Grant Thornton

Get ready for IFRS 18

The new financial statements presentation and disclosure standard

Entities should begin preparing for IFRS 18 'Presentation and Disclosure in Financial Statements' sooner rather than later. Changes from IAS 1 'Presentation of Financial Statements' could have a significant impact on the financial statements.

In April 2024, the International Accounting Standards Board (IASB) issued the new accounting standard, IFRS 18 'Presentation and Disclosure in Financial Statements'. This will replace the existing IAS 1 'Presentation of Financial Statements' standard that has been in use for many years.

On the surface this new Standard may appear straightforward, setting out a new presentation requirement for the statement of profit or loss, and providing new disclosures relating to management-defined performance measures. However, the detail of these new requirements can lead to potential challenges that reporting entities will need to deal with to appropriately apply the new Standard.

While entities are dealing with a wide range of new reporting requirements, from international tax reform to sustainability reporting, changes to the presentation and disclosures in financial statements may not currently be at the top of their priorities. However, given the potentially pervasive changes brought about by IFRS 18, getting ready for IFRS 18 implementation should be prioritised.

This publication sets out a high-level overview of IFRS 18's new requirements, along with practical insights into the application challenges. For some entities in particular, this will highlight the need to begin their transition journey early, to ensure that they are fully prepared for mandatory application for annual reporting periods beginning on or after 1 January 2027, including retrospective restatement of comparatives.

Summary of key changes

Primary financial statements

Provide **useful structured summaries** of the entity's assets, liabilities, equity, income, expenses and cash flows

Statement of profit or loss

Changes introduced by IFRS 18

- Two new defined subtotals – **operating profit** and **profit before financing and income taxes**
- Categories for classifying income and expenses – **operating, investing, financing, income taxes** and **discontinued operations**

clear linkage between information presented in the primary financial statements and in the notes

Notes to the financial statements

Provide **material information** to supplement the primary financial statements

Disclosures introduced or amended by IFRS 18. For example:

- **Management-defined performance measures**
- Specified expenses by nature

Enhanced guidance for grouping (aggregation and disaggregation) of information

Applicable in all primary financial statements and the notes

General requirements for the financial statements have been carried over from IAS 1. There are some limited changes to specific requirements for the statement of cash flows and statement of financial position, however the statement of comprehensive income and statement of changes in equity remain unchanged.

1. Changes to the statement of profit or loss

IFRS 18 has given the statement of profit or loss a major facelift. It requires two new subtotals above the required 'Profit or Loss' total, dividing the statement into five discrete sections or categories. The diagram below summarises the classification requirements for an entity without a 'specified main business activity' as defined in the Standard (see section on '**specified main business activities**'.)

Categories and subtotals in the statement of profit or loss

1 **Operating**
Income and expenses that do not meet the requirements to be classified in the other categories or that are specifically required to be classified in the operating category

A **Operating profit or loss**

2 **Investing**
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

B **Profit or loss before financing and income taxes**

3 **Financing**
- Income and expenses from liabilities that arise from transactions that involve only the raising of finance
- Interest income and expenses and income and expenses arising from changes in interest rates from liabilities that arise from transactions that do not involve only the raising of finance

4 **Income taxes**

5 **Discontinued operations**

Profit or loss

Categories of income and expenses

1. **Operating**
2. **Investing**
3. **Financing**
4. **Income taxes**
5. **Discontinued operations**

Although the operating, investing and financing categories may seem familiar, it is important to note that these categories are not aligned with the categories in the statement of cash flows, as set out in IAS 7 'Statement of Cash Flows'. The reason being that the IASB prioritised the objectives of each primary financial statement rather than seeking alignment between the categories used in both the statement of profit or loss and the statement of cash flows.

IFRS 18's classification of income and expenses is largely driven by the nature of the underlying assets and liabilities, transactions or other events, rather than the nature of the income or expenses themselves. For some entities, the changes to the presentation and disclosure in their financial statements may not be as simple as remapping some of their general ledger accounts. In some cases, significant changes to existing systems and processes, or entirely new ones may be required.

Practical insight
If entities have contracts or agreements with terms or covenants linked to existing profit or loss metrics, or remuneration policies based on achieving specified profit or loss measures, they will need to assess whether these need to be amended considering IFRS 18's new requirements.

The message to preparers is therefore to start planning early, and to assess the potential impacts that they may face.

New subtotals required

IFRS 18 introduces two new subtotals which must be reported above the usual 'profit or loss' total.

A Operating profit or loss

This subtotal comprises all income and expenses classified in the operating category (see below for further detail). The operating category includes income and expenses from an entity's 'core' business activities, other than any such income and expenses from investments accounted for using the equity method. However, it is important to note that the operating category is not limited to income and expenses from an entity's 'core' business activities. This is because the operating category includes all income and expenses that do not meet the criteria to be classified in other categories, including items which management considers volatile or non-recurring.

Practical insight
As the operating profit or loss subtotal may include more than the 'core' business income and expenses, this may increase the appetite for reporting non-IFRS performance measures. These will need to be assessed in line with the new guidance in IFRS 18 on management-defined performance measures (MPMs) which is covered in **section 2**.

B Profit or loss before financing and income taxes

This subtotal is made up of operating profit or loss, together with all income and expenses classified in the investing category. Given IFRS 18's new classification requirements this subtotal may differ from the commonly used earnings before interest and tax (EBIT) measure. Again, this may increase the number of entities reporting non-IFRS performance measures.

Specified main business activities: Exemption for entities providing financing to customers as a main business activity
There is a limited exemption from presenting this subtotal for certain entities with a **specified main business activity** of providing financing to customer.

IFRS 18 does allow entities to present additional subtotals when they are necessary to provide a useful structured summary of the entity's income and expenses (see **section 3** for further detail).

Classifying income and expenses

Under the new requirements of IFRS 18, items of income and expense are not classified based on their own nature, but rather they are classified based on the nature of the underlying asset, liability, transaction or other event from which they are derived. For example, take impairment. Where previously this may have been presented as a non-operating item, under IFRS 18 impairment losses related to some non-financial assets such as property, plant and equipment (PPE) and trade receivables (a financial asset) will have to be classified in the operating category. However, impairment losses in relation to certain other assets may be required to be classified in the investing category. For example, impairment losses in relation to financial assets other than trade receivables may be required to be classified in the investing category, depending on how the financial asset is measured and whether investing in specified financial assets is the entity's main business activity.

Specified main business activities: Overview

There are classification exceptions for entities that invest in particular types of assets specified by IFRS 18 ('investing in assets') or provide financing to customers as a main business activity.

Before classifying any income or expenses in the operating, investing or financing categories, an entity must assess whether it carries out either, or both, of the two main business activities specified in IFRS 18 that have classification exceptions. As discussed further below, these are:

- Investing in assets, and
- Providing financing to customers.

If an entity has one, or both of these main business activities, then IFRS 18 requires specific income and expenses that would otherwise be classified as investing or financing, to be included in the operating category instead.

The assessment of whether an entity has either or both of these main business activities should be performed for the reporting entity as a whole.

The assessment may require significant judgement as this is not merely an assertion, but rather must be based on:

- **Evidence, in accordance with IFRS 18's detailed application guidance.**
  - In general, investing in assets or providing financing to customers is likely to be a main business activity of a reporting entity if the reporting entity uses a subtotal similar to gross profit that includes income and expenses that would otherwise be classified in the investing or financing categories as an important indicator of operating performance. When these subtotals are used to explain operating performance externally or to assess or monitor operating performance internally, this may indicate that investing in assets or providing financing to customers is a main business activity of the entity.
  - When an entity invests in associates, joint ventures or unconsolidated subsidiaries which are not accounted for using the equity method, or invests in the assets specified by IFRS 18 which generate a return individually and largely independently of the entity's other resources, the entity must assess whether it invests in these assets as a main business activity on an individual asset basis or using groups of assets with shared characteristics.
- **Facts at the time of each reporting date.** If facts and circumstances change, and the conclusion of the assessment changes, the change in classification of income and expenses is applied prospectively from the date of change, and prior periods are not restated.

Practical insight

Although an entity does not need to assess whether it invests in cash and cash equivalents as a main business activity, the classification of income and expenses from cash and cash equivalents still depends on whether the entity has one of the two main business activities specified in IFRS 18, and if so, which one. Generally, an entity will classify income and expenses relating to cash and cash equivalents in the investing category. However, when an entity invests in financial assets as a main business activity it will classify income and expenses on cash and cash equivalents in the operating category. When an entity provides financing to customers as a main business activity, and the income and expenses from cash and cash equivalents relate to providing financing to customers then the related income and expenses must be classified as operating, otherwise, there is an accounting policy choice to classify the income and expenses either as operating or investing.

Specified main business activities: Overview (continued)

Entities that have either, or both, of the two main business activities specified by IFRS 18, must classify specific income and expenses that would otherwise be classified in the investing or financing category in the operating category. IFRS 18 contains detailed guidance on which income and expenses can or must be classified as operating for these entities. Additionally, IAS 7 was amended such that classification of dividends and interest received and interest paid in the statement of cash flows must be consistent with how the corresponding income and expenses are classified in the statement of profit or loss in accordance with IFRS 18. Furthermore, while entities that provide financing to customers as a main business activity can avail themselves of an accounting policy choice in relation to the classification of certain income and expenses, that accounting policy choice must be consistent (where applicable) with that made for the classification of income and expenses from cash and cash equivalents, all of which may therefore require careful monitoring.

Classification in the operating category

The operating category under IFRS 18 effectively functions as a 'residual' or 'default' category. However, income and expenses will only be classified in the operating category if they do not meet the requirements for classification in the investing, financing, income taxes or discontinued operations categories, or are specifically required to be classified in the operating category.

It is also important to note, as mentioned previously, that the objective of the categories in the statement of profit or loss (in accordance with IFRS 18) are not the same as the objective of the similarly named categories in the statement of cash flows. For example, when applying IAS 7 to prepare the statement of cash flows, cash utilised to acquire PPE that will be used in the entity's operations must be classified as cash flows from investing activities. However, when applying IFRS 18, in the statement of profit or loss, income and expenses generated from the use of such PPE in the entity's operations must be included in the operating category.

This misalignment is due to the fact that the IASB prioritised the objectives of each individual primary financial statement and did not seek to align the definition of the categories in the statement of profit or loss with those in the statement of cash flows.

Classification in the investing category

The investing category includes income and expenses derived from a specifically defined set of assets. These are:

Asset type	Description
Investments in associates and joint ventures	This includes investments accounted for using the equity method, investments that an entity has elected to measure at fair value through profit or loss and investments in separate financial statements which are accounted for at cost.
Investments in unconsolidated subsidiaries	Similar to investments in associates and joint ventures, this includes investments in unconsolidated subsidiaries that are: • accounted for using the equity method in separate financial statements • held by an investment entity at fair value through profit or loss, and • accounted for at cost in separate financial statements.
Cash and cash equivalents	We note here that the definition of cash equivalents in IAS 7 specifically states that cash equivalents are held to meet short-term cash commitments and not for investment or other purposes. This is therefore another key misalignment between IFRS 18 and IAS 7 to be aware of.
Other assets that generate a return individually and largely independently of the entity's other resources	• Assets that typically meet this definition include debt or equity investments and investment properties (and receivables for rent generated by these properties). Income and expenses from these assets can include interest, dividends, rental income, depreciation and impairment losses and reversals, as well as fair value gains or losses and any income or expense from the derecognition or classification and remeasurement as held for sale. • Assets that typically do not meet this definition include PPE, assets that arise from providing goods or services and loans to customers when the entity is providing financing as a main business activity. Income and expenses from such assets are included in the operating category. For example, revenue from the sale of goods or services, interest income, depreciation and impairment of PPE.

However, exceptions exists for entities that invest as a main business activity in associates, joint ventures and unconsolidated subsidiaries that are not accounted for under the equity method, or other assets that generate a return individually and largely independently of the entity's other resources (see **below** for further detail).

Specified main business activities: Exception for entities investing in 'specified assets' as a main business activity

There is an exception to the classification requirements set out above, when an entity invests as a main business activity in the specific assets set out in IFRS 18, ie investments in associates, joint ventures and unconsolidated subsidiaries that are not accounted for under the equity method, or other assets that generate a return individually and largely independently of the entity's other resources. For example, an investment property company that invest in a portfolio of investment properties as a main business activity in accordance with IFRS 18. In this case, income and expenses related to these investment property assets and activities would be included in the operating category, instead of in the investing category.

The assessment of whether investing in the assets specified by IFRS 18 is a main business activity of an entity is a matter that may require significant judgement by management. It is not merely an assertion but instead is based on facts, and must be supported by evidence (see **above** for further detail).

Practical insight

For some entities, applying IFRS 18 may require more detailed record keeping compared to their current systems. Taking the impairment example, highlighted **above**, where IAS 1 may have only needed one account in the general ledger for recording impairment losses, under IFRS 18, an entity may now need multiple general ledger accounts for different classes of assets in order to have the granularity of data needed to meet the new classification requirements. Some entities may already have the capability in their current reporting systems to adapt to this, but for those that do not, significant changes to reporting systems and processes may be required. On initial application, entities will also need to restate comparatives, and therefore new reporting systems will need to be in place at the start of the comparative year in order to facilitate this (eg 1 January 2026 for a 31 December year-end, if IFRS 18 is only applied from the mandatory adoption date).

Classification in the financing category

The financing category generally contains income and expenses arising from liabilities, however, IFRS 18 contains detailed requirements and application guidance for entities to determine which income and expenses must be included in this category.

IFRS 18 sets general principles for classifying income and expenses relating to liabilities, distinguishing between liabilities that arise from transactions that involve only the raising of finance, and liabilities that arise from transactions that do not involve only the raising of finance, with exceptions to these general principles and additional guidance for:

- entities providing financing to customers as a main business activity
- **hybrid contracts comprising host liabilities and embedded derivatives**
- **derivatives and designated hedging instruments**
- **issued investment contracts with participation features under IFRS 9 'Financial Instruments'**
- **insurance contracts when applying IFRS 17 'Insurance Contracts'.**

General principles for income and expenses relating to liabilities:

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

Income and expenses from such transactions must be classified in the financing category. IFRS 18 clarifies that these are transactions in which an entity receives finance in the form of cash, the extinguishment of a financial liability, or the receipt of the entity's own equity instruments, and at a later date will return either cash or its own equity instruments. These include liabilities such as cash settled debt instruments, liabilities under supplier finance arrangements in which the payable for goods or services is derecognised, bonds that will be settled through the delivery of the entity's own shares, and obligations for an entity to purchase its own equity instruments. Income and expenses for these items may include interest expense, fair value gains and losses or dividends on issued shares.

Liabilities that arise from transactions that do not involve only the raising of finance

These can include items such as payables for goods or services, lease liabilities, contract liabilities recognised under IFRS 15 'Revenue from Contracts with Customers', defined benefit pension scheme liabilities, decommissioning or asset restoration, provisions and litigation provisions. For these liabilities, only interest income and expenses and income and expenses arising from changes in interest rates are included in the financing category. Other items of income and expenses must be included in one or more of the other categories, for example, the current and past service cost arising from a defined benefit pension scheme must be classified in the operating category.

Specified main business activities: Exception for entities that provide financing to customers as a main business activity

There is an exception to the general principles set out above for entities that provide financing to customers as a main business activity. Entities that provide financing to customers as a main business activity classify certain income and expenses relating to liabilities in the operating category rather than the financing category.

- Liabilities arising from transactions that involve only the raising of finance:
  - Income and expenses from liabilities related to providing financing to customers > operating
  - Income and expenses from liabilities not related to providing financing to customers > operating or financing (accounting policy choice)
- Liabilities arising from transactions that do not involve only the raising of finance:
  - Income and expenses other than interest or income and expenses arising from interest rate movements > operating
  - Interest and income and expenses arising from interest rate movements > financing

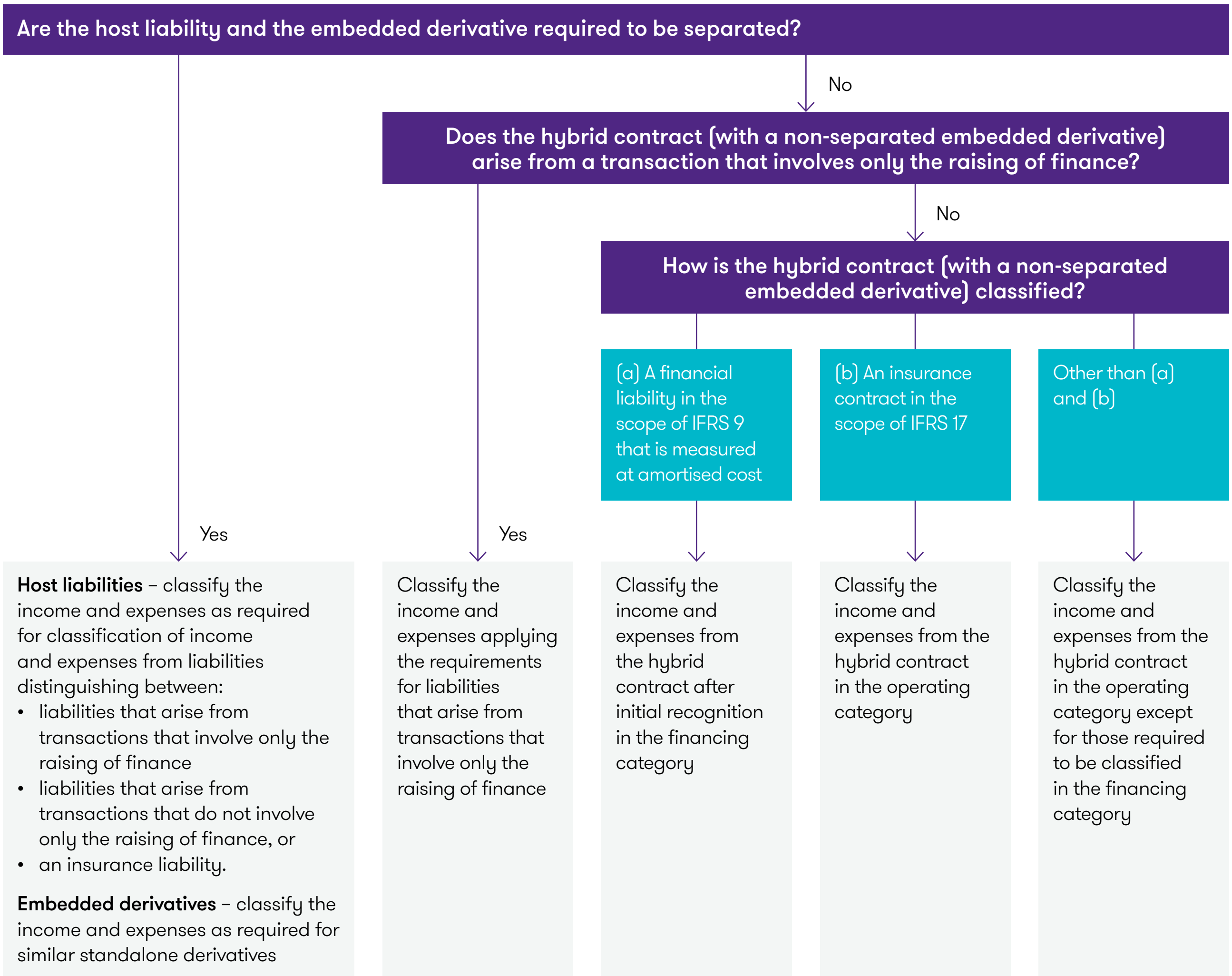
For entities providing financing to customers, such as banks or other credit providers, an assessment of their activities will be required to establish that providing financing to customers is a main business activity, in accordance with IFRS 18's requirements. This may involve judgement in some cases but is a matter of fact based on evidence rather than an assertion.

Exceptions to the general principles and detailed application guidance on the following topics

Hybrid contracts comprising host liabilities and embedded derivatives

Accounting for these contracts depends on whether the embedded derivative is separated from the host contract or not.

- If the embedded derivative is separated from the host contract, income and expenses related to the host liability will be treated in line with the general principles for liabilities. Income and expenses relating to the embedded derivative are treated in accordance with specific guidance for derivatives (see **below**).
- If the contract is not separated, it is considered as a whole, and the classification of income and expenses arising from it will be dependent on a number of factors, including whether the host contract is in the scope of IFRS 9 or whether the hybrid contract is scoped into IFRS 17. These considerations are set out in the following flowchart, reproduced from IFRS 18 Supporting Materials accompanying IFRS 18:



Derivatives and designated hedging instruments

Derivatives used to manage identified risks

For derivatives used to manage identified risks (whether designated as a hedging instrument applying IFRS 9 or not), the general principle is that the gains and losses on the derivative must be classified in the same category as the income and expenses affected by the risks the derivative is used to manage. For example, a derivative may be used to manage the risk of price increases for raw materials used in producing goods. In this case, the underlying risk is related to expenses in the operating category, so the gains and losses from the derivative should be included there as well. Alternatively, a derivative may be used to manage the risk of interest rates increasing on bank loans. If the income and expenses arising from these loans are included in the financing category, gains and losses recognised on the derivative will also be included in financing. There is an exception to this general principle however, if it would lead to the 'grossing up' of gains and losses; for example if a derivative is being used to hedge risks affecting items in multiple categories, in which case gains and losses on the derivative are classified in the operating category.

Derivatives not used to manage identified risks

When a derivative is not used to manage identified risks, gains or losses on the derivative must be included in the financing category if the derivative relates to a transaction involving only the raising of finance, unless the entity provides financing to customers as a main business activity.

Specified main business activities: Exception for entities providing financing to customers as a main business activity

If the entity provides financing to customers as a main business activity, and the derivative is not used to manage identified risks and relates to a transaction involving only the raising of finance:

- If the derivative relates to providing financing to customers – then the gains or losses on the derivative must be included in the operating category
- If the derivative does not relate to providing financing to customers – then the entity has an accounting policy choice to classify the gains or losses on the derivative in the operating or financing category.

If a derivative is not used to manage identified risks and the derivative does not relate to a transaction involving only the raising of finance, the gains or losses on the derivative are included in the operating category.

Liabilities arising from issued investment contracts with participation features under IFRS 9

Income and expenses from liabilities arising from issued investment contracts with participation features, which are accounted for in accordance with IFRS 9, are excluded from the financing category and are instead included in the operating category. An example of this type of contract is an investment contract with participation features issued by an investment entity.

Insurance contracts when applying IFRS 17

Insurance finance income and expenses are also included in the operating category, rather than in financing.

Specific requirements for classifying foreign exchange differences

The general requirement for foreign exchange differences which arise from the application of IAS 21 'The Effects of Changes in Foreign Exchange Rates' is that the exchange differences must be classified in the same category as the income or expenses from the items that gave rise to them. For example, if an entity has a receivable denominated in a foreign currency, from the sale of the entity's goods, which are classified in the operating category, the foreign exchange differences arising when translating the trade receivable into the functional currency will also be included in the operating category.

Practical insight

For a transaction that does not only involve the raising of finance, as mentioned **above**, income and expenses may have to be split between multiple categories. Any foreign exchange differences associated with such a transaction however, cannot be split between categories. Instead, the entity must use its judgement to determine which part of the transaction the foreign exchange differences relate to and the foreign exchange differences are then allocated to that relevant category only. There may be significant judgement involved in determining which part of a transaction the foreign exchange differences relate to, and therefore where they must be classified in the statement of profit or loss. This could apply to liabilities such as payables for goods or services denominated in a foreign currency which also include extended credit terms – given the expense for the purchase of the goods or services would be classified in operating whereas interest expenses would be classified in financing. We therefore recommend that entities with transactions denominated in a currency other than their functional currency begin assessing their arrangements early to identify any such challenging areas.

There is a relief available from this general requirement. If the assessment would require undue cost or effort, an entity may classify affected foreign exchange differences in the operating category. The assessment of undue cost or effort must be made for each item that gives rise to foreign exchange differences, and it must be specific to the facts and circumstances in each case. However, if the same facts and circumstances apply to a number of items, the same assessment could be applied to each. It is important to note that, if an entity is unable to allocate specific foreign exchange differences to the applicable categories, the undue cost or effort relief applies only to those specific foreign exchange differences – not to all foreign exchange differences. An example given of how the undue cost or effort exemption may be applied in practice is if all foreign exchange differences are currently being captured in aggregate at an entity level as a single amount, in order to facilitate central management of net exposure (such as, by a central treasury function), and allocating foreign exchange differences to the applicable categories would impose large implementation costs. In this case, management may assess that it would be appropriate to apply the undue cost or effort exemption because the cost and effort of compliance would be disproportionate to the benefit.

Classification of Income and expenses arising on derecognition of assets and liabilities

IFRS 18 includes detailed application guidance relating to the classification of income and expenses arising on derecognition of assets and liabilities, the classification and remeasurement of an asset when designated as held for sale, and upon a change in use of an asset. When dealing with an individual asset or liability this may be straightforward. The principle of IFRS 18 is that income and expenses on derecognition or reclassification will be classified in the same category as was required immediately before the derecognition or reclassification.

However, when dealing with a group of assets, or a group of assets and liabilities, this could become more complicated and therefore the Standard gives additional guidance on dealing with derecognition and changes in classification of groups of assets, or a group of assets and liabilities.

Applying this guidance may again require detailed record keeping and information to enable entities to apply it correctly.

Challenges with transition to IFRS 18

IFRS 18 must be mandatorily applied for the first time for annual reporting periods beginning on or after 1 January 2027, however it is required to be applied retrospectively, meaning that the comparative information must be restated. Early adoption is also permitted. Many entities may find the transition challenging, especially if the information required has not previously been captured by their systems. In addition to changing the classification of income and expenses, IFRS 18 requires the following in the first year of applying IFRS 18:

- If an entity applies IAS 34 'Interim Financial Reporting':
  - If an entity prepares condensed interim financial statements – the condensed interim financial statements must present in the statement of profit or loss each heading the entity expects to use in applying IFRS 18, as well as the subtotals required by IFRS 18. This is specified in IFRS 18 despite the requirement of IAS 34 to present at a minimum the headings and subtotals included in the entity's most recent annual financial statements.
  - The interim financial statements must include a reconciliation for each line item presented in the statement of profit or loss for comparative periods immediately preceding the current and cumulative current periods.
- In the entity's annual financial statements – a reconciliation of each line item in the statement of profit or loss for the comparative period, from the amounts previously presented under IAS 1, to the restated amounts presented when applying IFRS 18.

2. Management-defined performance measures

Given the prevalence and usefulness of alternative performance measures (APMs), IFRS 18 introduces new disclosure requirements in relation to the use of a narrowly defined set of APMs, referred to as 'management-defined performance measures' (MPMs).

While the use of APMs is subject to regulation in most jurisdictions, IFRS 18's objective to increase the transparency and discipline of the use of APMS, requires entities to pull into a single financial statement note, all disclosures concerning MPMs as defined by IFRS 18. For these newly defined MPMs, IFRS 18 requires the disclosure of the income tax effect, as well as the effect on non-controlling interests, for each item disclosed in the reconciliation of MPMs to IFRS Accounting Standard subtotals or totals. This represents a new requirement, even for most jurisdictions with existing regulations for APMs.

The process of applying IFRS 18, from first identifying MPMs, to subsequently complying with IFRS 18's detailed disclosure requirements, should not be underestimated. Considerable judgement may be required in applying IFRS 18's new MPM disclosure requirements and it may necessitate significant changes to existing systems and processes, and new systems and processes.

Early investor communication may also be necessary, given some of IFRS 18's requirements will be new, even for those entities in jurisdictions that are currently subject to regulation regarding APMs.

Practical insight

MPMs will be subject to audit. Given IFRS 18 requires MPMs to be disclosed in the financial statements, the MPM disclosures will be subject to the financial statement audit requirements in accordance with ISA 200 'Overall Objectives of the Independent Auditor and the Conduct of an Audit in Accordance with International Standards on Auditing', as opposed to simply falling within the scope of ISA 720 'The Auditor's Responsibilities Relating to Other Information'. The audit requirement means that the MPM disclosures will be subject to a higher level of scrutiny. Therefore, more onus will be placed on management to ensure that MPMs disclosed in accordance with IFRS 18, are useful to users and are labelled and described in a clear and understandable manner, such that they do not mislead users of the financial statements.

Challenges with the definition of MPMs

An MPM is defined by IFRS 18 as:

A subtotal of income **and** expenses that:
- an entity uses in public communications outside its financial statements
- an entity uses to communicate to users of its financial statements management's view of an aspect of the financial performance of the entity as a whole, and
- is not listed IFRS 18, or specifically required to be presented or disclosed by IFRS Accounting Standards.

Although this definition may seem narrow, there is a significant amount of application guidance which needs to be applied to determine whether an APM meets the definition of an MPM and therefore whether IFRS 18 disclosures are required. As such, there are a number of areas that can be challenging for entities in making these assessments.

What comprises a subtotal?

A subtotal must include both income and expenses. Therefore a 'total income' subtotal comprising the sum of operating, investing and financing income, but none of the expenses, does not meet IFRS 18's definition of an MPM. A financial ratio is therefore not considered an MPM, however if a subtotal used as a numerator or denominator in a financial ratio would meet IFRS 18's definition of an MPM if it were not part of a ratio, the subtotal used as the numerator or denominator will be an MPM, provided the rest of the definition is met. For example, the ratio 'adjusted return on equity' is not an MPM, however the subtotal and numerator in the ratio 'adjusted net earnings' would be an MPM provided the rest of the MPM definition is met.

What constitutes 'public communications'?

In accordance with IFRS 18, a subtotal is an MPM as defined only if an entity uses the subtotal in 'public communications' outside its financial statements. Public communications include management commentary, press releases and investor presentations. Oral communications (including written transcripts of oral communications) and social media posts are specifically excluded from public communications by IFRS 18, given they are challenging to monitor. In addition, entities must only consider public communications related to the current reporting period when identifying MPMs for disclosure in the current reporting period, unless an entity routinely issues such public communications after the date of issue of its financial statements, as part of its financial reporting process. In this case, the entity must also consider public communications related to the previous reporting period when identifying MPMs for disclosure in the current reporting period. Therefore, the list of MPMs reported in each reporting period may change. There are specific requirements when reported MPMs change, which are detailed in the '**what could go wrong**' section.

An aspect of financial performance of the entity as a whole

Determining whether a performance measure relates to an aspect of the financial performance of the entity as a whole may require significant judgement. For example, in some cases, a subtotal related to a reportable segment as defined by IFRS 8 'Operating Segments' will not be an MPM. However, if the reportable segment contains a single main business activity of the entity, and a subtotal of income and expenses for that segment is presented in the statement of profit or loss, that would indicate that the subtotal does provide information about an aspect of performance of the entity as a whole, and therefore is an MPM, if the subtotal meets the remainder of the MPM definition. Entities will need to carefully consider each performance measure that they are reporting to assess whether it will meet this aspect of the definition of an MPM.

Specifically excluded subtotals

IFRS 18 lists specific subtotals that are not MPMs. This includes profit or loss before income taxes; operating profit or loss before depreciation, amortisation and impairments within the scope of IAS 36 'Impairment of Assets' (OPDAI); profit or loss from continuing operations; and gross profit or loss and similar subtotals (for the full list please refer to the Standard). In relation to gross profit and similar subtotals, IFRS 18 specifies that a subtotal which consists only of a type of revenue and directly related expenses that were incurred in generating that revenue, such as net rental income or net interest income, are not MPMs.

Practical insight

Identifying subtotals that meet the definition of an MPM may be complex, and differences can be subtle. For example, if an entity were to define a measure of earnings before interest, taxes, depreciation and amortisation (EBITDA) as operating profit or loss before depreciation, amortisation and impairments within the scope of IAS 36 (OPDAI) because all of its earnings are included in operating profit, as noted in IFRS 18, OPDAI would not be an MPM. However, if the earnings measure used as the starting point of that EBITDA subtotal also included items of income and expense that were classified in the investing category, then that EBITDA subtotal could meet the definition of an MPM. Management therefore needs to carefully assess each subtotal to determine if it meets the definition of an MPM per IFRS 18.

It is important to note that any APM that meets the MPM definition is an MPM, whether or not it is presented in the statement of profit or loss.

IFRS 18's rebuttable presumption in the definition of MPMs

When assessing whether a communicated subtotal meets the definition of an MPM, IFRS 18 presumes that a subtotal of income and expenses used in public communications outside an entity's financial statements communicates management's view of an aspect of the financial performance of the entity as a whole. If management want to rebut this presumption they are required to have 'reasonable and supportable information' available to demonstrate the basis for the rebuttal.

This rebuttal requires management to have reasonable and supportable information available but does not require them to consider all reasonable and supportable information that is available. Therefore this may prove useful for management and provide some relief from making MPM disclosures.

However, IFRS 18 includes extensive application guidance for the use of this rebuttable presumption. Management must be able to demonstrate that a subtotal does not communicate management's view of an aspect of the financial performance of the entity as a whole, and that the entity has another reason for using this subtotal in its public communications other than communicating management's view of an aspect of the financial performance of the entity as a whole.

For example, if a subtotal is only included in a public communication due to a requirement of law or regulation or at the request of another external party, and management do not use the measure internally to assess or monitor performance, and the subtotal is communicated without prominence (for example management do not expand their commentary and explanations in public communications beyond the externally imposed requirements), there may be reasonable and supportable information that would allow management to rebut the presumption, and the particular measure may not be an MPM as defined by IFRS 18.

Significant judgement may be required when applying this rebuttal, and conclusions may change over time. Therefore, entities applying the rebuttal will have to reassess, at each reporting date, whether such subtotals have subsequently become MPMs, to ensure there is compliance with IFRS 18's requirements.

Challenges with the disclosure of MPMs

IFRS 18 requires that reporting entities bring together all of their MPMs and provide disclosures in a single note to the financial statements. For each MPM, an entity is required to disclose:

1. A description of the aspect of financial performance that the MPM communicates, along with an explanation of why management believe that the MPM provides useful information to users about the entity's financial performance
2. How the MPM is calculated
3. A reconciliation between the MPM and the most directly comparable subtotal listed in IFRS 18 or another total or subtotal specifically required by another IFRS Accounting Standard
4. The income tax effect (along with a description of how this is determined) for each reconciling item
5. The effect on non-controlling interest (NCI) for each reconciling item
6. If the MPM is reconciled to a total or subtotal that is not presented in the statement of financial performance, that total or subtotal must in turn be reconciled to the most directly comparable total or subtotal that is presented in its statement of financial performance (note, disclosure of the income tax and NCI impact of reconciling items in this 'secondary' reconciliation is not required).

These disclosure requirements can be seen in the example **here**, based on the illustrative example provided by the IASB (note that comparatives have not been reproduced but would be required for all MPMs).

Example MPM disclosures (based on IASB Illustrative Examples – Part 1, Note 2)

Management-Defined Performance Measures (MPMs)

The Group reports two MPMs in its public communications: **adjusted operating profit** and **adjusted profit from continuing operations**. These measures are not defined in IFRS Accounting Standards and therefore may differ from similar measures reported by other entities.

1 To reflect management's view of the Group's financial performance, operating profit and profit from continuing operations are adjusted for income and expense items that are not expected to recur over several future reporting periods. Management believes these adjustments provide useful insight into trends in the Group's underlying profitability.

2 Items that would be adjusted on this basis would include:

- Impairment losses (or reversals) on property, plant and equipment (including right-of-use assets) and intangible assets (see Note X)
- Restructuring costs (see Note X)
- Non-recurring litigation costs (see Note X) – Litigation costs are assessed on a case-by-case basis – typically, litigation relating to intellectual property disputes, regulatory breaches, or employee claims is classified as non-recurring, on the basis the Group takes proactive measures aimed at preventing such events (there were no such costs classified as non-recurring in the current year)
- Gains or losses on disposal of property, plant and equipment and intangible assets (see Note X)
- Gains or losses on disposal of subsidiaries, associates, and joint ventures (see Note X)

3 Reconciliation of MPMs to IFRS total or subtotal:

Management-defined performance measures 20XX (in thousands of CU)

		Adjustments:				
	IFRS	**Impairment losses**	**Restructuring expenses**	**Gains on disposal of associates and joint ventures**	**Gains on disposal of PPE**	**MPM**
Other operating income		–	–	–	(X)	
Research and development expenses		X	–	–	–	
General and administrative expenses		X	X	–	–	
Goodwill impairment loss		X	–	–	–	
Operating profit/Adjusted operating profit	**X**	**X**	**X**	–	**(X)**	**X**
Share of profit and gains on disposal of associates and joint ventures		–	–	(X)		
4 Income tax expense		–	X	X	X	
Profit from continuing operations/ Adjusted profit from continuing operations	**X**	**X**	**X**	**(X)**	**(X)**	**X**
5 Profit attributable to non-controlling interests		X	–	–	X	

4 **Determination of income tax effect:**

Impairment losses	Impairment losses recorded in 20XX did not result in any tax benefits, as these losses were not deductible under Country A's tax regulations.
Restructuring expenses	Restructuring costs incurred in 20XX relate to XXX (see Note X). These include redundancy payments for employees in the XXX business unit in Country B. The tax impact of these costs is calculated using the statutory tax rate applicable in Country B as at [year-end 20XX], which was X%.
Gains on disposal of associates and joint ventures	The tax impact of gains from the disposal of associates and joint ventures is determined using the statutory tax rate applicable in Country C as at [year-end 20XX], which was X%.
Gains on disposal of property, plant and equipment	The tax impact of gains from the disposal of PPE is determined using the statutory tax rate applicable in Country D as at [year-end 20XX], which was X%.

What could go wrong with MPMs?

If entities do not fully consider the application guidance and correctly identify MPMs, there are multiple issues that can arise.

- **Misapplication of guidance** – An entity may miss MPMs that must be disclosed, causing a completeness issue with their disclosures. They may prepare disclosures for APMs that do not meet the definition of MPMs, creating more workload for interim and annual reporting. They may also inadvertently create MPMs by communicating with the market without the appropriate governance measures in place.
- **Cross-referencing** – IFRS 18 requires that MPM disclosures are presented in a single financial statement note. It should be noted that IFRS 18 is silent regarding cross-referencing to another document outside the financial statements. Therefore, entities should exercise caution before cross-referring from the financial statements to information contained elsewhere. The requirement to disclose MPMs in a single financial statement note may be interpreted strictly by some regulators.
- **Interaction with IFRS 8** – For entities applying IFRS 8, when reportable segment information contains an MPM, management may disclose the information required by IFRS 18 about the MPM in the same note as the rest of the segmental reporting. If this is done, the requirement to present all MPM disclosures in a single note can either be met by including disclosures for all MPMs in the segmental reporting note, clearly distinguishing information required under IFRS 18 from information required under IFRS 8, or alternatively all information about MPMs (including any MPMs reported in the segmental reporting) may be presented in a separate note. Therefore, management may wish to carefully consider their financial reporting processes to avoid or minimise the duplication of disclosures. The detailed disclosures required on MPMs may also lead to more scrutiny over segmental reporting. Management will need to be aware of the level of information being presented under IFRS 18 and ensure that their financial reporting as a whole is communicating a consistent message about the entity's performance.
- **Comparison with current APM regulations in various jurisdictions** – As previously mentioned, there are jurisdictions globally that currently require some level of disclosure for APMs. However, complying with the requirements of IFRS 18 is likely to require a significant increase in the level of information to be disclosed about MPMs. Management should therefore be careful not to assume that any existing disclosures they have will be sufficient.
- **Changing MPMs over time** – If an entity reports a new MPM, stops using an MPM, or changes how it calculates a previously reported MPM or the income tax effects of reconciling items, disclosures are required explaining the change, the reason for the change, as well as its effects. Restated comparative information is also required, reflecting the change, unless restatement is impractical. Therefore, management may need to consider the requirements of IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors' to assess whether restatement is impracticable, and if it is, this must also be disclosed. We note that the existing threshold for justifying impracticability under IAS 8 is very high.

It is important to note that the IFRS 18 disclosures on MPMs are required for both annual and interim financial statements (if prepared). However, the MPM disclosures must relate to the same reporting period as the financial statements. Therefore, MPMs relating to the performance of the entity for the full twelve months (ie for the annual reporting period), and not relating to the interim financial statements, must be disclosed in the financial statements for that annual period, not in the interim financial statements. In contrast, MPMs relating to the interim reporting period and not the full annual reporting period would be an MPM in the interim financial statements only.

An MPM relating to the reporting period should be disclosed in the financial statements for that reporting period even if the performance measure is publicly communicated on the date the financial statements are authorised for issue. Given IFRS 18's focus on public communications for identifying MPMs, the financial reporting process of entities may need to be altered to avoid creating a greater reporting burden if MPMs are only communicated on the date the financial statements are authorised for issue.

How to ease transition

IFRS 18 must be applied for the first time for annual reporting periods beginning on or after 1 January 2027, so in order to make a smooth transition to making the new MPM disclosures, management should consider prioritising:

- Early identification of APMs that are expected to meet the definition of MPMs and that will require disclosure in the first annual reporting period in which IFRS 18 is applied
- Assessing whether existing systems and processes are sufficient to appropriately identify MPMs and gather the information that will be required for the disclosures
- When to start communicating foreseen changes to the information that is currently being provided to investors.

3. New and enhanced guidance on aggregation and disaggregation of information in the financial statements

While IAS 1 contained principles for the aggregation and disaggregation of information in the financial statements, when applying IFRS 18, significant judgement may be required to ensure that the primary financial statements fulfil their new role of providing 'useful structured summaries' to give users more useful information.

Challenges with presenting the primary financial statements as 'useful structured summaries'

The concept that the primary financial statements (ie the statement of financial performance, financial position, changes in equity and cash flows) are 'structured summaries' is not new, as it is a concept in the 'Conceptual Framework for Financial Reporting'. However, IFRS 18 takes this concept to a new level, which for some entities may take time to embed in their financial statement preparation process, and for other entities, may require significant changes to existing systems and processes or new systems and processes. Below are a few key areas that entities should be aware of.

- **Specifying that the role of primary financial statements is to provide 'useful structured summaries'** – IFRS 18 adds the word 'useful' to 'structured summaries'. Appendix A of the Standard clarifies that a 'useful structured summary' will be useful for users for:
  - obtaining an understandable overview of the entity's recognised assets, liabilities, income, expenses, equity and cash flows
  - making comparisons between entities and between reporting periods for the same entity
  - identifying items or key areas where they might want to get more information from the notes.

  This definition underpins IFRS 18's objective in presenting primary financial statements so reporting entities need to be aware of this.
- **Clarifying the role of the notes** – IFRS 18 states that the notes are there to provide material information which is necessary for a user of the financial statements to understand the line items presented in the primary financial statements, and to supplement the primary financial statements with additional information in order to achieve the objective of the financial statements (ie to provide users with financial information to allow them to assess the prospects for future net cash inflows to the entity and assess management's stewardship of the entity's economic resources).
- **New and enhanced application guidance for determining what should be included where** – IFRS 18 provides detailed application guidance for preparers to apply their judgement in determining what information must be disclosed on the face of the primary financial statements or in the notes. Some key areas of guidance includes:
  - An entity does not need to separately present a line item in a primary financial statement if doing so is not necessary for the statement to provide a 'useful structured summary'. This is the case even if a line item is specifically required by IFRS Accounting Standards. However, if any line items required by IFRS 18 are not presented in the relevant primary financial statement, they must be disclosed in the notes, unless the resulting information is not material. The specific requirements that determine the structure of a primary financial statement must however always be complied with (ie when applying this judgement entities cannot avoid the specific requirements relating to the structure of a primary financial statement).
  - An entity must also present additional line items and subtotals if they are necessary for a primary financial statement to provide a 'useful structured summary' and, if presented, these additional line items and subtotals must:
    - be recognised and measured in accordance with IFRS Accounting Standards
    - be compatible with the structure required for the specific primary financial statement
    - be presented consistently from period to period
    - not be given more prominence than totals and subtotals required by IFRS Accounting Standards.

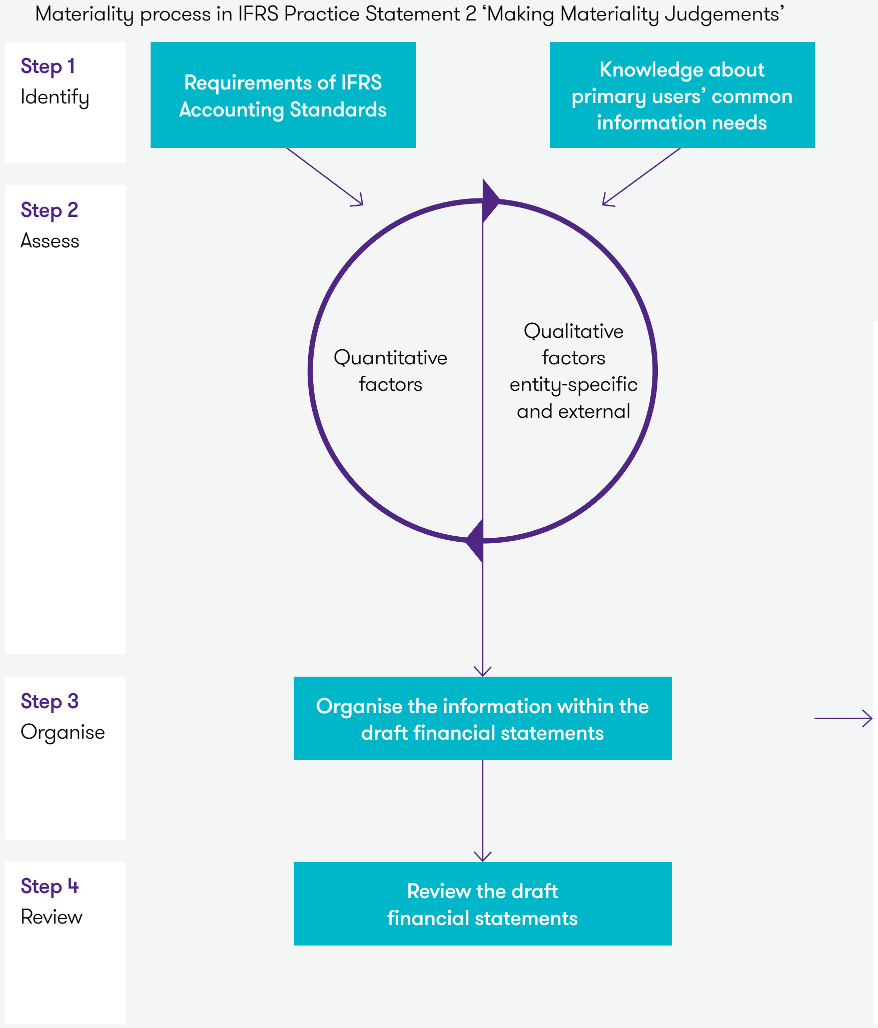
  Additional line items in the statement of profit or loss and financial position can be a disaggregation of required line items. When assessing whether to disaggregate information and present additional line items in the statement of profit or loss and financial position or to disclose items in the notes, IFRS 18 requires that entities base their judgement on an assessment of the characteristics of the items, which could be shared or not shared. These characteristics include things like the nature of the item, its function within the entity's business activities, the measurement basis, or geographic location. However, IFRS 18 provides a slightly different set of characteristics to consider for the statement of profit or loss and financial position.

Challenges with the interaction of the concept of materiality and presenting useful structured summaries

IFRS Practice Statement 2 'Making Materiality Judgements' contains useful guidance on making materiality judgements and may help an entity to decide whether an item of information should be presented separately in the primary financial statements, be aggregated with other information, or disclosed in the notes. It states that an entity should consider the different roles of the primary financial statements and notes in making this determination, with IFRS 18 now defining the roles of the primary financial statements and notes.

The flowchart, reproduced below from the Supporting Materials accompanying IFRS 18, depicts how the 'useful structured summary' relates to the materiality process in IFRS Practice Statement 2 'Making Materiality Judgements'.

How the 'useful structured summary' relates to the materiality process



In Step 3 of the materiality process, to organise the **material information** identified in Step 2 within the draft financial statements:

- an entity exercises judgement when deciding how to communicate information clearly and concisely; and
- an entity would consider the different **roles of primary financial statements and notes** in deciding whether to present an item of information separately in the financial statements, to aggregate it with other information or to disclose the information in the notes.

IFRS 18 states that:

- the role of the primary financial statements is to provide **useful structured summaries** of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows, and
- the role of the notes is to provide **material information** necessary to understand the line items presented in the primary financial statements and to supplement the financial statements.

Clearly an entity cannot include all material information in the primary statements. The role of primary statements is to provide 'useful structured summaries', and this role, now included in IFRS 18, will provide a basis for determining what material information should be included on the face of the primary financial statements and what should be included in the notes. The newly defined roles of the primary financial statements and notes therefore help to clarify that information is presented in the primary financial statements to provide a useful structured summary, and therefore, additional detailed information should be included in the notes, as long as that additional detailed information is material.

Practical insight

To help illustrate this we can use the example of an entity that has undergone a major restructuring and concluded that information about that restructuring is material. In order to decide whether to present a line item for restructuring expenses in the statement of profit or loss, the entity needs to consider whether that line item contributes to a 'useful structured summary'. The entity may consider that presenting a separate line item for restructuring expenses will help users of the financial statements to understand the increase in total operating expenses for the period. By presenting a separate line item this may also result in the other expense line items being more comparable to amounts presented by the entity in previous periods, enabling users to make more useful comparisons between periods and to amounts presented by other entities. The entity could also conclude that the separate line item will help users to identify restructuring as an area that they may wish to seek more information about in the notes.

Challenges with aggregation and disaggregation of information

While IAS 1 included high level principles of aggregation and disaggregation of information in the financial statements, IFRS 18 introduces new specific principles for aggregating and disaggregating information in the financial statements, along with detailed application guidance. As such, for some entities the application of IFRS 18 may require changes to existing systems and processes, given an entity is required by IFRS 18 to comply with the following (unless doing so would override specific aggregation or disaggregation requirements in IFRS Accounting Standards):

- Classify and aggregate assets, liabilities, equity, income, expenses or cash flows into items based on shared characteristics such as:
  - the nature of the item
  - its function within the entity's business activities
  - the measurement basis
  - geographical location
  - size
  - or other characteristics
- Disaggregate items based on characteristics that are not shared
- Aggregate or disaggregate items to present line items in the primary financial statements that fulfil their role of providing 'useful structured summaries'
- Aggregate or disaggregate items to disclose material information in the notes
- Ensure that aggregation and disaggregation in the financial statements does not obscure material information.

If an entity does not present material information in the primary financial statements, it must disclose that information in the notes.

As was also the case with IAS 1, IFRS 18 makes it clear that when applying these principles an entity must disaggregate items which have dissimilar characteristics when the resulting information is material. Some examples given in the Standard, of information that might need to be disaggregated, include PPE disaggregated into classes as set out in IAS 16 'Property, Plant and Equipment', inventories disaggregated into items such as merchandise, production supplies, materials, work in progress and trade payables – disaggregating those trade payables which are part of supplier finance arrangements.

Aggregating and disaggregating items based on shared or dissimilar characteristics will require management judgement. IFRS 18 includes examples of characteristics that should be considered when making this judgement. Although there are multiple factors to consider, IFRS 18 is clear that an entity must disaggregate items with dissimilar characteristics when the resulting information is material – even just one dissimilar characteristic could result in information about disaggregated items being material. For example, an entity would not be able to argue that a set of items have more similar characteristics than dissimilar, and therefore not disaggregate, if information about disaggregated items is material.

Practical insight

In order to illustrate this concept, IFRS 18 uses financial assets (debt and equity investments) as an example. Financial assets may have dissimilar characteristics based on the different measurement bases used (eg some are held at amortised cost and some at fair value through profit or loss). An entity may conclude that to provide a 'useful structured summary', it is necessary to disaggregate the financial assets into two line items, being financial assets measured at amortised cost, and financial assets measured at fair value through profit or loss. Further to this initial disaggregation, financial assets measured at fair value through profit or loss may also have further dissimilar characteristics, as some may be debt investments and some may be classed as equity. The entity could then further conclude that as debt and equity investments expose the entity to different risks, that it is necessary to further disaggregate the financial assets into separate line items for debt and equity investments in order to provide a 'useful structured summary'. However, if the entity was to conclude that disaggregation of debt and equity investments was not required to provide a 'useful structured summary', but the disaggregated information is still material, then they would need to disaggregate the debt and equity investments in the notes to the financial statements.

Challenges with the use of descriptive labels

IFRS 18 specifies that items presented in the primary financial statements, and disclosed in the notes must be labelled and described in a way that faithfully represents the characteristics of the item, and to do this an entity must include all descriptions and explanations necessary to allow a user of the financial statements to understand the item.

IFRS 18 includes specific application guidance and requirements for labelling aggregated items as well as specific disclosure requirements depending on whether items are aggregations of items for which information is material or not material. It also limits the use of the non-descriptive label 'other' when presenting and disclosing aggregated items. Labelling aggregated items with the label of 'other' is only permitted when an entity is unable to find a more informative label. To support this, IFRS 18 includes examples of how an entity might find a more informative label, application guidance around the labels that must be used if there is not a more informative label than 'other', and additional disclosure requirements around further information about aggregated amounts for specific circumstances.

An item for which information is:		Other items for which information is:	Disclosure requirements:
Material	Could be aggregated with	Material	Disclose information about each item
Material	Could be aggregated with	Not material	Disclose information about disaggregated items only if immaterial information would obscure material information
Not material	Could be aggregated with	Not material	Not required to disclose information about disaggregated items, but must consider if the aggregated amount is sufficiently large, and therefore, whether a user of the financial statements might reasonably question whether it includes items for which information could be material

How might an entity find a more informative label than ‘other’?

- If an item for which information is material is aggregated with items for which information is not material, find a label that describes the item for which information is material, or
- If items for which information is not material are aggregated, find a label based on the similar or dissimilar characteristics upon which the aggregation is based.

When there is no more informative label than ‘other’, an entity must use a label that describes the aggregated item as precisely as possible (eg ‘other operating expenses’). Importantly, if an entity is describing an aggregation comprising of only items for which information is not material, they must consider if the aggregated amount is sufficiently large that users of the financial statements might reasonably question whether it includes items for which information could be material.

Practical insight

In labelling and describing items in a way that faithfully represents the characteristics of the item, IFRS 18 specifies that an entity must provide all descriptions and explanations necessary for a user to understand the item. In providing a description or explanation of an item in the financial statements, it may be necessary for management to include definitions or meanings for specific terms used, as well as information about how they have aggregated or disaggregated assets, liabilities, equity, income, expenses, and cash flows. This may be especially relevant if items are labelled or described in a way that is highly specific to the entity in question. Therefore entities with highly specialised or unique business activities should ensure they assess whether items are adequately labelled and described such that they are understandable users of the financial statements.

Challenges with the requirements in relation to operating expenses

IFRS 18 allows entities to classify and present operating expenses in the operating category of the statement of profit or loss, using the characteristics of the nature and/or the function of the expenses. The reason for allowing the use of both nature and function on the face of the statement of profit or loss is because of concerns raised that prohibiting a mixed presentation may result in a loss of relevant information. In particular, for some operating expenses – like goodwill impairment, being a nature item – it may be difficult to allocate the operating expenses to functional line items in a non-arbitrary way.

While many may welcome this approach, judgement is required in applying IFRS 18’s detailed requirements and application guidance in relation to operating expenses. This may take some entities time to embed in their financial statement preparation process and for other entities, may require changes to existing systems and processes. Some key areas of challenge arising from the new requirements are:

- IFRS 18 does not permit operating expenses to be classified and presented using an arbitrary mixture of the characteristics of the nature and function of the expenses. Any individual line item must comprise operating expenses aggregated either only by nature or only by function. However, the same characteristic does not have to be used as the aggregation basis for all line items. In determining how to present operating expenses, an entity must consider what level of aggregation for operating expenses provides the most useful structured summary. For example, whether aggregating expenses for resources consumed in administrative activities, such as human resources, information technology, legal and accounting and presenting them in a line item labelled as ‘administrative expenses’ would provide the most useful structured summary.
- IFRS 18 includes detailed principles around classifying and presenting operating expenses using the characteristics of the nature of the expenses, for example raw material expense (‘nature expenses’), and/or the function of the expenses, for example cost of sales. IFRS 18 provides much more detailed guidance around the use of nature versus function than IAS 1 did previously, with the focus being using whichever provides the most useful structured summary. It also requires that each resulting line item be clearly labelled to identify what operating expenses are included.

- When an entity presents operating expenses classified by function, IFRS 18 includes detailed disaggregation requirements:
  - An entity is required to present a separate line item for its cost of sales, if the entity classifies operating expenses in functions that include a cost of sales function. When presenting a cost of sales line item, IFRS 18 requires that this includes the total of inventory expense as described in IAS 2 'Inventories'.
  - New disclosure requirements:
    - When classifying operating expenses by function, entities must disclose a qualitative description of the nature of expenses included in each function line item.
    - Entities classifying one or more line items by function must also disclose in a single financial statement note the total for each of five specified expenses by nature. IAS 1 required disclosure of three of these, namely depreciation, amortisation, and employee benefits, but IFRS 18 now also requires disclosure of impairment losses (and reversals thereof) and write-downs of inventories (and reversals thereof). The amounts presented or disclosed do not necessarily have to be recognised as an expense in the period (ie part, or all of the amounts could have been recognised as part of the carrying amount of an asset).
    - For each of the five specified expenses by nature, an entity needs to disclose the amount related to each line item in the operating category, as well as a list of any line items outside of the operating category which include amounts relating to the total. If the amounts are not the amounts recognised as an expense in the period, the entity must also give a qualitative explanation of that fact, identifying the assets involved.
    - When an entity classifies expenses by function and discloses the five totals of expenses by nature as described above, they are exempt from disclosing:
      - In relation to function line items presented in the operating category of the statement of profit or loss – disaggregated information about the amounts of nature expenses included in each line item beyond the amounts specified in IFRS 18 in relation to the five specified expenses by nature listed above.
      - In relation to nature expenses specifically required by an IFRS Accounting Standard to be disclosed in the notes – disaggregated information about the amounts of the expenses included in each function line item presented in the operating category of the statement of profit or loss beyond the amounts specified in IFRS 18 in relation to the five specified expenses by nature listed above.

    This exemption only relates to the disaggregation of operating expenses, and as such it does not exempt an entity from applying specific disclosure requirements relating to those expenses in other IFRS Accounting Standards.

4. Consequential amendments to other IFRS Accounting Standards

While a number of IFRS Accounting Standards were amended as a consequence of the release of IFRS 18, the most significant amendments were made to the following IFRS Accounting Standards:

- IAS 7 'Statement of Cash Flows'
- IAS 33 'Earnings per Share'
- IAS 34 'Interim Financial Reporting'

- with a simple relocation of requirements from IAS 1 into:
  - IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'
  - IFRS 7 'Financial Instruments: Disclosures'

Entities must apply all of these amendments when they first apply IFRS 18.

Amendments to IAS 7 'Statements of Cash Flows'

In order to make the statement of cash flows more consistent and comparable, IAS 7 was amended:

- To require all entities to use the new operating profit subtotal as the starting point for the indirect method of reporting cash flows from operating activities, which will remove some reconciling items.
- To remove the presentation alternatives for cash flows relating to interest and dividends paid and received. Dividends paid will always be classified as cash flows from financing activities. For entities that do not invest in the particular types of assets specified by IFRS 18 nor provide financing to customers as a main business activity, interest paid will be classified as cash flows from financing activities, and interest and dividends received will be classified as cash flows from investing activities.

Specified main business activities: Exception for entities with either or both of the main business activities specified in IFRS 18

For entities that have one, or both of the main business activities of investing in assets or providing financing to customers as specified in IFRS 18, the general principal is that the classification of dividends and interest received, as well as interest paid, in the statement of cash flows will be determined by referring to how the corresponding income and expenses are classified in the statement of profit or loss. However, an entity will have to classify the total of each of these cash flows (ie dividends and interest received, as well as interest paid) in a single category in the statement of cash flows.

Practical insight

When applying IFRS 18, an entity with a main business activity of investing in the assets specified by IFRS 18 or providing financing to customers, may be required to classify dividend and interest income and interest expense in more than one category in the statement of profit or loss. In this case, the entity will have to make an accounting policy choice to classify the related cash flows in one of the associated activities in the statement of cash flows.

- To require the application of IFRS 18's general requirements for financial statements to also be applied to the statement of cash flows, including the requirements around aggregation and disaggregation and the structure of the notes. This may mean that entities need to reconsider how items in their statement of cash flows are aggregated and disaggregated, as well as how they are labelled.

Amendments to IAS 33 'Earnings Per Share'

IAS 33 has been amended to include the following:

- In addition to presenting basic and diluted EPS as required by IAS 33, entities will be permitted to disclose in the notes additional amounts per share using a different measure of performance as the numerator in the earnings per share calculations. However, that **numerator must be** the amount attributable to ordinary equity holders of the parent entity **of a total or subtotal as specified in IFRS 18, or an MPM** as defined by the new requirements of IFRS 18 (see MPM **section 2**).
- When an entity does choose to present an additional amount per share, they must:
  - disclose the additional basic and diluted amounts per share with equal prominence
  - calculate the additional amount per share using the weighted average number of ordinary shares determined in accordance with IAS 33
  - only disclose the additional amount per share in the notes (ie the additional amount per share cannot be presented in the primary financial statements), and
  - when the numerator of the additional amount per share is an MPM, disclose all information that is required per the new MPM disclosures (see MPM **section 2**).

Amendments to IAS 34 'Interim Financial Reporting'

Amendments made to IAS 34 require

- An entity preparing condensed interim financial statements must apply IAS 34 and the requirements in IFRS 18, in relation to aggregation and disaggregation, as well as the requirements in IAS 8, regarding 'Fair presentation and compliance with IFRS Accounting Standards', 'Going concern' and 'Accrual basis of accounting'.
- The disclosures around MPMs (introduced by IFRS 18 and discussed in detail in **section 2**) must be included in all interim financial statements.

It is important to note that interim financial statements for the first year in which IFRS 18 is applied have specific transition requirements (see **section 5**).

Amendments to IAS 8 'Accounting Policies, Changes in Accounting Estimates and Errors'

IAS 8 has been retitled to IAS 8 'Basis of Preparation of Financial Statements', as the following requirements were removed from IAS 1 and inserted, unamended, into IAS 8, as opposed to being included in IFRS 18:

- Fair presentation and compliance with IFRS Accounting Standards
- Going concern
- Accrual basis of accounting
- Disclosure of selection and application of accounting policies
- Disclosure of sources of estimation uncertainty

Amendments to IFRS 7 'Financial Instruments: Disclosures'

The following requirements were removed from IAS 1 and inserted into IFRS 7 unamended (apart from editorial changes to reference relevant paragraphs in IAS 32 'Financial Instruments: Presentation'), as opposed to being included in IFRS 18:

- Disclosures in relation to puttable financial instruments classified as equity instruments.
- Disclosures in relation to the reclassification of puttable financial instruments classified as equity instruments, or other instruments that are classified as equity instruments that impose on the entity an obligation to deliver to another party a pro rata share of its net assets only on liquidation ie the requirement to disclose the amount, timing and reason for any reclassification of amounts between financial liabilities and equity for such instruments.

5. Effective date and transition

IFRS 18 is effective for annual reporting periods beginning on or after 1 January 2027, with earlier application permitted. Entities that early adopt IFRS 18 are required to disclose that fact in the notes, to their financial statements.

While IFRS 18 must be applied retrospectively applying IAS 8, entities are not required to disclose the quantitative information set out in IAS 8, ie entities do not have to disclose for the current period and each prior period presented the amount of the adjustment to each financial statement line item affected nor the adjustment to basic and diluted earnings per share.

For the comparative period, in an entity's annual financial statements an entity must disclose a reconciliation between the restated amounts presented under IFRS 18 and the amounts previously presented for the comparative period applying IAS 1.

For interim financial statements prepared under IAS 34:
- If an entity prepares condensed interim financial statements – the condensed interim financial statements must present in the statement of profit or loss each heading the entity expects to use in applying IFRS 18, as well as the subtotals required by IFRS 18. IFRS 18 requires this despite the requirements in IAS 34 to include, at a minimum, the headings and subtotals included in the entity's most recent annual financial statements.
- the interim financial statements must include a reconciliation for each line item presented in the statement of profit or loss for comparative periods immediately preceding the current and cumulative current periods.

Entities are permitted, but not required, to disclose the reconciliations above for the current period, as well as earlier comparative periods.

When first applying IFRS 18, an entity also has the option to change its election of how an investment in an associate or joint venture is measured. If they are eligible to apply the exemption in IAS 28 'Investments in Associates and Joint Ventures' (which applies for an investment in an associate or a joint venture held by, or indirectly held through, an entity that is a venture capital organisation, mutual fund, unit trust or similar entity), an entity may change its election for measuring these investments from the equity method to fair value through profit or loss in accordance with IFRS 9. If an entity makes this change, it must apply the change retrospectively in accordance with IAS 8. Additionally, if an entity applies IAS 27 'Separate Financial Statements', it is required to make the same change in its separate financial statements.

How we can help

We hope you find the information in this article helpful in giving you some insight into aspects of IFRS 18. If you would like to discuss any of the points raised, please speak to your usual Grant Thornton contact or visit **www.grantthornton.global/locations** to find your local member firm.

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