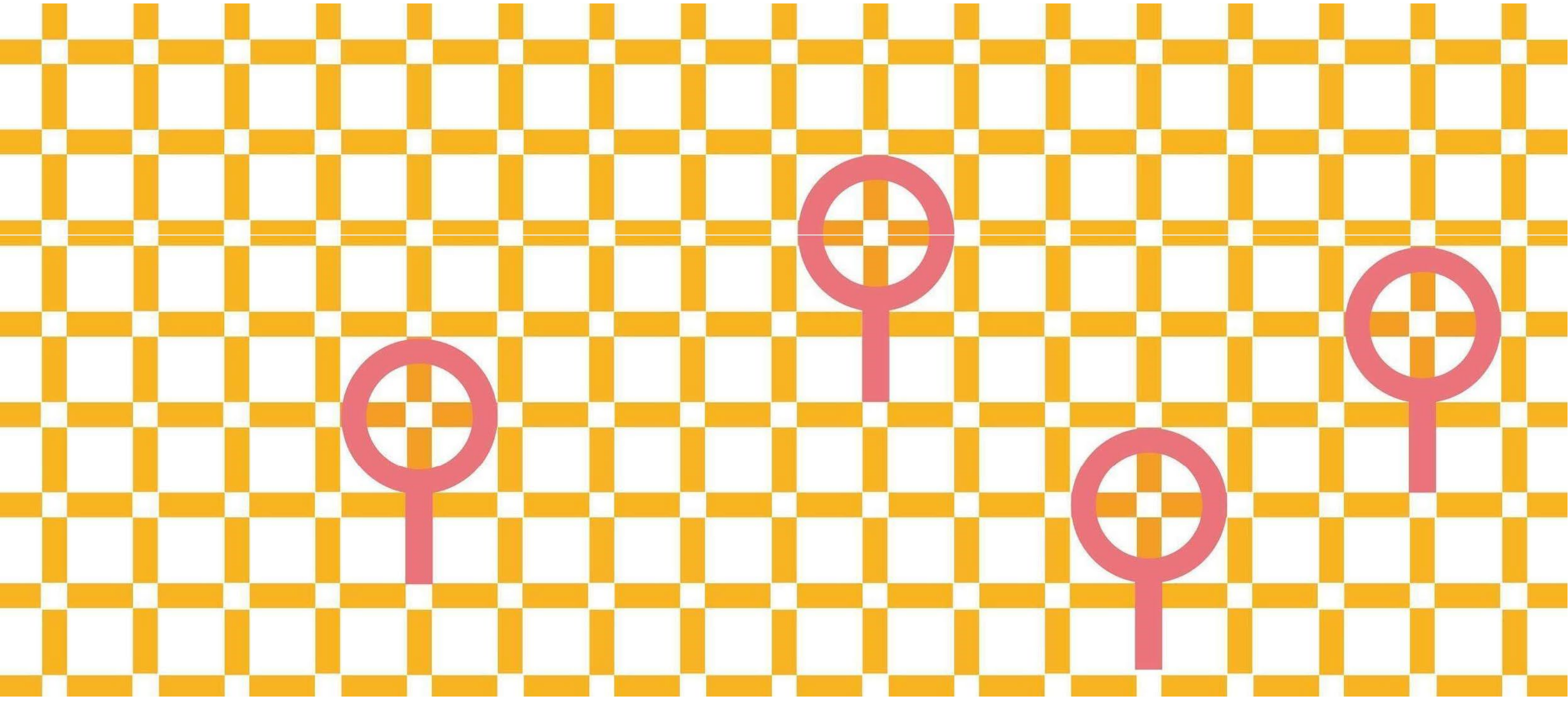

In brief

IFRS 18 is here: redefining financial performance reporting

Publication Date: 09 April 2024

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Key Points

The IASB has issued IFRS 18, the new standard on presentation and disclosure in financial statements, with a focus on updates to the statement of profit or loss. The key new concepts introduced in IFRS 18 relate to:

- the structure of the statement of profit or loss;
- required disclosures in the financial statements for certain profit or loss performance measures that are reported outside an entity's financial statements (that is, management-defined performance measures); and
- enhanced principles on aggregation and disaggregation which apply to the primary financial statements and notes in general.

IFRS 18 will replace IAS 1; many of the other existing principles in IAS 1 are retained, with limited changes. IFRS 18 will not impact the recognition or measurement of items in the financial statements, but it might change what an entity reports as its 'operating profit or loss'.

IFRS 18 will apply for reporting periods beginning on or after 1 January 2027 and also applies to comparative information. The changes in presentation and disclosure required by IFRS 18 might require system and process changes for many entities, so entities should focus now to be ready for adoption.

What´s the issue?

On 9 April 2024, the IASB issued a new standard – IFRS 18, 'Presentation and Disclosure in Financial Statements' – in response to investors' concerns about the comparability and transparency of entities' performance reporting. The new requirements introduced in IFRS 18 will help to achieve comparability of the financial performance of similar entities, especially related to how 'operating profit or loss' is defined. The new disclosures required for some management-defined performance measures will also enhance transparency.

Key Changes

1. Structure of the statement of profit or loss

IFRS 18 introduces a defined structure for the statement of profit or loss. The goal of the defined structure is to reduce diversity in the reporting of the statement of profit and loss, helping users of financial statements to understand the information and to make better comparisons between companies. The structure is composed of categories and required subtotals:

a. **Categories**: Items in the statement of profit or loss will need to be classified into one of five categories: operating, investing, financing, income taxes and discontinued operations. IFRS 18 provides general guidance for entities to classify the items among these categories – the three main categories are:

Operating category
Not defined by IFRS 18, this is the 'residual' category for income and expenses that are not classified in other categories. This will typically include the entity's results from its main business activities.

Investing category
This category typically includes:
- results of associates and joint ventures;
- results of cash and cash equivalents; and
- assets that generate a return individually and largely independently of other resources.

Financing category
This category includes:
- all income and expenses from liabilities that involve only the raising of finance (such as typical bank borrowings); and
- interest expense and the effects of changes in interest rates from other liabilities (such as unwinding of the discount on a pension liability).

IFRS 18 includes additional requirements for entities that provide financing to customers (for example, banks) or that invest in assets with specific characteristics (for example, an investment entity) as a main business activity. Some income and expenses that might ordinarily have been classified in the investing or financing category, when applying the general principles, will be presented in the operating category for these entities. The result of this is that operating profit will include the results of an entity's main business activities

b. **Required subtotals**: IFRS 18 requires entities to present specified totals and subtotals: the main change relates to the mandatory inclusion of 'Operating profit or loss'. The other required subtotals are 'Profit or loss' and 'Profit or loss before financing and income taxes', with some exceptions (for example, where a bank has financing as a main business activity and has made specific presentation choices).

These principles are illustrated in the following examples:
- Statement of profit or loss of a general corporate
- Statement of profit or loss of an insurer
- Statement of profit or loss of an investment and retail bank

2. Disclosures related to the statement of profit or loss

IFRS 18 introduces specific disclosure requirements related to the statement of profit or loss:

a. **Management-defined performance measures**: Management might define its own measures of performance, sometimes referred to as 'alternative performance measures' or 'non-GAAP measures'. IFRS 18 defines a subset of these measures which relate to an entity's financial performance as management-defined performance measures ('MPMs'). Information related to these measures should be disclosed in the financial statements in a single note, including a reconciliation between the MPM and the most similar specified subtotal in IFRS® Accounting Standards. This will effectively bring a portion of non-GAAP measures into the financial statements.
b. **Disclosure of expenses by nature, for entities that present the statement of profit or loss by function**: Entities will present expenses in the operating category by nature, function or a mix of both. IFRS 18 includes guidance for entities to assess and determine which approach is most appropriate, based on the facts and circumstances. Where items are presented by function, an entity is required to disclose information by nature for specific expenses.

3. Aggregation and disaggregation (impacting all primary financial statements and notes)

IFRS 18 provides enhanced guidance on the principles of aggregation and disaggregation which focus on grouping items based on their shared characteristics. These principles are applied across the financial statements, and they are used in defining which line items are presented in the primary financial statements and what information is disclosed in the notes.

4. Other limited changes

IFRS 18 will make some other limited changes to presentation and disclosure in the financial statements. For example, IAS 7, 'Statement of cash flows', is amended to:

a. specify 'operating profit or loss' as the starting point for reconciling cash flows from operating activities; and
b. remove the existing options for the presentation of interest and dividends paid and received.

PwC Observation
The guidance on aggregation and disaggregation has changed. This will require entities to reconsider their chart of accounts to evaluate whether their existing presentation is still appropriate or whether improvements can be made to the way in which line items are grouped and described in the primary financial statements. In addition, changes in the structure of the statement of profit or loss and additional disclosure requirements might require an entity to make significant changes to its systems, charts of accounts, mappings etc. The level of operational change required by the new standard should not be underestimated, and entities should start thinking about the operational challenges as soon as possible. It might be difficult to identify MPMs, and extensive procedures might be required by auditors to assess completeness.

Who is impacted?

All entities reporting under IFRS Accounting Standards will be impacted. The same requirements apply for both public and private entities, including the identification and disclosure of MPMs.

The classification among categories for the statement of profit or loss is performed at the reporting entity level – there might therefore be difference in classification between an entity´s individual financial statements and the consolidated financial statements.

When does it apply?

The new standard will be effective for annual reporting periods beginning on or after 1 January 2027, including for interim finanical statements. Retrospective application is required, and so comparative information needs to be prepared unter IFRS 18.

In the year of adopting IFRS 18, the standard requires a reconciliation betewen how the statement of profit or loss was presented for the comparative period under IAS 1 and how it is presented in the current year unter IFRS 18. Interim finanical statements in the first year of adoption include similar reconciliation requirements.

Appendix – Illustrative examples

1) Illustrative statement of profit or loss for a general corporate

Statement of profit or loss – general corporate (operating expenses by function)

Line item	CU	Category
Revenue	X	Operating
Cost of goods sold	(X)	
Gross profit	**X**	
Selling expenses	(X)	
General and administrative expenses	(X)	
Research and development expenses	(X)	
Operating profit	**X**	**Required subtotal**
Share of profit from associates and joint ventures accounted for using the equity method	X	Investing
Interest income from cash and cash equivalents	X	
Profit before financing and income tax	**X**	**Required subtotal**
Interest expense on borrowings	(X)	Financing
Interest expense on other liabilities	(X)	
Profit before income tax	**X**	
Income tax expense	(X)	Income tax
Profit from continuing operations	**X**	
Loss from discontinued operations	(X)	Discontinued operations
Profit for the year	**X**	**Required subtotal**

2) Illustrative statement of profit or loss for an insurer

Statement of profit or loss – insurer

Line item	**CU**	**Category**
Insurance revenue	X	Operating
Insurance service expenses	(X)	
Net expenses from reinsurance contracts held	(X)	
Insurance service result	**X**	
Interest revenue calculated using the effective interest rate method	X	
Dividends and fair value changes on financial assets	X	
Credit impairment losses	(X)	
Finance expenses from insurance contracts issued	(X)	
Finance income from reinsurance contracts held	X	
Net financial result	**X**	
Other expenses	(X)	
Operating profit	**X**	**Required subtotal**
Share of profit of associates and joint ventures accounted for using the equity method	X	Investing
Profit before financing and income tax	**X**	**Required subtotal**
Interest expense on borrowings and pension liabilities	(X)	Financing
Profit before income tax	**X**	
Income tax expense	(X)	Income tax
Profit for the year	**X**	**Required subtotal**

3) Illustrative statement of profit or loss for an investment and retail bank

Statement of profit or loss – investment and retail bank		
Line item	**CU**	**Category**
Interest revenue calculated using the effective interest rate method	X	Operating
Interest expense	(X)	
Net interest income	**X**	
Fee and commission income	X	
Fee and commission expense	(X)	
Net fee and commission income	**X**	
Net trading income	X	
Net investment income, including cash and cash equivalents	X	
Credit impairment losses	(X)	
Employee benefits expense	(X)	
Depreciation and amortisation expenses	(X)	
Operating profit	**X**	**Required subtotal**
Share of profit of associates and joint ventures	X	Non-main investing and financing
Interest expense on pension and lease liabilities	(X)	
Profit before income tax	**X**	
Income tax expense	(X)	Income tax
Profit for the year	**X**	**Required subtotal**

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