Presentation and disclosure in the financial statements

IFRS 18

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What's the issue?

The way companies communicate their financial performance is set to change.

In response to investors' calls for more relevant, transparent and comparable information, IFRS 18* requires all companies to:

- report a newly defined subtotal, **'operating profit'**;
- disclose certain **'non-GAAP' measures** – management performance measures (MPMs) – in the financial statements, meaning that they will now be subject to audit – e.g. 'adjusted' EBITDA; and
- improve how they group information.

What's the impact?

IFRS 18 will enable companies to tell their story better through their financial statements. Investors will benefit from greater consistency of presentation in the income and cash flow statements, and more disaggregated information.

Making certain 'non-GAAP' measures part of the audited financial statements will bring more credibility to management's key performance indicators.

Companies' net profit will not change. What is changing is how they:

- present their results on the face of the **income statement**; and
- disclose information in the **notes**.

IFRS 18 marks a step towards more connected reporting.

What's next?

IFRS 18 is effective from 1 January 2027 and applies retrospectively. Early adoption is permitted. Now is the time to get ready.

- Assess the impacts on your financial statements.
- Communicate the impacts with investors.
- Consider how the new requirements impact financial reporting systems and processes.
- Monitor any changes in the local reporting landscape.

Read this guide to help you understand the new accounting standard and assess the impact on your company. See also our **First Impressions** publication, with our detailed insights and comprehensive analysis, together with illustrative examples.

* IFRS 18 *Presentation and Disclosure in Financial Statements* will replace IAS 1 *Presentation of Financial Statements*.

Contents

> *IFRS 18 brings three categories of income and expenses, two income statement subtotals and one single note on management performance measures. These, combined with enhanced disaggregation guidance, set the stage for better and more consistent information for users – and will affect all companies."*
>
> Gabriela Kegalj
> KPMG global IFRS presentation leader

01 What are the key changes?

More structured income statement

- New subtotals including 'operating profit'
- Income and expenses classified into three categories – operating, investing, financing
- Main business activities drive the classification of income and expenses

Disclosed and audited MPMs

- MPMs* are now disclosed in the financial statements and subject to audit
- MPMs capture some but not all 'non-GAAP' measures
- New disclosures may involve additional effort

* Management performance measures

Greater disaggregation of information

- New disclosures for items labelled as 'other'
- Enhanced guidance on how to group information within the financial statements
- Remains a judgement area

02 How does the income statement look now?

IFRS 18 introduces some key changes for the income statement, including:

- **two newly required subtotals** on the face of the income statement;
- income and expenses classified into **three new categories**, depending on a company's main business activities; and
- **results of equity-accounted investees** no longer presented as part of operating profit (now always in the investing category).

All companies will need to carefully assess which income and expenses belong in each category. Classification will vary depending on whether a company has specified main business activities (see pages 6 and 7).

Income statement

Companies without specified main business activities

Operating*	Revenue	X
Operating*	Operating expenses (analysed by nature, function or both as appropriate)	(X)
	Operating profit	**X**
Investing*	**Share of profit or loss of equity-accounted investees**	X
Investing*	Income from other investments	X
Investing*	Interest income from cash and cash equivalents	X
	Profit or loss before financing and income tax*	**X**
Financing*	Interest expense on borrowings and lease liabilities	(X)
Financing*	Interest expense on pension liabilities	(X)
	Profit before tax	**X**
	Income tax	(X)
	Profit for the year	**X**

* The operating, investing and financing categories are **not** aligned with those for the cash flow statement.

* Companies providing financing to customers as a main business activity (e.g. banks) typically do not present this subtotal.

03 What are the new categories of income and expenses?

All companies classify income and expenses into three new categories.

Operating – income/expenses arising from a company's main business activities.

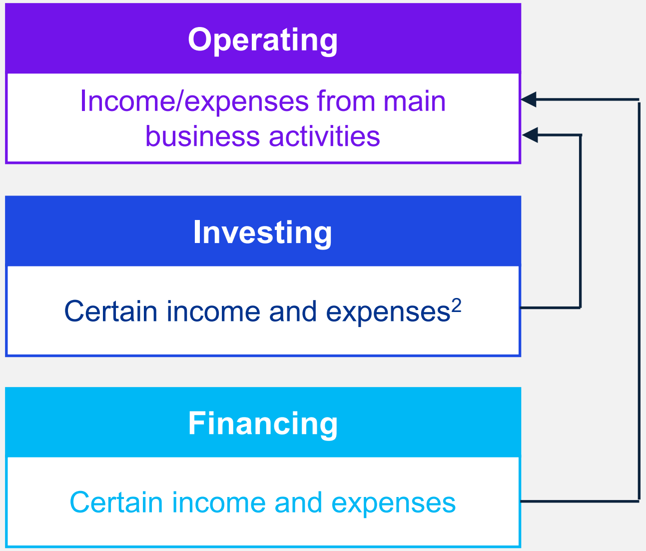
Investing – income/expenses from:

- investments in associates, joint ventures and unconsolidated subsidiaries;
- cash and cash equivalents; and
- assets that generate a return individually and largely independently (e.g. rental income from investment properties).

Financing – comprising:

- income/expenses from liabilities related to raising finance only (e.g. interest expense on borrowings); and
- interest income/expense and effects of changes in interest rates from other liabilities (e.g. interest expense on lease liabilities).

Companies with **specified main business activities**[1] classify additional items of income and expense in the **operating** category that would otherwise be classified in **investing** or **financing**.



[1] This term is defined in IFRS 18 as investing in assets (e.g. real estate companies, insurers) or providing financing to customers (e.g. banks).

[2] Share of profit/loss of equity-accounted investees is always classified in investing.

04 How does the nature of your business activities impact the categories?

The classification of income and expenses varies depending on a company's main business activities.

	Manufacturer A	Manufacturer B	Bank	Real estate
Main business activities	Manufacturing and sales of goods	Manufacturing and sales of goods and providing finance to customers	Providing finance to customers	Investing in assets
Interest expenses on borrowings	Financing	Operating* and choice between operating and financing**	Operating* and choice between operating and financing**	Financing
Gains/losses on investment property	Investing	Investing	Investing	Operating

* Includes all interest expenses from borrowings that relate to providing financing to customers.

** An accounting policy choice applies to interest expense from borrowings that do not relate to providing financing to customers.

Companies with multiple main business activities that include specified main business activities may find it onerous to classify income and expenses in the income statement.

05 How are operating expenses presented?

Companies present an **analysis of operating expenses on the face** of the income statement.

Under IFRS 18, companies are no longer permitted to disclose operating expenses only in the notes.

A company presents operating expenses in a way that provides the 'most useful structured summary' of its expenses, by either:

- **nature**;
- **function**; or
- using a **mixed presentation**.

If any operating expenses are presented by function, then new disclosures apply.

Mixed presentation of operating expenses represents a significant change in some jurisdictions.

Income statement

By nature

Revenue	X
Purchases of materials	(X)
Transport costs	(X)
Depreciation	(X)
Employee costs	(X)
Operating profit	**X**

By function*

Revenue	X
Cost of goods sold	(X)
Gross profit	X
R&D expenses	(X)
Admin expenses	(X)
Operating profit	**X**

Mixed*

Revenue	X
Cost of goods sold	(X)
Gross profit	X
Impairment expenses	(X)
Admin expenses	(X)
Operating profit	**X**

* New disclosures apply.

06 How are operating expenses disclosed?

If any operating expenses are presented **by function** on the face of the income statement, companies:

- present a separate cost of sales line item (where relevant); and
- disclose a qualitative description of the nature of expenses included in each function line item.

In addition, in a single note, companies disclose specific quantitative and qualitative information for each of **five 'nature' operating expenses**. This information is not intended to reconcile to the income statement as **it captures both capitalised and expensed amounts.**

Companies may need to adjust systems and processes to capture relevant information to satisfy these disclosures.

Notes to the income statement

Operating expenses by nature[a]	Depreciation	Amortisation	Employee benefits	Impairment losses/ reversals	Inventory write-downs/ reversals
Total amount recognised in the period	72[b]	X	X	X	X
Total amount included in:					
Cost of goods sold	50				
Admin expenses	3				
Research and development expenses	15				
Total amount included in the operating category	68[b]	X	X	X	X

(a) The amounts disclosed are those expensed during the period, except for depreciation which includes amounts capitalised to inventory.

(b) The difference between these totals relates to depreciation included in *[line item X]* in the investing category.

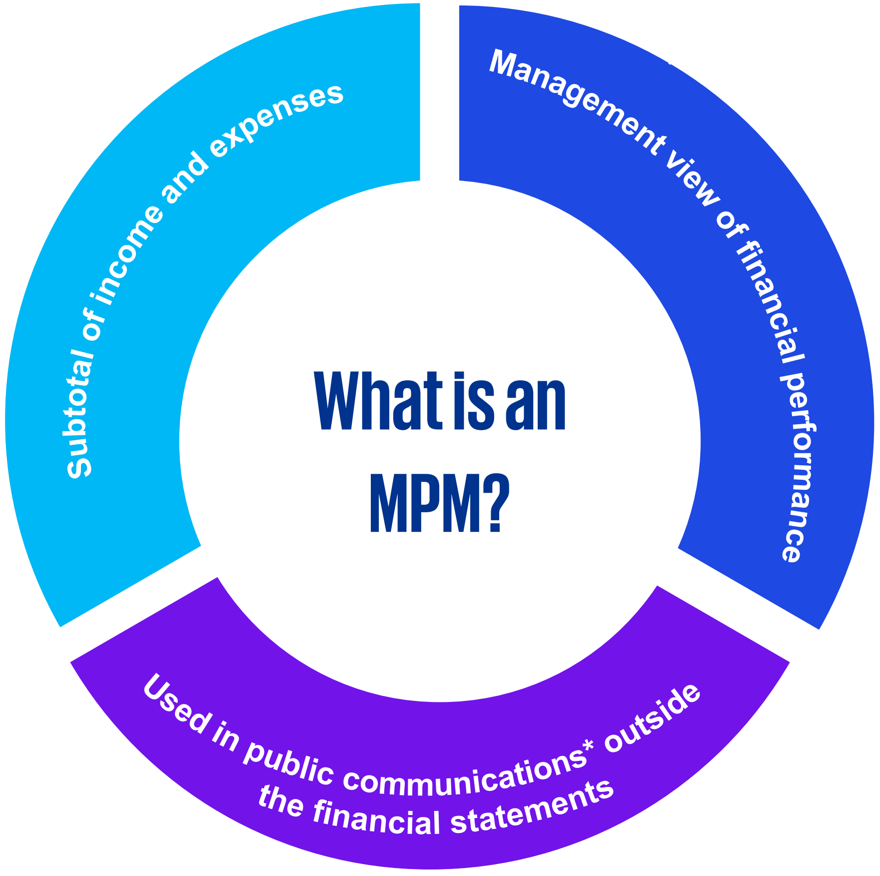
07 Which 'non-GAAP' measures are now reported in the financial statements?

Only 'non-GAAP' measures that are **subtotals of income and expenses** – i.e. **MPMs** – are reported.

The **definition** of MPMs is narrow and **excludes** the following.

- ✖ Non-financial performance measures – e.g. customer satisfaction statistics.
- ✖ Financial performance measures that are not subtotals of income and expenses – e.g. free cash flow.
- ✖ Totals/subtotals specified in IFRS® Accounting Standards – e.g. gross profit.

Certain 'non-GAAP' measures that meet the definition of MPMs will now be reported in the financial statements and subject to audit. As a result, companies may decide to revisit the purpose and relevance of existing 'non-GAAP' measures communicated outside of the financial statements.



* A subtotal used in public communications is presumed to represent management's view of financial performance unless it can be rebutted with reasonable and supportable information.

08 What are the new disclosures for MPMs?

In a **single note** in the financial statements, a company:

- states that the MPM provides management's view of the company's financial performance and is not necessarily comparable to MPMs of other companies;
- explains why the MPM provides useful information and how it is calculated;
- reconciles the MPM to a total/subtotal specified in IFRS Accounting Standards, including the tax and non-controlling interest effects for each reconciling item; and
- explains any changes – e.g. changes to calculations and any new MPMs.

Notes to the financial statements

	20X7	Tax effect	Effect on NCI
Adjusted operating profit (MPM)	**X**		
Restructuring costs	(X)	(X) [a]	(X)
Operating profit *	**X**		

(a) The tax effect of restructuring costs in [*Country S*] is calculated based on the statutory tax rate applicable in [*Country S*] at the end of 20X7, which was X percent.

The reconciliation may involve additional effort. For instance, a company may need to develop an appropriate method to calculate the income tax effect for each reconciling item in the note.

* Required subtotal under IFRS Accounting Standards

09 Will companies change how they group information in the financial statements?

Potentially, yes.

Companies now have enhanced guidance on grouping – i.e. aggregating and disaggregating – information in the financial statements.

This includes:

- **newly defined 'roles'** for the primary financial statements and for the notes;
- **shared characteristics** of items as a basis for aggregation and disaggregation – e.g. nature, function, size, geographical location and regulatory environment; and
- **single dissimilar characteristic,** which can result in disaggregating items, if material.

New disclosures apply to discourage companies from labelling items as **'other'** and aggregating items into large single amounts.

Determining how to group information remains a judgement area.

More **aggregated** information

Role of the primary financial statements

Provide a '**useful structured summary**' of the company's assets, liabilities, equity, income, expenses and cash flows

More **disaggregated** information

Role of the notes

Provide additional **material** information

Materiality continues to apply when presenting and disclosing information in the financial statements. However, for the primary financial statements, companies will also need to consider if the statements provide a 'useful structured summary'.

10 What other changes apply to the primary financial statements?

Cash flow statement

- **Operating profit is the starting point** for the indirect method.
- The **option** for classifying interest and dividend cash flows as **operating activities** has been **eliminated**.

Cash flows (general model)*

Financing	Investing
• Dividends paid	• Dividends received
• Interest paid	• Interest received

Balance sheet

- **Goodwill** is presented as a new line item on the face of the balance sheet.

Property, plant and equipment	X
Goodwill	**X**
Intangible assets	X
Total non-current assets	**X**

* Classifying interest and dividends will differ for companies with specified main business activities.

Keeping in touch

Gabriela Kegalj
Global IFRS Presentation Leader
KPMG in Canada
gabrielakegalj@kpmg.ca

Wietse Koster
Global IFRS Presentation Deputy Leader
KPMG in the Netherlands
Koster.Wietse@kpmg.nl

Agnieszka Sekita
Global IFRS Presentation Team
KPMG International
agnieszka.sekita@kpmgifrg.com

With thanks to our additional contributors

Daisuke Masuda   Genevieve Naik
Gina Desai

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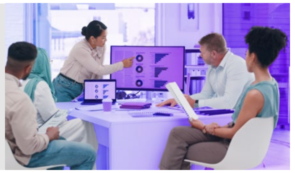

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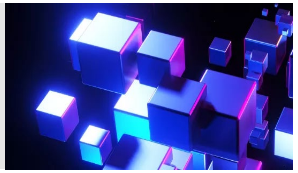

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