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Effects Of IFRS 18 On Income Statements Of Brazilian Non-Financial Institutions

Andrea Alves Corrêa, Prof. Dr. Jose Alves Dantas,
Vanessa De Moura Minervino
University Of Brasilia (Unb), Postgraduate Program In Accounting Sciences (Ppgcont)

Summary:
Objective: *This study discusses the modifications presented by the International Accounting Standards Board (IASB) with the publication of International Financial Reporting Standards 18 (IFRS 18) and analyzes the expected results with the implementation of the income statement model proposed by the standard.*
Method/Approach: *The research is based on a content analysis, with a survey of studies published between 2019 and 2024 (last five years) and the relevant regulations, offering a critical reflection on the expected results with the implementation of the income statement model proposed by IFRS 18 and its potential to promote transparency and comparability.*
Results: C*learly understand the differences in the presentation of the income statement between current legislation (Law No. 6,404, of December 15, 1976) and IFRS 18, and present a comparative model between the two structures.*
Contributions: *This research offers a discussion of the essence (IFRS 18) over the form (Law 6,404, of 1976) regarding the presentation of the DRE in non-financial institutions in Brazil, in addition to proposing a model of incomestatement in accordance with IFRS 18.*
Keywords: *Income Statement Quality; Income Statement; Exposure Draft 2009/7; IFRS18; International Financial Reporting.*

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I. Introduction

This study aims to discuss the proposed changes to the structure of the Income Statement presented by International Financial Reporting Standard 18 (IFRS 18), comparing it with the current standard established by Law No. 6,404 of 1976. The perspective of IFRS 18 is to modify the structure and the way of disclosing the components in the Income Statement, introducing new requirements, with the declared intention of improving the transparency and comparability of financial reports for investors.

The research highlights the changes proposed by IFRS 18 and discusses the impacts of its adoption, considering the various theoretical and economic foundations, considering that in Brazil the structure of the Income Statement is regulated by Law No. 6,404 of 1976, amended by Law No. 11,638 of 2007, which provides, in article 187, for the presentation of this statement. Additionally, Law No. 11,638 of 2007 establishes that the standards issued by the Brazilian Securities and Exchange Commission (CVM) must be prepared in accordance with the international accounting standards adopted in the main securities markets, promoting harmonization with global accounting practices, that is, the adoption of IFRS.

Thus, the implementation of IFRS 18 introduces an important duality: while it seeks to align Brazilian financial reports with international standards, it also needs to meet the legal requirements established by Law No. 6,404 of 1976. This duality reflects the challenge of reconciling the need for global comparability and transparency with the obligation to comply with national standards.

Among the main expected results of the study is the understanding of the differences between the presentation of the Income Statement according to Law No. 6,404 of 1976 and IFRS 18. In addition, a comparative model between the two structures will be presented, highlighting the changes and the expected benefits in terms of transparency and comparability. Additionally, the practical challenges in implementing IFRS 18 and the possible impacts on the accounting practices of Brazilian non-financial institutions will be discussed.

Previous studies have addressed general aspects of IFRS adoption in Brazil, but there is a specific gap regarding the direct effects of IFRS 18, due to its recent publication in April 2024, effective from 2027. This study will contribute to the literature by filling the existing gap on the specific effects of IFRS 18 on Brazilian non-financial institutions, providing a detailed and critical analysis of the new regulatory requirements. For accounting practice, the work will offer contributions on the adaptation to the new financial reporting model, highlighting the main differences between the Income Statement model provided for in Law No. 6,404 of 1976 and the model provided for in IFRS 18.

The study contributes to the analysis of essence versus form in accounting, highlighting how IFRS 18 prioritizes the economic essence of transactions in contrast to the formalistic approach of Law No. 6,404 of 1976.

II. The IFRS 18 Financial Reporting Model

The design of IFRS 18 was the result of a long review and feedback process initiated by the International Accounting Standards Board (IASB) in 2015 with the Primary Financial Statements project. Between May 2015 and May 2019, the IASB decided to issue an Exposure Draft to obtain feedback on the draft proposals. In December 2019, after several studies and discussions, the IASB released Exposure Draft ED/2019/07, entitled 'General Presentation and Disclosures', which was open for comments until the end of September 2020. The development of IFRS 18 over almost a decade demonstrates the IASB's commitment to improving the communication of companies' financial performance.

IASB Chairman Andreas Barckow stated that the implementation of IFRS 18 represents a major shift in the way companies report their financial performance, one that is among the most substantial changes witnessed since the inception of IFRS Accounting Standards more than two decades ago. Barckow emphasized the importance of IFRS 18 by highlighting its potential to provide investors with improved levels of information about companies' financial performance, providing them with more uniform and standardized references for their analysis (IFRS Foundation, 2024).

The premise is that IFRS 18, published in April 2024, will present investors with information with greater visibility and standardization of data on companies' financial results, enabling better investment decisions, affecting all companies that adopt IFRS standards (IFRS Foundation, 2024). According to Sultanoglu (2020), investors have difficulty finding useful information in financial statements due to the excess of irrelevant data and the lack of effectivecommunication.

In seeking to ensure that financial statements provide a faithful image of an entity's financial situation, performance and cash flows, meeting the needs of users of accounting information, IFRS 18 presents three distinct sets of new criteria that aim to increase the transparency of companies' financial results and, thus, offer investors a basis for evaluating and making comparisons between companies:

a) Improved comparability in the Income Statement: Currently, there is no designated structure for the statement in the IFRS standards, leaving it up to companies to choose the subtotals they wish to incorporate. Companies often present an operating profit, but the way this profit is calculated varies from one company to another, making comparability difficult. IFRS 18 introduces three specific categories for revenues and expenses - operating, investments and financing - to improve the structure of the income statement and requires all companies to present the newly defined subtotals, including operating profit. The improved structure and the new subtotals are expected to provide investors with a consistent basis for analyzing the performance of companies, in addition to facilitating the comparability of information. (IFRS, 2024). It is worth noting that in Brazil this freedom of the IFRS standards is more restricted, in view of the provisions of Law No. 6,404 of 1976, and its amendments, which imposes a more rigid and specific structure for the Income Statement, different from what is being provided for in IFRS 18.

b) Improved transparency of management-defined performance metrics: Many companies provide specific measures, called alternative performance measures, that investors consider useful. However, most companies currently do not provide sufficient information for investors to understand how these measures are calculated and how they relate to subtotals in the income statement. These new requirements are expected to improve the discipline and transparency of management-defined performance measures and, in addition, make auditing easier for companies subject to this process. (IFRS Foundation, 2024).

c) More efficient grouping of information in financial statements: Investors' analysis of companies' performance is compromised if the information provided is excessively summarized or detailed. In this sense, IFRS 18 establishes guidelines on the organization of data and whether it should be presented in the primary financial statements or in the explanatory notes. The standard also requires companies to increase the transparency of operating expenses, making it easier for investors to locate and understand the necessary information. (IFRS Foundation, 2024).

Braunbeck and Luccas (2020) state that the proposals contained in Exposure Draft ED/2019/07 may impact all entities, in various economic segments, and may present some challenges in implementation, but also opportunitiesfor more effective communication.

According to the IASB (2024), in IFRS 18, the role of primary financial statements is to provide structured summaries of an entity's recognized assets, liabilities, equity, revenues, expenses and cash flows. This information helps users understand the entity's financial position, compare different entities and periods, and identify areas that need further detail in the notes. In addition, the notes provide relevant and necessary information to enable users of the financial statements to understand the items presented in the primary financial statements and to supplement the primary financial statements with additional information to achieve the objective of the financial statements" (IFRS 18, 2024).

III. Literature review

The existing literature on the subject has explored the benefits and challenges of adopting the international reporting model, highlighting the importance of transparency and comparability of accounting information for the Brazilian financial market. According to the study carried out by Sousa, Dantas, Nascimento and Gonçalves (2023), the importance that the discussion has acquired is exemplified by the fact that stakeholders demand a solution from accounting standard setters in order to improve the comparability of reported information, since users claim that some companies have disclosed these measures without defining or explaining them, reducing their usefulness.

In the specific case of IFRS 18, in line with this concern, the IASB developed ED 2019/7 – General Presentation and Disclosure, a project that aimed to replace International Accounting Standard (IAS) 1 – Presentation of Financial Statements. The premise is that the information disclosed meets the basic requirements for control, analysis and decision-making, faithfully representing the data presented, and can positively influence users' decisions. In other words, IFRS 18 emerges as a standard that aims to meet these demands for greater transparency and comparability.

The gap in the literature that this work aims to fill is in the specific analysis of the impacts of IFRS 18 on Brazilian non-financial institutions, considering the particularities of the national context and taking into account the country's regulatory and business environment, as well as the possibility of generalizing the findings to other contexts. In this line of understanding, and taking as a reference the discussions of ED/2019/07, Braunbeck and Luccas (2020) promoted a literature review and empirical observation based on companies in the pulp and paper sector, highlighting how the proposed changes to the Income Statement by the IASB have the potential to impact several entities in different industries. They point out the challenges in implementing these changes, but also the opportunities for more effective communication.

Santana, Rodrigues, Motta and Cruz (2022), through a documentary study and qualitative analysis, showed the results of the comparison of the structures of the Income Statements of transnational third sector entities from different countries, such as Australia, Brazil, France, Portugal and the United Kingdom, noting similarities and differences in the structures of the statements in relation to the proposed changes by the IASB. In addition, the study highlighted the importance of comparability of financial statements for investors, as well as pointed out the possible changes in the structure of the Income Statement with the approval of the standard proposed by the IASB.

According to Maruszewska and Tuszkiewicz (2023), in a study carried out in Poland, the mandatory separation of investment and financial activities, as provided for in ED/2019/07, represents a major challenge due to differences in relation to national laws and current IAS/IFRS standards. This will require the reclassification of items in the Income Statement, such as exchange differences, investment income and expenses, which must now be allocated between different categories. This adjustment aims to increase the transparency and comparability of financial reports, facilitating analysis by investors and other users. The findings highlight the need to adjust accounting systems and promote educational events for accountants, ensuring the correct application of the new guidelines and improving the quality of financial information, in addition to strengthening investor confidence in the Polish market.

The study by Souza (2019) highlights the importance of compliance with international accounting standards, especially IFRS, evidencing their positive influence on companies' economic and financial indicators. In addition, it highlights the relevance of comparability of financial statements for investors and the need for transparency, relevance and comparability in the financial information presented by entities, contributing to improvingthe quality of accounting communication and assisting in economic decision-making.

Lima, Costa and Rodrigues (2022) contribute to the understanding of the importance of compliance with international accounting standards, highlighting the influence of IFRS on economic and financial indicators, the relevance of comparability of financial statements for investors and the need for transparency, relevance and comparability in the financial information presented by entities. Their results suggest that the new Operating Result proposed by ED/2019/07 has greater explanatory power for the market value of companies compared to Earnings Before Interest, Taxes, Depreciation, and Amortization (EBITDA) and Net Income, showing that the changes proposed by the IASB can improve the quality of accounting information and the predictability of the market value ofshares.

In general, the main findings highlight the importance of compliance with international accounting standards, the influence of IFRS on economic and financial indicators, the relevance of comparability of financial statements for investors and the need for transparency, relevance and comparability in the financial information presented by entities.

IV. Income Statement: Conflicts Between IFRS 18 And Law 6,404 Of 1976

Law 6,404 of 1976 is a special legislation composed of several rules governing Brazilian corporate law, with the objective of regulating the formalities for the incorporation and operational practices of corporations in Brazil. Article 187 of this law establishes the basic structure to be followed in the preparation of the Income Statement.

Non-financial institutions, which are the focus of this study, are classified as companies and may be publicly or privately held, according to the legislation. According to Law 6,404 of 1976, privately held companies have the option of following the financial reporting standards established by the CVM for publicly held companies. However, Law 11,638 of 2007 introduced changes and determined that privately held companies with net equity exceeding R$2million must adopt the same standards as publicly held companies.

Law 6,404 of 1976 determines that, when calculating the income for the year, the following must be computed, in accordance with the accrual principle: a) revenues and earnings earned in the period, regardless of whether they are realized in currency; and b) costs, expenses, charges and losses, paid or incurred, corresponding to such revenues and earnings. These provisions are compatible with IFRS standards, since the current IFRS model does not have a defined standard model. This raises the question of how the new IFRS 18 model relates to the model currently provided for in Brazilian legislation.

In this regard, Valor Econômico (2024) highlights that in Brazil, the new feature provided for in IFRS 18 still needs to overcome an old barrier: the Corporations Law, because despite the positive reception in the local market, the country's legal structure creates possible legal conflicts with the standard. This is because Law 6404, of 1976, determines how companies must present their results and some profit subtotals, contrasting with the specifications ofthis and other standards.

IFRS 18 recommends that entities analyze expenses that constitute operating profit or loss according to the nature or function of the expenses, using the method that provides the most relevant information, without mixing nature and function. However, the Law requires the presentation of certain items by function, as mentioned by the chairman of the audit and accounting standards committee of the Brazilian Association of Publicly-Held Companies (Abrasca), Alexsandro Tavares (Valor Econômico, 2024). When it mentions “function”, there is a reference to the separation of expenses between “cost” and “expense”, something that is not required by IFRS 18.

Eliseu Martins, a professor at the University of São Paulo (USP), notes that new conflicts with Brazilian legislation arise almost every time a new accounting standard is updated. He explains that, although Law 6,404 of 1976 was reformed by Law 11,638 in 2007, this reform was already outdated due to the long interval of almost eightyears for its approval (Valor Econômico, 2024).

Martins argues that, despite the changes made, the conflicts have not been eliminated. He emphasizes that it makes no sense to incorporate accounting standards into the law, since international standards are constantly evolving, often including new instruments and forms of implementation, which makes changing a law a much more laborious process (Valor Econômico, 2024). The accountant clarifies that, in practice, the conflict between Law 6,404 of 1976 and international accounting standards has no direct effects, since the changes made to the law require the CVM to adopt international standards, applicable to publicly traded companies and large corporations. For other companies, it is the CFC that sets the standards, following the CVM guidelines.

To answer the key questions of this research, this article used a theoretical essay, through content analysis, using a combination of bibliographic review and documentary analysis. To obtain data, the Capes and Scopus platforms were used, platforms that cover a large part of the academic literature, having included search terms for journals that individually mentioned in the title, abstract or keywords the terms "IFRS 18", “Exposure Draft 2019/7”, “Qualidade da DRE” and “Reporte Financeiro Internacional” (International Financial Reporting). Only studies published between 2019 and 2024 were included.

V. Potential Limitations And Analysis Procedures

One possibility to be considered is the scarcity in the availability of post-implementation data, given the recent publication, which may only provide probable results and limited understanding of the impacts of implementing the standard, especially in a national context with such specific characteristics.

It is important to contextualize the expected results with the implementation of IFRS 18 in Brazilian institutions, taking into account the particularities of the country's regulatory and business environment, as well as thepossibility of generalizing the findings to other contexts.

To ensure consistency of results, it is essential to carry out an in-depth analysis of the effects of implementing IFRS 18, considering not only the technical aspects, but also the practical and organizational aspects ofBrazilian institutions.

VI. Presentation And Analysis Of Results

Despite the challenges faced, IFRS 18 is widely valued due to the significant changes it introduces. Among these changes, the creation of new profit subtotals stands out, defined to offer a better presentation and disclosure structure for income statements.

According to Valor Econômico (2024), the International Standards Board (IASB) conducted a study when developing the IFRS 18 project and found that operating profit is the most widely used metric in financial statements. However, variations in how this metric is presented across companies make it difficult to compare operating profits. The implementation of IFRS 18 is expected to address issues like this.

Rogério Mota, technical director of the Brazilian Institute of Independent Auditors (Ibracon), highlights that the main objective of the project was achieved, resulting in improved reporting and increased comparability of results (Valor Econômico, 2024). In general, the comparison between the Income Statement of Law 6,404 of 1976 (art. 187) and the IFRS 18 proposal is summarized in Table 1:

Table 1 – Comparative analysis between the income statements (Law 6,404 x IFRS)

Brazilian Law nº 6.404	IFRS 18
Gross Revenue	**Net Sales Revenue**
(-) Taxes, Rebates and Refunds	(+) Other Income
= Net Revenue	(-) Consumption of raw materials and materials
(-) Cost of Goods Sold	(+) Variation in stocks
(-) Cost of Goods Sold	(-) Salary and benefit expenses
(-) Cost of Service Provided	(-) Depreciation expenses
= Gross Profit	(-) Amortization Expenses
(-) Sales Expenses	(-) Research Expenses
(-) General and Administrative Expenses	(-) Marketing Expenses
(-) Operating Expenses	(-) Impairment Losses
(-) Financial Expenses	(-) Other expenses
(+/-) Equity Result	**= Operating Profit**
(+) Other operating income	(+/-) Equity Result of Associated Companies
= Operating Profit	(+/-) Equity Result of Joint Ventures
(+/-) Other Income and Expenses	(+/-) Financial income/expense of financial assets
= Profit Before Income Tax (EBIT)	(+/-) Cash and cash equivalent financial income/expense
(-) Income Tax/Social Contribution	(+) Dividend income
(-) Participation of employees andadministrators	(+/-) Change in fair value of financial assets
	= Profit before financing and income tax/social contribution
= Net Profit	(-) Interest expenses on financing
	(+/-) Exchange rate variation on financing
	(-) Expenses related to Provisions
	= Profit before income tax (EBIT)
	(-) Income Tax/Social Contribution
	= Net Profit for the Year

Source: Adapted from IFRS 18 (2024) and Law 6,404

As can be seen in Table 1, the IASB created a structure for the Income Statement and introduced new mandatory categories and subtotals. IFRS 18 introduces three categories in the Income Statement structure: operating, investing and financing, and coincidentally, these are the same categories as the Cash Flow Statement (CFS). Thus, companies will need to classify their revenues and expenses according to these three categories, with the residual operating category. In addition, the standard adds two new subtotals defined in the Income Statement: "operating profit" and "earnings before interest and income taxes". The objective of these requirements is to establish a consistent structure for the Income Statement, promoting comparability between companies.

The aim is to take a critical look at the implications of this structure on companies' accounting practices and to analyze how IFRS 18 can influence the transparency and consistency of financial information. The adoption of this standard may provide a clearer view of operational performance, enabling better assessment and comparability between different companies and sectors. In addition, it is expected that the standardization of profit subtotals will contribute to reducing interpretative divergences and improving investor confidence in the financial statements presented.

VII. Final Considerations

The objective of this study was achieved, the analysis of the implementation of IFRS 18 shows a clear improvement in the quality of accounting information, which, despite being adopted by legal imposition, is in line with the findings found in the literature and in research conducted by the IASB.

In short, IFRS 18 represents a significant advance in international accounting, consolidating itself as an important milestone in the evolution of global accounting standards.

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