Need to know

IASB publishes new standard on presentation and disclosure in financial statements

Contents

This *Need to know* outlines IFRS 18 *Presentation and Disclosure in Financial Statements* published by the International Accounting Standards Board (IASB) on 9 April 2024.

- The new standard, IFRS 18, replaces IAS 1 *Presentation of Financial Statements* while carrying forward many of the requirements in IAS 1
- IFRS 18 introduces new requirements to:
  - present specified categories and defined subtotals in the statement of profit or loss
  - provide disclosures on management-defined performance measures (MPMs) in the notes to the financial statements
  - improve aggregation and disaggregation
- Some of the requirements in IAS 1 are moved to IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*[1] *and IFRS 7 Financial Instruments: Disclosures*
- The IASB also makes minor amendments to IAS 7 *Statement of Cash Flows* and IAS 33 *Earnings per Share*
- IFRS 18 requires retrospective application with specific transition provisions
- An entity is required to apply IFRS 18 for annual reporting periods beginning on or after 1 January 2027 with earlier application permitted.

For more information please see the following websites:

www.ukaccountingplus.co.uk

www.deloitte.co.uk

1. To reflect the extended content of IAS 8, the IASB is changing the title of the standard to 'Basis of Preparation of Financial Statements' once IFRS 18 is effective.

Background

In 2016, the IASB initiated its primary financial statements project in response to investors' concerns about the comparability and transparency of entities' performance reporting.

In December 2019, the IASB published ***ED/2019/7 General Presentation and Disclosures***. After the comment period expired, the IASB redeliberated the proposals considering the comments received. The proposals have now been finalised in IFRS 18, with some modifications.

> **Observation**
>
> The IASB decided not to finalise the following proposals in the ED:
>
> - the prohibition to analyse operating expenses by both nature and function (a 'mixed presentation')
> - the requirement to distinguish integral associates and joint ventures and non-integral associates and joint ventures
> - the requirement to disclose and explain unusual items (i.e. income and expenses with limited predictive value) in a single note.

IFRS 18 replaces IAS 1, carrying forward many of the requirements in IAS 1 unchanged and complementing them with new requirements. In addition, some IAS 1 paragraphs have been moved to IAS 8 and IFRS 7. Furthermore, the IASB has made minor amendments to IAS 7 and IAS 33.

This publication focuses on the new requirements that have been introduced by IFRS 18 and the amendments to IAS 7 and IAS 33.

> **Implication for UK companies**
>
> IFRS 18 has not yet been endorsed for use in the UK and can therefore not yet be applied by UK companies.

The new requirements

Categories for classifying income and expenses in the statement of profit or loss

IFRS 18 requires an entity to classify income and expenses included in profit or loss into one of the following categories:

- operating
- investing
- financing
- income taxes
- discontinued operations.

All entities are required to follow the same classification requirements, with some modifications for entities that invest in assets as a main business activity (such as investment entities, investment property entities and insurers) and entities that provide financing to customers as a main business activity (such as banks—see below under *Requirements for entities with specified main business activities*).

Operating category

The operating category comprises all income and expenses included in the statement of profit or loss that are not classified in the investing, financing, income taxes or discontinued operations categories. In other words, the operating category is a default category that includes, but is not limited to, income and expenses from an entity's main business activities. Income and expenses from other business activities, such as income and expenses from additional activities, are also classified in the operating category if those income and expenses do not meet the requirements to be classified in any of the other categories.

Investing category

The investing category comprises income and expenses from:

- investments in associates, joint ventures and unconsolidated subsidiaries
- cash and cash equivalents
- other assets that generate a return individually and largely independently of the entity's other resources.

'Income and expenses' classified in the investing category comprises:

- income generated by the assets
- income and expenses that arise from the initial and subsequent measurement of the assets, including on derecognition of the assets
- incremental expenses directly attributable to the acquisition and disposal of the assets (e.g. transaction costs and costs to sell the assets.

Examples of income and expenses that are required to be classified in the investing category are:

- the share of profit of associates and joint ventures accounted for using the equity method
- interest revenue from debt investments
- dividends from equity investments
- rental income and fair value gains or losses from investment properties.

Financing category
The financing category comprises income and expenses from liabilities arising from transactions that involve the raising of finance, whether the transaction involves only the raising of finance or not.

Liabilities that arise from transactions that involve only the raising of finance include:

- debt instruments settled in cash
- bonds that will be settled through the delivery of an entity's own shares.

Liabilities arising from transactions that do not involve only the raising of finance include:

- payables for goods or services
- lease liabilities
- defined benefit pension liabilities.

'Income and expenses' classified in the financing category depends on the transaction that results in recognition of the liability:

- for liabilities that arise from transactions that involve only the raising of finance, it includes income and expenses that arise from the initial and subsequent measurement of the liabilities (including on derecognition of the liabilities) and incremental expenses directly attributable to the issue and extinguishment of the liabilities;
- for liabilities arising from transactions that do not involve only the raising of finance, it includes interest income and expenses, and income and expenses arising from changes in interest rates, identified applying the relevant IFRS Accounting Standard.

Income taxes category
The income taxes category comprises:

- tax expense or tax income included in profit or loss applying IAS 12 *Income Taxes*
- any related foreign exchange differences.

Discontinued operations category
The discontinued operations category comprises income and expenses from discontinued operations as defined in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations.*

Illustrative statement of profit or loss

The following is an extract from an example statement of profit or loss that is included in the Illustrative Examples on IFRS 18. As illustrated, in addition to the total profit or loss, entities are required to present two new defined subtotals—'operating profit' and 'profit before financing and income taxes'.

The entity in the example is a manufacturer that does not invest in assets as a main business activity, nor provides financing to customers as a main business activity.

Statement of profit or loss	20X2	20X1	Categories[2]
Revenue	XXX	XXX	
Cost of sales	(XXX)	(XXX)	
Gross profit	XXX	XXX	
Other operating income	XXX	XXX	
Selling expenses	(XXX)	(XXX)	Operating
Reseach and development expenses	(XXX)	(XXX)	
General and administrative expenses	(XXX)	(XXX)	
Goodwill impairment loss	(XXX)	-	
Other operating expenses	(XXX)	(XXX)	
Operating profit	**XXX**	**XXX**	
Share of profit and gains on disposal of associates and joint ventures	XXX	XXX	Investing
Profit before financing and income taxes	**XXX**	**XXX**	
Interest expenses on borrowings and lease liabilities	(XXX)	(XXX)	Financing
Interest expenses on pension liabilities and provisions	(XXX)	(XXX)	
Profit before income taxes	**XXX**	**XXX**	
Income tax expense	(XXX)	(XXX)	Income taxes
Profit from continuing operations	**XXX**	**XXX**	
Loss from discontinued operations	-	(XXX)	Discontinued operations
Profit	**XXX**	**XXX**	

2 The 'Categories' column is presented to illustrate the structure of the statement of profit or loss. Category labels are not required to be presented in the statement of profit or loss

Requirements for entities with specified main business activities

IFRS 18 identifies two types of "specified main business activities": investing in assets as a main business activity and providing financing to customers as a main business activity. Entities that conduct these specified main business activities are required to classify in the operating category some income and expenses that would otherwise be classified in the investing category or the financing category.

IFRS 18 explains that whether an entity invests in assets or provides financing to customers as a main business activity is a matter of fact. The standard provides detailed guidance on the factors to be considered as part of this assessment.

Some entities, for example investment entities and retail banks, may both invest in assets and provide financing to customers as main business activities.

Classification of specific income and expenses

- **Foreign exchange differences:** Foreign exchange differences are classified in the same category as the income and expenses from the items that gave rise to those differences. For example, foreign exchange differences on a foreign-currency denominated receivable for a sale of goods are classified in the operating category (the same category as the sale of goods). However, an entity is permitted to classify foreign exchange differences in the operating category if classifying them in the same category as the income and expenses from the items that gave rise to them would involve undue cost or effort
- **Fair value gains and losses on derivatives:** The classification of fair value gains and losses on derivatives depends on whether the derivatives are used to manage exposure to identified risks and whether they are designated as hedging instruments
- **Income and expenses from hybrid contracts:** The classification of income and expenses from hybrid contracts comprising host liabilities and embedded derivatives depends on whether the embedded derivative is separated from the host liability and the nature of the hybrid contract.

Management-defined performance measures (MPMs)

Definition

MPMs are subtotals of income and expenses that meet all of the following criteria:

- are used in public communications outside financial statements, such as management commentary, press releases and investor presentations (NB: oral communications, written transcripts of oral communications or social media posts do not represent public communications for the purpose of identifying MPMs)
- are used to communicate to investors management's view of an aspect of the financial performance of the entity as a whole—it is presumed that a subtotal of income and expenses that an entity uses in public communications outside its financial statements communicates management's view of an aspect of the financial performance of the entity as a whole, unless the entity rebuts the presumption
- are not listed in IFRS 18 or specifically required by IFRS Accounting Standards.

Disclosure requirements

An entity is required to disclose information about its MPMs in a single note to the financial statements. The note requires 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.

For each MPM, an entity is required to disclose:

- a description of the aspect of financial performance that it communicates, including why management believes the MPM provides useful information about the entity's financial performance
- a description of how the MPM is calculated
- a reconciliation between the MPM and the most directly comparable subtotal listed in IFRS 18 or total or subtotal required by IFRS Accounting Standards, including for each item disclosed in the reconciliation:
  - the income tax effect
  - the effect on non-controlling interests
- a description of how the entity determined the income tax effect.

If an entity changes the calculation of an MPM, introduces a new MPM, or ceases to use a previously disclosed MPM, it is required to disclose:

- an explanation of the change, addition or cessation and its effects
- the reasons for the change, addition or cessation
- restated comparative information to reflect the change, addition or cessation unless it is impracticable to do so.

IFRS 18 specifies certain subtotals of income and expenses that are not MPMs and therefore are not subject to these requirements. These subtotals include operating profit or loss before depreciation, amortisation and impairments within the scope of IAS 36 *Impairment of Assets* (OPDAI).

Observation

Notably, the list of subtotals does not include 'earnings before interest, tax, depreciation and amortisation' (EBITDA). The IASB noted that, although EBITDA is one of the most commonly used measures in communications with users of financial statements, it is not used by entities in some industries, such as banking and insurance. Furthermore, no consensus could be reached on what EBITDA represents, other than it being a starting point for various analyses.

EBITDA measures might meet the definition of MPMs. The IASB concluded that OPDAI provides similar information to many of the EBITDA measures currently provided. The IASB consequently decided to include OPDAI in the list of subtotals in IFRS 18.

Aggregation and disaggregation of information

Roles of the primary financial statements and the notes

The objective of financial statements is to provide financial information about the entity's recognised assets, liabilities, equity, income and expenses that is useful to investors in assessing the prospects for future net cash inflows to the entity and in assessing management's stewardship of the entity's economic resources.

To achieve this objective, the primary financial statements and the notes have the following distinct and complementary roles in providing financial information:

- primary financial statements provide structured summaries of an entity's recognised assets, liabilities, equity, income, expenses and cash flows, that are useful for:
  - obtaining an understandable overview of the entity's recognised assets, liabilities, equity, income, expenses and cash flows
  - making comparisons between entities, and between reporting periods for the same entity
  - identifying items or areas about which users of financial statements may wish to seek additional information in the notes
- the notes provide material information necessary:
  - to enable investors to understand the items in the primary financial statements
  - to supplement the primary financial statements with additional information to achieve the objective of the financial statements.

Principles for aggregation and disaggregation of information

IFRS 18 requires entities to aggregate or disaggregate information about individual transactions and other events into the information presented in the primary financial statements and disclosed in the notes.

The requirements are based on principles for aggregation and disaggregation of information. IFRS 18 requires entities to ensure that:

- items are classified and aggregated based on shared characteristics and disaggregated based on characteristics that are not shared
- items are aggregated or disaggregated such that the primary financial statements and the notes fulfil their roles
- the aggregation and disaggregation of items does not obscure material information.

Entities are specifically required to disaggregate information whenever the resulting information is material.

To help entities apply the principles, IFRS 18 provides application guidance on aggregating and disaggregating items and labelling aggregated items, including which characteristics to consider when assessing whether items have similar or dissimilar characteristics.

Presentation of operating expenses

IFRS 18 requires entities to classify and present operating expenses in a way that provides the most useful structured summary of its expenses using one or both of these the characteristics of:

- the nature of the expense (for example, raw material expenses and employee benefit expenses)
- the function of the expenses within the entity (for example, cost of sales).

In deciding how to present operating expenses, an entity is required to consider factors such as what line items provide the most useful information about the main components or drivers of the entity's profitability and industry practice.

An entity that presents one or more line items for operating expenses classified by function is required to disclose amounts for specified expenses by nature in a single note to the financial statements.

Amendments to other IFRS standards

Amendments to IAS 7

The IASB amended IAS 7 to:

- require all entities to use the operating profit subtotal as the starting point for the indirect method of reporting cash flows from operating activities
- remove the presentation alternatives for cash flows related to interest and dividends paid and received as follows:
  - for entities with no specified main business activities:
    - interest and dividends received will always be classified as cash flows from investing activities
    - interest and dividends paid will always be classified as cash flows from financing activities
  - for entities that invest in assets or provide financing to customers as a main business activity, the entity is required to:
    - determine how to classify dividends received, interest received and interest paid in the statement of cash flows by referring to how—applying IFRS 18—it classifies dividend income, interest income and interest expenses in the statement of profit or loss
    - classify the total of each of these cash flows in a single category in the statement of cash flows (that is, either as operating, investing or financing activities)
    - classify dividends paid as cash flows from financing activities

Observation

The operating, investing and financing categories in IFRS 18 have different meanings to those in IAS 7. In developing IFRS 18, the IASB prioritised the objectives of each primary financial statement and did not seek alignment between the categories in the statement of profit or loss and the statement of cash flows.

The IASB added a research project on the statement of cash flows and related matters to the research project pipeline in its third agenda consultation completed in July 2022.

Amendments to IAS 33

In addition to reporting basic and diluted earnings per share (EPS), entities are permitted by IAS 33 to disclose (in the notes only) additional EPS calculated based on any component of the statement of comprehensive income.

The amendments to IAS 33 permit an entity to disclose these additional EPS only if the numerator is either a total or subtotal identified in IFRS 18 or is an MPM.

Effective date and transition

An entity is required to apply IFRS 18 for annual reporting periods beginning on or after 1 January 2027. Earlier application is permitted. If an entity applies IFRS 18 for an earlier period, it is required to disclose that fact in the notes. The amendments to IAS 7 and IAS 33, as well as the revised IAS 8 and IFRS 7, become effective when an entity applies IFRS 18.

An entity is required to apply IFRS 18 retrospectively applying IAS 8. However, an entity is not required to present the quantitative information specified in IAS 8:28(f) (i.e. the adjustment for each financial statement line item affected and the related effect on basic and diluted EPS, for each period presented).

Instead, in its annual financial statements, an entity is required to disclose, for the comparative period immediately preceding the period in which IFRS 18 is first applied, a reconciliation for each line item in the statement of profit or loss between:

- the restated amounts presented applying IFRS 18
- the amounts previously presented applying IAS 1.

If an entity applies IAS 34 *Interim Financial Reporting* in preparing condensed interim financial statements in the first year of applying IFRS 18, the entity is required to present in the condensed interim financial statements each heading it expects to use in applying IFRS 18 and the subtotals required in IFRS 18, despite the requirements in IAS 34:10 (which requires that interim financial statements retains the headings and subtotals included in the most recent annual financial statements). Indeed, an entity should not apply the requirements in IAS 34:10 for headings and subtotals in condensed interim financial statements until it has issued its first set of annual financial statements prepared in accordance with IFRS 18.

If an entity applies IAS 34 in preparing interim financial statements in the first year of applying IFRS 18, the entity is required to disclose, for the comparative period and cumulative comparative period immediately preceding the current period and cumulative current period, a reconciliation for each line item presented in the statement of profit or loss for the interim financial statements between:

- the restated amounts presented applying the accounting policies for the comparative period and the cumulative comparative period when the entity applies IFRS 18 and
- the amounts previously presented applying the accounting policies for the comparative period and cumulative comparative period when the entity applied IAS 1.

An entity is permitted, but not required, to disclose the reconciliations for the current period or earlier comparative periods.

At the date of initial application of IFRS 18, an entity eligible to apply paragraph 18 of IAS 28 Investments in Associates and Joint Ventures is permitted to change its election for measuring an investment in an associate or joint venture from the equity method to fair value through profit or loss in accordance with IFRS 9. If an entity makes such a change, the entity is required to apply the change retrospectively applying IAS 8. An entity applying paragraph 11 of IAS 27 Separate Financial Statements is required to make the same change in its separate financial statements.

Further information

If you have any questions about IFRS 18, please speak to your usual Deloitte contact.

The Deloitte Accounting Research Tool (DART) is a comprehensive online library of accounting and financial disclosures literature. **GAAP in the UK on DART** allows access to the full IFRS Standards and UK GAAP, linking to and from:

- Deloitte's authoritative, up-to-date, GAAP in the UK manuals which provide guidance for reporting under IFRS Standards and UK GAAP
- illustrative financial statements for entities reporting under IFRS Accounting Standards and UK GAAP.

In addition, our **sustainability reporting** volumes of GAAP in the UK provide guidance on disclosure requirements and recommendations which businesses must consider in light of the broader environmental, social and governance matters which can significantly drive the value of an entity.

To apply for a subscription to GAAP in the UK on DART, click **here** to start the application process and select the GAAP in the UK package. For more information about GAAP in the UK on DART, including pricing of the subscription packages, click **here.**

Deloitte.

This publication has been written in general terms and we recommend that you obtain professional advice before acting or refraining from action on any of the contents of this publication. Deloitte LLP accepts no liability for any loss occasioned to any person acting or refraining from action as a result of any material in this publication.

Deloitte LLP is a limited liability partnership registered in England and Wales with registered number OC303675 and its registered office at 1 New Street Square, London EC4A 3HQ, United Kingdom.

Deloitte LLP is the United Kingdom affiliate of Deloitte NSE LLP, a member firm of Deloitte Touche Tohmatsu Limited, a UK private company limited by guarantee ("DTTL"). DTTL and each of its member firms are legally separate and independent entities. DTTL and Deloitte NSE LLP do not provide services to clients.
Please click **here** to learn more about our global network of member firms.

© 2024 Deloitte LLP. All rights reserved.

Designed by Deloitte CoRe Creative Services. RITM1734868