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IFRS 18 – the clock is ticking: practical effects on financial reporting

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Background

IFRS 18 *Presentation and Disclosure in Financial Statements* supersedes IAS 1 *Presentation of Financial Statements* and is effective for annual reporting periods beginning on or after 1 January 2027, meaning that the 'clock is ticking' for entities to assess the effects of this new standard on their financial statements.

For entities with calendar year-ends, the 31 December 2027 annual financial statements (and any interim financial statements prepared during 2027, such as 30 June 2027 half-year financial statements) will reflect the effects of IFRS 18 on the primary financial statements and related notes.

IFRS 18 does not affect the recognition and measurement requirements of IFRS Accounting Standards, unlike other major new standards (e.g., IFRS 16 *Leases*, IFRS 17 *Insurance Contracts*, etc.), however, the effects of IFRS 18 on financial statements should not be underestimated.

This publication illustrates the practical effects that IFRS 18 may have on entities' financial statements using miniature case studies in following format:

EXECUTIVE SUMMARY

IFRS 18 will significantly affect how entities present and explain financial performance, even though it does not change recognition and measurement requirements.

This publication uses practical scenarios to illustrate how the new requirements may affect operating profit, classification of income and expenses, aggregation and disaggregation, cash flow presentation, management-defined performance measures and related disclosures.

The examples highlight that implementation may require changes to systems, processes, performance metrics, covenants and external communications. Entities should begin assessing these effects early so that the impact of IFRS 18 is understood before its first application in annual and interim reporting periods.

- **Background information**: necessary contextual information on the hypothetical entity.
- **IFRS 18 requirements**: explanation of how IFRS 18 affects the financial statements, with references to BDO's in-depth IFRS Accounting Standards In Practice - IFRS 18 publication for additional information.
- **Effect of adoption**: practical consequences of adopting IFRS 18 on the entity, such as effects on key performance indicators, covenants, etc.

These case studies are sub-divided into the following topics:

1. Structure of the statement of profit or loss
2. Aggregation and disaggregation of information in financial statements
3. Statement of cash flows: consequential amendments to IAS 7
4. Note disclosure
5. Other matters

This publication assumes that readers have a basic working understanding of the requirements of IFRS 18, however, you may access the following additional resources on IFRS 18:

- IFRS 18 At a Glance: condensed summaries of every IFRS Accounting Standard, including IFRS 18 summarised into four pages.
- IFRS Accounting Standards In Practice - IFRS 18: our comprehensive guide to IFRS 18 with detailed explanations, worked examples, illustrative statements of profit or loss and BDO's insights on the application of the standard.
- IFRS 18 online training resources: we have six e-learning courses on the requirements of IFRS 18 which equip learners with a basic working knowledge of IFRS 18.

Structure of the statement of profit or loss

For many entities, the most significant effect of applying IFRS 18 will be the introduction of a new structure in the statement of profit or loss. IFRS 18 requires entities to classify all income and expenses in the statement of profit or loss into one of five categories:

- Operating
- Investing
- Financing
- Income taxes
- Discontinued operations.

This classification drives the presentation of mandatory and additional sub-totals in the statement. For example, all entities that apply IFRS 18 are required to present an 'operating profit' sub-total, which consists of all income and expenses classified in the operating category.

IAS 1 had very limited requirements concerning the structure of the statement of profit or loss, therefore, these new requirements may significantly affect how an entity communicates its financial performance.

All references to 'IFRS 18 IP' below refer to [IFRS Accounting Standards In Practice - IFRS 18](#).

SCENARIO 1 – CHANGE IN PREVIOUSLY REPORTED OPERATING PROFIT	
Background information	Entity A is a manufacturing group that has historically presented an operating profit subtotal in its statement of profit or loss electively. Management defined this subtotal by excluding items it considered not reflective of underlying performance, including: ▶ Government grant income to support employees in the trades; ▶ Expected credit losses on trade receivables; and ▶ Goodwill impairment. Management also included the following in operating income: ▶ Fair value movements in investment property (vacant land held for uncertain future use); and ▶ Interest income from significant cash and cash equivalents held by the treasury department of the entity. Operating profit is a key performance indicator used with investors and the board of directors of Entity A.
IFRS 18 requirements	Operating profit is derived based on the classification requirements of IFRS 18. Entities are required to classify income and expenses based on how they are classified. Assuming that Entity A does not have any specified main business activities, it will be required to include/exclude the following income and expenses from operating profit, which will differ from its previous approach (see IFRS 18 IP section 3.9.5 for detailed explanations of the reason for the classification of these items): ▶ Government grant income must be classified in the operating category as it does not relate to specified assets or liabilities but rather to operating expenses (the salaries of trade employees); ▶ Expected credit losses on trade receivables must be classified in the operating category; ▶ Goodwill impairment must be classified in the operating category; ▶ Fair value movements in investment property must be classified in the investing category (i.e. excluded from operating profit) because the entity does not invest in them as a main business activity; and

SCENARIO 1 – CHANGE IN PREVIOUSLY REPORTED OPERATING PROFIT	
	▶ Income and expenses related to cash and cash equivalents are classified in the investing category (i.e. excluded from operating profit) (see IFRS 18 IP section 3.9.1).
Effect of adoption	Entity A's operating profit will significantly change as a result of how IFRS 18 requires income and expenses to be classified. Management will have much less discretion in how the statement of profit or loss is structured. This may increase or decrease operating profit compared to prior periods and create significant changes from previously reported subtotals.
	KPIs and performance targets: Changes in operating profit may affect internal metrics and external benchmarking.
	Covenants and remuneration: Debt covenants and share-based payments and other bonuses linked to operating profit may be affected.
	Communication: Additional use of management performance measures (MPMs) may be required to explain performance to users.

SCENARIO 2 – COMPOSITION OF FINANCE COSTS	
Background information	Entity B is a retail group that has historically presented a 'finance costs' line item in accordance with IAS 1. This line item included a broad range of expenses, including interest expense, credit card processing fees and foreign exchange losses on trade receivables. For the purpose of presenting operating profit, Entity B excluded these amounts from operating profit, resulting in a higher operating profit subtotal that was used internally and in communications with stakeholders.
IFRS 18 requirements	IFRS 18 removes the undefined concept of 'finance costs' and requires entities to classify income and expenses into defined categories: operating, investing, financing, income taxes and discontinued operations. Items are classified in the financing category only when they meet specific criteria. For example, interest expenses on long-term debt (assuming an entity does not have a specified main business activity). As a result, operating becomes the residual category under IFRS 18, meaning that income and expense not classified in another category must always be classified in operating. The resulting classification differs from Entity B's historical presentation as follows: ▶ Credit card processing fees must be classified in the operating category (do not relate to specified assets/liabilities; must be classified in operating as the residual category); and ▶ Foreign exchange losses on trade receivables must be classified in the operating category (see IFRS 18 IP section 3.9.3).
Effect of adoption	Entity B will need to reclassify certain expenses previously included in finance costs (and therefore excluded from operating profit) into the operating category. This will result in a reduction in operating profit compared to prior periods and a change in the composition of reported subtotals.
	Operating profit impact: Operating profit will decrease as additional expenses are included within the operating category.
	KPIs and performance targets: Changes in operating profit may affect internal metrics and external benchmarking.
	Comparability: Trends may no longer be directly comparable with prior periods, requiring explanation.
	Communication: Entity B may consider using management performance measures (MPMs) and enhanced disclosures to explain the impact of these changes to users of the financial statements.

SCENARIO 3 – ASSOCIATES AND JOINT VENTURES ACCOUNTED FOR USING THE EQUITY METHOD THAT ARE INTEGRAL TO THE ENTITY'S BUSINESS MODEL	
Background information	Entity C is a manufacturing group that has historically held interests in associates and joint ventures that are integral to its operations. For example, Entity C purchases key components from an associate that manufactures parts used in its production process. In presenting operating profit, Entity C has included its share of profit or loss from these associates and joint ventures accounted for using the equity method, on the basis that they are integral to its core business activities. Operating profit is a key performance indicator used in communications with investors and management.
IFRS 18 requirements	IFRS 18 requires income and expenses from associates and joint ventures accounted for using the equity method to always be classified in the investing category with no exceptions (see IFRS 18 IP section 3.8.1).
Effect of adoption	Entity C will be required to exclude its share of profit or loss from associates and joint ventures from operating profit. This represents a change from its historical presentation where such amounts were included.
	Operating profit impact: Operating profit will decrease where these investments generate income.
	Comparability: Subtotals may differ significantly from prior periods.
	Communication: Entity C may consider using management performance measures (MPMs) to explain performance, such as presenting an 'adjusted' operating profit, which includes these amounts that must be excluded from operating profit.

SCENARIO 4 – FOREIGN EXCHANGE DIFFERENCES	
Background information	Entity D is a multinational group that has historically aggregated foreign exchange gains and losses into a single line item within profit or loss, but not included in operating profit. This line includes foreign exchange differences arising from operating activities (e.g., trade receivables and payables), investing activities (e.g., financial assets) and financing activities (e.g., loans).
IFRS 18 requirements	Foreign exchange differences are generally classified consistently with the underlying item to which they relate; these requirements are complex to apply in practice (see IFRS 18 IP section 3.9.3). The resulting classification differs from Entity D's historical presentation as follows: ▶ Foreign exchange differences relating to operating items are classified in the operating category; ▶ Foreign exchange differences relating to investing items are classified in the investing category; and ▶ Foreign exchange differences relating to financing items are classified in the financing category.
Effect of adoption	Entity D will be required to disaggregate foreign exchange differences and classify them across multiple categories.
	Volatility in subtotals: Operating profit and other subtotals may become more volatile.
	Presentation changes: Greater disaggregation will be required.
	System changes: Systems and processes may not be designed to record foreign exchange differences in this way (i.e., systems may be programmed to record all foreign exchange amounts in a single journal entry as part of period end close).

SCENARIO 4 – FOREIGN EXCHANGE DIFFERENCES	
	Communication: Additional explanation may be required to support comparability.

SCENARIO 5 – DERIVATIVES AND HYBRID CONTRACTS	
Background information	Entity E issues a variety of financial instruments, including derivatives and hybrid contracts, which are used for risk management and financing purposes. These include interest rate swaps, foreign exchange forwards and convertible notes. Historically, Entity E has exercised judgement in presenting income and expenses from these instruments, often grouping them within finance costs or presenting them outside of operating profit.
IFRS 18 requirements	IFRS 18 requires entities to classify income and expenses based on their nature, the related assets or liabilities and the entity's business model. The classification of derivatives and hybrid contracts is complex and depends on multiple factors, including their use and accounting treatment (see IFRS 18 IP sections 3.9.2 and 3.9.4). For example, if Entity E issued convertible notes which it subsequently measured at fair value through profit or loss because it elected to use the 'fair value option' in IFRS 9, Entity E may have presented the fair value movements on those financial instruments as part of operating profit. However, upon adoption of IFRS 18, the fair value movements must be classified in the financing category, assuming Entity E does not have any specified main business activities (i.e., outside of operating profit) (see IFRS 18 IP section 3.9.4). Additionally, Entity E may have classified the fair value movement on derivatives that are not used to manage any of Entity E's risks (speculative derivatives) outside of operating profit (e.g., derivatives related to commodity or share prices). Such derivatives will generally be classified in the operating category and form part of operating profit, assuming Entity E does not have any specified main business activities (see IFRS 18 IP section 3.9.2).
Effect of adoption	Entity E may need to reclassify income and expenses arising from derivatives and hybrid contracts between categories. **Operating profit impact**: Operating profit may increase or decrease depending on classification outcomes. **Volatility**: Greater volatility in operating profit or loss may arise. **Communication**: Additional disclosures or MPMs may be needed.

SCENARIO 6 – ASSETS THAT GENERATE PASSIVE INCOME	
Background information	Entity F is a manufacturing entity that holds certain assets that generate passive income, including financial investments and a rental property. These assets are not part of its core operations, but Entity F has invested excess capital in those assets to generate additional return. Historically, Entity F has exercised judgement in how it has presented income from these assets, and Entity F has included them in operating profit. In some periods, they have formed a significant part of Entity F's operating profits.
IFRS 18 requirements	IFRS 18 requires income and expenses to be classified based on their nature and the entity's business activities. For entities that do not have a main business activity of investing in such assets, income from these assets will generally be classified in the investing category (see IFRS 18 IP section 3.2). Therefore, income from these assets will be excluded from operating profit. As noted above, entities will need to make an assessment of whether they have specified main business activities, as this will affect the classification of certain income and expenses. This may require the exercising of judgement (see IFRS 18 IP section 3.7).
Effect of adoption	Entity F will be required to present income from passive assets outside operating profit if it does not have a specified main business activity of investing in assets. **Operating profit impact**: Operating profit may decrease. **Performance measures**: KPIs may change. **Communication**: Additional explanation may be required.

SCENARIO 7 – EXPENSES RELATED TO INCOME GENERATING ASSETS	
Background information	Entity G holds investment property that generates rental income and fair value gains. Entity G has included this income as part of operating profit. Historically, Entity G has presented related expenses, such as cleaning and maintenance and management fees payable to third parties as part of operating profit as well, as they are related to the income earned on the properties.
IFRS 18 requirements	IFRS 18 limits the types of income and expenses that may be classified in the investing category. Assuming that Entity G does not invest in investment properties as a main business activity, the rental income and fair value gains will be classified in the investing category, and therefore be excluded from operating profit (see IFRS 18 IP section 3.8). However, only specified income and expenses are classified in the investing category (see IFRS 18 IP section 3.2.2). While cleaning and maintenance and management fees are related to the investment property, they do not meet the criteria to be classified in the investing category. Therefore, there will be a 'mismatch' – rental income and fair value gains will be excluded from operating profit, whereas cleaning and maintenance and management fees will be included in operating profit.

SCENARIO 7 – EXPENSES RELATED TO INCOME GENERATING ASSETS	
Effect of adoption	Entity G's operating profit may decrease as a result of this 'mismatch'.
	Operating profit impact: Operating profit may decrease.
	Mismatch: Income and related expenses may be presented in different categories.
	Communication: Additional explanation may be required.

SCENARIO 8 – CLASSIFICATION FOR GROUPS WITH DIVERSE OPERATIONS / CONGLOMERATES	
Background information	Entity H is a conglomerate with diverse operations, including manufacturing, financial services and investment activities. Historically, Entity H has exercised judgement in determining which activities are included within operating profit.
IFRS 18 requirements	IFRS 18 requires classification to reflect whether an entity has specified main business activities, such as investing in assets or providing financing to customers. This is a matter of fact and requires judgement, particularly when a group has a complex structure (see IFRS 18 IP section 3.7). For entities with specified main business activities, such as investing in financial assets and/or providing financing to customers, numerous accounting policy choices and special requirements apply to the classification of income and expenses from cash and cash equivalents and certain liabilities, such as bank loans (see IFRS 18 IP section 3.8).
Effect of adoption	Entity H may need to reclassify income and expenses based on its assessment of main business activities. Assessing its specified main business activities and the associated effect on the classification of income and expenses may take time and result in changes in presentation.
	Operating profit impact: Operating profit may increase or decrease.
	Judgement: Significant judgement will be required.
	Communication: Enhanced disclosure may be required to explain classification decisions.

Aggregation and disaggregation of information in financial statements

SCENARIO 9 – PRINCIPLES OF AGGREGATION AND DISAGGREGATION USED THROUGHOUT FINANCIAL STATEMENTS	
Background information	Entity I is a multinational group that prepares financial statements comprising thousands of individual transactions. Historically, Entity I has applied judgement under IAS 1 to determine how information is aggregated and disaggregated in the primary financial statements and notes. In practice, certain balances and expenses have been aggregated, including the use of 'other' categories in the statement of profit or loss and notes (e.g., 'other operating expenses').
IFRS 18 requirements	IFRS 18 introduces a comprehensive framework for aggregation and disaggregation that applies across the financial statements. These requirements require entities to group items based on shared characteristics and to disaggregate items that have dissimilar characteristics (see IFRS 18 IP section 4.2). The resulting presentation may differ from Entity I's historical approach as follows: ▶ Items previously aggregated may need to be disaggregated where they have different characteristics; ▶ Additional disaggregation may be required in both primary financial statements and notes; and ▶ The use of 'other' labelling for line items is restricted and only permitted in limited circumstances (see IFRS 18 IP section 4.5.1).
Effect of adoption	Entity I may be required to provide more granular disaggregation of information across its financial statements, resulting in changes to both the statement of profit or loss and note disclosures. **Level of detail**: Financial statements may contain more detailed information. **Use of 'other'**: Categories previously labelled as 'other' may need to be broken down further. **Systems and processes**: Systems may need to capture more granular data to support disaggregation. **Communication**: Additional disclosures may be required to explain the composition of balances.

Statement of cash flows: consequential amendments

SCENARIO 10 – CLASSIFICATION OF INTEREST AND DIVIDEND CASH FLOWS IN THE STATEMENT OF CASH FLOWS	
Background information	Entity J is a listed entity that prepares a statement of cash flows in accordance with IAS 7. Entity J sells goods to customers and providers financing to those customers to enable them to purchase goods on extended credit terms (e.g., heavy equipment). Therefore, Entity J provides financing to customers as a main business activity. Historically, Entity J has applied accounting policy choices permitted by IAS 7 in classifying interest and dividend cash flows as operating, investing or financing activities. For example, Entity J classified all its interest cash outflows as financing cash flows.
IFRS 18 requirements	IFRS 18 amends IAS 7 to remove accounting policy choices for the classification of interest and dividend cash flows and introduces a consistent classification framework. For entities without specified main business activities, interest and dividend cash inflows are classified as investing cash flows, and interest and dividend cash outflows are classified as financing cash flows. For entities with specified main business activities (such as Entity J), the amended requirements of IAS 7 are more complex. Entity J may classify the interest cash outflows in either operating or financing cash flows, but Entity J must apply a consistent choice for <u>all</u> interest cash outflows. For example, the single category selected would also apply to interest cash out flows on lease liabilities and those capitalised in accordance with IAS 23 (e.g., interest capitalised as part of a building constructed over a number of reporting periods).
Effect of adoption	Entity J will be required to change the classification of certain cash flows between operating, investing and financing activities. **Cash flow metrics**: Operating, investing and financing cash flow balances may increase or decrease. **Covenants and KPIs**: Changes in classification may affect metrics used in covenants and internal performance measures. **Communication**: Entities may need to explain changes in classification to stakeholders.

Note disclosure

SCENARIO 11 – MANAGEMENT-DEFINED PERFORMANCE MEASURES (MPMS)	
Background information	Entity K is a public company and has historically presented alternative performance measures (APMs), such as adjusted operating profit, in investor presentations and management commentary outside of the financial statements. These measures are not defined by IFRS Accounting Standards and are subject to regulatory reconciliation requirements in certain jurisdictions.
IFRS 18 requirements	IFRS 18 introduces the concept of management-defined performance measures (MPMs) and requires these measures to be disclosed within the financial statements. Detailed disclosure requirements apply, including: ▶ A description of the performance measure; ▶ An explanation of why the measure provides useful information; and ▶ A reconciliation to the most directly comparable subtotal defined by IFRS Accounting Standards (see IFRS 18 IP section 6.3).
Effect of adoption	Entity K will need to include MPM disclosures within the financial statements, rather than solely in external communications. **Disclosure requirements**: Disclosures may be more detailed and structured. **Audit implications**: MPM disclosures will be subject to audit. **Systems and processes**: Processes may need to be updated to ensure consistent calculation and reconciliation. **Communication**: Entities may reconsider how performance measures are presented externally.

SCENARIO 12 – NATURE/FUNCTION RECONCILIATION	
Background information	Entity L presents operating expenses by function (e.g., cost of sales, administrative expenses) in its statement of profit or loss. Historically, Entity L has not disclosed additional information about the nature of these expenses beyond the minimal requirements in IAS 1.104 ('additional information on the nature of expenses, including depreciation and amortisation expense and employee benefits expense').
IFRS 18 requirements	IFRS 18 continues to permit the presentation of expenses by function or nature, or a mixed basis. However, if operating expenses are presented by function wholly or in part, entities must disclose additional information about the nature of expenses (see IFRS 18 IP section 4.4.4). The extent of information to be disclosed is significantly more than IAS 1, and may require an entity to consider whether it includes operating expenses capitalised into the carrying amounts of assets (e.g., depreciation capitalised into inventories).
Effect of adoption	Entity L will be required to provide additional disclosures detailing the nature of expenses included within functional categories. **Disclosure complexity**: Additional disclosures may be extensive. **Systems and processes**: Systems may need to capture information by both function and nature. **Presentation**: Entities must determine how to present this information effectively.

SCENARIO 13 – EARNINGS PER SHARE		
Background information	Entity M has historically disclosed additional earnings per share measures, such as adjusted operating profit per share, with limited constraints on how these were calculated.	
IFRS 18 requirements	IFRS 18 amends IAS 33 to restrict additional per share measures to those based on IFRS-defined subtotals or management-defined performance measures. Where based on MPMs, IFRS 18 disclosure requirements apply (see IFRS 18 IP section 6.4.1). For example, Entity M would be required to provide MPM disclosures if it uses 'adjusted operating profit' as the numerator in an earnings per share calculation assuming it meets the other requirements to be an MPM.	
Effect of adoption	Entity M may need to revise how additional per share measures are calculated and disclosed.	
		Disclosure requirements: Additional disclosures may be required.
		MPM linkage: Some per share measures may trigger MPM disclosures.
		Communication: Entities may reassess whether to present additional per share metrics.

Other matters

SCENARIO 14 – INTERIM FINANCIAL REPORTING		
Background information	Entity N prepares interim financial reports in accordance with IAS 34, including quarterly and half-year reporting. Historically, changes in accounting standards have often been considered primarily at year-end.	
IFRS 18 requirements	IFRS 18 must be applied in interim financial statements when it becomes effective. Entities must reflect the presentation and classification requirements in interim reports and provide relevant disclosures, including MPM disclosures (see IFRS 18 IP sections 7 and 7.4). Therefore, Entity N must assess the effect of IFRS 18 in time for its interim financial reports (e.g., 31 March 2027), as those are affected by the adoption of IFRS 18.	
Effect of adoption	Entity N will need to apply IFRS 18 from the first interim reporting period in the year of adoption.	
		Timing: Effects of adoption must be reflected early in the reporting cycle.
		Systems and processes: Early implementation may require accelerated system changes.
		Communication: Interim reporting may require additional explanation of changes.

Conclusion

The scenarios in this publication illustrate that, although IFRS 18 does not change the recognition or measurement of items in the financial statements, its presentation and disclosure requirements may have pervasive practical effects. For some entities, the changes may be limited to presentation and labelling. For others, the effect on operating profit, management-defined performance measures, cash flow classification, note disclosures, systems and processes, covenants, remuneration arrangements and external communications may be significant.

Entities should therefore begin assessing the effects of IFRS 18 as soon as possible. This assessment should not be limited to the finance reporting team, as the adoption of IFRS 18 may require input from treasury, tax, investor relations, legal, remuneration, systems and operational teams. Early analysis will help entities identify areas of judgement, determine whether data is available at the required level of granularity, assess whether systems and processes require changes, and develop a communication plan for explaining changes to users of the financial statements.

Additional resources on IFRS 18

Entities should refer to BDO's tools and resources on IFRS 18, including:

- IFRS 18 At a Glance: condensed summaries of every IFRS Accounting Standard, including IFRS 18 summarised into four pages.
- IFRS Accounting Standards In Practice - IFRS 18: our comprehensive guide to IFRS 18 with detailed explanations, worked examples, illustrative statements of profit or loss and BDO's insights on the application of the standard.
- IFRS 18 online training resources: we have six e-learning courses on the requirements of IFRS 18 which equip learners with a basic working knowledge of IFRS 18.

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