IASB PUBLISHES IFRS 18 *PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS*

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Introduction

The latest IFRS® Accounting Standard, IFRS 18 *Presentation and Disclosure in Financial Statements,* issued by the International Accounting Standards Board (IASB), replaces IAS 1 *Presentation of Financial Statements* and is mandatorily effective for annual reporting periods beginning on or after 1 January 2027.

In July 2023, the International Accounting Standards Board (IASB) completed technical work on its primary financial statements (PFS) project, which concluded with the release of IFRS 18.

IFRS 18, which was published by the IASB on 9 April 2024, sets out significant new requirements for how financial statements are presented, with particular focus on the statement of profit or loss, including requirements for mandatory sub-totals to be presented, aggregation and disaggregation of information, as well as disclosures related to management-defined performance measures.

The aim of the IASB in publishing IFRS 18 is to improve comparability and transparency of companies' performance reporting. IFRS 18 has also resulted in narrow changes to the statement of cash flows.

Status
Final standard published on 9 April 2024

Effective Date
Annual reporting periods beginning on or after 1 January 2027

Accounting Impact
IFRS 18 will have a significant effect on how entities present their financial statements with emphasis on reporting of financial performance. The areas that will be significantly affected include categorisation and sub-totals in the statement of profit or loss, aggregation/ disaggregation and labelling of information, and disclosure of management-defined performance measures.

There are a host of supporting documents and educational materials on the IFRS 18 implementation page on the IFRS Foundation website. These pages are expected to be updated regularly with webcasts and other relevant information focussed on the implementation of IFRS 18. BDO will also publish further guidance on IFRS 18 in due course, including IFRS 18 At a Glance and IFRS Accounting Standards In Practice.

This publication is organised as follows:

1. Background on the PFS project
2. Requirements in IAS 1 brought forward into IFRS 18
3. Areas of significant change from IAS 1 vs. IFRS 18
   - Categories in the statement of profit or loss
   - Line items and sub-totals
   - Labelling, aggregation and disaggregation
   - Statement of cash flows: operating cash flows, and classification of interest and dividend cash flows
   - Management-defined performance measures
4. Practical implications of the new requirements
5. Transition and effective date
6. How to get started

Background on the PFS project

The IASB has received feedback from investors that the comparability of entities' statement of profit or loss was reduced due to a lack of consistency in how financial performance has been presented. For example, two entities may have similar operations in a similar industry, but they may present the results of their operations differently. Some entities also use management-defined performance measures of profit that reduce comparability as well. For example:

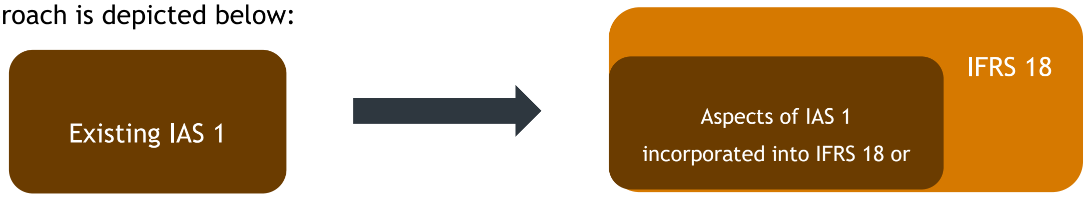
- Many entities present 'operating profit' in the statement of profit or loss, but it may be defined differently. Some entities may not present operating profit at all, as there is no requirement to present such a sub-total in IAS 1.
- One entity may present 'operating profit' as including the results of associates accounted for using the equity method, with others including this amount outside of operating profit. There may be other differences in how entities calculate sub-totals.
- Entities may disclose management-defined performance measures of financial performance outside of the financial statements (e.g. press releases, strategic reports, management discussion & analysis, etc.), which are defined differently (e.g. earnings before interest, taxes, depreciation and amortisation (EBITDA), adjusted profit, profit excluding non-recurring items, etc.).

In response to these concerns, the IASB undertook a project to replace IAS 1 with a new IFRS Accounting Standard to increase the comparability of financial performance presented by entities.

The IASB issued an exposure draft (ED) in 2019, which set out its proposals (see BDO's comment letter in response to the ED). The IASB deliberated on the feedback received and completed its technical work in July 2023.

Requirements in IAS 1 brought forward into IFRS 18

While IFRS 18 introduces significant changes to financial statement presentation, not all aspects of IAS 1 are being revised. In many areas, the requirements of IAS 1 are 'brought forward' into IFRS 18 and/or IAS 8 substantially unchanged. In certain cases, requirements from IAS 1 have been inserted into a revised version of IAS 8, which has been retitled *Basis for Preparation of Financial Statements*. This approach is depicted below:



Examples of requirements that have been incorporated into IAS 8 rather than IFRS 18 include the requirement to disclose an unreserved statement of compliance with IFRS Accounting Standards, the 'true and fair' override, going concern considerations, the disclosure of material accounting policy information and the disclosure of sources of estimation uncertainty.

The following is a summary of topics in IAS 1 that are 'brought forward' into IFRS 18 without significant changes:

1. The primary financial statements required to be included in financial statements (e.g. statements of financial position, profit or loss, cash flows, etc.)
2. Frequency of reporting
3. Comparative information
4. Offsetting
5. Most statement of financial position requirements
6. Classification of assets and liabilities as current vs. non-current (subject to 2020 and 2022 amendments concerning the classification of certain liabilities – (See *IFRB 2024/02 -*

Amendments to IAS 1 - Clarification of the Meaning of 'Settlement' in the Classification of Liabilities and IFRS Accounting Standards in Practice - IAS 1 Classification of Loans as Current or Non-current)

7. Most statement of cash flows requirements (refer to IAS 7)
8. Statement of comprehensive income requirements
9. Statement of changes in equity requirements
10. Capital disclosures

Areas of significant change from IAS 1 vs. IFRS 18

Categories in the statement of profit or loss

Under IAS 1, there is no requirement to classify income and expenses into 'classes' or 'categories'. In order to enhance consistency, and to permit consistent line items and sub-totals (see below), IFRS 18 requires items of income and expense to be classified into five categories:

Category	Description
Investing	*Income and expenses relating to: - Assets that generate a return individually and largely independently of the entity's other resources (e.g. interest income, returns on other financial assets); - Investments in subsidiaries, associates and joint ventures; and - Cash and cash equivalents.
Financing	*Income and expenses relating to: - Changes in the carrying amount of liabilities that arise from transactions that involve only the raising of finance (e.g. interest expense); - Certain other items of interest income and expense (e.g. interest income arising from the unwinding of the discount on an asset retirement obligation in the scope of IAS 37).
Income tax	Income tax expense and income arising from the application of IAS 12 *Income Taxes*.
Discontinued operations	Income and expenses from discontinued operations arising from the application of IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations*.
Operating	Residual category if income and expenses are not classified into other categories.

*Classification of investing and financing cash flows are also affected by certain accounting policy choices made and an assessment of an entity's 'main business activities' – see explanation below.

Despite IFRS 18 containing operating, investing and financing categories, there is not explicit alignment between these categories and the corresponding categories in the statement of cash flows as per IAS 7, however, income and expense and the associated cash flows may be classified similarly in some cases.

While the stated goal of the PFS project was to increase the comparability of financial performance between entities, the classification of income and expenses will not be identical for all entities. This is because IFRS 18 requires entities to assess 'main business activities'. Entities with specified main business activities may classify investing and/or financing items as operating in certain cases.

For example, Entity A is a manufacturer with excess cash invested in publicly traded equity instruments, however, investing in such assets is not a main business activity for Entity A. Entity Z is a bank with a significant number of publicly traded equity instruments held, which it actively trades as part of its main business activities.

Entity A is likely to classify income arising from its equity investments as investing, whereas Entity Z will likely classify such income as operating because it relates to Entity Z's main business activities.

IFRS 18 also includes certain accounting policy choices regarding classification of certain income and expenses for entities with specified main business activities. These options are beyond the scope of this publication.

Line items and sub-totals

Once items of income and expense are classified, the categorisation results in line items and sub-totals being presented in the statement of profit or loss, some of which are mandatory.

IAS 1 has limited requirements regarding line items and sub-totals. Revenue is presented as the 'top line' in the statement of profit or loss, with 'profit' being presented as the final line item, with limited guidance about how income and expenses are categorised and which sub-totals are presented.

In addition to mandatory totals and sub-totals required by IAS 1 currently (e.g. profit before income taxes, profit or loss, etc.), IFRS 18 introduces two new mandatory sub-totals:

- Operating profit or loss: the sub-total of all income and expense classified as operating.
- Profit before financing and income tax: the sub-total of operating profit or loss and all income and expenses classified as investing. This sub-total will not be applicable for entities with specified main business activities (e.g. banks).

A simple illustration of these requirements is presented below for an entity without specified main business activities (i.e. the entity does not invest in assets or provide financing to customers as a main business activity):

Line item / sub-total	*Amount in currency units (CU)*	*Classification of income and expenses*	*Explanation*
Revenue	1,000	Operating	
Cost of sales	(400)		'Cost of sales' line item must include inventories expensed (IAS 2).
Gross profit	600		IFRS 18 does not mandate the presentation of a 'gross profit' sub-total, however, IFRS 18 does not preclude this approach.
Salaries and benefits	(100)	Operating	
Operating profit	500		**New mandatory sub-total**: the sub-total of all income and expense classified as operating.
Share of profit from associates	25	Investing	Income or expense related to the application of the equity method are never classified as operating, which may be a change in practice for some entities.
Profit before financing and income tax	525		**New mandatory sub-total:** the sub-total of operating profit or loss and all income and expenses classified as investing.
Interest expense on bank loans	(50)	Financing	Expense classified as financing.
Profit before income tax and discontinued operations	475		Sub-total already required by IAS 1 / IFRS 5.
Income tax expense	(100)	Income tax	
Profit from continuing operations	375		Sub-total already required by IAS 1.
Profit from discontinued operations	10	Discontinued operations	Sub-total already required by IAS 1 / IFRS 5.
Profit	385		Total already required by IAS 1.

This presentation may not differ significantly from the presentation adopted by some entities under current practice; however, this example is simple and does not illustrate more complex situations and the application of certain policy choices that IFRS 18 introduces for certain entities.

Labelling, aggregation and disaggregation

IFRS 18 expands the requirements for labelling, aggregation and disaggregation as follows:

Requirement	*Explanation of Requirement*
Principles of aggregation and disaggregation	• Require an entity to classify identified assets, liabilities, equity, income and expenses into groups based on shared characteristics and to separate those items based on further characteristics. Items should be disaggregated if the resulting disaggregation is material. • IFRS 18 also sets out characteristics of items that may result in their aggregation or disaggregation.
Use of 'other' label	• Require an entity to use the 'other' label only if it is unable to find a more informative label. • For an aggregation of varied material items, require use of a label that is as precise as possible about the type of item the 'other' amount is, for example, 'other operating expenses' or 'other finance expenses'. • For an aggregation of varied immaterial items, require an entity to consider whether the aggregated amount is large enough that users of financial statements might question what it includes. If so, further information about that amount is material and accordingly would be provided by the entity.
Presentation and disclosure of expenses classified as operating	• Continue to permit presentation of expenses in the operating category by nature (e.g. salaries, depreciation, etc.) or function (e.g. administration, selling, etc.). • A 'mixed' presentation of operating expenses by nature (e.g. salaries) and function (e.g. cost of sales) may be appropriate. • Introduce new requirements for entities that classify expenses by function, including the requirement to disclose in a single note expenses by nature for certain amounts (depreciation, amortisation, employee benefits, impairment and write-downs of inventories).

Statement of cash flows: operating cash flows, and classification of interest and dividend cash flows

IFRS 18 supersedes IAS 1, and has resulted in certain consequential amendments to other IFRS Accounting Standards, such as IAS 7 *Statement of Cash Flows* as below:

The current requirements of IAS 7 are compared with the revised requirements of IFRS 18 in the following table:

Requirement of IAS 7	*Current requirements*	*Revised requirements upon adoption of IFRS 18*
Starting point for operating cash flows in the statement of cash flow when the indirect method is used	Profit or loss	Newly introduced mandatory sub-total in the statement of profit or loss: operating profit or loss
Classification of interest and dividend cash inflows	Accounting policy choice: operating or investing cash flows	Elimination of accounting policy choice: investing cash flows, except for entities with specified main business activities (see below).
Classification of interest cash outflows	Accounting policy choice: operating or financing cash flows	Elimination of accounting policy choice: financing cash flows, except for entities with specified main business activities (see below).
Classification of dividend outflows	Accounting policy choice: operating or financing cash flows	Elimination of accounting policy choice: financing cash flows

The classification of interest and dividend cash inflows and interest cash outflows will usually be investing and financing respectively, as set out above, however, exceptions apply for certain entities.

For entities that provide financing to customers as a main business activity (e.g. a bank) or invest in the course of their main business activities in assets that generate a return individually and largely independently of other resources held by the entity (e.g. insurance and investment entities), interest and dividend income and interest expense may be classified into different categories in the statement of profit or loss. For these entities, the corresponding cash flows are to be classified in the statement of cash flows as follows:

<table>
<tr><th>Classification in the statement of profit or loss</th><th>Classification of the corresponding cash flows in the statement of cash flows</th></tr>
<tr><td>Interest and dividend income and interest expense are all classified into a single category.</td><td>Cash flows are classified into the same category (e.g. operating in the statement of profit or loss and operating in the statement of cash flows).</td></tr>
<tr><td>Interest and dividend income and interest expense are classified into more than one category.</td><td>All cash flows are classified into a single category as an accounting policy choice. For example:
<table>
<tr><th>Category</th><th>Classification in statement of profit or loss</th><th>Classification in the statement of cash flows</th></tr>
<tr><td>Interest received</td><td>Some as operating and some as investing</td><td>Accounting policy to classify all cash flows as operating or investing</td></tr>
<tr><td>Interest paid</td><td>Some as operating and some as financing</td><td>Accounting policy to classify all cash flows as operating or financing</td></tr>
<tr><td>Dividend received</td><td>Investing</td><td>Investing</td></tr>
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Management-defined performance measures

Entities may disclose management-defined performance measures (MPMs) outside of the financial statements to communicate management's view of an aspect of the entity's financial performance. These MPMs are often based on a total or sub-total required by IFRS Accounting Standards with adjustments made. For example:

- Earnings before interest, taxes, depreciation and amortisation (EBITDA);
- 'Adjusted' profit (e.g. profit excluding goodwill impairment, share-based payments, etc.); or
- Operating profit excluding non-recurring items (e.g. operating profit excluding the effect of a natural disaster).

These MPMs may be included in press releases, strategic reports, management discussion & analysis, etc. IFRS 18 requires that certain MPMs be included in the financial statements with corresponding disclosures.

Which MPMs will be subject to disclosure requirements in the financial statements?

To be subject to IFRS 18's disclosure requirements, an MPM will need to be:

1. Used in public communications outside financial statements; and
2. Used to communicate to users of financial statements, management's view of an aspect of the financial performance of the entity as a whole.

IFRS 18 excludes certain forms of public communication (e.g. social media posts, oral communications, etc.), meaning that not all public communications may result in MPM disclosure requirements. Additionally, if an entity does not make such public communications containing MPMs, they may not be subject to any new disclosure requirements. This may be the case for many private companies.

MPMs are only included in IFRS 18's disclosure requirements if they communicate an entity's financial performance, meaning MPMs based solely on the statement of financial position (e.g. adjusted current ratio) or the statement of cash flows (e.g. adjusted operating cash flows) are not included.

As a rule, IFRS 18 will also exclude from the scope of the disclosure requirements of MPMs certain specified sub-totals, such as gross profit or loss and similar sub-totals.

What are the disclosure requirements for MPMs in the scope of IFRS 18's requirements?

For 'scoped in' MPMs, entities will be required to disclose the following information in a single note to the financial statements:

- A description of why the management-defined performance measure communicates management's view of an aspect of the entity's financial performance
- How the management-defined performance measure is calculated
- A reconciliation to the most directly comparable total or subtotal specified by IFRS Accounting Standards (e.g. reconcile 'adjusted operating profit' to 'operating profit' as defined by IFRS 18 and explain the adjustments)
- The income tax effect and effect on non-controlling interest for each reconciling item disclosed as per above.
- A description of how the entity determines the income tax effect

The inclusion of MPMs in financial statements will be a significant adjustment for many entities, as this type of information has historically been disclosed outside of the financial statements. These requirements will also impose a requirement on auditors to be aware of public communications made by entities, which may trigger the requirement to include MPMs in financial statements.

Practical implications of the new requirements

While IFRS 18 does not change any recognition or measurement requirements in IFRS Accounting Standards, it may still have effects on systems and processes. These implications may include the following:

- Financial reporting systems may not be designed to appropriately 'tag' and categorise income and expenses into the categories required by IFRS 18. This may be more complex for groups with multiple financial reporting systems which need to be consolidated into a single financial statement. This may necessitate changes to group financial reporting and consolidation processes.
- The requirement to categorise income and expenses into categories may change how systems and processes function. For example, IFRS 18's requirements for the classification of foreign exchange gains and losses recognised in accordance with IAS 21 may change how an entity's systems and processes are designed compared to existing practice.
- Groups may have entities with multiple main business activities, which change at the consolidated level.
    - For example, Group L is comprised of subsidiaries M and N. Entity M manufactures and sells widgets and has no specified main business activities, so it follows the default categorisation requirements in IFRS 18 for the statement of profit or loss. Entity N provides financing to its customers as a main business activity, and therefore its categorisation of income and expenses differs from Entity M (e.g. it categories finance income and expense as operating). At the consolidated level, it may be concluded that the group does not provide financing to customers as a main business activity for reasons of materiality (i.e. providing financing to customers is incidental at the consolidated level), meaning the categorisation of expenses by Entity N will need to be adjusted at the consolidated level (e.g. finance income and expenses of Entity N would be reclassified to the investing and financing categories at the consolidated level of Group L).
- Entities will need to review how they aggregate, disaggregate and label information based on the revised requirements of IFRS 18. For example, how 'other' labels are used, and how operating expenses are presented.
- Entities will need to identify MPMs and determine which (if any) are within the scope of IFRS 18's disclosure requirements. Entities may need to design new systems, processes and controls around MPMs as a result of their inclusion in the financial reporting process.

Transition and effective date

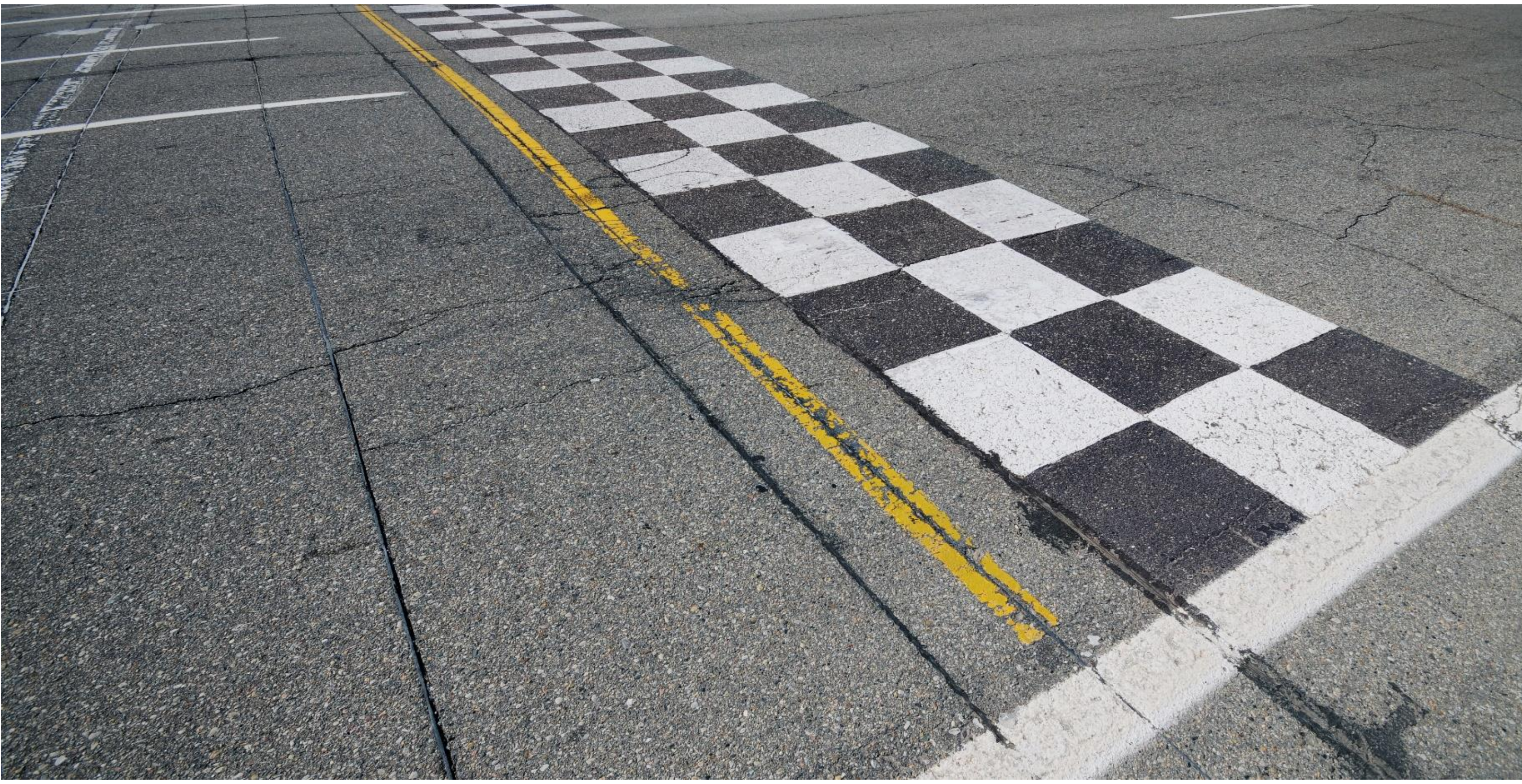
IFRS 18 will be effective for annual reporting periods beginning on or after 1 January 2027 with restatement of the comparative period being required. Therefore, an entity with a calendar year-end that presents one annual period as a comparative will need to restate the year-ended 31 December 2026 period when it is included as comparative information in the 2027 annual financial statements. For the comparative period immediately preceding the period in which IFRS 18 is first applied, entities are required to disclose a reconciliation for each line item in the statement of profit or loss between (a) the restated amounts presented applying IFRS 18 and (b) the amounts previously presented applying IAS 1 *Presentation of Financial Statements*.

Consequential amendments to IAS 34 will also require an entity to present each of the required headings and subtotals in IFRS 18 in its condensed interim financial statements in the first year of applying IFRS 18. Therefore, an entity with quarterly reporting requirements in accordance with IAS 34 will be required to report its statement of profit or loss in accordance with IFRS 18's requirements for Q1 2027.

How to get started

While entities are required to consider the requirements of IFRS 18 starting from 1 January 2026 (the comparative period for entities with calendar year-ends), the implications of the new standard may be significant for entities. Management and those charged with governance should begin educating stakeholders about the expected requirements of IFRS 18 and the effects it may have on an entity's financial reporting systems, processes and controls. The requirement to disclose certain MPMs in the financial statements may also cause entities to involve communications and investor outreach departments to ensure they are aware of the implications of IFRS 18's requirements on entities in making public communications.

For further information on IFRS Accounting Standards, including the implications of IFRS 18, please contact your local BDO firm.



FOR MORE INFORMATION:

BDO's IFRS Policy Committee

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