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IFRS Alert

Introducing IFRS 18 – The IASB's new presentation and disclosure standard

April 2024 – IFRS Alert 2024-01

Executive summary

On April 9, 2024 the International Accounting Standards Board (IASB) published a new standard, its first since 2017. The new standard, IFRS 18 'Presentation and Disclosure in Financial Statements' (the Standard) replaces IAS 1 'Presentation of financial statements' and will impact every reporting entity that currently uses International Financial Reporting Standards (IFRS).

The objective of the Standard is to improve how information is communicated in an entity's financial statements, particularly in the statement of profit or loss and in its notes to the financial statements.

Background

The release of the Standard is the final stage of the Primary Financial Statements project, which came about due to the lack of detailed requirements in IAS 1 for the following areas:

- the classification of income and expenses in the statement of profit or loss
- the presentation of subtotals in the statement of profit or loss, and
- the aggregation and disaggregation of information presented in the primary financial statements or disclosed in the notes.

This led to diversity in practice as entities defined their own subtotals and performance measures, which made comparison of financial performance between entities difficult for investors. The IASB believes IFRS 18 will resolve these issues and improve the overall quality of financial reporting.

The key changes in the new Standard

Overall, the majority of changes made in IFRS 18 impact the statement of profit or loss and notes to the financial statements, but there are also limited changes to specific requirements that are set out in IAS 7 'Statement of cash flows'. Only minimal changes were made to the disclosures required for the statement presenting comprehensive income, the statement of changes in equity and the statement of financial position. While much has been carried forward from IAS 1, there are some key changes that reporting entities need to be aware of.

Changes to presentation requirements in the statement of profit or loss

The main change introduced by IFRS 18 is to the way in which reporting entities will structure their statement of profit or loss.

Firstly, the Standard introduces two new defined subtotals:

- Operating profit, and
- Profit before financing and income taxes.

These new required subtotals are intended to increase comparability by ensuring that information presented for investors is consistent across different entities.

Additionally, the Standard requires an entity to classify all income and expenses into one of the following five categories:

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

The investing category includes income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries, cash and cash equivalents, and any other assets (such as cash and cash equivalents) that generate returns separately from the entity's other resources.

The financing category distinguishes between transactions that are solely for the purpose of raising finance, and those that are not. Income and expenses from all liabilities that result solely from the raising of finance are included in this category, along with some elements of interest income or expense recognized by applying other IFRS. This category, together with the subtotal for profit before financing and income taxes enables investors to assess the reporting entity's performance before the effects of its financing.

The income taxes and discontinued operations categories include income and expenses resulting from the application of IAS 12 'Income taxes' and any related foreign exchange differences, and IFRS 5 'Non-current assets held for sale and discontinued operations' respectively.

Finally, the operating category includes all other items of income and expense that are not allocated to one of the other four categories. It is a default category, so it is important to note this category will include income and expenses from an entity's main business activities, regardless of whether the income or expenses are volatile or unusual. The operating profit subtotal provides not only a measure of past performance, but also a starting point for forecasting an entity's future cash flows.

Foreign exchange differences

IFRS 18 requires foreign exchange differences to be classified in the same category of the statement of profit or loss as the income and expenses from items that gave rise to the foreign exchange differences. This means, for example, that foreign exchange differences on bank loans would be classified in the financing category. However, if classifying foreign exchange differences this way would involve undue cost or effort, an entity is permitted to classify them in the operating category.

Careful attention should be given to specific requirements for classifying income and expenses from hybrid contracts and fair value gains and losses on derivatives.

Entities with specified main business activities

While the above applies to most entities, it is complicated for reporting entities such as investment firms, financial institutions and insurers where their main business activities (for which income and expenses would usually be classified in the operating category), would fall into the definition of investing or financing activities.

When a reporting entity has assessed that it invests in assets as its main business activity, income and expenses are split between the investing category and operating category, depending on how the underlying assets are accounted for. For all assets accounted for using the equity method, income and expenses are included in the investing category, and for all other assets income and expenses are included in the operating category.

When a reporting entity has assessed that it provides financing to customers as its main business activity, it will classify income and expenses from liabilities relating to providing such finance in the operating category.

The assessment of an entity's main business activities is therefore going to be a key judgement which may significantly impact the geography of where items appear in the statement of profit or loss. This is likely to prove particularly challenging for mixed groups and groups of reporting entities which provide multiple services.

New requirements to be included in the notes to the financial statements

The Standard also introduces new disclosures, in addition to those carried forward from IAS 1, to supplement the primary financial statements. They are:

- Management-defined performance measures, and
- Specified expenses by nature.

Management-defined performance measures

In order to address the significant diversity in practice currently seen when it comes to so-called 'alternative performance measures' and any non-GAAP performance measures, IFRS 18 introduces the concept of a 'management-defined performance measure' (MPM).

MPMs are subtotals of income and expenses other than those listed by IFRS 18 or specifically required by another IFRS, that an entity uses:

- in public communications outside financial statements, and/or
- to communicate to users of financial statements management's view of an aspect of the financial performance of the entity as a whole.

Alongside any MPMs that are disclosed, a reporting entity will also be required to disclose information including:

- a reconciliation between the MPM and the most directly comparable IFRS 18 subtotal, total or subtotal required by another IFRS
- a description of how the MPM communicates management's view and how it is calculated
- an explanation of changes to the MPMs disclosed or to how any of the measures are calculated, and
- a statement indicating that measures used reflect management's view of the financial performance of the entity as a whole and indicates that the measure may not always be directly comparable to any measures sharing similar labels and descriptions provided by other reporting entities.

These disclosures will be required for any measure that meets the definition of a MPM and when applicable and they must be included in a single note in the reporting entity's financial statements.

Updated guidance for the aggregation and disaggregation of information

The Standard provides specific guidance to ensure that aggregation and disaggregation in the financial statements is consistent and provides investors with the information they need for analysis. The basic principles set out in IFRS 18 require entities to:

- aggregate or disaggregate items based on whether they share similar characteristics or have different characteristics
- ensure that the method of grouping items does not obscure material information or reduce understanding, and
- apply aggregation or disaggregation based on characteristics in both in the primary financial statements and the notes to the financial statements.

Changes to how expenses in the operating category are presented

Consistent with IAS 1, IFRS 18 requires an entity to present in a structured and meaningful way its operating expenses based either on their nature or their function. This means some entities might decide to classify some expenses by nature and other expenses by function. The Standard requires entities that present expenses classified by function to disclose the amount of depreciation, amortisation, employee benefits, impairment losses and write-down of inventories included in each line in the operating category of the statement of profit or loss.

Consequential changes made to other standards

Consequential changes have been made to the standard on cash flow statements. IAS 7 now requires entities to use the operating profit total as defined in IFRS 18 as the starting point for reporting cash flows from operating activities using the indirect method. In addition, the interest and dividend presentation alternatives that previously existed have also been removed to simplify practice and reduce diversity in preparation.

Elsewhere, IAS 33 'Earnings per share' (EPS) requirements have been amended to permit an entity to disclose additional EPS information over and above reporting basic and diluted EPS amounts. However, additional amounts can only be included in the EPS calculation if the numerator is either a total or subtotal identified in IFRS 18 or a MPM. IAS 34 'Interim financial reporting' has also been updated to require disclosure of information about MPMs in interim financial statements and guidance is now provided on how subtotals should be dealt with in interim financial statements.

Effective date of IFRS 18

The Standard is effective from annual reporting periods beginning on or after January 1, 2027 allowing reporting entities and their auditors time to properly prepare for the transition to IFRS 18. Early adoption of the Standard is permitted. It is important to note, IFRS 18 must be applied retrospectively, so restatement of all comparative information is required when the Standard is adopted.

Our thoughts

We support the release of this new Standard, which should improve the overall quality of financial reporting and enable better comparison of financial statements by investors.

While the effective date is a while away, we would encourage entities to start considering the impact sooner rather than later. To assist with this, we have plans to release a 'Getting ready for IFRS 18' guide later in the year that will provide a more detailed look at the requirements of this Standard, and the likely impact on reporting entities.

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