclosures about puttable financial instruments classified as equity	Relocated to Ind AS 107 substantially unchanged
Miscellaneous other disclosures (declared dividends, cumulative preference dividends not recognised, domicile and legal form, description of the nature of the entity's operations, etc.)	Substantially unchanged from Ind AS 1

This worked example illustrates possible changes in the classification of a few items of income and expenses for a manufacturer that does not have any specified main business activities.

EXTRACT OF STATEMENT OF PROFIT AND LOSS (SIMPLIFIED)	INR
Revenue from operations	398,700
Other income	700
Total income	399,400
Expenses Cost of materials consumed	(150,000)
Changes in inventories of finished goods and work-in-progress	(3,000)
Employee benefits expense	(107,000)
Finance costs	(1,800)
Depreciation and amortization expenses	(37,500)
Other expenses	(17,100)
Total expenses	(316,400)
Profit before share of net profits of investments accounted for using equity method and tax	83,000
Share of net profit of investments accounted for using the equity method	1,000
Profit before tax	84,000
Tax expense: ▪ Current tax ▪ Deferred tax expense	 (300) (25)
Profit for the year	83,675

	EXTRACT OF STATEMENT OF PROFIT & LOSS UNDER PROPOSED IND AS 118 (SIMPLIFIED)	INR
OPERATING	Revenue from operations	398,700
OPERATING	Operating expenses Cost of materials consumed	(150,000)
OPERATING	Changes in inventories of finished goods and work-in-progress	(3,000)
OPERATING	Employee benefits expense	(107,000)
OPERATING	Depreciation and amortization expenses	(37,500)
OPERATING	Other operating expenses	(17,100)
OPERATING	Total operating expenses	(314,600)
	Operating profit	84,100
INVESTING	Share of net profit of investments accounted for using the equity method	1,000
INVESTING	Other income	700
	Profit before financing and income taxes	85,800
FINANCING	Finance costs	(1,800)
	Profit before tax	84,000
	Tax expense: ▪ Current tax ▪ Deferred tax expense	 (300) (25)
	Profit for the year	83,675

- Other income, i.e., interest from fixed deposits, will be re-classified to the investing category (earlier included in 'Total income').
- Share of profit of investments accounted for using equity method will be classified under investing category.
- Finance costs, i.e., interest on borrowings, will be re-classified to the financing category (earlier included under 'Total expenses').

MANAGEMENT-DEFINED PERFORMANCE MEASURES

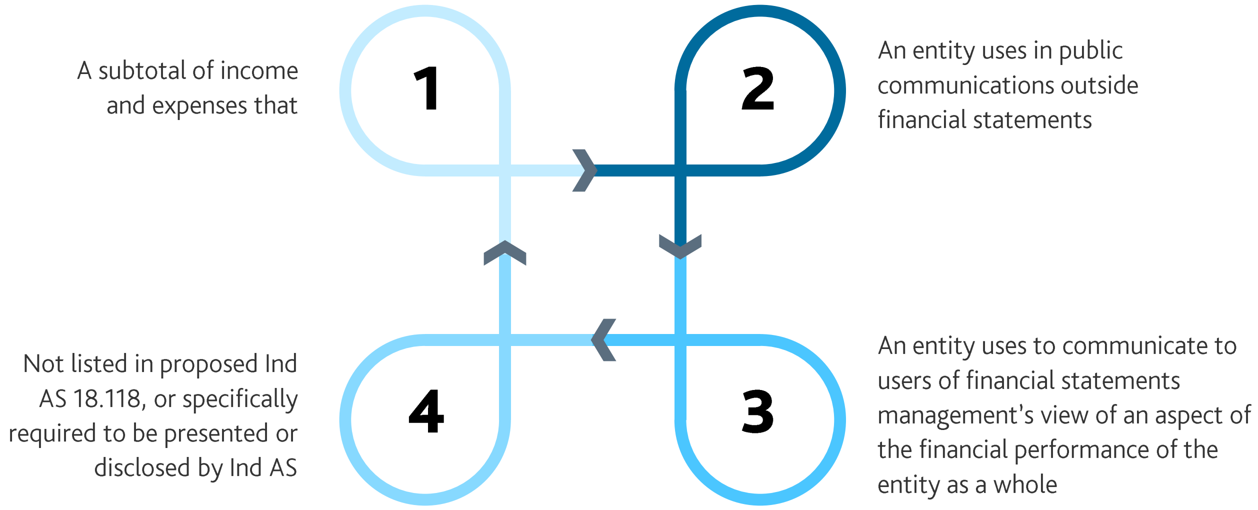
One of the key concepts proposed by Ind AS 118 is management-defined performance measures (MPMs). Proposed Ind AS 118 defines MPMs and includes specific disclosure requirements. Historically, these measures have generally been contained outside of the financial statements, for example, in management discussion and analysis, strategic reports, etc. Ind AS 118 proposes that disclosures relating to MPMs be included in the financial statements in a single note.

It should be noted that an entity might have no MPMs, one MPM or more than one MPM. For example, an entity that publicly communicates its financial performance to users of financial statements using only totals and subtotals required to be presented or disclosed under Ind AS has no MPMs within the disclosure requirements of the proposed Ind AS 118.

For entities subject to audit, this single MPM note will also be audited, which may be a significant change in practice for many entities where information traditionally outside the financial statements has not historically been subject to audit.

WHAT ARE MANAGEMENT-DEFINED PERFORMANCE MEASURES?

Proposed Ind AS 118. 117 defines an MPM as:



The following subsections discuss the four components of the definition of an MPM.

SUBTOTAL OF INCOME AND EXPENSES

The definition of MPMs in proposed Ind AS 118 is limited to subtotals of income and expenses. It is not required for a subtotal of income and expenses to be presented in the statement of profit or loss to meet the definition of an MPM. A subtotal that meets the definition is an MPM irrespective of whether it is presented in the statement of profit or loss (proposed Ind AS 118.B118).

Some stakeholders suggested including in the definition of MPMs measures other than subtotals of income and expenses (for example, subtotals of assets and liabilities, or measures of cash flow) to bring about transparency and discipline in communicating these other measures. While acknowledging the observation, it was decided to restrict the definition of MPMs to subtotals of income and expenses, as widening the definition would involve substantial work that would go beyond the scope of reporting of financial performance in the statement of profit or loss and the related notes.

The following are several examples of measures that are not MPMs as they are not subtotals of income and expenses:

NATURE (PROPOSED IND AS 118.B116)	EXAMPLE
Subtotals of only income or only expenses	▶ Adjusted revenue ▶ Employee benefit expenses, excluding share-based payment expenses
Assets, liabilities, equity or combinations of these elements	▶ Net working capital ▶ Net debt
Financial ratios *(A numerator or denominator of a financial ratio may be an MPM. See section 6.2.1.1)*	▶ Debtor turnover ratio ▶ Debt to equity ratio ▶ Loan to value ratio ▶ Loan recovery rate
Measures of liquidity or cash flows	Free cash flows
Non-financial performance measures	▶ Product recall rate ▶ Employee turnover rate ▶ Customer retention ratio

It was observed that some subtotals are not defined by Ind AS, but are commonly used in financial statements and well understood by users of financial statements. Therefore, it was decided to exclude such subtotals from the scope of MPM disclosure requirements. These excluded subtotals are listed in proposed Ind AS 118.118 as below:

- Gross profit or loss (revenue minus cost of sales) and similar subtotals
- Operating profit or loss before depreciation, amortisation and impairments within the scope of Ind AS 36, *Impairment of Assets*
- Operating profit or loss and income and expenses from all investments accounted for using the equity method
- For an entity that provides financing to customers and applies the accounting policy choice of classifying in the operating category income and expenses from liabilities that do not relate to the provision of financing to customers as per the proposed Ind AS 118.73, a subtotal comprising operating profit or loss and all income and expenses classified in the investing category
- Profit or loss before income taxes
- Profit or loss from continuing operations

A financial ratio is not an MPM as it is not a subtotal of income and expenses. However, a subtotal that is the numerator or denominator in a financial ratio is an MPM if the subtotal would meet the definition of an MPM if it were not part of a ratio (proposed Ind AS 118.B117). For example, an entity measures 'adjusted operating profit per share' as (adjusted operating profit/ number of equity shares outstanding). Adjusted operating profit per share is not an MPM as it is not a subtotal of income and expenses. But 'adjusted operating profit', which is the numerator of the ratio, is a subtotal of income and expenses. Therefore, the disclosure requirements related to MPMs apply to adjusted operating profit.

OUR TAKE – DISCLOSURE OF OTHER MEASURES

The standard setters did not specifically prohibit the disclosure of measures that do not meet the definition of MPMs in the financial statements, as such requirements might discourage best practice for voluntary disclosures that are useful to users of financial statements. Therefore, an entity is not prohibited from disclosing measures that do not meet the definition of MPMs in the financial statements as long as such disclosure is to enable users of financial statements to understand the effect of transactions and other events and conditions on the entity's financial position and financial performance.

However, the information in the note is required to be labelled in a way that clearly distinguishes the information required to be disclosed as per the MPM disclosure requirements from the other information (proposed Ind AS 118.B132). The disclosures of such other measures must also comply with the requirements of proposed Ind AS 118 related to faithful representation of the characteristics of the items.

OUR TAKE – IS EBITDA (EARNINGS BEFORE INTEREST, TAX, DEPRECIATION AND AMORTISATION) AN MPM?

If an entity uses EBITDA as a performance measure in its public communications outside financial statements, there are two scenarios:

- *EBITDA is an accurate labelling of operating profit before depreciation, amortisation and specified impairments within the scope of Ind AS 36:* In this case, EBITDA would be exempted from the MPM disclosure requirements as operating profit before depreciation, amortisation and specified impairments within the scope of Ind AS 36 is excluded from the scope of MPM disclosures as proposed in Ind AS 118.118.
- *EBITDA is different from operating profit before depreciation, amortisation and specified impairments within the scope of Ind AS 36:* In this case, EBITDA would be considered an MPM as it is not one of the exclusions proposed in Ind AS 118.118 or a subtotal specifically required by Ind AS.

OUR TAKE – ADDITIONAL SUBTOTALS AS MPMS

Proposed Ind AS 118.24 requires an entity to present additional subtotals if such presentations are necessary for a primary financial statement to provide a useful, structured summary. Although proposed Ind AS 118.24 generally requires an entity to provide additional subtotals when necessary to provide a useful, structured summary, these are not specifically required. Therefore, additional subtotals would meet the definition of an MPM, provided the other criteria of the definition are met.

One of the emerging discussions is whether there is a need to amend Schedule III to the Companies Act, 2013 in light of the proposed Ind AS 118, or whether the Schedule need not be amended as it provides an adequate mechanism to accommodate the requirements of the proposed Ind AS 118.

Preparers of the financial statements should track this development before taking a final decision.

PUBLIC COMMUNICATIONS OUTSIDE FINANCIAL STATEMENTS

To meet the definition of an MPM, a subtotal of income and expenses is required to be included in public communications outside financial statements. Proposed Ind AS 118 does not define public communications, but it provides the following non-exhaustive list of which public communications would be considered to be included or excluded from this definition:

Included in public communications	Excluded from public communications
Management commentary	Oral communications
Press releases	Written transcripts of oral communications
Investor presentations	Social media posts

It was decided to provide exclusions for oral communication, written transcripts of oral communications and social media posts because these forms of communication are expected to contain information about MPMs already included in other forms of communication. Another reason for these exclusions was to address stakeholder concerns that these forms of communication are the most challenging to monitor.

OUR TAKE – EXEMPTIONS TO PRIVATE COMPANIES?

There is no exemption for private companies from providing disclosures related to MPMs. However, many private companies do not make public communications outside financial statements. Therefore, many private companies will not make any public communications that trigger the MPM disclosure requirements.

If a private entity uses subtotals of income and expenses in public communications outside financial statements that meet the definition of MPMs, the entity would be required to provide the applicable disclosures for those MPMs.

MANAGEMENT'S VIEW OF AN ASPECT OF THE FINANCIAL PERFORMANCE OF THE ENTITY AS A WHOLE

To meet the definition of an MPM, a subtotal of income and expenses must be used by the entity to communicate to users of financial statements:

MANAGEMENT'S VIEW:

Proposed Ind AS 118 contains a rebuttable presumption that a subtotal of income and expenses used in public communications outside financial statements communicates to users of financial statements the management's view of an aspect of the financial performance of the entity as a whole. The presumption is expected to provide rigour and discipline in the assessment of whether a measure communicates the management's view by setting out a condition usually expected to be true. It is reasonable to expect that the inclusion of a subtotal in public communications is for the purpose of communicating to users of financial statements the management's view of an aspect of its financial performance.

At times, an entity might adjust the subtotal communicated in public communications for use internally by management. In such cases, the entity is required to use its judgement to assess whether the subtotal it uses internally is sufficiently similar to the subtotal used in its public communications. The more similar the subtotals are, the more likely it is that the subtotal used in the entity's public communications conveys to users of financial statements the management's view of an aspect of the financial performance of the entity as a whole. (proposed Ind AS 118.B128). A subtotal used only internally by management does not meet the definition of an MPM as it is not used in public communications (proposed Ind AS 118.B127).

OUR TAKE – MEASURES MADE AVAILABLE THROUGH REGULATORY FILINGS

Regulators may require entities to disclose certain measures in their regulatory filings which may be subtotals of income and expenses and which may not be specifically required by Ind AS. The following questions arise in respect of such filings:

Are such regulatory filings considered public communications?

If a particular regulatory filing is available to users, without requiring an approval from the entity or the regulatory authority, such filings can be considered to be public communications. These filings are public communications even if accessing them requires the user to register and/or pay a nominal fee to access the public communication.

Are the measures disclosed considered to communicate management's view?

The mere fact that a regulatory authority requires disclosure of a particular subtotal is not a sufficient reason in isolation to rebut the presumption of communicating management's view. A subtotal required to be disclosed by a regulatory authority may also be used by management internally to assess the entity's financial performance. In such cases, the subtotal would meet the definition of an MPM, provided the other criteria are met.

If the subtotal is included in regulatory filings only because of regulatory requirements and the subtotal is not used by management internally to assess the entity's financial performance, the presumption of communicating management's view may be rebutted.

AN ASPECT OF THE FINANCIAL PERFORMANCE

Proposed Ind AS 118 does not define 'an aspect of the financial performance'. At times, judgement may be needed to determine whether a measure communicates management's view of an aspect of the entity's financial performance. A measure need not relate to the overall financial performance of the entity, but may relate only to an element of the financial performance. However, the measure must relate to an aspect of the financial performance of the entity as a whole. The focus of MPMs is on communicating management's view of an aspect of the entity's performance and not management's performance. A subtotal used solely for the purpose of measuring management's performance, for example, a measure used internally to determine management remuneration, would not meet the definition of MPMs. However, in some cases, such a measure may be used internally to evaluate management performance and externally to communicate management's view of an aspect of the entity's performance. In such cases, it would meet the definition of MPMs, provided the other criteria are met.

ENTITY AS A WHOLE

The definition of an MPM requires the measure to communicate management's view of an aspect of the financial performance of the entity as a whole.

For example, XYZ Group uses a performance measure 'profit or loss before non-recurring expenses and non-recurring income' in its public communications. This measure is a subtotal of income and expenses and is not one of the subtotals listed in proposed Ind AS 118.118 which are excluded from the definition of MPMs. The measure would typically not be a subtotal similar to gross profit, as it would typically consist of multiple expenses that are not directly related to generating the revenue included in profit. The measure communicates management's view of an aspect of the financial performance of XYZ Group as a whole, since it excludes non-recurring income and expenses from profit or loss for the entire group. Such a measure would meet the definition of an MPM, provided the other criteria are met.

In contrast, consider another scenario, where XYZ Group presents a measure 'profit or loss before non-recurring expenses' of Subsidiary S. This measure does not relate to an aspect of the financial performance of XYZ Group as a whole. Therefore, it would typically not be expected to meet the definition of an MPM, although this requires the exercising of judgement.

OUR TAKE – REPORTABLE SEGMENT DISCLOSURES

Subtotal related to a reportable segment could provide information about an aspect of the financial performance of the entity as a whole. For example, a subtotal of income and expenses relating to a segment containing a single main business activity is presented in the statement of profit or loss. In such cases, the subtotal would meet the definition of an MPM, provided the other criteria of the definition are met (proposed Ind AS 118.B115).

CHANGES IN USE OF AN MPM

An entity may change the method of calculation of an MPM, add a new MPM, cease the use of a previously disclosed MPM or change the method of determining the income tax effect of its reconciling items. In these cases, the entity is required to provide additional disclosures to explain the change and the reason for the change. The entity is also required to provide restated comparative information, unless impracticable to do so (proposed Ind AS 118.124).

OUR TAKE – MPM AN ACCOUNTING POLICY CHOICE?

An MPM is not determined in the context of preparing and presenting financial statements in accordance with Ind AS. It is defined to communicate an aspect of the entity's financial performance outside the financial statements. Thus, identification and calculation of MPMs is not an accounting policy.

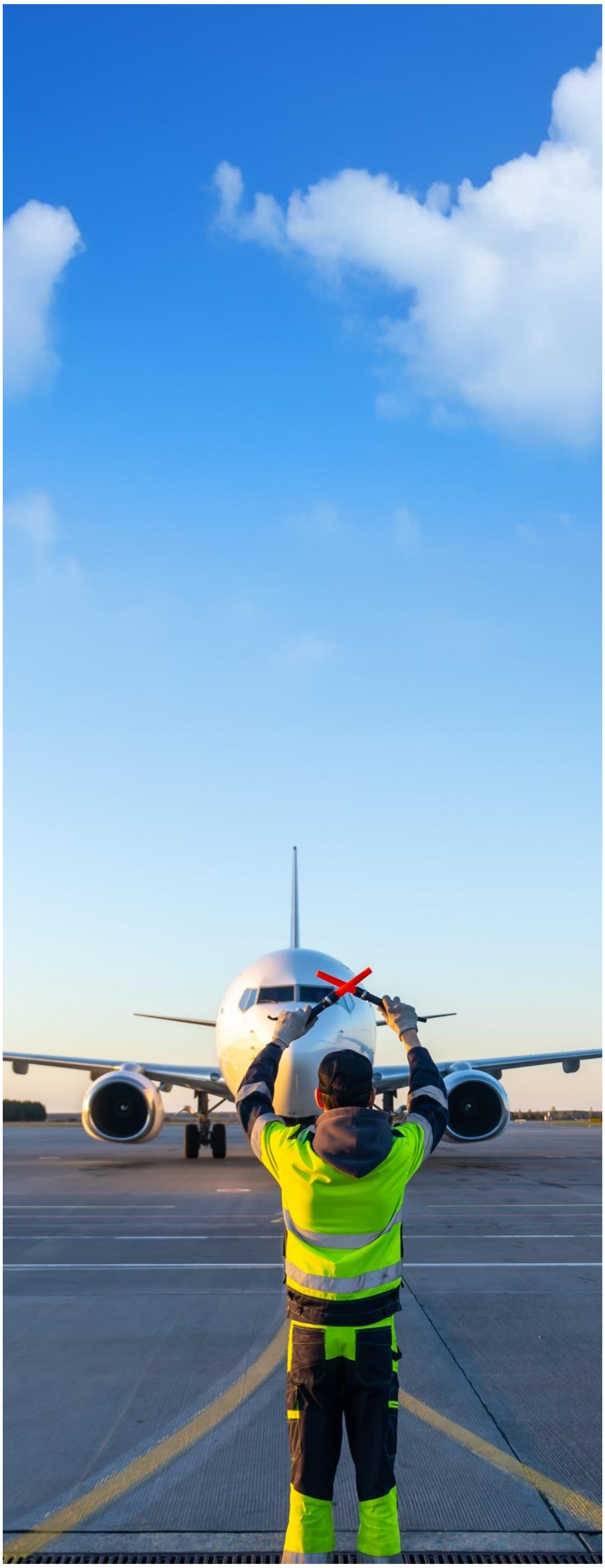
However, when there is a change in an MPM or an addition or cessation of an MPM, the entity is required to disclose restated comparative information, unless impracticable to do so.

OUR TAKE – CALCULATION OF MPMs

Proposed Ind AS 118.B134(b) provides additional disclosure requirements if the MPM is calculated by using accounting policies other than those used in the statement of profit and loss or different from those required or permitted by Ind AS. This indicates that an entity is not prohibited from using accounting policies different from the ones applied in its financial statements or required/ permitted by Ind AS.

Does this mean that management has absolute discretion in determining the method of calculation of an MPM?

No. The MPM to be disclosed is required to comply with the general requirements for information included in the financial statements, including that it faithfully represents the aspect of an entity's financial performance it purports to represent. However, an MPM is by definition always management-defined; therefore, 'faithful representation' is considered in the context of whether the MPM provides information about management's view.



DISCLOSURES OF MPMs

Proposed Ind AS 118.121 identifies two disclosure objectives for MPM disclosures: To provide information to help users of financial statements understand: the aspect of financial performance that, in management's view, is communicated by an MPM; and how the MPM compares with the measures defined by Ind AS. To meet the above disclosure objectives, proposed Ind AS 118 requires the disclosure of the following information for each MPM:

What is the MPM?	▶ A description of the aspect of financial performance that, in management's view, is communicated by the MPM ▶ Explanation of why, in management's view, the MPM provides useful information about the entity's financial performance
Method of calculation	▶ How is the MPM calculated?
Comparison with measures defined by Ind AS	▶ A reconciliation between the MPM and: ▪ the most directly comparable subtotal listed in Ind AS 18; or ▪ total or subtotal specifically required by Ind AS
Income tax and non-controlling interests (NCI) effects	▶ For each reconciling item: ▪ the income tax effect ▪ the effect on NCI
How is the income tax effect determined?	▶ A description of how Ind AS 118.B141 is applied to determine the income tax effect (An entity is permitted to determine the income tax effect using the statutory rate applicable to the transaction or based on a reasonable pro rata allocation of the current and deferred tax or by using another method that achieves a more appropriate allocation)

SINGLE NOTE DISCLOSURE

Proposed Ind AS 118 requires the disclosure of information related to MPMs to be made in a single note, i.e., an entity is not permitted to disclose the information to MPMs by cross-referencing other notes in the financial statements. The intention behind this proposal was to prevent fragmentation of information disclosed and to improve transparency. Proposed Ind AS 118 does not prohibit an entity from disclosing other information in the note that includes the MPM disclosures. But, in this case, the entity is required to label the information in a way that clearly distinguishes the disclosures related to MPMs.

MANAGEMENT'S STATEMENT ON MPMS

The single note on MPM disclosures is required to include a statement that the 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 sharing similar labels or descriptions provided by other entities (proposed Ind AS 118.122).

LABELLING OF INFORMATION

An entity is required to label and describe each MPM in a clear and understandable manner that does not mislead users of financial statements (proposed Ind AS 118.123). Proposed Ind AS 118 specifically requires an entity to label and describe the measure in a way that faithfully represents its characteristics in accordance with the requirements of proposed Ind AS 118.43. To achieve this faithful representation, the entity is required to:

- label the measure in a way that represents the characteristics of the subtotal (for example, using the label 'operating profit before non-recurring expenses' only for a subtotal that excludes from operating profit all expenses identified by the entity as non-recurring); and
- explain the meaning of terms it uses in its descriptions that are necessary to understand the aspect of financial performance being communicated (for example, explaining how the entity defines 'non-recurring expenses') (proposed Ind AS 118.B135).

RECONCILIATION

Ind AS 18 requires an entity to reconcile each MPM to either of the following:

- the most directly comparable subtotal listed in Ind AS 18.118 or
- total or subtotal specifically required to be presented or disclosed by Ind AS.

These subtotals are:

Subtotals listed in Ind AS 18.118

- Gross profit or loss (revenue minus cost of sales) and similar subtotals
- Operating profit or loss before depreciation, amortisation and impairments within the scope of Ind AS 36
- Operating profit or loss and income and expenses from all investments accounted for using the equity method
- For certain entities, a subtotal comprising operating profit or loss and all income and expenses classified in the investing category
- Profit or loss before income taxes
- Profit or loss from continuing operations

Note: A secondary reconciliation may be required

Totals or subtotals specifically required to be presented or disclosed by Ind AS

- Operating profit or loss
- Profit or loss before financing and income taxes (*not permitted for certain entities*)
- Profit or loss
- Total other comprehensive income
- Total comprehensive income

For each reconciling item, the entity is required to provide the following disclosures (Ind AS 18.B137):

Disclosure requirement	Applicability of the disclosure requirement
The amount(s) related to each line item in the statement of financial performance.	Applicable for each reconciling item, irrespective of the number of reconciling items.
A description of how the item: ▶ is calculated ▶ contributes to the MPM providing useful information	Applicable for each reconciling item where there is more than one reconciling item and each reconciling item is calculated using a different method or contributes to providing useful information in a different way. For example, an MPM may be calculated by excluding multiple items of expenses as they were identified as: ▶ Outside management's control; ▶ Non-recurring. In such cases, the entity is required to disclose which item contributed to which type of adjustment, explaining how the MPM provides useful information. (Ind AS18.B138)

WHAT ARE THE LIKELY COSTS ?

It is expected that all entities will incur additional efforts, including implementation costs, and possibly some ongoing costs, once these proposals are notified. Implementation efforts will vary depending on the company's current systems and reporting practices. Some companies will need to change their internal processes and adapt their accounting systems to comply with the requirements, including those relating to changes to the data collection process, financial reporting systems, and period-end closure process. Implementation efforts are likely to arise from:

CLASSIFICATION OF INCOME AND EXPENSES

The efforts for implementation are likely to be higher for entities with large volumes of derivatives and foreign currency-denominated items that are managed centrally. Such entities might incur additional costs to classify foreign exchange differences and derivatives in the relevant categories of the statement of profit or loss. The requirements to present new subtotals and line items mean that entities that digitally report their financial statements will need to re-tag their financial statements for these subtotals and line items. Retagging is likely to involve some one-time costs.

DISCLOSURE OF MPMS

The costs for implementing the disclosure proposals related to MPMs are expected to vary by entity. Entities that already communicate using measures that are MPMs will incur some costs of implementation. For example, entities are likely to incur costs in providing a reconciliation between those measures and the most directly comparable subtotal listed in proposed Ind AS 118, or total or subtotal required by Ind AS, and in providing the other disclosures required for MPMs.

EDUCATION AND COMMUNICATION

Staff will need to be trained, for example, in understanding the classification of income and expenses into categories in the statement of profit and loss. Entities will incur costs in communicating with external parties, such as investors and lenders, about the changes in their reported information.

ONGOING COSTS

An entity may incur some ongoing costs when there are changes in it's business, how it operates or how it communicates performance. For example, when there is a significant change to a company, such as a business combination or a restructuring, the company may be required to exercise judgement on whether the change affects the assessment of the main business activities, which would lead to changes in the classification of income and expenses in the statement of profit and loss.

The Ind AS 118 proposes certain cost mitigations to ensure that, in providing useful information to investors about their performance, entities will not incur undue costs. For example, simplified approaches to calculating the income tax effect for each reconciling item in MPM has been proposed.

ARE THERE ANY OTHER LIKELY EFFECTS?

Proposed Ind AS 118 may significantly impact contracts, agreements, compensation arrangements that rely on financial metrics and digital reporting. Entities may need to reassess how financial covenants, executive bonuses, and earnout clauses are defined and monitored. Inconsistent or undefined terms in agreements could lead to disputes if reported figures differ under the Exposure Draft. Examples include the following:

CONTRACTS AND AGREEMENTS

When information reported in financial statements is used to monitor compliance with contracts and agreements, the proposals might affect existing contracts and agreements. For example, covenants in loan agreements might impose minimum requirements for measures such as the profit subtotal presented in a borrower's financial statements. Many companies may need to change what they include in the subtotals to align with the proposals in Ind AS 118. In such cases, the parties to the contract or agreement will need to consider how the proposed changes by Ind AS 118 could affect the contract or agreement.

In contrast, the changes proposed by Ind AS 118 will have no effect on loan covenants that specify the calculation of such requirements without reference to amounts in financial statements.

COMPENSATION

Many companies have remuneration policies for management based on particular measures in the statement of profit and loss. Performance measures commonly linked to management remuneration included EBITDA and measures such as adjusted EBITDA. Entities with management remuneration policies based on particular measures in the statement of profit and loss will need to consider whether to change their policies to reflect changes to those measures. In addition, if measures linked to management remuneration meet the definition of MPMs, an entity will provide the MPM disclosures for such measures.

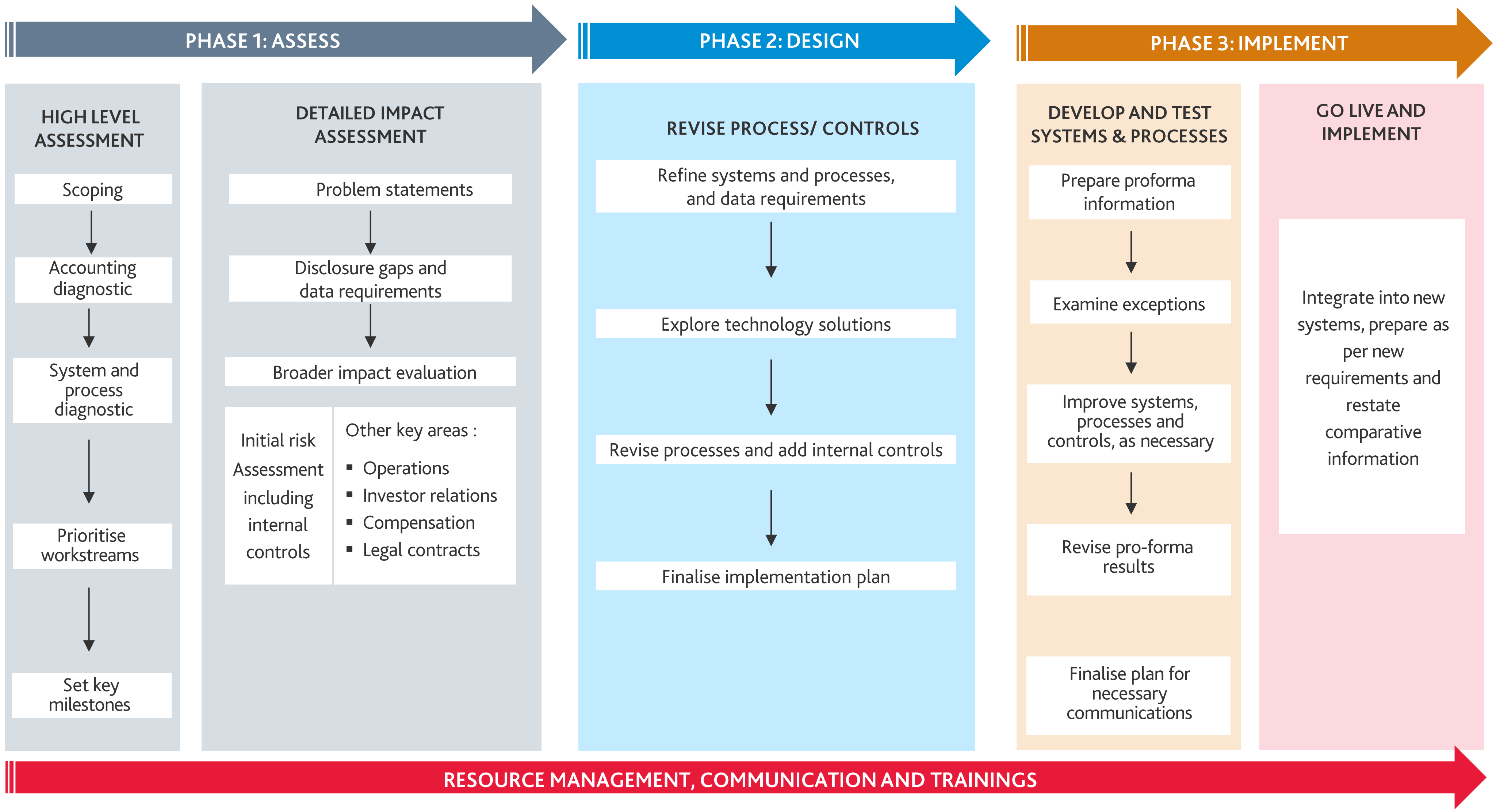
DIGITAL REPORTING

The proposed changes can require significant updates to the XBRL (eXtensible Business Reporting Language), taxonomy to reflect the new disclosure and presentation requirements. The proposed mandatory line items (i.e. Operating Profit and Profit before Financing and Income Taxes) may require new tags within the XBRL taxonomy, necessitating updates in reporting software and processes. The transition will require system updates, staff training, and possible consultation with technology and accounting experts to implement the new taxonomy and maintain compliance.

HOW SHOULD A COMPANY BEGIN ITS ASSESSMENT?

Ind AS 118 is proposed to become effective for annual reporting periods beginning on or after 1 April 2027. A company would apply Ind AS 118 retrospectively, which means restating comparative information when it first applies Ind AS 118. While this may seem distant, companies should begin their assessment as early as possible, ideally by 2025, to ensure a smooth and compliant transition. The early start is essential not only for compliance but also to manage the broader operational, contractual, and strategic impacts of the new standard.

Companies that prepare quarterly results under SEBI Listing Regulations in the first year of applying Ind AS 118 would need to present each subtotal required by Ind AS 118 in their quarterly results — including information for each of the comparative period(s). Therefore, such companies should also allow time and budget for preparing quarterly results/ interim financial reports in the first year of applying Ind AS 118.



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