Crowe RSA

Insight ...

IFRS 18 – Presentation of Financial Statements and disclosures

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AN UPDATE ON...

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IFRS 18 - Presentation of Financial Statements and disclosures

In April, the IASB published IFRS 18, a new standard designed to enhance the usefulness and transparency of the information presented and provided by entities in their financial statements about their financial performance. This new standard aims to improve the structure and comparability of the income statement, by introducing standardized subtotals and a categorization of income and expenses, as well as specifying how information is divided between the primary financial statements and the notes.

The main new features introduced by IFRS 18 are as follows:

- Classification of income and expenses into three categories (operating, investing and financing);
- Presentation of mandatory and standardized income statement subtotals ;
- The presentation, in a dedicated note to the financial statements, of information on performance indicators defined by management which correspond to subtotals of income and expenses and which are not subtotals specified by IFRS;
- The presentation, in the appendix, of an enhanced breakdown of operating expenses by nature, for companies that have opted for a presentation of expenses by function;
- The use of the mandatory subtotal "operating income" as the starting point for the indirect method of presenting operating cash flows within the cash flow statement.

Presentation of mandatory and standardized income statement subtotals

IAS 1 does not specify a structure for the income statement. Companies currently choose the subtotals to include themselves, and often present operating income, but the method of calculation varies, making comparison difficult.

The new IFRS 18 introduces three distinct categories of income and expense: operating, investing and financing (see Figure 1).

On the one hand, **it introduces a new "investment" category in the income statement, which includes the share of net income from associates, as well as income and expenses arising from investments in cash and cash equivalents.**

Figure 1: New categorization of income and expenses in the income statement under IFRS 18

Income and expense categories	Contents
Operation	**Income and expenses not attributable to either of the other two categories** • Classification exceptions applicable to entities for which investing or financing is a principal activity
Investment	**Income and expenses linked to investments that are individual and largely independent of other resources held by the entity** • Share of profit of associates • Income and expenses related to cash and cash equivalents *Example: dividends, rental income, interest income, change in fair value of financial assets, investment property revaluations*
Financing	**Income and expenses resulting from transactions involving only the raising of funds, accretion expenses** *Example: Interest expense on loans and rental debts, unwinding of long-term provisions/ provisions for IDR*

On the other hand, **it requires the presentation of two new mandatory and standardized subtotals: operating income and income before financingand income tax.** (See figure 2). The latter will include operating income as well as income and expenses in the "investment" category.

Figure 2: Presentation of mandatory and standardized income statement subtotals

Before (IAS 1)	After (IFRS 18)	
Revenue from ordinary activities	Revenue from ordinary activities	Operation
Operating expenses per by nature or function	Operating expenses by nature or function	
	Operating income	
Share of profit of associates	Share of profit of associates	Investment
	Gains on disposal of associates and joint ventures	
	Income and expenses related to cash and cash equivalents	
	Earnings before interest and income tax	
Financial expenses	Interest expense on borrowings and rental debt	Financing
	Accretion expense	
	Earnings before income tax	
Income tax	Income tax	
Net income	**Net income**	

Presentation of performance indicators defined by management (Management Performance Measures: MPM) in an appendix.

IFRS 18 does not require companies to provide management-defined performance indicators other than mandatory, standardized income statement subtotals or totals.

Disclosure of the MPMs will only be permitted in the notes to the financial statements. When groups choose to provide them in their IFRS financial statements, they must present a single note dedicated to the MPMs containing, in particular, for each of them :

- The usefulness of the indicator in terms of describing the entity's performance ;
- Calculation method ;
- A reconciliation between the indicator and the most directly comparable sub-total or standardized total (e.g., net income or operating income).

Presentation of operating expenses by nature or function: need to justify choice

Under IAS 1, groups present operating expenses by nature or by function, or even by a mixed method, choosing the option that provides the most relevant and reliable information, without having to justify it.

IFRS 18 now imposes criteria for choosing an expense presentation method, such as the key components or drivers of profitability, the way in which the company is managed and communicates information internally, segment practices and the potentially arbitrary nature of a breakdown by function.

In the case of presentation of expenses by function, "cost of sales" would be a mandatory item to be presented on the income statement. In addition, groups will be required to present the breakdown of functional items by type of expense, specifying not only personnel costs and depreciation and amortization as at present, but also IAS 36 asset impairment and inventory write-downs.

Presentation of the cash flow statement

Where the indirect method of cash flow presentation is applied, **the mandatory starting point for the cash flow statement is operating income.**

In addition, it will no longer be possible to classify interest and dividends as cash flows from operating activities, except for entities with principal investing or financing activities (see Figure 3).

Figure 3: Classification of interest and dividends in the cash flow statement

	FlowsBefore (IAS 7)	After (IFRS 18)
Dividends received	Investment or operational	Investment
Dividends paid	Financing or operational	Financing
Interest received	Investment or operational	Investment
Interest paid	Financing or operational	Financing

First-time adoption of IFRS 18

Subject to its adoption in the European Union, **IFRS 18 will be effective for annual periods beginning on or after January 1st 2027**, although earlier application is possible. It will then replace IAS 1, most of whose provisions have been carried forward without major modification.

An entity is required to apply IFRS 18 retrospectively by applying IAS 8. In its annual financial statements, it must provide, for the comparative period immediately preceding the period in which IFRS 18 is first applied, a reconciliation for each income statement line item between :

(a) restated amounts presented in accordance with IFRS 18; and

(b) the amounts previously presented in application of IAS 1.

Impact on companies

The changes brought about by IFRS 18 could have a structuring impact on financial communications, particularly on the performance indicators used in group financial communications, as well as on consolidation and reporting tools and procedures (parameterization of tools, chart of accounts, etc.).

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