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IFRS Developments

The IASB issues IFRS 18 *Presentation and Disclosure in Financial Statements*

What you need to know

- IFRS 18 replaces IAS 1 and responds to investors' demand for better information about companies' financial performance.
- The new requirements include:
  - Required totals, subtotals and new categories in the statement of profit or loss
  - Disclosure of management-defined performance measures or 'MPMs'
  - Guidance on aggregation and disaggregation
- Some requirements previously included in IAS 1 have been moved to IAS 8 and limited amendments have been made to IAS 7 and IAS 34.
- IFRS 18 is effective for reporting periods beginning on or after 1 January 2027, with earlier application permitted.
- Retrospective application is required in both annual and interim financial statements.

Highlights

On 09 April 2024, the International Accounting Standards Board (the IASB or the Board) issued IFRS 18 *Presentation and Disclosure in Financial Statements* (IFRS 18) which replaces IAS 1 *Presentation of Financial Statements* (IAS 1). The new IFRS accounting standard is a result of the IASB's *Primary Financial Statements* project, which is aimed at improving comparability and transparency of communication in financial statements.

While a number of sections have been brought forward from IAS 1, with limited wording changes, IFRS 18 introduces new requirements on presentation within the statement of profit or loss, including specified totals and subtotals. It also requires disclosure of management-defined performance measures and includes new requirements for aggregation and disaggregation of financial information based on the identified 'roles' of the primary financial statements (PFS) and the notes. These new requirements are expected to impact all reporting entities.

Narrow scope amendments have been made to IAS 7 *Statement of Cash Flows* (IAS 7) and some requirements previously included within IAS 1 have been moved to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* (IAS 8), which has also been renamed IAS 8 *Basis of Preparation of Financial Statements*. IAS 34 *Interim Financial Reporting* (IAS 34) was amended to require disclosure of management-defined performance measures. Minor consequential amendments to other standards were also made.

Key new requirements

Statement of profit or loss

IFRS 18 requires an entity to classify all income and expenses within its statement of profit or loss into one of five categories: operating; investing; financing; income taxes; and discontinued operations. The first three categories are new. These categories are complemented by the requirement to present subtotals and totals for 'operating profit or loss', 'profit or loss before financing and income taxes' and 'profit or loss'.

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An entity will be required to assess whether it has a 'specified main business activity' of investing in assets or providing finance to customers, as there are specific requirements for such entities.

Main business activities

For the purposes of classifying its income and expenses into the three new categories required by IFRS 18, an entity will need to assess whether it has a '*specified main business activity*' of investing in assets or providing finance to customers, as specific classification requirements apply to such entities. Determining whether an entity has such a specified main business activity is a matter of fact and circumstances which requires judgement. An entity may have more than one main business activity.

The investing category

The investing category will generally include income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries, cash and cash equivalents and other assets, if they generate a return individually and largely independently of the entity's other resources (IFRS 18 includes examples of such assets). To illustrate, for entities that do not have a specified main business activity of investing in assets or providing finance to customers, income and expenses in the investing category could include:

- Income generated by the assets mentioned above (for example, interest, dividends and rental income)
- Income and expenses that arise from the initial and subsequent measurement of those assets including on derecognition of the assets (for example, impairment losses and reversals of impairment losses)
- Incremental expenses directly attributable to acquiring and disposing of those assets (for example, transaction costs and costs to sell)

The financing category

In order to determine what income and expenses to classify in the financing category, IFRS 18 requires an entity to differentiate between two types of liabilities (which we have termed 'Type 1' and 'Type 2' for brevity in this publication):

1) Type 1: liabilities that arise from transactions that involve only the raising of finance (i.e., entity receives finance in the form of cash, own equity or the discharge of a liability and will return cash or its own equity in exchange at a later date); and
2) Type 2: other liabilities (i.e., liabilities other than Type 1 liabilities)

For entities that do not provide financing to customers as a main business activity, the financing category includes income and expenses that arise from the initial and subsequent measurement of all Type 1 liabilities, as well as incremental expenses attributable to the issue and extinguishment of such liabilities. For example, interest expense on a debt instrument issued. There are separate requirements for entities that provide financing to customers as a main business activity, which is discussed in the 'Operating' section below.

Interest income and expenses, as well as the effect of interest rate changes, that arise while applying another IFRS accounting standard to 'other liabilities' (i.e., Type 2 liabilities above), are recognised in the financing category. For example, the interest expenses recognised under IFRS 16 *Leases* on the accounting for lease liabilities.

The operating category

The operating category is intended to capture income and expenses from the entity's main business activities. However, IFRS 18 describes it as a residual category, so the operating category will comprise all income and expenses not included within the other categories even if these income and expenses are volatile and/or unusual.

This approach was intended to work for different business models, while still providing a complete picture of the entity's operations. By applying the residual approach, the operating category will include all income and expenses from an entity's main business activities. However, any income or loss from investments accounted for using the equity method is to be included in the investing category, regardless of the specified main business activities of the entity.

If an entity has a specified main business activity of investing in assets, the income and expenses from those assets will be included in the operating category, e.g., real estate companies will need to present rental income in the operating category.

Entities with a specified main business activity of providing financing to customers will classify income and expenses from cash and cash equivalents that relate to providing financing to customers (for example, cash and cash equivalents held for related regulatory requirements) within the operating category. These entities will also need to determine which of their Type 1 liabilities (mentioned above) relate to providing financing to customers, since income and expenses arising from these liabilities must be included in the operating category. For income and expenses from Type 1 liabilities that do not relate to providing financing to customers, a policy choice is available to the entity to include these in either the operating or the financing categories. If an entity is unable to distinguish between these Type 1 liabilities, the income and expenses on all Type 1 liabilities will need to be included in the operating category.

How we see it

All entities will need to carefully reconsider the structure of their statement of profit or loss in light of the three new categories and subtotals required by IFRS 18. Classifying income and expenses into the relevant profit or loss categories may require the use of judgement. Although many entities already present an operating profit or loss subtotal, the current classification of income and expenses in this category might not be the same as required under the new standard.

The policy choices available to entities with specified main business activities could create some diversity in practice which may impact comparability between entities.

Entities also need to consider the broader impact of changing the structure of their statement of profit or loss if, for example, their current subtotals are inputs in determining management incentives, income tax or compliance with covenants.

Management-defined performance measures

The standard clarifies that subtotals required by an IFRS accounting standard are not MPMs, and specifically lists some other subtotals that are also not MPMs.

IFRS 18 introduces the concept of a management-defined performance measure (MPM) and defines it as a subtotal of income and expenses that an entity uses in public communications outside financial statements, to communicate management's view of an aspect of the financial performance of the entity as a whole to users. The standard clarifies that subtotals required by an IFRS accounting standard are not MPMs, and specifically lists some other subtotals that are also not MPMs, e.g., "gross profit or loss (revenue minus cost of sales) and similar subtotals".

IFRS 18 requires entities to disclose information about all its MPMs in a single note to the financial statements and lists several disclosures to be made. These include: how the measure is calculated; how it provides useful information; and a reconciliation to the most comparable subtotal specified by IFRS 18 or another standard.

How we see it

We believe that the required disclosure around MPMs will improve transparency for users and since MPMs are required to be included in the financial statements, they will generally also be subject to audit.

Many entities use alternative performance measures (APMs) that are outside the financial statements, in their communications with capital markets. MPMs, as defined in IFRS 18, are a subset of APMs and, therefore, entities will still need to carefully consider whether it is appropriate to include APMs that are not also MPMs within the financial statements.

Furthermore, considering the new disclosure requirements, many entities may take the opportunity to revisit the purpose and relevance of the APMs, including MPMs, used in their current communication with external users and capital markets.

Location of information, aggregation and disaggregation

The standard differentiates between 'presenting' information in the PFS and 'disclosing' it in the notes and introduces a principle for determining the location of information based on identified 'roles' of the PFS and the notes. An entity is required to 'present' information in the PFS to provide structured summaries of the entity's income, expenses, assets, liabilities, equity and cash flows that are useful to users. The entity will also need to 'disclose' other material financial information in the notes, to supplement the PFS.

IFRS 18 requires aggregation and disaggregation of information to be performed with reference to similar and dissimilar characteristics while keeping the identified roles of the PFS and the notes in mind. Since the purpose of the PFS is to provide a useful structured summary, an entity will, by design, aggregate material items on the face of the PFS, and then need to disaggregate them in the notes.

IFRS 18 also includes guidance on determining meaningful descriptions, or labels, for items that are aggregated in the financial statements and it requires disclosure of further information regarding items labelled as 'other'.

Consequential amendments to IAS 7

Narrow scope consequential amendments were made to IAS 7, which include changing the starting point for determining cash flows from operations under the indirect method, from 'profit or loss' to 'operating profit or loss'.

The optionality around classification of cash flows from dividends and interest in the statement of cash flows has also largely been removed. Dividends paid will now be included in financing cash flows. Entities that do not have a specified main business activity of investing in assets or providing finance to customers will be required to classify interest paid as financing activities, and interest and dividends received as cash flows from investing activities. For entities that do have a specified main business activity of investing in assets or providing finance to customers, the classification of dividends received, interest paid and interest received will be impacted by the classification of the related income and expenses in the statement of profit or loss.

Transition

IFRS 18, and the amendments to the other standards, is effective for reporting periods beginning on or after 1 January 2027, but earlier application is permitted and must be disclosed. IFRS 18 will apply retrospectively. An entity that prepares condensed interim financial statements in accordance with IAS 34 in the first year of adoption of IFRS 18, must present the headings and mandatory subtotals it expects to use in its annual financial statements.

Comparative periods in both the interim and annual financial statements will need to be restated and a reconciliation of the statement of profit or loss previously published will be required for the immediately preceding comparative period.

How we see it

While there may appear to be ample time before the effective date of IFRS 18, entities are strongly encouraged to begin analysing the new requirements. Many entities will need to identify and collect information, which in some cases, may necessitate changes to their internal information systems. Entities are advised to monitor practice as it develops, with a focus on the specific developments in their particular industry.

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