## IFRS 18 – Insights for financial services companies

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In brief INT2024-08

### Key Points

The IASB has issued IFRS 18, the new standard on presentation and disclosure in financial statements, with a focus on the statement of profit or loss. This In brief highlights some key elements most relevant to the financial services industry.
For a general overview of the requirements for all industries, see our In brief IFRS 18 is here: redefining financial performance reporting.

### What´s the issue?

In April 2024, the IASB issued IFRS 18, *'Presentation and Disclosure in Financial Statements'* in response to investors' concerns about comparability and transparency of entities' performance reporting. The new presentation requirements introduced in IFRS 18 will increase comparability of the financial performance of similar entities, especially related to how 'operating profit or loss' is defined. The new disclosure requirements for 'management-defined performance measures' will enhance transparency.

IFRS 18 will:

- apply for reporting periods beginning on or after 1 January 2027 (with a requirement to restate comparative information);
- replace IAS 1, but with many of the existing principles in IAS 1 retained with limited changes; and

- not impact the recognition or measurement of items in the financial statements, but might change what an entity reports as its 'operating profit or loss'.

The key changes introduced by IFRS 18 for financial services entities relate to:

- Structure of the statement of profit or loss.
- Disclosures related to management-defined performance measures.
- Aggregation and disaggregation
- Foreign currency and derivatives.

This In brief provides an overview of the requirements for each of these aspects, alongside focus areas for the financial services industry. It also provides an illustrative statement of profit or loss for (1) an investment and retail bank and (2) an insurer.

**Structure of the statement of profit or loss**

*Classification categories*

IFRS 18 introduces a defined structure for the statement of profit or loss. The goal is to reduce diversity, so as to help investors understand the information and make better comparisons between entities. The structure is composed of categories and required subtotals.

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

IFRS 18 requires entities to assess whether their main business activities include investing in assets and/or providing financing to customers. If so, some specific income and expenses that would otherwise be outside of the operating category are classified in the operating category.

Accordingly, for entities (such as insurers and investment funds) for which investing in assets is a main business activity, we expect that the required categories will generally reflect the following:

| Operating category | Investing category | Financing category |
| --- | --- | --- |
| Results from main business activities, including investing in assets* (which includes income and expenses from cash and cash equivalents for entities that invest in financial assets as a main business activity) | • Results of associates and joint ventures accounted for applying the equity method*<br>• Income and expenses relating to assets invested in that are not invested in as a main business activity | • All income and expenses from liabilities that involve only the raising of finance (for example, typical borrowings)<br>• Interest expense and effects of changes in interest rates from other liabilities (for example, unwinding of the discount on a pension liability) |

* Income and expenses from investments in associates and joint ventures that an entity elects to measure at fair value through profit or loss (FVTPL) applying the exception in paragraph 18 of IAS 28, that are invested in as a main business activity, are classified in the operating category. In contrast, if the share of profit or loss of associates and joint ventures is accounted for using the equity method, that share of profit or loss is required to be classified as investing.

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| PwC Observation – investments in associates and joint ventures |
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| Some insurers invest in associates and joint ventures as part of the assets that back their insurance liabilities, so presenting the results from such investments outside the operating category would create a classification mismatch. To address this issue, IFRS 18 provides an option on transition to IFRS 18. Applying that option, if an entity was eligible to account for an associate or joint venture in accordance with IFRS 9 (applying paragraph 18 of IAS 28), but previously elected not to do so, it can change that election on transition to IFRS 18. |

For entities (such as banks) for which investing in assets and providing financing to customers are both main business activities, we expect that the required categories will generally reflect the following:

| Operating category | Investing category | Financing category |
| --- | --- | --- |
| Results from main business activities, including providing financing* and investing in assets (which includes income and expenses from cash and cash equivalents, for entities that invest in financial assets as a main business activity) | • Results of associates and joint ventures accounted for applying the equity method<br>• Income and expenses relating to assets invested in that are not invested in as a main business activity | • Income and expenses from liabilities that are not related to the entity providing financing to customers (depending on policy choice*)<br>• Interest expense on other liabilities (for example unwinding of the discount on a pension liability) |

* An entity that provides financing to customers as a main business activity can choose to classify income and expenses as operating for all liabilities that involve only the raising of finance, regardless of whether those liabilities relate to providing financing to customers.

| PwC Observation – main business activity assessment |
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| The assessment of main business activity is performed at the reporting entity level. This means that the conclusion at group level might differ from that at the subsidiary level, resulting in some income and expenses needing to be reclassified on consolidation. |

*Required subtotals*

IFRS 18 requires entities to present specified totals and subtotals. The main change is the mandatory inclusion of ‘Operating profit or loss’, which is defined as the result from the operating category. The other required subtotals are ‘Profit or loss before financing and income taxes’ and ‘Profit or loss’, as shown in the Illustrative examples. However, the ‘Profit or loss before financing and income taxes’ subtotal is not permitted for an entity that provides financing to customers as a main business activity and chooses to classify income and expenses as operating for all liabilities that involve only the raising of finance, regardless of whether those liabilities relate to providing financing to customers.

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| PwC Observation – additional line items and subtotals |
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| Entities should also present additional line items and subtotals if they are necessary for the primary financial statements to provide a useful structured summary. Among other requirements, any subtotals that the entity presents must be consistent from period to period, and they must not be displayed with more prominence than the required totals and subtotals.<br><br>As part of the transition to IFRS 18, entities will need to assess the line items and subtotals that they currently present, to determine whether those items meet this IFRS 18 requirement, and whether any changes might be needed. |

**Disclosures related to 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 that relate to an entity's financial performance as 'management-defined performance measures' ('MPMs'). An MPM is a subtotal of income and expenses that:

a. is used in public communications outside the financial statements.
b. communicates an aspect of the financial performance of the entity as a whole; and
c. is not specifically required to be presented applying an IFRS® Accounting Standard or is otherwise explicitly excluded from the scope of IFRS 18.

A financial ratio is not an MPM because it is not a subtotal of income and expenses. However, if a subtotal of income and expenses is the numerator or the denominator of a financial ratio, that subtotal might be an MPM (if the subtotal meets the definition of an MPM on a stand-alone basis). In such situations, the MPM disclosure requirements apply to the numerator or denominator that meets the definition of an MPM, but not to the ratio as a whole.

| PwC Observation – balance sheet or gross measures |
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| As compared to most other industries, financial institutions can often have more alternative performance measures based on balance sheet metrics, gross aggregations of income or expenses and regulatory measures, rather than subtotals of income and expenses.<br><br>Accordingly, many of the alternative performance measures currently used by financial services entities (for example, the loan-to-deposit ratio for banks, or the solvency capital ratios for insurance entities) will not be within the scope of the new disclosure requirements. |

Information related to MPMs 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 audited financial statements.

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| PwC Observation – MPM disclosures |
| --- |
| Judgement might be required to determine which measures meet the definition of an MPM. Additionally, the new disclosure requirements might go beyond what is typically disclosed today for an entity's alternative performance measures. Entities should begin the process of identifying their MPMs now to prepare for any process or internal control changes that might be required to comply with the new requirements. |

**Aggregation and disaggregation**

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

Totals, subtotals and line items presented in the primary financial statements and items disclosed in the notes need to be described in a way that faithfully represents the characteristics of the item. Entities should provide all necessary descriptions and explanations, including, in some cases, the meaning of terms used and information about how amounts have been aggregated.

**Foreign exchange differences, derivatives and designated hedging instruments**

IFRS 18 requires foreign exchange differences to be classified in the same category as the income and expenses from the items that resulted in the foreign exchange differences, unless doing so would involve undue cost or effort.

As an example, foreign exchange differences arising on a foreign currency-denominated liability that arises from a transaction that involves only the raising of finance (for an entity that does not provide financing to customers as its main business activity) would be classified in the financing category.

For derivatives used to manage identified risks (which includes economic hedges), gains and losses are classified in the same category as the income and expenses affected by the risks that the derivatives are managing. The same requirement applies to non-derivatives designated as a hedging instrument in accordance with IFRS 9 or IAS 39.

Gains and losses on derivatives that are not used to manage identified risks are typically classified in the operating category. However, there are additional considerations for some transactions that relate to the raising of finance that might result in some gains and losses being classified in the financing category.

**Who is impacted?**

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

**When does it apply?**

IFRS 18 will be effective for annual reporting periods beginning on or after 1 January 2027, including for interim financial statements. An entity is required to restate comparative information. Early application is permitted.

## Appendix – Illustrative examples

### *(1) 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 accounted for using the equity method | X | Non-main investing and financing |
| Interest expense on pension and lease liabilities | (X) | |
| **Profit before tax** | **X** | |
| Income tax | (X) | Income tax |
| **Profit for the year** | **X** | Required subtotal |

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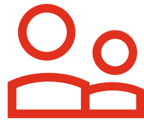
### *(2) Illustrative statement of profit or loss for an insurer*

| 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) | |
| **Net investment income** | **X** | |
| Finance expenses from insurance contracts issued | (X) | |
| Finance income from reinsurance contracts held | X | |
| **Net insurance finance expenses** | **(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 employee pension liabilities | (X) | Financing |
| **Profit before tax** | **X** | |
| Income tax | (X) | Income tax |
| **Profit for the year** | **X** | Required subtotal |



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