

EFRAG's Letter to the European Commission Regarding Endorsement of IFRS 18 Presentation and Disclosure in Financial Statements

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European Commission
1049 Brussels

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Dear Mr John Berrigan,

Endorsement of IFRS 18 Presentation and Disclosure in Financial Statements

Based on the requirements of the Regulation (EC) No 1606/2002 of the European Parliament and of the Council on the application of international accounting standards, EFRAG is pleased to provide its opinion on the IFRS 18 *Presentation and Disclosure in Financial Statements* ('IFRS 18'), which was issued by the IASB on 9 April 2024. An Exposure Draft of IFRS 18 was issued on 17 December 2019. EFRAG provided its comment letter on that Exposure Draft on 2 November 2020. At the end of the redeliberation phase, the IASB conducted targeted outreach on those key aspects where the IASB's tentative decisions changed the proposals in the Exposure Draft. EFRAG provided a summary report of the feedback received together with recommendations to the IASB on 21 December 2022.

The objective of IFRS 18 is to improve the usefulness of information presented and disclosed in financial statements. It responds to stakeholders' demand – particularly from users of financial statements - for better information about companies' financial performance improving how companies communicate information in the financial statements and giving investors a better basis for analysing and comparing companies' performance. In particular, IFRS 18 introduces new requirements for information presented in the primary financial statements and disclosed in the notes, with a particular focus on the statement of profit or loss, which can be summarised as follows:

- (a) presentation of new defined subtotals in the statement of profit or loss and consistent classification of income and expenses in five defined categories;
- (b) disclosure of information about management-defined performance measures (MPMs); and
- (c) enhanced requirements for grouping (aggregation and disaggregation) of information in both the primary financial statements and the notes.

IFRS 18 shall be applied retrospectively for annual periods beginning on or after 1 January 2027, with earlier application being permitted. If entities apply IFRS 18 earlier, they shall disclose that fact. A description of its requirements is included in Appendix 1 to this letter.

In order to provide our endorsement advice as you have requested, we have first assessed whether IFRS 18 would meet the technical criteria for endorsement, in other words whether IFRS 18 would provide relevant, reliable, comparable and understandable information required to support economic decisions and the assessment of stewardship, leads to prudent accounting and is not contrary to the true and fair view principle. We have then assessed whether IFRS 18 would be conducive to the European public good. We provide our conclusions below.

EFRAG has carried out an evaluation of IFRS 18. As part of that process, EFRAG issued its initial assessment for public comment and, when finalising its advice and the content of this letter, took the comments received in response into account. EFRAG's evaluation is based on input from standard setters, market participants, other interested parties and its discussions of technical matters are open to the public.

Does IFRS 18 meet the IAS Regulation technical endorsement criteria?

EFRAG has preliminary concluded that IFRS 18 meets the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, and raises no issues regarding prudent accounting.

EFRAG notes that the IASB issued IFRS 18 after reaching an overall consensus, following extensive consultations with a wide range of constituents, including those from Europe. EFRAG organised numerous joint outreach events and invited the IASB to several of its meetings where proposals for IFRS 18 were discussed. Stakeholders' recommendations and concerns raised during the ED-consultation and the redeliberation phases have been further discussed by the IASB, albeit to varying extents. In its assessment, EFRAG has identified topics for which some stakeholders expressed concerns or provided mixed views in terms of relevance, reliability, comparability and understandability. However, none of them prevents IFRS 18 from meeting each of the criteria and from delivering prudent accounting.

EFRAG has also assessed that IFRS 18 does not create any distortion in its interaction with other IFRS Accounting Standards and that all necessary disclosures are required. Therefore, EFRAG has concluded that IFRS 18 is not contrary to the true and fair view principle. EFRAG's reasoning is explained in Appendix 2 to this letter.

Is IFRS 18 conducive to the European public good?

EFRAG has assessed that IFRS 18 would improve financial reporting and would reach an acceptable cost-benefit trade-off. EFRAG has not identified that IFRS 18 could have any adverse effect on the European economy, including financial stability and economic growth. Accordingly, EFRAG assesses that endorsing IFRS 18 is conducive to the European public good. EFRAG's reasoning is explained in Appendix 3 to this letter.

We provide insights into those assessments below.

Improvement to financial reporting

We have assessed whether IFRS 18 would contribute to improving financial reporting by comparing it to the current guidance. Due to the enhanced structure of the profit and loss statement resulting

from the introduction of requirements for classification into categories and defined subtotals, users receive more relevant and comparable information, and transparency is improved. The introduction of requirements for improved aggregation and disaggregation aims to provide additional relevant information in the primary financial statements and in the notes and ensures that material information is not obscured. The introduction of disclosures on the Management-defined Performance Measures (MPMs) in a single note to the financial statements and the resulting audit of such information will support transparency and discipline in the use of such measures. The reconciliations to be provided to the next subtotal in the statement of profit or loss will help users of financial statements in their analysis. In addition, targeted improvements to IAS 7 like the uniform starting point and removing presentation alternatives aim to improve comparability between entities.

Costs and benefits

IFRS 18 has impact on the presentation of financial information of each entity. The analysis performed revealed that entities will incur implementation costs, but ongoing costs will be relatively low. EFRAG's overall assessment is that the benefits from IFRS 18 will outweigh the resulting costs.

Effects on economic growth

We have also considered, on the assumption of normal business behaviour, whether the changes triggered by IFRS 18 could have an impact on economic growth. As IFRS 18 changes presentation requirements only, such impact is not expected.

Our advice to the European Commission

As explained above, we have concluded that IFRS 18 meets the qualitative characteristics of relevance, reliability, comparability and understandability required to support economic decisions and the assessment of stewardship, raises no issues regarding prudent accounting, and that it is not contrary to the true and fair view principle. We have also concluded that IFRS 18 is conducive to the European public good. Therefore, we recommend IFRS 18 for endorsement.

On behalf of EFRAG, I would be happy to discuss our advice with you, other officials of the European Commission or the Accounting Regulatory Committee as you may wish.

Yours sincerely,

Wolf Klinz
Chair of the EFRAG FRB

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Appendix 1: Understanding the changes brought about by IFRS 18

Background to IFRS 18

- 1 IFRS 18 was issued in response to a strong demand from stakeholders, particularly from users of financial statements, for improvements to financial performance reporting, and it replaces IAS 1 *Presentation of Financial Statements*. Indeed, feedback on the IASB's 2015 Agenda Consultation and subsequent research and outreaches revealed a need for improved requirements relating to:
 - (a) categories and subtotals in the statement of profit or loss – IAS 1 required an entity to present profit or loss but no specific subtotals. There were no detailed requirements on where to classify income and expenses in the statement of profit or loss. In practice, entities that applied IAS 1 often presented subtotals using the same label, but it included varying income and expenses, leading to diversity in presentation and to the calculation of subtotals even among entities in the same industry. Such diversity impaired the comparability and understandability of financial information for users of financial statements;
 - (b) management-defined performance measures – entities often provide their own management-defined measures of performance (sometimes called 'alternative performance measures' or 'non-GAAP measures'). Users of financial statements find some of these measures useful in analysing performance or making forecasts about future performance, but they are concerned about the lack of transparency on why these measures are used and how they are calculated. Furthermore, entities typically report such measures outside the financial statements, thus raising concerns about their reliability; and
 - (c) enhanced requirements for grouping (aggregation and disaggregation) of information – the requirements in IAS 1 for the aggregation and disaggregation of information in the primary financial statements and the notes were sometimes not understood or applied well in practice, leading to diversity and inconsistency in application. Some companies did not provide sufficiently detailed information. Furthermore, absence of specific guidance in IAS 1 sometimes resulted in information being obscured in the financial statements, for example disclosing large expenses in the notes as 'other expenses', with no information provided to help users of financial statements understand their composition. This situation impaired the relevance of financial information for users of financial statements, making the analysis of information ineffective.
- 2 This lack of detailed requirements in IAS 1 led to diversity in practice and lack of transparency in some cases. Investors found it difficult to analyse and compare companies' financial performance.

The issues and how they have been addressed

- 3 In order to address the above issues, IFRS 18 introduces new requirements for information presented in the primary financial statements and disclosed in the notes, with a particular focus on the statement of profit or loss, which can be summarised as follows:

- (a) the presentation of two new defined subtotals, including operating profit or loss in the statement of profit or loss, based on a new set of requirements for classifying income and expenses in categories to provide useful information and improve comparability;
 - (b) disclosure of information about management-defined performance measures (MPMs) in a single note to promote transparency and discipline;
 - (c) enhanced requirements for grouping (aggregation and disaggregation) of information to help a company provide useful information; and
 - (d) limited changes to the statement of cash flows and statement of financial position to improve comparability and transparency.
- 4 During the standard-setting process, the IASB retained many of the other existing principles in IAS 1 besides presentation and mainly updated the language used for paragraphs taken over from IAS 1 to IFRS 18. Some paragraphs were moved from IAS 1 to IAS 8 *Basis of Preparation of Financial Statements*¹ and IFRS 7 *Financial Instruments: Disclosures*. The most important changes introduced by IFRS 18 compared to IAS 1 are detailed in the following section.

What has changed?

Subtotals and categories

- 5 IFRS 18 requires an entity:
- (a) to present two new defined subtotals named 'operating profit or loss' and 'profit or loss before financing and income taxes';
 - (b) to classify income and expenses in the statement of profit or loss based on five defined categories, which are operating, investing, financing, income taxes and discontinued operations, and
 - (c) to present additional subtotals in the statement of profit or loss when such presentations are necessary to provide a useful structured summary of the company's income and expenses.
- 6 The operating category includes all income and expenses in the statement of profit or loss that are not classified in the other categories (i.e. default category). Therefore, (a) it comprises all income and expenses arising from a company's operations regardless of whether they are volatile or unusual in some way, and (b) it includes, but is not limited to, income and expenses from a company's main business activities.
- 7 The investing category comprises income and expenses from: (a) investments in associates, joint ventures and unconsolidated subsidiaries; (b) cash and cash equivalents; and (c) other assets that generate a return individually and largely independently of the company's other resources.

¹ When issuing IFRS 18, the IASB revised the title of IAS 8 from *Accounting Policies, Changes in Accounting Estimates and Errors* to *Basis of Preparation of Financial Statements*.

- 8 The financing category comprises: (a) income and expenses from liabilities arising from transactions that involve only the raising of finance; and (b) interest income and expenses and the effects of changes in interest rates from liabilities arising from transactions that do not involve only the raising of finance.
- 9 The investing and financing categories comprise income generated by the respective assets, income and expenses that arise from the initial and subsequent measurement of the respective assets or liabilities, including on derecognition and incremental expenses directly attributable to the acquisition and disposal, for example transaction costs and costs to sell.
- 10 IFRS 18 requires a company to assess whether it invests in assets as a main business activity or it provides financing to customers as a main business activity. Indeed, entities with specified main business activities are required to classify in the operating category some income and expenses that would otherwise be classified in the investing category or the financing category as follows.
- (a) Entities that invest in assets as a main business activity (paragraph B31 of IFRS 18 provides a non-exhaustive list of examples of such entities, which includes investment entities, investment property companies and insurers) will classify in the operating category the income and expenses that arise from those assets that would otherwise be classified in the investing category. However, income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method are always classified in the investing category.
 - (b) Entities that provide financing to customers as a main business activity (e.g. banks or producers that offer financing of products like the automotive finance companies) will:
 - (i) classify in the operating category income and expenses from liabilities that arise from transactions that involve only the raising of finance related to the provision of financing to customers;
 - (ii) make an accounting policy choice to classify in the operating category or financing category income and expenses from liabilities that arise from transactions that involve only the raising of finance not related to the provision of financing to customers; and
 - (iii) classify interest income and expenses (and the effect of changes in interest rates) from liabilities that arise from transactions that do not involve only the raising of finance in the financing category.

- 11 Furthermore, IFRS 18 introduces specific guidance for the classification of foreign exchange differences, fair value gain or loss on derivatives and income and expenses from hybrid contracts.

Management-defined Performance Measures (MPMs)

- 12 Companies which report alternative performance measures or non-GAAP measures have to disclose in the notes additional information when those measures meet the definition of management-defined performance measures (MPMs). IFRS 18 defines an MPM as a subtotal of income and expenses that:

- (a) is used in public communications outside financial statements;
 - (b) is used to communicate to investors management's view of an aspect of the financial performance of the company as a whole; and
 - (c) is not listed in IFRS 18 or specifically required by IFRS Accounting Standards.
- 13 Disclosure requirements might apply when financial ratios represent management views. A subtotal that is the numerator or denominator in a financial ratio is a management-defined performance measure if the subtotal would meet the definition of a management-defined performance measure if it were not part of a ratio. Accordingly, an entity shall apply the disclosure requirements to such a numerator or denominator.
- 14 IFRS 18 introduces a rebuttable presumption that a subtotal of income and expenses used in public communications communicates management's view. A company is permitted to rebut this presumption if it has reasonable and supportable information demonstrating that such a subtotal does not communicate management's view.
- 15 In addition, IFRS 18 requires an entity to disclose the following information about its MPMs in a single note to the financial statements:
- (a) a description of the aspect of financial performance that it communicates, including why management believes the MPM provides useful information about the company's financial performance;
 - (b) a description of how the MPM is calculated;
 - (c) a reconciliation between the MPM and the most directly comparable subtotal listed in IFRS 18 or the total or subtotal required by IFRS Accounting Standards, including the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation; and
 - (d) a description of how the company determined the income tax effect.
- 16 Furthermore, if an entity changes the calculation of an MPM, introduces a new MPM or ceases to use a previously disclosed MPM, it will disclose:
- (a) an explanation of the change, addition or cessation and its effects;
 - (b) the reasons for the change, addition or cessation; and
 - (c) restated comparative information to reflect the change, addition or cessation unless it is impracticable to do so.

Enhanced requirements on grouping of information (aggregation and disaggregation)

- 17 The objective of financial statements is to provide financial information about the company's recognised assets, liabilities, equity, income and expenses that is useful to investors in assessing the prospects for future net cash inflows to the company and in assessing management's stewardship of the company's economic resources.
- 18 To achieve this objective, IFRS 18:
- (a) defines the roles of the primary financial statements and the notes to help companies to determine whether information should be in the primary financial

statements or in the notes and provides principles for determining the level of detail needed;

- (b) enhances requirements for grouping of information and labelling of items by introducing consistent principles; and
- (c) improves guidance to assess how to present operating expenses in the statement of financial performance and requires entities to disclose specified expenses by nature when presenting by function.

Roles of the primary financial statements and the notes

- 19 IFRS 18 defines distinct and complementary roles in providing financial information to the primary financial statements and the notes. The former aims to provide structured summaries (referred to as a useful structured summary) of a company's recognised assets, liabilities, equity, income, expenses and cash flows; the latter provides material information necessary to enable investors to understand the items in the primary financial statements and to supplement the primary financial statements with additional information to achieve the objective of the financial statements.
- 20 To provide a useful structured summary in a primary financial statement, an entity shall comply with specific requirements that determine the structure of the statement as specified by IFRS 18. At the same time, IFRS 18 provides additional flexibility, allowing an entity not to present separately a line item in a primary financial statement if doing so is not necessary for the statement to provide a useful structured summary even if such line item is required by other IFRS Accounting Standards. On the other hand, IFRS 18 requires an entity to present additional line items and subtotals if such presentations are necessary for a primary financial statement to provide a useful structured summary.

Grouping of information

- 21 IFRS 18 introduces principles for grouping (aggregation and disaggregation) of information to require entities to aggregate or disaggregate information about individual transactions and other events into the information presented in the primary financial statements and disclosed in the notes.
- 22 IFRS 18 requires companies to ensure that:
- (a) items be aggregated based on shared characteristics and disaggregated based on characteristics that are not shared;
 - (b) items be aggregated or disaggregated such that the primary financial statements and the notes fulfil their roles; and
 - (c) the aggregation and disaggregation of items does not obscure material information.
- 23 Companies will be specifically required to disaggregate information whenever the resulting information is material. If a company does not present such information in the primary financial statements, it will disclose the information in the notes. To help companies apply the principles, IFRS 18 provides application guidance on grouping items and labelling aggregated items, including which characteristics to consider when assessing whether items have similar or dissimilar characteristics.

- 24 Furthermore, IFRS 18 requires an entity to use meaningful labels to describe items presented in the primary financial statements. In particular, an entity may use the label 'other' only when it is unable to find a more informative label and when such a label has to be as precise as possible (e.g. 'other operating expenses').

Presentation and disclosure of operating expenses

- 25 Consistent with IAS 1, IFRS 18 requires companies to classify and present operating expenses in a way that this provides the most useful structured summary of their expenses focusing on the following characteristics:

- (a) the nature of the expenses; or
- (b) the function of the expenses within the company.

- 26 In contrast to IAS 1, IFRS 18 introduces some changes to previous requirements in IAS 1 as follows.

- (a) It provides more detailed guidance than IAS 1 to assist entities in deciding how to present operating expenses by providing factors to be considered (e.g. what line items provide the most useful information about the main components or drivers of the company's profitability and industry practice).
- (b) It requires a company that presents one or more line items of operating expenses classified by function to disclose the amounts for five specified expenses by nature related to each line item in the operating category of the statement of profit or loss. These specified expenses are: depreciation, amortisation, employee benefits, impairment losses and reversal of impairment losses, and write-down and reversal of inventories.

Other changes to financial reporting

- 27 IFRS 18 introduces a requirement to present in the statement of financial position a separate line item for 'goodwill'. Indeed, goodwill is an unidentifiable asset and is measured only as a residual. It cannot be measured directly. Therefore, the IASB considers that the characteristics of goodwill are sufficiently dissimilar from those of intangible assets to warrant separate presentation.

- 28 IFRS 18 amends IAS 7 *Statement of Cash Flows* to:

- (a) require all companies to use the operating profit subtotal as the starting point for the indirect method of reporting cash flows from operating activities to simplify the presentation of cash flows from operating activities; and
- (b) remove the presentation alternatives for cash flows related to interest and dividends paid and received to improve the comparability of the statement of cash flows.

- 29 IFRS 18 amends the disclosure requirements in IAS 33 *Earnings per Share* to specify the numerator (or numerators) that entities can use to calculate amounts per share using a measure of performance. When disclosing additional amounts per share, an entity can only use as the numerator an amount attributable to ordinary equity holders of the parent of totals or subtotals in paragraphs 69, 86 and 118 of IFRS 18 or a management-defined performance measure as defined by IFRS 18.

- 30 IFRS 18 also amends IAS 33 to specify that information about amounts per share, in addition to information about basic and diluted earnings per share as required by IAS 33, may only be disclosed in the notes and may not be presented in the primary financial statements. The IASB concluded that additional amounts per share calculations require additional information and reconciliation to the measures presented in the primary financial statements to be understood by users of financial statements. This additional information and reconciliations can only be provided in the notes. Disclosure in the notes also addresses the concerns of some stakeholders that adjusted measures of performance should not be given more prominence than measures specified by IFRS Accounting Standards.
- 31 Furthermore, IFRS 18 amends the disclosure requirements for interim financial reporting. Under IAS 34 *Interim Financial Reporting* as amended by IFRS 18, an entity is required to make disclosures about its management-defined performance measures in the notes to its condensed interim financial statements; they are the same disclosures as those that are required in an entity's complete set of financial statements by paragraphs 121-125 of IFRS 18. The IASB concluded that requiring information about management-defined performance measures in interim financial reports would provide users of financial statements with transparent information about these measures and allow them to analyse all aspects of an entity's performance on a timely basis.
- 32 Consistent with the objective of condensed interim financial reports, an entity would not need to duplicate previously reported information about management-defined performance measures – for example, information about why an entity's management thinks a management-defined performance measure communicates aspects of the entity's performance.

When does IFRS 18 become effective?

- 33 An entity shall apply IFRS 18 for annual periods beginning on or after 1 January 2027, with earlier application permitted. If an entity applies IFRS 18 for an earlier period, it shall disclose that fact in the notes.

Transition requirements

- 34 An entity shall apply IFRS 18 retrospectively applying IAS 8. Entities have to restate comparative information for the prior year presented.
- 35 If an entity applies IAS 34 *Interim Financial Reporting* in preparing condensed interim financial statements in the first year of applying IFRS 18, it is required to present the headings that it expects to use in applying IFRS 18 and subtotals consistent with the requirements in IFRS 18. In addition, an entity is required to disclose reconciliations for each line item presented in the statement of financial performance for the comparative periods immediately preceding the current and cumulative current periods.
- 36 If an investment is held by or held indirectly through a venture capital organisation or a mutual fund, unit trust or similar entities, including investment-linked insurance funds (e.g. a fund held by an entity as the underlying items for a group of insurance contracts with direct participation features), a measurement method election is allowed. At the date of initial application of IFRS 18, an entity eligible to apply paragraph 18 of IAS 28 *Investments in Associates and Joint Ventures* is permitted to change its election for measuring an investment in an associate or joint venture from the equity method to fair value through

profit or loss in accordance with IFRS 9 *Financial Instruments*. If an entity makes such a change, the entity shall apply the change retrospectively by applying IAS 8. An entity applying paragraph 11 of IAS 27 *Separate Financial Statements* shall make the same change in its separate financial statements.

Monitoring and subsequent retrospective evaluation

37 In the early stage of the application of IFRS 18, EFRAG will monitor any issues that arise through:

- (a) Comments made directly to EFRAG; and
- (b) Issues raised to the IASB through its IFRS Interpretations Committee or through the planned processes for issues to be identified through the IASB's website.
- (c) In the longer term, the IASB will conduct a post-implementation review as required by the *IASB Due Process handbook*. Post-implementation reviews are normally carried out two years after new requirements have become mandatory and been implemented. EFRAG will participate in this review process and will actively seek comments from constituents.

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Appendix 2: EFRAG's technical assessment of IFRS 18 against the endorsement criteria

Summary

- 1 Appendix 2 contains EFRAG's assessment of IFRS 18 against the technical endorsement criteria. In summary, EFRAG's overall assessment is that IFRS 18 meets the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management and leads to prudent accounting.
- 2 EFRAG assesses that IFRS 18 is not contrary to the true and fair view principle, in that it:
 - (a) meets the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management, and leads to prudent accounting;
 - (b) does not create any negative interactions with other IFRS Accounting Standards and does not lead to unavoidable distortions or significant omissions of information that would be contrary to the true and fair view principle; and
 - (c) requires appropriate disclosures that provide a complete and reliable depiction of an entity's assets, liabilities, financial position, profit or loss and cash flows.
- 3 When assessing these criteria, IFRS 18 requirements are analysed through the main areas of the standard and focusing on the key topics for which some stakeholders expressed concerns or provided mixed views in terms of relevance, reliability, comparability and understandability (please refer to paragraph 12 below for further information). However, none of them prevents IFRS 18 from meeting each of the criteria and from delivering prudent accounting.
- 4 As a result, EFRAG concludes that IFRS 18 meets the technical criteria for endorsement.

Does the accounting that results from the application of IFRS 18 meet the technical criteria for endorsement in the European Union?

- 5 EFRAG has considered whether IFRS 18 meets the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002 (The IAS Regulation), in other words that IFRS 18:
 - (a) is not contrary to the principle set out in Article 4(3) of Council Directive 2013/34/EU (The Accounting Directive); and
 - (b) meets the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 6 Article 4(3) of the Accounting Directive provides that:

The annual financial statements shall give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss. Where the application of this Directive would not be sufficient to give a true and fair view of the undertaking's assets, liabilities, financial position and profit or loss, such additional information as is necessary to comply with that requirement shall be given in the notes to the financial statements.
- 7 The IAS Regulation further clarifies that *'to adopt an international accounting standard for application in the Community, it is necessary firstly that it meets the basic requirement of the aforementioned Council Directives, that is to say that its application results in a true and fair*

view of the financial position and performance of an enterprise - this principle being considered in the light of the said Council Directives without implying a strict conformity with each and every provision of this Directive' (Recital 9 of the IAS Regulation).

- 8 EFRAG's assessment as to whether IFRS 18 would not be contrary to the true and fair view principle has been performed against the European legal background summarised above.
- 9 In its assessment, EFRAG has considered IFRS 18 from the perspectives of both usefulness for decision-making and assessing the stewardship of management. EFRAG has concluded that the information resulting from the application of IFRS 18 is appropriate both for making decisions and assessing the stewardship of management.
- 10 EFRAG's assessment on whether IFRS 18 is not contrary to the true and fair view principle set out in Article 4(3) of Council Directive 2013/34/EU is based on the assessment of whether it meets all other technical criteria and whether it leads to prudent accounting. EFRAG's assessment also includes assessing whether IFRS 18 does not interact negatively with other IFRS Accounting Standards and whether all necessary disclosures are required. Detailed assessments are included in this appendix in the following paragraphs:
 - (a) relevance: paragraphs 15-76;
 - (b) reliability: paragraphs 77-93;
 - (c) comparability: paragraphs 94-109;
 - (d) understandability: paragraphs 110-125;
 - (e) whether overall it leads to prudent accounting: paragraphs 126-127; and
 - (f) whether it would not be contrary to the true and fair view principle: paragraphs 128-131.
- 11 In providing its assessment on whether IFRS 18 results in relevant, reliable, understandable and comparable information, EFRAG has considered all the requirements of IFRS 18. EFRAG has, however, focused its assessment on the requirements it considered most significant in relation to each of the criteria. EFRAG has accordingly focused on guidance that:
 - (a) is fundamental to the presentation and disclosures in financial statements;
 - (b) has been subject to substantial debate (evidenced by the comments EFRAG has received from constituents including participants in EFRAG's field-tests of the IASB's Exposure Draft); and
 - (c) may be problematic to apply as evidenced by the results of EFRAG's field-tests.
- 12 As such, when assessing the technical criteria, IFRS 18 requirements are analysed through the main areas of the standard based on the assessment of the feedback from the stakeholders including targeted outreaches, field tests, educational events and other activities performed by EFRAG while the standard was being developed. Topics which have been subject to substantial debate or for which stakeholders raised some practical challenges were:
 - (a) Defined categories and required sub-totals in the statement of profit or loss;

- (i) Classification of income and expenses arising from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method;
 - (ii) Assessment of the entity's main business activities;
 - (iii) Classification of interest expenses from other liabilities in the financing category.
 - (b) Management-defined performance measures;
 - (i) Scoping and rebuttable presumption;
 - (ii) Reconciliation requirements, including NCI and income tax effects.
 - (c) Enhanced requirements for grouping of information
 - (i) Analysis of expenses by nature when presenting by function;
 - (ii) Concept of 'useful structured summary';
 - (d) Other changes and transition
 - (i) Restatement of any comparative period;
 - (ii) Fair value option under IAS 28 paragraph 18;
 - (iii) Limited changes to the cash flow statement.
- 13 For certain technical criteria, all topics listed above are considered. For other technical criteria, only some of the topics listed above were deemed significant and relevant and were therefore considered.
- 14 EFRAG notes that the IASB issued IFRS 18 after reaching an overall consensus, following extensive consultations with a wide range of constituents, including those from Europe. EFRAG organised numerous joint outreach events and invited the IASB to several of its meetings where proposals for IFRS 18 were discussed. Stakeholders' recommendations and concerns raised during the ED-consultation and the redeliberation phases – including all the key topics analysed by EFRAG in the following sections - have been further discussed by the IASB, albeit to varying extents. The main reasoning behind the final decisions then reflected in IFRS 18 are widely described in the Basis for Conclusions. In its assessment, EFRAG recognises that IFRS 18 is intended to be an industry-agnostic standard which aims to define principle-based requirements which could be practicable and applied in a consistent manner across entities and industries.

Relevance

- 15 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.
- 16 EFRAG considered whether IFRS 18 would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

- 17 Overall, EFRAG received positive feedback from a wide range of stakeholders that IFRS 18 improves the relevance of financial information. It meets the intended user needs by taking into account the costs for preparers. In particular:
- (a) defined categories and new required subtotals will help companies to improve the communication of their financial performance in the statement of profit or loss to investors on a transparent and comparable basis. Better information will contribute to efficient and resilient capital markets by enabling investors to make better decisions;
 - (b) guidance on MPMs will introduce more rigour and transparency providing users of financial statements with more useful and consistent information for making their analyses;
 - (c) Enhanced guidance for grouping information in the financial statements will improve its clarity and consistent application across entities.
- 18 In its assessment of relevance, EFRAG also considered the following key topics for which stakeholders expressed some concerns or provided mixed views and arguments, which overall do not prevent IFRS 18 from providing relevant information.

Defined categories and required sub-totals in the statement of profit or loss

General concept – Defined categories and required sub-totals in the statement of profit or loss

- 19 EFRAG assesses that the concept improves the relevance of information prepared. Preparers acknowledge that the concept in IFRS 18 helps companies to improve the communication of their financial performance in the statement of profit or loss to investors on a transparent and comparable basis. Investors have given positive overall feedback on the concept. In particular, the consistent definition of operating profit has been recognised. Better information will contribute to efficient and resilient capital markets by enabling investors to make better decisions.

Classification of income and expenses arising from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method

- 20 IFRS 18 requires an entity to classify, in the investing category, all income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method, including:
- (a) the entity's share of the profit or loss from associates, joint ventures and unconsolidated subsidiaries; and
 - (b) other income and expenses from those investments in associates, joint ventures and unconsolidated subsidiaries (such as impairment losses).
- 21 The same presentation requirement applies to income and expenses from subsidiaries in separate financial statements accounted for using the equity method in accordance with paragraph 10(c) of IAS 27.
- 22 The classification in the investing category is independent of whether the main business activity is investing.
- 23 Research shows that current presentation of income and expenses arising from investments in associates and joint ventures differs. Therefore, EFRAG assesses that comparable presentation as a one line item after the operating result improves the relevance of financial

- information presented to users and facilitates their analysis. The introduction of a specified subtotal “operating profit or loss and income and expenses from all investments accounted for using the equity method” helps to address concerns raised by preparers which would like to present the respective result close to the operating result.
- 24 EFRAG notes that this requirement follows the request of investors. The classification of such income and expenses in the investing category provides investors with a consistent starting point for their analysis. Investors stated that they analyse results from these associates and joint ventures separately because:
- (a) this share of profit or loss is a net result after financing and income tax. The equity method combines income and expenses that users of financial statements would usually analyse separately;
 - (b) classifying those income and expenses in the operating category would disrupt users’ analyses of operating margins; and
 - (c) an entity does not control the activities of associates and joint ventures, therefore, results of non-controlled operations should not be presented within the operating activities and would not be relevant for the assessment and entity’s stewardship of management.
- 25 Several entities informed EFRAG that they consider those investments to be directly related to their operating activities. In some jurisdictions and industries, it is common for entities to operate through an associate or joint venture. For example, such a structure is common for the insurance and banking sector and some corporate entities.
- 26 In its assessment, EFRAG recognised that in its attempt to address the concerns of some stakeholders who consider these investments to be part of their core business, the IASB consulted, in the ED phase, on the possibility to differentiate between ‘integral’ and ‘non-integral’ investments with different related presentation requirements. Such a proposal would have taken into account the interests of both users and preparers. In addition to the operating profit or loss, companies with integral associates and joint ventures would have presented an additional subtotal “operating profit or loss and income and expenses from integral associates and joint ventures” which clearly indicates the connection to the operating result. This proposal did not obtain support from the stakeholders who stated that separately identifying associates and joint ventures that are ‘integral’ and ‘non-integral’ would be subjective, leading to complexity and diversity, or even to opportunistic application of such a requirement.
- 27 Based on the feedback received, the IASB decided to require an entity to classify the income and expenses from the investments in question in the investing category. This approach reflects that investments in associates and joint ventures generate returns individually and largely independent of the entity’s other resources, which is consistent with other income and expenses classified in the investing category. EFRAG notes that before the decision became final, the IASB and EFRAG consulted constituents again on the tentative decision made as part of its targeted outreach in H2 2022. The topic led again to mixed views. After considering all the arguments, the IASB, on balance, maintained its decision.
- 28 EFRAG is aware that stakeholders in the insurance industry raised specific concerns about classifying, in the investing category, income and expenses from investments in associates

- and joint ventures accounted for using the equity method that are linked to insurance contracts or held for prudential purposes to meet solvency requirements. These stakeholders suggested that insurers classify such income and expenses in the operating category, because those income and expenses are part of 'net financial result' (investment income minus insurance finance income and expenses), which is an important indicator of an insurer's operating performance. IFRS 17 *Insurance Contracts* requires an entity to disclose and explain the relationship between investment returns on its assets and insurance finance income and expenses.
- 29 The IASB acknowledged that a presentation 'mismatch' could arise if the income and expenses described above are excluded from the operating category, because 'net financial result' would contain insurance finance income and expenses from insurance contract liabilities but might not contain all the associated investment income from the assets held to service those liabilities. However, as also highlighted in paragraph BC121-128 of IFRS 18, the IASB concluded that the extent of any mismatch would be entity-specific and even within the insurance industry itself, the nature and purpose of those investments may differ.
- 30 According to the feedback received, for the entities with the above-mentioned structure and business model, the presentation of income and expenses of the related investments outside of their operating profit or loss would not allow to evaluate correctly and completely the performance of their business nor the stewardship of management, reducing the relevance of the information provided.
- 31 In making its assessment, EFRAG consulted the user community. Despite understanding the concerns raised by specific industries, many users of financial statements stated that all income and expenses from equity-accounted investments should be excluded from the operating category - regardless of whether the activities of associates or joint ventures are integral to an entity's main business activities. In their view, the relevance of information thus presented is improved. They referred to the arguments listed in paragraph 24 above and added that:
- (a) presenting the result from associates and joint ventures accounted for using the equity method separately on a comparable basis for all industries supported their analysis;
 - (b) entities with comparable business activities would report similar effects on operating profit; and
 - (c) reporting entities were free to provide additional information on these results to inform about any impact on the operating result.
- 32 Based on this feedback, EFRAG understands that the IASB decided not to provide industry-specific exemptions and to require an entity to exclude, from the operating category, all income and expenses from associates and joint ventures accounted for using the equity method, to better align with the way users of financial statements use information to analyse investments in associates and joint ventures.
- 33 In its assessment, EFRAG acknowledges that, to address the concerns of the stakeholders who consider that the presentation of income and expenses of those equity-accounted investments should be viewed as part of their operating results, IFRS 18 permits the

presentation of additional subtotals. This allows an entity to communicate information similar to the alternative approaches discussed above by:

- (a) presenting all income and expenses from investments in associates and joint ventures accounted for using the equity method as the first line item after operating profit followed by an additional subtotal for operating profit and income and expenses from all investments accounted for using the equity method; or
- (b) presenting income and expenses from some investments in associates and joint ventures accounted for using the equity method directly after operating profit and presenting a subtotal for 'operating profit and income and expenses from those associates and joint ventures accounted for using the equity method'. An entity might present such a subtotal when it disaggregates into one or more line items income and expenses from associates and joint ventures with dissimilar characteristics.

- 34 In addition, an entity may disclose the information it deems necessary and relevant for the users to understand its performance through the so-called 'alternative performance measures', 'non-GAAP measures' or management-defined performance measures as defined by IFRS 18.
- 35 Furthermore, EFRAG admits that IFRS 18 allows an entity eligible to apply paragraph 18 of IAS 28 (such as some insurers) to change its election for measuring an investment in an associate or joint venture from the equity method to fair value through profit or loss upon transition. The IASB allowed this to address the concern raised by the insurance industry in relation to the presentation mismatch of income and expenses between its insurance contract liabilities and related investments. As such, if an insurer that invests as a main business activity measures income and expenses from those investments in associates and joint ventures at fair value through profit or loss, the insurer would classify those income and expenses in the operating category and no mismatch would arise.
- 36 In this regard, EFRAG has been informed that there is a different understanding about the scope of paragraph 18 of IAS 28 which allows only specific entities to measure associates and joint ventures at fair value. EFRAG also noted that users considered measuring such investments at fair value through profit or loss might deliver more relevant information. This option is further discussed in the section dedicated to the transition requirements of IFRS 18 in paragraphs 70-74 below.
- 37 EFRAG acknowledges the concerns resulting from classifying insurance costs and the result from the equity-accounted investments into separate categories. Nevertheless, based on user feedback, EFRAG concludes that this does not impair relevance, because relevant information can still be provided either with a defined subtotal on the face of the profit or loss, or by measuring such investments at fair value and presenting the remeasurement gains or losses within the operating category, or by providing additional information in the notes, as discussed above.
- 38 In relation to the presentation requirement for income and expenses from subsidiaries in separate financial statements, it should be recognised that the presentation of the results will differ depending on the measurement method election offered by paragraph 10 of IAS 27. In separate financial statements, the measurement method can be elected according

to paragraph 10 of IAS 27 being at cost, at equity or at fair value. When using at cost or at fair value measurement, related results would be presented in the operating result for the same type of investment. However, as for the respective result from equity accounted associates and joint ventures, a separate line item is required so that users will receive information that allows them to adapt the information in their analysis on a comparable basis. Therefore, and considering arguments provided above, it will be possible for users of financial statements to receive the necessary relevant information. Therefore, EFRAG considers the presentation acceptable when assessing the relevance of information.

Assessment of an entity's main business activities

- 39 As further explained in paragraph 10 of Appendix 1, IFRS 18 requires an entity to assess whether investing in assets or providing financing to customers is a main business activity at the reporting entity level. Despite the difficulties when classifying income and expenses into categories, EFRAG assesses that the classification would result in information that can help users of financial statements in their analysis and evaluate developments and will improve transparency in financial reporting and reduce diversity in practice. EFRAG is aware that, while the investing and financing categories are relatively clearly defined, the operating category is a residual. For conglomerates, determining the entity's main business activities at the reporting-entity level will be complex and might be costly. The classification might change over the different levels of a group. For example, a subsidiary might invest as a main business activity even though the group does not. As a result, the subsidiary's classification of income and expenses in its statement of profit or loss could differ from that of the group.
- 40 Despite the fact that there might be classification differences between the group and its subsidiary or between various financial statements (i.e. consolidated vs separate) and application challenges foreseen by the conglomerates, EFRAG assesses that such classification differences would appropriately reflect the differences between the main business activities of the respective reporting entities.
- 41 In making its assessment, EFRAG recognises that users of the financial statements indicated that the above-mentioned provisions of IFRS 18 do not deviate from current practices applied while analysing the information prepared under IAS 1 guidance. They indicated that various activities of the entities are generally analysed separately, and it is expected that the IFRS 18 guidance will further enhance the relevance of the information provided in all its aspects – predictive and confirmatory value of information is improved when the analysis is done at a more granular level (business activity level) and management stewardship can be better assessed as well. As such, the classification of relevant income and expenses based on the assessment of an entity's main business activity within the operating category is deemed to have a positive impact on the relevance of this category.
- 42 EFRAG further notes that required disclosures about whether an entity invests in assets or provides financing to customers as a main business activity would help users of financial statements understand the structure of an entity's statement of profit or loss. Considering that any change of the assessment done by an entity is to be reflected prospectively and in order to avoid disrupting the analysis done by users, additional disclosures are required by IFRS 18 (including the effects of the change unless impracticable to do so) when there is a change in the assessment of an entity's main business activity(ies).

Classification of interest expenses from other liabilities in the financing category

- 43 IFRS 18 requires an entity to classify in the financing category:
- (a) income and expenses from liabilities that arise from transactions that involve only the raising of finance; and
 - (b) specified income and expenses from other liabilities - that is, liabilities that arise from transactions that do not involve only the raising of finance (including the effect of changes in interest rates).
- 44 In making its assessment, EFRAG considered the detailed discussions during the Exposure Draft phase ('ED-consultation phase' or 'consultation phase') and the redeliberation phase related to specific topics. If the first provision of the requirement was well received by the stakeholders, the second provision – namely, the classification of income and expenses from the liabilities that do not involve only the raising of finance – raised some concerns as to its relevance.
- 45 EFRAG observes that, many entities consider that the income and expenses from other liabilities which were incurred as part of the normal operations of a company would better fit within the operating category. For example, interest on lease liability is often considered by entities as part of their operating results. Similar considerations were expressed in regard to the interest on defined benefit liabilities, which are often considered as part of the payroll cost, and interest on long-term provisions recognised applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets*.
- 46 In its decision, the IASB acknowledged that current practice is mixed and further emphasised the need to provide a consistent presentation by all entities in regard to such income and expenses. Further, requiring a different classification of income and expenses for selected types of liabilities was not deemed appropriate because of the lack of any conceptual basis for such a classification.
- 47 Based on user feedback, EFRAG concludes that the relevance is improved. The user community supported the IFRS 18 requirements highlighting that the relevance is enhanced when the income and expenses from other liabilities are presented within the financing category. Indeed, users expressed that, for example, the interest on lease liabilities is considered in their analysis as remuneration for the use of external capital and therefore is part of the financing result. Similarly, the interest on defined benefit liabilities is considered in their analysis as remuneration of time value of money and is also more relevant in the financing category. However, for financial institutions, classification of interest expenses on lease liabilities and pension liabilities outside of the operating result (contrary to interest expenses on all other financial liabilities which are classified in operating activities) is less relevant as it may not reflect banks' holistic management of interest rate risk which is part of their main business activity. Additional considerations on the relevance of the subtotal 'Operating profit' for financial institutions, especially banks, are provided in paragraphs 47 - 55 of Appendix 3.

Management-defined performance measures

General

- 48 EFRAG observes that non-IFRS measures are often used in practice and additional guidance could bring more transparency and consistency on their use. In Europe, ESMA's guidelines,

applicable to all entities listed on EU markets for management reporting, address measures of financial performance, financial position or cash flows in management reporting. For the purposes of analysing the effects of IFRS 18, EFRAG acknowledges that these guidelines are applicable in Europe only. The management report is not subject to an audit comparable to an audit of financial statements and the level of assurance for a management report is limited/or only reasonable in the EU or - depending on the jurisdictional requirements outside the EU - there is no audit for the management report. EFRAG therefore assesses that IFRS 18 guidance on MPMs will enhance the relevance of information.

Scoping and rebuttable presumption

- 49 In its comment letter on the ED, EFRAG considered that not only subtotals on the face of the profit or loss but also other measures, such as indicators of financial position or ratios, should be included in the scope of these requirements. IFRS 18 introduces disclosure requirements for management-defined performance measures to provide insight into management's view of an aspect of an entity's financial performance as a whole, only. Even though IFRS 18 requirements are focused on a sub-population of performance measures, EFRAG assesses that relevance will be improved. It should be noted that IFRS 18 allows preparers to include additional information in the notes to provide the complete picture of the performance measures. However, users cannot insist on receiving this information as part of the IFRS financial statements.
- 50 EFRAG, in its assessment, considers the mixed views expressed by the preparers in relation to the relevance of the requirement. In particular, it is noted that various performance measures are already communicated in practice and for specific industries may include measures required by regulators. For regulated industries, entities may need to rebut the presumption that regulatory measures disclosed in its public communications are MPMs. The relevance of the scope of the requirements and the above-mentioned presumption were therefore questioned as to their ability to significantly improve the relevance of financial information compared to the current practice. Indeed, in practice, many of the measures disclosed by the banking industry is about solvency and liquidity which would be out of the scope of the IFRS 18 requirements.
- 51 Although users would welcome the extension of the scope to the measures outside of the profit or loss, they were overall supportive of the proposed requirements noting that the scope is consistent with the objective of the IASB's work focusing on the performance measures and helping users with their analysis of the stewardship of the company. Users also suggested that the presumption included in IFRS 18 provides rigour and discipline in the assessment and being able to rebut the presumption acknowledges the existence of circumstances in which an entity might include a measure in its public communications even though that measure does not communicate management's view of an aspect of the entity's financial performance.
- 52 As already stated in the comment letter on the ED, EFRAG considers the rebuttable presumption (as detailed in paragraph 14 of Appendix 1) being useful to focus on the most relevant information. While public communications may include many subtotals, the presumption is not intended to result in disclosure of information about a large number of subtotals. The rebuttable presumption provides an objective process for an entity to determine which measures in its public communications to disclose in its financial

statements to meet the objective of the disclosures for management-defined performance measures. Moreover, some of the issues noted by the preparers are likely to be temporary as users become more familiar with the differences in the underlying requirements (i.e., requirements of IFRS 18 related to the MPMs and regulatory requirements). The effect of a 'learning curve' is empirically evidenced, for example, by recent experience with IFRS 15 *Revenue from Contracts with Customers* effects.²

Reconciliation requirements, including NCI and income tax effects

- 53 Once a performance measure is identified as a MPM, an entity will need to comply with various disclosure requirements introduced by IFRS 18 as outlined in paragraphs 15-16 of Appendix 1. In its final comment letter and targeted outreach report, EFRAG supported that an entity is required to provide a reconciliation between the MPM and the most directly comparable subtotal as it will provide relevant information to the users. In its FCL, EFRAG questioned the cost benefit relationship related to the disclosure of the income tax effect and the effect on non-controlling interests for each item disclosed in this reconciliation, but not the relevance of the respective information for the users.
- 54 In making its assessment EFRAG considered concerns raised within the community of preparers of financial statements. Preparers considered it costly and complex to produce such information (further assessed within the Appendix 3 of this document) and questioned its relevance. They reported that this type of information - NCI effects and income taxes on each reconciling item - were not requested by the users during the investor calls or presentations. EFRAG acknowledges, in its assessment, the simplification provided by the IASB for the tax reconciliation to save costs. EFRAG also noted that the IASB considered the relevance of the information for the users and clarified that subtotals similar to gross profit (paragraph B123 of IFRS 18) are not management-defined performance measures. However, the definition of such subtotals in paragraph B123 addresses only the subtotals which depict the difference between a type of revenue and directly related expenses incurred in generating that revenue. EFRAG understands that in the banking industry in certain jurisdictions it is common to have a subtotal composed of multiple types of revenue and their related expenses, for example, "net banking income" which might be composed of interest income and expenses, fee income and expenses, insurance services income and expenses as well as other types of incomes and expenses. As such, and despite the fact that the subtotal can be directly computed on the face of the profit or loss statement with the line items directly preceding the sub-total, an entity might need to comply with MPM requirements deemed less relevant for these type of subtotals.
- 55 EFRAG notes that the user community suggested that the information required by IFRS 18 would be relevant for the calculation of adjusted earnings per share. Users needed information about the amounts of the adjustments attributable to owners of the parent and the tax effects of those adjustments to be able to adjust the earnings per share figure. Users noted that this type of calculation was currently done based on limited information they had available from management which led to a significant level of estimation uncertainty. Having the required information for each reconciling item and within the financial statements would improve both the predictive value as it relates to future adjusted earnings per share as well

² [European Accounting Associate response on IFRS 15 Post Implementation Review](#)

as confirmatory value for the previously done analysis. Users considered that they would still receive more relevant information even with the simplification provided by the IASB for the tax reconciliation.

- 56 EFRAG accordingly assesses that the reconciliation requirements will result in the provision of relevant information and therefore satisfy the relevance criterion.

Enhanced requirements for grouping of information (aggregation and disaggregation)

General

- 57 EFRAG assesses that providing enhanced requirements related to aggregation and disaggregation for all types of primary financial statements will provide more relevant information and it will complement the created additional subtotals in the statement of profit or loss. EFRAG notes that having these requirements within a single place in IFRS 18 will improve clarity and consistent application across entities.

Analysis of expenses by nature when presenting by function (including mixed presentation)

- 58 In making its assessment, EFRAG notes that preparers of financial statements questioned the relevance of the requirement noting that the presentation by function is a well-established international practice and is more relevant for certain industries. For example, the banking and insurance sectors suggested that the presentation by nature of certain items would not provide meaningful information to the users of financial statements. Insurers further highlighted that IFRS 17 is prescriptive as to how the statement of profit or loss is to be presented and requires the presentation by function as deemed most relevant for many items.
- 59 Users of financial statements indicated that presenting operating expenses classified by function can provide useful information but can also result in a loss of useful information. Classifying expenses by function aggregates various expense items by nature that respond differently to changes in the economic environment, making it difficult for users of financial statements to forecast future operating expenses. Information about the nature of expenses makes it easier to forecast future operating expenses and also enables an understanding of links with the information presented in the statement of cash flows.
- 60 Users also noted that the cost of sales is not defined. It is presented differently by preparers, which implies that additional information should be provided.
- 61 In its intention to find the right balance regarding additional disclosures about the nature of the expenses, IFRS 18 limited the requirement to five types of expenses based on the feedback from the users of financial statements. Indeed, users of financial statements stated that information about the amounts of employee benefits, depreciation and amortisation included in each line item in the operating category was generally useful, regardless of the industry in which an entity operates. Some users of financial statements also stated that information about the amounts of impairments (or reversals) and write-down of inventories (or reversals) included in each line item in the operating category was useful (for example, because of their non-cash nature).
- 62 EFRAG assesses that these disclosures will provide useful information to users about the expenses by nature. Although the simplification to mitigate costs makes the information less useful than the IASB's proposal in the ED, the information remains helpful for users and more relevant than the current one provided under IAS 1.

Aggregation and disaggregation principles

- 63 EFRAG acknowledges that the concept of a useful structured summary and the aggregation and disaggregation requirements of the principle-based standard are intended to focus users on the relevant information. IFRS 18 stipulates that the role of primary financial statements is to provide useful structured summaries of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows and to explain better the role of the notes of financial statements. EFRAG notes that entities have to apply judgement when establishing an understandable overview of the entity's recognised assets, liabilities, equity, income, expenses and cash flows and identifying items or areas about which users of financial statements may wish to seek additional information in the notes. To exercise judgement on how to structure information in a useful way, is more likely to lead to the provision of relevant information. Nevertheless, applying IFRS 18 aggregation and disaggregation principles, and specifically the concept of a useful structured summary, can lead to different results for similar types of preparers. Good communication between users and preparers is important for an appropriate result.
- 64 IFRS 18 and other IFRS Accounting Standards set out requirements for an entity to present line items in the statement(s) of financial performance and in the statement of financial position. The IASB concluded that an entity need not present such line items in a primary financial statement if doing so is not necessary for the statement to provide a useful structured summary. This is the case even when IFRS Accounting Standards describe those line items as required or minimum requirements because there may be situations where presenting those line items would not result in a primary financial statement providing a useful structured summary.
- 65 In its assessment, EFRAG notes that if an entity does not present a line item required by IFRS Accounting Standards as it does not support a useful structured summary, the entity is required to disclose the item in the notes, if it is material. IFRS 18 also specifies that an entity presents additional subtotals and line items if such presentations are necessary for a primary financial statement to provide a useful structured summary. EFRAG observes also that the concept of a useful structured summary cannot be used to justify a different classification in the statement of profit or loss.
- 66 Both preparers and users of financial statements welcomed the related provisions of IFRS 18 noting that the relevance of the financial information was improved because:
- (a) the concept of a 'useful structured summary' allowed users to focus on the important and relevant information on the face of financial statements with additional information included within the notes; and
 - (b) additional subtotals that an entity would be allowed (and would be required) to present would contribute to meeting the objectives of the financial statements while enabling an entity to present its statement of financial performance using the structure which best reflects its activity (notwithstanding defined categories and subtotals).
- 67 EFRAG noted in its assessment that some users expressed certain concerns on the possibility to have a very condensed presentation on the face of the financial statements, which is expected to be compensated by additional disclosures in the notes. If an entity does not

present a line item required by IFRS Accounting Standards, but only discloses it, the visibility of the information is changed. The information then becomes part of a large amount of information in the notes and is more difficult to identify. Users suggested that the practical application of the concept of a 'useful structured summary', and whether it had achieved its objectives, should be monitored and further evaluated as part of the post-implementation review ('PIR') on IFRS 18.

Other changes and transition

Restatement of any comparative period

- 68 The IASB decided to require retrospective application of IFRS 18. It is expected that the new requirements will result in extensive changes to the statement of profit or loss. EFRAG assesses that under this approach users would receive relevant information. If comparative information were not restated, there would be a risk that the information included in the statement of profit or loss could be misleading. It is worth to mention that, because the requirements affect presentation and disclosure only, an entity will not need to consider periods before the start of the earliest comparative period.
- 69 As such, this transition requirement contributes to both the confirmatory value of information as well as the predictive value as it gives the correct basis for the analysis of any subsequent periods.

Fair value option under IAS 28 paragraph 18

- 70 As mentioned in paragraphs 35-37 above, the IASB decided to provide transitional requirements in IFRS 18 to allow an eligible entity to elect to measure an investment in an associate or joint venture at fair value through profit or loss (as specified in paragraph 18 of IAS 28) when it first applies IFRS 18.
- 71 The IASB provided the election in IAS 28 because fair value measurement provides more useful information to users of the financial statements of those entities than would application of the equity method (paragraph BC12 of the Basis for Conclusions on IAS 28). EFRAG notes that some eligible entities might have chosen not to apply the election on initial recognition of an investment before they were aware of the effects of IFRS 18. If that is the case, the IASB concluded that an entity is permitted to apply that election on initial application of IFRS 18.
- 72 As discussed above in relation to the presentation of income and expenses from equity-accounted investments, this option might allow certain entities (for example insurers with specified main business activity) to better align the presentation of income and expenses from certain types of investments with their business model.
- 73 Users expressed general support for this transition provision noting that the equity-accounted investments were usually analysed separately and that the fair value information was deemed most relevant for the user analysis. Any resulting volatility in the statement of profit or loss would not be deemed to be a factor which could impact the relevance of the information.
- 74 Preparers of financial statements, specifically banks and insurers, noted that the option allowed by paragraph 18 of IAS 28 is subject to the interpretation and its application is determined by the structure of the holding or the features of the insurance contract rather than the business model of the entity itself. For instance, for the insurance entities it is a

common practice to have equity-accounted investments as part of the specific business models, which may include a direct link between investments in the equity-accounted associates or joint ventures to insurance liabilities forming part of the underwriting result included within the operating profit. Such contracts are generally accounted for under the variable fee approach (VFA). The same question about the application of IAS 28.18 is raised for other types of contracts, for example, property and casualty contracts (P&C), accounted for under the general model or the premium allocation approach (PAA). Whereas there will be a direct link between the insurance liability and its servicing asset under the VFA model, there will be no direct link for the contracts accounted for under the general model or PAA. However, the investments in associates or joint ventures will still serve the same purpose – i.e. to provide income to the insurance entity so that it can service its insurance liabilities or will be held for solvency purposes. As such, EFRAG notes the applicability of this option is limited and its relevance for the respective industries will depend on the understanding of paragraph 18 of IAS 28. Similarly, EFRAG notes that the application of the paragraph 64(a) and B58 of IFRS 18 would have benefitted from clarifying that the required classification from financing to operating category of the income and expenses from liabilities arising from investment contracts recognised applying IFRS 9 applies not only to those with participation features but also to those without participation features.

Overall conclusion on relevance

- 75 EFRAG's analysis focused on the main features of IFRS 18 which were deemed significant for the assessment of the relevance criterion based on the feedback from stakeholders. EFRAG notes that certain specific industries (banking and insurance industries) questioned the relevance of some provisions of IFRS 18 but acknowledged the efforts done by the IASB to mitigate the concerns raised and to find the balance between the users' needs and preparers' concerns.
- 76 When focusing on the assessment from an industry-neutral point of view, EFRAG notes that the provisions of IFRS 18 largely improve the relevance of the financial information compared to the current practices under IAS 1.

EFRAG's overall assessment is that IFRS 18 would result in the provision of relevant information and therefore satisfy the relevance criterion.

Reliability

- 77 EFRAG also considered the reliability of the information that will be provided by applying IFRS 18. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 78 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.
- 79 Overall, EFRAG received positive feedback that IFRS 18 provides reliable information. In particular:
- (a) freedom from material error will be mainly ensured by:

- (i) clearly defining the financing and investing category for presentation – supported by illustrative examples for the classification and setting up of the operating category as a default category; and
 - (ii) MPMs to be disclosed in the financial statements in a single note and therefore subjected to an audit which, although with potential differences at each jurisdiction level, provides a higher level of assurance of such measures and information compared to current requirements.
- (b) unbiased and faithful representation of financial information will be supported by:
- (i) categories and new required subtotals clearly defined in IFRS 18 to improve the structure of the profit or loss statement and to ensure comparability and transparency; and
 - (ii) the guidance for aggregating and disaggregating information which have been enhanced compared to that included in IAS 1.

80 EFRAG believes that providing the information in the primary financial statements or in the notes would not be excessively complex to collect.

81 In its assessment of reliability, EFRAG also considered the following key topics for which stakeholders expressed some concerns or provided mixed views and arguments, which overall do not prevent IFRS 18 from providing reliable information.

Defined categories and required sub-totals

Classification of income and expenses arising from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method

82 As noted in the relevance session of this endorsement advice (see paragraphs 20-38 above), stakeholders specifically from banking and insurance industry raised a concern that the presentation requirements related to the equity-accounted investments are driven by the measurement method, rather than the underlying business model, and therefore questioned the resulting faithful representation.

83 EFRAG was made aware that it is a common practice for banks to enter into joint-ventures or similar types of at equity-accounted investments to establish a shared-service company providing operating services for a pool of banks, for example. In this case, presentation of related income and expenses outside of the operating category might impair the faithful presentation of their business model and the completeness of their operating results. Insurers raised a similar concern in relation to the investments which are linked to insurance liabilities forming part of the underwriting result included within the operating profit. In such a case, the faithful representation of at equity-accounted investments and completeness of the operating result is also questioned by insurance entities.

84 On the other hand, as already mentioned in paragraph 24 above, the user community emphasised that including post-tax results from equity-accounted investments within the pre-tax operating results and presenting together the results from controlled activities with the results of uncontrolled activities would jeopardise the faithful representation criterion. During the ED-consultation phase, it was even rejected to have a separate line item for those type of investments as the concept of integral and non-integral was considered being subjective and judgemental. It was further noted that, in practice, this information might be

communicated to investors using a separate line item below the operating profit and/or as part of the so-called alternative performance measures or non-GAAP measures or MPMs if fulfilling the definition under IFRS 18. As such, in the users' view, the requirements of IFRS 18 would improve the reliability criterion across industries and for the entities within an industry.

Management-defined performance measures

- 85 IFRS 18 requirements on management-defined performance measures would result in all those measures and related disclosures being included in a single note within the financial statements and thus being subject to audit procedures. From this point of view, the requirements of IFRS 18 improve the reliability of information related to the MPMs ensuring that the related presentation and disclosures are free from material error and bias.
- 86 IFRS 18 requirements based on the rebuttable presumption that all income and expense subtotals communicated by management are MPMs unless proved otherwise would further positively impact the completeness aspect of the reliability criterion.
- 87 However, some stakeholders noted that the reliability of the tax effects on reconciling items underlying the MPM adjustments was questionable despite the audit of this information. In particular, they questioned whether the fact that companies were allowed to apply a simplified approach based on the statutory tax rate to calculate the tax effect on each reconciling items might impair the faithful representation of such effects. Overall, EFRAG recognises the shortcomings of the simplified approach and assesses that the information provided, in conjunction with disclosing the calculation method applied, will be reliable.

Enhanced requirements for grouping of information

Analysis of expenses by nature when presenting by function

- 88 As noted in paragraph 26 of Appendix 1, one of the requirements brought by IFRS 18 is to disclose in a single note the total amount of the five specified expenses included in each operating category function-based line item. However, to better balance costs and benefits considerations, the IASB allowed an entity to present or disclose the cost amounts – i.e. including the amounts that have been recognised as part of the carrying amount of an asset – rather than the amounts recognised as an expense for the period. In such cases, an entity is required to provide a qualitative explanation if part of the amount disclosed has been included in the carrying amount of assets (including identifying which assets) to help users of financial statements understand the disclosed information.
- 89 Some stakeholders questioned the reliability of the information such presented as it might reduce users' capability to reconcile and understand such cost amounts. However, a majority of the users of financial statements emphasised that the request for this type of information was motivated by their need to have more detailed information for their cash flow analysis and projections. Users stated that both expenses and the total cost could be a good proxy for the associated cash-out, which is the information they ultimately want to obtain and can work with both options in their cash flow models as long as an entity specifies if the disclosures are based on the expense-only amounts or total cost amounts. EFRAG recognises the shortcomings of the simplified approach and assesses that the information provided delivers helpful information to the users of financial statements when prepared over time on a consistent basis.

Concept of 'useful structured summary'

- 90 The concept of a 'useful structured summary' already evoked above in the section relating to the relevance criterion is also considered for the assessment of the criterion of reliability. Some users addressed that the possibility for the entities to condense information on the face of the financial statements if such a presentation is deemed to satisfy the useful structure summary concept bears a risk to the faithful and complete presentation of any primary financial statements.
- 91 EFRAG recognised that the entities' assessment of the useful structured summary concept is judgemental and may also be prone to management's bias. However, IFRS 18 requirements and provisions outlining the roles of financial statements and accompanying notes, including enhanced guidance on aggregation and disaggregation of information, are expected to help the stakeholders to properly assess the concept of useful structured summary leading to a faithful and complete representation of an entity's activities. Considering the intention to focus on important information and that some information only loses prominence when disclosed in the notes instead of the primary financial statements, EFRAG assesses that reliability criterion is not impaired.

Overall conclusion on reliability

- 92 Based on the analysis performed for the items specifically addressed to EFRAG, EFRAG still concludes that the criterion of reliability is overall improved by the IFRS 18 provisions.
- 93 EFRAG takes note of the concerns about the reliability of information related to certain aspects of IFRS 18 requirements as outlined above, namely the impact on faithful representation, completeness of information and potential error or bias of management related to the results of equity-accounted investments for certain industries or specific business models, tax impacts on the MPM adjustments, analysis of the expenses by nature and the concept of a useful structure summary.

Overall, these concerns are deemed to be mitigated by other provisions included within IFRS 18 (i.e. disclosing how the income tax effect on MPMs is calculated and adding additional subtotals in the statement of profit or loss) and outweighed by expected positive effects on the reliability criterion, especially when compared to current IAS 1 requirements.

Comparability

- 94 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 95 EFRAG has considered whether IFRS 18 results in transactions that are:
- (a) economically similar being accounted for differently; or
 - (b) transactions that are economically different being accounted for as if they are similar.
- 96 One of the key reasons for issuing IFRS 18 is that users stated that existing diversity in practice in presenting and disclosing financial information made it difficult to analyse and compare entities' performance, both between different companies and between different reporting periods for the same company. Feedback received during the ED-consultation

phase, the IASB redeliberation phase and the field-testing confirmed that IFRS 18 improves financial information comparability, especially among entities operating in the same industry.

97 Based on the criteria enumerated in paragraph 11, EFRAG considers that the main factors to be assessed in relation to IFRS 18, as far as comparability is concerned, relate to:

- (a) whether the requirements in IFRS 18 will be interpreted in a consistent manner to reduce existing diversity in practice;
- (b) whether IFRS 18 includes accounting policy choices that might impair comparability; and
- (c) the transition requirements.

Whether the requirements in IFRS 18 will be interpreted in a consistent manner to reduce existing diversity in practice?

98 In making its assessment EFRAG notes that, overall, comparability will increase considering the following changes introduced by IFRS 18:

- (a) The introduction of new defined categories – especially investing and financing category - and subtotals in the statement of profit or loss (see paragraphs 5-9 of Appendix 1 for further details);
- (b) The introduction of specific presentation and classification requirements for entities with specified main business activities (see paragraph 10 of Appendix 1);
- (c) Reconciliation and disclosure requirements about MPMs (see paragraphs 15-16 of Appendix 1 for further details), including disclosure about any change compared to the previous year as well as the need to restate comparative measures;
- (d) Additional guidance and clarifications to the classification of specific items that are prone to diverge in practice, such as income and expenses arising from derivatives, hybrid contracts and cash and cash equivalents and foreign exchange gain or loss;
- (e) Enhanced disclosures about the five specified operating expenses in the notes when an entity presents one or more line items comprising expenses classified by function in the operating category (see paragraph 26 of Appendix 1 for further details).
- (f) Presentation, in the statement of financial position, of a separate line item for goodwill;
- (g) Using the operating profit as the single starting point for the indirect method of reporting cash flows from operating activities; and
- (h) The removal of the presentation alternatives for cash flows related to interest and dividends paid and received previously provided by IAS 7 (see paragraph 28 of Appendix I for further details). The user community supported such a “single category” approach as it would reduce the existing diversity in practice in this regard.

99 Stakeholders generally supported the IASB's efforts to increase the comparability especially of the statement of profit or loss and within entities that have the same main business

activities. Users of financial statements welcomed the increased transparency on MPMs and operating expenses as it would provide more detailed information for their analysis.

- 100 In assessing the above, EFRAG also considered points in addition to the positive developments for comparability mentioned in paragraph 98 above. In its assessment, EFRAG considered that comparability might be limited in some areas because of the judgement required by IFRS 18 mainly to:
- (a) assess whether investing in assets or providing financing to customers is a main business activity of the entity. This impacts the classification requirements in the operating, investing or financing category and might be particularly complex for conglomerates.
 - (b) assess how the requirements of IFRS 18 apply for certain specific industries. Financial institutions, notably financial conglomerates, observed diversity in practice among European jurisdictions in how their statement of profit and loss is prepared and presented (this divergence is observed even though IFRS 17 was implemented in 2023). IFRS 18 does not seem to have sufficient guidance to mitigate such a diversity in practice;
 - (c) assess whether subtotal of income and expenses communicates to users of financial statements management's view of an aspect of the financial performance of the entity. This impacts the identification of an MPM; and
 - (d) determine the level of aggregation and disaggregation of the information in the primary financial statements and in the notes, including whether to present additional line items or subtotals.
- 101 Making judgements is inherent in a principle-based standard and may be necessary to achieve comparability rather than uniformity. Moreover, EFRAG notes that IFRS 18 provides additional or enhanced guidance compared to IAS 1 to support entities in exercising their judgement in the areas listed above.
- 102 EFRAG also observes that IFRS 18 requires all entities, independently of their main business activity, to classify specific income and expenses in the investing – such as those arising from equity-accounted investments - and financing category – such as interest on lease liabilities and on employee benefits plans.
- 103 As already mentioned in paragraphs 20-38 above, some representatives of both financial institutions and general corporates expressed concerns about such a classification as it might not support comparability among:
- (a) similar investments classified differently based on the measurement method applied (i.e. equity method, at cost or at fair value through profit or loss);
 - (b) lease transactions on, for example, fleet vehicles or other items similar to other remuneration forms accounted for differently from the regular employee benefits classified within the operating costs.
- 104 In its assessment, EFRAG recognises that the user community supported these IFRS 18 requirements highlighting that comparability within and across sectors is improved classifying these income and expenses in the investing (please refer to the arguments summarised in paragraph 24 above) or financing category for all the entities.

Whether IFRS 18 includes accounting policy choices that might impair comparability

- 105 IFRS 18 provides the accounting policy choice to classify income and expenses arising from liabilities that arise from transactions that involve only the raising of finance not related to the provision of financing to customers (see paragraph 10(b)(ii) of Appendix 1 for further details). In addition to that, IFRS 18 requires entities that do not invest in financial assets but provide financing to their customers to classify the income and expenses from cash and cash equivalents that do not relate to providing financing to customers in the operating or in the investing category by applying an accounting policy choice.
- 106 In its assessment, EFRAG notes that despite such limited accounting policy choices, IFRS 18 will ensure comparability between entities with the same main business activities.

The transition requirements

- 107 Notwithstanding the aforementioned expressed concern about the application of the fair value option under IAS 28 by a few eligible entities (see paragraphs 70-74 above), EFRAG assesses that the transition requirements in IFRS 18 ensure comparability between the comparative period immediately preceding the period in which IFRS 18 is first applied and the first year of its application. Indeed, at transition to IFRS 18, companies shall disclose, both in their annual and interim financial reporting according with IAS 34, a reconciliation for each line item in the statement of profit or loss between (a) the restated amounts presented applying IFRS 18 and (b) the amounts previously presented applying IAS 1.

Overall conclusion on comparability

- 108 IFRS 18 requires the exercise of judgement in a number of areas. Judgements are inevitable in principles-based standards and may be necessary in order to achieve comparability rather than uniformity (which in some instances disregards the substance of a transaction or event). However, EFRAG considers that the level of judgement required by IFRS 18 is not so exceptional that it would generally result in information that is not comparable.
- 109 EFRAG's overall assessment is that the requirements in IFRS 18 will result in comparable information, both in the primary financial statements and in the notes. Limitations to comparability that have been identified are outweighed by the general improvement of comparability in the statement of profit or loss through defining categories and subtotals to specify the structure of the income statement, the integration of management performance measures in financial information and requiring disclosures in a single note, the improved guidance for grouping of information and the introduction of a uniform starting point for the cash flow reporting when using the indirect method and removing the presentation alternatives for interest and dividends. In this regard, EFRAG refers to relevance of the resulting information as further discussed in the dedicated section (see paragraphs 15-0 above).

Understandability

- 110 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence.

- 111 Although there are several aspects related to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.
- 112 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of IFRS 18 is understandable, is whether that information will be unduly complex.

Defined categories and required sub-totals

- 113 EFRAG assesses that the classification of income and expenses in five defined categories: operating, investing, financing, income tax and discontinued operations is partly challenging (like for intercompany transactions) but not unduly complex.
- 114 Specifically, as noted in paragraphs 20-38 above, presentation of the results of equity-accounted investments within the investing category separately from the related operating insurance costs may not enhance the understandability of the financial statements for the insurance industry. As a clear structure of the statement of financial performance and comparable presentation across entities, including the presentation of results of equity-accounted investments within the investing category, were deemed beneficial for the understandability of the financial statements by the user community, EFRAG assesses that the understandability criterion is not impaired.
- 115 Similar considerations were expressed by preparers and users for the classification of interest expenses on liabilities other than those involving the raising of finance, as outlined in paragraphs 43-47 of the section discussing the relevance criterion.
- 116 In addition, some stakeholders representing the financial sector expressed concerns that understandability may be impaired in the context of financial conglomerates, as outlined in paragraph 103 of the section discussing the comparability criterion.
- 117 In terms of the complexity of the requirements, preparers highlighted that the assessment of the entity's main business activity and presentation requirements specific for certain specified main business activities may be complex to combine with the segment reporting requirements of IFRS 8, especially when considering different reporting entity levels. It is however expected that the concept of a useful structure summary should further guide the entities to structure the presentation of performance of their various activities in the most meaningful and understandable way.

Management-defined performance measures (MPMs)

- 118 The IASB developed the disclosure requirements for MPMs to provide insight into management's view of an aspect of entity's financial performance as a whole, which improves the understandability of how the business is managed, how management views the entity's financial performance and the persistence of financial performance.
- 119 From a practical perspective, preparers noted some challenges. The assessment related to the rebuttable presumption includes considering whether an entity is 'communicating a subtotal without prominence'. Such an assessment is a matter of judgement. Further, there might be some learning curve necessary for users to understand the differences in scope between the IFRS 18 requirements and ESMA's Alternative Performance Measures guidelines. Moreover, the reconciliations were deemed complex to prepare in an understandable way in practice. EFRAG recognises that the rebuttable presumption was

introduced as a relief for preparers to reduce the need for disclosures. However, the user community deemed that the requirements introduced by IFRS 18 improved the understandability of the information related to MPMs as, among the others, IFRS 18 requires entities to provide (and disclose how the amounts have been determined), for each reconciling item, additional information, such as income tax and non-controlling interest effects, which are considered very helpful for their analyses.

Enhanced requirements for grouping of information (aggregation and disaggregation)

- 120 The guidance provided by IFRS 18 in relation to the roles of primary statements and the notes, and the principles of aggregation and disaggregation of information, is expected to improve the understandability of the financial information from both preparers' and users' views. Indeed, the IASB considered the qualitative characteristic of 'understandability' when developing the proposals, noting that an entity could clutter its primary financial statements by presenting many income and expense items as line items, making it difficult for users of financial statements to obtain and understand the overview of the entity's income and expenses. As such, using the guidance outlined in IFRS 18, an entity will determine what information will provide an understandable overview considering its specific facts and circumstances.
- 121 There were some concerns expressed mainly by users in relation to the simplified approach to provide the analysis of expenses by nature when presenting by function, as discussed in paragraphs 88-89 above. Indeed, if an entity discloses in the notes the total amount of costs rather than expenses, the reconciliation to the amounts presented in the statement of profit or loss may be challenging to understand. Users acknowledged the difficulties and costs for preparers presenting by function to disclose expenses by nature. Many of the users then considered that for their analysis and cash flow forecast the difference between the total cost and the expense recorded within the statement of profit or loss will not lead to significant impacts or issues, but the additional information thus provided will improve the understandability as a whole.

Other changes and transition

- 122 The transition requirements brought about by IFRS 18 are considered to improve the understandability of the financial information presented as it will be compiled in a homogeneous way for all periods presented.
- 123 IFRS 18 introduces categories in the statement of profit or loss with a similar label as used in the cash flow statement without those categories being aligned in terms of contents. This similar labelling without the intention to align both statements raised concerns as to their impact on the understandability of the financial statements. Both preparers and users noted that there are inconsistencies between the categories, even though the same titles are attributed to both – operating, investing and financing. Use of the same titles may lead users and preparers of financial statements to believe that the same items are affecting the same categories in these two primary financial statements and might lead to complexity in understanding the information presented. In its assessment, EFRAG recognises that the IASB already started a research project 'Statement of Cash Flows and Related Matters' where the respective concerns might be addressed.

Overall conclusion on understandability

- 124 In EFRAG's assessment, IFRS 18 improves the understandability of the financial statements in their entirety by improving the characteristics of relevance, reliability and comparability. It leads to a better structure of primary financial statements aiming to present a useful and understandable overview of an entity's financial performance, position and cash flows. It also enhances the quality of information disclosed within the notes of financial statements, underlying the role of the notes in enabling users of financial statements to understand the line items presented within the primary financial statements.
- 125 Although some requirements of IFRS 18 may lead to a certain complexity in understanding, EFRAG believes that it will be alleviated when IFRS 18 is fully implemented, and all stakeholders are accustomed to its requirements and provisions.

Prudence

- 126 For the purpose of this endorsement advice, prudence is defined as caution in conditions of uncertainty. In some circumstances, prudence requires asymmetry in recognition such that assets or income are not overstated, and liabilities or expenses are not understated.
- 127 IFRS 18 does not affect existing (and does not introduce new) recognition and measurement³ requirements in IFRS Accounting Standards. EFRAG has therefore concluded that it raises no issues in relation to prudence as defined above.

True and Fair View Principle

- 128 A Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:
- (a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and
 - (b) requires appropriate disclosures that provide a complete and reliable depiction of an entity's assets, liabilities, financial position, profit or loss and cash flows.
- 129 EFRAG assessed that, on a stand-alone basis, IFRS 18 provides relevant, reliable, comparable and understandable information and does not impact prudent accounting. That is, the application of IFRS 18 provides information that is useful for decision-making and for assessing the stewardship of management.
- 130 EFRAG also concluded that IFRS 18 requires the appropriate disclosures that are necessary to provide a complete and reliable depiction of an entity's recognised assets, liabilities, equity, income, expenses and cash flows.
- 131 EFRAG also assessed that IFRS 18 does not create any negative interactions with other IFRS Accounting Standards as it only introduces presentation and disclosure requirements to improve the relevance of the information. Accordingly, EFRAG assessed that IFRS 18 does not lead to unavoidable distortions or significant omissions and therefore it does not impede financial statements from providing a true and fair view. As a result, EFRAG concludes that the application of IFRS 18 would not lead to information that would be contrary to the true and fair view principle.

Conclusion

- 132 Accordingly, for the reasons set out above, EFRAG's assessment is that IFRS 18 meets the technical requirements for EU endorsement as set out in the IAS Regulation.

³ IFRS 18 provides only a voluntary change of measurement method in accordance with IAS 28.18 for eligible entities.

Appendix 3: Assessing whether IFRS 18 is conducive to the European public good

Introduction

- 1 EFRAG considered whether it would be conducive to the European public good to endorse IFRS 18. In addition to its assessment included in Appendix 2, EFRAG has considered a number of issues in order to identify any potential negative effects for the European economy upon the application of IFRS 18. In doing this, EFRAG considered:
 - (a) whether IFRS 18 improves financial reporting. This requires a comparison of IFRS 18 with the existing requirements and how it/they fit into IFRS Accounting Standards as a whole;
 - (b) the costs and benefits associated with IFRS 18; and
 - (a) whether IFRS 18 could have an adverse effect on the European economy, including financial stability and economic growth.
- 2 These assessments allow EFRAG to draw a conclusion as to whether IFRS 18 is likely to be conducive to the European public good. If the assessment concludes there is a net benefit, IFRS 18 will be conducive to the objectives of the IAS Regulation.

EFRAG's evaluation of whether IFRS 18 is likely to improve the quality of financial reporting

- 3 The general purpose of financial reporting is to provide financial information about the reporting entity that is useful to existing and potential investors, lenders and other creditors in making decisions relating to providing resources to the entity. The IASB's conceptual framework for financial reporting states that the fundamental qualitative characteristics of useful financial information are relevance and faithful representation (complete, neutral and free from error). Comparability, verifiability, timeliness and understandability are qualitative characteristics that enhance the usefulness of information that both is relevant and provides a faithful representation of what it purports to represent.
- 4 In order to assess whether IFRS 18 is likely to improve the quality of financial reporting, EFRAG has focused its assessment on the areas it considers most significant in the change from IAS 1 to IFRS 18. EFRAG's assessment also considers how these changes affect different industries.
- 5 Paragraph 1 of Appendix 1 of this document outlines the new requirements of IFRS 18 and highlights which issues identified in the current IAS 1 are addressed by these new requirements. It covers as well the reasons for the necessary changes.
- 6 Specifically, IFRS 18 introduces defined categories and subtotals in the statement of profit or loss to fill in the void left by IAS 1 as to the presentation of the statement of financial performance resulting in significant diversity in practice. To illustrate the situation, the IASB's study conducted at the onset of the project revealed that out of 100 companies analysed more than 60% used in their presentation a measure labelled 'operating profit'; however, there were at least nine different definitions of that measure. In general, the lack of clear guidance in IAS 1 leading to diversity in presentation of information within the statement of profit or loss and variability in calculation of subtotals made comparability and understandability of the financial information challenging to stakeholders. The improved

structure and new subtotals will give investors a consistent starting point for analysing companies' performance and will make it easier to compare companies.

- 7 At the same time, cognisant of the specificities of certain industries, IFRS 18 aims to find a balance between stricter requirements, compared to IAS 1, and flexibility for management to present relevant information in a usefully structured way. Therefore, entities with specified business activities benefit from additional guidance incorporated in the Standard.
- 8 Further, IFRS 18 tightens the requirements related to the MPMs, as outlined in the Appendix 1. Indeed, these measures are typically customised subtotals of income and expenses that an entity uses to convey management's alternative view of its performance. To address stakeholders' concerns about the lack of transparency on how the alternative performance measures are calculated and why these specific measures are used, IFRS 18 requires the measures that fulfil the criteria of being an MPM be included within a single note to the financial statements and be accompanied by a specified set of disclosures and reconciliations. The new requirements improve the discipline and transparency of management-defined performance measures and make them subject to audit, improving reliability.
- 9 Another issue raised by stakeholders under the current IAS 1 guidance is that companies did not provide enough detailed information or that information was obscured and hard to find or understand. Two classic bad practices noted were (a) lack of details or breakdown of operating expenses and (b) grouping of significant and numerous expenses or other items as 'other'. Appendix 1 provides an overview of the new requirements introduced by IFRS 18 or clarifications of already existing requirements in IAS 1 which were not applied consistently. Notably, IFRS 18 distinguishes between presenting a useful structured summary and disclosing subsequent material information in the notes to supplement the summary numbers in the notes. It also specifies the roles of the primary financial statements and the notes and provides additional guidance on aggregation and disaggregation of information. The changes are expected to provide more detailed and useful information, improving its relevance and understandability.
- 10 Appendix 2 of this document focuses on the assessment of the technical criteria of the new requirements such as relevance, reliability (including freedom from material error and bias, faithful representation and completeness), comparability, understandability and true and fair view.
- 11 As it appears from Appendix 2, EFRAG assessed that the requirements of IFRS 18 are either improving or are not impacting the qualitative characteristics of financial information compared to IAS 1. The timeliness criterion is not subject to the technical assessment as it is not impacted by IFRS Accounting Standards.
- 12 Based on the reasons given above and following the assessment documented within Appendix 2, EFRAG believes that IFRS 18 is an improvement over IAS 1 and will lead to higher quality financial reporting.

EFRAG's analysis of the costs and benefits of IFRS 18

- 13 EFRAG has considered whether – and if so, to what extent – the implementation of IFRS 18 would result in incremental costs for preparers and users and whether those costs are likely to be exceeded by the benefits stemming from its adoption. Therefore, the approach that

EFRAG adopted has been to carry out a detailed impact assessment of the likely costs and benefits of implementing IFRS 18 in the EU, to consult on the results of this assessment and to finalise it in light of the comments received.

General approach and scope

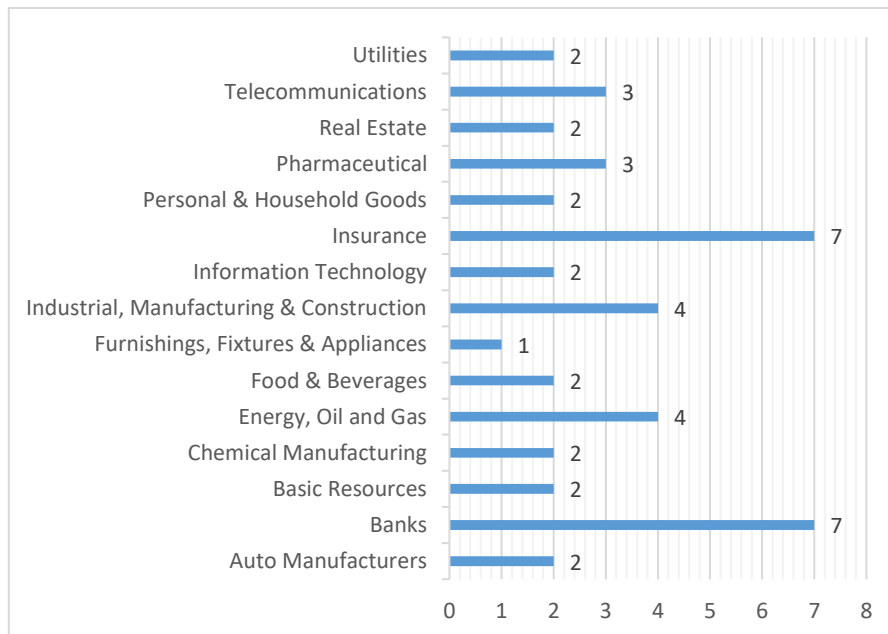
- 14 EFRAG's evaluation of the costs and benefits related to the implementation and on-going use of IFRS 18 is based on a desktop analysis of the current practices and various other outreach activities explained below.
- 15 To understand the costs related to the adoption and use of IFRS 18, EFRAG conducted a desktop analysis which involved analysing the 2023 annual reports and associated press releases (for the assessment related to the management-defined performance measures) of 45 European listed entities. The objective of this desktop analysis is to understand current practices on presentation and disclosures and how IFRS 18 requirements will impact those practices. To better assess the impacts, EFRAG considered the feedback received during its [field-test](#) in 2020 and during the [targeted outreach](#) in 2022. Further, EFRAG's evaluation integrated the feedback collected from EFRAG's technical expert group (EFRAG FR TEG), various EFRAG FR TEG working groups and public educational sessions conducted in June 2024 dedicated to [corporates](#) and [financial institutions](#).
- 16 The costs thus identified are confronted with the expected benefits stemming from the new requirements. To identify expected benefits, EFRAG is basing its assessment on various outreaches conducted with users of financial statements and other stakeholders referenced in the paragraph above – namely, through the field-tests, targeted outreaches, technical expert group and working groups' feedback as well as public educational sessions conducted in June 2024.
- 17 The assessment is structured in four parts:
 - (a) statement of financial performance
 - (i) categories
 - (ii) subtotals
 - (iii) aggregation and disaggregation of line items
 - (iv) results of associates and joint ventures accounted for using the equity method
 - (v) presentation of expenses by nature and by function
 - (vi) unusual items
 - (b) statement of financial position
 - (i) goodwill
 - (ii) aggregation and disaggregation of line items
 - (c) statement of cash flows
 - (i) indirect method of presentation
 - (ii) aggregation and disaggregation of line items
 - (d) performance measures.

- 18 Where relevant, the analysis is provided separately for corporates and financial institutions, as the structure and content of the financial statements between these two types of entities may vary significantly. For the purposes of this analysis, the financial institutions are composed of banks, insurance companies and financial conglomerates. Corporates include, among others, non-financial conglomerates.
- 19 In its 2020 Draft Comment Letter (DCL), EFRAG included the results of a similar analysis of the 2018 financial statements of 40 European listed entities with the objective of understanding how the IASB's tentative decisions would have impacted the presentation of financial statements. This impact assessment follows a similar approach to the previous analysis in regard to the criteria used for selecting the sample as well as the scope of the analysis.

Sample

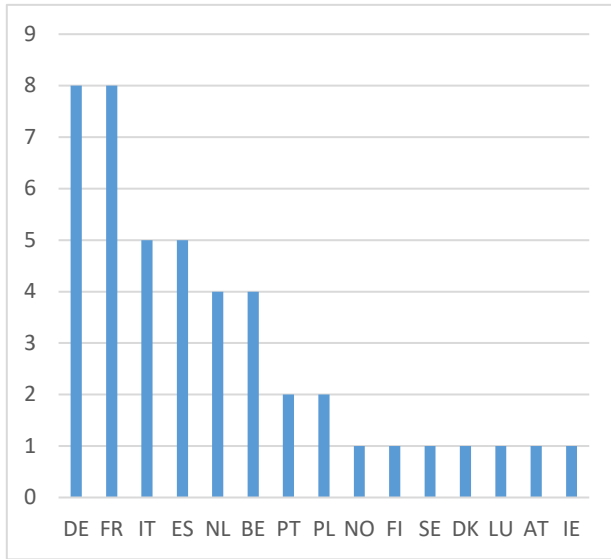
- 20 The sample consists of 45 European listed entities included in the S&P Europe 350 Index and STOXX 600 applying IFRS Accounting Standards. It should be noted that the sample of 45 listed entities is not statistically representative of the European listed entities.
- 21 The entities included in the sample have been selected to represent a wide range of industries, countries and entity size (with the market capitalisation used as a proxy for size criterion). Compared to the 2020 analysis included in EFRAG's DCL, the sample has been enlarged to include 5 additional financial institutions (banks and insurance companies) to better understand the impact of the IFRS 18 requirements focused on entities with financing and investing activities. Further, analysis presented in EFRAG's DCL included four entities domiciliated in the UK, which were replaced in the current analysis by entities domiciliated in EU or EEA jurisdictions. Thus, the sample differs from the sample taken in 2020. It contains to a large extent the same entities as in 2020.
- 22 EFRAG has analysed the financial statements of entities from 15 different industries.

Figure 1: Industry



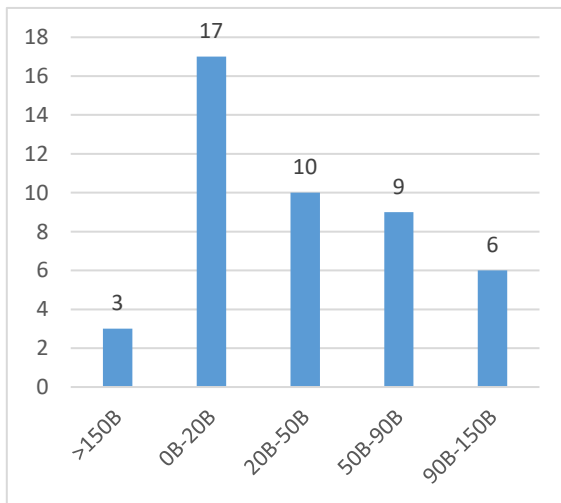
23 The sample also consists of entities incorporated in 15 different EU countries.

Figure 2: Country of incorporation



24 Finally, the sample selection focused on entities with different sizes in terms of market capitalisation to avoid focusing only on the biggest European listed entities.

Figure 3: Market capitalisation range



Statement of financial performance

Categories

25 IFRS 18 sets out new requirements in relation to the structure and content of the financial statements. The main changes relate to presentation in the statement of profit or loss. IFRS 18 requires the classification of income and expenses in five defined categories: operating, investing, financing, income tax and discontinued operations. The analysis below focuses on the three new categories – operating, investing and financing. Separate presentation of income tax and discontinued operations was already required by IAS 1 although not as a defined category. Presentation of recently introduced related subtotals is addressed in the next section.

Corporates

26 In general, the analysis revealed that the structure and content of the financial statements of corporates varies significantly, with some entities presenting information about operating, financing and investing activities separately while others were simply presenting all the above activities without subtotals in the statement of financial performance and therefore as part of profit before tax. In particular, the following categories were used by entities when presenting their statement of financial performance:

- (a) operating category: 61%
- (b) investing category: 13%
- (c) financing category: 61%

27 The definition of the categories will lead to further changes. Feedback collected from outreach and field-testing activities revealed that entities presenting an operating category may need to analyse where to present certain types of income and expenses according to IFRS 18 (e.g. for foreign currency income or expenses, results from investments in associates or joint ventures using the equity method or interest expenses for leases or pensions). Specifically with relation to the foreign currency income or expenses, stakeholders shared that IT systems needed to undergo significant changes to be able to correctly reflect the accounting of foreign currency gains or losses specifically related to tax and VAT transactions, as these transactions are always denominated in the local currency (which may be different from the functional and bookkeeping currency of the company).

Financial institutions

28 In general, the analysis revealed that the structure and content of the financial statements of financial institutions varied significantly. Many financial institutions analysed presented separately information about operating activities, though the meaning of 'operating' as currently used in their statements of financial performance may be rather different than the new requirements of IFRS 18. They used either 'operating profit or loss' (14%) or other similar subtotals (29%, e.g. 'net operating income', 'operating result', etc.). A majority (57%), however, did not use the subtotal 'operating profit or loss' or similar subtotals. For instance, they used the subtotals 'operating income' and 'operating expenses' or 'total income' and 'total expenses' without having 'operating profit or loss' or similar subtotal as a resulting subtotal or went directly to 'result before tax' or a similar subtotal without, including 'operating profit or loss' as an intermediary subtotal. A limited number of financial institutions presented 'investing' and/or 'financing' as separate subtotals – however, mostly as subtotals within the operating category and often meaning something different than what the definition in IFRS 18 stipulates.

Associated costs and benefits

29 Considering the new requirements on the structure and content of financial statements, EFRAG anticipates that in general the new requirements would lead to significant changes and therefore implementation costs in relation to changes in internal processes and systems for both external and internal management that is reporting depending on each entities' current systems and reporting practices, staff training costs and audit costs. For instance, such implementation costs may be related to classification changes between categories (e.g.

- reclassification of interest expenses on leases into the financing category) throughout reporting systems and processes and changing subtotals.
- 30 In addition to the costs associated with the classification changes between categories, entities are also expected to incur expenses related to the breakdown of income and expenses across multiple categories. For instance, entities may incur additional costs when classifying foreign exchange differences and gains or losses on derivatives, even when taking into account the undue cost and effort relief provided by IFRS 18.
- 31 The changes are expected to impact all levels within the group – subsidiaries as well as parent entities. Consolidation processes and systems might be impacted. For conglomerates this means that various conclusions may be reached at various group levels if various main business activities are identified and various accounting policy choices are made under IFRS 18 guidance (for example, for specified main business activities some items can be presented in the operating category instead of in investing or financing). Further, there might be costs associated with splitting income and expenses from investment activities outside the main business activities between the operating and investing sections. Such a split may be challenging to automate and would require specific analysis for each reporting period.
- 32 Ongoing costs are expected to be low once practices are established. In addition, IFRS 18 provides relief from some classification requirements if too costly and allows entities to elect an accounting policy choice for entities with specified main business activities in classifying income and expenses, which is expected to be used by a vast majority of financial institutions and conglomerates.
- 33 However, for financial institutions the volume of these costs, both one-off and on-going, will depend on the level of alignment of the reporting under IFRS 18 with regulatory requirements, which in turn will be subject to the position of regulators.
- 34 On balance, EFRAG assesses that the new requirements would result in significant benefits, as the respective changes would allow users to save time and effort when performing their analyses due to a more consistent classification of income and expenses across entities and over time from one period to another.
- 35 EFRAG queried the user community as to potential costs related to the fact that the operating category is defined by IFRS 18 as a default category and thus would include all the elements that were not classified in the other four categories. This may include non-recurring elements which do not have predictive value and may not be relevant for the investors' projections, therefore requiring adjustments. Users noted that these types of adjustments were already necessary under current IAS 1 guidance; however, having a clear 'mind map' of the statement of financial performance with defined categories homogeneously applied by all entities would facilitate the analytical work performed by analysts.
- 36 However, these benefits are likely to be less significant than those related to non-financial entities, as the operating category under IFRS 18 is likely to include a significant majority of the overall results of financial institutions. Many financial institutions, especially banks, do not consider that using 'operating profit' as a milestone in the statement of financial performance reflects well the nature of their business. Also, many insurance entities

consider that IFRS 18 represents a significant change in their existing processes and systems arriving shortly after a previous fundamental change caused by the implementation of IFRS 17. Therefore, implementation of IFRS 18 causes additional costs even if they are less significant than those related to the implementation of IFRS 17 without providing equally significant benefits to the preparers from the insurance industry, users of financial statements from insurance entities or other related stakeholders.

- 37 Despite concerns expressed by financial institutions, users expressed a preference for a principle-based approach without industry-specific exemptions or exceptions, as in their view homogeneous structure of presentation and clearly defined categories will result in significant benefits with long lasting effects.
- 38 Therefore, based on the considerations above, the benefits are expected to outweigh the associated costs.

Subtotals

- 39 IFRS 18 requires two new defined subtotals: operating profit or loss and profit or loss before financing and income taxes. In addition to the required totals and subtotals, entities are required to present additional subtotals in the statement of profit or loss when such presentation is necessary to provide a useful structured summary of the entity's income and expenses.
- 40 It is noted, however, that if an entity discloses an additional subtotal which fulfils the criteria of being a management-defined performance measure, the entity shall comply with the requirements that are specific to management-defined performance measures, which may represent additional cost and effort to the entity. The IASB decided that some subtotals specifically listed in paragraph 118 of IFRS 18 or specifically required to be disclosed by IFRS Accounting Standards are not management-defined performance measures. Indeed, some subtotals, even if not defined by IFRS Accounting Standards, are commonly used in financial statements and are well understood by users of financial statements. Therefore, the benefit of providing the management-defined performance measure disclosures for such measures would not outweigh the cost and effort experienced by preparers of financial statements to provide such a disclosure. Therefore, the IASB's cost-mitigating decision resulted in IFRS 18 listing six additional sub-totals which are not management-defined performance measures. Some of these subtotals include:

- (a) gross profit or loss (revenues minus cost of sales) and similar subtotals;
- (b) operating profit or loss before depreciation, amortisation and impairments within the scope of IAS 36 (OPDAI); and
- (c) operating profit or loss and income and expenses from all investments accounted for using the equity method.

Corporates

- 41 The analysis revealed that most entities (55%) presented at least two additional subtotals besides the ones required by IAS 1, 'profit or loss before tax' and 'profit for the year', including:
- (a) gross profit; and
 - (b) operating profit or loss.

- 42 We also noted that 65% of the entities also used additional levels of subtotals within other subtotals. For example, some entities presented 'total operating income', 'total operating costs' and then 'total operating profit'.
- 43 The entities analysed used various subtotals on the face of the statement of financial performance, including:
- 44 gross profit: 55% of the entities that presented analyses of expenses by function, presented gross profit subtotals;
- (a) operating profit: this subtotal was used by the majority of entities (68%). The subtotal operating profit typically excluded line items related to share of profit from equity accounted investments, exceptional items, finance costs, investment costs and income taxes. However, the composition of the operating profit varied between entities as, for example, some entities included results from associates and joint ventures in operating profit while others excluded them, and similarly with income and expenses from investment activities. Finally, in many cases this subtotal was similar to earnings before interest and tax (EBIT) as it only excluded finance costs and share of profit from equity accounted investments and taxes; however, it was labelled as operating profit;
 - (b) profit before interest and tax or EBIT: 32% of the entities made explicit reference to EBIT. This subtotal excluded items such as 'net financial expenses', 'unwinding of discount of provisions', 'share of profit from equity accounted investments' and 'income taxes'. Their calculation also varied between entities as, for example, some entities included results from associates and joint ventures in EBIT while others excluded them. Finally, as referred above, in many cases 'operating profit' was a term similar to 'EBIT'; and
 - (c) finance results: many entities (52%) presented a separate subtotal related to 'finance results'.
- 45 Other less common subtotals presented include the following:
- (a) total revenues and total costs
 - (b) total operating cost and total operating income
 - (c) profit on sales
 - (d) income (expenses) from investments
 - (e) income from property management
 - (f) EBITDA.
- 46 EFRAG assesses that the new requirements on new defined subtotals based on new categories will significantly impact current practices on the presentation of the following most used subtotals.
- (a) *Gross profit*. Currently there is no definition of gross profit in IFRS Accounting Standards; however, the IASB noted that this subtotal is widespread in practice and decided to specifically indicate that this subtotal (or similar subtotals representing the entity's revenue minus the cost of sales) is not a management-

defined performance measure and thus not subject to additional disclosure requirements. Therefore, EFRAG believes that from the adoption of IFRS 18 there is no significant impact on this subtotal if used by management.

- (b) *Operating profit.* Currently there is no definition of operating profit in IFRS Accounting Standards, and therefore it is a subtotal defined by management. IFRS 18 provides guidance on what should be presented within operating profit, which means that entities will have to revise one of their most common performance measures. The label 'operating profit' can only be used when it is presented as required by IFRS 18.
- (c) *EBIT.* Currently there is no definition of EBIT in IFRS Accounting Standards, and therefore it is a subtotal considered as being defined by management. IFRS 18 does not include a definition of EBIT but provides guidance on the calculation of 'profit or loss before finance and tax'. Thus, some entities will have to revise their calculation of the subtotal 'EBIT' or provide additional disclosures related to management-defined performance measures.
- (d) *Finance results.* Currently there is no definition in IFRS Accounting Standards of what should be included in finance costs. IFRS 18 provides the definition of the financing category. Thus, entities will have to revise their presentation of the subtotal 'finance results' or disclose desired subtotal as part of management-defined performance measures. Finance result is not a required subtotal within IFRS 18; however, as laid out above, more than half of the entities in the scope of the analysis presented this subtotal. It is noted, however, that if finance results' subtotal presented by management is a pure mathematical subtotal of the line items presented in the financing category of the statement of financial performance, such subtotal is not subject to required disclosures of management-defined performance measures.
- (e) *Use of different subtotals.* Entities will have to reconsider whether they will be able to continue using some of their subtotals (e.g. EBITDA). Some of the subtotals used to date may trigger MPM disclosures, others may not fit within the specified structure of IFRS 18 and entities will need to analyse whether they have to present additional subtotals to provide a useful structured summary of the statement of financial performance.

Financial institutions

47 Financial institutions tend to use more subtotals (on average, six for banks and eight for insurance entities, including two mandatory subtotals required under the existing IAS 1 and the regulatory reporting mentioned below) than non-financial entities. Financial institutions presented many different subtotals such as:

- (a) **operating income, operating expenses and/or operating profit:** many financial institutions (43% - please refer to the section on categories) used a subtotal related to operating profit. However, the composition of these subtotals varied. Normally, these subtotals included interest income, fee and commission income, trading income, dividend income, gains or losses on financial assets and liabilities, personnel and other administrative or operating expenses. In many cases, this subtotal excluded line items such as 'share of profit in associates and joint

ventures', impairment charges (e.g. loans), 'goodwill', 'net gain on non-current assets' and 'net less on held for sale group entity'. The new requirements of IFRS 18 are expected to result in significant harmonisation of the use of this category by financial institutions;

- (b) **subtotals similar to gross profit** (i.e. they represent the difference between a type of revenue and directly related expenses incurred in generating that revenue), as described in paragraph B123 of IFRS 18:
- (i) net interest income / net interest margin (typically used by banks);
 - (ii) net fee (and commission) income (typically used by banks);
 - (iii) insurance service result (typically used by insurance entities); and
 - (iv) net finance result (investment income minus insurance finance income and expenses – typically used by insurance entities).

The use of these subtotals is not expected to be significantly impacted by IFRS 18 as they are already aligned, in general, with the requirements of IFRS 18 and will likely be part of the useful structured summary of most financial institutions;

- (c) **total income and total expenses:** some financial institutions used subtotals that were an aggregation of mostly income (with some negative components) or mostly expenses, such as 'total income' or 'total expenses'. Under IFRS 18, such subtotals, with limited adjustments, are likely to be reintegrated into the useful structured summary of these financial institutions;
- (d) Some financial institutions presented a separate subtotal or category named '**finance result**', '**investment result**' or a similar one. However, in most cases the meaning of this category is different from the intentions of IFRS 18 (e.g. it is used by some insurance entities as subtotals within net insurance result);
- (e) **profit before tax:** all financial institutions, except one insurance entity, used this or a similar subtotal (e.g. 'result before tax'), as required by IAS 1; and
- (f) **profit or loss:** all financial institutions used this subtotal as required by IAS 1. Some financial institutions used different terms such as 'net income' or 'net result' to present their profit for the period.

48 Besides the subtotals listed above, financial institutions used many other subtotals on the face of the statement of financial performance, including subtotals within subtotals (e.g. subtotals within net insurance result, subtotals related to impairments or subtotals that excluded non-recurring items). Such an extensive use of subtotals may be due to many reasons, e.g. the need for financial communication, including disaggregation by banks of their results which are otherwise almost exclusively classified as operating, alignment with regulatory requirements (notably for banks), the need to explain the composition of the operating result of insurance entities reporting under IFRS 17 (i.e. incorporating components of both insurance and investment activities of insurance entities,) etc.

49 A limited number of insurance entities used subtotals similar in substance to 'profit before financing and income taxes', which is the new required subtotal under IFRS 18.

Associated costs and benefits

50 The new requirements related to subtotals are expected to give rise to initial implementation costs. Feedback received suggested that entities need to review the labelling of items and adapt their systems in order to be able to present the newly introduced subtotals. In addition, entities may also need to adapt their internal reporting

systems and may need to revise their remuneration arrangements, bonus schemes and covenant tests that are linked to existing subtotals in order to realign those with the new defined subtotals. Such changes might be costly for preparers.

- 51 Ongoing costs are expected to be limited once accounting systems, remuneration and bonus schemes and contracts are adapted to comply with / reflect the new requirements. Further, EFRAG acknowledges the IASB's efforts to provide additional cost relief measures, such as defining additional subtotals which are not considered management-defined performance measures and are therefore not subject to the related disclosure requirements (e.g. operating profit and result from associates and joint ventures).
- 52 For the financial institutions, the costs to be incurred may be further limited depending on the position of the regulators about the potential harmonisation of the regulatory requirements with those of IFRS 18.
- 53 Even though IFRS 18 provides two defined subtotals, entities can still present other subtotals that they deem necessary to provide a useful structured summary of the company's income and expenses, suggesting that users will still receive useful information. This flexibility is thus beneficial for both preparers and users.
- 54 Further, users will benefit from improved comparability achieved by the new defined subtotals, as they will experience a reduction in costs for recalculating key subtotals for their analyses when they differ across entities, including financial and non-financial entities, and the consistent calculation between entities and over time will increase efficiency when performing their analyses. Operating profit as defined in IFRS 18 does not mix gross and net results, which will allow users to calculate margins more easily.
- 55 However, for financial institutions these benefits are likely to be less significant than those related to corporate entities, as the operating category under IFRS 18 is likely to include a significant majority of the overall results of financial institutions. Therefore, in many cases, especially for banks, operating profit is likely to be very close to total profit or loss. On the other hand, the other newly defined subtotal 'profit or loss before financing and income tax' is unlikely to be used by many financial institutions, notably by those entities which provide financing to customers as a main business activity. It is also worth noting that exclusion of share of results from investments in associates and joint ventures from the subtotal 'operating profit', contrary to how this line item is currently classified by many financial institutions (please refer to section on results from associates and joint ventures accounted for using equity method), will have a negative impact on the relevance of the subtotal 'operating profit' for many financial institutions, especially for insurance entities. EFRAG assesses that, in providing the useful structured summary, banks and insurance entities will likely use subtotals similar to those they currently use, which limits the costs to be borne.
- 56 Overall and based on the considerations above, the benefits are expected to outweigh the costs related to these requirements.

Aggregation and disaggregation of line items

- 57 IFRS 18 introduces enhanced requirements for grouping information, meaning that entities may need to change the way they aggregate and disaggregate information presented in the primary financial statements and disclosed in the notes. Further, IFRS 18 notes that an entity does not need to present so-called minimum required line items if doing so is not necessary

for the statement to provide a useful structured summary. However, if an entity does not present a line item required by IFRS Accounting Standards, the entity is required to disclose the item in the notes if it is material. Finally, for items that are labelled as 'other', entities would need to provide more informative labels or present additional disclosures requested by IFRS 18.

Corporates

58 For corporates, the analysis showed that the level of disaggregation within the statement of financial performance varied significantly between entities, from six to 23 line items. It was observed that on average corporates presented 13 line items, which were distributed as follows:

- (a) up to 10 line items: 13%
- (b) from 11 to 15 line items: 65%
- (c) more than 15 line items: 23%.

Financial institutions

59 Financial institutions tend to provide a higher level of disaggregation than non-financial entities. For example, we observed that financial institutions presented on average 20 line items while non-financial entities presented on average 13 lines items. Further, the number of line items were distributed as follows:

- (a) up to 10-line items: 0%
- (b) from 11 to 15 line-items: 7%
- (c) more than 15 line-items: 93%.

60 In addition, many financial institutions provide further disaggregation of these line-items by providing additional lines on the face of the statement of financial performance.

Associated costs and benefits

61 EFRAG notes that IAS 1 already included principles of materiality and aggregation. IFRS 18 adds additional clarity and structure by specifying how the requirements are to be applied. The application of the principles of aggregation and disaggregation, similar to the categorisation in the statement of profit or loss, will affect all entities as there would be a need to assess the compliance of the current reporting structure with the principles of aggregation and disaggregation as outlined in IFRS 18 as well as to ensure its alignment, where possible, with regulatory reporting for the financial institutions. For the entities who would conclude following such an assessment that changes to the presentation and/or disclosures are needed, EFRAG anticipates initial implementation costs related to changes in internal processes and systems.

62 For all entities, EFRAG anticipates ongoing costs related to the continued assessment of the shared characteristics allowing to aggregate items of information on one hand and the dissimilar characteristics warranting disaggregation on the other hand. Such ongoing assessment is, however, not considered to be a cost attributable to IFRS 18 Standard as such but are costs inherent to any area where judgement is involved, as management needs to constantly reassess its considerations and ensure that the assessment made for the respective reporting date is in compliance with the relevant standard.

- 63 For financial entities, most importantly for banks, possible future changes in regulatory requirements may result in a need to review the existing level of disaggregation and adapt the reporting structure accordingly, which may imply additional costs.
- 64 On balance, EFRAG considers that the costs to ensure compliance with the grouping requirements in IFRS 18 would result in higher benefits, as it would improve the understandability of information that users receive and would enhance comparability. However, it should be mentioned that the application of judgement by entities when applying the principles of aggregation and disaggregation may result in users receiving less granular information. For the preparers of financial statements, clarified requirements included in IFRS 18 regarding the grouping of information and the possibility to assess where the minimum required line items are better suited (within primary financial statements or in the notes) provide an opportunity to take a fresh look at the structure of the financial statements, considering stakeholders' information needs while allowing additional flexibility for management. However, for financial institutions some of the new requirements, while improving comparability with non-financial entities, may result in presenting less relevant information (e.g. the requirement to present interest expenses on lease liabilities in the financing category).
- 65 Overall and based on the considerations above, the benefits are expected to outweigh the costs of these requirements.

Results of associates and joint ventures accounted for using the equity method

- 66 IFRS 18 requires a company to classify income and expenses from all associates and joint ventures accounted for using the equity method in the investing category, even when the entity invests in assets as a main business activity.

Corporates

- 67 The analysis revealed diversity in practice in the classification of income and expenses from associates and joint ventures accounted for using the equity method, with some including it in an operating profit subtotal, while others do not:
- (a) included in an operating profit subtotal (or EBIT/EBITDA) – 29%
 - (b) presented outside an operating profit subtotal – 71%
 - (i) *between an operating profit subtotal and profit before tax* – 57%
 - (ii) *below profit before tax* – 14%
- 68 Only four entities in our sample of 31 corporates (13%) presented a statement of financial performance clearly separate operating, financing and investing categories. These entities included the share of profit (loss) from equity-accounted investments in the investing category.
- 69 There were eight entities that presented a separate line item for the results of equity-accounted investments between two other subtotals; however, no particular subtotal was created to show the results in performance before and after this had been considered.
- 70 None of the entities used an additional subtotal to distinguish different type of equity-accounted investments.

Financial institutions

- 71 All financial institutions analysed, except one insurance entity, presented share of results from associates and joint ventures as a separate line item on the face of the statement of financial performance.
- 72 The presentation of the share of profit or loss from associates and joint ventures varied. 57% of financial institutions analysed included this line-item in the subtotal 'operating profit' / 'total income' or a similar subtotal, while 29% presented it as a line item outside 'operating profit' / 'total income', and 14% presented it in a different manner.
- 73 None of the financial institutions analysed created a separate subtotal to present the results before and after share in profit / (loss) of joint ventures, associates and tax or used an additional subtotal to distinguish between different types of equity-accounted investments.

Associated costs and benefits

- 74 For corporates as well as financial institutions, the requirement to classify income and expenses from associates and joint ventures accounted for using the equity method in the investing category is not expected to incur implementation costs in relation to the statement of financial performance, as related information is already available, and the presentation changes are limited.
- 75 However, there are entities who consider those equity-accounted investments as part of their operating activity and who would like to continue communicating on their financial performance, including said associates and joint ventures.
- 76 Specifically, EFRAG notes a concern from numerous financial institutions, notably insurance entities, who consider that given the nature of their business, share in profit/loss of a major part of their associates and joint ventures would be directly linked to their operating business and should therefore be classified in the operating category rather than the investing category in the statement of financial performance. Insurers claim that income and expenses that are directly linked to insurance liabilities should be included in operating profit because they form part of the underwriting result.
- 77 To mitigate this concern, the IASB explicitly permitted in paragraph 73 of IFRS 18 to present a subtotal for operating profit or loss and income and expenses from investments accounted for using the equity method if the entity determines doing so is necessary to provide a useful structured summary of its income and expenses. However, the specified subtotal would include income and expenses from all associates and joint ventures accounted for using the equity method, so if an entity used a subtotal that included only the income and expenses from selected associates and joint ventures, that subtotal would be a management performance measure. In addition, transition requirements of IFRS 18 allow to change, at initial application of IFRS 18 the election made in accounting for investment in associates and joint ventures under paragraph 18 of IAS 28, i.e. for an entity that is a venture capital organisation or a mutual fund, unit trust and similar entities including investment-linked insurance funds, to measure such an investment at fair value through profit or loss in accordance with IFRS 9 instead of using the equity method. Paragraph 18 of IAS 28 provides as an example of an investment-linked insurance fund, a fund held by an entity as the underlying items for a group of insurance contracts with direct participation features and further clarifies that, for the purposes of this election, insurance contracts include

investment contracts with discretionary participation features. Therefore, the transition relief of IFRS 18 may be helpful for some insurance entities. Overall, whilst commending these mitigating solutions, the EFRAG notes that the issue is not considered as fully resolved by some financial institutions.

- 78 Overall, mitigating options given by the IASB and outlined above would result in additional incremental costs related to either presenting an additional defined subtotal below the operating result (operating profit or loss and income and expenses from investments accounted for using the equity method⁴) or presenting a management-defined performance measure with inherent disclosure requirements, as specified by IFRS 18.
- 79 On the other hand, users typically analyse an entity's performance separately from its investments in associates and joint ventures accounted for using the equity method for three main reasons. First of all, investors would like to be able to differentiate performance from the management-controlled activities from the activities which are not controlled by management and thus be able to assess the stewardship of the company. Secondly, the results from equity-accounted investments impact the statement of financial performance as one line item without related ventilation across revenue and costs, thus potentially distorting the margin analysis. Last but not least, results from equity-accounted investments are net of interest and taxes and in investors' eyes represent a peculiar item impacted by both performance and measurement effects. Therefore, the large majority of investors noted that the analysis related to the equity-accounted investments is done separately from the rest of the financial performance analysis.
- 80 Thus, users of financial information from financial institutions stated that they consider receiving useful information for their analysis. They expressed their opposition to an industry-specific exemption.
- 81 Taking into account all of the above, the cost/benefit considerations on preparers' and users' sides are considered balanced.

Presentation of expenses by nature and by function

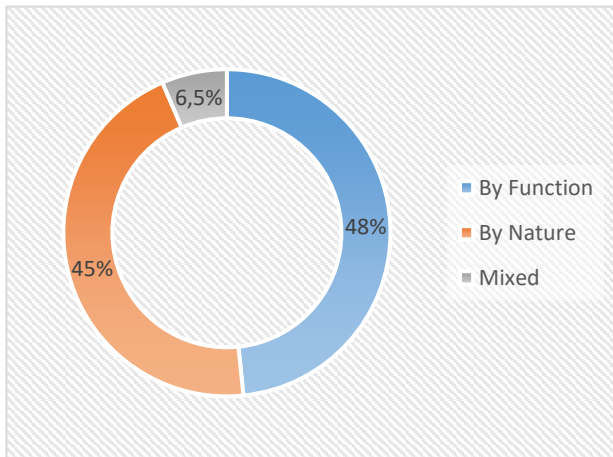
- 82 IFRS 18 requires entities to present operating expenses in a way that provides the most useful structured summary of its expenses: by nature, by function or using a mixed presentation. IFRS 18 requires an entity that presents in the statement of profit or loss one or more line items comprising operating expenses classified by function to disclose in a single note the total and the amount of the expenses included in each line item for depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) and write-down of inventories (and reversals).

⁴ This specified subtotal would include income and expenses from all associates and joint ventures accounted for using the equity method, so if an entity used a subtotal that included only the income and expenses from selected associates and joint ventures, that subtotal would be a management performance measure.

Corporates

- 83 The analysis revealed that 48% of entities present their analysis of expenses classified by function, which is the most common classification used. Of the remaining entities, 45% used a classification of expenses by nature and 6% used mixed presentation classifying expenses both by nature and function.

Figure 4: Presentation of expenses in the profit or losses



- 84 A trend was noted within some industries:
- (a) **auto manufacturers:** preference for presentation by function
 - (b) **industrial, manufacturing and construction:** preference for presentation by function
 - (c) **energy, oil and gas:** preference for presentation by nature
 - (d) **pharmaceutical:** preference for presentation by function
 - (e) **telecommunication services:** preference for presentation by nature
 - (f) **real estate:** preference for presentation by nature.
- 85 Entities that presented both by nature and function used line items such as 'distribution expenses' and 'administrative expenses' together with items such as restructuring, provisions, amortisation, depreciation and impairments.

Associated costs and benefits

- 86 IFRS 18 does not prohibit the mixed presentation of expenses, and entities already classifying expenses both by nature and by function will therefore not necessarily be impacted. In addition, all entities will have to reassess whether their presentation provides the most useful structured summary of their expenses.
- 87 All entities will need to reassess how to present expenses in the operating category,, and if they determined that a change is required, implementation costs will occur related to changes in internal processes and systems. The requirement to disclose the amounts of certain expenses if material by nature in the notes when presented by function is expected to give rise to some implementation costs depending on the information that entities currently disclose. Such information needs to be derived on subsidiary level, needs to be reported on a 'consolidated basis' and has to be audited. At the same time, EFRAG acknowledges the cost-mitigating decisions of limiting the disclosure requirement to five

expenses only and allowing to present the total cost rather than expenses recognised in profit or loss. Based on the feedback obtained by EFRAG from the preparer community, such cost relief measures were welcome and were expected to facilitate the implementation of these requirements. They lead to simpler and therefore more cost-effective implementation and also to lower ongoing costs. Some entities, however, noted that there would be a need for them to change or tailor their IT systems in order to gather the required information. This information must be generated in the subsidiaries and thus leads to adjustments in their systems, which can result in different IT systems having to be adapted (if a standardised system is not implemented for all subsidiaries)

- 88 Users appreciate receiving detailed information about entities' operating expenses by nature, as that is helpful for their analysis. They would have most appreciated receiving the statement of financial performance presented by nature with audited information to support their analysis and cash flows projections but consider the requirements of IFRS 18 an improvement compared to current practice. The five specific expense categories required to be disclosed when presenting by function (depreciation and amortisation, employee benefits, impairment losses and reversals, inventory write-downs and reversals) were selected by the IASB based on feedback from the user community and with the objective of minimising the impact on the preparers. Indeed, feedback from users of financial statements indicated that presenting operating expenses classified by function can provide useful information but can also result in a loss of useful information. Classifying expenses by function aggregates various expense items by nature that respond differently to changes in the economic environment, making it difficult for users of financial statements to forecast future operating expenses. Information about the nature of expenses makes it easier to forecast future operating expenses and also enables an understanding of links with the information presented in the statement of cash flows. Therefore, the analysis of the financial statements is performed in a more efficient and effective manner.
- 89 Further, EFRAG notes that IAS 1 already required an entity that classified expenses by function to disclose additional information about the nature of expenses, including depreciation expense, amortisation expense and employee benefits expense. However, in practice some entities that classified expenses by function disclosed little additional information about the nature of expenses. Because of strong user demand for additional information about the nature of expenses, the IASB decided to strengthen the requirement.
- 90 Overall, EFRAG considers that the costs and benefits are balanced following the strengthening of this requirement in IFRS 18.

Financial institutions and associated costs and benefits

- 91 All of the banks analysed used mixed presentation, i.e. the analysis is done predominantly by nature, with some limited elements of analysis by function, namely presenting on the face of the statement of financial performance:
- (a) the line item 'administrative expenses', 'other operating expenses' or similar, often as a residual number ('other'); and/or
 - (b) the line item 'insurance service expenses' or similar (in case of financial conglomerates with a dominating proportion of banking activities).

- 92 In many cases, where a line item 'administrative expenses' / operating expenses' is separately presented by a bank on the face of the statement of financial performance, it is further disaggregated by nature also on the face of the statement of financial performance (e.g. additional lines present the amounts of personnel/staff expenses included in the line item). Further disclosure of the nature of the line items presented by function is usually provided in the disclosure notes, subject to materiality.
- 93 Therefore, even though some banks may have to further expand analysis by nature in the disclosure notes, it is unlikely that the costs of such a change will be significant for banks.
- 94 On the contrary, all insurers presented an analysis of expenses predominantly by function in the statement of financial performance, as the key expense line-item 'insurance service expenses' has become mandatory under IFRS 17. Further analysis by nature is usually presented in the disclosure notes. However, its level of detail may vary and will not necessarily be sufficient to satisfy the new requirements of IFRS 18. Therefore, subject to materiality, some insurers may have to further expand the related disclosure notes, which in turn could imply one-off costs to update reporting systems and processes. Similar as for corporates, the information has to be derived on subsidiary level, 'consolidated' and audited to be included in the financial information.
- 95 EFRAG considers that costs and benefits are balanced given, on the one hand, strong user demand for additional information concerning the nature of expenses (further described in the section on non-financial entities above) and, on the other hand, costs to be borne by financial institutions to update reporting processes and systems.

Unusual items

- 96 IAS 1 prohibited the presentation of items of income or expense as 'extraordinary items' in the statement(s) of financial performance. IFRS 18 does not mention extraordinary items explicitly. An entity is required to classify all income and expenses included in the statement of profit or loss in one of the specified categories in that statement and is prohibited from creating a separate category for extraordinary items. The operating category as a default category includes any item of income and expenses that IFRS 18 does not require to be classified in another category.
- 97 The IASB developed the requirements relating to the description of items presented in the financial statements or disclosed in the notes based on feedback that, in some cases, the descriptions used are not always complete. For example, some entities provide information about 'unusual' income or expense items but do not explain why an entity considers those items to be 'unusual'. During the ED-phase, the IASB tried to define 'unusual' and decided based on the mixed feedback received not to proceed and to withdraw the definition. EFRAG acknowledged the difficulties of developing a definition of unusual items and stated in its 'Summary Report and Recommendations' that timely completion of the Primary Financial Statements project was a priority. The application of the general requirement to disaggregate amounts whenever information about the disaggregated amounts is material, or as a voluntary disclosure, and reconciliations related to MPMs could mitigate to a certain extent the lack of information being provided under the definition of unusual income and expenses.

- 98 IFRS 18 specifically requires an entity to describe a presented or disclosed item in a way that faithfully represents the characteristics of the item. To achieve a faithful representation, an entity provides descriptions and explanations necessary for a user of financial statements to understand the item.
- 99 EFRAG notes that all items not classified in the four defined categories would be presented in the operating category, which is a default category. EFRAG did not identify any relevant costs to be taken into consideration for the purposes of this assessment as it relates to unusual or non-recurring items by themselves. We believe that the assessment covers any such items through other sections of the analysis – for example, costs and benefits analysis of IFRS 18 guidance on aggregation and disaggregation or management-defined performance measures if management deems necessary to provide financial performance information excluding some items that are considered unusual by the entity.

Statement of financial position

Goodwill

- 100 IFRS 18 introduces a requirement for presenting in the statement of financial position a separate line item of 'goodwill'. Indeed, goodwill is an unidentifiable asset and is measured only as a residual. It cannot be measured directly. Therefore, the IASB considered that the characteristics of goodwill are sufficiently dissimilar from those of intangible assets to warrant separate presentation.

Corporates

- 101 The analysis showed that 58% of entities presented a separate line item of goodwill in the statement of financial position. The remaining entities included goodwill in 'Intangible Assets' and provided the goodwill amount and related information in the notes. Entities are not expected to incur costs in implementing this requirement, as the goodwill amount for an entity which has goodwill is already available. Users are expected to benefit from the presentation of a separate line item within a primary financial statement across all entities, as this information will be easily available and the users interested only in the total amount would not need to search for the information within the notes.

Financial institutions

- 102 The majority of financial institutions analysed presented goodwill on the face of statement of financial position – either as a separate line item (36%) or as a line, included in the additional disaggregation of the line item 'Intangible assets' presented on the face of statement of financial position (29%). Others included goodwill in the line-item 'Intangible assets' (29%) or 'Goodwill and intangible assets' (7%) and presented an additional disaggregation in the disclosure notes. Similarly to non-financial entities, financial institutions are not likely to incur significant costs in implementing this requirement, while users are expected to benefit from the presentation of a separate line item across all entities, both financial and non-financial.

Aggregation and Disaggregation of line items

- 103 The analysis included here applies to both corporates and financial institutions. The application of the principles of aggregation and disaggregation has to be applied similarly to the statement of profit or loss. It will affect all entities as there would be a need for assessing the compliance of current reporting structure with the principles of aggregation and disaggregation as outlined in IFRS 18. The implementation cost will depend on the current

accounting practice, for example entities might need to reconsider the use of 'other' line items, such as 'other assets' or 'other liabilities'. During the ED's consultation phase, some stakeholders suggested a specific disaggregation threshold such as a mandatory quantitative threshold. However, the IASB concluded it would not be feasible to create a threshold that all entities could apply. Such a threshold also might have conflicted with the definition of material information and the requirement for an entity's materiality judgements to include a qualitative assessment. Therefore, cost considerations related to the application of the judgement upon the implementation of IFRS 18 as well as ongoing re-assessment of the judgement applied, as outlined above in paragraph 62 related to the statement of financial performance, also apply to the statement of financial position. Based on feedback received, there are only minor changes expected for financial institutions. Due to regulatory requirements financial institutions provide already detailed information. The resulting benefits for users due to improved transparency in reporting will outweigh the costs.

Statement of cash flows

Indirect method of presentation and other presentation changes

104 IFRS 18 requires all entities that use the indirect method of reporting cash flows from operating activities to use the 'operating profit' subtotal as a starting point. In addition, IFRS 18 clarifies the classification of interest and dividends paid and received in the statement of cash flows by removing presentation alternatives.

Corporates

105 When analysing the statement of cash flows, we noted diversity in practice related to the starting point for the indirect method. The majority of the entities (71%) used 'profit after tax'. The remaining entities used 'profit before tax' (23%) or an operating profit subtotal (3%). Only one entity used the direct method and is therefore not included in the analysis. There was also diversity in practice in the classification of interest and dividends paid and received, as shown in Table 1.

Table 1: Classification of interest and dividends paid and received:

| | <i>Interest received</i> <i>(investing category as per IFRS 18)</i> | <i>Interest paid</i> <i>(financing category as per IFRS 18)</i> | <i>Dividends received</i> <i>(investing category as per IFRS 18)</i> | <i>Dividends paid</i> <i>(financing category as per IFRS 18)</i> |
|----------------------------------|---|---|--|--|
| <i>Operating category</i> | 64% | 56% | 68% | 0% |
| <i>Investing category</i> | 32% | 0% | 32% | 0% |
| <i>Financing category</i> | 5% | 44% | 0% | 100% |

106 Based on our analysis, the new IFRS 18 requirements will change current practice, as described below.

- (a) **Starting point for the indirect method:** IFRS 18 requires entities using the indirect method to use 'operating profit' as the starting point, meaning that the majority of entities will need to revise their practices.

- (b) **Interest received:** IFRS 18 requires entities without specified main business activity to classify interest received in the investing category. This requirement will significantly change current practice as the majority of corporates (64%) classified interest received in the operating category rather than the investing category.
 - (c) **Interest paid:** IFRS 18 requires entities without specified main business activity to classify interest paid in the financing category. This requirement will affect many corporates (56%) that currently classify interest paid within operating category.
 - (d) **Dividends received:** IFRS 18 requires entities without specified main business activity to classify dividends received in the investing category. This requirement will affect the majority of corporates (68%) that currently classify dividends received within the operating category.
 - (e) **Dividends paid:** IFRS 18 requires entities without specified main business activity to classify dividends paid in the financing category. This requirement will not change current practice as all entities classified dividends paid within the financing category.
- 107 All in all, the analysis revealed that the majority of entities will need to adjust the starting point for the indirect method as well as the classification of interest received, interest paid and dividends received in order to comply with the new requirements of IFRS 18. Feedback collected by EFRAG suggests that these changes will mainly result in implementation costs and operational burden for entities, as they need to change their current accounting practices and adapt their systems. Some preparers suggested that the changes brought by IFRS 18 to the statement of cash flows will be the most significant from the operational burden and system modifications point of views. The related implementation costs are expected to vary across entities depending on current accounting practices and systems used. Examples of relevant costs include:
- (a) system modifications for changing the starting point for the indirect method;
 - (b) staff training and related costs; and
 - (c) data collection on interest and dividends at the subsidiary level.
- 108 In addition, feedback revealed that the same labelling of categories in the statement of profit or loss and the statement of cash flows and the lack of cohesiveness across the two primary financial statements can be confusing. In regard to ongoing costs, it is expected that these would be limited.
- 109 The enhanced comparability and transparency resulting from these new requirements is appreciated by the users of financial statements and will provide benefits to them that outweigh the costs. As the ongoing costs are rather low, the costs are justified from a long-term perspective considering comparability in particular.
- Financial institutions
- 110 All of the financial institutions analysed, except one insurance entity, used the indirect method in their statement of cash flows. They used either 'profit before tax' (36%) or 'profit after tax' (57%) as a starting point. None of the financial institutions analysed started with 'operating profit'.

- 111 All of the financial institutions analysed, except one insurance entity, presented **interest received** within the operating activities. However, such classification was not always clearly presented on the face of the statement of cash flows when financial institutions used the indirect method. In some cases, this information was separately presented at the bottom of the statement of cash flows or in a further disclosure. The only exception was the insurance entity who presented interest received within the investing activities in full, which was also the only financial institution analysed which prepared the statement of cash flows using the direct method. There were no cases where interest received would be explicitly split between the operating and investing categories.
- 112 All of the financial institutions analysed, except one insurance entity, presented **interest paid** within the operating activities, either fully or partially. Similarly to interest received, such classification was not always presented on the face of the statement of cash flows, and in some cases it was presented elsewhere in the financial statements. Also, similarly to interest received, the only exception was the insurance entity which presented interest paid within the financing activities in full, which was also the only financial institution analysed that prepared the statement of cash flows using the direct method.
- 113 However, contrary to interest received, 43% of the banks and 43% of the insurance entities analysed divided interest paid between the operating and the financing category. Typically, in such a case the entity would present the interest paid on subordinated loans, perpetual debt and other similar instruments within the financing category, while the rest of the interest paid would be presented within the operating category. This illustrates the difference in nature of the underlying instruments for the financing structure of the entities in question, i.e. very long-term or perpetual debt with certain characteristics of equity (subordinated to all other liabilities of the entity).
- 114 **Dividends paid** are typically presented within the financing activities; no exceptions have been observed.
- 115 All of the financial institutions analysed, except one insurance entity, presented **dividends received** within operating activities, either fully or partially. The only exception was the insurance entity who presented dividends received within the investing activities, which was also the only financial institution analysed that prepared the statement of cash flows using the direct method. At the same time, 71% of the banks and 57% of the insurance entities analysed presented dividends received within the operating activities in full, while 29% of the banks and 29% of the insurance entities analysed divided them between the operating and the investing activities. Typically, in the latter case the entity would present dividends received from associates and joint ventures within the investing category, while the rest of the dividends received would be presented within the operating category.
- 116 Based on our analysis, the new IFRS 18 requirements will change current practice, as described below.
- (a) **Starting point for the indirect method:** IFRS 18 requires entities using the indirect method to use 'operating profit' as the starting point, which is a significant change to current practice. Thus, most – if not all – financial institutions will need to revise their statement of cash flows to start with operating profit.

- (b) **Dividends paid:** the new IFRS 18 requirement for classifying all dividends paid within financing activities will not change current practice as all financial institutions analysed presented dividends paid within the financing activities section.
- (c) **Interest paid, interest received and dividends received:** the impact on the statement of cash flows will depend on how financial institutions classify related income/expenses in the statement of financial performance. When applying the requirements for classification in the statement(s) of financial performance for financial entities, it is likely that many financial entities will present most, or all, of their interest income, interest expenses and/or dividend income in the operating profit section of the statement(s) of financial performance. EFRAG assesses that this will result in certain changes in practice. In particular, the financial institutions that currently classify part of the interest paid as financing (e.g. interest paid related to subordinated loans, perpetual or similar debt), dividends received as investing, fully or partially (e.g. dividends received from associates and joint ventures), or interest received as investing will have to revise their classifications as (i) the classification in the statement of cash flows will depend on classification of related income/expenses in the statement of financial performance, and (ii) entities with specified main business activities (notably banks as well as the insurers which meet the criteria of paragraph B31 of IFRS 18) will have to present each of these items in a single category, without the possibility of dividing them between two categories, as many of them currently do.

117 These changes will incur considerable implementation costs (like for corporates), considering that the financial institutions might have to allocate majority of the cash flow items into the operating category, warranting significant changes to the IT systems. These costs are expected to be one-off costs incurred at initial implementation. . The enhanced comparability resulting from these new requirements will provide benefits that outweigh such costs. However, some of the changes mentioned above (e.g. the need to reclassify part of interest paid from the financing to the operating category so that interest paid is presented in a single category in full) may have a certain negative impact on the relevance of the information presented in the statement of cash flows.

Aggregation and Disaggregation of line items

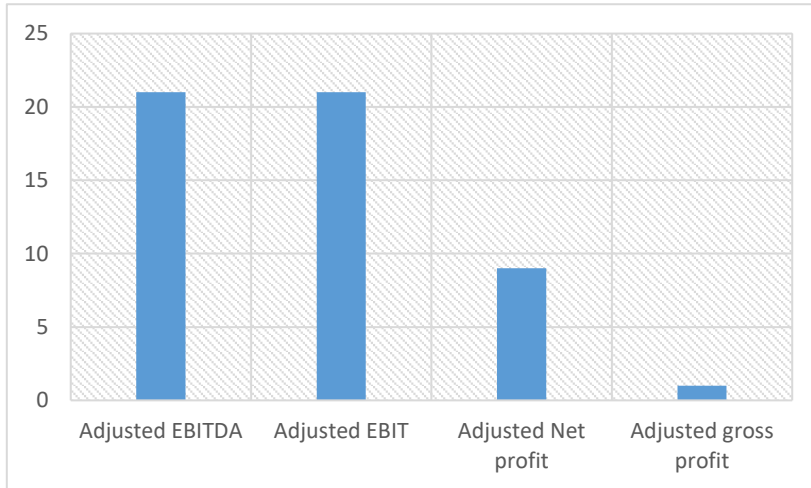
118 The application of the principles of aggregation and disaggregation has to be applied similarly to the statement of profit or loss and applies both to corporates and financial institutions. It will affect all entities as there would be a need to assess the compliance of current reporting structure with the principles of aggregation and disaggregation as outlined in IFRS 18. The implementation cost will depend on the current accounting practices and systems used at parent and subsidiary levels. Due to the judgement involved, entities will need to reassess the application of principles on an ongoing basis, involving incremental costs inherent to all judgemental areas of the financial reporting. The resulting benefits for the users due to improved transparency in reporting will outweigh the costs.

Management-defined performance measures (MPMs)

Corporates

119 The performed desktop review showed that corporate entities on average use between six and seven commonly used performance measures. Some of these performance measures would meet the definition of a management-defined performance measure ('MPM') as defined by IFRS 18. The diagram below shows a breakdown of the most common APMs that would qualify to become MPMs in line with the IFRS 18 definition.

Figure 5: Commonly used APMs by corporates



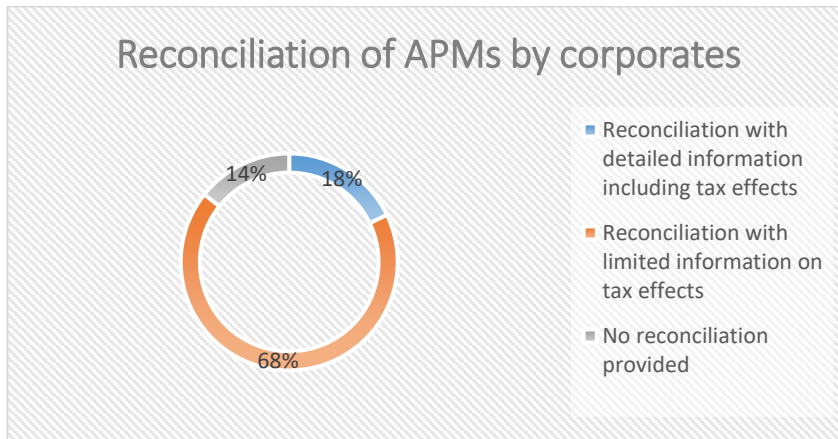
120 With respect to the location of information about APMs, EFRAG research showed that entities include information about APMs in a variety of locations. Around 60% the sampled reporting entities have included APMs inside their financial statements, 20% of entities have included such information in the notes to the financial statements and 20% have reported such measures only outside of the financial statements.

121 For corporate entities that have reported APMs only outside the financial statements, EFRAG assesses that around 30% of the APMs included in public communications will meet the definition of MPMs as per IFRS 18.

122 The sampled entities provided a different level of reconciliation between APMs used in their communications and IFRS accounting information. In general,

- (a) A majority of corporate entities (68%) provided reconciliation with limited information on tax effects; and
- (b) around 20% of corporates provided more detailed information, which also included tax effects.

Figure 6: Reconciliation of APMs by corporates



Financial institutions

123 The performed desktop review showed that financial institutions use between one and six commonly used performance measures which may meet the definition of the MPM under IFRS 18, with banks using slightly more of such measures than insurance entities (2-6 for banks versus 1-5 for insurance entities). Whilst the overall quantity of APMs used by the financial institutions significantly exceeds this number, most of them will not qualify as MPMs under IFRS for the following main reasons.

- (a) They are excluded from MPMs on the basis of paragraph 118 of IFRS 18.
- (b) They represent measures and ratios which do not meet, either entirely or partially as numerator or denominator in a ratio, the definition of MPM as subtotals of income and expenses. For instance, this may include capital adequacy/solvency ratios, performance ratios (e.g. cost-income ratio, combined and similar ratios for insurance entities), liquidity ratios and measures of operational performance (e.g. loan-to-deposit ratio), leverage ratios, performance indicators for loan portfolios (e.g. coverage ratio for non-performing loans), etc.

124 As a result, in accordance with the desktop review performed, the share of performance measures which meet the definition of MPM under IFRS 18 does not exceed 20% of all APMs currently used by financial institutions in their financial reporting and financial communication with very limited exceptions, and in most cases it is below this proportion (10-15%).

125 Most of the financial institutions included in the review used adjusted net result, among other MPMs used, either as a stand-alone MPM or as a numerator in a ratio (e.g. ROE, ROTE, ROA, RORWA, etc.). Many financial institutions used multiple MPMs and/or ratios containing MPMs which are based on adjusted net profit. Therefore, to better illustrate potential costs to be borne to fulfil the requirements of IFRS 18, especially those concerning reconciliation in paragraph 123 above, we referred to the number of MPMs only, including numerators and denominators used in the ratios (e.g. adjusted IFRS result is only calculated once even if it is used as numerator in multiple ratios). On the contrary, the total number of performance measures containing MPMs, including ratios, is between 2 and 12.

126 All financial institutions included in the review used APMs in their financial communication outside of the financial communication, while many also used them inside the financial statements. However, in general the information on the APMs provided outside of the financial statements (e.g. in press releases, investor presentations and in separate sessions

of annual reports) is much more detailed compared to the level of details on the APMs provided inside the financial statements. Almost all financial institutions analysed, with very limited exception, provide a separate section on APMs or a glossary with a description of the APMs they use. 57% of the financial institutions analysed provide this section outside of the financial statements (most frequently, as a separate section in the annual report), while 36% include it as a separate section in the financial statements.

- 127 All financial institutions analysed provide various levels of disclosure over the way they calculate the APMs they currently use. Many financial institutions only provide a qualitative description of the APMs they currently use. Others provide a quantitative reconciliation of these APMs which can be reused when providing the reconciliation of MPMs as required by IFRS 18. However, in order to meet the requirements of IFRS 18, such reconciliations are to be further updated, e.g. to include information on tax effects, which is not done as of now.

Associated costs and benefits

Costs for preparers

- 128 When assessing the costs associated with the newly introduced requirements in IFRS 18 to disclose information about MPMs, EFRAG considers that some initial one-off costs will be incurred by reporting entities.
- 129 IFRS 18 requires that entities identify their MPMs and explain what aspect of the entity's performance is communicated by the disclosed measure. In EFRAG's view, this requirement will involve some training time for employees to get familiar with the new requirements on MPMs. Therefore, reporting entities will need to invest some manhours to familiarise their staff with the description and disclosure requirements for MPMs. These costs are, however, expected to be one-off costs that entities will incur.
- 130 Considering the results of the desktop review carried out on MPMs, EFRAG observes that reporting entities already report APMs inside and outside their financial statements. Applying IFRS 18 requirements, entities will need to assess how many of the reported APMs will qualify as MPMs. Based on EFRAG's assessment, one in three observed APMs will qualify to be considered MPMs by corporate entities and no more than 20% by financial institutions (in most cases, 10-15%). The costs associated with this assessment are expected to be one-off costs except in cases where there is a change in a previously disclosed MPM or a new measure being identified.
- 131 Additionally, considering that the IASB limited the scope of MPMs to only include a subtotal of income and expenses, the resources necessary to perform the assessment on scope of MPMs should not be burdensome for entities to carry out. The definition of MPMs eliminates a significant part of the performance measures which are calculated as a ratio usually including assets, liabilities, debt and equity as a numerator or denominator. For these APMs a more detailed analysis needs to be carried out to conclude whether a numerator or a denominator of the ratio represents an MPM (e.g. adjusted net profit).
- 132 EFRAG also expects that the number of MPMs which require disclosure under IFRS 18 may be further reduced due to the permission of the IASB to rebut the presumption that a subtotal of income and expenses that it uses in public communications outside its financial statements communicates to users of financial statements management's view of an aspect

- of the financial performance of the entity as a whole (paragraphs 120 and B124-B131 of IFRS 18).
- 133 Paragraph B125 of IFRS 18 provides the following examples of reasonable and supportable information that demonstrate that a subtotal does not communicate to users of financial statements management's view of an aspect of the financial performance of an entity as a whole:
- (a) an entity communicating the subtotal without prominence; and
 - (b) management not using the subtotal internally to assess or monitor the entity's financial performance.
- 134 In addition, paragraph B129 of IFRS 18 provides examples of reasonable and supportable information that demonstrates an entity has a reason for using a subtotal in its public communications other than to communicate to users of its financial statements management's view of an aspect of the financial performance of the entity as a whole are that the subtotal in question:
- (a) is required in a public communication by law or regulation;
 - (b) communicates performance related to financial statements prepared in accordance with an accounting framework other than IFRS Accounting Standards;
 - (c) is used in a public communication to satisfy a request from an external party; or
 - (d) is used in a public communication for the purpose of communicating information other than financial performance.
- 135 It is likely that preparers will actively use this area of judgement, e.g. financial institutions may apply the arguments of paragraph B129 (a)(c) mentioned above. This may further reduce the number of MPMs and, accordingly, the costs to be borne by the preparers.
- 136 For all the identified MPMs, IFRS 18 requires reporting entities to disclose how the MPM has been calculated and reconcile it to the most directly comparable subtotal listed in paragraph 118 of IFRS 18 or the total or subtotal specifically required by IFRS Accounting Standards. As mentioned above with regard to financial institutions, the way the calculation of APMs is currently presented may provide some basis for the reconciliations under IFRS 18, especially for the entities which already use a degree of quantitative reconciliation when explaining their APMs.
- 137 In general, EFRAG considers that these MPM disclosures will result in costs for preparers, as new disclosures will need to be prepared by reporting entities.
- 138 With respect to providing reconciliation for MPMs, although both corporate entities and financial institutions already provide in most cases a reasonable level of reconciliation, either qualitative or quantitative, or a description including some information on tax effects, EFRAG anticipates that these disclosures will result in some costs for entities. Some preparers that participated in EFRAG's outreach on the topic have indicated that entities might need to make changes to their consolidation and reporting systems to collect the necessary information on tax and NCI effects.
- 139 EFRAG also acknowledges that the IASB provided a simplification for how entities are to determine the income tax effect when providing MPM reconciliation. This simplification is

intended to mitigate preparers' cost when preparing the reconciliation. Preparers have indicated that the simplifications introduced were appreciated, including being able to calculate the tax effects by multiplying the reconciling line item at the statutory tax rate of the jurisdiction. However, no simplification was provided for NCI effects which would require adjusting their consolidation system.

- 140 EFRAG anticipates that the incremental costs to comply with the new requirements should be minimal, as entities are not expected to change their management-defined performance measures often. The main ongoing costs will relate to auditing these disclosures.
- 141 On balance, EFRAG assesses that the costs of complying with the new disclosure requirements for MPMs will be moderate, with only several disclosures related to providing reconciliation between MPMs and IFRS accounting information resulting in higher one-off costs.

Costs for users

- 142 As it relates to the costs for users, EFRAG does not anticipate any significant costs related to disclosures of MPMs for users of the financial statements. In general, the IASB added the MPM requirements based on feedback received from users to increase transparency of reporting of APMs.
- 143 Initially, users will need to invest time to become familiar with the new MPM requirements. However, EFRAG anticipates that the time they invest in getting to learn the new disclosure requirements will be minimal. In general, users are quite familiar with the APMs that entities present in their public communications and how these measures can be used in users' analysis.

Benefits for preparers and users

- 144 EFRAG has carried out an assessment of the benefits for users and preparers resulting from IFRS 18.
- 145 Usually introducing new disclosures for preparers is associated with extra cost burden for reporting entities. Entities will have to collect information about APMs that meet the definition of MPMs and present this piece of information in a single note to the financial statements. This will create a better structured summary of their performance measures and impose a discipline for reporting entities to be consistent in their analysis.
- 146 For users, the benefits of disclosing information about MPMs are numerous. It was the users' feedback that indicated to the IASB that some disclosures about performance measures were necessary. The most important benefits of the disclosure of MPMs for users are the following:
- (a) increased transparency about MPMs;
 - (b) improvement of users' understanding of how and why certain performance measures are provided;
 - (c) the provision of a link between MPMs and IFRS accounting information, including income tax effect and the effect on NCI for each reconciling item;
 - (d) the provision of explanations about all the major changes related to MPM disclosures; and

- (e) a clear location for the MPMs in a single note to the financial statements.

Summary and Conclusion on the costs and benefits of IFRS 18

- 147 As outlined in the beginning of Appendix 3, the impact assessment performed by EFRAG, which included the analysis of the financial statements and press releases from 45 entities, is not statistically representative; however, it allows for the identification and understanding of the main areas where entities and users of financial statements are likely to incur the costs or to avail themselves of the benefits associated with IFRS 18.
- 148 The analysis performed by EFRAG is based on the published annual financial statements. It should be noted that costs are also incurred for interim reporting albeit to a limited extent.

Implementation costs for preparers and users

- 149 EFRAG identified implementation costs for the companies stemming from the need to reconsider the current presentation of the financial statements and associated disclosures, to adjust business processes and systems accordingly, to train employees on the new IFRS 18 requirements, to reassess and where necessary change existing contracts (ex-covenants, bonus schemes), to adapt performance metrics used internally and/or communicated externally and to support associated audit costs. These various costs are expected to be incurred to various degrees at both subsidiaries level and parent level and across all industries. EFRAG's analysis looked separately at corporates and financial institutions; however, it is evident that all industries will be impacted and that the impact may differ based on the entity's current practices, availability of information, adaptability of the IT systems, business model and other factors. As such, for some of the entities, such costs may be significant.
- 150 EFRAG notes that financial institutions, namely banks and insurance companies, face particular challenges, as outlined in the dedicated sections. The banking industry is highly regulated and must comply with specific requirements on top of IFRS Accounting Standards. Banks are required to provide additional disclosures, and the presentation of their financial statements is impacted by the regulatory authorities (e.g. FINREP). Therefore, their implementation costs also include the costs of adjusting their reporting towards various regulatory and compliance authorities based on the adjusted financial statements following the implementation of IFRS 18.
- 151 Regulatory requirements exist as well for the insurance industry. In addition, insurance companies have just undergone the implementation of IFRS 17 *Insurance Contracts*, which included significant modifications introduced in the statement of financial performance and performance measures used by the entities, and would need to reassess their reporting practices in light of IFRS 18. As mentioned in the dedicated sections, insurance companies often have specific business models which may include a direct link between investments in the equity-accounted associates or joint ventures and insurance liabilities forming part of the underwriting result included within the operating profit. EFRAG acknowledges that IFRS 18 offers various mitigating solutions to the issue raised by the industry; however, all of those solutions may result in additional costs (e.g. disclosing adjusted performance measures as MPMs with related reconciliations and disclosures) and may not fully address the issue raised by the industry, as results from equity-accounted associates or joint ventures can only be reported related to the operating result.

- 152 Further, it is worth noting that entities falling within the scope of the expected rate-regulated activities standard will soon be subject to a separate Standard affecting the presentation in the statement of profit or loss. The Standard is expected to be issued in the second half of 2025. The timing of the issuance may affect implementation costs. An early issuance date could enable preparers to consider the new requirements when implementing IFRS 18 for that specific industry.
- 153 Moreover, since IFRS 18 does not offer transitional relief for entities that are required to present more than one comparative period by their jurisdiction, these entities are expected to incur additional costs. They may need to implement IFRS 18 earlier than anticipated, with potential challenges such as adapting systems still in development by service providers or changing an additional year of financials prepared in accordance with IAS 1.
- 154 On the users' side and based on the feedback collected by EFRAG, there were no significant implementation costs raised. Nevertheless, as with any new Standard, it is reasonable to expect that the users will need to understand the impact of the change on their analysis and potential system changes, adjust their ratios, analysis and databases for the historical information, train employees, etc. These are one-off costs generally experienced with any new Standard, and considering the significance of IFRS 18 and various areas it will impact, the costs are also expected in various areas and to various degrees.

Ongoing costs

- 155 Ongoing costs for preparers are expected to be relatively low. Certain areas requiring continuing reassessment and/or involving judgement (e.g. considerations on aggregation and disaggregation) will require management's involvement on a continuing basis; however, these costs are normal for any area of accounting where judgement is involved and are not specific to IFRS 18. The reconciliation related to the use of Management Performance Measures might incur regular ongoing costs. Audit costs are expected to be higher due to the inclusion of MPMs in a single note within the financial statements or the assessment of the judgement used. However, based on the analysis performed the number of the alternative performance metrics filling in the criteria to become an MPM is not very significant.

Cost-mitigating factors introduced by the IASB

- 156 From preparers' point of view, it is noted that the IASB considered concerns raised by the companies and various industries and incorporated various provisions aiming to mitigate the costs and/or undue effort associated with IFRS 18 requirements. It is further noted that the Standard allows sufficient flexibility for management to structure their financial statements in a useful way, reflecting specificities of the entity or its industry (various accounting policy options, specified main business activities, additional subtotals, MPMs, guidance on roles of financial statements and the notes, etc.).

Benefits

- 157 As to the benefits identified, it is important to highlight that the user community provided very positive overall feedback. They highlighted the clear structure of the statement of profit or loss, allowing for better analysis based on improved comparable information quality helping streamline data collection. The improvement of the aggregation and disaggregation requirements will lead to less judgement involved when preparing the financial statements and better understandability of the information presented. For entities presenting by

function or using a mixed presentation, receiving additional information will support their analysis. The one single location for the disclosure of MPMs within the notes of the financial statements and the reconciliation requirements will ease the retrieval of information and will improve the reliability of such information. Feedback received from the user community is aligned with the view of the IASB that IFRS 18 represents the most significant change to companies' presentation of financial performance since IFRS Accounting Standards were introduced more than 20 years ago. In the IASB's view, it will give investors better information about companies' financial performance and consistent anchor points for their analyses.

- 158 Users acknowledged that for some industries the implementation of IFRS 18 may be more costly, and for some industries or specific business models certain provisions of IFRS 18 may be less relevant; however, they insisted on sector-agnostic requirements and homogenous presentation of financial statements across entities and industries.
- 159 Both preparers and users commented on the labelling of categories within the statement of financial performance, noting that the labelling is the same as under IAS 7 *Statement of Cash Flows*; however, there is no reciprocity between the two statements, in line with the IASB's intention. This may lead to some training costs to avoid confusion, specifically for users of financial statements. Such costs are expected to diminish following the learning curve.
- 160 Better information about a company's performance is expected to benefit both preparers and users of financial statements, contributing to proper evaluation of stewardship and fair capital allocation within the market.

Conclusion

- 161 Based on the impact assessment performed and considering the feedback received from various stakeholders, EFRAG concludes that the benefits of IFRS 18 are likely to outweigh the implementation costs and any associated on-going costs.

Effects on the European economy, including financial stability and economic growth

Assessing whether IFRS 18 is likely to have an impact on financial stability

- 162 IFRS 18 is expected to improve the quality of financial reporting and brings significant changes mainly to the information companies provide about their financial performance. According to the IASB's [Effects Analysis](#), IFRS 18 is expected to provide investors with more useful information about financial performance, improve comparability between entities and reporting periods and increase transparency about non-GAAP measures, enabling better evaluation of management stewardship.
- 163 The Standard is the result of a major standard-setting project that has been running for several years and will impact all entities applying IFRS Accounting Standards. Nevertheless, IFRS 18 brings almost exclusively changes to the presentation of financial statements and, therefore, it is not expected to have an impact on financial stability.

Potential effects on competitiveness

- 164 For understanding the potential effects to the European economy and particularly the effect on competitiveness, a comparison between the requirements under IFRS 18 and Generally Accepted Accounting Principles in the United States ('US GAAP') has been conducted. Relevant SEC regulations (or 'guidance') applicable to US publicly traded companies have also been considered in this comparison, as they provide incremental guidance and govern various aspects of how registrants must disclose information. Although SEC guidance is mandatory for publicly listed entities, private companies may also refer to it for best practices or for certain disclosures with respect to the presentation of financial statements, as US GAAP does not provide prescriptive guidance on the presentation of financial statements. US GAAP together with IFRS are the two primary financial reporting frameworks used worldwide. However, given the extensive application in practice of SEC guidance by both public and private, both US GAAP and SEC guidance have been considered for the purposes of this analysis. Therefore, it is important to consider whether the lack of convergence between IFRS 18 and US GAAP and SEC guidance will result in any material competitive advantage or disadvantage for European entities applying IFRS Accounting Standards.
- 165 The US GAAP requirements and SEC guidance for presentation and disclosure of information differ from the requirements of IFRS 18. The main differences between the two frameworks are presented across the following topics:
- (a) categories and subtotals in the statement of profit or loss;
 - (b) management-defined Performance Measures (MPMs);
 - (c) enhanced requirements on grouping of information (aggregation and disaggregation); and
 - (d) other changes to financial reporting
- 166 The key requirements under IFRS 18 and US GAAP and SEC guidance for each of the topics listed in paragraph 165 are outlined, highlighting the key differences between the two accounting frameworks. EFRAG's overall assessment of the expected effects on competitiveness to the European economy is provided at the end of the section.

Categories and subtotals in the statement of profit or loss

Categories

- 167 IFRS 18 promotes a more structured income statement, as entities need to classify income and expenses into five categories: operating, investing, financing, income taxes and discontinued operations. Entities with specified main business activities are required to classify in the operating category some income and expenses that would otherwise be classified in the investing category or the financing category.
- 168 Unlike IFRS 18, US GAAP is not prescriptive about the format of the income statement but requires entities to distinguish between income from continuing operations and discontinuing operations. Some articles in regulation S-X prescribes separate income statement line-item captions for income and expenses of specific industries. However, unlike IFRS 18, US GAAP and SEC guidance do not prescribe the classification of income and expenses by comparable specific categories. SEC guidance prescribes income tax expenses and discontinued operations line items, which can be equivalent to the income taxes and discontinued operations categories under IFRS 18 requiring the separate presentation of income tax and discontinued operations.
- 169 Similar to the IFRS 18 requirement related to the classification of some income and expenses of entities with main business activities, Regulation S-X (Articles 7 and 9) prescribe the classification requirements for certain specialised industries, insurance and bank holding companies. These kinds of companies would typically be entities with specified business activities under IFRS 18.
- 170 Under IFRS 18, results from equity-accounted investees are presented below operating profit, in the investing category. Under US GAAP⁵, the presentation rules generally require equity method earnings to be presented below the income tax line unless a different presentation is justified by the circumstances. The SEC staff has indicated that in certain limited circumstances it may be appropriate to include income from equity investments in operations because some reporting entities operate their business largely through equity investees, or the equity investee may be integral to the investor's operations.

Subtotals

- 171 IFRS 18 introduces two new required subtotals: 'operating profit or loss' and 'profit before financing and income taxes'. In addition, entities are required to present additional subtotals when such presentations are necessary to provide a 'useful structured summary' of the company's income and expenses.
- 172 Unlike IFRS 18, US GAAP does not define the term 'operating' and does not require the presentation of a subtotal similar to 'operating profit or loss'. However, the use of the subtotal 'operating income' is mentioned in various topics as a possible subtotal to be presented in the income statement⁶. Similarly, US GAAP does not prescribe the presentation of a subtotal comparable to 'profit before financing and income taxes'. In practice, many companies present operating profit although it is not defined under US GAAP. [Regulation S-X](#) prescribes specific line items/subtotals in the income statement, but they do not align with

⁵ Please see ASC 323.

⁶ For example, ASC 360-10-45-5, ASC 410-3-45-4 and ASC 420-10-45-3.

those newly defined by IFRS 18. Nevertheless, entities are permitted to provide additional subtotals beyond those required by SEC regulations.

- 173 In addition, under IFRS 18, results from equity-accounted investees are presented in a separate line item outside the operating profit subtotal. Similarly, SEC regulations require separate presentation of equity in earnings of equity method investees. However, placement would be after income tax expense but before discontinued operations, separate from other line items instead of being part of the profit before financing and income taxes.

Management-defined Performance Measures (MPMs)

General approach

- 174 IFRS 18 defines and introduces new disclosure requirements for 'management-defined performance measures' (MPMs) in the notes to the financial statements. The requirements introduced by IFRS 18 are applicable only to measures of financial performance used in public communication (as part of the financial reporting or outside financial reporting). Europe ESMA's guidelines, which are applicable to all entities listed on EU markets for management reporting, address measures of financial performance, financial position or cash flows. For the purposes of analysing the effects of IFRS 18 on the European economy, ESMA's guidelines are not considered as they remain unchanged since the publication of IFRS 18 and any similarities or differences with the US regulations remain as such.
- 175 Similar to ESMA's guidelines for the EU capital market, SEC registrants also need to comply with the specific regulatory requirements when they publicly disclose alternative performance measures referred to as 'non-GAAP measures' in the regulatory literature. Non-GAAP financial measures refer to metrics that are not defined by GAAP (US GAAP for domestic SEC registrants or IFRS for foreign private issuers that prepare financial statements in accordance with IFRS Accounting Standards) but are used by companies to provide additional insights into their financial performance.
- 176 The applicable guidance for a non-GAAP measures depends on where it is disclosed, whether in an SEC filing (such as a Form 10-K or Form 10-Q), earnings release or other public disclosure. Companies that disclose non-GAAP measures have to follow SEC's rules and interpretations in Regulation G, Regulation S-K Item 10(e) and the SEC staff Compliance and Disclosure Interpretations (C&DIs) on non-GAAP measures, which help companies to interpret how these regulations apply in practice.
- 177 For the purposes of this analysis, two main layers of regulation⁷ that apply to the publicly disclosed non-GAAP measures have been considered:
- (a) **Layer 1:** Regulation G which applies to any public disclosure of non-GAAP financial measures; and
 - (b) **Layer 2:** Item 10(e) of Regulation S-K which contains additional requirements for non-GAAP measures disclosed in SEC filings (e.g., Form 10-K or Form 10Q).

⁷ Authoritative guidance regarding the use of non-GAAP financial measures can be found in: (a) Regulation G, (b) S-K 10(e)(c) Exchange Act Release No. 47226, *Conditions for Use of Non-GAAP Financial Measures*.

- 178 Regulation G provides the definition of non-GAAP measures and governs disclosure requirements when public entities disclose non-GAAP financial measures in their public communications.
- 179 Item 10(e) of Regulation S-K introduces additional requirements for non-GAAP measures disclosed in SEC filings and includes several prohibitions and guidelines for these measures. (e.g. the presentation of non-GAAP measures is prohibited in the face of the financial statements and in the accompanying notes, or any pro-forma information).

Definition

- 180 IFRS 18 provides the definition of a MPM as provided in paragraph 12 of Appendix 1.
- 181 A non-GAAP financial measure is defined as a numerical measure of a registrant's historical or future financial performance, financial position or cash flows that:
- (a) Excludes amounts, or is subject to adjustments that have the effect of excluding amounts, that are included in the most directly comparable measure calculated and presented in accordance with GAAP in the statement of income, balance sheet or statement of cash flows of the issuer; or
 - (b) Includes amounts or is subject to adjustments that have the effect of including amounts, that are excluded from the most directly comparable measurements calculated and presented in accordance with GAAP.
- 182 A non-GAAP financial measure does not include operating and other financial measures and ratios or statistical measures calculated using exclusively:
- (a) financial measures calculated in accordance with GAAP; and/or
 - (b) operating measures or other measures that are not non-GAAP financial measures.
- 183 A non-GAAP financial measure does not include financial measures required to be disclosed by GAAP, Commission rules, or a system of regulation of a government or governmental authority or self-regulatory organisation that is applicable to the registrant.
- 184 Finally, Regulation G contains an antifraud prohibition stating that registrants shall not make any non-GAAP financial measure public, if that measure contains an untrue statement of a material fact or omits to state a material fact necessary in order to make the presentation of the non-GAAP financial measure misleading.
- 185 Even though not equivalent, non-GAAP financial measures are the closest measures to MPMs that apply to SEC-registrants, which are dealt by Regulation G (Art. 2). Non-GAAP financial measures have a broader definition than MPMs as they include measures of financial performance, financial position or cash flows.

Disclosure requirements

- 186 IFRS 18 requires entities to disclose information about all measures that meet the definition of a MPM in a single note within the financial statements. This note shall include a statement that the MPMs provided the management's view of an aspect of the financial performance of the entity as a whole and that they are not necessarily comparable with measures sharing similar labels or descriptions provided by other entities.
- 187 For each MPM, entities shall disclose:

- (a) a description of the aspect of financial performance that it communicates;
 - (b) a description of how the MPM is calculated;
 - (c) a reconciliation between the MPM and the most directly comparable subtotal listed in IFRS 18.118 or the total or subtotal specifically required to be presented or disclosed by IFRS Accounting Standards;
 - (d) the income tax effect and the effect on non-controlling interest for each item disclosed in the reconciliation required by (c); and
 - (e) a description of how the entity determined the income tax effect in (d).
- 188 Similar to IFRS 18, Regulation G includes some reconciliation requirements for SEC registrants: whenever an entity discloses any material information that includes a non-GAAP financial measure, it should provide the following information:
- (a) a presentation of the most directly comparable financial measure calculated and presented in accordance with GAAP; and
 - (b) a reconciliation, which shall be quantitative, of the difference between the non-GAAP measure and the most directly comparable financial measure in accordance with GAAP.
- 189 In addition, for non-GAAP measures included by a public entity in an SEC filing (or an earnings release under Form 8-K, Item 10(e) of Regulation S-K requires entities to include:
- (a) a presentation, with equal or greater prominence, of the most directly comparable GAAP financial measure;
 - (b) a quantitative reconciliation of the differences between the non-GAAP financial measure and the most directly comparable GAAP financial measure;
 - (c) a statement why management believes the non-GAAP financial measure provides useful information for investors; and
 - (d) to the extent material, a statement of the additional purposes for which management uses the non-GAAP financial measure.
- 190 In terms of how the non-GAAP measure is to be calculated or presented, Regulation S-K prohibits:
- (a) excluding charges or liabilities that required, or will require, cash settlement or that would have required cash settlement absent an ability to settle in another manner from non-GAAP liquidity measures. This prohibition does not apply to EBIT and EBITDA used as liquidity measures;
 - (b) adjusting a non-GAAP performance measure to eliminate or smooth items identified as non-recurring, infrequent or unusual when (1) the nature of the charge or gain is reasonably likely to recur within two years or (2) there was a similar charge or gain within the prior two years;
 - (c) presenting non-GAAP financial measures on the face of the GAAP financial statements or in the notes;

- (d) presenting non-GAAP financial measures on the face of any pro forma information required to be disclosed by Article 11; and
- (e) using titles or descriptions of non-GAAP measures that are the same or confusingly similar to GAAP titles.

Enhanced requirements for grouping of information (aggregation and disaggregation)

Principles for grouping of information

- 191 IFRS 18 enhances the requirements for grouping (aggregation and disaggregation) information in the primary financial statements and the notes. The requirements are based on principles for grouping of information whereby entities:
- (a) aggregate items based on shared characteristics;
 - (b) disaggregate items based on characteristics that are not shared;
 - (c) aggregate or disaggregate items so that they provide a 'useful structured summary' or disclose material information in the notes; and
 - (d) ensure that aggregation and disaggregation do not obscure material information.
- 192 Unlike IFRS 18, US GAAP does not contain detailed guidance on how to group information, however, Regulation S-X prescribes for specific industries sub-captions and disaggregation of specific items. In this context, it should be noted that on 27 November 2023, the FASB issued ASU No. 2023-07, which requires additional disclosures for public entities' reportable segments and provides users of financial statement with more disaggregated expense information. However, while the FASB's ASU focuses on a specific reporting area, IFRS 18 introduces a broader disaggregation principle applicable across all primary financial statements.
- 193 What is similar, though, is that in both IFRS 18 and US GAAP each line item should include classes of items with similar characteristics. Moreover, for some specified items material amounts should be separately stated (disaggregated) – see, for example, Regulation S-X Article 5-03 item 3 – similar to IFRS 18.

Presentation of operating expenses

- 194 As under IAS 1, IFRS 18 allows entities to present an analysis of operating expenses either by nature, by function or on a mixed basis. However, IFRS 18 provides guidance on the presentation of expenses that will help entities to choose the presentation method that would provide the most 'useful structured summary'.
- 195 Unlike IFRS 18, US GAAP does not contain detailed guidance on the presentation of the income statement, US GAAP does not define 'operating' and there is no comparable guidance that requires the classification of expenses by nature or by function. However, as previously discussed SEC has prescriptive guidance on the face of the income statement for registrants in different industries and of different size or maturity..

Disclosure of specified expenses by nature

- 196 IFRS 18 requires entities that present operating expenses by function in the statement of profit or loss to disclose five specified expenses by nature.
- 197 Under US GAAP, there is no equivalent requirement for disclosing specified operating expenses by nature when presented by function. However, on 4 November 2024 the FASB

issued the Accounting Standards Update ('ASU') No. 2024-03, [Disaggregation of Income Statement Expenses](#) with an effective date of 31 December 2027 and requires additional disaggregation of income statement expenses in the form of a note disclosure. The ASU differs from IFRS 18 requirements in that it focuses solely on disclosure, whereas IFRS 18 includes additional income statement presentation and disclosure requirements beyond its scope. In particular, it will require public business entities to:

- (a) Disclose the amounts of (a) purchases of inventory; (b) employee compensation; (c) depreciation; (d) intangible asset amortization; and (e) depreciation, depletion, and amortization recognized as part of oil- and gas-producing activities (or other amounts of depletion expense) included in each relevant expense caption.
- (b) Include certain amounts that are already required to be disclosed under current generally accepted accounting principles (GAAP) in the same disclosure as the other disaggregation requirements.
- (c) Disclose a qualitative description of the amounts remaining in relevant expense captions that are not separately disaggregated quantitatively.
- (d) Disclose the total amount of selling expenses and, in annual reporting periods, an entity's definition of selling expenses.

Other changes to financial reporting

Interest and dividend cash flows

198 IFRS 18 removes the presentation alternatives for cash flows related to interest and dividends paid and received. For those entities without a specified main business activity, interest and dividends paid are classified in the financing category and interest and dividends received in the investing category.

199 Like IFRS 18, US GAAP⁸ prescribes the classification of interest and dividends paid and received in different categories, however, and regardless of whether the entity's main business activity. Interest received and paid as well as dividends received from previously undistributed earnings are required to be classified in the operating category. Dividends paid are classified in the financing category, like under IFRS 18.

Statement of cash flows – starting point for the indirect method

200 IFRS 18 requires all entities to use the new defined operating profit or loss subtotal as the starting point for reporting cash flows from operating cash flows using the indirect method.

201 Similar to IFRS 18, US GAAP⁹ also requires entities to use a specified subtotal as a starting point for the indirect method. However, unlike IFRS 18 the starting point is required to be 'net income', which requires the use of 'operating profit or loss'.

Expected effects of competitiveness on the European economy - summary and conclusion

202 Appendix 1 provided a summary of the issues raised by stakeholders, following the 2015 Agenda Consultation and subsequent research and outreaches, which led to improved requirements brought by IFRS 18. The feedback provided in EU pre-IFRS 18 is similar to the

⁸ Topic 230, Subtopic 405-50.

⁹ Topic 230, Subtopic 405-50

some of the key areas addressed by the SEC staff in their comment letters and some of the feedback received in the [2021 FASB Agenda Consultation](#), as demonstrated in the topics outlined below.

- (a) **Categories and subtotals in the statement of profit or loss:** IFRS 18 is expected to improve relevance, reliability, comparability and understandability in the classification of income and expenses and related subtotals in response to the issues raised by stakeholders highlighting diversity in practice, lack of information and other issues outlined in Appendix 1. Similar to the issues faced by EU stakeholders pre-IFRS 18, in recent years the SEC frequently commented on the presentation of revenue and cost of sales in the income statement, the lack of disclosures related to certain line items and the exclusion of depreciation and amortisation from income statement subtotals (e.g. gross profit). As business models evolve, these may not fit into the presentation requirements of Regulation S-X (Articles 5, 7 and 9), leading to the acceptance of hybrid presentations, especially for industries like financial technology. Registrants were also reminded to ensure proper classification and labelling of line items.
- (b) **Management-defined Performance Measures:** Users of financial statements have called for improved transparency on why entities use non-GAAP financial measures and how they are calculated, which led to the introduction of the new requirements for MPMs under IFRS 18. Similarly, non-GAAP financial measures are frequently mentioned in SEC staff's comment letters regarding an entity's compliance with SEC guidance. As a result, the SEC staff has called the need for further guidance on non-GAAP financial measures that were considered misleading, which lead to the 2022 updates in the [Compliance & Disclosure Interpretations](#) ('C&Dis'), focusing on issues like the higher prominence of non-GAAP measures over GAAP results as well as issues with mislabelling and insufficient disclosures. For the measures specific to financial performance (MPMs under IFRS 18), entities reporting under IFRS will have benefit of having the information audited, as it will be part of the financial statements. Based on the current regulatory requirements in the US, such measures are prohibited from being presented on the face or in the notes of the financial statements.
- (c) **Enhanced requirements on grouping of information:** IFRS 18 improved the requirements and guidance for application and disaggregation to address issues related to insufficiently detailed information, diversity in practice and inconsistency in aggregating and disaggregating items in the primary financial statements. Feedback received from the 2021 FASB Agenda Consultation, primarily from investors, underlined the need for greater disaggregation and granularity of financial reporting information. However, the focus was primarily on income statement expenses. This led to the IASB's revision of the project objective from [Disaggregation—Income Statement Expenses](#), which aimed at improving the usefulness of expense information that investors receive. Therefore, the difference is that IFRS 18 focuses on improved aggregation and disaggregation of items in all primary financial statements and the notes, compared to the FASB's ASU No. 2024-03 that focuses specifically on the disaggregation of income statement expenses only.

- 203 Based on the analysis provided above, it can be concluded that the issues raised by stakeholders bringing improved requirements under IFRS 18 are similar to those observed in the US. Even though IFRS 18 is expected to address the issues described above and lead to improved quality of financial reporting, some of these may still persist in the US, considering the current US-GAAP and SEC regulation requirements.
- 204 Overall, EFRAG's analysis suggests that IFRS 18 will improve relevance, reliability, understandability and comparability of information. Different lines of academic literature often provide a theoretical link between information quality and the cost of capital¹⁰. In addition, some academic studies have provided empirical evidence suggesting that increased transparency of financial performance information reduces a firm's cost of capital¹¹. Based on the evidence provided by academic studies, one view could be that improvements in information quality brought by IFRS 18 may result in lower cost of capital for entities implementing the new Standard, which in turn could potentially bring competitive advantage for entities in Europe applying IFRS compared to their US counterparts. Alternatively, it could also be argued that the new requirements introduced by IFRS 18, particularly the enhanced disclosure requirements, may impose a disadvantage and additional burden on preparers to ensure compliance. This could potentially result in a competitive disadvantage for these entities compared to their US counterparts; however, the expectation is that benefits stemming from IFRS 18 will outweigh the associated costs.
- 205 A number of provisions included in both IFRS 18 and US GAAP / SEC regulation are subject to management's judgement, and the effects of these requirements will depend on how entities apply them in practice. However, based on the analysis performed above, EFRAG has not identified circumstances in which IFRS 18 could have any adverse effect on the European economy, including financial stability and economic growth.

Overall assessing whether IFRS 18 is conducive to the European public good

- 206 EFRAG believes that IFRS 18 will generally bring improved financial reporting when compared to current guidance. As such, endorsement of IFRS 18 is conducive to the European public good in that improved financial reporting improves transparency and comparability and assists in the assessment of management stewardship. EFRAG has not identified any adverse effect on the European economy, including financial stability and economic growth. Further, EFRAG has concluded that the benefits of the endorsement of IFRS 18 outweigh the costs involved. Furthermore, EFRAG has not identified any other factors that would mean endorsement is not conducive to the public good. Having considered all relevant aspects, including the trade-off between the costs and benefits of implementing the Standard, EFRAG assesses that endorsing IFRS 18 is conducive to the European public good.

¹⁰ See, for example, Botosan (1997).

¹¹ See, for example, Barth et al. (2008).