

# IFRS 18 Presentation and Disclosure in Financial Statements — Basis for Conclusions

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*This Basis for Conclusions accompanies, but is not part of, IFRS 18. It summarises the considerations of the International Accounting Standards Board (IASB) when developing IFRS 18. Individual IASB members gave greater weight to some factors than to others.*

*IFRS 18 replaced IAS 1 Presentation of Financial Statements. When IAS 1 was revised in 2007, it was accompanied by a Basis for Conclusions summarising the considerations of the IASB in reaching some of its conclusions in that Standard. That Basis for Conclusions was later updated to reflect amendments to IAS 1. For convenience, the IASB has incorporated into its Basis for Conclusions on IFRS 18 paragraphs from the Basis for Conclusions on IAS 1 that discuss matters the IASB has not reconsidered. That material is contained in paragraphs denoted by the numbers with the prefix BCZ. In those paragraphs, cross-references to IAS 1 have been updated to the corresponding paragraphs in IFRS 18 and minor necessary editorial changes have been made. Some requirements brought forward from IAS 1 to IFRS 18 are not mentioned in this Basis for Conclusions. Those paragraphs were developed by the International Accounting Standards Committee (IASC) when they originally issued IAS 1. The IASC did not issue a Basis for Conclusions.*

*The IASB also published an Effects Analysis describing the likely benefits and costs of IFRS 18.*

## Introduction

BC1 The International Accounting Standards Board (IASB) issued IFRS 18 *Presentation and Disclosure in Financial Statements* in 2024 to replace IAS 1 *Presentation of Financial Statements*. The IASB did not reconsider all aspects of IAS 1 when developing IFRS 18, but instead focused on the statement of profit or loss. Nonetheless, the IASB decided to retain a single IFRS Accounting Standard for requirements relating to presentation and disclosure. The IASB retained some paragraphs from IAS 1 in IFRS 18 and moved some paragraphs from IAS 1 to IAS 8 *Basis of Preparation of Financial Statements* 1 and IFRS 7 *Financial Instruments: Disclosures*. The IASB updated the retained paragraphs to ensure consistency with the IASB's decisions on IFRS 18 and with the 2018 *Conceptual Framework for Financial Reporting (Conceptual Framework)*.

### The need for change

- BC2 The IASB developed IFRS 18 in response to strong demand from stakeholders, particularly from users of financial statements, for improvements to financial performance reporting.
- BC3 Research and meetings with stakeholders revealed a need for improved requirements relating to:
- subtotals in the statement of profit or loss*—IAS 1 required an entity to present profit or loss, but no specific subtotals, leading to diversity in the presentation and calculation of subtotals even among entities in the same industry. Entities that applied IAS 1 often presented subtotals using the same label, but which included varying income and expenses. Such diversity made it difficult for users of financial statements to understand and compare information. Comparability is important to users, particularly to buy-side investors, who typically analyse many entities in varied industries.
  - aggregation and disaggregation*—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 in application. This diversity in application made it difficult for users of financial statements to find and understand relevant information. Entities sometimes also disclosed large expenses in the notes as 'other expenses', with no information provided to help users of financial statements understand their composition.
  - 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. However, users of financial statements have expressed concern that information about such measures, including why the measures are used and how they are calculated, can be difficult to find and understand. Entities typically report such measures outside the financial statements, where they are often not subject to assurance.

### Proposals in the Exposure Draft *General Presentation and Disclosures*

- BC4 In December 2019 the IASB published the Exposure Draft *General Presentation and Disclosures* (Exposure Draft). The Exposure Draft included a proposal to replace IAS 1 with a new Standard, together with proposed limited amendments to IAS 7 *Statement of Cash Flows*. The proposed new Standard would comprise:
- new presentation and disclosure requirements; and
  - requirements brought forward from IAS 1, with a few wording changes.
- BC5 The main presentation and disclosure requirements proposed in the Exposure Draft related to:

- (a) subtotals in the statement of profit or loss (see paragraphs BC7–BC8);
  - (b) roles of the primary financial statements and the notes, aggregation and disaggregation (see paragraphs BC9–BC10); and
  - (c) management-defined performance measures (see paragraph BC11).
- BC6 Research and meetings with stakeholders revealed the potential costs to preparers that could result from responding to the need for change. In developing the proposals in the Exposure Draft, the IASB sought to develop requirements that would provide more useful information to users of financial statements at a reasonable cost to preparers of those statements.

**Subtotals in the statement of profit or loss**

- BC7 The IASB proposed requiring an entity to use defined categories to classify income and expenses in the statement of profit or loss:
- (a) operating;
  - (b) integral associates and joint ventures;
  - (c) investing;
  - (d) financing;
  - (e) income taxes; and
  - (f) discontinued operations.
- BC8 The IASB proposed requiring an entity to present three additional defined subtotals based on the categories in paragraph BC7:
- (a) operating profit;
  - (b) operating profit and income and expenses from integral associates and joint ventures; and
  - (c) profit before financing and income taxes.

**Roles of the primary financial statements and the notes, aggregation and disaggregation**

- BC9 The IASB proposed improved general requirements for aggregating and disaggregating information in the financial statements, including adding:
- (a) a description of the roles of the primary financial statements and the notes; and
  - (b) principles for aggregation and disaggregation of items or groups of items.
- BC10 The IASB also proposed specific requirements on disaggregation, including on:
- (a) the presentation of operating expenses in the statement of profit or loss and the disclosure of information about those expenses in the notes; and
  - (b) the definition of, and disclosure of information about, unusual income and expenses.

**Management-defined performance measures**

- BC11 The IASB proposed defining some entity-specific performance measures as 'management-defined performance measures' and requiring an entity to include information about such measures in a single note.

**Feedback on the Exposure Draft**

- BC12 The IASB received 216 comment letters in response to the Exposure Draft. The IASB also obtained feedback on the proposals from individual stakeholder meetings, publicly available webinars, conferences, roundtable meetings and meetings with IASB advisory bodies and consultative groups. In the IASB's fieldwork, 50 companies tested the application of the proposals in the Exposure Draft to their statements of profit or loss, statements of cash flows and selected disclosures.
- BC13 Most stakeholders generally agreed with the proposals in the Exposure Draft. Users of financial statements expressed strong agreement with the project objectives and most of the specific proposals.
- BC14 Respondents generally agreed with:
- (a) the proposals for defined categories and required subtotals in the statement of profit or loss. Fieldwork participants were generally able to apply most of these proposals without difficulty.
  - (b) the objectives of the proposals for general requirements on aggregation and disaggregation and of the requirements on unusual income and expenses.
  - (c) the proposals for management-defined performance measures. Fieldwork participants were able to apply these proposals without significant difficulty.
- BC15 However, many respondents raised concerns about aspects of these proposals, including the proposed definition of unusual income and expenses and the scope of management-defined performance measures. Fieldwork participants reported they could apply the proposals for unusual income and expenses, but raised application questions. Many respondents suggested expanding the scope of the proposals for management-defined performance measures to include more non-GAAP measures.
- BC16 Stakeholders found the proposals for integral and non-integral associates and joint ventures, and for the disclosure of information about operating expenses, challenging and difficult to apply. Respondents raised conceptual and practical concerns about both sets of proposals. Fieldwork participants also found these proposals difficult to apply.

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**General requirements for financial statements**

**Objective of financial statements (paragraph 9)**

- BC17 The IASB decided to align the objective of financial statements in IFRS 18 with paragraph 3.2 of the *Conceptual Framework*. The objective of financial statements is to provide financial information about a reporting entity's assets, liabilities, equity, income and expenses that is useful to users of financial statements in assessing the prospects for future net cash inflows to the reporting entity and in assessing management's stewardship of the entity's economic resources.
- BC18 This objective does not refer to providing information about cash flows. Nonetheless, IFRS 18 includes some general requirements for financial statements that apply to the statement of cash flows. IAS 7 sets out requirements for the presentation and disclosure of cash flow information. Paragraphs 9 and 20 of IFRS 18 do not refer to cash flow information. This is because financial performance includes cash flow information, as explained in paragraph 1.20 of the *Conceptual Framework*.

#### **Titles of financial statements (paragraph 9)**

- BCZ19 The Exposure Draft *Amendments to IAS 1 Presentation of Financial Statements—A Revised Presentation* (2006 Exposure Draft) proposed changes to the titles of some of the financial statements—from 'balance sheet' to 'statement of financial position', from 'income statement' to 'statement of profit or loss' and from 'cash flow statement' to 'statement of cash flows'. In addition, the 2006 Exposure Draft proposed a 'statement of recognised income and expense' and that all owner changes in equity should be included in a 'statement of changes in equity'. The IASB did not propose to make any of these changes of nomenclature mandatory.
- BCZ20 Many respondents opposed the proposed changes, pointing out that the existing titles had a long tradition and were well understood. However, the IASB reaffirmed its view that the proposed new titles better reflect the function of each financial statement, and pointed out that an entity could choose to use other titles in its financial report.
- BCZ21 The IASB reaffirmed its conclusion that the title 'statement of financial position' not only better reflects the function of the statement but is consistent with the *Framework for the Preparation and Presentation of Financial Statements (Framework)*, 2 which contains several references to 'financial position'. Paragraph 12 of the *Framework* states that the objective of financial statements is to provide information about the financial position, performance and changes in financial position of an entity. Paragraph 19 of the *Framework* states that information about financial position is primarily provided in a balance sheet. In the IASB's view, the title 'balance sheet' simply reflects that double entry bookkeeping requires debits to equal credits. It does not identify the content or purpose of the statement. The IASB also noted that 'financial position' is a well-known and accepted term, as it has been used in auditors' opinions internationally for more than 20 years to describe what the 'balance sheet' presents. The IASB decided that aligning the statement's title with its content and the opinion rendered by the auditor would help users of financial statements.
- BCZ22 In May 2010 the IASB published the Exposure Draft *Presentation of Items of Other Comprehensive Income* (2010 Exposure Draft) relating to the presentation of items of other comprehensive income. One of the proposals in the 2010 Exposure Draft related to the title of the statement containing profit or loss and other comprehensive income. The IASB proposed this change so that it would be clear that the statement had two components: profit or loss, and other comprehensive income. A majority of the respondents to the 2010 Exposure Draft supported the change and therefore the IASB confirmed the proposal in June 2011. IFRS 18 allows preparers to use other titles for the statement that reflect the nature of their activities.
- BCZ23 Several other IFRS Accounting Standards refer to the 'statement of comprehensive income'. The IASB considered whether it should change all such references to 'statement of profit or loss and other comprehensive income'. The IASB noted that the terminology used in IAS 1 (now in IFRS 18) is not mandatory and that 'statement of comprehensive income' 3 is one of the examples used in IAS 1 (now in IFRS 18). The IASB decided that there was little benefit in replacing the title 'statement of comprehensive income' in other IFRS Accounting Standards or 'income statement' with the 'statement of profit or loss'. However, the IASB did change the terminology when other IFRS Accounting Standards made reference to the two-statement option.
- BCZ24 In finalising its revision, the IASB confirmed that the titles of financial statements used in IAS 1 (now used in IFRS 18) would not be mandatory. The titles would be used in future IFRS Accounting Standards but are not required to be used by entities in their financial statements. Some respondents to the 2010 Exposure Draft expressed concern that non-mandatory titles would result in confusion. However, the IASB believed that making use of the titles non-mandatory would allow time for entities to implement changes gradually as the new titles become more familiar.

#### **Equal prominence (paragraph 14)**

- BCZ25 The IASB noted that the financial performance of an entity is not assessed by reference to a single financial statement or a single measure within a financial statement. The IASB believes that the financial performance of an entity can be assessed only after all aspects of the financial statements are taken into account and understood in their entirety. Accordingly, the IASB decided that in order to help users of the financial statements to understand the financial performance of an entity comprehensively, all financial statements within the complete set of financial statements should be presented with equal prominence.

#### **Materiality (paragraphs B1–B5)**

##### **Background**

- BCZ26 The IASB was informed at the Discussion Forum on Financial Reporting Disclosure it hosted in January 2013, through feedback on the amendments to IAS 1 in the 2014 Exposure Draft *Disclosure Initiative*, the 2017 Discussion Paper *Disclosure Initiative—Principles of Disclosure*, and from other sources, that entities experience difficulties in making materiality judgements when preparing financial statements.
- BCZ27 The feedback indicated that difficulties in making materiality judgements are generally behavioural rather than related to the definition of 'material'. That feedback indicated that some entities apply the disclosure requirements in IFRS Accounting

Standards mechanically, using them as a checklist for disclosures in their financial statements, rather than applying their judgement to determine what information is material. Some entities have said that it is easier to use a checklist approach than to apply judgement because of management resource constraints, and because following a mechanical approach means that their judgement is less likely to be challenged by auditors, regulators or users of their financial statements. Similarly, some entities say that they prefer to be cautious when deciding whether to omit disclosures to avoid the risk of being challenged by these parties.

BCZ28 The IASB concluded that these behavioural difficulties could best be addressed by providing guidance to help entities make materiality judgements, rather than by making substantive changes to the definition of 'material'. Consequently, in September 2017 the IASB issued IFRS Practice Statement 2 *Making Materiality Judgements* (Materiality Practice Statement).

BCZ29 Although many stakeholders agreed that substantive changes to the definition of 'material' were unnecessary, the IASB received some feedback that the definition of 'material' might encourage entities to disclose immaterial information in their financial statements. Feedback suggested that the IASB should address the following points:

- (a) the phrase 'could influence decisions of users', to describe the threshold for deciding whether information is material, may be understood as requiring too much information to be provided, because almost anything 'could' influence the decisions of some users of the financial statements, even if such a possibility were remote;
- (b) the phrase 'information is material if omitting it or misstating it' focuses only on information that cannot be omitted (material information) and does not also consider the effect of including immaterial information; and
- (c) the definition refers to 'users' but does not specify their characteristics, which is interpreted by some as implying that an entity is required to consider all possible users of its financial statements when deciding what information to disclose.

BCZ30 The IASB also observed that the wording of the definition of 'material' in the *Conceptual Framework* differed from the wording that was used in IAS 1 and IAS 8. The IASB believes that the substance of the definitions is the same because these definitions all cover the omission or misstatement of information that could influence the decisions of users of financial statements. Nevertheless, the existence of more than one definition of 'material' could be confusing and could imply that the IASB intended these definitions to have different meanings and be applied differently in practice.

BCZ31 Consequently, the IASB decided to propose refinements to the definition of 'material' and to align the definition across IFRS Accounting Standards and other publications. The IASB observed that these refinements were intended to make the definition easier to understand and were not intended to alter the concept of materiality in IFRS Accounting Standards.

#### **Refinements of the definition of 'material'**

BCZ32 In September 2017 the IASB published the Exposure Draft *Definition of Material* which proposed a revised definition.

BCZ33 The IASB developed this definition by:

- (a) replacing the description of the threshold 'could influence' with 'could reasonably be expected to influence' to incorporate the clarification that was included in IAS 1 (now included in paragraph B4 of IFRS 18). This wording helps to address concerns raised by some parties that the threshold 'could influence' in the existing definition of 'material' is too low and might be applied too broadly (see paragraph BCZ29(a)).
- (b) using the wording of the definition of 'material' in the *Conceptual Framework*. The IASB concluded that this wording was clearer than the definition that was included in IAS 1 and IAS 8. However, the IASB decided to refer to 'financial statements' rather than 'financial reports' in the amendments to IAS 1 to be consistent with the scope of that Standard at that time. The *Conceptual Framework* definition also clarifies that the users to whom the definition refers are the primary users of an entity's financial reports or statements. Referring to the primary users in the definition of 'material' helps to respond to concerns that the term 'users' may be interpreted too widely (see paragraph BCZ29(c)).
- (c) including 'obscuring' in the definition of 'material' to incorporate the concept that was included in IAS 1, which stated: 'An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating items that have different natures or functions.' Referring to 'obscuring' in the definition of 'material' is intended to respond to concerns that the effect of including immaterial information should also be considered in addition to 'misstating' and 'omitting' (see paragraphs BCZ29(a) and (b)).
- (d) relocating wording that explains rather than defines 'material' from the definition itself to its explanatory paragraphs. This reorganisation clarifies which requirements are part of the definition and which paragraphs explain the definition.

BCZ34 Some parties said that the IASB should raise the threshold at which information becomes material by replacing 'could' with 'would' in the definition. However, the IASB did not do this because it concluded that using 'would' would be a substantive change that might have unintended consequences. For example, 'would influence decisions' might be interpreted as a presumption that information is not material unless it can be proved otherwise—that is, for information to be seen as material it would be necessary to prove that the information would influence the decisions of users of financial statements.

#### **Obscuring information**

BCZ35 Responses to the Exposure Draft *Definition of Material* indicated strong support for the definition of 'material' to be aligned across the *Conceptual Framework* and IFRS Accounting Standards. However, many respondents had some concerns—in particular about including the existing concept of 'obscuring' (that was included in IAS 1) in the definition of 'material' in the way proposed in the Exposure Draft *Definition of Material*. Many respondents thought that if the IASB were to include this concept in the

definition, then 'obscuring information' would need to be more precisely defined or explained than it was in the Exposure Draft *Definition of Material*.

BCZ36 The IASB agreed with respondents that the concept of 'obscuring information' is inherently more judgemental than 'omitting' or 'misstating' information and considered removing the concept from the definition of 'material' and its explanatory paragraphs altogether. However, the IASB decided that the benefit of including 'obscuring' in the definition of 'material' outweighed these concerns. Including this concept emphasises that obscuring information can affect the decisions of primary users, just as omitting or misstating that information can. In particular, including 'obscuring' in the definition of 'material' addresses concerns that the former definition could be perceived by stakeholders as focusing only on information that cannot be omitted (material information) and not also on why it may be unhelpful to include immaterial information.

BCZ37 The IASB did not intend to be prescriptive by including the word 'obscuring' in the definition of 'material' and by further clarifying it—the IASB is not prohibiting entities from disclosing immaterial information or introducing a required quality of explanations and information included in the financial statements. For example, the IASB did not intend the addition of the word 'obscure' to prevent entities from providing information required by local regulators or prescribe how an entity organises and communicates information in the financial statements. Rather, the IASB's intention is to:

- (a) support the requirement that was included in IAS 1 which stated that 'An entity shall not reduce the understandability of its financial statements by obscuring material information with immaterial information or by aggregating material items that have different natures or functions'; and
- (b) help entities and other stakeholders avoid instances in which material information may be obscured by immaterial information to the extent that it has a similar effect on the primary users of financial statements to omitting or misstating that information.

#### **Other amendments**

BCZ38 While the revised definition of 'material' in IAS 1 (now in IFRS 18) has been based on the definition of 'material' in the *Conceptual Framework*, some adjustments were made to the *Conceptual Framework* definition to improve clarity and consistency between the *Conceptual Framework* and IFRS Accounting Standards. The definition in the *Conceptual Framework*, however, continues to refer to 'financial reports' rather than 'financial statements'.

BCZ39 The IASB also made amendments to the Materiality Practice Statement to align it with the revised definition of 'material'. The Materiality Practice Statement continues to refer to both 'immaterial' and 'not material' as the IASB concluded that these terms have the same meaning.

BCZ40 As explained in paragraph BCZ33, the amendments incorporate existing guidance from the *Conceptual Framework* and IAS 1 and are not substantive changes to the existing requirements in IFRS Accounting Standards. For this reason, the IASB concluded that the guidance in the Materiality Practice Statement and the *Conceptual Framework* would not be affected by these amendments.

BCZ41 Because the amendments are based on existing guidance, they are not considered to be substantive changes. The IASB consequently concluded that amendments to other requirements in IFRS Accounting Standards are unnecessary, other than to update the definition of 'material' where it is quoted or referred to directly.

BCZ42 The IASB also decided that it was unnecessary to change all instances of 'economic decisions' to 'decisions', and all instances of 'users' to 'the primary users of financial statements' in IFRS Accounting Standards. In its *Conceptual Framework* project, the IASB clarified that:

- (a) the terms 'primary users' and 'users' are intended to be interpreted the same way and both refer to existing and potential investors, lenders and other creditors who must rely on general purpose financial reports for much of the financial information they need (see the footnote to paragraph 1.5 of the *Conceptual Framework*); and
- (b) the terms 'decisions' and 'economic decisions' are intended to be interpreted the same way.

#### **Likely effects of the amendments to IFRS Accounting Standards**

BCZ43 In the IASB's view, the amendments improve the understanding of the definition of 'material' by:

- (a) aligning the wording of the definition in IFRS Accounting Standards and the *Conceptual Framework* to avoid the potential for confusion arising from different definitions;
- (b) incorporating supporting requirements in IAS 1 (now in IFRS 18) into the definition to give them more prominence and clarify their applicability; and
- (c) providing existing guidance on the definition of 'material' in one place, together with the definition.

BCZ44 The IASB concluded that the amendments do not change existing requirements substantively because:

- (a) the refinements to the definition of 'material':
  - (i) are based on wording in the *Conceptual Framework* that is similar to but clearer than the definition that was included in IAS 1 and IAS 8 (see paragraphs BCZ30 and BCZ33(b)); and
  - (ii) incorporate wording that already existed in IAS 1 (see paragraphs BCZ33(a), (c) and (d)).
- (b) the clarification that 'users' are the primary users and the description of their characteristics have been taken from the *Conceptual Framework*.
- (c) the inclusion of 'obscuring information' reflects the existing requirement, as was set out in IAS 1, that an entity shall not reduce the understandability of its financial statements by obscuring material information. This amendment is not

expected substantively to change an entity's decisions about whether information is material—in no circumstances would obscuring information influence the decisions of users, if omitting or misstating the same information would have no influence on those decisions.

Consequently, the IASB expects that the effect of the revised definition will be to help entities to make better materiality judgements.

#### **The roles of the primary financial statements and the notes (paragraphs 15–24 and B6–B9)**

- BC45 To achieve the objective of financial statements (discussed in paragraph BC17), an entity applies the roles of the primary financial statements and the notes to present summarised information in the primary financial statements and disclose more detailed information in the notes. The IASB developed the descriptions of the roles of the primary financial statements and the notes set out in IFRS 18 based on the *Conceptual Framework*, feedback and research on how users of financial statements use information in the financial statements. Feedback and research showed that users of financial statements pay more attention to information presented in the primary financial statements and use it more frequently than information disclosed in the notes because the primary financial statements:
- (a) give an overview of an entity's financial performance, financial position, cash flows and changes in equity;
  - (b) are more structured than the notes and can be easier to use to compare entities; and
  - (c) can be used to identify items or areas that users of financial statements might wish to seek additional information on.
- BC46 The IASB developed the roles of the primary financial statements and the notes to help an entity judge whether to present information in the primary financial statements or disclose it in the notes. The descriptions will also help the IASB in the future when it develops new or revised presentation and disclosure requirements in IFRS Accounting Standards.
- BC47 The role of primary financial statements is to provide structured summaries of a reporting entity's recognised assets, liabilities, equity, income, expenses and cash flows that are useful for:
- (a) obtaining an understandable overview of the entity's recognised assets, liabilities, equity, income, expenses and cash flows;
  - (b) making comparisons between entities, and between reporting periods for the same entity; and
  - (c) identifying items or areas about which users of financial statements may wish to seek additional information in the notes.
- BC48 The role of the notes is to provide material financial information necessary:
- (a) to enable users of financial statements to understand the line items presented in the primary financial statements; and
  - (b) to supplement the primary financial statements with other financial information to achieve the objective of financial statements.
- BC49 The role of the primary financial statements in paragraph BC47 is referred to as a 'useful structured summary'. Because each primary financial statement provides a useful structured summary, information presented in these statements is more prominent than information disclosed in the notes. However, greater prominence does not mean the information disclosed in the notes is secondary to, or less important than, information presented in the primary financial statements. The notes have a different role from the primary financial statements both in digital and paper-based reporting (see paragraphs BC62–BC63). Understanding those respective roles helps an entity determine where to provide information in the financial statements.

#### **Information presented in the primary financial statements or disclosed in the notes**

- BCZ50 The IASB amended IAS 1 to highlight that materiality also applies to disclosures specifically required by IFRS Accounting Standards. In addition, to highlight that materiality not only involves decisions about excluding information from the financial statements, the IASB amended IAS 1 to reiterate the notion already stated in IAS 1 that materiality also involves decisions about whether to include additional information in the financial statements. Consequently, an entity should make additional disclosures when compliance with the specific requirements in IFRS Accounting Standards is insufficient to enable users of financial statements to understand the impact of particular transactions, other events and conditions on the entity's financial position and financial performance (retained in paragraph 20 of IFRS 18).
- BCZ51 The IASB noted that the definition of 'material' in IAS 1 (now located in Appendix A and paragraphs B1–B5 of IFRS 18) discusses omissions or misstatements of items being material if they could individually or collectively influence economic decisions. The IASB had considered making amendments to the requirements in IAS 1 (now in paragraph 19 of IFRS 18) to say that an entity need not provide a specific disclosure if the information provided by that disclosure is not material, either individually or collectively. However, the IASB decided not to make that change since the definition of material already incorporates the notions of individual and collective assessment and, therefore, reference to the term 'material' in paragraph 19 of IFRS 18 is sufficient to incorporate this concept.
- BC52 Some stakeholders suggested the IASB consider how an entity's judgements in determining whether information is material affect how the entity judges whether to provide information in the primary financial statements or in the notes.
- BC53 The materiality requirements apply equally to all requirements to present or disclose information in an entity's financial statements. Information is either material—and is provided to contribute to the objective of financial statements—or it is not material and need not be provided. In other words, materiality requirements set out *whether* an entity is required to provide information, but do not set out *where* in the financial statements information is provided.
- BC54 To help clarify that not all material information can be presented in the primary financial statements, the IASB included a reference to the qualitative characteristic of 'understandability' (see paragraphs 2.34–2.36 of the *Conceptual Framework*) in the description

of the role of the primary financial statements. That role includes presenting information that is useful for obtaining an understandable overview of the entity's assets, liabilities, equity, income, expenses and cash flows. 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. An entity's specific facts and circumstances determine what information will provide an understandable overview.

BC55 All the aspects of the role of the primary financial statements help an entity to determine whether to present an item as a line item in a primary financial statement. For example, if an entity undertakes a major restructuring during the reporting period it might conclude that information about the restructuring is material. To decide whether to present a line item for restructuring expenses in its statement of profit or loss, the entity would consider whether doing so contributes to a useful structured summary. To contribute to a useful structured summary, the information needs to help users of financial statements:

- (a) obtain an understandable overview of an entity's expenses for the period—for example, separate presentation of the restructuring expenses could help users of financial statements to understand an increase in total operating expenses for the period;
- (b) make comparisons between entities or reporting periods—for example, presenting the restructuring expenses separately from other expenses because they lack persistence could make other line items more comparable to amounts presented in the prior period and to amounts presented by other entities, thereby helping users of financial statements with trend analyses; or
- (c) identify items or areas about which users of financial statements may wish to seek additional information in the notes—for example, when additional information about restructuring expenses is disclosed in the notes, separate presentation of those expenses (including cross-reference to the related note disclosing other material information about the restructuring) could draw users' attention to it.

#### **Information presented in the primary financial statements**

BC56 Some IFRS Accounting Standards contain requirements for presentation in the primary financial statements. The IASB concluded that, in some cases, an entity assesses whether applying these requirements will result in a primary financial statement providing a useful structured summary. In other cases, it is not necessary for an entity to perform this assessment because applying the requirements will always be necessary for a primary financial statement to provide a useful structured summary. For example, the totals and subtotals required to be presented in the statement of profit or loss by paragraph 69 of IFRS 18 and the classification of income and expenses in categories will always be necessary to provide a useful structured summary of the entity's income and expenses. Therefore, an entity does not assess whether classifying its income and expenses in the categories and presenting the required subtotals will result in a useful structured summary.

BC57 IFRS 18 and other IFRS Accounting Standards set out requirements for an entity to present line items in the statement(s) of financial performance (see paragraphs BC236–BC239) and in the statement of financial position (see paragraphs BC313–BC315). 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.

BC58 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. For example, if an entity concludes that presenting impairment losses determined in accordance with IFRS 9 *Financial Instruments* is not necessary to provide a useful structured summary of the entity's income and expenses, the entity is required to disclose those losses in the notes if doing so provides material information.

BC59 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.

BC60 Stakeholders informed the IASB of their concerns about the presentation of such additional subtotals when they are not specified in IFRS Accounting Standards. These stakeholders said some of these additional subtotals can be misleading. Therefore, the IASB decided to require that additional line items and subtotals presented to provide a useful structured summary are:

- (a) comprised of amounts recognised and measured in accordance with IFRS Accounting Standards;
- (b) compatible with the statement structure;
- (c) consistent from period to period; and
- (d) displayed no more prominently than the totals and subtotals required by IFRS Accounting Standards.

BC61 The requirements for additional line items and subtotals discussed in paragraphs BC59–BC60 supplement the requirements on fair presentation moved from IAS 1 to IAS 8.

#### **Digital reporting**

BC62 Some stakeholders queried the role of the primary financial statements in the context of digital access to financial information. The IASB concluded that providing a useful structured summary of an entity's recognised assets, liabilities, equity, income, expenses and cash flows in accordance with the role of the primary financial statements provides a context in which individual items of information accessed digitally can be understood. For example, if items are tagged for digital reporting purposes:

- (a) operating profit will be identified as a subtotal in the statement of profit or loss that includes all income and expenses classified in the operating category; and



(b) a specific item of operating expense will be identified as being included in operating profit.

BC63 The IASB concluded that providing a useful structured summary of an entity's recognised assets, liabilities, equity, income, expenses and cash flows is as important for information accessed digitally as it is for paper-based information.

### **Comparative information (paragraphs 31–40 and B13–B15)**

#### **A statement of financial position as at the beginning of the earliest comparative period (paragraphs 37–40)**

BCZ64 The 2006 Exposure Draft proposed that a statement of financial position as at the beginning of the earliest comparative period should be presented as part of a complete set of financial statements. This statement would provide a basis for investors and creditors to evaluate information about the entity's performance during the period. However, many respondents expressed concern that the requirement would unnecessarily increase disclosures in financial statements, or would be impracticable, excessive and costly.

BCZ65 By adding a statement of financial position as at the beginning of the earliest comparative period, the 2006 Exposure Draft proposed that an entity should present three statements of financial position and two of each of the other statements. Considering that financial statements from prior years are readily available for financial analysis, the IASB decided to require only two statements of financial position, except when the financial statements have been affected by retrospective application or retrospective restatement, as defined in IAS 8, or when a reclassification has been made. In those circumstances, three statements of financial position are required.

#### **Clarification of requirements for comparative information (paragraphs 37–40 and B14–B15)**

##### *Opening statement of financial position*

BCZ66 In *Annual Improvements 2009–2011 Cycle* (issued in May 2012) the IASB addressed a request to clarify the appropriate date for the opening statement of financial position. The IASB decided to amend the requirements in IAS 1 that related to the presentation of a statement of financial position for the beginning of the earliest comparative period presented in cases of changes in accounting policies, retrospective restatements or reclassifications to clarify that the appropriate date for the opening statement of financial position is the beginning of the preceding period.

BCZ67 The IASB also decided to change the previous requirements so that related notes to this opening statement of financial position were no longer required to be presented. The IASB's decision to give this relief was based on the fact that circumstances in which an entity changes an accounting policy, or makes a retrospective restatement or a reclassification in accordance with IAS 8, are considered narrow, specific and limited. However, the circumstances in which an entity chooses to provide additional financial statements (that is, on a voluntary basis) can be viewed as more generic and may arise for different reasons. Accordingly, this relief was not available when additional financial statements were provided on a voluntary basis.

BCZ68 The IASB added the guidance in paragraph 37(a) of IFRS 18 to clarify when an opening statement of financial position provides useful information and should therefore be required. Paragraph 37(b) of IFRS 18 is a reminder that the concept of materiality should be considered in applying the guidance in paragraph 37(a). The IASB noted that the entity would still be required to disclose the information required by IAS 8 for changes in accounting policies and retrospective restatements.

##### *Additional comparative information*

BCZ69 In *Annual Improvements 2009–2011 Cycle* the IASB addressed a request to clarify the requirements for providing comparative information. Specifically, the IASB was asked to consider whether an entity should be required to present a complete set of financial statements when it provides financial statements beyond the minimum comparative information requirements (that is, additional comparative information). In response to this request, the IASB decided to clarify that additional financial statement information need not be presented in the form of a complete set of financial statements for periods beyond the minimum requirements. The IASB also noted that additional comparative information might include:

- (a) information that is presented voluntarily, beyond the information that is included within a complete set of financial statements; or
- (b) comparative information that is required by law or other regulations but that is not required by IFRS Accounting Standards.

BCZ70 The IASB also decided to amend IAS 1 to clarify that when additional comparative information (that is not required by IFRS Accounting Standards) is provided by an entity, this information should be presented in accordance with IFRS Accounting Standards and the entity should present comparative information in the related notes for that additional information (now in paragraphs B14–B15 of IFRS 18). The IASB determined that requiring full notes for additional information in accordance with paragraph B14 of IFRS 18 is necessary to ensure that the additional information that the entity provides is balanced and results in financial statements that achieve a fair presentation.

### **Aggregation and disaggregation**

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#### **Principles of aggregation and disaggregation (paragraphs 41–43 and B16–B26)**

BC71 The IASB decided to set out principles for the aggregation and disaggregation of items in the financial statements. The IASB developed these principles and other requirements in response to feedback from users of financial statements that financial statements do not always include appropriately aggregated or disaggregated information. For example, an entity might disclose in the notes a large amount of 'other' expenses with no information to help users of financial statements understand what expenses those items include. In contrast, an entity might sometimes disclose too much detail, obscuring material information.

BC72 The IASB developed the principles of aggregation and disaggregation from the descriptions of classification and aggregation in the *Conceptual Framework*. Those descriptions recognise shared characteristics as a condition for classifying and aggregating items.

For example, aggregating items that have shared characteristics makes large volumes of information understandable. Similarly, disaggregating items with dissimilar characteristics provides material information.

- BC73 Aggregating and disaggregating information requires an entity to avoid both omitting useful information by providing insufficient detail and obscuring information with too much detail. For example, an entity's total assets, total liabilities, total equity, total income, total expenses and total cash flows provide some information about the entity's financial position, financial performance and cash flows, but are too aggregated to be useful on their own. Conversely, disaggregated information about individual transactions or other events provides detailed information, but may be so detailed as to obscure material information. Accordingly, an entity uses its judgement to determine how much detail is necessary to provide useful information.
- BC74 To help an entity apply the principles of aggregation and disaggregation, the IASB decided to provide application guidance on:
- (a) the process involved in deciding whether to aggregate or disaggregate information;
  - (b) the basis of aggregation and disaggregation;
  - (c) the description of items presented or disclosed; and
  - (d) the characteristics of assets, liabilities, equity, income and expenses that an entity considers in assessing whether items have dissimilar characteristics.
- BC75 The IASB replaced requirements in IAS 1 for aggregation and disaggregation, including a requirement for an entity to present separately each material class of similar items, with the principles of aggregation and disaggregation in IFRS 18. The concept of a 'material class of items' was replaced with a requirement to aggregate and disaggregate items based on characteristics and guidance on the roles of the primary financial statements and the notes to help an entity determine the line items to be presented in the primary financial statements and the items to be disclosed in the notes (see paragraphs BCZ50–BC55). The IASB expects that an entity would generally conclude that line items previously determined to be a 'material class of items' would also contribute to a useful structured summary. Replacing the IAS 1 requirement for 'material class of items' does not change the requirements in other IFRS Accounting Standards that contain requirements related to classes of items.

#### **Basis of aggregation and disaggregation (paragraphs B19–B23)**

- BC76 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.

#### **Description of items (paragraphs B24–B26)**

- BC77 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'.
- BC78 The IASB decided to specifically require 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. For example, if an entity described some items of income or expense as 'unusual', it would explain its definition of 'unusual'.
- BC79 Users of financial statements raised concerns about the label 'other'. For example, an entity might present or disclose a large amount of 'other expenses' without providing information about what those expenses include. Using the label 'other' for such an aggregation is often unhelpful. The IASB developed the application guidance in paragraphs B25–B26 of IFRS 18 on determining a more informative label than 'other' to help an entity provide more useful information.
- BC80 Sometimes an entity might aggregate immaterial items that have dissimilar characteristics. Cumulatively, the resulting item might be large despite comprising individually immaterial items. If the amount of the resulting item is sufficiently large that users of financial statements would reasonably question whether it includes material amounts, further information to resolve that question is material information. The IASB decided to include in IFRS 18 examples of the type of information that an entity might disclose in such circumstances.

### **Statement of profit or loss**

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#### **Structure of the statement of profit or loss (paragraphs 46–74 and B29–B76)**

- BC81 IAS 1 required an entity to present profit or loss, but no other specific subtotals. The lack of specific requirements in IAS 1 led to diversity in reporting, making it difficult for users of financial statements to understand the information presented in the statement of profit or loss and compare information between entities. In response, the IASB developed new requirements for the structure of the statement of profit or loss to increase the comparability and understandability of information presented in that statement.
- BC82 The IASB decided to require an entity to classify income and expenses included in profit or loss—other than income and expenses related to income taxes or discontinued operations—into three categories:
- (a) operating (paragraphs BC88–BC102);
  - (b) investing (paragraphs BC103–BC147); and
  - (c) financing (paragraphs BC148–BC199).
- BC83 The IASB also decided to require an entity to classify in the discontinued operations category income and expenses related to discontinued operations and in the income taxes category income and expenses related to income taxes. The IASB concluded that

classifying income and expenses from discontinued operations and income taxes in these categories would comply with the presentation requirements in IFRS 5 *Non-current Assets Held for Sale and Discontinued Operations* and IAS 12 *Income Taxes*. Income and expenses classified in these categories are not classified in the operating, investing and financing categories. Although these categories do not result in required subtotals, entities generally present the subtotals profit before income taxes and profit before discontinued operations when they are applicable.

- BC84 The IASB also decided to require an entity to present two additional subtotals in the statement of profit or loss (except in the circumstances discussed in paragraph BC189). The two subtotals are:
- (a) operating profit or loss (see paragraphs BC88–BC102); and
  - (b) profit or loss before financing and income tax (see paragraphs BC148–BC152).
- BC85 When developing the requirements discussed in BC82, the IASB considered specific requirements for:
- (a) classifying income and expenses of an entity with specified main business activities (see paragraphs BC94–BC102, BC121–BC128, BC136–BC141, BC145–BC147 and BC180–BC191);
  - (b) classifying income and expenses on derecognition and changes in classification of assets and liabilities (see paragraphs BC200–BC206);
  - (c) classifying foreign exchange differences (see paragraphs BC207–BC219);
  - (d) classifying the gain or loss on the net monetary position recognised applying IAS 29 *Financial Reporting in Hyperinflationary Economies* (see paragraphs BC220–BC222); and
  - (e) classifying gains and losses on derivatives and designated hedging instruments (see paragraphs BC223–BC235).
- BC86 In developing the requirements on the structure of the statement of profit or loss, the IASB focused on the information needs of users of financial statements. Users of financial statements have varied information needs in relation to each of the primary financial statements resulting in varying classification objectives. For example, the investing category in the statement of profit or loss is different from 'investing activities' as defined in IAS 7. The objective of the IAS 7 classification is to identify investments made in long-term assets that will generate future returns. The IAS 7 definition of 'investment activities' includes investments in operating assets, such as property, plant and equipment. However, in the statement of profit or loss, an entity classifies in the operating category income and expenses from its operating assets (see paragraphs BC88–BC93). When developing IFRS 18 the IASB considered aligning the structure of the statement of profit or loss with the structure of the statement of cash flows when doing so did not conflict with the objectives of each statement. However, the IASB prioritised the objectives of each of the primary financial statements over alignment between those statements.
- BC87 Some stakeholders suggested using different labels for categories in the statement of profit or loss—for example, using a label for the investing category (such as 'non-operating') to differentiate it from investing activities as defined in IAS 7. IFRS 18 does not require an entity to label each category in the statement of profit or loss, nor does it require an entity to present subtotals for each category. For example, an entity is not required to present a subtotal for all income and expenses classified in the investing category. Accordingly, the IASB concluded that using different labels would not affect the presentation of items in the investing category in the statement of profit or loss.

**Operating category and operating profit subtotal (paragraphs 52, 69–70 and B30–B42)**

- BC88 The IASB decided to require an entity to present an operating profit subtotal in the statement of profit or loss and to specify which income and expenses are classified in the operating category. The IASB developed these requirements in response to feedback from users of financial statements and other stakeholders, who said:
- (a) requiring an entity to present an operating profit subtotal in the statement of profit or loss would provide users with useful information; and
  - (b) specifying which income and expenses to classify in the operating category would reduce diversity in the reporting of such items and enhance comparability between entities.
- BC89 The IASB decided to require an entity to classify in the operating category all income and expenses included in profit or loss that are not classified in the investing, financing, income taxes or discontinued operations categories. As a result, the operating category is the 'default' category. This approach reflects the IASB's view that all income and expenses included in profit or loss—other than those related to investing, financing, income taxes and discontinued operations—arise from an entity's operations. More specifically, in the IASB's view:
- (a) an entity's operations include, but are not limited to, an entity's main business activities. For example, income and expenses from supporting activities, which might not generate revenue directly, nonetheless arise from activities conducted in the course of an entity's operations.
  - (b) income and expenses should be included in the operating category regardless of whether they are volatile or unusual in some way. The IASB acknowledged that such income and expenses might not have predictive value. However, in the IASB's view, predictive value is not a characteristic that determines whether to include income or expenses in the operating category or in another category. An entity's operations can be volatile; therefore, such income and expenses arise from an entity's operations. Moreover, excluding volatile or unusual income or expenses from operating profit would not faithfully represent the results of an entity's operations for the period. For example, if equipment is used to produce goods or services, it is necessary for the operating category to include all income and expenses, including depreciation and impairment, relating to that equipment to provide a complete picture of the results from its operations

for the period. The income and expenses would not arise without the operating decisions to purchase the equipment and decide how to use it in its operations.

- BC90 The IASB considered how this approach to classification would be applied when one of an entity's main business activities is investing in assets or providing financing to customers. The IASB acknowledged that classifying income or expenses related to these main business activities in the investing or financing categories would prevent an entity from presenting key measures of its operating performance in the operating category. Consequently, the IASB decided that if one of an entity's main business activities is investing in assets or providing financing to customers ('specified main business activities'), it classifies some income and expenses in the operating category instead of in the investing or financing categories. However, the reverse does not apply. The IASB did not design the operating category to require an entity to *exclude* income and expenses from the operating category based on whether they arise from its main business activities.
- BC91 The IASB also considered whether to define 'operating profit' directly, by reference to what is included in the subtotal, instead of as a default category, but decided not to do so. The IASB concluded that:
- (a) it would be difficult—if not impossible—to develop a direct definition of 'operating profit' that would be appropriate for all entities and could be applied consistently. Previous standard-setting attempts by the IASB based on this type of approach were unsuccessful.
  - (b) it would be more difficult—and likely more costly—for an entity to apply a direct definition of operating profit because doing so would likely require significant judgement. In contrast, determining which income and expenses to classify in the investing or financing categories is expected to require less judgement. That determination will be simpler for an entity to apply and is expected to result in more consistent application.
  - (c) a direct definition of 'operating profit' would result in less consistent classification of operating expenses because it might exclude some items that would otherwise be included if the operating category is the default category. For example, using a direct definition, an entity presenting operating expenses using the function of expense method might not classify in the operating category an operating expense that is not allocated to function line items.
- BC92 Most of the stakeholders who preferred a direct approach did so because, in their view, a direct definition would provide users of financial statements with more focused information about an entity's operating profit measure. In their view, operating profit should not include unusual or volatile income and expenses, or income and expenses not arising from an entity's main business activities. Some stakeholders suggested a definition of 'operating profit' to reflect an entity's 'core earnings' or its 'normalised earnings', which would define operating profit more narrowly than the approach discussed in paragraph BC89.
- BC93 The IASB acknowledged the varied views about 'operating profit' and that the term had been used with different meanings. However, the IASB concluded that even if it had agreed with those views, a narrow definition of operating profit that could be applied consistently would have been difficult to develop. Users of financial statements had emphasised the importance of having an operating profit subtotal in the statement of profit or loss that provides a consistent starting point for their analyses and is generally comparable between entities. The IASB expects the approach discussed in paragraph BC89 to achieve this objective. An entity can use other mechanisms to provide additional information about aspects of its financial performance, including presenting additional line items or subtotals in the statement(s) of financial performance or disclosing further disaggregation or information about management-defined performance measures in the notes. For example, an entity might disclose information about an aspect of its operating performance by presenting a management-defined performance measure of operating profit excluding expenses it regards as non-recurring or unusual (see paragraphs BC325–BC390) or by disclosing disaggregated information about such items (see paragraphs BC407–BC413).
- Entities with specified main business activities*
- BC94 An entity's operations include (but are not limited to) its main business activities (see paragraphs BC89–BC90). The IASB considered whether to require an entity with specified main business activities of investing in assets or providing financing to customers to classify income and expenses in the operating category that otherwise would not have been classified in that category. Specifically, the IASB considered this requirement for entities that:
- (a) invest in assets as a main business activity. As discussed in paragraphs BC145–BC147, investment returns are an important indicator of operating performance for these entities. The IASB decided to require such entities to classify in the operating category some income and expenses that otherwise would have been classified in the investing category.
  - (b) provide financing to customers as a main business activity. As discussed in paragraphs BC180–BC191, the difference between interest revenue from that activity and the related interest expense is an important indicator of operating performance for these entities. The IASB decided to require such entities to classify in the operating category some income and expenses that otherwise would have been classified in the investing or financing categories.
- BC95 Although many entities that provide financing to customers as a main business activity will also invest in assets as a main business activity, some entities might have only one specified main business activity. The IASB decided to provide application guidance to help an entity assess whether investing in assets or providing financing to customers is a main business activity.
- BC96 The IASB decided to specify that whether investing in assets or providing financing to customers is a main business activity is a matter of fact and not merely an assertion. Accordingly, an entity is required to base its assessment on evidence. In general, investing in assets or providing financing to customers is likely to be a main business activity of an entity if the entity uses, as an important indicator of operating performance, subtotals similar to gross profit described in paragraph B123 of IFRS 18. Evidence that subtotals similar to gross profit are important indicators of operating performance include using such subtotals to explain

operating performance externally or to monitor and assess performance internally. For example, if an entity provides financing to customers as a main business activity, it generally communicates or monitors 'net interest income' as a measure of its operating performance.

- BC97 Information about segments may provide evidence that investing in assets or providing financing to customers is a main business activity of an entity that applies IFRS 8 *Operating Segments*. The IASB concluded that a reportable segment that comprises a single business activity of investing in assets or providing financing to customers is a main business activity because the performance of that operating segment is an important indicator of the entity's operating performance. The business activity of an operating segment that comprises a single business activity might also be a main business activity if the performance of that operating segment is an important indicator of the entity's operating performance. For example, if a reportable segment comprises more than one operating segment and one of the operating segments comprises a single main business activity, the entity might determine that the business activity included in that reportable segment is a main business activity.
- BC98 The IASB decided to require an entity to assess whether investing in assets or providing financing to customers is a main business activity at the reporting entity level. A consolidated group's assessment and a subsidiary within that group's assessment could result in different conclusions. 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. The IASB decided that classification differences between the group and its subsidiary (when they occur) appropriately reflect the differences between their main business activities. The IASB concluded that appropriately reflecting the main business activities of each reporting entity outweighs the costs an entity might incur to make consolidation adjustments.
- BC99 Similar considerations apply if a parent entity prepares separate financial statements and consolidated financial statements. For example, a consolidated group and a subsidiary might each conclude that the reporting entity provides financing to customers as a main business activity. However, the parent entity might reach a different conclusion for the purposes of its separate financial statements. For example, the parent entity could be a holding company, with only the subsidiary providing financing to customers.
- BC100 Stakeholders said information 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, especially in digital financial reports. The IASB therefore decided if an entity invests in assets or provides financing to customers as a main business activity the entity is required to disclose that fact. Only main business activities of investing in assets or providing financing to customers would affect the structure of the statement of profit or loss. Accordingly, this disclosure requirement is separate from the requirement in paragraph 116(b) of IFRS 18 that requires an entity to disclose a description of the nature of the entity's operations and its principal activities, which provides different information about the entity's activities.
- BC101 An entity assesses whether it invests in assets or provides financing to customers as a main business activity based on facts and circumstances. If those facts and circumstances change, an entity reassesses its main business activities and reflects any change in its main business activities from the date when the facts have changed. The IASB decided that an entity classifies and presents income and expenses from the change in assessment prospectively and does not reclassify amounts presented before the change. For example, a change to an entity's assessment at the start of the current reporting period would not change its assessment for previous reporting periods.
- BC102 However, a change in this assessment could disrupt users of financial statements' trend analysis of operating profit. The IASB therefore decided if the assessment changes, an entity is required to disclose that fact and information about the effects of the change unless it is impracticable to do so.

#### **Investing category (paragraphs 53–58 and B43–B49)**

- BC103 IFRS 18 sets out requirements for classifying income and expenses in the investing category if an entity does not invest in assets as a main business activity. The IASB decided to require an entity that does not invest in assets as a main business activity to classify in the investing category income and expenses from:
- (a) investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method (see paragraphs BC110–BC129);
  - (b) investments in associates, joint ventures and unconsolidated subsidiaries not accounted for using the equity method (see paragraphs BC130–BC132);
  - (c) cash and cash equivalents (see paragraphs BC133–BC141); and
  - (d) other assets that generate a return individually and largely independently of the entity's other resources (see paragraphs BC142–BC147).
- BC104 IFRS 18 also sets out requirements for classifying income and expenses in the operating category (instead of the investing category) if investing in assets is an entity's main business activity. These requirements apply to:
- (a) investments in associates, joint ventures and unconsolidated subsidiaries not accounted for using the equity method (see paragraph BC132);
  - (b) cash and cash equivalents (see paragraphs BC136–BC141); and
  - (c) other assets that generate a return individually and largely independently of the entity's other resources (see paragraphs BC145–BC147).

BC105 Users of financial statements often analyse returns from an entity's investments separately from its operations. The investing category enables users of financial statements to identify returns from investments that are not a part of an entity's main business activities. For example, equity or debt investments typically generate returns, such as dividends or interest, individually and largely independently of an entity's other resources.

BC106 For the specific assets listed in paragraph BC103, the IASB decided to require an entity to classify in the investing category:

- (a) the income generated by the assets;
- (b) the income and expenses that arise on the initial and subsequent measurement of the assets, including derecognition of the assets; and
- (c) the incremental expenses directly attributable to the acquisition and disposal of the assets—for example, transaction costs and costs to sell the assets.

BC107 The IASB concluded that classifying incremental expenses directly attributable to acquisition and disposal would lead to more consistent classification of income and expenses in each category. Without a specific requirement to classify such expenses in the investing category, the requirements in other IFRS Accounting Standards for the recognition and subsequent measurement of the specific assets might have resulted in inconsistent classification. For example, in some circumstances directly attributable transaction costs are required to be included in the initial recognition of the asset and would have been subsequently classified in the investing category, whereas in other cases the directly attributable transaction costs are required to be recognised as an expense immediately and would have been classified in the operating category.

BC108 Identifying incremental expenses directly attributable to acquisition and disposal is not expected to be costly because they are typically external costs identifiable without performing an allocation exercise. Incremental expenses directly attributable to acquisition and disposal are a narrower set of expenses than the other approaches considered by the IASB and decided against, or that might apply in other IFRS Accounting Standards (see paragraph BC109).

BC109 The other approaches the IASB considered and decided against were to require an entity:

- (a) to classify *all* expenses directly related to the specific assets discussed in paragraph BC103 in the investing category. The IASB concluded such an approach would be too complex and costly for an entity to apply. For example, expenses relating to an investment could include an allocation of employee benefits if some employees are engaged in managing both an entity's investments and other activities.
- (b) to classify all incremental expenses related to the specific assets discussed in paragraph BC103 in the investing category—that is, expenses that would not have been incurred without the investment. Such an approach would result in classifying in the investing category some expenses relating to an entity's investments, such as ongoing investment management fees paid to a third party, while avoiding complex and costly allocations of other costs. However, stakeholders said such a requirement might result in inconsistent application and developing application guidance to address this could have unintended consequences for other IFRS Accounting Standards.

*Investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method*

BC110 IFRS 18 requires an entity to classify in the investing category all income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries, including:

- (a) the entity's share of the profit or loss from associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method; and
- (b) other income and expenses from those investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method (such as impairment losses).

BC111 The IASB observed diversity in the presentation of income and expenses from investments in associates and joint ventures accounted for using the equity method. For example, some entities present the share of profit or loss from such investments within operating profit, some present it immediately below operating profit and others present it after the income tax line item. Feedback from users of financial statements emphasised the importance of eliminating such diversity. Stakeholders said a requirement specifying the location of income and expenses from such investments in the statement of profit or loss is necessary. This requirement will provide users of financial statements with a consistent starting point for their analyses of investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method. The consistent starting point is important because users of financial statements generally analyse those investments separately from the operating results of the consolidated group (see paragraph BC114).

BC112 When deciding how to best respond to user needs as described in paragraph BC111, the IASB considered:

- (a) whether an entity should classify in the operating category any income and expenses from investments in associates and joint ventures accounted for using the equity method (see paragraphs BC113–BC115);
- (b) in which category an entity would classify those income and expenses if they are not classified in the operating category (see paragraphs BC116–BC120);
- (c) whether the IASB's general conclusions on those matters would also apply to an entity with specified main business activities (see paragraphs BC121–BC128); and
- (d) whether the IASB's general conclusions on those matters would also apply to subsidiaries accounted for using the equity method in separate financial statements (see paragraph BC129).

**Classification outside the operating category**

BC113 Some stakeholders said the activities of associates and joint ventures can be integral to an entity's main business activities. For example, in some jurisdictions and industries, it is common for entities to operate through an associate or joint venture. In some cases, an entity might invest in associates and joint ventures as a main business activity (see paragraphs BC121–BC128). For those reasons, some stakeholders suggested that, in those cases, an entity classifies in the operating category income and expenses from investments in associates and joint ventures accounted for using the equity method.

BC114 Many users of financial statements said all income and expenses from such 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—because:

- (a) the equity method combines income and expenses that users of financial statements would usually analyse separately, including financing expenses and income taxes;
- (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.

BC115 The IASB decided 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.

**Classification in the investing category or another category**

BC116 After the IASB decided to exclude from the operating category income and expenses from associates and joint ventures accounted for using the equity method, it considered an alternative approach. The approach would require an entity:

- (a) to identify 'integral' associates and joint ventures separately from 'non-integral' associates and joint ventures;
- (b) to classify income and expenses from investments in integral associates and joint ventures in an 'integral associates and joint ventures' category, presented immediately below the operating profit subtotal;
- (c) to present a subtotal for 'operating profit or loss and income and expenses from integral associates and joint ventures'; and
- (d) to classify income and expenses from investments in non-integral associates and joint ventures in the investing category.

BC117 However, stakeholders raised concerns about this approach and the IASB decided not to proceed with it. Many users of financial statements said the separate identification of integral and non-integral associates and joint ventures (described in paragraph BC116(a)) and the proposed subtotal (described in paragraph BC116(c)) would not provide useful information. Some stakeholders also raised concerns about how to identify 'integral' and 'non-integral' associates and joint ventures, which would have been difficult to resolve. These stakeholders said 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.

BC118 The IASB also considered whether to require an entity to classify all income and expenses from investments in associates and joint ventures accounted for using the equity method in a separate 'associates and joint ventures' category, which would be presented immediately below the operating profit subtotal. However, the IASB decided not to proceed with this approach because it would add complexity to the structure of the statement of profit or loss.

BC119 Having decided to exclude income and expenses from investments in associates and joint ventures accounted for using the equity method from operating profit for the reasons discussed in paragraph BC114, the IASB instead decided to require an entity to classify such income and expenses in the investing category. This approach:

- (a) reflects that investments in associates and joint ventures that are not closely related to an entity's main business activities generate returns individually and largely independently of the entity's other resources, which is consistent with other income and expenses classified in the investing category;
- (b) results in classification of such income and expenses in a consistent location, ensuring users of financial statements have a consistent starting point for their analysis;
- (c) simplifies the requirements relating to the structure of the statement of profit or loss; and
- (d) avoids imposing requirements for a separate category that might be unnecessary for many entities for which income and expenses from associates and joint ventures accounted for using the equity method is not an important aspect of the entity's financial performance.

BC120 The approach in BC119 does not specify the location of the line item in the investing category presenting income and expenses from associates and joint ventures accounted for using the equity method. The heading 'investing category' is not required to be presented in the statement of profit or loss and an entity is permitted to present additional subtotals within the investing category (see paragraphs BC56–BC61). This allows an entity to communicate similar information to the approaches discussed in BC116–BC118 by:

- (a) presenting 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 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.

#### **Entities with specified main business activities**

- BC121 The IASB concluded that its reasons for excluding from operating profit income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method also applied to such investments made as a main business activity (see paragraphs BC113–BC115). Consequently, the IASB decided not to develop different classification requirements for income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method for an entity with specified main business activities. Instead, all entities are required to classify income and expenses from such investments in the investing category.
- BC122 The IASB considered whether to allow some entities with specified main business activities to classify income and expenses from associates and joint ventures accounted for using the equity method in the operating category. Some stakeholders—for example, in the real estate industry—said common legal structures used in some jurisdictions result in such investments being accounted for using the equity method, but these investments are actively managed as part of investing in assets as a main business activity. In the view of these stakeholders, an entity with such investments should classify income and expenses from those investments in the operating category.
- BC123 Some 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 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.
- BC124 The IASB acknowledged that a presentation 'mismatch' could arise if the income and expenses described in paragraph BC123 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. The extent of any mismatch would be entity-specific and depend on whether the insurer accounts for these investments using the equity method or measures them at fair value through profit or loss.
- BC125 IAS 28 *Investments in Associates and Joint Ventures* allows some entities to measure at fair value through profit or loss an investment—or a portion of an investment—in an associate or joint venture, as discussed further in paragraphs BC126–BC128. 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 in the operating category those income and expenses and no mismatch would arise. The IASB's research and meetings with stakeholders indicated that a mismatch might be material for some insurers, but it does not appear to be pervasive in the insurance industry.
- BC126 The IASB's research and meetings with stakeholders also revealed that investments in associates and joint ventures by insurers are diverse. If the IASB were to allow or require an insurer to classify in the operating category income and expenses from some investments in associates and joint ventures accounted for using the equity method, it would be difficult to define the scope of eligible investments in a manner that would be practicable and could be applied consistently.
- BC127 The requirement described in paragraph BC119 does not preclude an insurer or any other entity from:
- (a) presenting a line item for income and expenses from investments in associates and joint ventures accounted for using the equity method immediately below its operating profit;
  - (b) disaggregating that line item to highlight equity method investments that users of financial statements could consider as part of net financial result;
  - (c) presenting an additional subtotal (see paragraph BC120); or
  - (d) disclosing a management-defined performance measure.
- BC128 The IASB also decided to provide transitional requirements that would allow an eligible entity 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 (as specified in paragraph 18 of IAS 28) when it first applies IFRS 18 (see paragraph BC423). The IASB decided it was unnecessary to provide transitional requirements in IFRS 18 for an entity that, in applying paragraph 19 of IAS 28, decides to measure a portion of an investment in an associate at fair value through profit or loss. Transitional requirements are unnecessary for an entity applying that paragraph because its application is not limited to initial recognition of an investment in an associate.

#### **Investments in subsidiaries accounted for using the equity method in separate financial statements**

- BC129 The IASB decided to require an entity to classify in the investing category income and expenses from investments in subsidiaries accounted for using the equity method in separate financial statements prepared in accordance with IAS 27 *Separate Financial Statements*. This approach is consistent with:
- (a) suggestions from users of financial statements that an entity present income and expenses from investments accounted for using the equity method outside operating profit because the equity method combines income and expenses that users of financial statements would usually analyse separately, including financing expenses and income taxes;



- (b) the IASB's decision to require an entity to classify in the investing category income and expenses from investments in associates and joint ventures accounted for using the equity method (see paragraphs BC116–BC120); and
- (c) the IASB's conclusion that a parent entity follows the method in IAS 28 applicable to an associate or joint venture if it elects to apply the equity method to its subsidiaries in its separate financial statements (see paragraph BC10H of the Basis for Conclusions on IAS 27).

*Investments in associates, joint ventures and unconsolidated subsidiaries not accounted for using the equity method*

- BC130 The IASB concluded that generally its reasons for excluding from operating profit income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries accounted for using the equity method do not apply to such investments accounted for using the cost or fair value methods (see paragraphs BC113–BC115). The IASB considered how an entity classifies income and expenses from investments in associates, joint ventures and unconsolidated subsidiaries not accounted for using the equity method.
- BC131 The IASB first considered whether the classification of such income and expenses should depend on whether the investment is an asset that generates returns individually and largely independently of an entity's other resources (see paragraphs BC142–BC147). In some cases, it might be difficult for an entity to determine whether an investment in an associate, joint venture or unconsolidated subsidiary generates returns individually and largely independently of its other resources. For example, practical difficulties could arise if the associate, joint venture or unconsolidated subsidiary's activities are related to the entity's main business activities. In such cases, it might be unclear whether the entity's investment in that associate, joint venture or unconsolidated subsidiary generates returns largely independently of the entity's other resources.
- BC132 To avoid such difficulties, the IASB decided that income and expenses from associates, joint ventures and unconsolidated subsidiaries not accounted for using the equity method are classified in the investing category unless, applying paragraph 55(b) of IFRS 18, the entity assesses that investing in these assets is a main business activity (see paragraphs BC94–BC102). Therefore, an entity classifies those income and expenses:
- (a) in the investing category, if investing in associates, joint ventures or unconsolidated subsidiaries not accounted for using the equity method is not a main business activity; or
  - (b) in the operating category, if investing in associates, joint ventures or unconsolidated subsidiaries not accounted for using the equity method is a main business activity.

*Cash and cash equivalents*

- BC133 The IASB considered how an entity classifies income and expenses from cash and cash equivalents. The IASB first considered requiring an entity to classify such income and expenses in the financing category, as a proxy for income and expenses from excess cash and temporary investments of excess cash. Users of financial statements typically treat excess cash (and temporary investments of excess cash) as part of an entity's financing because how the entity manages such assets is often interrelated with its decisions about debt and equity financing. For example, excess cash could be used to pay dividends, repay debt or buy back shares. Although it would be difficult for the IASB to develop a definition of 'excess cash and temporary investments of excess cash' that could be applied consistently, the definitions of 'cash' and 'cash equivalents' in IAS 7 could be used. The IASB acknowledged that some entities hold cash for operational purposes—for example, as part of working capital—which might not be viewed as 'excess cash'. Nonetheless, in general, 'cash and cash equivalents' was expected to provide a reasonable proxy for excess cash and temporary investments of excess cash.
- BC134 Some stakeholders expressed concerns about classifying income and expenses from cash and cash equivalents in the financing category, saying:
- (a) contrary to the expectations in BC133, cash and cash equivalents might not be a reasonable proxy for excess cash and temporary investments of excess cash.
  - (b) cash and cash equivalents are assets that generate returns individually and largely independently of an entity's other resources. Therefore, income and expenses from cash and cash equivalents should be classified in the investing category.
  - (c) the financing category would be simpler to understand if it included income and expenses from liabilities, and did not include income and expenses from cash and cash equivalents.
- BC135 The IASB decided to require an entity to classify in the investing category income and expenses from cash and cash equivalents unless an entity has specified main business activities, as discussed in paragraphs BC136–BC141. This approach will make the structure of the statement of profit or loss easier to understand. The investing category relates to assets and the financing category generally relates to liabilities.

**Entities with specified main business activities**

- BC136 In some cases, an entity that invests in financial assets as a main business activity holds a large amount of cash and cash equivalents for operational purposes. For example, insurers and investment funds often have large balances of cash and cash equivalents because of continuously rebalancing their investment portfolios. Feedback from users of financial statements indicated that for such entities, classifying income and expenses from cash and cash equivalents in the operating category (instead of the investing category) provides more useful information.
- BC137 The IASB considered several ways to describe those entities that are required to classify income and expenses from cash and cash equivalents in the operating category. The IASB decided to limit the scope of the requirement to entities that invest as a main business activity in financial assets other than cash and cash equivalents and associates, joint ventures and unconsolidated

subsidiaries. Feedback from users of financial statements suggested it would not result in useful information if an entity that invests only in non-financial assets as a main business activity—such as investment property companies—classified income and expenses from cash and cash equivalents in the operating category.

BC138 Many entities—such as banks—that provide financing to customers as a main business activity also invest in financial assets as a main business activity. The requirement described in paragraph 56(a) of IFRS 18 to classify income and expenses from cash and cash equivalents in the operating category (instead of the investing category) applies to such entities.

BC139 However, some entities that provide financing to customers as a main business activity do not invest in financial assets as a main business activity. Examples include entities that provide financing to customers to buy the entity's products (such as car manufacturers) and some specialised financial institutions. Like an entity that invests in financial assets as a main business activity, an entity that provides financing to customers might hold large amounts of cash for regulatory or operational purposes. Such an entity generally reports its income and expenses from cash and cash equivalents as part of net interest income, a subtotal similar to gross profit, which is one of its key operating performance metrics.

BC140 For similar reasons to those discussed in paragraphs BC180–BC188, the IASB decided to provide an accounting policy choice for an entity that provides financing to customers as a main business activity but does not invest in financial assets as a main business activity to classify in the operating category either:

- (a) income and expenses from all cash and cash equivalents; or
- (b) the portion of income and expenses from cash and cash equivalents related to providing financing to customers.

BC141 The outcome of applying the accounting policy choice is that, regardless of the policy selected, an entity always classifies in the operating category income and expenses from cash and cash equivalents related to providing financing to customers as a main business activity. Consequently, the accounting policy choice in IFRS 18 relates only to the classification of those income and expenses from cash and cash equivalents that do not relate to providing financing to customers. If an entity cannot distinguish between which income and expenses from cash and cash equivalents relate to providing financing to customers and which do not, an entity applies the accounting policy choice to classify in the operating category all income and expenses from cash and cash equivalents.

*Other assets that generate a return individually and largely independently of an entity's other resources*

BC142 Assets that generate a return individually and largely independently of an entity's other resources—for example, debt and equity investments—generate returns differently from the way returns are generated by:

- (a) assets that do not generate returns either individually or largely independently of an entity's other resources, such as plant and equipment used to produce goods or supply services;
- (b) assets that generate returns individually but not largely independently of an entity's other resources, such as an entity's receivables arising from the supply of goods and services for which income and expenses are classified in the operating category; and
- (c) assets that generate returns largely independently of an entity's other resources, but only as part of a group of assets, such as assets in a disposal group held for sale.

BC143 If an entity provides financing to customers as a main business activity, any asset arising from providing financing to customers (for example, a loan to a customer) is not an asset that generates returns individually and largely independently of the entity's other resources. Consistent with the example in paragraph BC142(b), for such an entity, providing financing is the service it provides to customers, which it does in combination with its other resources.

BC144 The IASB decided to clarify that an entity classifies in the operating category income and expenses from a business combination. Income and expenses from a business combination do not arise from assets that generate returns individually and largely independently of an entity's other resources. For example, a gain on a bargain purchase is generated from the underlying assets acquired and liabilities assumed in a business combination and is not a return generated by an asset individually and largely independently of an entity's other resources.

#### **Entities that invest in assets as a main business activity**

BC145 If investing in assets is an entity's main business activity, investment returns are an important indicator of operating performance (see paragraphs BC94–BC102). For some of these entities, presenting investment returns in the investing category might mean the operating category would include only expenses. For example, the operating category of an investment property company would exclude rental income and remeasurements of investment property. For these entities, an operating profit subtotal that excludes returns from those investments would not faithfully represent the results of the entity's operations. The IASB decided to require an entity that invests as a main business activity to classify in the operating category income and expenses from those assets that generate returns individually and largely independently of the entity's other resources and are invested in as a main business activity.

BC146 The requirement to classify such income and expenses in the operating category applies only to income and expenses from assets in which the entity invests as a main business activity. An entity investing in assets as a main business activity might have other investments. For example, an entity that invests in investment property as a main business activity might also invest in financial assets that generate returns individually and largely independently of its other resources, but not as a main business activity. Classifying in the investing category income or expenses from those other investments means that for any entity—those that invest as a main business activity and those that do not—users of financial statements will receive separate information about returns from investments that are not part of the entity's main business activities.

BC147 Some stakeholders said a requirement for an entity to determine whether each investment is made as a main business activity could be onerous. The IASB concluded that in some cases assessing each item individually would be unnecessary. For example, an entity might only invest in a single type of asset, such as investment property, or invest in portfolios of financial assets for which the outcome of the assessment would be the same regardless of whether the entity performs the assessment for each investment or for the portfolio as a whole. The IASB decided to allow an entity to group assets with shared characteristics for the purpose of assessing whether those investments were made as a main business activity. The IASB provided application guidance to help an entity determine how to group assets with shared characteristics for the purpose of that assessment.

**Financing category and profit or loss before financing and income taxes subtotal (paragraphs 59–66 and B50–B59)**

*Profit or loss before financing and income taxes*

BC148 IFRS 18 requires an entity to present a subtotal for profit or loss before financing and income taxes in the statement of profit or loss (except in the circumstances discussed in paragraph BC189). The IASB developed this requirement because many users of financial statements seek to analyse an entity's performance independently of how the entity is financed. The presentation of a subtotal for profit or loss before financing and income taxes helps facilitate that analysis.

BC149 The IASB observed that the required subtotal for profit or loss before financing and income taxes serves a similar purpose to a subtotal for earnings before interest and tax (EBIT), which many users of financial statements use to compare the financial performance of entities with varied financing structures. However, EBIT and similar subtotals are not comparable between entities because of the diverse ways entities distinguish between finance income and expenses and other items of income and expense. The required subtotal for profit or loss before financing and income taxes would increase comparability between entities. The IASB decided not to describe that required subtotal as 'EBIT' because such a description could be misleading and would rarely be a faithful representation of it. For example, it might imply that all interest has been excluded from the subtotal, including interest revenue. It might also imply that the required subtotal excludes only interest and income taxes, and nothing else, which might be incorrect.

BC150 In developing the requirements on profit before financing and income taxes, the IASB considered feedback suggesting that an entity not be required to present the subtotal. Some stakeholders instead suggested the investing and financing categories be merged into a single category because:

- (a) merging the investing and financing categories would resolve classification issues between those two categories (such as the classification of income and expenses from cash and cash equivalents, as discussed in paragraphs BC133–BC135);
- (b) the investing category might include only a few items of income and expenses for many entities, in which case the subtotal for profit or loss before financing and income taxes might provide little incremental value compared to the operating profit subtotal; and
- (c) a separate investing category and a subtotal for profit before financing and income taxes might clutter the statement of profit or loss.

BC151 The IASB decided against the approach described in paragraph BC150 because a merged investing and financing category would result in an entity presenting together income and expenses that have different characteristics and are often analysed separately. Moreover, this approach would not respond to feedback from users of financial statements—almost all of whom agreed with the IASB's proposal to require an entity to present a subtotal for profit or loss before financing and income taxes. The proposed subtotal would provide a comparable anchor for users' analyses.

BC152 The IASB also decided not to modify the requirement to present both subtotals when the operating profit subtotal is equal to the subtotal for profit or loss before financing and income taxes. Identifying both subtotals provides useful information, even if they are equal, particularly if information is accessed digitally. A user of paper-based financial statements might understand from the structure of the statement of profit or loss that two required subtotals are reported even if only one is identified because the amounts are equal. However, if information is accessed digitally, users of financial statements might be unable to identify the required subtotals if they are not all reported or tagged—because an entity reports or tags only one of the equal subtotals. It is helpful to users of financial statements accessing the information digitally if an entity reports or tags all required subtotals, even if they are equal. The IASB expects that the requirements will result in entities digitally tagging both subtotals even when the amounts are equal.

*Financing category*

BC153 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 (see paragraphs BC161–BC163); 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 (see paragraphs BC164–BC168).

BC154 In developing these requirements, the IASB considered whether to use:

- (a) a narrow approach that limits the items classified in the financing category to those income and expenses most users of financial statements view as arising from an entity's financing activities, such as income and expenses arising from bank loans or corporate bonds; or

- (b) a broader approach that includes in the financing category some income and expenses on other liabilities, which some users of financial statements believe to be similar to income and expenses from an entity's financing activities, such as the net interest expense on a defined benefit liability or the unwinding of the discount on a decommissioning liability.

BC155 The IASB decided to use the broader approach because, in the IASB's view, this approach best meets the information needs of users of financial statements (see paragraphs BC157–BC160). The requirements in IFRS 18 provide a consistent basis for classifying income and expenses in the financing category and disaggregating material information about those income and expenses in the notes. Users of financial statements that have a narrower view of such income and expenses are able to use the information provided in an entity's financial statements to make any adjustments they consider necessary in their analyses.

BC156 The IASB also decided to:

- (a) specify how to apply the requirements described in paragraph BC153 to hybrid contracts containing host liabilities and embedded derivatives (see paragraphs BC169–BC179);
- (b) provide specific requirements for an entity that provides financing to customers as a main business activity (see paragraphs BC180–BC191);
- (c) provide specific requirements for classification of income and expenses on liabilities arising from issued investment contracts with participation features recognised in accordance with IFRS 9 (see paragraphs BC192–BC195);
- (d) provide specific requirements for classification of insurance finance income and expenses (see paragraphs BC196–BC197); and
- (e) provide no specific requirements for intermediate lessors (see paragraphs BC198–BC199).

**Approach to distinguishing liabilities with income and expenses classified in the financing category**

BC157 The IASB considered requiring an entity to classify in the financing category income and expenses on liabilities arising from its financing activities, based on the definition of 'financing activities' in IAS 7. The IASB also considered amending IAS 7 to clarify that definition so that it could be applied consistently. The IASB proposed specifying that, in relation to borrowings, financing activities involve the receipt or use of a resource from a provider of finance with the expectation that:

- (a) the resource will be returned to the provider of finance; and
- (b) the provider of finance will be appropriately compensated through the payment of a finance charge dependent on both the amount of the credit and its duration.

BC158 Some stakeholders raised questions about the proposed amendment to the definition of financing activities in IAS 7, such as asking for the meaning of the terms 'provider of finance' and 'finance charge'. These questions would have been difficult to resolve and would likely have involved addressing other issues relating to the statement of cash flows, which could have added significantly to the scope of the project to develop IFRS 18 and delayed its completion. The IASB therefore decided not to proceed with the proposed amendment to the definition of 'financing activities' in IAS 7.

BC159 Instead, the IASB developed a practical approach that focused more broadly on income and expenses that are financing by nature. To do this, the IASB distinguishes between:

- (a) liabilities that arise from transactions that involve only the raising of finance, such as corporate bonds, bank loans and mortgages. The purpose of such transactions is solely the raising of finance for an entity's operating and investing activities, so income and expenses from those liabilities are classified in the financing category.
- (b) liabilities that arise from transactions that do not involve only the raising of finance such as payables for goods or services received with extended payment terms, lease liabilities and pension liabilities. Such transactions both contribute to an operating (or investing) activity and provide finance to an entity. Some income and expenses that are financing in nature from these liabilities are classified in the financing category (see paragraphs BC164–BC168).

BC160 This distinction is easier to make than the distinction between liabilities that arise from financing activities and other liabilities because it is only necessary to identify which liabilities involve only the raising of finance. It is unnecessary to identify whether liabilities that involve activities other than financing (for example, a lease or pension liability) are also part of an entity's financing activities. Regardless of whether a liability is regarded as part of an entity's financing activities, income and expenses that are financing by nature will be classified in the financing category.

**Liabilities that arise from transactions that involve only the raising of finance**

BC161 For liabilities that arise from transactions that involve only the raising of finance, IFRS 18 requires an entity to classify in the financing category:

- (a) income and expenses that arise from the initial and subsequent measurement of the liabilities, including derecognition of the liabilities—for example, interest expense on debt instruments issued; and
- (b) incremental expenses directly attributable to the issue and extinguishment of the liabilities—for example, transaction costs arising on issuing a financial liability that is measured at fair value through profit or loss.

BC162 The IASB decided to require an entity to classify in the financing category the incremental expenses directly attributable to the issue and disposal of liabilities that arise from transactions that involve only the raising of finance to provide consistency in the classification of these expenses. Without a specific requirement to classify such expenses in the financing category, the requirements in other IFRS Accounting Standards for the recognition and subsequent measurement of liabilities might have resulted in inconsistent classification. For example, IFRS 9 requires an entity to include transaction costs in the initial recognition of a financial liability measured at amortised cost and these costs would have been classified subsequently in the

financing category, while for financial liabilities measured at fair value through profit or loss, transaction costs are required to be recognised as expenses immediately and would have been classified in the operating category.

BC163 Requiring an entity to classify in the financing category incremental expenses directly attributable to the issue and extinguishment of these liabilities aligns the approach to classifying similar expenses from assets in the investing category. Identifying incremental expenses directly attributable to the issue and disposal of the liabilities is not expected to be costly because they are typically external costs identifiable without performing an allocation exercise.

**Liabilities that arise from transactions that do not involve only the raising of finance**

BC164 For liabilities that arise from transactions that do not involve only the raising of finance, IFRS 18 requires an entity to classify in the financing category only interest income and expenses (including the effects of changes in interest rates).

BC165 For example, a long-term provision recognised applying IAS 37 *Provisions, Contingent Liabilities and Contingent Assets* might result in an entity recognising various types of income and expenses, such as:

- (a) periodic unwinding of the discount on the liability;
- (b) the effects of changes in the discount rate used to measure the liability; and
- (c) the effects of changes in the best estimate of the expenditure required to settle the liability.

BC166 The IASB's approach is that the unwinding of the discount and the effects of changes in the discount rate are classified in the financing category because they are financing in nature.

BC167 However, not all IFRS Accounting Standards require an entity to disaggregate income and expenses arising from changes in the carrying amount of a liability into separate amounts for interest income and expenses (including the effects of changes in interest rates) and other types of income and expenses. For example, IFRS 2 *Share-based Payment* does not require an entity to disaggregate the income and expenses arising from changes in the carrying amount of a share-based payment liability into components for service costs, interest expense and other changes in that liability.

BC168 The IASB decided to limit the requirement described in paragraph BC164 to those interest income and expense amounts an entity identifies applying the requirements in other IFRS Accounting Standards. The IASB decided not to include additional disaggregation requirements in IFRS 18 beyond those required by other IFRS Accounting Standards because:

- (a) it would not be feasible to develop overarching disaggregation requirements in IFRS 18 that could be applied consistently with the requirements in other IFRS Accounting Standards, because of the different measurement requirements in those other IFRS Accounting Standards; and
- (b) it would be beyond the scope of the project to separately consider the requirements in each of the applicable IFRS Accounting Standards and develop additional disaggregation requirements for the purpose of classifying income and expenses in the statement of profit or loss.

**Classification of income and expenses from hybrid contracts containing a host that is a liability**

BC169 Some contracts within the scope of IFRS 9 are hybrid contracts that contain a host that is a liability and an embedded derivative. For example, a bank loan might include a prepayment option, which allows the borrower to settle the loan before its maturity date. IFRS 9 includes requirements for when an entity is required to separate an embedded derivative from a host liability.

BC170 If an embedded derivative and host that is a liability are separated, IFRS 9 requires an entity to account for them separately. If they are not separated, IFRS 9 requires an entity to account for the combined liability—both the host liability and the embedded derivative—as a single unit of account. An entity measures the combined liability in its entirety, without separately measuring the host liability or embedded derivative.

BC171 The IASB considered how an entity would classify income and expenses from liabilities that arise from such hybrid contracts. To maintain consistency with the requirements in IFRS 9, the IASB decided that if the host that is a liability and embedded derivative are separated, an entity classifies income and expenses from:

- (a) a separated host liability in the same way as a similar liability that is not a host in a hybrid contract; and
- (b) a separated embedded derivative in the same way as a similar stand-alone derivative (see paragraphs BC223–BC235).

BC172 The IASB next considered situations in which the host that is a liability and embedded derivative are not separated. Such hybrid contracts could arise from transactions that:

- (a) involve only the raising of finance; or
- (b) combine financing with another activity.

BC173 The IASB concluded that:

- (a) if the hybrid contract arises from transactions that involve only the raising of finance, an entity classifies in the financing category all income and expenses from such contracts, to be consistent with the IASB's conclusions on such liabilities (see paragraphs BC161–BC163); and
- (b) if the hybrid contract arises from transactions that combine financing with another activity, except as discussed in paragraphs BC174–BC177, an entity classifies in the financing category interest income and expenses from such contracts (including the effects of changes in interest rates), to be consistent with the classification of income and expenses on other such liabilities (see paragraphs BC164–BC168).

BC174 Hybrid contracts that arise from transactions that combine financing with another activity could include hybrid contracts measured at amortised cost because the contract contains:

- (a) a host that is a financial liability in the scope of IFRS 9; and
- (b) an embedded derivative that has not been separated because it is closely related to the economic characteristics and risks of the host liability.

BC175 For example, a payable to a supplier for goods or services received could arise from a contract with extended credit terms that includes an early prepayment option. This contract could give rise to income and expenses resulting from changes in expected future cash flows, as and when expectations about the use of the early prepayment option are updated. Applying the approach discussed in paragraphs BC164–BC168, an entity would identify interest income and expenses (including the effects of changes in interest rates) separately from other income and expenses from that liability. However, for such liabilities, it might be unclear whether the income or expenses arising from a change in expected future cash flows are identified as interest or another type of income or expense.

BC176 The IASB decided not to require an entity to identify interest income and expense separately from other types of income and expenses that arise from remeasuring the liability. However, the IASB expects that in most cases the majority of income and expenses will be interest expense because they arise from liabilities measured at amortised cost. Consequently, the IASB decided to require an entity to classify all income and expenses from such hybrid contracts in the financing category. The IASB acknowledged that, in some cases, the requirement could result in income and expenses that do not relate to financing being classified in the financing category. However, the IASB expects the costs of requiring an entity to identify interest expenses for such cases would outweigh the benefits of the resulting information.

BC177 Income and expenses from hybrid contracts described in paragraph BC174 are classified in the financing category in a manner similar to income and expenses from liabilities that arise from transactions that involve only the raising of finance. However, unlike income and expenses from liabilities that arise from transactions that involve only the raising of finance, income and expenses from the hybrid contracts are not eligible to be classified in the operating category by entities that provide financing to customers as a main business activity. The hybrid contracts are liabilities that arise from transactions other than those that involve only the raising of finance, for which the accounting policy choice for an entity that provides financing to customers as a main business activity does not apply.

BC178 Hybrid contracts that arise from transactions that combine financing with another activity could include hybrid contracts measured at fair value through profit or loss applying paragraph 4.3.5 of IFRS 9. Generally, income and expenses from such hybrid contracts are classified in the operating category because interest expense is not recognised separately from changes in fair value.

BC179 Some contracts in the scope of IFRS 17 are hybrid contracts that contain a host that is an insurance liability and an embedded derivative. If the embedded derivative and host liability are:

- (a) separated applying the requirements in IFRS 17, an entity classifies the income and expenses from the host liability applying the requirements for classifying insurance finance income and expenses (see paragraph BC196) and from the separated embedded derivative in the same way as a similar stand-alone derivative, as discussed in paragraph BC171(b); and
- (b) not separated applying the requirements in IFRS 17, an entity classifies the income and expenses from the hybrid contract applying the requirements for classifying income and expenses from insurance contracts. Consequently, income and expenses from the hybrid contract, including insurance finance income and expenses, are classified in the operating category (see paragraph BC196).

#### **Entities that provide financing to customers as a main business activity**

BC180 If an entity provides financing to customers as a main business activity, the difference between the interest revenue from that main business activity and the interest expense incurred to obtain the financing needed for that main business activity is an important measure of the entity's operating performance (see paragraphs BC94–BC102). If an entity provides financing to customers as a main business activity, it classifies in the operating category (instead of the financing category) income and expenses from liabilities arising from transactions that involve only the raising of finance, to the extent that such liabilities relate to providing financing to customers.

BC181 If an entity provides financing to customers, it might have liabilities arising from transactions that involve only the raising of finance that are unrelated to providing financing to customers. In these situations, the entity might be unable to identify—without undue cost or effort—income and expenses from liabilities that relate to providing financing to customers.

BC182 For example, an entity with a central treasury function that raises funding for all the entity's activities might be unable to identify—in a non-arbitrary way—income and expenses from liabilities that relate to providing financing to customers.

BC183 The IASB decided to allow an entity that provides financing to customers as a main business activity to make an accounting policy choice for classifying income and expenses from liabilities that arise from transactions that involve only the raising of finance. Such an entity would classify in the operating category either:

- (a) income and expenses from all liabilities that arise from transactions that involve only the raising of finance; or
- (b) income and expenses from liabilities that arise from transactions that involve only the raising of finance to the extent those liabilities relate to providing financing to customers.

BC184 The outcome of applying the accounting policy choice is that an entity always classifies in the operating category income and expenses from liabilities that arise from transactions that involve only the raising of finance and relate to providing financing to customers as a main business activity. Consequently, the accounting policy choice in IFRS 18 relates only to the classification of those income and expenses from such liabilities that do not relate to providing financing to customers. If an entity cannot

distinguish between which income and expenses from such liabilities relate to providing financing to customers, an entity applies the accounting policy choice to classify in the operating category all income and expenses from such liabilities.

BC185 The IASB recognised that allowing an accounting policy choice might result in some loss of comparability between entities. The IASB also acknowledged that more useful information would result from an entity classifying in the operating category income and expenses from liabilities only to the extent those liabilities relate to providing financing to customers. However, because of the difficulty, in some cases, of allocating income or expenses between the operating and financing categories, the IASB concluded such an allocation is not required.

BC186 The IASB considered other suggested approaches, including:

- (a) requiring an entity to allocate income and expenses to different categories unless the allocation would be arbitrary or involve undue cost or effort. However, requiring an entity to prove an allocation is arbitrary or involves undue cost or effort would add costs and complexity for an entity that provides financing to customers as a main business activity, without necessarily changing the outcome. The IASB expects that an entity that can allocate—in a non-arbitrary way— income and expenses between the operating and financing categories without undue cost or effort is likely to choose to do so.
- (b) requiring an entity to make an accounting policy choice based on how income and expenses are allocated in internal reporting. However, the IASB expects an entity would likely consider how income and expenses are allocated in internal reporting when selecting its accounting policy, even without such a requirement in IFRS 18. In the IASB's view, requiring an entity to do so when selecting its accounting policy is unlikely to add discipline beyond what IFRS Accounting Standards already require for selecting, applying and making changes to an accounting policy.
- (c) requiring an entity to allocate income and expenses to different categories, but with a practical expedient that allows an entity not to allocate them if specified conditions are met. Although the IASB acknowledged that such an approach might resolve some of the concerns of stakeholders who disagreed with allowing an accounting policy choice, determining the specific conditions to be met and requiring an entity to assess whether those conditions are met would add complexity. The IASB concluded the time required to develop those conditions and the costs and complexity for an entity to apply those conditions would outweigh the benefits of such an approach as an alternative to an accounting policy choice.
- (d) requiring an entity to allocate income and expenses to different categories and providing application guidance on how to make that allocation. However, the IASB concluded it would be difficult to develop application guidance that could be applied consistently.

BC187 The accounting policy choice discussed in paragraphs BC180–BC185 applies only to income and expenses from liabilities arising from transactions that involve only the raising of finance. This accounting policy choice does not apply to the requirements to classify in the financing category specific income and expenses from other liabilities, such as lease liabilities or defined benefit liabilities (see paragraphs BC164–BC168) including other liabilities that are hybrid contracts (see paragraph BC177). The IASB concluded those requirements apply to all entities, including entities that provide financing to customers as a main business activity.

BC188 In reaching this conclusion, the IASB acknowledged that practice is mixed, with some banks including interest expenses on lease liabilities or defined benefit liabilities in net interest income. The IASB expects the requirements in IFRS 18 will change the practice of some banks. However, the IASB concluded that:

- (a) requiring a different classification of the specific income and expenses from those liabilities would be inappropriate, because of the lack of any conceptual basis for such a classification.
- (b) the requirements would not allow an entity to choose its own entity-specific classification of the specific income and expenses. The requirement to classify those specific income and expenses in the financing category ensures consistent presentation by all entities.

**Subtotals in the financing category if providing financing to customers is a main business activity**

BC189 The IASB also considered how the accounting policy choice discussed in paragraphs BC183–BC185 affects the requirement to present a subtotal for profit before financing and income taxes. An entity that provides financing to customers as a main business activity might make an accounting policy choice to classify in the operating category income and expenses from *all* liabilities that arise from transactions that involve only the raising of finance. The IASB concluded that it would be misleading for such an entity to present a subtotal described as profit *before* financing and income taxes because most of the entity's expenses from financing would be included in that subtotal. The IASB decided to prohibit an entity from presenting that subtotal if it classifies in the operating category income and expenses from all liabilities that arise from transactions that involve only the raising of finance.

BC190 However, the prohibition does not preclude an entity from presenting an additional subtotal after operating profit and before any line items for income and expenses classified in the financing category, if doing so is necessary to provide a useful structured summary of the entity's income and expenses. For example, distinguishing between the line items in the investing and financing categories might be necessary to provide a useful structured summary—such a subtotal would still be prohibited from being labelled profit before financing and income taxes.

BC191 Consistent with paper-based reporting, in digital reporting an entity would tag such a subtotal using a tag for operating profit or loss and all income and expenses classified in the investing category and not use the tag for profit before financing and income taxes. Users of financial statements would be able to understand that the subtotal profit or loss before financing and income taxes

is not applicable by the absence of a subtotal with this tag. This is because an entity is expected to tag such a subtotal when it is not prohibited from using it, even when it is equal to another subtotal (see paragraph BC152).

#### **Income and expenses on liabilities arising from issued investment contracts with participation features**

- BC192 As part of their main business activities, some entities, such as investment entities and insurers, issue investment contracts with participation features within the scope of IFRS 9—contracts specifying that the return owed to the investor varies with the returns on underlying items. For these contracts, the entity issuing the contract recognises the investor's claim as a liability and the investments linked to the contract as assets.
- BC193 Applying the IASB's decisions on the classification of income and expenses, an entity would classify in the financing category the income or expenses from the investment contract liability (see paragraph BC153), but classify in the operating category the returns on the underlying investments in which they invest as a main business activity, unless the investments are accounted for using the equity method (see paragraphs BC121–BC128).
- BC194 However, for such contracts, the expense from the investment contract liability depends (to at least some extent) on the returns on the investments. Accordingly, the difference between the investment returns and the expense from the investment contract liability is typically an important indicator of an entity's operating performance. Classifying the income and expenses on these liabilities in the operating category (instead of the financing category) would provide more useful information. As a result, the IASB decided to require an entity to classify in the operating category income and expenses on liabilities arising from issued investment contracts with participation features recognised in accordance with IFRS 9.
- BC195 In most cases, if an entity issues investment contracts with participation features, it will invest in the assets as a main business activity. Therefore, the IASB decided that the requirement described in paragraph BC194 applies to all entities that issue investment contracts with participation features.

#### **Insurance finance income and expenses**

- BC196 Insurance finance income and expenses arise from insurance contracts issued, reinsurance contracts held and investment contracts with direct participation features that an entity accounts for in accordance with IFRS 17. Such income and expenses relate to an insurer's main business activities. The IASB concluded that an entity classifies insurance finance income and expenses in the operating category instead of the financing category.
- BC197 In most cases, an entity that issues insurance contracts will do so as a main business activity. The IASB therefore decided that the requirement applies regardless of whether an entity issues insurance contracts as a main business activity, because developing requirements for other entities to classify insurance finance income and expenses in the financing category would add complexity to IFRS 18.

#### **Intermediate lessors**

- BC198 Intermediate lessors sublease assets they lease from another party. The IASB considered whether intermediate lessors should classify interest expense on lease liabilities in the operating category instead of the financing category. If the sublease is a finance lease, the difference between finance income on the sublease receivable and interest expenses on the lease liability might be a key measure of the intermediate lessor's operating performance.
- BC199 The IASB decided not to develop specific requirements for intermediate lessors. Such an entity is required to classify income and expenses on lease liabilities in the financing category. Research and discussions with stakeholders showed that the difference between finance income on a sublease receivable and interest expenses on a lease liability is typically not a key performance measure for many intermediate lessors because:
- (a) subleases are typically operating subleases and not finance subleases.
  - (b) subleasing is generally not a main business activity for intermediate lessors with finance subleases. Finance subleases most often relate to assets like unused office space.

#### **Derecognition and changes in classification of assets, liabilities or income and expenses (paragraphs B60–B64)**

- BC200 Some transactions or other events might change the category in which an entity classifies income and expenses. An example is the acquisition of a controlling interest in an entity that was an associate accounted for using the equity method. Before the business combination, the acquirer would have classified the income and expenses from its investment in the associate in the investing category. After the business combination, the acquirer would classify the income and expenses from the subsidiary's individual assets and liabilities in the applicable categories in its consolidated statement of profit or loss. In accounting for the business combination, the acquirer might recognise a gain or loss on remeasurement of its previously held investment in the associate.
- BC201 Similar gains or losses could arise if an entity accounts for a transaction or other event that results in:
- (a) the derecognition of a non-financial asset (or its classification as held for sale);
  - (b) the derecognition of one asset or liability and the recognition of another (such as in a sale-and-leaseback transaction); or
  - (c) a change to the accounting treatment of an asset, without the asset being derecognised (such as a transfer into investment property).
- BC202 Stakeholders asked the IASB to clarify whether such gains and losses are classified using the 'old' or 'new' classification of income and expenses. The IASB concluded that a gain or loss on derecognition of an asset or liability is classified in the same way as any other income or expense arising from that asset or liability. For example, in the business combination discussed in paragraph BC200, the entity classifies any gain or loss on remeasuring its previously held investment in an associate in the investing



category—the same category in which it had previously classified other income and expenses from that investment in the associate (that is, the 'old' category).

- BC203 The IASB decided to apply the same approach to transactions or other events that change the category in which an entity classifies income or expenses due to a change in the accounting treatment of an asset. For example, a change in the use of a property could result in an entity transferring the property from within the scope of IAS 16 *Property, Plant and Equipment* to an investment property within the scope of IAS 40 *Investment Property*. The entity would classify any gain or loss recognised in accounting for that change in use in the operating category—the same category in which it had classified income and expenses from that property immediately before the change in use.
- BC204 The IASB also considered whether the same approach should apply to a single transaction or other event that results in the derecognition of a group of assets (or a group of assets and liabilities) that gave rise to income and expenses classified in more than one category. For example, an entity could sell a subsidiary. If the subsidiary is classified as a discontinued operation applying IFRS 5, all income and expenses are classified in the discontinued operations category. However, if the subsidiary is not classified as a discontinued operation before its disposal, the gain or loss on disposal of the subsidiary might relate to more than one category. Requiring an entity to allocate the gain or loss on derecognition of a group of assets (or a group of assets and liabilities) to the categories related to those assets (or assets and liabilities) could result in arbitrary allocations and be costly for preparers to apply. As a result, the IASB concluded that an entity classifies the gain or loss in one category and, in most cases, classification in the operating category would provide useful information.
- BC205 In some cases, the derecognised assets might not include any assets that gave rise to income and expenses classified in the operating category. For example, the subsidiary sold might have held only investment property and related income tax assets or liabilities (for an entity that does not invest in property as a main business activity). If so, classifying the gain or loss on derecognition of such a group of assets in the operating category might not provide a faithful representation of that gain or loss.
- BC206 The IASB decided that unless the derecognised assets include only assets that gave rise to income and expenses classified outside the operating category immediately before the transaction or other event, an entity is required to classify income or expenses from the transaction or event in the operating category. The IASB decided the approach also applies if a transaction or other event results in a change to the classification of income and expenses relating to a group of assets (or a group of assets and liabilities), without the derecognition of those assets (or those assets and liabilities).

#### **Classification of foreign exchange differences (paragraphs 48 and B65–B68)**

- BC207 The IASB developed requirements for classifying foreign exchange differences that an entity recognises in the statement of profit or loss. Without such requirements, it might have been difficult in particular circumstances to apply the general requirements for classifying income and expenses in the operating, investing and financing categories.
- BC208 The IASB decided to require an entity to classify foreign exchange differences in the same category of the statement of profit or loss as income and expenses from the items that give rise to the foreign exchange differences, unless doing so would involve undue cost or effort (see paragraph BC211).
- BC209 In the IASB's view, classifying foreign exchange differences in the same category as income and expenses from the items that give rise to the foreign exchange differences contributes to a faithful representation of an entity's business activities. For example, an entity would provide an incomplete picture of the performance of its main business activities if it excluded from operating profit foreign exchange differences related to those activities.
- BC210 Some stakeholders raised concerns about the implementation costs of classifying foreign exchange differences in the same category of the statement of profit or loss as income and expenses from the items that give rise to them. These stakeholders said allocating foreign exchange differences to the applicable categories could entail costly enhancements to some entities' reporting systems because those entities currently capture all foreign exchange differences in aggregate as a single amount. For some entities, capturing foreign exchange differences in aggregate at an entity level facilitates central management of net exposure (for example, by a central treasury function). Stakeholders suggested the IASB could allow an entity to classify all foreign exchange differences in a single category.
- BC211 After considering the feedback, the IASB concluded that classifying foreign exchange differences in the applicable categories could impose large implementation costs on some entities. Consequently, the IASB decided to provide an exemption from classifying foreign exchange differences in the applicable categories if doing so would involve undue cost or effort.
- BC212 An entity assesses whether classifying foreign exchange differences in each applicable category involves undue cost or effort for each item that gives rise to foreign exchange differences. If an entity cannot allocate some foreign exchange differences to the applicable categories without undue cost or effort, the exemption would apply only to those foreign exchange differences.
- BC213 Having decided to provide that exemption, the IASB considered in which category those foreign exchange differences should be classified. The IASB acknowledged there is no perfect solution—the classification of all foreign exchange differences in any one category could cause other categories to be incomplete.
- BC214 Some stakeholders suggested classifying foreign exchange differences in the financing category to avoid volatility in operating profit and because it would be consistent with the practice of some entities. However, as discussed in paragraph BC89, excluding volatile income or expenses from operating profit would not faithfully represent the results of an entity's operations for the period. In the IASB's view, volatility is not a reason to classify foreign exchange differences in the financing category.
- BC215 Alternatively, foreign exchange differences subject to the exemption could be classified in the operating category because:

- (a) classifying foreign exchange differences related to an entity's operations (such as sales or purchases of goods or services in a foreign currency) outside the operating category would result in incomplete operating profit, which could reduce the usefulness of the operating profit subtotal as a measure of the entity's performance; and
- (b) classifying such differences in the operating category would be consistent with the IASB's approach to the operating category—income and expenses not required to be classified in other categories of the statement of profit or loss are classified in the operating category (see paragraph BC89).

BC216 After considering the points in paragraphs BC214–BC215, the IASB decided to require an entity to classify foreign exchange differences subject to the exemption in the operating category.

BC217 The IASB also considered whether to specify how an entity classifies foreign exchange differences on liabilities that arise from transactions that involve financing and another activity. For example, an entity might buy goods or services used in its operations from a supplier on extended payment terms. In applying IFRS 18, the entity would classify:

- (a) in the operating category income and expenses from the purchase of goods or services; and
- (b) in the financing category interest expense on the payable.

BC218 If the payable is in a foreign currency, an entity needs to determine how to classify foreign exchange differences arising from that liability. Foreign exchange differences on such a liability might be viewed as arising from:

- (a) the entity's financing decisions and therefore classified in the financing category;
- (b) the entity's purchasing decisions and therefore classified in the operating category; or
- (c) both (a) and (b) and therefore allocated to both the financing and operating categories.

BC219 The IASB observed that foreign exchange differences on liabilities arising from transactions that involve financing and another activity could occur in a range of circumstances. Furthermore, decisions on how to classify such foreign exchange differences are often influenced by the specific circumstances in which the foreign exchange differences arise. The IASB decided not to develop specific requirements on classifying such foreign exchange differences. Instead, the IASB decided to include application guidance to explain that an entity uses its judgement to determine whether the foreign currency differences relate to either amounts classified in the operating category or another category. An entity does not allocate foreign exchange difference arising on such a liability between categories.

#### **Classification of the gain or loss on the net monetary position (paragraphs 48 and B69)**

BC220 The IASB decided to clarify that if an entity applying IAS 29 does not present the gain or loss on the net monetary position with the associated income and expenses, as described in paragraph 28 of IAS 29, it classifies the gain or loss in the operating category.

BC221 If the gain or loss on the net monetary position is not presented with the income and expenses associated with the net monetary position, that gain or loss does not—in totality—meet the requirements to be classified in the investing or financing categories. The IASB decided that, in such circumstances, an entity classifies the gain or loss on the net monetary position in the operating category. This requirement is consistent with the IASB's approach to the operating category—income and expenses not required to be classified in other categories of the statement of profit or loss are classified in the operating category (see paragraph BC89).

BC222 In reaching this conclusion, the IASB considered whether to create a separate category for the gain or loss on the net monetary position but decided against doing so. The IASB concluded such an approach would add unnecessary complexity to the structure of the statement of profit or loss.

#### **Classification of gains and losses on derivatives and designated hedging instruments (paragraphs 48 and B70–B76)**

BC223 The IASB concluded that applying the classification requirements developed for other income and expenses to gains or losses on derivatives and designated hedging instruments might not provide useful information to users of financial statements. For example, if a derivative is used to manage an identified risk, the derivative relates to the income or expenses (or assets or liabilities) affected by the risk being managed.

BC224 The IASB decided to require an entity to classify gains or losses:

- (a) on a financial instrument designated as a hedging instrument, to the extent it is recognised in the statement of profit or loss, in the same category as the income or expenses affected by the risks the entity uses the financial instrument to manage. This classification is not permitted if doing so would require the grossing up of gains or losses (see paragraph BC226). In such cases, an entity classifies all such gains and losses in the operating category (see paragraphs BC230–BC231).
- (b) on a derivative not designated as a hedging instrument, but nonetheless used to manage exposure to identified risks, in the same category of the statement of profit or loss as the income or expenses affected by the risks the entity uses the financial instrument to manage. This classification is not required if doing so would involve undue cost or effort (see paragraph BC228) and is not permitted when doing so would require grossing up of gains or losses. In these cases, an entity classifies all such gains or losses in the operating category (see paragraphs BC230–BC231).
- (c) on a derivative not used to manage exposures to identified risks in the operating category, unless the derivative relates to a transaction that involves only the raising of finance. In that case, an entity would classify all gains or losses on the derivative in the financing category (see paragraph BC232).

#### *Gains and losses on designated hedging instruments*

BC225 When an entity designates derivatives in a hedging relationship in accordance with IFRS 9, it identifies the link between the derivative and the risk being hedged to comply with the eligibility criteria and documentation requirements in IFRS 9. The IASB concluded that requiring an entity to classify gains or losses on derivatives in the category that reflects an entity's risk management, instead of a single category, would provide useful information about the entity's activities.

BC226 If a hedging instrument hedges a group of items with offsetting risk positions and the hedged items are classified in more than one category of the statement of profit or loss, an entity would have to gross up the gains or losses on the hedging instrument to classify them in the applicable categories. In such circumstances, paragraphs 6.6.4 and B6.6.15 of IFRS 9 require the entity to present gains or losses on the hedging instrument in a separate line item to avoid the grossing up of gains and losses from a single hedging instrument. The IASB decided if the requirement to classify gains or losses on a hedging instrument in the applicable category would result in the grossing up of gains or losses, an entity classifies those gains or losses in the operating category (see paragraphs BC230–BC231).

*Gains and losses on other derivatives used to manage exposures to identified risks*

BC227 An entity can also use a derivative to manage an identified risk without designating a hedging relationship for the purposes of IFRS 9. In many cases, the IASB expects that an entity can identify the link between the derivative and the risk it uses the derivative to manage because entities typically enter into derivatives in accordance with approved risk management policies. Risk managers usually monitor and report internally on whether derivatives continue to mitigate the risks being managed. Accordingly, an entity would typically have the information necessary to determine the link between a derivative and the risk the entity uses the derivative to manage. Consequently, the IASB concluded that classifying gains or losses on other derivatives used to manage exposures to identified risks using the same approach as for gains or losses on designated hedging instruments would provide useful information about an entity's risk management activities.

BC228 However, stakeholder feedback revealed that, in some cases, identifying gains or losses affected by the risk(s) managed using non-designated derivatives might involve undue cost or effort. For example, an entity's central treasury function might be the counterparty to internal derivatives used for risk management, which are then 'externalised' on a net exposure basis. In this example, systems and processes might require changes to be able to identify the gains or losses on the external derivatives that would be applicable to each of the categories. In such cases, the IASB decided to require an entity to classify gains and losses in the operating category (see paragraphs BC230–BC231).

BC229 The IASB considered requiring an entity to apply a similar approach to the one described in paragraph BC224(b) to non-derivative financial instruments not designated as hedging instruments and used to manage exposures to identified risks. For example, a debt instrument denominated in a foreign currency might provide financing and be used to manage foreign currency risk. The IASB decided against this approach because it would be costly for an entity to identify the categories affected by the risk(s) managed and monitor whether it holds the financial instrument to manage exposures to identified risks. An entity might hold non-derivative financial instruments for more than one purpose, including to manage exposures to identified risks. These non-derivative financial instruments differ from derivatives, which are often held only for the purpose of managing such exposures. Instead, the IASB concluded an entity classifies income and expenses on these non-derivative financial instruments in the operating, investing or financing categories by applying the general classification requirements in IFRS 18.

*Prohibition on grossing up of gains and losses on derivatives and undue cost or effort*

BC230 Applying the requirements described in paragraph BC224(a)–(b), an entity classifies gains or losses on derivatives used to manage identified risks and designated non-derivative financial instruments in the categories affected by the risk the entity manages. However, the IASB decided this requirement does not apply to:

- (a) designated hedging instruments and derivatives not designated as hedging instruments, but instead used to manage exposure to identified risks, if allocating the gains or losses to the applicable categories would require the grossing up of gains or losses (see paragraph BC226); and
- (b) derivatives not designated as hedging instruments, but instead used to manage identified risks, if allocating the gains or losses to the applicable categories would involve undue cost or effort (see paragraph BC228).

BC231 The IASB decided that if either of these exceptions apply, an entity is required to classify the gains or losses in the operating category. This approach will:

- (a) better reflect risk management and reduce mismatches. For example, an entity might use a financial instrument for risk management of a group of items with offsetting risk positions that include items in the operating category. For many entities, such a scenario is likely to occur more frequently.
- (b) be consistent with the IASB's approach to the operating category. As discussed in paragraph BC89, income and expenses not required to be classified in other categories of the statement of profit or loss are classified in the operating category.

*Derivatives not used to manage exposures to identified risks*

BC232 Derivatives not used to manage exposures to identified risks could include derivatives related to transactions that involve only the raising of finance. Often these derivatives are transacted as part of raising finance in a more cost-effective manner. Therefore, the financing category would best depict their effect on the entity's activities. For example, some derivatives involve an exchange of an entity's own equity instruments for cash or another financial instrument, such as a conversion option embedded in a convertible bond. In some cases, such derivatives do not meet the criteria in IAS 32 *Financial Instruments: Presentation* to be classified as equity instruments, in which case an entity recognises gains or losses on such derivatives in the statement of profit or loss. In these cases, the IASB decided an entity classifies the gains or losses on such derivatives in the financing

category because the gains or losses relate to a transaction that involves only the raising of finance. The IASB also decided an entity that provides financing to customers as a main business activity is permitted to apply the accounting policy choice to classify such gains and losses in the operating category because they arise from a transaction that involves only the raising of finance.

- BC233 A derivative not used to manage exposures to identified risks and not related to transactions that involve only the raising of finance will generally generate returns individually and largely independently of an entity's other resources. The IASB considered whether to require an entity to classify fair value gains and losses on such derivatives in the investing category, but decided not to do so.
- BC234 Derivatives could be assets or liabilities, whereas the investing category includes only income and expenses from assets. The IASB considered this matter together with its decisions on those derivatives relating to transactions that involve only the raising of finance. The IASB concluded it could be simpler to require an entity to classify in the financing category all gains or losses from derivatives not used to manage exposures to identified risks. However, if derivatives do not relate to the raising of finance, classification in the financing category would not faithfully represent their purpose and the effect on an entity's activities.
- BC235 The IASB decided to require an entity to classify gains or losses on derivatives not used to manage exposures to identified risks in the operating category (except as discussed in paragraph BC232) because it is simpler. Classifying the gains and losses in the operating category is simpler because:
- (a) it removes the need for an entity to make an assessment of whether it holds the derivatives as a main business activity.
  - (b) it is consistent with the approach applied to derivatives used to manage exposures to identified risks. The IASB decided that if an entity does not allocate gains or losses on derivatives used to manage exposures to identified risks to the applicable categories, the entity classifies those gains or losses in the operating category (see paragraphs BC228–BC229).

**Items to be presented in the statement of profit or loss or disclosed in the notes (paragraphs 75–85 and B77–B85)**

- BC236 IFRS 18 lists line items an entity is required to present in the statement of profit or loss. The IASB decided not to reconsider the items that come from an equivalent list in IAS 1, other than to remove the line item 'finance costs' (see paragraphs BC242–BC243) and to include operating expenses. The IASB created the list of line items during other projects. Revisiting those requirements would have likely involved substantial resources and delayed the development of IFRS 18.
- BC237 Instead, the IASB decided to clarify how those requirements interact with the role of the primary financial statements. An entity is required to present the listed line items unless doing so is unnecessary for the statement of profit or loss to provide a useful structured summary of the entity's income and expenses. In such cases, an entity is required to disclose the item in the notes if it provides material information. As discussed in paragraphs BC45–BC63:
- (a) not all material information can be presented in an entity's primary financial statements; and
  - (b) when deciding where to provide material information, an entity considers the respective roles of the primary financial statements and the notes.
- BC238 Placing the requirements for the listed line items in the context of the role of the primary financial statements avoids an entity having to present a line item that would be unnecessary for the statement of profit or loss to provide a useful structured summary of the entity's income or expenses.
- BC239 In applying the classification requirements in IFRS 18, an entity might be required to present a line item listed in paragraph 75 of IFRS 18 in more than one category in the statement of profit or loss. The IASB concluded this outcome is appropriate because it is necessary to achieve the IASB's objective in developing the requirements for the structure of the statement of profit or loss—to increase the comparability and understandability of information presented in that statement. If the IASB allowed an entity to present each line item listed in paragraph 75 in a single category, it would reduce comparability and understandability. If an entity provides a line item in more than one category, the entity applies the requirements in paragraph 43 of IFRS 18 to describe items presented in the primary financial statements in a way that faithfully represents the characteristics of those items.

**Line item for impairment of non-financial assets**

- BC240 The IASB decided not to add 'impairment of non-financial assets' to the list of line items in paragraph 75 of IFRS 18. As discussed in paragraph BC236, the IASB decided not to reconsider the items that come from an equivalent list in IAS 1. However, the IASB considered the costs and benefits of adding impairment of non-financial assets because some stakeholders suggested this addition, saying it would be consistent with the line item brought forward from IAS 1 for impairment of financial assets.
- BC241 The IASB concluded the costs of requiring an entity to present a line item for impairment of non-financial assets would outweigh the benefits. IFRS 18 requires an entity to present operating expenses in its statement of profit or loss using the characteristics of the nature of expenses and their function within the entity (see paragraphs BC246–BC252). In this context, an entity might often present impairment of non-financial assets separately from other operating expenses because of its dissimilar nature. For example, when the IASB considered prohibiting an entity from using classification by both function and nature, many stakeholders disagreed with that proposed prohibition. These stakeholders argued it would prevent an entity that classified expenses by function from presenting a line item for impairment of non-financial assets (see paragraph BC251(a)(ii)). Consequently, the IASB concluded that adding this requirement would be unlikely to add much to the information entities present beyond that presented applying other requirements in IFRS 18.

**Line items in the financing category**

- BC242 The IASB also decided not to add any line items for expenses classified in the financing category to paragraph 75 of IFRS 18. However, an entity is required to present items classified in the financing category considering the role of the primary financial statements, which replaces the requirement in IAS 1 to present a line item for 'finance costs'. In applying the requirements in IFRS 18, an entity classifies in the financing category:
- (a) income and expenses that arise from the initial and subsequent measurement of liabilities that arise from transactions that involve only the raising of finance;
  - (b) incremental expenses directly attributable to the issue and extinguishment of liabilities that arise from transactions that involve only the raising of finance; and
  - (c) interest expenses and income and expenses arising from changes in interest rates of liabilities that do not arise from a transaction that involves only the raising of finance, but only if the entity identifies such income and expenses for the purpose of applying other requirements in IFRS Accounting Standards.
- BC243 The IASB developed the distinction between liabilities that arise from transactions that involve only the raising of finance and liabilities that do not arise from transactions that involve only the raising of finance as an operational mechanism for identifying which income and expenses are classified in the financing category. The distinction is not intended to identify liabilities relating to 'financing activities'. Some users of financial statements believe some or all of the income and expenses from liabilities that do not arise from transactions that involve only the raising of finance are similar to income and expenses from liabilities that arise from transactions that involve only the raising of finance (see paragraph BC154(b)). An entity judges whether and how a distinction between amounts classified in the financing category is presented in the statement of profit or loss in determining what provides a useful structured summary of its income and expenses. In addition, even if an entity presents a single line item for expenses classified in the financing category in its statement of profit or loss, the entity is required to disclose in the notes disaggregated information about those expenses, including disaggregation arising from any specific disclosure requirements, if the resulting information is material (see paragraphs BC45–BC55).

**Non-controlling interests (paragraphs 76 and 87)**

- BCZ244 IFRS 18 requires the 'profit or loss attributable to non-controlling interests' and 'profit or loss attributable to owners of the parent' each to be presented in the income statement (now called 'statement(s) of financial performance') in accordance with paragraphs 76 and 87. These amounts are to be presented as allocations of profit or loss, not as items of income or expense. A similar requirement has been added for the statement of changes in equity, in paragraph 107(a). These changes are consistent with IFRS 10 *Consolidated Financial Statements*, which requires that in a consolidated balance sheet (now called 'statement of financial position'), non-controlling interest is presented within equity because it does not meet the definition of a liability in the *Conceptual Framework*.

**Extraordinary items**

- BC245 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. 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 includes any item of income and expenses that IFRS 18 does not require to be classified in another category (see paragraph BC89). Paragraphs BC77–BC78 discuss the presentation and disclosure of items of income or expense an entity regards as unusual.

**Presentation and disclosure of expenses classified in the operating category (paragraphs 78–85 and B80–B85)**

- BC246 IFRS 18 requires an entity to present expenses in the operating category in a way that provides the most useful structured summary of the expenses. To do so, the entity presents expenses using the characteristics of the nature of expenses and their function within the entity.
- BC247 Classifying and presenting expenses based on their nature and function improves the usefulness of information for users of financial statements. Information about the nature of expenses allows users to analyse the components of an entity's operating expenses, helping them to forecast those expenses in future periods. Information that aggregates expenses by function facilitates the calculation of some performance metrics, including margins. In some cases, classifying some expenses by function and other expenses by nature provides the most useful structured summary.
- BC248 In developing the requirement in paragraph 78 of IFRS 18, the IASB considered:
- (a) whether to require an entity to classify and present all operating expenses using only the nature of expense characteristic or only the function of expense characteristic—that is, prohibiting a mixed presentation (see paragraphs BC250–BC252); and
  - (b) specific issues relating to presenting expenses by function (see paragraphs BC253–BC258).
- BC249 IFRS 18 also requires an entity that presents line items comprising expenses classified by function to disclose in the notes additional information about specified expenses classified by nature (paragraphs BC259–BC276). The IASB considered requiring an entity that presents items comprising expenses classified by nature to disclose in the notes additional information about expenses classified by function. However, the IASB decided not to develop such requirements because there was little demand from users of financial statements for such information. Therefore, the expected costs of such a requirement would exceed the expected benefits.

*A mixed presentation*

BC250 The IASB considered whether to require an entity to classify and present all operating expenses using only the nature of expense characteristic or only the function of expense characteristic. If an entity classifies and presents some operating expenses based on their nature and others based on their function, the result is a 'mixed presentation'. Users of financial statements said mixed presentations can make it difficult to compare entities, particularly if the labels used for nature line items do not make it clear whether expenses of that nature are also included in some function line items.

BC251 However, many stakeholders raised concerns about prohibiting a mixed presentation. In their view, prohibiting a mixed presentation:

- (a) would prevent an entity from presenting useful information in the statement of profit or loss. For example:
  - (i) an entity might have two types of main business activities, in which case a mixed presentation could provide the most useful information. The entity could provide information about the main drivers of its profitability by presenting some expenses classified by nature and some classified by function.
  - (ii) a manufacturing entity that recognised a substantive impairment of its property, plant or equipment could not present the impairment expense separately in the statement of profit or loss if it classified expenses by function.
  - (iii) an entity might conclude that, in general, classifying expenses by function would provide the most useful information. However, the entity could have some operating expenses that are difficult to allocate to functions in a non-arbitrary way. For example, allocating goodwill impairment to functions might be arbitrary. Some stakeholders were concerned that if allocating some expenses (such as goodwill impairment) to functions was arbitrary, an entity would be required to classify all its operating expenses by nature.
- (b) would be inconsistent with the IASB's decision to retain from IAS 1 the list of line items to be presented in the statement of profit or loss, some of which are expenses classified by nature. If an entity classifies expenses by function, the presentation of those listed line items would result in a mixed presentation.

BC252 Prohibiting a mixed presentation might also prevent an entity from presenting operating expenses in a way that contributes to providing the most useful structured summary of those expenses. Accordingly, the IASB decided against prohibiting a mixed presentation. Instead, it decided to provide additional application guidance to improve comparability and help ensure information is faithfully represented if an entity classifies some operating expenses by nature and some by function.

*Presentation of line items classified by function*

BC253 The IASB decided not to develop a definition of 'function'. Some stakeholders said it was unclear how to apply the function of expense method. However, the IASB observed that classifying expenses by function is not a new concept. IAS 1 required an entity to present an analysis of expenses recognised in profit or loss using either the function of expense method or the nature of expense method. The IASB also concluded that it would be difficult to develop a definition of 'function' and application guidance on allocating expenses to functions that would be practicable.

BC254 However, to help an entity identify the line items classified and presented by function that provide the most useful structured summary of its expenses, the IASB:

- (a) expanded the proposed description of classification by function in paragraph 81 of IFRS 18 to clarify that, in applying that classification, an entity can allocate expenses relating to economic resources of the same nature (such as employee services) to several function line items (such as cost of sales and research and development); and
- (b) provided application guidance in paragraph B85 of IFRS 18 on the level of aggregation for operating expenses that provides the most useful structured summary, to help avoid too much or too little aggregation.

BC255 The IASB also decided to require an entity classifying operating expenses by function that include a cost of sales function to present a line item for its cost of sales separately from any other expenses classified by function. This requirement builds on a requirement from IAS 1 for an entity that uses the function of expense method to disclose its cost of sales separately from other expenses. Cost of sales is an important line item that facilitates the calculation of some performance metrics, such as gross margins, and is therefore not aggregated with other expenses classified by function.

BC256 Some stakeholders raised concerns about diversity in the costs included in the line item cost of sales, which they said could be resolved if the IASB developed a definition of 'cost of sales'. The IASB acknowledged those concerns, but concluded it would be difficult to develop a definition of 'cost of sales' within a reasonable time frame. Such work would likely delay completion of IFRS 18 and was also ranked as low priority in the IASB's *Third Agenda Consultation*. Developing a definition also could have unintended consequences for the application of the requirements in IAS 2 *Inventories*. Consequently, the IASB decided not to develop a definition of 'cost of sales'.

BC257 However, the IASB decided to require an entity that presents cost of sales to include in that line item inventory expense, as described in paragraph 38 of IAS 2. In practice, some entities exclude components of inventory expense in presenting cost of sales. The IASB concluded that requiring an entity to include inventory expense would help reduce diversity in the costs included in cost of sales, improving comparability between entities that present that line item. The IASB also concluded such a requirement would not be costly for an entity to apply, because IAS 2 requires an entity:

- (a) to recognise the amount of inventories as an expense in the period in which the related revenue is recognised; and
- (b) to disclose the amount of inventories recognised as an expense during the period.

BC258 To enhance the understandability of the composition of line items, the IASB decided to require an entity to disclose a description of the nature of expenses included in each line item comprising expenses classified by function. This description could help

users of financial statements assess the extent of comparability between entities that present cost of sales. The IASB concluded that a similar disclosure requirement for line items of expenses was unnecessary for expenses classified by nature. Typically, the composition of those line items is clear (except for 'other' expenses, for which IFRS 18 includes specific requirements as discussed in paragraph BC79).

*Disclosure of information about specified nature expenses*

- BC259 The IASB decided to require 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).
- BC260 Feedback from users of financial statements indicated that presenting operating expenses classified by function can provide useful information (see paragraph BC247), 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.
- BC261 IAS 1 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.
- BC262 The IASB considered whether to require an entity to disclose an analysis of each function line item, disaggregated by the nature of expenses included in the line item. Such an analysis would provide users of financial statements with useful information. For example, the analysis could help users to more accurately forecast operating expenses relating to each function line item. However, feedback from preparers of financial statements indicated this approach could be complex and costly for some entities to apply. These preparers said an entity presenting operating expenses classified by function generally does not track all operating expenses classified by nature. Furthermore, if an entity tracks expenses classified by nature at the subsidiary level, that information is often lost because of consolidation by function and as a result of intercompany transactions (for example, if the output of one group entity is the input of another group entity). Preparers said obtaining the information at the reporting entity level would require fundamental changes to their reporting systems.
- BC263 The IASB next considered whether to require an entity to disclose an analysis of its *total* operating expenses classified based on their nature. Instead of disaggregating each function line item by nature (see paragraph BC262), an entity would provide an additional analysis of its total operating expenses classified based on their nature. The IASB expected that approach would provide useful information to users of financial statements at a lower cost to preparers of financial statements compared to the approach described in paragraph BC262. However, many preparers of financial statements raised concerns about the costs of applying that approach, for the same reasons.
- BC264 The IASB researched further how to better balance the costs and benefits of disclosing additional information about the nature of operating expenses if an entity presents expenses classified by function. Stakeholders gave the IASB more detailed feedback on what specific information about the nature of expenses is most useful to users of financial statements and the costs to an entity of providing that additional information.
- BC265 After considering that feedback, the IASB concluded that requiring an entity to disclose the amounts included in each line item in the operating category for specific nature expenses would achieve a better cost–benefit balance than the approach described in paragraph BC263. This disclosure would be:
- (a) less costly for most entities to provide than the disclosures described in paragraph BC263. Preparers of financial statements said they could provide at a reasonable cost disaggregated information about the amounts included in each line item in the operating category for a limited number of expenses classified by nature (subject to the matter discussed in paragraph BC270).
  - (b) useful to users of financial statements because it would enable them to better understand:
    - (i) what is included in line items in the operating category of the statement of profit or loss (which is useful, for example, when performing margin analysis);
    - (ii) how information presented in the primary financial statements relates to information disclosed in the notes; and
    - (iii) how non-cash items included in line items in the operating category of the statement of profit or loss relate to the statement of cash flows.
- BC266 In feedback, users of financial statements said information about the amounts of employee benefits, depreciation and amortisation included in each line item in the operating category is generally useful, regardless of the industry in which an entity operates. Some users of financial statements also said information about the amounts of impairments (or reversals) and write-down of inventories (or reversals) included in each line item in the operating category is useful (for example, because of their non-cash nature). Preparers of financial statements said providing disaggregated information about those specific expenses would not be too costly (subject to the matter discussed in paragraph BC270).
- BC267 Stakeholder feedback also indicated that requiring disaggregated information beyond those five types of expenses (employee benefits, depreciation, amortisation, impairments and write-down of inventories) would impair the cost–benefit balance. For

example, some users of financial statements suggested the IASB require an entity to provide disaggregated information about other expense items, but acknowledged that the benefits of such information would often depend on the industry in which the entity operates. Overall, the feedback suggested that adding more expenses to the list set out in paragraph 83 of IFRS 18 would likely result in additional costs to preparers of financial statements that could not be justified by the benefits to users of financial statements.

BC268 The IASB also decided:

- (a) to require an entity to disclose in a single note the information required to be disclosed about depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) and write-down of inventories (and reversals) (see paragraph BC259). In general, users of financial statements analyse information about operating expenses together. Disclosing that information in a single note would make it easier for users of financial statements to locate and analyse that information.
- (b) to require an entity to disclose an explanation of which line items classified outside the operating category include any difference between the total amounts disclosed for depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) or write-down of inventories (and reversals) and the amounts disclosed for each of these expenses included in line items in the operating category. Disclosing such an explanation would help users of financial statements understand why the total amount differs from the amount disclosed as being included in the operating category.
- (c) to provide application guidance to clarify that the amounts disclosed of depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) or write-down of inventories (and reversals) need not be the amounts recognised as an expense for the period (see paragraphs BC269–BC271).
- (d) to provide an exemption from the general disaggregation requirement in IFRS 18 in relation to line items presented for expenses classified by function (see paragraphs BC272–BC275).

**Nature amounts presented or disclosed need not be expense amounts**

BC269 It is common practice for an entity that presents or discloses operating expenses classified by nature to present or disclose amounts that differ from the amounts recognised as an expense for the period. For example, IAS 1 included an example of an analysis of expenses classified by nature in which some line items comprised a combination of both amounts recognised as an expense in the period and amounts that were included in the carrying amount of assets (and therefore would be recognised as expenses in future periods). To reconcile the analysis and the total expenses recognised in the statement of profit or loss for the period, the example included a line item for 'changes in inventories of finished goods and work in progress' (an example of presenting operating expenses by nature is included in the Illustrative Examples on IFRS 18).

BC270 Feedback from preparers of financial statements indicated that it might be unduly costly to determine the amounts that were recognised in the statement of profit or loss during the period for depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) or write-down of inventories (and reversals). For example, these preparers of financial statements said an entity usually can determine the costs of employee services used in its different activities during the period, such as in its manufacturing activities and administrative activities. However, if some of those costs were not immediately recognised as an expense but were instead included in the carrying amount of assets (such as inventories), an entity might have to incur excessive costs to track which costs were recognised as an expense in the current period or will be in a future period.

BC271 The IASB decided to provide application guidance to clarify that the amounts disclosed for depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) or write-down of inventories (and reversals) need not be the amounts recognised as an expense for the period. It also decided to require an entity 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.

**Exemption from the general disaggregation requirement**

BC272 The IASB considered the interaction of:

- (a) the general requirement in IFRS 18 to disclose disaggregated information in the notes whenever the resulting information is material (see paragraph 42 of IFRS 18); and
- (b) the specific requirements in IFRS 18 on disclosing disaggregated information about depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) or write-down of inventories (and reversals) (see paragraph BC259).

BC273 The IASB decided that if an entity presents operating expenses by function, it is required by paragraph 83 of IFRS 18 to disclose disaggregated information about specific operating expenses by nature. The IASB aimed to achieve a cost–benefit balance in developing this requirement (see paragraphs BC262–BC267). If the IASB required such an entity to apply the general disaggregation requirement, the entity would need to disclose further information (if material) about its expenses by nature, upsetting the cost–benefit balance. To avoid such a situation, the IASB decided to provide an exemption from applying the general disaggregation requirement described in paragraph BC272(a).

BC274 In developing that exemption, the IASB decided not to include a cost threshold (such as exempting an entity from the general disaggregation requirement if applying that requirement would involve undue cost or effort). Based on its research and meetings with stakeholders in developing disclosure requirements on operating expenses, the IASB concluded that including a cost threshold:



- (a) might not result in different outcomes, compared with an exemption that does not include a cost threshold; and
- (b) might be difficult to apply.

BCZ275 The IASB observed that applying IAS 1 some entities disclosed disaggregated information about more operating expenses by nature than depreciation, amortisation, employee benefits, impairment of non-financial assets (and reversals) and write-down of inventories (and reversals). The IASB did not intend to prevent such an entity from continuing to disclose this information with the exemption described in paragraph BC273.

BCZ276 The IASB also decided not to set a specific disclosure objective for the disclosure of information about specified nature items. A specific disclosure objective might require preparers to provide additional disclosures which could jeopardise the cost–benefit balance discussed in paragraph BC273.

## **Statement presenting comprehensive income**

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### **Reporting comprehensive income (paragraphs 88–89)**

BCZ277 In 2013 the IFRS Interpretations Committee reported to the IASB that there was uncertainty about the requirements in IAS 1 for presenting an entity's share of items of other comprehensive income of associates and joint ventures accounted for using the equity method. The IASB agreed that IAS 1 allowed for diverse interpretations, and therefore decided:

- (a) to clarify that IAS 1 (now in paragraphs 88–89 of IFRS 18) requires entities to present the share of other comprehensive income of associates and joint ventures accounted for using the equity method, separated into the share of items that:
  - (i) will not be reclassified subsequently to profit or loss; and
  - (ii) will be reclassified subsequently to profit or loss when specific conditions are met; and
- (b) to amend the Guidance on Implementing IAS 1 to reflect the clarifications (now in paragraphs 88–89 of IFRS 18).

The IASB noted that whether an amount is reclassified to profit or loss is determined by the nature of the underlying item. It also noted that the timing of reclassification is usually determined by the actions of the investee. It may however also be triggered by the investor, which would be the case on the disposal of the investee by the investor.

BCZ278 The feedback received on the 2014 Exposure Draft *Disclosure Initiative* included requests for the IASB to clarify whether the investor's share of the other comprehensive income of its associate or joint venture should be presented net or gross of tax and the applicability of the guidance in IAS 1 in this regard (now in paragraphs 93–95 of IFRS 18). The IASB noted that an investor's share of other comprehensive income of associates or joint ventures is after tax and non-controlling interests of the associate or joint venture, as illustrated in the Guidance on Implementing IAS 1 (now in the Illustrative Examples on IFRS 18). It also noted that the disclosure requirements in IAS 1 (now in paragraphs 94–95 of IFRS 18) do not apply to the tax of the associate or joint venture that is already reflected in the investor's share of other comprehensive income of the associate or joint venture. However, the IASB noted that if the investor itself is liable for tax in respect of its share of other comprehensive income of the associate or joint venture, then the requirements in IAS 1 (now in paragraphs 93–95 of IFRS 18) would apply to this tax. Therefore, the IASB decided not to add additional guidance to IAS 1 on this topic.

### **Reclassification adjustments (paragraphs 90–92 and B88–B89)**

BCZ279 In the 2006 Exposure Draft, the IASB proposed that an entity should separately present reclassification adjustments. These adjustments are the amounts reclassified to profit or loss in the current period that were previously recognised in other comprehensive income. The IASB decided that adjustments were necessary to avoid double-counting items in total comprehensive income when those items are reclassified to profit or loss in accordance with IFRS Accounting Standards. The IASB's view was that separate presentation of reclassification adjustments is essential to inform users of those amounts that are included as income and expenses in different periods—as income or expenses in other comprehensive income in previous periods and as income or expenses in profit or loss in the current period. Without such information, users may find it difficult to assess the effect of reclassifications on profit or loss and to calculate the overall gain or loss associated with available-for-sale financial assets, cash flow hedges and on translation or disposal of foreign operations. 4

BCZ280 The 2006 Exposure Draft proposed to allow the presentation of reclassification adjustments in the statement of recognised income and expense (now 'statement(s) of financial performance') or in the notes. Most respondents supported this approach.

BCZ281 Some respondents noted some inconsistencies in the definition of 'reclassification adjustments' in the 2006 Exposure Draft (now in Appendix A and paragraph 91 of IFRS 18). Respondents suggested that the IASB should expand the definition in IAS 1 (now in Appendix A of IFRS 18) to include gains and losses recognised in current periods in addition to those recognised in earlier periods, to make the definition consistent with paragraph 93 of IAS 1 (now paragraph 91 of IFRS 18). They commented that, without clarification, there could be differences between interim and annual reporting, for reclassifications of items that arise in one interim period and reverse out in a different interim period within the same annual period.

BCZ282 The IASB decided to align the definition of reclassification adjustments with the Statement of Financial Accounting Standards No. 130 *Reporting Comprehensive Income* (SFAS 130) 5 and include additional reference to 'current periods' in IAS 1 (included in Appendix A of IFRS 18).

### **Tax effects on items of other comprehensive income (paragraphs 93–95)**

BCZ283 The IASB decided to maintain the disclosure of income tax expense or benefit allocated to each component of other comprehensive income. Users of financial statements often requested further information on tax amounts relating to components of other comprehensive income, because tax rates often differed from those applied to profit or loss. The IASB also observed

that an entity should have such tax information available and that a disclosure requirement would therefore not involve additional cost for preparers of financial statements.

BCZ284 In the 2010 Exposure Draft the IASB proposed requiring that income tax on items presented in other comprehensive income should be allocated between items that will not be subsequently reclassified to profit or loss and those that might be reclassified, if the items in other comprehensive income are presented before tax. Most respondents agreed with this proposal as this would be in line with the existing options in IAS 1 (retained in IFRS 18) regarding presentation of income tax on other comprehensive income items. Therefore, the IASB confirmed the proposal in June 2011.

## **Statement of financial position**

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### **Classification of assets and liabilities as current or non-current (paragraphs 96–102 and B90–B108)**

#### **Liabilities held primarily for the purpose of trading (paragraphs 101(b) and B97)**

BCZ285 As part of its Annual Improvements project in 2007, the IASB identified inconsistent guidance regarding the current/non-current classification of derivatives. Some might read the guidance included in paragraph B97 of IFRS 18 as implying that financial liabilities classified as held for trading in accordance with IAS 39 *Financial Instruments: Recognition and Measurement* (now the 'held for trading' definition in Appendix A of IFRS 9) are always required to be presented as current.

BCZ286 The IASB expects the criteria set out in paragraph 101(b) of IFRS 18 to be used to assess whether a financial liability should be presented as current or non-current. The 'held for trading' category in paragraph 9 of IAS 39 (now the 'held for trading' definition in Appendix A of IFRS 9) is for measurement purposes and includes financial assets and liabilities that may not be held primarily for trading purposes.

BCZ287 The IASB reaffirmed that if a financial liability is held primarily for trading purposes it should be presented as current regardless of its maturity date. However, a financial liability that is held for trading purposes, such as a derivative that is not a financial guarantee contract or a designated hedging instrument, should be presented as current or non-current on the basis of its settlement date. For example, derivatives that have a maturity of more than twelve months and are expected to be held for more than twelve months after the reporting period should be presented as non-current assets or liabilities.

BCZ288 Therefore, the IASB decided to remove the identified inconsistency by amending the examples of current liabilities (now in paragraph B97 of IFRS 18). The IASB also amended IAS 1 in respect of current assets to remove a similar inconsistency (now paragraph B95 of IFRS 18).

#### **Current liabilities (paragraphs 101–102 and B96–B108)**

##### *Effects of events after the reporting period (paragraphs 101 and B96–B108)*

BCZ289 IAS 1 (as issued in 1997) stated that an enterprise should continue to classify its long-term interest-bearing liabilities as non-current, even when they are due to be settled within twelve months of the balance sheet date if:

- (a) the original term was for a period of more than twelve months;
- (b) the enterprise intends to refinance the obligation on a long-term basis; and
- (c) that intention is supported by an agreement to refinance, or to reschedule payments, which is completed before the financial statements are authorised for issue.

BCZ290 IAS 1 (as issued in 1997) also stated that some borrowing agreements incorporate undertakings by the borrower (covenants) which have the effect that the liability becomes payable on demand if certain conditions related to the borrower's financial position are breached. In these circumstances, the liability is classified as non-current only when:

- (a) the lender has agreed, prior to the authorisation of the financial statements for issue, not to demand payment as a consequence of the breach; and
- (b) it is not probable that further breaches will occur within 12 months of the balance sheet date.

BCZ291 The IASB considered these requirements and concluded that refinancing, or the receipt of a waiver of the lender's right to demand payment, that occurs after the reporting period should not be taken into account in the classification of a liability.

BCZ292 Therefore, the Exposure Draft *Improvements to International Accounting Standards* (2002 Exposure Draft), published in 2002, proposed:

- (a) to amend IAS 1 to specify that a long-term financial liability due to be settled within twelve months of the balance sheet date should not be classified as a non-current liability because an agreement to refinance, or to reschedule payments, on a long-term basis is completed after the balance sheet date and before the financial statements are authorised for issue. This amendment would not affect the classification of a liability as non-current when the entity has, under the terms of an existing loan facility, the discretion to refinance or roll over its obligations for at least twelve months after the balance sheet date.
- (b) to amend IAS 1 to specify that a long-term financial liability that is payable on demand because the entity breached a condition of its loan agreement should be classified as current at the balance sheet date even if the lender has agreed after the balance sheet date, and before the financial statements are authorised for issue, not to demand payment as a consequence of the breach. However, if the lender has agreed by the balance sheet date to provide a period of grace within which the entity can rectify the breach and during which the lender cannot demand immediate repayment, the liability is classified as non-current if it is due for settlement, without that breach of the loan agreement, at least twelve months after the balance sheet date and:

- (i) the entity rectifies the breach within the period of grace; or
- (ii) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.

BCZ293 Some respondents disagreed with these proposals. They advocated classifying a liability as current or non-current according to whether it is expected to use current assets of the entity, rather than strictly on the basis of its date of maturity and whether it is callable at the end of the reporting period. In their view, this would provide more relevant information about the liability's future effect on the timing of the entity's resource flows.

BCZ294 However, the IASB decided that the following arguments for changing IAS 1 were more persuasive:

- (a) refinancing a liability after the balance sheet date does not affect the entity's liquidity and solvency at the balance sheet date, the reporting of which should reflect contractual arrangements in force on that date. Therefore, it is a non-adjusting event in accordance with IAS 10 *Events after the Balance Sheet Date*<sup>6</sup> and should not affect the presentation of the entity's balance sheet.
- (b) it is illogical to adopt a criterion that 'non-current' classification of short-term obligations expected to be rolled over for at least twelve months after the balance sheet date depends on whether the rollover is at the discretion of the entity, and then to provide an exception based on refinancing occurring after the balance sheet date.
- (c) in the circumstances described in paragraph BCZ290, unless the lender has waived its right to demand immediate repayment or granted a period of grace within which the entity may rectify the breach of the loan agreement, the financial condition of the entity at the balance sheet date was that the entity did not hold an absolute right to defer repayment, based on the terms of the loan agreement. The granting of a waiver or a period of grace changes the terms of the loan agreement. Therefore, an entity's receipt from the lender, after the balance sheet date, of a waiver or a period of grace of at least twelve months does not change the nature of the liability to non-current until it occurs.

BCZ295 IAS 1 included the amendments proposed in 2002, with one change. The change related to the classification of a long-term loan when, at the end of the reporting period, the lender has provided a period of grace within which a breach of the loan agreement can be rectified, and during which period the lender cannot demand immediate repayment of the loan.

BCZ296 The 2002 Exposure Draft proposed that such a loan should be classified as non-current if it is due for settlement, without the breach, at least twelve months after the balance sheet date and:

- (a) the entity rectifies the breach within the period of grace; or
- (b) when the financial statements are authorised for issue, the period of grace is incomplete and it is probable that the breach will be rectified.

BCZ297 After considering respondents' comments, the IASB decided that the occurrence or probability of a rectification of a breach after the reporting period is irrelevant to the conditions existing at the end of the reporting period. The revised IAS 1 required that, for the loan to be classified as non-current, the period of grace must end at least twelve months after the reporting period. Therefore, the conditions in paragraph BCZ296(a)–(b) are redundant. This requirement was retained unchanged in paragraph B103 of IFRS 18.

BCZ298 The IASB considered arguments that if a period of grace to remedy a breach of a long-term loan agreement is provided before the end of the reporting period, the loan should be classified as non-current regardless of the length of the period of grace. These arguments are based on the view that, at the end of the reporting period, the lender does not have an unconditional legal right to demand repayment before the original maturity date (that is, if the entity remedies the breach during the period of grace, it is entitled to repay the loan on the original maturity date). However, the IASB concluded that an entity should classify a loan as non-current only if it has an unconditional right to defer settlement of the loan for at least twelve months after the reporting period. This criterion focused on the legal rights of the entity, rather than those of the lender.

*Right to defer settlement for at least twelve months (paragraphs 101(d) and B99–B106)—2020 amendments*

BCZ299 IAS 1 specified that, to classify a liability as non-current, an entity must have the right to defer settlement of the liability for at least twelve months after the reporting period (now in paragraph 101(d) of IFRS 18). In January 2020 the IASB amended aspects of this classification principle and related application requirements in IAS 1 (now in paragraphs B101–B105 of IFRS 18). The IASB made the amendments in response to a request to reconcile apparent contradictions between a paragraph in IAS 1—which required an 'unconditional right' to defer settlement—and another—which referred to an entity that 'expects, and has the discretion, to' refinance or roll over an obligation.

BCZ300 The IASB added to the classification principle in IAS 1 (now in paragraph 101(d) of IFRS 18) clarification that an entity's right to defer settlement must exist 'at the end of the reporting period'. The need for the right to exist at the end of the reporting period was already illustrated in IAS 1 (now in paragraphs B102–B103 of IFRS 18), but was not stated explicitly in the classification principle.

BCZ301 The IASB also observed that the classification principle requires an assessment of whether an entity has the right to defer settlement of a liability and not whether the entity will exercise that right. Accordingly:

- (a) the IASB amended the requirement in IAS 1 (now in paragraph B101 of IFRS 18), which discusses liability from IAS 1 a suggestion that, to classify such a liability as non-current, an entity must not only have the right to roll over the liability, but also expect to exercise that right. The IASB also aligned the terminology by replacing 'discretion' with 'right' in IAS 1 (now in paragraph B101 of IFRS 18).

- (b) the IASB added a paragraph to IAS 1 (now paragraph B104 of IFRS 18), which explicitly clarifies that classification is unaffected by management intentions or expectations, or by settlement of the liability within twelve months after the reporting period.

BCZ302 The IASB considered whether an entity's right to defer settlement needs to be unconditional. The IASB noted that rights to defer settlement of a loan are rarely unconditional—they are often conditional on compliance with covenants. The IASB decided that if an entity's right to defer settlement of a liability is subject to the entity complying with specified conditions, the entity has a right to defer settlement of the liability at the end of the reporting period if it complies with those conditions at that date.

Accordingly, the IASB:

- (a) deleted the word 'unconditional' from the classification principle in IAS 1 (now in paragraph 101(d) of IFRS 18); and
- (b) added a paragraph (now in paragraph B100 of IFRS 18) 7 to clarify that if an entity's right to defer settlement is subject to compliance with specified conditions:
  - (i) the right exists at the end of the reporting period only if the entity complies with those conditions at the end of the reporting period; and
  - (ii) the entity must comply with the conditions at the end of the reporting period, even if the lender does not test compliance until a later date.

BCZ303 The IASB considered whether to specify how management assesses an entity's compliance with a condition relating to the entity's cumulative financial performance (for example, profit) for a period extending beyond the reporting period. The IASB concluded that comparing the entity's actual performance up to the end of the reporting period with the performance required over a longer period would not provide useful information—one of these measures would have to be adjusted to make the two comparable. However, the IASB decided not to specify a method of adjustment because any single method could be inappropriate in some situations.

*Right to defer settlement for at least twelve months (paragraphs 101(d) and B99–B106)—2022 amendments*

BCZ304 In October 2022 the IASB issued *Non-current Liabilities with Covenants*. The IASB made the amendments to:

- (a) improve the information an entity provides about liabilities arising from loan arrangements for which an entity's right to defer settlement of those liabilities for at least twelve months after the reporting period is subject to the entity complying with conditions specified in the loan arrangement (liabilities with covenants); and
- (b) respond to stakeholders' concerns about the outcomes of applying the amendments in *Classification of Liabilities as Current or Non-current* issued in 2020. In particular, stakeholders said the 2020 amendments:
  - (i) could result in an entity classifying a liability as current even if, at the end of the reporting period (reporting date), the entity has no contractual obligation to settle the liability at that date or within twelve months;
  - (ii) took no account of the design of covenants negotiated to reflect an entity's required financial position or performance at specified dates, such as when a loan arrangement specifies different covenants at different dates to reflect the expected effects of seasonality or the entity's future performance; and
  - (iii) were unclear about how an entity would assess, at the reporting date, whether it would have complied with covenants that are not based on an entity's financial position or performance (non-financial covenants) and covenants based on cumulative financial performance or cash flows for a period extending beyond the reporting period (financial performance covenants).

#### **Classification and disclosure of non-current liabilities with covenants**

BCZ305 The IASB considered stakeholders' concerns, which included new information it had not considered when developing the 2020 amendments. In particular, the IASB considered the usefulness of the information that would result from applying the 2020 amendments in some circumstances. The IASB observed that an entity may be unable to avoid having to repay a liability within twelve months if the entity's right to defer settlement of the liability is subject to compliance with covenants during that period. The entity may be unable to avoid such repayment even if, at the reporting date, the entity has no contractual obligation to settle the liability within that period. Therefore, in such situations, the related liability could be repayable either within or after twelve months, depending on whether the entity complies with those covenants after the reporting date. The 2020 amendments specified one way of reflecting this conditionality within the constraints of a model that classifies liabilities as either current or non-current. However, the IASB concluded that the information provided by such a binary classification model, alone, cannot meet user information needs in such situations. For example, the classification of a liability as current or non-current does not in itself provide information about the potential effects of such conditionality on when the liability is repayable.

BCZ306 Having considered the new information, the IASB decided to amend the requirements in IAS 1 on:

- (a) *the classification of liabilities with covenants as current or non-current*—the IASB decided that only covenants with which an entity is required to comply on or before the reporting date should affect the classification of a liability as current or non-current. The IASB concluded that amending the requirements in this way would:
  - (i) avoid classification outcomes that might not provide useful information to users of financial statements (for example, for some entities whose business is highly seasonal);
  - (ii) make it unnecessary for the IASB to specify how the 2020 amendments apply to non-financial and financial performance covenants, thereby avoiding adding complexity to the requirements; and
  - (iii) resolve many of the other concerns stakeholders raised.

- (b) *the disclosure of information about non-current liabilities with covenants*—the IASB decided to require an entity to disclose information in the notes that enables users of financial statements to understand the risk that non-current liabilities with covenants could become repayable within twelve months. The IASB concluded that this information would be useful to users of financial statements because it would allow them to understand the nature of the covenants and the risk that a liability classified as non-current could nonetheless be repayable within twelve months.

BCZ307 The amendments to the requirements on the classification of liabilities with covenants as current or non-current are linked to the requirements on disclosure about such liabilities. The IASB concluded that the classification requirements would provide useful information when considered together with the requirements to disclose information about non-current liabilities with covenants in the notes. For this reason, the disclosure requirements in paragraph B106 of IFRS 18 apply only to an entity that presents current and non-current liabilities as separate classifications in its statement of financial position. However, the IASB observed that an entity that presents liabilities in order of liquidity might nonetheless disclose similar information about liabilities with covenants when applying the requirements in IFRS 7 on its exposure to liquidity risk.

BCZ308 Some respondents to the draft amendments noted that, because non-current liabilities are often subject to covenants, the disclosure requirements could result in entities providing a large volume of detailed information. In these respondents' view, the amendments could result in excessive disclosure, which might obscure material information about covenants. In response to these comments, the IASB observed that:

- (a) in applying the requirements in IAS 1 (now in paragraphs 19–20 and 41–43 of IFRS 18), an entity would assess what information about covenants is material and determine how to aggregate such information. Accordingly, the entity would not disclose immaterial information about covenants that would reduce the understandability of its financial statements by obscuring material information.
- (b) an entity in need of further guidance when making materiality judgements could refer to the guidance on assessing the materiality of information about covenants in paragraphs 81–83 of IFRS Practice Statement 2 *Making Materiality Judgements*. That guidance explains that:
  - (i) an entity considers both the consequences and the likelihood of a breach occurring when assessing whether information about a covenant is material; and
  - (ii) information about a covenant for which there is only a remote likelihood of a breach occurring is immaterial irrespective of the consequences of that breach.

#### **Other considerations**

BCZ309 When developing the amendments, the IASB also considered:

- (a) *the presentation of non-current liabilities with covenants*—when it exposed the 2021 Exposure Draft *Non-current Liabilities with Covenants* for comment, the IASB proposed to require an entity to present non-current liabilities with covenants separately in the statement of financial position. The main reason for this proposal was to avoid users of financial statements being misled by a non-current classification without any indication that the liability could become repayable within twelve months. However, feedback on the draft amendments suggested that users of financial statements would not be misled if the conditionality of non-current liabilities were explained in the notes instead of through separate presentation of these liabilities in the statement of financial position. Therefore, the IASB decided not to finalise the proposal. Instead, in providing information about non-current liabilities with covenants in the notes, an entity is required to disclose the carrying amount of related liabilities.
- (b) *disclosure about expected compliance with covenants*—when it exposed draft amendments for comment in the 2021 Exposure Draft, the IASB proposed to require an entity to disclose whether and, if so, how it expected to comply with covenants after the reporting date. Feedback on the draft amendments suggested that the costs of providing this information might outweigh the benefits of providing it. Consequently, the IASB decided instead to require an entity to disclose any facts and circumstances that indicate the entity may have difficulty complying with covenants. The IASB concluded that this information would not be costly to prepare and would be useful to users of financial statements by helping them to understand the risk that non-current liabilities with covenants could become repayable within twelve months.
- (c) *other conditional settlement terms*—when it exposed draft amendments for comment in the 2021 Exposure Draft, the IASB proposed to clarify some situations in which an entity would not have a right to defer settlement of a liability. The IASB intended the clarification to avoid the classification requirements in IAS 1 (now in paragraph B100 of IFRS 18) being applied to liabilities outside the scope of the amendments. However, feedback on the draft amendments suggested that the proposed clarification would fail to achieve that objective. Therefore, the IASB decided instead to specify that the requirements in IAS 1 (now in paragraph B100 of IFRS 18) apply only to liabilities arising from loan arrangements.

#### *Settlement (paragraphs B107–B108)*

BCZ310 While developing the amendments discussed in paragraphs BCZ299–BCZ303, the IASB considered whether a liability is 'settled' when it is rolled over under an existing loan facility. The IASB concluded that rolling over a liability does not constitute settlement because it is the extension of an existing liability, which does not involve any transfer of economic resources. The IASB also observed that a liability is defined as an obligation 'to transfer an economic resource' and that some types of liabilities are settled by transferring economic resources other than cash. For example, performance obligations within the scope of IFRS 15 *Revenue from Contracts with Customers* are settled by transferring promised goods or services. The IASB decided it would

be helpful to clarify those aspects of the meaning of the term 'settlement' and so added a paragraph to IAS 1 (now paragraph B107 of IFRS 18).

BCZ311 While considering the meaning of the term settlement, the IASB also considered liabilities an entity will or may settle by issuing its own equity instruments or, in other words, by converting the liability to equity. In *Improvements to IFRSs* issued in 2009, the IASB added to IAS 1 a statement that 'terms of a liability that could, at the option of the counterparty, result in its settlement by the issue of equity instruments do not affect its classification'. The effect of this statement is that a bond that the holder may convert to equity before maturity is classified as current or non-current according to the terms of the bond, without considering the possibility of earlier settlement by conversion to equity.

BCZ312 The IASB concluded that, when it had added the statement about counterparty conversion options in 2009, it had intended the statement to apply only to liabilities that include a counterparty conversion option that meets the definition of an equity instrument and, applying IAS 32, is recognised separately from the host liability as the equity component of a compound financial instrument. The IASB further concluded that, in other cases—that is, if an obligation to transfer equity instruments is classified applying IAS 32 as a liability or part of a liability—the transfer of equity instruments would constitute settlement of the liability for the purpose of classifying it as current or non-current. To reflect those conclusions, the IASB moved the statement about counterparty conversion options in IAS 1 to a new paragraph (now in paragraph B108 of IFRS 18) and clarified its scope.

### **Line items to be presented in the statement of financial position (paragraphs 103–106 and B109–B111)**

BC313 As it did with the list of line items to be presented in the statement of profit or loss, the IASB decided not to revisit the list of line items that IAS 1 required an entity to present in its statement of financial position, beyond clarifying how those requirements work in the context of the role of the primary financial statements (see paragraphs BC236–BC239).

BC314 However, the IASB decided to add to the list of line items a requirement to present goodwill separately from intangible assets. 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.

BC315 The IASB decided to require an entity to use the characteristics of nature and function to aggregate and disaggregate assets and liabilities into separate line items. Other characteristics, like duration, liquidity, measurement basis, type and tax effects assist an entity in identifying the nature or function of assets and liabilities. IFRS 18 requires an entity to include additional line items in the statement of financial position if necessary to present a useful structured summary of the entity's assets, liabilities and equity (see paragraphs BC56–BC61). Requiring an entity to use the characteristics of nature and function to disaggregate assets and liabilities in the statement of financial position retains an emphasis from IAS 1 on presentation of line items based on the nature and function of assets and liabilities. An emphasis on nature and function in the statement of financial position also aligns with a similar emphasis in the statement of profit or loss, in which an entity is required to aggregate and disaggregate operating expenses into line items using the nature of expenses and their function within the entity (see paragraphs BC246–BC258).

## **Statement of changes in equity**

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### **Reporting owner and non-owner changes in equity (paragraph 107)**

BCZ316 The 2006 Exposure Draft proposed to separate changes in equity of an entity during a period arising from transactions with owners in their capacity as owners (that is, all owner changes in equity) from other changes in equity (that is, non-owner changes in equity). All owner changes in equity would be presented in the statement of changes in equity, separately from non-owner changes in equity.

BCZ317 Most respondents welcomed this proposal and saw this change as an improvement of financial reporting, by increasing the transparency of those items recognised in equity that are not reported as part of profit or loss. However, some respondents pointed out that the terms 'owner' and 'non-owner' were not defined in the 2006 Exposure Draft, the *Framework* or elsewhere in IFRS Accounting Standards, although they are extensively used in national accounting standards. They also noted that the terms 'owner' and 'equity holder' were used interchangeably in the 2006 Exposure Draft. The IASB decided to adopt the term 'owner' and use it throughout IAS 1 to converge with SFAS 130, which used the term in the definition of 'comprehensive income'. 8

### **Presentation of dividends (paragraph 110)**

BCZ318 The IASB reaffirmed its conclusion to require the presentation of dividends in the statement of changes in equity or disclosure of dividends in the notes, because dividends are distributions to owners in their capacity as owners and the statement of changes in equity presents all owner changes in equity. The IASB concluded that an entity should not present dividends in the statement of comprehensive income because that statement presents non-owner changes in equity.

## **Notes**

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### **Structure of the notes (paragraphs 113–116 and B112)**

BCZ319 The IASB was aware that some had interpreted IAS 1 as requiring a specific order for the notes. IAS 1 stated that 'an entity normally presents notes in the [following] order' and then listed a particular order for the notes. Some think that the use of 'normally' makes it difficult for an entity to vary the order of the notes from the one that was listed in IAS 1 (now in paragraph B112 of IFRS 18), for example, by disclosing the notes in order of importance or disclosing related information together in sections.

- BCZ320 Investors' feedback suggested that some investors prefer an entity to vary the order of the notes from the one that was listed in IAS 1 (now in paragraph B112 of IFRS 18). Other investors would prefer entities to use that order because they think it will increase comparability between periods and across entities.
- BCZ321 The IASB considered the use of the word normally in IAS 1 and concluded that it was not intended that entities be required to disclose their notes in that order. Instead, it thinks that the order listed was intended to provide an example of how an entity could order the notes and that the term normal was not meant to imply that alternative ordering of the notes is 'abnormal'. The IASB therefore amended IAS 1 to clarify that the order listed in IAS 1 (now in paragraph B112 of IFRS 18) is an example of how an entity could order or group its notes in a systematic manner. The IASB also made amendments to clarify that significant accounting policies<sup>9</sup> do not need to be disclosed in one note, but instead can be included with related information in other notes.
- BCZ322 The IASB also noted the requirement in IAS 1 (now in paragraph 114 of IFRS 18) for entities to, as far as practicable, present the notes in a systematic manner. In the IASB's view, this means that there must be a system or reason behind the ordering and grouping of the notes. For example, notes could be ordered by importance to the entity, in the order line items are presented in the financial statements or a combination of both. The IASB amended IAS 1 (now in paragraph 114 of IFRS 18) to clarify that an entity should consider the effect on the understandability and comparability of its financial statements when determining the order of the notes. The IASB acknowledged that there is a trade-off between understandability and comparability; for example, ordering notes to increase understandability could mean that comparability, including consistency, between entities and periods is reduced. In particular, the IASB acknowledged that consistency in the order of the notes for a specific entity from period to period is important. The IASB noted that it would generally be helpful for users of financial statements if the ordering of notes by an entity is consistent and noted that it does not expect the order of an entity's notes to change frequently. A change in the order of the notes previously determined to be an optimal mix of understandability and comparability should generally result from a specific event or transaction, such as a change in business. The IASB also noted that the requirements in IAS 1 (now in paragraph 30 of IFRS 18) for consistency of presentation still apply.
- BCZ323 The IASB also observed that electronic versions of financial statements can make it easier to search for, locate and compare information within the financial statements, between periods and between entities.
- BC324 Users of financial statements also said it is important for them to understand how amounts disclosed in the notes relate to the line items in the primary financial statements. In response, the IASB decided to require an entity to provide a qualitative explanation of how amounts disclosed in the notes are included in the line items in the primary financial statements.

#### **Management-defined performance measures (paragraphs 117–125 and B113–B142)**

- BC325 The IASB developed the 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. Users of financial statements said information about management-defined performance measures is useful because it provides insight into how the business is managed, how management views the entity's financial performance, and the persistence of the entity's financial performance. Information about these measures is generally communicated outside the financial statements. However, users of financial statements raised concerns about the quality of the information provided about these measures.
- BC326 The IASB agreed that management-defined performance measures can provide useful information about an entity's financial performance. Subtotals required by IFRS Accounting Standards provide useful information that is comparable between entities, and additional subtotals defined by management can provide entity-specific information. The IASB concluded that the management-defined performance measure requirements in IFRS 18 will improve the transparency of these measures. Including such measures in the financial statements will make the measures subject to the same disclosure requirements, regardless of an entity's jurisdiction, and likely bring them within the scope of audit.
- BC327 In developing the requirements, the IASB considered:
- how to identify management-defined performance measures (see paragraphs BC328–BC368);
  - where in the financial statements to include information about management-defined performance measures (see paragraphs BC369–BC375); and
  - what information to require an entity to provide about management-defined performance measures (see paragraphs BC376–BC390).

#### **Identification of management-defined performance measures (paragraphs 117–120 and B113–B131)**

- BC328 The IASB decided to define 'management-defined performance measures' as a subtotal of income and expenses (see paragraphs BC330–BC333) that:
- an entity uses in public communications outside financial statements (see paragraphs BC334–BC342);
  - an entity uses to communicate to users of financial statements management's view of an aspect of the financial performance of an entity as a whole (see paragraphs BC343–BC346); and
  - is not specifically required to be presented or disclosed by IFRS Accounting Standards or listed in paragraph 118 of IFRS 18 (see paragraphs BC362–BC367).
- BC329 The IASB also decided to include application guidance on:
- the presumption that a subtotal of income and expenses used in public communications outside an entity's financial statements communicates to users of financial statements management's view of an aspect of the entity's financial performance (see paragraphs BC347–BC356);

- (b) the restrictions on calculating management-defined performance measures (see paragraphs BC357–BC361); and
- (c) the relationship between management-defined performance measures and the requirements in IAS 8 (see paragraph BC368).

*Subtotals of income and expenses*

- BC330 Each management-defined performance measure is defined by management, and therefore is not a specific measure required by IFRS Accounting Standards.
- BC331 The IASB decided to limit the definition of 'management-defined performance measures' to subtotals of income and expenses. For example, measures that adjust a total or subtotal specified in IFRS Accounting Standards, such as adjusted profit or loss, are management-defined performance measures. Other measures (such as free cash flow or customer retention rate) are not management-defined performance measures.
- BC332 Some stakeholders suggested that the IASB include in the definition of 'management-defined performance measures' measures other than subtotals of income and expenses—for example, subtotals of assets and liabilities or measures of cash flow. These stakeholders said including such measures would be useful because it would be equally beneficial to require transparency and discipline in communicating these measures as it is in communicating management-defined subtotals of income and expenses.
- BC333 The IASB acknowledged that widening the definition of 'management-defined performance measures' could result in useful information. However, including additional types of measures as 'management-defined performance measures' (beyond subtotals of income and expenses) would require the development of additional definitions, disclosure requirements and application guidance setting out the relationship with other IFRS Accounting Standards. This work could be substantial and would go beyond the scope of the project's focus on the reporting of financial performance in the statement of profit or loss and the related notes. Accordingly, the IASB decided not to widen the definition of 'management-defined performance measures' beyond subtotals of income and expenses.

*Public communications*

- BC334 The IASB decided that only measures publicly communicated outside the financial statements can be management-defined performance measures. The IASB's view is that performance measures used in public communications outside financial statements should be consistent with the performance measures disclosed in the financial statements.
- BC335 Some stakeholders raised concerns that 'public communications' is not defined and could be interpreted broadly, making it onerous for an entity (and auditors and regulators) to identify all publicly communicated measures. However, the IASB observed that an entity actively decides how it communicates publicly and the performance measures it includes in those communications. An entity usually has systems and processes in place to monitor and control its communications to comply with laws and regulations restricting the type and timing of information permitted to be provided to the market—for example, to prevent unfair advantages arising from communicating such information to different parties at different times.
- BC336 However, for the purpose of identifying management-defined performance measures, the IASB decided that 'public communications' excludes oral statements, transcripts of oral statements and social media posts. The IASB expects these forms of communication to contain information about management-defined performance measures already included in other forms of communication. Therefore, the risk of excluding measures that otherwise meet the definition of a management-defined performance measure is low. These types of communications were also, in the view of some stakeholders, the most challenging to monitor. Removing these categories from the scope of 'public communications' is therefore expected to reduce the costs of applying the definition by eliminating the need to search these forms of communications.
- BC337 Some stakeholders questioned how the timing of public communications relates to the financial statements. The IASB observed that the management-defined performance measure requirements relate to performance for the period covered by the financial statements. For example, if an entity includes management-defined performance measures in interim public communications, the related disclosures are required in the interim financial statements. However, management-defined performance measures included only in annual public communications would require disclosures only in annual financial statements and not in interim financial statements.
- BC338 If an entity stops including a measure in its public communications—for example, because the measure no longer communicates management's view or is not permitted in the entity's public communications—the measure no longer meets the definition of a 'management-defined performance measure' and is no longer included in the financial statements. In such cases an entity would be required to disclose information about the reasons for and effects of the change to its management-defined performance measures (see paragraphs BC388–BC390).
- BC339 In most jurisdictions, entities issue public communications, such as press releases, before or on the same day as the financial statements are authorised for issue. However, some stakeholders said that, in some jurisdictions, investor presentations that might include performance measures are not made available until after the financial statements are authorised for issue. The IASB decided to require an entity to consider the measures it included in public communications related to the previous reporting period to identify management-defined performance measures for the current period, if it routinely issues public communications containing performance measures after the financial statements are authorised for issue.
- BC340 However, an entity is not required to include a measure identified in the prior period as a management-defined performance measure if there is evidence that the measure will not be included in the public communications to be issued relating to the current reporting period. Requiring an entity to consider whether such measures are management-defined performance measures in the subsequent period avoids practical issues in determining the completeness of management-defined performance measures



to be included in the financial statements that are authorised for issue before public communications containing the measures. It also prevents an entity from avoiding the disclosure requirements by routinely including its management-defined performance measures in public communications after the financial statements are authorised for issue. If a management-defined performance measure was disclosed in the prior-period financial statements and will not be disclosed in the current period financial statements, the disclosure requirements for a change to, or cessation of, a management-defined performance measure in paragraph 124 of IFRS 18 apply.

BC341 The IASB considered whether to include in the definition of management-defined performance measures the term 'measures used internally by management', but decided against doing so. The IASB observed that 'measures used internally by management' would reflect management's view of an aspect of the entity's financial performance. However, a measure solely used internally might not always communicate information that is useful to users of financial statements.

BC342 The IASB also considered providing specific requirements for private entities because such entities are less likely to have public communications than public entities. However, the IASB concluded that the intention of the requirements is to provide transparency and discipline over measures communicated to users outside the financial statements, regardless of whether the entity is public or private. If an entity communicates no measures of financial performance outside the financial statements, then no measures require additional disclosures. The requirements apply to all entities applying IFRS Accounting Standards and, therefore, if a private entity communicates subtotals that meet the definition of 'management-defined performance measures' it is subject to the requirements.

*Management's view of an aspect of the entity's financial performance*

BC343 The IASB decided to include 'management's view of an aspect of the entity's financial performance' in the definition of a management-defined performance measure. Information about management's view of an entity's performance was the reason for the IASB developing the management-defined performance measure requirements. As a result, 'management-defined performance measures' include those measures that communicate to users of financial statements management's view of an aspect of the financial performance of the entity as a whole.

BC344 Management-defined performance measures focus on communicating an aspect of an *entity's* performance and not on communicating *management's* performance. A subtotal used solely for the purpose of measuring management's performance—for example, a measure used only internally for the purpose of management remuneration—would not meet the definition of management-defined performance measures. However, there might be circumstances in which such a measure is used both externally to communicate management's view of an aspect of an entity's performance and internally to evaluate management's performance.

**Application to individual segment measures**

BC345 The IASB observed that some subtotals of income and expenses provided in an entity's public communications outside the financial statements might relate to a reportable segment disclosed in accordance with IFRS 8. A reportable segment measure might not provide information about the performance of an entity as a whole.

BC346 However, in some circumstances, a reportable segment measure might provide information about the performance of an entity as a whole—for example, if it presents a subtotal in the statement of profit or loss that relates to only one of its reportable segments. The IASB did not exclude such segment measures from the definition of management-defined performance measures. The IASB instead decided to clarify that management-defined performance measures reflect management's view of an aspect of the performance of an entity as a whole.

*Presumption about communicating management's view*

BC347 IFRS 18 requires an entity to presume that a subtotal of income and expenses used in its public communications outside its financial statements communicates management's view of an aspect of the entity's financial performance, which can be rebutted with reasonable and supportable information as set out in paragraph 120 of IFRS 18. 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 (see paragraph 121 of IFRS 18).

BC348 The IASB developed the rebuttable presumption after considering stakeholders' concerns that:

- (a) it might be difficult to assess whether a measure communicates management's view of an aspect of the entity's financial performance; and
- (b) a measure communicated outside financial statements that did not reflect management's view might nonetheless be considered to meet the definition of a management-defined performance measure.

BC349 The presumption provides rigour and discipline in the assessment of whether a measure communicates management's view by setting out a condition usually expected to be true—it is reasonable to expect that an entity includes in public communications a subtotal of income and expenses for the purposes of communicating to users of financial statements management's view of an aspect of its financial performance. If this condition is not true, there needs to be reasonable and supportable information that supports this assessment to rebut the presumption.

BC350 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—for example, if a regulator requires disclosure of a measure. In these cases, an entity could rebut the presumption and the measure would not be a management-defined performance measure.

- BC351 The IASB considered whether an entity should be able to rebut the presumption for specific types of measures, such as industry-defined or regulatory-defined measures. However, the basis for defining a measure does not determine whether it communicates management's view of an aspect of the entity's financial performance. For example, a subtotal required for regulatory purposes might also be used to communicate management's view of an aspect of the entity's financial performance. Consequently, the IASB decided not to specify types of measures for which it would be appropriate to rebut the presumption. Instead, the IASB provided examples of reasonable and supportable information that could be used to rebut the presumption.
- BC352 Reasonable and supportable information for rebutting the presumption needs to demonstrate that the subtotal does not communicate management's view of an aspect of the entity's financial performance for the entity as a whole to users of financial statements, and show why the subtotal is included in the entity's public communications, despite the fact it does not communicate management's view.
- BC353 For example, an entity may include in its public communications a net debt measure comprised of assets and liabilities. Net debt is not a management-defined performance measure because it is not a subtotal of income and expenses. The entity may also include a subtotal such as cost of net debt as supplementary information. If the entity can demonstrate that the subtotal is communicated without prominence because it is supplementary information for the net debt measure and the entity does not use the subtotal internally to assess and monitor the entity's financial performance this may be reasonable and supportable information to rebut the presumption. However, if there are numerous references to such a subtotal, accompanied by management analysis and commentary, this would be evidence that the entity cannot rebut the presumption.
- BC354 An entity may replicate the statement of profit or loss in a public communication—for example, when the entity replicates in a presentation to users of financial statements the statement of profit or loss included in its financial statements. If that statement of profit or loss includes an additional subtotal that is not listed in paragraph 118 of IFRS 18 or that is not a subtotal specifically required to be presented or disclosed by IFRS Accounting Standards, that subtotal would meet the definition of a management-defined performance measure unless the entity rebuts the presumption. For example, if the subtotal is not used internally to assess and monitor financial performance and the entity's public communications do not include management analysis and commentary on that subtotal, that may be reasonable and supportable information that the subtotal is communicated without prominence and the entity might rebut the presumption.
- BC355 The IASB decided not to require an entity to disclose whether it has rebutted the presumption for a subtotal it includes in its public communications. Requiring disclosure in the financial statements of a separate list of measures that are not management-defined performance measures is not expected to provide useful information.
- BC356 Other requirements in IFRS Accounting Standards use 'reasonable and supportable information'. The use of reasonable and supportable information in IFRS 18 is consistent with the use of the term 'reasonable and supportable information' in paragraph B5.5.20 of IFRS 9, which permits an entity to rebut the presumption in paragraph 5.5.11 of IFRS 9 only if an entity has reasonable and supportable information *available* to demonstrate that it can be rebutted. However, the use of reasonable and supportable information in IFRS 18 differs from the use of reasonable and supportable information in paragraph B5.5.27 of IFRS 9, which requires an entity to assess whether there has been a significant increase in credit risk since initial recognition on the basis of *all* reasonable and supportable information that is available without undue cost or effort.

*Restrictions on calculating management-defined performance measures*

- BC357 The IASB decided it would place no specific restrictions on how an entity calculates a subtotal of income and expenses that is a management-defined performance measure. The IASB concluded such restrictions might prevent an entity from disclosing measures that users of financial statements find useful.
- BC358 However, management-defined performance measures are required to comply with the general requirements for information included in the financial statements. This means:
- (a) a management-defined performance measure needs to faithfully represent the aspect of an entity's financial performance it purports to represent;
  - (b) the disclosures supporting a management-defined performance measure need to meet the requirements on aggregation and disaggregation—for example, when disclosing reconciling items; and
  - (c) an entity is required to provide comparative information for a management-defined performance measure and related disclosures.
- BC359 To achieve a faithful representation for a management-defined performance measure, an entity is required to describe in a clear and understandable manner the aspect of performance it communicates, including the meanings of terms it uses in its descriptions. The entity is then required to apply the terms and the descriptions to produce a faithful representation—complete, neutral and free from error.
- BC360 Faithful representation does not in itself convey other information about the measure. For example, it does not provide information about whether a measure is a 'good' or 'bad' measure. A management-defined performance measure is only required to faithfully represent the aspect of performance being communicated.
- BC361 The requirements for management-defined performance measures are intended to provide transparency about how such measures are calculated, what they communicate, how they relate to the financial statements and how they might have changed. That transparency contributes to meeting the requirement for faithful representation.

*Subtotals excluded from the definition of management-defined performance measures*

BC362 The IASB decided subtotals listed in paragraph 118 of IFRS 18 or specifically required to be disclosed by IFRS Accounting Standards are not management-defined performance measures. Some subtotals are not defined by IFRS Accounting Standards, but are commonly used in financial statements and are well understood by users of financial statements—for example, a gross profit subtotal. In the IASB's view, providing the management-defined performance measures disclosures for such measures would not provide useful information because their purpose and relationship to totals or subtotals defined by IFRS Accounting Standards are well understood or would usually be apparent from their presentation in the statement(s) of financial performance. The IASB included such subtotals in the list in paragraph 118 of IFRS 18 which includes operating profit before depreciation, amortisation and specified impairments (see paragraphs BC363–BC366) and operating profit and income and expenses from associates and joint ventures accounted for using the equity method (see paragraph BC367).

**Operating profit before depreciation, amortisation and specified impairments**

BC363 The IASB considered whether to define 'earnings before interest, tax, depreciation and amortisation' (EBITDA). The IASB observed that, although EBITDA is one of the most commonly used measures in communications to users of financial statements, it is not used by entities in some industries, such as banking and insurance. Furthermore, no consensus has been reached on what EBITDA represents, other than it being a starting point for various analyses.

BC364 EBITDA measures might meet the definition of 'management-defined performance measures'. The IASB concluded that a measure calculated as operating profit before depreciation, amortisation and impairments within the scope of IAS 36 *Impairment of Assets* provides similar information to many of the EBITDA measures currently provided. In the IASB's view, if an entity presents the subtotal operating profit before depreciation, amortisation and impairments within the scope of IAS 36, the costs of the additional information required to be disclosed for management-defined performance measures would exceed the benefits provided by that information because the measure is well defined. The IASB consequently decided to include that subtotal in the list of subtotals in paragraph 118 of IFRS 18.

BC365 The IASB decided not to describe this subtotal as 'EBITDA' because doing so would imply that operating profit or loss is the same as what users of financial statements understand 'earnings before interest and tax' to be, which might not be the case. For example, operating profit excludes income and expenses classified in the investing category and the measure therefore might not include income that some consider to be 'earnings'.

BC366 However, in some cases, the label might be an accurate description of the corresponding measure—for example, if an entity has no income and expenses in the investing category such that all its earnings are included in operating profit. In such cases, an entity would not be prevented from labelling the subtotal operating profit before depreciation, amortisation and specified impairments within the scope of IAS 36 as 'EBITDA'.

**Operating profit and income and expenses from associates and joint ventures accounted for using the equity method**

BC367 Some entities invest in associates and joint ventures that the entities judge to be closely related to their main business activities. Such entities might conclude that it would be necessary for a useful structured summary of their income and expenses to present a subtotal in the statement of profit or loss comprising operating profit and income and expenses from associates and joint ventures accounted for using the equity method. The IASB concluded that for such a subtotal, the additional information required to be disclosed for management-defined performance measures would not provide useful information because the information necessary to understand the subtotal would be clear from the statement of profit or loss. The IASB consequently decided to include this subtotal in the list of subtotals in paragraph 118 of IFRS 18. The subtotal included in the list would include income and expenses from all associates and joint ventures accounted for using the equity method. If an entity used a subtotal that included only the income and expenses from selected associates and joint ventures accounted for using the equity method, that subtotal would be a management-defined performance measure.

*Relationship with the requirements in IAS 8*

BC368 The IASB concluded that the identification of a management-defined performance measure, including how the measure is calculated, is not an accounting policy choice as defined in IAS 8. The IASB acknowledged the many similarities between the definition of an 'accounting policy' and the determination of a management-defined performance measure. However, unlike an accounting policy, a management-defined performance measure is not determined in the context of preparing and presenting financial statements in accordance with IFRS Accounting Standards. An entity selects and applies its accounting policies for its financial statements within the confines of IFRS Accounting Standards. In contrast, management defines its management-defined performance measures to communicate an aspect of the entity's financial performance *outside* the financial statements.

**Disclosure of management-defined performance measures (paragraphs 121–125 and B132–B142)**

*Location of information about management-defined performance measures*

BC369 The IASB decided to require an entity to disclose management-defined performance measures and all related information in a single note to improve the transparency of those measures. Disclosing the information in a single note improves transparency by:

- (a) providing management-defined performance measures together with the calculations, explanations and reconciliations necessary to understand them; and
- (b) helping users of financial statements to easily locate all information about management-defined performance measures.

BC370 The IASB considered allowing an entity to comply with the requirements by cross-referencing the required information in other documents. Allowing cross-referencing can help avoid duplication of information, which can increase the clarity of financial reporting. However, if an entity uses cross-referencing, information is fragmented between several locations, which can reduce

transparency by making it more difficult for users of financial statements to locate information and understand the financial statements as a whole. To make information about management-defined performance measures transparent, the IASB decided not to specify that management-defined performance measure disclosures can be included in the financial statements by reference to another document.

- BC371 The IASB considered prohibiting an entity from complying with the requirements by cross-referencing to the information required by IFRS 18 included in another document. The IASB concluded it was unnecessary to include application guidance specifically prohibiting cross-referencing because in practice entities generally do not disclose information required to meet IFRS Accounting Standards by cross-reference unless an IFRS Accounting Standard specifically allows it. The IASB also concluded that including such a prohibition might have unintended consequences.
- BC372 Some stakeholders asked whether information about measures that do not meet the definition of management-defined performance measures could be disclosed in the financial statements. The IASB decided not to provide specific requirements relating to information included in the financial statements in addition to that required by IFRS 18. The IASB observed a risk that such requirements might discourage best practice for voluntary disclosures that are useful to users of financial statements.
- BC373 IFRS Accounting Standards require disclosure of additional information when compliance with the specific requirements in IFRS Accounting Standards is insufficient to enable users of financial statements to understand the effect of transactions and other events and conditions on the entity's financial position and financial performance. It would be challenging to identify specific information to be permitted or prohibited and to develop criteria that distinguish between the two types of information. However, the IASB concluded that it was important to identify the required information about management-defined performance measures separately from other information included in the financial statements to be clear which measures are subject to the management-defined performance measure requirements.
- BC374 The IASB considered prohibiting an entity from presenting management-defined performance measures in the statement(s) of financial performance, in response to the concerns of some stakeholders that management-defined performance measures could be misleading and might be given undue prominence. However, IFRS 18 requires an entity to present line items and subtotals in the statement(s) of financial performance if such presentations are necessary to provide a useful structured summary of the entity's income and expenses. Prohibiting an entity from presenting management-defined performance measures in the statement(s) of financial performance could prevent it from complying with this requirement. Therefore, the IASB decided not to prohibit an entity from presenting management-defined performance measures in the statement(s) of financial performance. An entity presenting a management-defined performance measure in the statement(s) of financial performance would still be required to disclose all the information required for management-defined performance measures in a single note.
- BC375 The IASB also observed that if an entity presents a management-defined performance measure in the statement(s) of financial performance, it needs to comply with the requirements for subtotals presented in the statement(s) of financial performance in paragraph 24 of IFRS 18.

*Information to be disclosed about management-defined performance measures*

- BC376 The objective of the disclosures for management-defined performance measures in IFRS 18 is for an entity to provide information to help users of financial statements understand:
- (a) the aspect of financial performance that, in management's view, is communicated by each management-defined performance measure; and
  - (b) how the measure compares with the measures defined by IFRS Accounting Standards.

- BC377 The IASB concluded that transparency is enhanced by an entity clearly stating the purpose and limitations of a management-defined performance measure. A management-defined performance measure reflects management's judgement about what is useful to users of financial statements. Users of financial statements require enough information about that judgement to understand the information the management-defined performance measure provides and how it faithfully represents an aspect of an entity's financial performance.

*Reconciliation to the most directly comparable total or subtotal*

- BC378 The IASB decided to require an entity to provide a reconciliation between the management-defined performance measure and the most directly comparable subtotal listed in paragraph 118 of IFRS 18, or total or subtotal specifically required to be presented or disclosed by IFRS Accounting Standards. This reconciliation is required for each management-defined performance measure. A reconciliation is important information for users of financial statements to understand how a management-defined performance measure relates to the totals or subtotals required by IFRS Accounting Standards. A reconciliation also provides users of financial statements with information to help them understand how the measure compares with similar measures provided by other entities and judge whether to make their own adjustments.
- BC379 Paragraph B137 of IFRS 18 requires an entity to disclose, for each item in the reconciliation:
- (a) the amount(s) related to each line item in the statement(s) of financial performance; and
  - (b) a description of how the item is calculated and contributes to providing useful information, if necessary to comply with paragraphs 123(a) and (b) of IFRS 18.
- BC380 Fieldwork as part of the project showed that the information provided by the reconciliation could vary depending on the form of the reconciliation and the amount of detail included. The IASB concluded that linking the line items that make up the subtotals helps users of financial statements understand the relationship between a management-defined performance measure and the most directly comparable total or subtotal listed in paragraph 118 of IFRS 18 or specifically required to be presented or disclosed

by IFRS Accounting Standards. Consequently, the IASB decided to require an entity to disclose how the individual reconciling items relate to the line items in the statement(s) of financial performance.

BC381 In some cases, it might be difficult for a user of financial statements to understand how an individual reconciling item is calculated or how it contributes to the management-defined performance measure communicating management's view of an aspect of the entity's performance. For example, if a management-defined performance measure includes reconciling items included to communicate different aspects of the entity's performance, explaining each of those aspects would be necessary to understand the measure. Consequently, the IASB decided that if it is necessary to understanding how a management-defined performance measure is calculated, or how it contributes to the measure providing useful information, an entity is required to disclose this information for each reconciling item.

BC382 The IASB considered requiring an entity to provide the reconciliation in a specific format—for example, a table with reconciling items as columns adjusting the line items presented in the statement(s) of financial performance. However, the IASB decided not to do so because the most appropriate format for the reconciliation will depend on the specific management-defined performance measure.

*Disclosing the income tax effect and the effect on non-controlling interests*

BC383 The IASB decided to require an entity to disclose the income tax effect and the effect on non-controlling interests for each item disclosed in the reconciliation between a management-defined performance measure and the most directly comparable subtotal listed in paragraph 118 of IFRS 18 or total or subtotal specifically required to be presented or disclosed by IFRS Accounting Standards.

BC384 The IASB considered feedback that information on earnings per share is important to users of financial statements and that one of the benefits of management-defined performance measure disclosures is the detailed information users could use to calculate a related earnings per share figure. Users need 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. Therefore, the IASB decided to require an entity to disclose separately the amount attributable to non-controlling interests and the effect of income taxes for each reconciling item in the reconciliation required by paragraph 123(c) of IFRS 18.

BC385 The IASB decided to require this disclosure for each reconciling item because it gives users of financial statements information needed to calculate an adjusted earnings per share measure based on only the adjustments they want to consider in their analysis.

BC386 Some preparers of financial statements raised concerns that the disclosure of the tax effect for each reconciling item might be complex and costly if calculated in accordance with IAS 12. Users of financial statements said high-level information about the tax effects of each reconciling item would meet their needs. To alleviate the costs of preparing disclosures about the tax effects, the IASB decided to allow a simplified approach for calculating the income tax effect of the reconciling items based on the tax effects of the underlying transaction at the statutory rate applicable to the transaction in the tax jurisdiction concerned.

BC387 The IASB also decided to allow an entity to use alternative approaches for calculating the tax effects. Limiting the methods an entity might use to calculate the tax effects would restrict judgement in providing the best information possible in the circumstances, thereby reducing the usefulness of the information provided. The IASB therefore decided to provide application guidance so that, as an alternative to the simplified calculation, an entity can calculate the tax effects of reconciling items based on a reasonable pro rata allocation of the current and deferred tax of the entity in the tax jurisdiction concerned or by another method that achieves a more appropriate allocation in the circumstances. This approach is similar to the approach for determining the income tax effect on items of other comprehensive income set out in IAS 12. The IASB concluded that specifically allowing the simplified approach—and alternative approaches—balances the needs of users and preparers of financial statements by providing users with a reasonable estimate of the income tax effect of reconciling items and reducing the costs for preparers by simplifying the calculation of those tax effects.

*Information about changes to management-defined performance measures*

BC388 The IASB decided to require an entity to disclose information about the reasons for and effects of an entity changing, adding or ceasing to use a management-defined performance measure. The information required is based on the information IAS 8 requires an entity to disclose if it changes its accounting policies. The IASB concluded that similar information would be useful to users of financial statements if an entity makes changes to its management-defined performance measures. However, the choice of a management-defined performance measure, including how the measure is calculated or how it calculates the tax effects of reconciling items, is not an accounting policy choice as defined in IAS 8 and the disclosure requirements in that Standard do not apply (see paragraph BC368).

BC389 Both transparency and comparability of an entity's management-defined performance measures from period to period are enhanced by providing information about changes to those measures. The IASB observed that a change in the value of an input to a management-defined performance measure is not a change to its calculation, even if that change results in no adjustment in a period. For example, if an entity calculates an adjusted operating profit measure that excludes the effects of restructuring from its operating profit but the entity has no restructuring in a reporting period, the fact that the adjustment for restructuring is zero does not represent a change in the calculation of the management-defined performance measure.

BC390 The IASB decided to require an entity to restate its comparatives if a management-defined performance measure is changed, unless it is impracticable to do so. Trend information for management-defined performance measures is important to users of financial statements. The information provided by those measures is management's view of an aspect of an entity's financial performance. The IASB therefore would generally expect management to monitor the information necessary to provide comparative information.

### **Disclosures about capital (paragraphs 126–129)**

- BCZ391 In July 2004 the IASB published the Exposure Draft *Financial Instruments: Disclosures* (2004 Exposure Draft). As part of that project, the IASB considered whether it should require disclosures about capital.
- BCZ392 The level of an entity's capital and how it manages capital are important factors for users to consider in assessing the risk profile of an entity and its ability to withstand unexpected adverse events. The level of capital might also affect the entity's ability to pay dividends. Consequently, the 2004 Exposure Draft proposed disclosures about capital.
- BCZ393 In the 2004 Exposure Draft, the IASB decided that it should not limit the requirements for disclosures about capital to entities that are subject to external capital requirements (for example, regulatory capital requirements established by legislation or other regulation). The IASB believes that information about capital is useful for all entities, as is evidenced by the fact that some entities set internal capital requirements and norms have been established for some industries. The IASB noted that the capital disclosures are not intended to replace disclosures required by regulators. The IASB also noted that the financial statements should not be regarded as a substitute for disclosures to regulators (which may not be available to all users) because the function of disclosures made to regulators may differ from the function of those to other users. Therefore, the IASB decided that information about capital should be required of all entities because it is useful to users of general purpose financial statements. Accordingly, the IASB did not distinguish between the requirements for regulated and non-regulated entities.
- BCZ394 Some respondents to the 2004 Exposure Draft questioned the relevance of the capital disclosures in an IFRS Accounting Standard dealing with disclosures relating to financial instruments. The IASB noted that an entity's capital does not relate solely to financial instruments and, thus, capital disclosures have more general relevance. Accordingly, the IASB included these disclosures in IAS 1 (retained in IFRS 18), rather than IFRS 7, resulting from the 2004 Exposure Draft.
- BCZ395 The IASB also decided that an entity's decision to adopt the amendments to IAS 1 (retained in IFRS 18) should be independent of the entity's decision to adopt IFRS 7. The IASB noted that issuing a separate amendment facilitates separate adoption decisions.

### **Objectives, policies and processes for managing capital (paragraphs 126–128)**

- BCZ396 The IASB decided that disclosure about capital should be placed in the context of a discussion of the entity's objectives, policies and processes for managing capital. This is because the IASB believes that such a discussion both communicates important information about the entity's capital strategy and provides the context for other disclosures.
- BCZ397 The IASB considered whether an entity can have a view of capital that differs from what IFRS Accounting Standards define as equity. The IASB noted that, although for the purposes of this disclosure capital would often equate with 'equity' as defined in IFRS Accounting Standards, it might also include or exclude some components. The IASB also noted that this disclosure is intended to give entities the opportunity to describe how they view the components of capital they manage, if this is different from what IFRS Accounting Standards define as equity.

### **Externally imposed capital requirements (paragraph 129)**

- BCZ398 The IASB considered whether it should require disclosure of any externally imposed capital requirements. Such a capital requirement could be:
- (a) an industry-wide requirement with which all entities in the industry must comply; or
  - (b) an entity-specific requirement imposed on a particular entity by its prudential supervisor or other regulator.
- BCZ399 The IASB noted that some industries and countries have industry-wide capital requirements, and others do not. Thus, the IASB concluded that it should not require disclosure of industry-wide requirements, or compliance with such requirements, because such disclosure would not lead to comparability between different entities or between similar entities in different countries.
- BCZ400 The IASB concluded that disclosure of the existence and level of entity-specific capital requirements is important information for users, because it informs them about the risk assessment of the regulator. Such disclosure improves transparency and market discipline.
- BCZ401 However, the IASB noted the following arguments against requiring disclosure of externally imposed entity-specific capital requirements:
- (a) users of financial statements might rely primarily on the regulator's assessment of solvency risk without making their own risk assessment.
  - (b) the focus of a regulator's risk assessment is for those whose interests the regulations are intended to protect (for example, depositors or policyholders). This emphasis is different from that of a shareholder. Thus, it could be misleading to suggest that the regulator's risk assessment could, or should, be a substitute for independent analysis by investors.
  - (c) the disclosure of entity-specific capital requirements imposed by a regulator might undermine that regulator's ability to impose such requirements. For example, the information could cause depositors to withdraw funds, a prospect that might discourage regulators from imposing requirements. Furthermore, an entity's regulatory dialogue would become public, which might not be appropriate in all circumstances.
  - (d) because different regulators have different tools available—for example formal requirements and moral suasion—a requirement to disclose entity-specific capital requirements could not be framed in a way that would lead to the provision of information that is comparable across entities.
  - (e) disclosure of capital requirements (and hence, regulatory judgements) could hamper clear communication to the entity of the regulator's assessment by creating incentives to use moral suasion and other informal mechanisms.

- (f) disclosure requirements should not focus on entity-specific capital requirements in isolation, but should focus on how entity-specific capital requirements affect how an entity manages and determines the adequacy of its capital resources.
- (g) a requirement to disclose entity-specific capital requirements imposed by a regulator is not part of Pillar 3 of the Basel II Framework developed by the Basel Committee on Banking Supervision.

BCZ402 Taking into account all of the above arguments, the IASB decided not to require quantitative disclosure of externally imposed capital requirements. Rather, it decided to require disclosures about whether the entity complied with any externally imposed capital requirements during the period and, if not, the consequences of non-compliance. This retains confidentiality between regulators and the entity, but alerts users to breaches of capital requirements and their consequences.

BCZ403 Some respondents to the 2004 Exposure Draft did not agree that breaches of externally imposed capital requirements should be disclosed. They argued that disclosure about breaches of externally imposed capital requirements and the associated regulatory measures subsequently imposed could be disproportionately damaging to entities. The IASB was not persuaded by these arguments because it believes that such concerns indicate that information about breaches of externally imposed capital requirements may often be material by its nature. The *Framework* stated that 'Information is material if its omission or misstatement could influence the economic decisions of users taken on the basis of the financial statements.'<sup>10</sup> Similarly, the IASB decided not to provide an exemption for temporary non-compliance with regulatory requirements during the year. Information that an entity is sufficiently close to its limits to breach them, even on a temporary basis, is useful for users.

### **Internal capital targets**

BCZ404 The IASB proposed in the 2004 Exposure Draft that the requirement to disclose information about breaches of capital requirements should apply equally to breaches of internally imposed requirements, because it believed the information is also useful to a user of the financial statements.

BCZ405 However, this proposal was criticised by respondents to the 2004 Exposure Draft for the following reasons:

- (a) the information is subjective and, thus, not comparable between entities. In particular, different entities will set internal targets for different reasons, so a breach of a requirement might signify different things for different entities. In contrast, a breach of an external requirement has similar implications for all entities required to comply with similar requirements.
- (b) capital targets are not more important than other internally set financial targets, and to require disclosure only of capital targets would provide users with incomplete, and perhaps misleading, information.
- (c) internal targets are estimates that are subject to change by the entity. It is not appropriate to require the entity's performance against this benchmark to be disclosed.
- (d) an internally set capital target can be manipulated by management. The disclosure requirement could cause management to set the target so that it would always be achieved, providing little useful information to users and potentially reducing the effectiveness of the entity's capital management.

BCZ406 As a result, the IASB decided not to require disclosure of the capital targets set by management, whether the entity has complied with those targets, or the consequences of any non-compliance. However, the IASB confirmed its view that when an entity has policies and processes for managing capital, qualitative disclosures about these policies and processes are useful. The IASB also concluded that these disclosures, together with disclosure of the components of equity and their changes during the year (required by paragraphs 107–112 of IFRS 18), would give sufficient information about entities that are not regulated or subject to externally imposed capital requirements.

### **Unusual income and expenses**

BC407 Many entities disclose information about unusual (or similarly described) income and expenses. However, the way in which entities provide that information varies significantly and it is often unclear how or why items are identified as unusual. Stakeholders, especially users of financial statements, suggested that the IASB:

- (a) define 'unusual income and expenses' and provide principles for identifying items as unusual to help an entity identify its unusual income and expenses and reduce opportunistic classification of items as unusual; and
- (b) specify requirements for what information should be disclosed about such income and expenses, to increase the relevance and completeness of information provided about those items.

BC408 In response to this feedback, the IASB developed a proposed definition of 'unusual income and expenses' and proposed disclosure requirements. The objective of the proposed definition was to help users of financial statements identify income and expenses that might not persist so that those income and expenses could be analysed separately when predicting an entity's future cash flows. The IASB proposed defining 'unusual income and expenses' in the Exposure Draft as 'income and expenses with limited predictive value. Income and expenses have limited predictive value when it is reasonable to expect that income or expenses that are similar in type and amount will not arise for several future annual reporting periods.'

BC409 Most stakeholders agreed that the IASB should define 'unusual income and expenses'. However, most stakeholders disagreed with the proposed definition because of concerns about:

- (a) the scope of the items captured in the proposed definition; and
- (b) the subjectivity inherent in the proposed definition.

BC410 The IASB considered various alternative definitions of 'unusual income and expenses', attempting to resolve these concerns. However, stakeholders had differing views on how the IASB should define 'unusual income and expenses'. Further discussions

with stakeholders on alternative definitions did not resolve the differences in views, which were expressed by all types of stakeholders, including by users of financial statements.

- BC411 The differences in views indicated that it would not be possible to develop a practicable definition on a timely basis. Stakeholder feedback, including from users of financial statements, showed the IASB should not delay the completion of the project by developing a definition of 'unusual income and expenses'. The IASB therefore decided not to proceed with developing such a definition.
- BC412 The IASB also concluded that without a definition of 'unusual income and expenses', it would be difficult to specify disclosure requirements that would significantly improve the information disclosed about unusual income and expenses in the financial statements. The IASB therefore decided not to specify any such requirements.
- BC413 However, the IASB's decision not to define 'unusual income and expenses' did not change its view that information about unusual income and expenses is useful to users of financial statements. The IASB expects that the disclosure of information about unusual income and expenses will be improved by other requirements in IFRS 18, particularly the requirements relating to:
- (a) the disaggregation of items with dissimilar characteristics—for example, if an item of income or expense lacks persistence, an entity would need to consider whether information about the lack of persistence of the item is material and needs to be disclosed;
  - (b) the description of items using labels that faithfully represent the characteristics of those items—for example, if an entity discloses an item because it lacks persistence, or is identified as unusual, it would be described as such (this might include an explanation of how the entity defines unusual); and
  - (c) the disclosure of information about management-defined performance measures—for example, in some cases, unusual income and expenses might be adjusting items in the calculation of a management-defined performance measure.

## **Effective date and transition**

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- BC414 The IASB decided to make IFRS 18 effective for annual reporting periods beginning on or after 1 January 2027 and to permit earlier application. In determining the effective date, the IASB considered feedback from stakeholders on the time they would need to implement the requirements, including for jurisdictional authorities to incorporate the requirements into their legal systems. The IASB also considered feedback from users of financial statements regarding the need to make the information required by IFRS 18 available as soon as possible.
- BC415 IFRS 18 will result in changes to presentation and disclosure throughout the financial statements, with the greatest effect on the statement of profit or loss. Entities are likely to require changes to data collection processes and IT systems, and discussions with internal and external stakeholders, including lenders, auditors and regulators. For example, some stakeholders said:
- (a) changes would be required to remuneration policies and debt covenants linked to metrics in the statement of profit or loss and it would be necessary to negotiate and approve those changes with relevant stakeholders; and
  - (b) the disclosures for management-defined performance measures would require discussion between preparers, auditors and regulators because alternative performance measures and non-GAAP measures are often not subject to audit.
- BC416 The IASB acknowledged some entities might require less time to apply the changes required by IFRS 18. However, stakeholder feedback also indicated that some entities might require at least two years to implement the changes. Considering endorsement and translation processes and changes to regulatory requirements, as well as feedback from preparers of financial statements, the IASB concluded that setting an effective date of annual reporting periods beginning on or after 1 January 2027 will provide enough time to implement the requirements.
- BC417 The IASB decided to require retrospective application of IFRS 18. The IASB expects the new requirements to result in extensive changes to the statement of profit or loss. 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. Because the requirements affect presentation and disclosure only, an entity will not need to consider periods before the start of the earliest comparative period.

### **Disclosure on initial application (paragraphs C2–C3 and C6)**

- BC418 The IASB decided to require an entity on initial application to disclose in its annual financial statements a reconciliation between each item in the statement of profit or loss in accordance with IFRS 18 and each line item presented in accordance with IAS 1. An entity is required to disclose the reconciliation for the comparative period immediately preceding the period in which IFRS 18 is first applied. The IASB concluded that changes to the structure of the statement of profit or loss required by IFRS 18 would make it difficult for users of financial statements to analyse trends without a reconciliation to the amounts presented before the implementation of IFRS 18. The IASB decided this requirement would replace the requirement in paragraph 28(f) of IAS 8 requiring an entity to disclose the amount of the adjustment for each line item affected if initial application of any IFRS Accounting Standard has an effect on the current or any prior period.
- BC419 The IASB also decided not to require an entity to provide the reconciliation described in paragraph BC418 for:
- (a) the reporting period in which IFRS 18 is first applied; or
  - (b) comparative periods presented, other than the comparative period immediately preceding the period in which IFRS 18 is first applied.
- BC420 The IASB concluded that requiring an entity to report the reconciliation for the reporting period in which IFRS 18 is first applied would require the entity to maintain systems for preparing its financial statements in accordance with IAS 1 for the duration of



the year of initial application. This would increase implementation costs. The IASB also expects the resulting information to be of limited benefit because IFRS 18 is required to be applied retrospectively.

#### **Interim financial statements (paragraphs C4–C6)**

BC421 Paragraph 10 of IAS 34 *Interim Financial Reporting* requires an entity to present, at a minimum, the same headings and subtotals as in the most recent annual financial statements. In the first year of application, an entity might have different subtotals in its statement of profit or loss in its most recent annual financial statements from those required by IFRS 18. Consequently, the IASB decided that in the first year of applying IFRS 18, an entity presents the headings and subtotals required by IFRS 18 in condensed financial statements in interim financial reports. Presenting the subtotals required by IFRS 18 will provide useful information to users of financial statements.

BC422 The IASB decided to require an entity to disclose, as part of the information required by paragraph 16A(a) of IAS 34, a reconciliation for the comparative period and the cumulative comparative period immediately preceding the period in which IFRS 18 is first applied for each line item presented in the statement of profit or loss in the interim financial statements. The IASB concluded, as it did for annual financial statements, that users of financial statements would have difficulty understanding comparative information in interim financial statements and analysing trends without a reconciliation to the amounts presented before the implementation of IFRS 18. The IASB also concluded the interim financial statements would be of limited use to users of financial statements without such comparative information for both the comparative and cumulative comparative periods. The IASB therefore concluded the benefits of disclosing both reconciliations would outweigh the cost of preparation.

#### **Investments in associates and joint ventures (paragraph C7)**

BC423 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 (see paragraphs BC123–BC128). 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 (see paragraph BC12 of the Basis for Conclusions on IAS 28). 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. An entity that applies the election is required to account for the applicable investments in the same way in its separate financial statements as required by paragraph 11 of IAS 27. If an entity makes such a change, it applies the change retrospectively applying IAS 8.

#### **Definition of IFRS Accounting Standards**

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BC424 Following the establishment of the International Sustainability Standards Board, IFRS Standards are defined in the IFRS Foundation Constitution as both IFRS Accounting Standards and IFRS Sustainability Disclosure Standards. Appendix A of IFRS 18 includes a definition of 'IFRS Accounting Standards'. This definition replaces the definition of 'International Financial Reporting Standards' included in IAS 1, which were previously known as IFRS, IFRSs and IFRS Standards.

BC425 Consequential amendments were made to IFRS 1 *First-time Adoption of International Financial Reporting Standards*, IAS 8 and IAS 34 to refer to paragraphs of IFRS Accounting Standards that discuss an entity's statement of compliance with IFRS Accounting Standards. However, in all other cases where IFRS Accounting Standards refer to IFRS, IFRSs or IFRS Standards these references were left unchanged.

#### **Amended references to the Conceptual Framework**

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BCZ426 Following the issue of the revised *Conceptual Framework for Financial Reporting* in 2018, the IASB issued *Amendments to References to the Conceptual Framework in IFRS Standards*. In IAS 1, that document replaced the reference in IAS 1 to the *Framework* with references to the 2018 *Conceptual Framework* (now in paragraph B86 of IFRS 18).

BCZ427 The IASB does not expect the replacement of the references to the *Framework* to have a significant effect on the application of IFRS 18 because replacing the reference in IAS 1 (now in paragraph B86 of IFRS 18) to the *Framework* means referring to the revised definitions of income and expenses in the 2018 *Conceptual Framework*. The IASB concluded that this is unlikely to lead to changes in applying the requirements of IAS 1 (now in IFRS 18) because the definitions of income and expenses in the 2018 *Conceptual Framework* were updated only to align them with the revised definitions of an asset and a liability. Moreover, the main purpose of the requirement in IAS 1 (now in paragraph B86 of IFRS 18) is to indicate that particular items of income or expenses can be recognised outside profit or loss only if required by other IFRS Accounting Standards.

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## Footnotes

<sup>1</sup>. 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*.

- <sup>2</sup>. The IASC's *Framework for the Preparation and Presentation of Financial Statements (Framework)* was adopted by the IASB in 2001 and in effect when IAS 1 *Presentation of Financial Statements* was revised and amended in 2003, 2005 and 2007. The IASB replaced the *Framework* with the *Conceptual Framework for Financial Reporting (Conceptual Framework)* in 2010, which it revised in 2018.
- <sup>3</sup>. The IASB revised the title 'statement of comprehensive income' to 'statement presenting comprehensive income' when it issued IFRS 18 *Presentation and Disclosure in Financial Statements*.
- <sup>4</sup>. IFRS 9 *Financial Instruments* eliminated the category of available-for-sale financial assets. This paragraph refers to matters relevant when IAS 1 was issued.
- <sup>5</sup>. SFAS 130 was the Financial Accounting Standards Board (FASB) Standard on reporting comprehensive income when the IASB made this decision. SFAS 130 was superseded by the FASB Accounting Standards Codification in July 2009.
- <sup>6</sup>. In September 2007 the IASB amended the title of IAS 10 from *Events after the Balance Sheet Date* to *Events after the Reporting Period* as a consequence of the amendments in IAS 1 *Presentation of Financial Statements* (as revised in 2007).
- <sup>7</sup>. The IASB amended IAS 1 in 2022, removing the clarification discussed in paragraph BCZ302(b). See paragraphs BCZ304–BCZ309 for further information about these amendments.
- <sup>8</sup>. IFRS 18 revised the definition of the term 'owners' to align with the *Conceptual Framework*.
- <sup>9</sup>. *Disclosure of Accounting Policies*, issued in February 2021, amended paragraphs 117–122 of IAS 1 to refer to 'material accounting policy information'. When issuing IFRS 18, the IASB retained paragraphs 117–122 of IAS 1 in paragraphs 27A–27G of IAS 8.
- <sup>10</sup>. The *Conceptual Framework* replaced the *Framework*. Materiality is discussed in paragraph 2.11 of the *Conceptual Framework* and defined in Appendix A of IFRS 18.

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