Redefining the Bottom Line
IFRS 18

External Reporting Centre of Excellence – October 2024

CPA AUSTRALIA

Authors:

Shaun Steenkamp CPA
Accounting Policy & Advisory Lead
Transurban

Michelle Harrison FCPA
Director, Advisory and Professional Development
South Australian Department of Treasury and Finance (DTF)

Tiffany Tan FCPA
External Reporting and Assurance Lead
Policy and Advocacy
CPA Australia

Reviewers:

Nikole Gyles FCPA, FCA, EMBA
Managing Director
Greenway Avenue Consulting

Ram Subramanian FCPA
Head of Policy and Advocacy
Policy and Advocacy
CPA Australia

Other contributors:

Gabriel Teo FCPA
Managing Partner
GTC Group

Nadee Dissanayake CPA, FCA, MBA
Technical Advisor External Reporting
Policy and Advocacy
CPA Australia

Design services:

Mira Stojcevska
Learning Designer
Learning Design & Publishing
CPA Australia

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CPA Australia Ltd Level 20, 28 Freshwater Place Southbank VIC 3006 Australia.

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Introduction

The introduction of IFRS 18 'Presentation and Disclosure in Financial Statements' represents one of the most significant change in accounting standards since IFRS was first implemented over 20 years ago. By replacing IAS 1 *Presentation of Financial Statements* (IAS 1) and amending other related standards, IFRS 18 introduces new requirements that fundamentally change how entities present their financial performance, including a renewed focus on the classification of income and expenses. These changes are expected to impact entities of all sizes and industries, prompting a closer look at what they mean for financial reporting.

In this publication we will explore the key changes introduced by IFRS 18, how entities can prepare for implementation, the implications of using revenue as a benchmark and additional considerations for not-for-profit and public sector entities.

What are the key changes introduced by IFRS 18?

At a glance, IFRS 18 requirements have been enhanced as compared to IAS 1.

Requirements	IFRS 18	IAS 1
Presentation of Profit or Loss	Requires categories and defined subtotals	Less structured presentation
Statement types	Single statement or two separate statements	Primarily one statement
Management Performance Measures (MPMs)	New disclosure requirements for MPMs	No specific guidance
Aggregation/Disaggregation	Stricter guidelines for clarity	More general guidance

New mandatory information on the face of the statement of profit or loss

IFRS 18 introduces several new requirements to enhance the presentation of the statement of profit or loss:

- income and expenses must be classified into five different categories
- two new mandatory subtotals are required
- additional requirements for aggregation and disaggregation of information

Figure 1: Comparing IAS 1 with IFRS 18: The statement of profit or loss

IAS 1

Revenue	xx
Cost of sales	xx
Gross profit	**xx**
Other income	xx
Distribution costs	xx
Administrative expenses	xx
Other expenses	xx
Finance costs	xx
Share of profit of associates	xx
Profit before tax	**xx**
Income tax expense	xx
Profit for the year from continuing operations	**xx**
Loss for the year from discountinued operations	xx
Profit for the year	**xx**

IFRS 18

Revenue	**Operating**
Cost of sales	
Gross profit	
Other operating income	
Selling expenses	
General and administrative expenses	
Research and development expenses	
Goodwill impairment loss	
Other operating expenses	
Operating profit or loss	**New** mandatory subtotal
Share of profit and gains on disposal of associates and joint ventures	**Investing**
Profit or loss before financing and income taxes	**New** mandatory subtotal
Interest expenses on borrowings and lease liabilities	**Financing**
Interest expenses on pension liabilities and provisions	
Profit before income taxes	Subtotal
Income tax expense	**Income tax**
Profit for the year from continuing operations	Subtotal
Loss for the year from discontinued operations	**Discontinued operation**
Profit	Total

Enhancements of IFRS 18

Five categories for classifying income and expenses:
- Operating
- Investing
- Financing
- Income tax
- Discontinued operations

Two new mandatory subtotals:
- Operating profit or loss
- Profit or loss before financing and income tax

Aggregation and disaggregation of information such as other income and other expenses

These changes contrast with IAS 1, which did not mandate such subtotals. As a consequence, entities defined their own measures of operating profit. This flexibility often led to inconsistencies across companies and jurisdictions.

The new presentation requirements will have varying impacts across jurisdictions. For example, in Australia, entities must comply with ASIC Regulatory Guide RG 230 *Disclosing non-IFRS Financial Information*, which limits the inclusion of additional subtotals in the statement of profit or loss. Consequently, Australian preparers have historically not deviated far from the totals specified in IAS 1. However, the new subtotals required under IFRS 18 provide these entities with an opportunity to enhance the connection between statutory financial reporting and management reporting.

Additionally, IFRS 18 also requires an entity to classify items of income and expense as either **operating**, **investing** or **financing activities** based on the entity's 'main business activities'. While these categories are familiar, they do not necessarily mirror the classification of the related cash flows in the statement of cash flows.

IFRS 18 retains the requirement to separately present **discontinued operations** (as a category under the new requirements) and elevates **income tax** from a required line item under IAS 1 into its own category.

Additionally, subtotals are required for '**operating profit or loss**' and '**profit or loss before financing and income tax**'.

Judgment on main business activities

Whilst these new categories and subtotals aim to address the perceived inconsistencies under IAS 1, the judgement required to classify income and expenses into these categories can be substantial. This judgment centres around the 'main business activities' of the entity, which determines the classification of items of income and expenses. However, IFRS 18 provides limited guidance for preparers to make this determination. Although the IASB was asked to clarify how 'main business activities' differs from 'ordinary activities' under IFRS 15 *Revenue from Contracts with Customers* (IFRS 15), it decided not to define the term. However, the IASB did provide guidance for entities with specified main business activities, such as investing in particular types of assets or providing financing to customers. Ultimately, preparers and auditors of financial statements will need to carefully consider and document their assessment of the entity's main business activities.

Management-defined performance measures

Management-defined performance measures (MPMs) are increasingly prevalent in annual reports and company announcements as companies seek to provide a clearer picture of their financial performance. MPMs complement totals specified by IFRS and communicate management's perspective on financial performance.

Management-Defined Performance Measures (MPMs)

Purpose of MPMs

- Provide clarity on financial performance
- Complement IFRS totals
- Reflect management's perspective

Characteristics of MPMs

- Previously non-GAAP measures
- Used internally for decision-making
- Publicly communicated outside financial statements

Disclosure requirements

- Description of the aspect communicated
- Calculation method
- Reconciliation to comparable IFRS measures
- Income tax effect for each item
- Explanation of changes in MPMs

MPMs are a subtotal of income and expenses that:

- were previously alternative or non-GAAP performance measures, that is, measures that are not defined by IFRS Accounting Standards
- are measures that are used internally by management to make decisions
- an entity uses in public communications **outside** financial statements
- an entity uses to communicate to users of financial statements, management's view of an aspect of the financial performance of the entity as a whole

IFRS 18 requires that companies disclose MPMs in a single note to the financial statements, detailing how these measures are calculated, their relevance, and reconciling them to the most comparable IFRS measures. While companies have been publicly disclosing MPMs for many years, the requirement to specifically consider and reconcile these measures to the most comparable IFRS measures is unprecedented.

Financial statement preparers may need to develop new processes to disclose relevant MPMs and consideration of completeness of disclosures will form part of audit procedures.

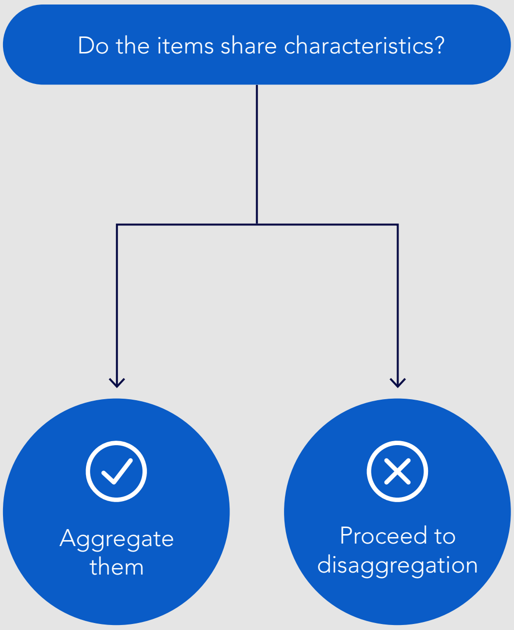
The single note approach required by IFRS 18 should capture:

- why MPMs are reported,
- how these MPMs is calculated,
- management's view on the MPMs,
- a reconciliation between the MPMs and
- the most comparable subtotal listed in the related profit or loss statement.

A further practical challenge is the requirement to calculate the income tax effect for each adjusting item in the MPM reconciliation. This aims to enhance transparency and consistency, as many companies previously reported these measures without sufficient context.

Aggregation and disaggregation

Identify items for Aggregation



IFRS 18 provides clearer guidance on how to group items applying enhanced requirements for aggregation and disaggregation of information.

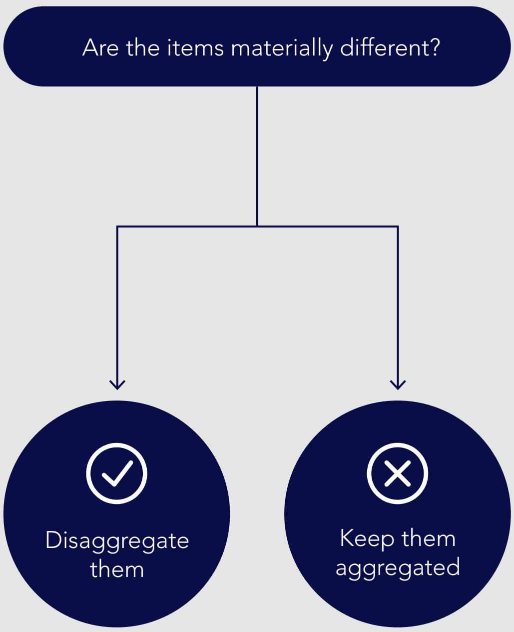
It discourages the use of generic labels such as 'other' and emphasises the need for informative labelling of line items. This change aims to improve the clarity and usefulness of the financial statements.

Additionally, entities presenting profit or loss by function must prepare a separate note that discloses specified expenses by nature. Additional work will be required by preparers to separately disclose the amount of depreciation, amortisation, employee benefits, impairment losses and write-downs of inventories included in each line item. However, this disclosure will enhance transparency and provide additional context to the financial statements.

Reconciliation and comparatives

Upon first-time application, entities must present a reconciliation of amounts previously reported under IAS 1 to those restated under IFRS 18 for the immediately preceding period.

Identify items for Disaggregation



Preparing for the implementation of IFRS 18

IFRS 18 is effective from 1 January 2027, however, this date may differ across jurisdictions and types of entity. It is important to remember that a change to financial reporting does not occur in isolation. Many stakeholders, systems and processes are involved in not only the change process but also in the final implementation. Effective scoping and engaging all relevant stakeholders take considerable time in addition to the financial reporting considerations. Depending on the complexity of the entity, successful implementation of IFRS 18 could take up to 24 months.

The process of preparing financial statements under IFRS 18

Data collection
Gathering financial data

↓

Classification
Classify data into categories (e.g. operating, investing)

↓

Aggregation/Disaggregation
Determine which items to aggregate or present separately

↓

Presentation format
Choose between single or multiple statements

↓

MPMs disclosures
To disclose MPMs as a single note in the notes to the financial statements

↓

Final review
Ensure compliance with IFRS 18 requirements

Activities that might need consideration during the implementation of IFRS 18 may include:

- Updating and upgrading accounting systems.
- Engaging those charged with governance to educate them about the impact on the reporting entity specifically and how the entity will transition to IFRS 18.
- Engaging internal finance functions (e.g. accounting services, internal audit, financial planning and analytics, and risk and governance) to establish a change project and consider internal information requirements.
- Engaging external-facing functions such as investor relations to educate them on the upcoming change and determine if any additional communication is required to explain the entity's implementation of IFRS 18 to the users of financial statements.
- Assessing and documenting key judgements required by IFRS 18 and obtaining external auditor feedback on this.
- Consulting with financiers and understanding if the new presentation of the statement of comprehensive income is sufficient for their purposes or if additional information will be required in the future.

While these are some examples, entities will need to consider additional factors based on their specific circumstances. The key takeaway is that it takes considerable time to identify areas affected by IFRS 18 and even more time to design a change program to successfully implement the new requirements. One such area where many entities struggle to achieve success is financial reporting systems.

Revenue: The key benchmark for thresholds in many jurisdictions

Key points

- Critical for determining company size
- Influences statutory reporting obligations
- Broader definition includes various income types
- Requires careful assessment for compliance

One of the most significant aspects of IFRS 18 is its emphasis on the classification of income and expenses. For instance, in Australia companies with consolidated revenues of $50 million or more will soon find themselves obligated to disclose their climate-related risks and risks and opportunities including strategies, aligning with the global push for sustainability and accountability. Similarly, countries like Malaysia and Singapore use revenue thresholds to assess audit exemption criteria.

> This might impact jurisdictions that use revenue as one of their thresholds in determining the grouping/size of a company for the purpose of local reporting, auditing and other obligations.

Many jurisdictions include revenue reported in the financial statements as a threshold for certain statutory obligations. Those obligations might include additional reporting, different tax rates, levies or licensing. The IASB clarifies in the Basis for Conclusions to IFRS 15 that the revenue of an entity is not strictly limited to revenue recognised in accordance with IFRS 15. An entity's revenue is its income arising in the course of its ordinary activities, which is broader than (but includes) revenue from contracts with customers. Consequently, determining an entity's revenue for the purposes of statutory thresholds has always been judgemental and in some cases, this revenue figure could not be directly referenced in an entity's financial statements.

> With the introduction of the operating income and expense category in IFRS 18, many could be tempted to conclude that the era of confusion is over. Unfortunately, it is not.

Revenue is still defined as income arising in the course of an entity's ordinary activities and the sum of operating income under IFRS 18 is not a valid substitute. This is not only because of the judgement involved in determining an entity's main business activities, but also because the operating category is the 'default' category for items of income and expense that are not classified elsewhere. This means that operating income includes, but is not limited to, income arising from an entity's main business activities.

Whilst IFRS 18 does not change the judgement required for what constitutes the revenue of an entity, the need to classify items of income and expense into the five new categories (and the related assessment of a reporting entity's main business activities) is very closely tied with the determination of the entity's ordinary activities. For some entities, this might be the first time these concepts will be reassessed since the entity first applied IFRS. In such cases, and in light of the requirements of IFRS 18, the scope of an entity's revenue for the purposes of statutory thresholds might be quite different from prior periods. Entities will need to ensure they are comfortable with their determination of revenue (i.e. income from ordinary activities) with a view to developing clear explanations for any variances to income from main business activities under IFRS 18. With mandatory sustainability reporting on the horizon, users will be particularly interested in the judgements of entities that fall close to the reporting thresholds.

Call for action

Given the complexity and potential workload associated with these changes, companies are encouraged to begin preparations as soon as possible to ensure compliance by the effective date from **1 January 2027**.

ASAP	**Assess financial statement impacts** Companies need to evaluate how IFRS 18 will affect their financial statements, particularly in terms of new judgments and classifications required by the standard. This includes understanding the implications of the new categories and subtotals in the statement of profit or loss, which now include operating, investing, and financing categories.
ASAP	**Reconsider presentation structures** Companies must revise their current presentation practices to align with IFRS 18's requirements for aggregation and disaggregation of financial information. This involves re-evaluating their chart of accounts and ensuring that line items are grouped and described appropriately in the primary financial statements.
Before January 2027	**Implement system changes** Significant operational changes may be necessary to accommodate the new reporting requirements. Companies should start planning for updates to their accounting systems and processes to handle the changes in presentation and disclosure effectively.
Ongoing	**Focus on Management-Defined Performance Measures (MPMs)** For the first time, IFRS 18 requires disclosures about MPMs in the financial statements, which necessitates a clear understanding of how these measures will be defined and reported.
Ongoing	**Prepare for auditing challenges** Companies should anticipate that auditors will perform extensive procedures to assess the completeness and accuracy of the disclosures under IFRS 18, which may involve significant documentation and justification of new classifications and judgments.

Application challenges for not-for-profit and public-sector entities

Information arising from the application of IFRS Standards is designed to meet the needs of investors and other capital market participants, not specifically for the not-for-profit sector and public sector entities.

International developments

The International Public Sector Accounting Standards Board (IPSASB) which primarily develops standards for public sector entities has a current project on the Presentation of Financial Statements. This project aims to enhance the communication effectiveness of financial information reported in general purpose financial statements. Aligning IPSASB standards with IFRS, including IFRS 18, where appropriate will ensure consistency and comparability in financial reporting across different sectors.

While aligning with IFRS, the IPSASB takes into account the unique characteristics and needs of the public sector. This includes considerations of accountability, transparency, and the specific nature of public sector transactions. The approach will involve aligning with the requirements, structure, and texts of IFRS 18 unless there is a public sector reason to warrant a departure. For instance, IPSASB will be considering where different presentation approaches should be permitted in response to the diverse range of public sector user needs. The IPSASB expects to begin discussions on the presentation of the Statement of Financial Performance in December 2024.

Australian developments

The Australian Accounting Standard Board (AASB) uses IFRS standards as a base for requirements that apply to the public sector and not-for-profit sector, making modifications through adding 'Aus' paragraphs, and/or Australian-specific guidance. Some sector-specific standards have also been issued by the AASB.

The AASB has identified that further modifications to AASB 18, the Australian equivalent to IFRS 18, may be necessary for not-for-profit entities, the public sector and entities applying AASB 1056 *Superannuation Entities*. The AASB is undertaking targeted outreach about issues and a pronouncement may be issued in late 2025.

AASB staff has identified the below issues in the June 2024 meeting as requiring further consideration:

- Whether income and expenses relating to grants received by not-for-profit entities that will be used to acquire or construct certain non-financial assets should be classified as operating or financing
- Whether 'endowments', such as assets provided for ongoing support where the principal is required to be preserved, are operating or investing
- Whether disclosures required for Management-defined Performance Measures should be applied to other important financial performance measures
- How AASB 18's income statement categorisations might interact with classifications used for whole-of-government and general government sector consolidated financial statements
- How presentation requirements of AASB 1056 might work with the income statement categorisation required by IFRS 18.

Application of AASB 18 to not-for-profit entities and superannuation entities applying AASB 1056 is deferred to financial reporting periods beginning on or after 1 January 2028.

Conclusion

The implementation of IFRS 18 marks a new chapter in the evolution of financial reporting. As entities prepare for the adoption of IFRS 18 they must address the complexities of new classification requirements, reconsider management-defined performance measures, and update their systems and processes accordingly. For many, this will involve substantial effort and collaboration across various internal and external stakeholders. Ultimately, when implemented, IFRS 18 will build greater transparency in financial reporting information.

Appendix

Key challenges in applying IFRS 18: Navigating revenue requirements

1. Difficulties in ascertaining investing versus operating

   a. **Classification of surplus inventory for property developers**

   Under IFRS 18, property developers face specific challenges when distinguishing between operating and investing activities, particularly regarding surplus inventory that may be rented out if it remains unsold.

   - Surplus inventory

     Property developers often have unsold properties that can be classified as inventory. Under IFRS 18, the classification of income generated from these properties – whether through rental income or eventual sale – poses a challenge. If the properties are rented out, the income could be classified as operating income; however, if the intention is to sell them, it may be classified as investing income. The determination of the primary purpose of holding the inventory (investment vs. operational use) can lead to complexities in classification.

   - Judgment in business model assessment

     Determining the appropriate classification requires judgment regarding the entity's business model. If a property developer primarily engages in selling properties but occasionally rents out surplus inventory, they must assess whether rental income aligns more closely with their operating activities or if it should be treated as investing income. This assessment can lead to inconsistencies, especially if the business model evolves over time or if different properties are treated differently.

   - Impact of rental income on profitability metrics

     The classification of rental income can significantly affect reported profitability metrics. Under IFRS 18, the distinction between operating and investing activities is crucial for calculating operating profit. If rental income is classified as operating income, it may enhance the perceived profitability of the core business. Conversely, if classified as investing income, it may dilute the operating profit margins, leading to potential misinterpretations by investors and stakeholders.

   - Disclosures and reconciliation requirements

     IFRS 18 mandates detailed disclosures about how income and expenses are categorised. This requirement can be burdensome for property developers, especially when reconciling rental income with the broader categories of operating and investing activities. The need to provide clear explanations and justifications for these classifications may require significant documentation and can complicate financial reporting processes.

- **Changes in reporting systems and processes**

  Implementing IFRS 18 will likely necessitate changes to the property developer's accounting systems and processes to ensure compliance with the new classification and disclosure requirements. This could involve revising charts of accounts, updating financial reporting software, and training staff to understand the nuances of the new standard. The operational changes required to adapt to IFRS 18 may strain resources and require careful planning to avoid disruptions in reporting.

b. Classification of cryptocurrency activities

Classification of cryptocurrency activities under IFRS 18 is not straightforward and requires careful consideration of the entity's business model and the nature of the transactions. Companies must apply judgment to determine the appropriate classification, ensuring that they comply with the new requirements for presentation and disclosure in financial statements.

Depending on the nature of the transactions and the entity's business model when using and dealing with cryptocurrency, the classification between operating and investing may differ.

- **Holding cryptocurrencies**

  If an entity holds cryptocurrencies as an investment, this would typically fall under the investing activities category. This classification aligns with the treatment of financial assets under IFRS 9, where cryptocurrencies are often accounted for at fair value through profit or loss or as intangible assets under IAS 38, depending on how the entity chooses to recognise them.

- **Mining cryptocurrencies**

  Activities related to mining cryptocurrencies may be classified as operating activities. This is because mining can be viewed as part of the entity's core business operations, especially for companies whose primary business involves cryptocurrency production. The income generated from mining would thus be included in the operating category of the statement of profit or loss.

- **Cryptocurrency transactions in the course of business**

  If a company engages in transactions involving cryptocurrencies as part of its normal business operations (e.g., accepting cryptocurrency as payment for goods or services), these transactions would generally be classified as operating activities. The rationale is that these transactions are integral to the company's revenue-generating activities.

c. Treatment of grant income

Grant income can complicate the categorisation of revenue under IFRS 18 requirements as they may not fit neatly into the defined categories of operating, investing, or financing.

- **Nature of grant income**

  Depending on how the grant is intended to be used (e.g., for operational purposes or capital investments), it could potentially be classified in multiple ways. This flexibility can lead to inconsistencies in reporting practices among different entities.

- **Assessment of main business activities**

  Companies need to assess whether grant income is related to the main business activities. Grant income may need to be classified differently than traditional revenue streams. For instance, if a grant is received for a specific project that involves asset acquisition for investment purposes, it may be classified as investing income, whereas operational grants might be treated as operating income.

- **Reclassification issues**

  For consolidated entities, the assessment of main business activities is performed at the entity level, which means that subsidiaries might classify grant income differently than the parent company. This could lead to reclassification challenges during consolidation if different entities within a group report grant income under varying categories.

d. Short-term surplus cash in term deposits

Under IFRS 18, the treatment of short-term surplus cash held in term deposits presents several challenges for companies. Determining whether short-term surplus cash in term deposits qualifies as cash equivalents can be challenging. IFRS 18 emphasises that cash equivalents are held for the purpose of meeting short-term cash commitments (operating) rather than for investment purposes. Companies must assess whether the term deposits are readily convertible to known amounts of cash and subject to an insignificant risk of changes in value. If the term deposits do not meet these criteria, they may need to be classified differently, potentially impacting liquidity ratios and financial analysis.

2. Onerous effort in allocating foreign exchange differences to each of the five categories in the statement of profit or loss

- Disaggregation of foreign exchange differences

  IFRS 18 requires foreign exchange differences to be classified in the same category as the underlying items that gave rise to them. This means that foreign exchange differences must be allocated to operating, investing, or financing categories based on the nature of the underlying transaction. This disaggregation can be complex, especially for entities with numerous transactions across different categories, making it challenging to track and report these differences accurately.

- Judgment in classification

  Entities must exercise significant judgment in determining the appropriate category for foreign exchange differences. For instance, foreign exchange gains or losses arising from trade receivables are classified as operating, while those from debt instruments may fall under financing.

- Undue cost or effort exemption

  IFRS 18 allows an exemption for classifying foreign exchange differences if determining the appropriate category involves 'undue cost or effort.' In such cases, foreign exchange differences may be classified in the operating category by default. However, this exemption may lead to a lack of precision in reporting, as it could result in significant amounts being aggregated in the operating category without a detailed breakdown of their origins, potentially obscuring the true financial performance of the entity. For companies that are at the revenue cusp, classifying significant amounts of foreign exchange differences could tip it over to the reporting and auditing threshold.

3. Non-recurring items and special events

Companies may encounter difficulties when dealing with non-recurring items, such as gains from the sale of assets or restructuring costs. IFRS 18 requires that these items be separately presented if they have sufficiently dissimilar characteristics to warrant distinct classification. Determining the appropriate classification – whether as operating, investing, or financing – can be subjective and may lead to inconsistencies in reporting, depending on management's judgment.

4. Business with mixed-activity

Entities that engage in multiple business activities, such as retail, manufacturing and financial services, may struggle to classify income accurately. For example, a retail company or a car dealership that provides financing options to customers must assess whether the interest income from these financing arrangements should be classified as operating income or financing income. This assessment can complicate reporting, especially if the company's primary business model does not clearly fit into one category.

5. Gains or losses from joint ventures and associates

The requirement to classify share of profits from associates and joint ventures outside the operating category can lead to a mismatch in how an entity presents its overall performance. For entities whose main business activities involve significant investments in associates or joint ventures, this could obscure the true operating performance as these gains are not reflected in operating profit.

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