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BE PREPARED FOR A NEW STANDARD, IFRS 18 *PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS*

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Andreas Barkow, the Chair of the IASB, called it 'the first significant change to the presentation of financial statements in over twenty years.'[1] This latest IFRS Accounting Standard, IFRS 18 *Presentation and Disclosure in Financial Statements*, published on 9 April 2024, will replace IAS 1 *Presentation of Financial Statements* from 1 January 2027.

This new Standard will also be effective from 1 January 2027 as it is a requirement in Malaysia for financial statements to assert compliance with IFRS Accounting Standards.

If the effective date seems far ahead, it is because IFRS 18 brings some significant changes that the IASB has heeded stakeholder calls to allow a longer time to prepare for them. These fundamental changes will affect all companies that apply IFRS Accounting Standards, in all industries.

What's changing?

The biggest changes will affect

- the statement of profit or loss, and
- notes to the financial statements.

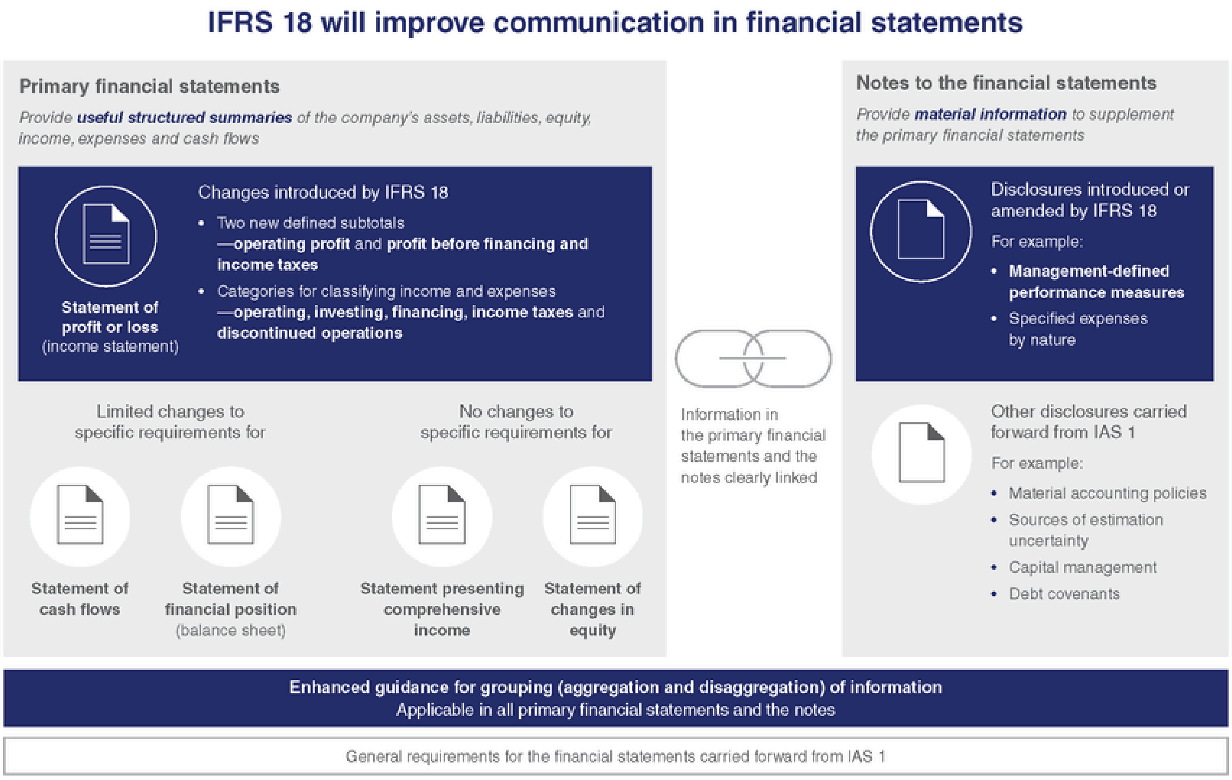
IFRS 18 also sets out principles for the grouping of information (aggregation and disaggregation) which will apply to all primary financial statements[2] and the notes.

The statement of cash flows and the statement of financial position will also see some change.

1 IFRS Foundation (2024) 'Video: IFRS Members Introduce IFRS 18 in English, Chinese, French, Japanese, Portuguese and Spanish', https://www.ifrs.org/projects/completed-projects/2024/primary-financial-statements/video-iasb-members-introduce-ifrs-18/

2 The primary financial statements include the statement of financial position, the statement of profit or loss, the statement presenting comprehensive income (previously known as the statement of comprehensive income), the statement of changes in equity, and the statement of cash flows.

Figure 1: Overview of IFRS 18



Source: IFRS Foundation (2024) *IFRS 18 One-Page Overview*

At a very high level, the key changes are as follows.

1. **Statement of profit or loss (P/L)**

   a) To improve comparability, IFRS 18 introduces two subtotals which must be presented in P/L – including 'operating profit', which has been specifically defined.

   b) Income and expenses must be presented in five categories: operating, investing, financing, income taxes and discontinued operations.

   Note that although the first three categories resemble those of the statement of cash flows, they are distinct concepts.

   The IASB recognises that the classification of income and expenses may be different for banks and insurance companies – the Illustrative Examples provide examples of bank and insurance company P/L.

2. **Management-defined performance measures in the notes to financial statements**

   a) To enhance transparency, management-define performance measures (MPM)[3] must be reconciled to a total or subtotal required by IFRS 18 or another IFRS Accounting Standard.

   b) IFRS 18 also requires other disclosures, including how each MPM is calculated, what the MPM communicates about the entity's financial performance, and any changes made to the MPMs in the year.

[3] Defined in IFRS 18 paragraph 117 as a subtotal of income and expenses that an entity uses in public communications outside of the financial statements, to communicate to users management's view of an aspect of financial performance for the entity as a whole.

3. Aggregation and disaggregation across the financial statements

a) Expenses in the ‘operating’ category in the P/L must be classified by nature (for example, raw materials, salaries, asset impairments) or function (for example, cost of sales or distribution costs), or both. Entities may decide that presenting some expenses by nature, and other expenses by function, provide the most useful information to users: for example, the P/L may feature ‘cost of sales’ and ‘goodwill impairment’ as line items.

b) Entities that classify operating expenses by function are required to disclose in the notes to the financial statements, the amount of depreciation, amortisation, employee benefits, impairment losses and write-downs of inventories included in each line item in the operating category.

c) Subject to materiality, items presented or disclosed as ‘other’ should be labelled and/or described in as faithfully representative and precise a way as possible.

However, as always, the devil is in the detail: readers would be well-advised to familiarise themselves with the new Standard and the supporting materials as soon as possible.

More to come on statements of cash flow

The IASB also made targeted amendments to IAS 7 *Statement of Cash Flows*, notably:

- requiring companies to use the operating profit subtotal as the starting point for reporting cash flows from operating activities using the indirect method; and

- removing the presentation alternatives for interest and dividend cash flows for most companies—dividends and interest paid are generally classified in cash flows from financing activities, and dividends and interest received are generally classified in cash flows from investing activities.

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These changes aim to simplify practice and reduce diversity in presentation. However, there may be more change to come as the IASB plans for new projects, including a project on *Statement of Cash Flows and Related Matters.*

Application challenges

The impact of the Standard varies from one company to another and therefore there is no short cut other than familiarising with the requirements so as to achieve a better understanding of the Standard to prepare for its application.

That said, as a quick reference, the IASB's Effects Analysis and Feedback Statements suggests that those changes that will require companies to change their accounting systems, leading to one-off transition costs, include:

1. **Allocating foreign exchange differences to each of the five categories in P/L** (operating, investing, financing, income taxes and discontinued operations).

   Groups that manage a large number of foreign currency denominated transactions centrally will particularly need to review the systems in place. The IASB has provided an undue cost or effort relief for this. The concept of undue cost or effort is not new in IFRS Accounting Standards although it is more prevalent in the *IFRS for SMEs* Accounting Standard.

2. **Management-defined performance measures: Calculating the income tax effect for each adjusting item in the MPM reconciliation.**

   This will be particularly challenging for groups that operate across a large number of tax jurisdictions. IFRS 18 includes a simplified approach for calculating the income tax effect.

3. **Separate disclosure for companies that disclose operating expenses by function.**

   Additional costs will be incurred to separately disclose the amount of depreciation, amortisation, employee benefits, impairment losses and write-downs of inventories included in each line item. The IASB had restricted the separate disclosure requirement to these five items in a bid to provide useful information to investors without undue cost or effort for preparers.

A good place to start may be to consider the areas for which the IASB has provided cost mitigations: these generally focus on aspects of the new Standard which are expected to be the most complex to implement.

Figure 2: Overview of cost mitigations in IFRS 18

	Cost mitigations
Subtotals and categories	• Reliefs for undue cost or effort for classification in the statement of profit or loss of: o gains or losses on derivatives not designated as hedging instruments applying IFRS 9 *Financial Instruments*; and o foreign exchange differences • Accounting policy choice for companies that provide financing to customers as a main business activity • Grouping of assets with shared characteristics for purposes of assessing whether investments are made as a main business activity
MPMs	• Exclusion of some communications from public communications • Rebuttable presumption in the definition of MPMs • Simplified approach to calculating income tax effects for each reconciling item disclosed in MPM reconciliations
Grouping of information	• Limiting the requirement to disclose specified expenses by nature to five • Amounts disclosed for nature expenses may be the cost incurred for the period

Source: IFRS Foundation (2024) Effects Analysis: IFRS 18 *Presentation and Disclosure in the Financial Statements*

Time to act now

Given the fundamental nature of some of the changes, there is no reason to put this Standard on the back burner!

Although 1 January 2027 may seem a long way away, companies have only slightly more than two and a half years from today to prepare for the application of the Standard. IFRS 18 requires companies to restate comparatives in the first year of application, which means that companies need to have data aligned with the new Standard from 2026.

Companies would do well to start assessing their readiness for the new Standard, including making any accounting system changes and educating internal and external stakeholders, as early as possible.

Apart video of IASB Chair Andreas Barckow summarising the new requirements, an in-person session on IFRS 18 will be organised in Kuala Lumpur in the coming months. Stay tuned!

END

Useful links

IFRS 18 *Presentation and disclosure of financial statements*

Basis for Conclusions–Setting out the IASB's rationale and thought process for the changes

Illustrative Examples–worked examples for aspects of IFRS 18, including flowcharts relating to key requirements in IFRS 18

New IFRS Accounting Standard will aid investor analysis of companies' financial performance

Short video of IASB Chair Andreas Barckow summarising the new requirements

One-page quick view of IFRS 18

Project Summary–overview of the project in non-technical language

Effects Analysis–description of the likely benefits and costs of IFRS 18

Feedback Statement–summary of feedback on proposals and the IASB's response to feedback

Reference materials–comparison table of requirements in IAS 1 and IFRS 18 showing changes to each paragraph of IAS 1