IFRS 18 *Presentation and Disclosure in Financial Statements*

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Project Overview and expected effects

Helicopter view

New IFRS Accounting Standard to improve reporting of financial performance

Responds to investors' demand for better information about companies' financial performance

›

Improves how information is communicated in the financial statements

›

Gives investors a better basis for analysing and comparing companies' performance

IFRS 18 – the new requirements

New required subtotals in statement of profit or loss, including ‘operating profit’

Disclosures about management-defined performance measures (MPMs)

Enhanced requirements on grouping of information (aggregation and disaggregation)

Better information for better decisions
– increases comparability, transparency and usefulness of information

Effective date: 1 January 2027

IFRS Accounting

Effects of changes to the statement of profit or loss

Main changes

- Classification of income and expenses in three new defined categories to provide a consistent structure:
  - operating, investing and financing
- Two new required subtotals
  - operating profit
  - profit before financing and income taxes

Likely benefits

- Providing investors with additional useful information about financial performance
- Improving investors' ability to compare performance

Potential costs and cost mitigations

- Systems and process changes classify items into the three new categories
- Cost mitigations
  - Relief from some classification requirements if the requirements would result in undue cost or effort
  - Accounting policy choice for some companies for specific types of income and expenses

IFRS Accounting

Effects of changes to the notes to the financial statements

Main changes

- Disclosure of MPMs in a single note
  - explanation of why MPM is reported, how it is calculated, and any changes to MPMs
  - reconciliation to the most directly comparable IFRS subtotal
- Disclosure of specified expenses by nature in each line item in the operating category, for entities that present by function

Likely benefits

- Providing investors with additional useful information about financial performance
- Improving investors' ability to compare performance
- Improving transparency to help investors understand how companies measure their own performance

Potential costs and cost mitigations

- Calculation of income tax effect on reconciling items
  - cost mitigated by options for simplified approaches to the calculation of the income tax effect
- Disclosure of expenses by nature
  - Cost mitigated by limitation to five specific items: depreciation, amortisation, employee benefits, impairment losses and inventory write-downs
  - disclosure can be based on cost rather than expense

IFRS Accounting

Effects of changes to both the primary financial statements and the notes

Main changes

- Enhanced requirements for grouping of information
  - aggregation and disaggregation requirements
- Guidance on whether information should be in the primary financial statements or in the notes
- Requirements about items labelled ‘other’

Likely benefits

- Providing investors with additional useful information about financial performance
- Improving investors’ ability to compare performance

Potential costs and cost mitigations

- Assessment of what aggregation/disaggregation provides material information
- Cost mitigated by exemption from providing information about the nature of expenses beyond that specifically required by IFRS Accounting Standards

(1) Categories and subtotals

Categories and subtotals in the statement of profit or loss

Investors’ concerns

- Difficulty comparing financial performance because companies’ statement of profit or loss vary in content and structure

IFRS 18 introduces

- Three new defined categories to provide a consistent structure of the statement of profit or loss:
  - operating
  - investing
  - financing
- Two new required subtotals to enable analysis:
  - operating profit
  - profit before financing and taxes

New required subtotals

Operating profit

Gives a complete picture of a company's operations

Profit before financing and income taxes

Gives a picture of a company's performance before the effects of its financing

Statement of profit or loss

Revenue	Operating
Cost of sales	Operating
Gross profit	Operating
Other operating income	Operating
Selling expense	Operating
Research and development expenses	Operating
General and administrative expenses	Operating
Goodwill impairment loss	Operating
Other operating expenses	Operating
Operating profit	
Share of profit or loss of associates and joint ventures	Investing
Other investment income	Investing
Profit before financing and income taxes	
Interest expense on borrowings and lease liabilities	Financing
Interest expense on pension liabilities and provisions	Financing
Profit before income taxes	
Income tax expense	
PROFIT	

What is in the operating category?

Income and expenses:

- All income and expenses from a company’s operations, regardless of whether they are volatile or unusual in some way
- Including from its main business activities

Works for all business models

Provides complete picture of company’s operations

What is in the investing category?

Income and expenses from assets that generate a return individually and largely independently of other resources held by an entity

- rental income and remeasurements of investment property
- interest income and fair value changes on financial assets, such as debt securities
- dividends and fair value changes on non-consolidated equity investments

Income and expenses from associates, joint ventures and non-consolidated subsidiaries

Income and expenses from cash and cash equivalents

What is in the financing category?

All income and expenses from liabilities from transactions that involve only the raising of finance

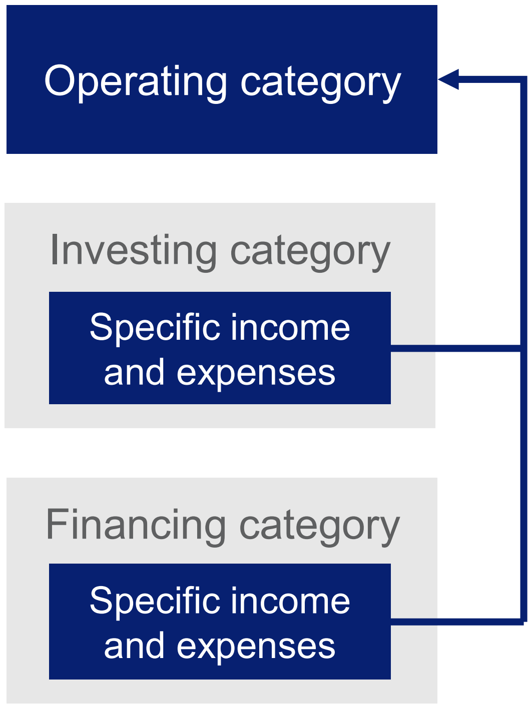
- Receipt and return of cash or company's own shares
- Reduction in financial liability
- E.g., bank loans

Interest expense and effects of changes in interest rates from other liabilities

- Lease liabilities
- Defined benefit pension liabilities

Requirements for specific companies

- For some companies, financing and investing activities are their main business activities – for example banks and insurers
- These companies include income and expenses in their operating profit that for other companies would be included in the investing or financing categories



Assessment of main business activities

The role of main business activities is limited to assessing whether an entity either:

- **invests** as a main business activity; or
- **provides financing to customers** as a main business activity

An entity uses **judgement** to assess its main business activities **based on evidence**. For example:

- Operating performance measures, such as net interest income and net financial result, used to explain operating performance externally
- A reportable segment or operating segment that comprises a single business activity and performance of that segment is an important indicator of the entity's operating performance

IFRS Accounting

Examples of statements of profit or loss for other entities

Statement of profit or loss for a bank	
Interest revenue	Operating
Interest expense	
Net interest income	
Fee and commission income	
Fee and commission expenses	
Net fee and commission income	
Net trading income	
Net investment income	
Credit impairment losses	
Employee benefits	
Depreciation and amortisation	
Other operating expenses	
Operating profit	
Share of profit or loss of associates and joint ventures	Non-main Investing and financing
Interest expense on pension and lease liabilities	
Profit before income taxes	
Income tax expense	
PROFIT	

Statement of profit or loss for an insurer	
Insurance revenue	Operating
Insurance service expenses	
Insurance service result	
Investment revenue	
Credit impairment losses	
Insurance finance expenses	
Net financial result	
Other operating expenses	
Operating profit	
Share of profit or loss of associates and joint ventures	Investing
Profit before financing and income taxes	
Interest expense on borrowings and pension liabilities	Financing
Profit before income taxes	
Income tax expense	
PROFIT	

IFRS 18

PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS

Identifying Research Opportunities

EAA Reporting Standards Workshop

24 February 2025

EFRAG Financial reporting

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EFRAG

STRUCTURE

- Introduction
- EFRAG's perspective on:
  - ✓ General evaluation of IFRS 18 and subtotals
  - ✓ Management-defined Performance Measures (MPMs)
  - ✓ Aggregation and disaggregation

EFRAG

INTRODUCTION

Overview of EFRAG's work performed to date

Comment letters

Round tables

Targeted outreaches

Discussions with EFRAG FR TEG

Discussions with EFRAG FRB

Discussions with EFRAG WG

EFRAG:
SUMMARY OF THE ISSUES AND RECOMMENDATIONS

IASB:
Changes to the IFRS 18 proposed requirements to mitigate raised issues and accommodate various stakeholders

After publication of IFRS 18

Educational event Corporates

Educational event Financial Institutions

Desktop research; EFRAG FRB, FR TEG+WG; outreach

EFRAG:
Identification of issues to be addressed in the endorsement advice

EFRAG:
DRAFT ENDORSEMENT ADVICE
(DEA)

IFRS ENDORSEMENT CRITERIA ASSESSMENT

IFRS 18 was published in April 2024 and will be effective for annual reporting periods beginning on or after 1 January 2027, with earlier application being permitted, subject to the adoption in the EU.

Regulation (EC) No 1606/2002 (IAS Regulation) establishes the criteria for the IFRS Accounting Standards to be adopted in the EU. (see appendix to the slides for more information)

Technical endorsement criteria

- Relevance
- Reliability including prudence
- Comparability
- Understandability
- True and Fair view

European public good criteria

- Potential effect on EU economy (financial stability, competitiveness)
- Potential effects on stakeholders
- Costs and benefits analysis

Other criteria

- No other criteria were requested by the EC

GENERAL EVALUATION OF IFRS 18

- Achieving an overall consensus, following extensive consultations with a wide range of stakeholders including those from Europe.
- EFRAG was able to exchange with the IASB timely.
- As a resulting effect the endorsement advice request received from the EC did not include the request for the assessment of additional criteria.
- No blocking factors were identified for the endorsement in the EU - however several critical points were raised by specific stakeholder groups.
- Cost and benefits: IFRS 18 has impact on the presentation of financial information of each entity. The analysis performed revealed that entities will incur implementation costs, but ongoing costs will be relatively low. EFRAG's overall assessment is that the benefits from IFRS 18 will outweigh the resulting costs. IFRS 18 cost mitigating simplifications were highly appreciated by preparers and accepted by users.

EFRAG

Subtotals

- EFRAG considers the presentation of new defined subtotals in the statement of profit or loss and consistent classification of income and expenses in five defined categories being an improvement. Users receive more relevant and comparable information, and transparency is improved.

- Some issues raised by stakeholders include:
  - ✓ classification of income and expenses arising **from equity-accounted investments** in the investing category: problematic for certain industries (banking, insurance...) and for certain types of business models (shared-service joint ventures...).
  - ✓ assessment of the entity's main business activities in case of conglomerates: potentially different accounting policies for different activities.
  - ✓ classification of interest expenses from other liabilities (considered by many companies as part of the operating activity – i.e., leases) in the financing category.

Potential research areas:

- ➢ Impacts on the operating results (when equity-accounted investments were deemed part of operating activity and will now be presented outside); specifically relevant for the insurance industry
- ➢ Use of additional sub-totals in the statement of profit or loss;
- ➢ Overall cost / benefit assessment after the implementation
- ➢ Changes from equity accounting to fair value measurement (applying para 18 of IAS 28)

Empirical evidence on income statement subtotals

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EAA REPORTING STANDARDS WORKSHOP: IDENTIFYING RESEARCH OPPORTUNITIES ON IFRS 18 *PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS*

24 February 2025

Introduction and brief recap

Two new defined subtotals (IFRS 18.69)

- operating profit: residual catch-all category (IFRS 18.70)
- profit before financing and income taxes: "… AND all income and expenses classified in the investing category" (IFRS 18.71)
  - *'investing'* category includes, i.a., equity-accounted investments

EFRAG's *ex-ante* assessment

- Overall: "the benefits from IFRS 18 will outweigh the resulting costs" (p. 6)
- On the new defined subtotals in the P&L: "an improvement. Users receive more relevant and comparable information, and transparency is improved" (p. 7)

Relevant research can be *ex ante* or *ex post*

Ex-ante research

- Can be conducted ***before*** a standard is adopted/implemented – when specific empirical insights are limited
- General purpose of **subtotals**: Organize line items into 'buckets' with similar conceptual attributes

		Source	
		operating	*financing*
Time-series proper-ties	*recurring*	Depreciation	Interest expense
	transitory	Goodwill impairment	Fair value remeasurement of ‚trading' financial asset

- The new IFRS 18 subtotals consider ***source***—but seem to abstract away from *time-series properties*

Ex-post perspectives

- Must wait until ***after*** a standard is implemented
- Are the new defined subtotals in fact "an improvement" in that users "receive more relevant and comparable information, and transparency is improved"?
- How to **conceptualize** these attributes?

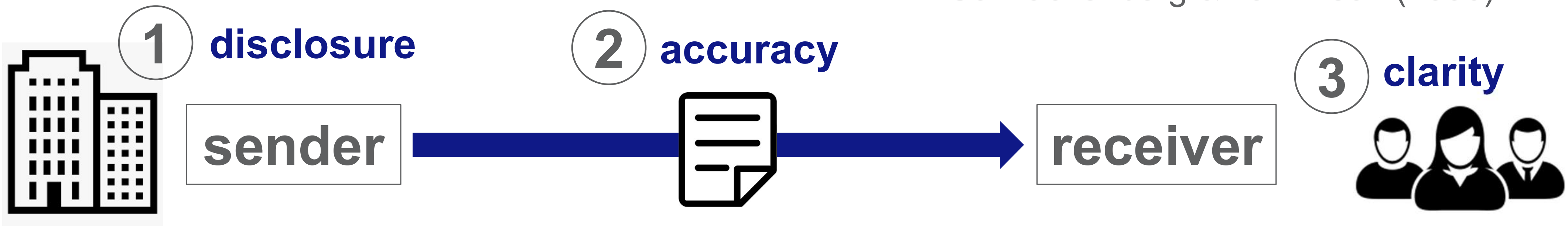
– Transparency – Relevance – Comparability	Transparency (=usefulness?) Relevance Comparability

- How to **operationalize** them for empirical measurement in a way that is in line with standard setters' objectives?
- [Are accounting attributes ends in themselves – or means towards **(capital-market, real) impacts**?]

Transparency = decision usefulness?

"***Transparency*** *is the perceived quality of intentionally shared information from a sender.*"

Schnackenberg & Tomlinson (2006)



Disclosure: Is there sufficient detail? ***Accuracy***: Are the numbers reliable? ***Clarity***: Are they easily accessible?

Decision usefulness: "If financial information is to be useful, it must be *relevant* and *faithfully represent* what it purports to represent. The usefulness of financial information is enhanced if it is *comparable*, *verifiable*, *timely* and *understandable*." (Conceptual Framework for Financial Reporting, para. 2.4)

→ **Transparency and decision usefulness seem to be similar concepts with similar elements/attributes.**

Quelle: Schnackenberg, A. K., & Tomlinson, E. C. (2016). Organizational transparency: A new perspective on managing trust in organization-stakeholder relationships. Journal of Management, 42(7), 1784-1810; IFRS Foundation, *Conceptual Framework for Financial Reporting*, 2018.

Relevance

- Relevance and related concepts – along with attempts to operationalize them for empirical measurement – have been at the **core of empirical accounting research** for the last 60 years

- The ‚godfathers‘ **Ball and Brown (1968)**:
  - “Accounting theorists have generally evaluated the usefulness of accounting practices by the extent of their agreement with a particular analytic model” (p. 159)
    → ***Ex-ante research***
  - “Because net income is a number of particular interest to investors, the outcome we use as a predictive criterion is the investment decision as it is reflected in security prices” (p. 160)
    → ***Ex-post research***

- **But:** “An empirical evaluation of accounting income numbers requires *agreement* as to what real-world outcome constitutes an appropriate test of usefulness” (p. 160)
  → **Is there such agreement?**

Relevance (cont‘d)

- Value relevance: The ‚epic battle‘ of **Barth et al. (2001)** ***vs*** **Holthausen and Watts (2001)**
  - “an accounting amount is defined as ***value relevant*** if it has a predicted association with equity market values” (Barth et al. 2001, p. 79)
  - “value relevance research provides ***insights into questions of interest to standard setters*** and other non-academic constituents” (Barth et al. 2001, p. 78)
  - “the value-relevance literature’s reported associations between accounting numbers and common equity valuations have ***limited implications or inferences for standard setting***” (Holthausen and Watts 2001, p. 3)

- According to **standard setters**:
  - How would you like empirical researchers to ***measure*** the fundamental qualitative characteristic of relevance – including for the new IFRS 18 subtotals?
  - Do you consider existing research ***useful*** in this regard?

Relevance (cont‘d)

- Example: Comparing the usefulness of two profit subtotals: Operating income and earnings before interest and taxes (Eng and Vichitsarawong 2022)
  - „This study aims to provide evidence for the proposal made by the IASB, that is, examining whether … operating income (OI) and earnings before interest and taxes (EBIT) … help investors analyze the earnings of companies and ***forecast their future cash flows***” (p. 1)
  - More specifically: “We regress stock prices on these profit measures and use a prediction model in which ***future operating cash flows*** are regressed on the profit measures” (p. 2)
- Does this empirical test speak to the **IASB‘s and EFRAG‘s assessment criteria** for IFRS 18?

Comparability

Conceptual Framework for Financial Reporting

- "Comparability is **not uniformity**. For information to be comparable, like things must look alike and different things must look different." (para. 2.27)

De Franco, Kothari, and Verdi (2011)

- "… all emphasize the importance of financial statement comparability. However, an empirical construct of comparability is typically *not specified*." (p. 895)
- "the accounting system is a mapping from economic events to financial statements" (p. 896)
- "For *a given set of economic events*, two firms have comparable accounting systems if they produce *similar financial statements*." (p. 896)

Using De Franco et al.'s (2011) measure, **Barth, Landsman, Lang, and Williams (2012)** show:

- "IFRS firms have greater … comparability with US firms when IFRS firms apply IFRS than when they applied domestic standards." (p. 68)

Is this operationalization of comparability **consistent with standard setters' understanding**?

How could we do better? Could you help us do better?

Ex-ante research

- How should relevant research approach the **operational empirical measurement** of qualitative characteristics of financial reporting information?
- Could the IASB and EFRAG help **elicit stakeholders‘ views** on these matters through their outreach activities?

Ex-post research

- Post-implementation reviews (PIRs) and cost-benefit analyses benefit from **causal evidence**.
- Would the IASB and EFRAG be interested in **co-designing and preregistering studies** that will be useful for the PIRs of new standards, e.g., by facilitating staggered field tests?

Thank you.

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IFRS Accounting

(2) Management-defined performance measures

Management-defined Performance Measures (MPMs)

Investors' concerns

- Investors find MPMs useful but they have concerns about lack of transparency of how these measures are calculated

Examples of alternative performance measures (APMs) or non-GAAP measures used today

- **Adjusted operating profit**
- **Adjusted profit or loss**
- **Adjusted EBITDA**
- Free cash flow
- Return on equity

Management-defined Performance Measures (MPMs)

Subtotals of income and expenses not required or specifically exempted by IFRS Accounting Standards

Included in **public communications outside financial statements**

Measures that communicate **management's view** of a company's financial performance

Disclosures for MPMs

IFRS 18 introduces requirements to disclose in a single note

- **Reconciliation** back to IFRS-defined subtotal
- Explanation of **why** the MPM is reported
- Explanation of **how** the MPM is calculated
- Explanation of any **changes** to the MPM

What might a reconciliation look like?

	IFRS	Impairment losses	Restructuring expenses	Gains on disposal of PP&E	MPM
Other operating income		-	-	(1,800)	
Research and development expenses		1,600	-	-	
General and administrative expenses		-	3,800	-	
Goodwill impairment loss		4,500	-	-	
Operating profit / Adjusted operating profit	**57,000**	6,100	3,800	(1,800)	**65,100**
Income tax expense		-	(589)	297	
Profit from continuing operations / Adjusted profit from continuing operations	**32,100**	6,100	3,211	(1,503)	**39,908**
Profit attributable to non-controlling interests		305	161	-	

Calculating the income tax effects – possible methods

1

statutory
tax rate(s)

2

pro rata allocation
of tax

3

other method
if it gives better
information

+

Disclosures of how tax effects calculated
— required for each reconciling item if more than one method is used

IFRS 18

PRESENTATION AND DISCLOSURE IN FINANCIAL STATEMENTS

Identifying Research Opportunities

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Financial reporting

MANAGEMENT-DEFINED PERFORMANCE MEASURES

- The introduction of disclosures on the Management-defined Performance Measures (MPMs) in a single note to the financial statements and the resulting audit of such information will support transparency and discipline in the use of such measures.
- The reconciliations to be provided for income tax effects and NCI to the next subtotal in the statement of profit or loss will help users of financial statements in their analysis.

MANAGEMENT-DEFINED PERFORMANCE MEASURES

- Specific to management-defined performance measures, stakeholders raised issues about:

  - ✓ scoping and rebuttable presumption: complexity in understanding the scoping of IFRS 18 and other requirements (i.e., ESMA's guidance on alternative performance measures, industry-specific regulatory guidance for regulated industries - entities may need to rebut the presumption that regulatory measures disclosed in its public communications are MPMs; in practice, many of the measures disclosed by the banking industry is about solvency and liquidity which would be out of the scope of the IFRS 18 requirements)

  - ✓ reconciliation requirements (including NCI and tax effects): cost-benefit balance and complexity of understanding in case of multiple business activities and/or different segments

Potential research areas:

- Number of MPMs disclosed by companies (industry specifics might exist)
- Articulation between MPMs, APMs (European issue), regulatory metrics (presented together or in different section of the annual report, impact on the understandability for users);
- Impact of IFRS 18 on overall performance reporting, will IFRS 18 lead to reduced cost of capital as investors will have better / more information about performance.

EVIDENCE & RESEARCH OPPORTUNITIES

ANA MARQUES

ARE THE OBJECTIVES OF IFRS18 MET?

- Has the communication of financial information improved?
- Is the analysis and comparison of firms' performance easier?

  - More specifically, what happens to comparability, consistency, and usefulness of the information disclosed?

THREE SPECIFIC PERIODS TO STUDY

1. Before IFRS18 was published (pre-Apr/2024)
2. After the publication, but before it is adopted
3. After it is adopted (2027 onwards)

- Comparison of pre- vs post-adoption: (1&2) vs 3 **OR** 2 vs 3

POSSIBLE VARIABLES TO HAND-COLLECT

- Disclosure of the two subtotals (Operating profit, and Profit before financing and income taxes) => also in the text of the press release, increasing emphasis?
- Note on MPMs => which measures? How are they explained/justified?
- Reconciliations in this note => format? type/value of adjustments made?
- “Other” and “unusual” items => presence, revenues/gains or expenses/losses, and values

POSSIBLE ANALYSES (I)

1. Op. profit includes all income and expenses from a company's operations, *regardless of whether they are volatile or unusual* => will there be an increase of disclosure of adjusted operating income (MPM)? If so, will this MPM be more useful for capital markets than operating profit?
2. Given need for disclosure of specified expenses by nature in each line item in the operating category, for entities that present by function => Is there an increase in usefulness when firms change the way they disclose this information?
3. Persistence of "other"/"unusual" items?

POSSIBLE ANALYSES (II)

4. Given PBFT is in the financial statements => will disclosure of EBITDA decrease? Impact?
5. Will disclosure of non-GAAP/APM measures that are not MPM (like FCF) decrease? Become concentrated only in a few industries (e.g.: financial)? Impact?
6. How do firms justify their changes in MPM? Is the need for justification associated with an increase in consistency and comparability of MPMs? What if firms are already following ESMA's guidelines on APMs?
7. Given the presence of a reconciliation, is explanation of how the MPM is calculated useful? Does format matter?
8. Are the explanations of why MPMs are reported boilerplate?

METHODOLOGICAL ISSUES

- Empirical archival studies => consider (i) control groups, (ii), definition of variables, and (iii) metrics of impact
- Focus groups with different stakeholder groups, such as (i) investors, (ii) regulators, (iii) directors, and (iv) accounting professionals

- Can researches provide evidence that changes are really related to the standard, instead of an already existing trend?

AUDITING

- The figures included in financial statements will now be audited, alongside the rest of the financial statements
- In 2017, the PCAOB's Investor Advisory Group recommended that non-GAAP financial measures be included within audited financial statements to ensure they are subject to independent validation.
- Ege et al. (2024, WP) provides some evidence on how non-GAAP measures are of higher quality when they are audited

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IFRS Accounting

(3) Grouping – aggregation and disaggregation – of information

Grouping – aggregation and disaggregation – of information

Investors’ concerns

- some companies don’t provide enough detailed information
- some companies provide too much detailed information

IFRS 18 introduces

- guidance on whether information should be in the primary financial statements or the notes
- enhanced requirements for grouping of information, including disclosures about items labelled as ‘other’
- requirements for presenting and disclosing operating expenses

Roles of the primary financial statements and the notes

Primary financial statements (PFS)

Statement of financial position (balance sheet)	Statement of profit or loss (income statement)	Statement presenting comprehensive income	Statement of changes in equity	Statement of cash flows	Notes to the financial statements

Role is to provide **useful structured summaries** of a company's assets, liabilities, equity, income, expenses and cash flows

Role is to provide further **material information** and supplement PFS

Role of the primary financial statements

To provide ***structured summaries*** of a reporting entity's recognised assets, liabilities, equity, income, expenses and cashflows that are ***useful*** for:

Obtaining an understandable overview

Making comparisons between entities, and between reporting periods for the same entity

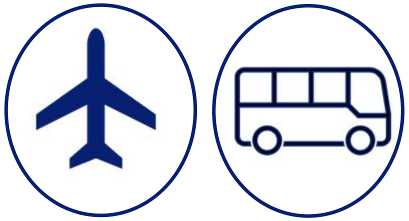
Identifying items/areas about which users wish to seek additional information in the notes

An entity will use the role of primary financial statements to determine what ***material*** information to present in the primary financial statements.

IFRS Accounting

Aggregation, disaggregation and meaningful labels

Aggregate based on shared characteristics



Single dissimilar characteristic can be enough to disaggregate if resulting information is material

Use meaningful labels

- use the label ‘other’ only when unable to find a more informative label
- label as precisely as possible (eg ‘other operating expenses’)

IFRS Accounting

Disclosure of specified expenses by nature

Disclose the amounts included in each line item in the operating category of the statement of profit or loss for

Depreciation	Amortisation	Employee benefits	Specified impairments	Write-down of inventories

Qualitative explanation is required to be disclosed if part of the amount disclosed has been included in the carrying amount of assets

Specified expenses by nature note

(in currency units)	20X2	20X1
Cost of sales	23,710	21,990
Research and development expenses	2,515	2,590
General and administrative expenses	4,975	4,750
Total depreciation	**31,200**	**29,330**
Research and development expenses	13,840	12,690
Total amortisation	**13,840**	**12,690**
Cost of sales	61,640	57,175
Selling expenses	7,515	7,110
Research and development expenses	6,545	6,750
General and administrative expenses	8,920	5,825
Total employee benefits	**84,620**	**76,860**
Research and development expenses	1,600	1,500
Goodwill impairment loss	4,500	–
Total impairment loss	**6,100**	**1,500**
Cost of sales	2,775	2,625
Total write-down of inventories	**2,775**	**2,625**

The amounts disclosed are those recognised as expenses in the statement of profit or loss for the year, except for depreciation and employee benefits.

The amounts disclosed for depreciation are the charge for the year, calculated in accordance with IAS 16 *Property, Plant and Equipment*. The amounts include amounts that have been capitalised by including them in the carrying amount of inventory at the end of the reporting period.

The amounts disclosed for employee benefits are the costs incurred for the year, including pension costs, for employee services, calculated in accordance with IAS 19 *Employee Benefits*. The amounts include amounts that have been capitalised by including them in the carrying amount of inventory at the end of the reporting period.

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IFRS 18

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AGGREGATION AND DISAGGREGATION

- EFRAG assessed whether IFRS 18 would contribute to improving financial reporting by comparing it to the current guidance. EFRAG concluded that the introduction of requirements for improved aggregation and disaggregation is likely to provide additional relevant information in the primary financial statements and in the notes and ensures that material information is not obscured.

- IFRS 18 improves guidance to assess how to present operating expenses in the statement of financial performance and requires entities to disclose specified expenses by nature when presenting by function. Users accept the simplification provided as cost relief for preparers.

AGGREGATION AND DISAGGREGATION

- Specific to aggregation and disaggregation, stakeholders raised issues about:
  - ✓ analysis of expenses by nature when presenting by function: total cost and not only P&L expense can be presented, potentially impacting the comparability and understandability. Insurance industry considering that IFRS 17 mandates the presentation and entity cannot choose by nature or by function presentation.
  - ✓ concept of **useful structured summary** with some investors questioning the possibility to significantly condense primary financial statements.

Potential research areas:

- ➢ Impact of IFRS 18 on overall aggregation / disaggregation of information on the face of financial statements and in the notes (i.e., use and significant of 'other' items);
- ➢ Application of the useful structure summary concept in practice and its impact on primary financial statements and the notes.

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Aggregation and Disaggregation – Empirical Evidence and Gaps in the Literature

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IFRS 18
Aggregation and disaggregation

- **Quick recap**

Objective: *Investors would like to see information more appropriately grouped (aggregated or disaggregated) in the financial statements. Setting out requirements on whether information should be in the primary financial statements or the notes and providing principles on the level of detail needed improves effective communication of information* [IFRS 18 Project Summary]

- **Principles** [IFRS 18.41]
  - Materiality
  - Judgement
- **Judgement based on shared characteristics for aggregation**
  - Examples: Nature; function; persistence; measurement basis; measurement or outcome uncertainty; size; geographical location or regulatory environment; tax effects; initial recognition or subsequent change [IFRS 18.B78];
    Duration and recovery or settlement; liquidity; type; restrictions on use or transferability [IFRS 18.B110]
- **Meaningful labeling**
  - Should avoid "*other*" [IFRS 18.B26], "*unusual*" [IFRS 18.BC77], etc.

Aggregation and disaggregation

- **Likely benefits and costs** [IFRS 18 Effects Analysis]
  - Possible benefits
    - Provides investors with more detailed information about financial performance
    - Improves transparency about performance
    - Improves investors' ability to compare performance
      (i) between companies and (ii) between reporting periods for same company
  - Possible costs for companies
    - Implementation costs, e.g., adaptation of internal processes and systems
    - Ongoing preparatory costs for additional (possibly unimportant) information
    - Risk of judgments
  - Possible costs for investors (and other stakeholders)
    - Implementation costs, e.g., adjusting models to provided information
    - Ongoing costs of understanding and processing (too) detailed information

Aggregation and disaggregation
Theory papers (selection)

- **Formally, aggregation entails a loss of information**
  But: Costs of users understanding the information and bounded rationality
  - *Arya* and *Glover* (2014): Aggregation can be beneficial, e.g., improve decision-making because it may permit **offsetting of errors**, aggregation choice may be **informative** itself, **commitment** device in agency problems
  - *Dye* and *Sridhar* (2004): Aggregated reports can be strictly more efficient than disaggregated reports because aggregation **tempers manager's misreporting** incentives
  - *Amir* et al. (2014): Disaggregated accounting data can help to **detect and mitigate reporting manipulations**, particularly for items that are tightly interrelated by their economic nature and that differ in their sensitivity to reporting manipulations
  - *Kanodia* et al. (2004): **Real effects** of information differ when intangibles are disclosed separately from operating expenses than when they are commingled
  - *Ebert* et al. (2017): Aggregation can change the nature of **voluntary disclosure** to disclosing only unfavorable information
  - *Caskey* (2008): Investors' **ambiguity aversion** can lead them to prefer aggregate information even if there is a loss of informativeness
  - *Lu* (2022): Investors with **limited information-processing capacity** may prefer less detailed information to avoid information overload

Aggregation and disaggregation
Empirical papers (selection)

- **Archival research**
  - *Bowen* (1981), *Lipe* (1986): Generally, higher disaggregation supports decision usefulness, it **increases predictability** of the amount, the timing, and the uncertainty of future cash flows
  - *Ertimur* et al. (2003), *Jegadeesh* and *Livnat* (2006): Investors **react differently** to expense and revenue components in financial reports
  - *Chen* et al. (2015): Use level of disaggregation as **measure of disclosure quality** It is positively associated with analyst forecast accuracy and negatively associated with bid-ask spreads and cost of equity
  - *Bui* et al. (2023): Investors deem disaggregated information disclosed by **high-ability managers** as more credible, as measured by reduced stock price crash risk and lower cost of equity
  - *Holzman* et al. (2021): Benefits of disaggregation in terms of more efficient market response arise only from **disaggregating heterogeneous earnings** components. Disaggregation of homogeneous earning components can even increase investor disagreement
  - *Blankespoor* et al. (2020): Investors may prefer aggregate totals rather than disaggregated amounts because of high **information processing costs**
  - *Berger* et al. (2024): Disaggregation of cost of sales **reveals competitive information** to peers that negatively impacts profitability and reduces investments in process and cost innovations

Aggregation and disaggregation
Empirical papers (selection)

- **Experimental research**
  - *Hirst* et al. (2007): Income disaggregation **enhances credibility of forecasts**.
    With aggregated forecasts, credibility is a function of managers' incentives;
    with disaggregation, credibility is judged regardless of the manager's incentives
  - *Hewitt* (2009): Disaggregation of income statement items with differential persistence improves **accuracy of** analyst and investor **forecasts**
  - *Elliott* et al. (2011): Investors' **earnings fixation** is reduced when investors initially observe a disaggregated management forecast (earnings and its components) compared to when they initially observe an aggregated forecast
  - *Ragland* and *Reck* (2016): Disaggregating complex items helps reduce investors' **cognitive load** and helps overcome **limited attention** bias

Aggregation and disaggregation
Possible future research

- **Descriptive analyses: How do companies react to IFRS 18?**
  - Do they change their presentation and disclosures?
  - Which characteristics do companies apply to combine or segregate items?
  - Does the use of labels such as “other”, “unusual” etc decline?
    How do companies now label such items?
  - What are the smallest amounts that are presented or disclosed?
    Has the materiality threshold changed?
  - How are disaggregated disclosures tagged in XBRL?

- **Effects on capital market, investors and analysts**
  - How do investors react to more disaggregated disclosures?
    Are prices becoming more efficient, does cost of capital decrease?
  - Are companies’ disclosures more comparable?
  - Do analyst forecasts become more precise?
  - Are there real effects to the change in presentation and disclosure?
  - …

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Appendix 1:
KEY TOPICS AND STRUCTURE OF THE DEA

KEY TOPICS DISCUSSED IN THE DEA

Cover letter:

- Reminds the process of developing IFRS 18 and its main provisions highlighting the balance and consensus between interests of various stakeholder groups and some key aspects from appendix 2 and appendix 3

Appendix 1: ***Understanding the changes brought about by IFRS 18:***

- Provides background of the project and issues addressed
- Details the main requirements introduced by the Standard

Appendix 2: ***Technical assessment of IFRS 18 against the endorsement criteria:***

- Presents analysis of the Standard against technical endorsement criteria
- Addresses specific considerations raised during EFRAG outreach activities regarding:
  - ✓ classification of income and expenses from equity-accounted investments and scope of paragraph 18 of IAS 28
  - ✓ classification of interest expense from other liabilities in the financing category
  - ✓ MPM-related issues (scoping and rebuttable presumption, reconciliation requirements)
  - ✓ analysis of expenses by nature when presenting by function
  - ✓ concept of useful structured summary
  - ✓ other changes and transition

KEY TOPICS DISCUSSED IN THE DEA

Appendix 3 - *Assessment of European public good:*

Part 1 – Cost-benefits assessment:

- Detailed desktop analysis covering 45 entities, highlighting that:
  - ✓ implementation costs might be significant for some companies and will depend on current practices, systems, processes and business model
  - ✓ insurance companies have just undergone the implementation of IFRS 17 *Insurance Contracts* which was a significant effort and would need to reassess their reporting practices again
  - ✓ mitigation solutions offered by IASB to address the issues raised by the financial industry may result in additional costs and may not fully address the issue
  - ✓ on-going costs are expected to not be significant
  - ✓ benefits for users are expected to be significant and to have on-going effects

Part 2 – Effects on European economy:

- Comparison with US GAAP in order to assess potential effects on competitiveness
- Assessment of impacts on financial stability and economic growth

Appendix 2: IFRS ENDORSEMENT CRITERIA and KEY TOPICS CONSIDERED BY CRITERIA

IFRS ENDORSEMENT CRITERIA (reminder)

IFRS 18 was published in April 2024 and will be effective for annual reporting periods beginning on or after 1 January 2027, with earlier application being permitted, subject to the adoption in the EU.

Regulation (EC) No 1606/2002 (IAS Regulation) establishes the criteria for the IFRS Accounting Standards to be adopted in the EU.

Technical endorsement criteria

- Relevance
- Reliability including prudence
- Comparability
- Understandability
- True and Fair view

European public good criteria

- Potential effect on EU economy (financial stability, competitiveness)
- Potential effects on stakeholders
- Costs and benefits analysis

Other criteria

- No other criteria were requested by the EC

IFRS ENDORSEMENT CRITERIA (reminder)

- **Relevance** – information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations. Information is also relevant when it assists in evaluating the stewardship of management.

- **Reliability** – information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent, or could reasonably be expected to represent, and is complete within the bounds of materiality and cost. There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.

- **Comparability** - the notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.

IFRS ENDORSEMENT CRITERIA (reminder)

- **Understandability** - the notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting, and the willingness to study the information with reasonable diligence. Further, in assessing whether the information resulting from the application of a Standard is understandable, EFRAG considers whether that information will be unduly complex.

- **True and Fair view** – a Standard will not impede information from meeting the true and fair view principle when, on a stand-alone basis and in conjunction with other IFRS Standards, it:
  a) does not lead to unavoidable distortions or significant omissions in the representation of that entity's assets, liabilities, financial position and profit or loss; and
  b) includes all disclosures that are necessary to provide a complete and reliable depiction of an entity's assets, liabilities, financial position and profit or loss.

ENDORSEMENT CRITERIA ANALYSIS (reminder)

Categories and subtotals

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand ability	Cost/Benefit balance
Classification of income and expenses arising from equity-accounted investments	P	Reduced for Insurance sectors, issues for the Banking sector and some corporates. Many entities within these sectors consider such investments as part of the operating activity.	Reduced as classification driven by measurement method vs business model. Possibility to reconsider measuring at FV through PL for investment entities, however not all entities will be able to change to FV option based on the IAS 28 scope restrictions	Reduced especially for banks and insurance sectors – similar investments classified differently based on measurement method reducing comparability	Reduced especially for Banks and insurance sectors. The insurance industry claims that they might end up with a negative operating result (mismatch of presentation of insurance costs and related investment).	Additional cost associated with mitigating options (re-assessment of IAS 28, MPMs).
	U	Improved, Definition of operating avoids mix of gross and net result; Users are against sector-specific requirements, information which investments are related to the operating business can be provided in the notes or management report. Operating should only include results over which the entity has control. FVTPL measurement is considered relevant as it provides the FV information that the users are interested in	Improved: Providing picture of operating activities not “polluted” by post-tax results of companies that are not controlled. The classification as operating activities is judgemental and therefore "completeness" of operating would be questionable. Related information could be provided in addition (notes, management report).	Improved within the sector and cross-sectors by requiring similar presentation within the investing category; by, defining categories and sub-totals and not mixing pre-and post-tax result. Additional information can be provided to improve comparability for similar investments with different measurement method and to ensure comparability with peers.	Overall improved, Users are against sector-specific requirements despite understandable arguments from banks and insurance companies. As the treatment is defined for all entities the issue will be known and can be explained. Investors treat equity investments separately and differently from the parent entity as those are not controlled	Increased, is a benefit having defined homogeneous categories and sub-totals within and across industries

ENDORSEMENT CRITERIA ANALYSIS (reminder)
Categories and subtotals

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand ability	Cost/Benefit balance
Assessment of the entity's main business activities (conglomerates)	P	Mixed views. Assessment of the main business activity at the reporting entity level may differ from the assessment done at the sub-consolidation or a subsidiary level. Conglomerates see application challenges	No impact	Assessment is judgmental, however additional guidance included in IFRS 18 compared to IAS 1 is beneficial and is expected to improve the comparability. Complexity for conglomerates.	Mixed views. Articulation with IFRS 8 Segment reporting may be complex, especially when considering different reporting entity levels	Additional cost related to the assessment of the main business activity at each reporting entity level
	U	No major impacts compared to IAS 1 currently in place. Different activities are generally analysed separately by the users and are expected to be analysed separately under IFRS 18 anyway. Additional guidance and requirements included in IFRS 18 (roles of FS and notes, guidance on aggregation and disaggregation of information, concept of useful structured summary, requirements on MPMs) are seen as an improvement which would help with the analysis of conglomerates' financial statements	No impact	Assessment of the main business activity is judgmental, however additional guidance compared to IAS 1 is an improvement (useful structure summary, roles of FS and notes, aggregation and disaggregation etc.)	Improved when applying the concept of useful structured summary	Overall, enhanced guidance compared to IAS 1 should lead to increased benefits, albeit limited

ENDORSEMENT CRITERIA ANALYSIS (reminder)

Categories and subtotals

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand Ability	Cost/Benefit balance
Classification of interest expenses from other liabilities (not involving the raising of finance) in the financing category	P	Reduced, these interest expenses are often considered part of operating results of an entity (ex. lease liability, defined benefit liability).	No impact	Reduced. Some mentioned: when leasing is offered instead of remuneration for employees it should be treated similar to other renumeration	Reduced, these expenses are often considered part of operating results of an entity	Additional cost for Insurance Industry (IT systems aligned on IFRS 17 requirements)
	U	Improved, these expenses are considered financing by users (remuneration of the use of external capital, remuneration of time value of money). Less relevant for financial institutions *	No impact	Improved, similar treatment across sectors	Improved, these expenses are considered financing by users (remuneration for the use of external capital)	Improved benefits by providing clear and homogeneous structure of PL

* For financial institutions, classification of interest expenses on lease liabilities and pension liabilities outside of the operating result (contrary to interest expenses on all other financial liabilities which are classified in operating activities) is less relevant as it may not reflect banks' holistic management of interest rate risk which is part of their main business activity.

ENDORSEMENT CRITERIA ANALYSIS (reminder)
Management-defined Performance Measures

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand ability	Cost/Benefit balance
Scoping and rebuttable presumption	P	Mixed views, performance metrics were disclosed previously and are not expected to change as such	Improved, information will be audited	Improved, additional information will be provided allowing comparability	Mixed views, used with or without prominence is highly judgmental, only P&L related metrics are in scope,	Increased cost all industries. Additional cost for Financial and Insurance sector to rebut the presumption for metrics required by regulation and not considered MPMs by entity
	U	Improved, additional information will be provided, in a single note	Improved, information will be audited	Improved, additional information will be provided allowing comparability	Improved, additional information will be provided	Benefit for the users (all metrics in a single note, details of the calculation)
Reconciliation, including NCI and Income Tax effect	P	Mixed views, information was not requested by users in the past	Mixed views for tax: the information content is questionable due to the simplification for taxes; Overall -Improved, information will be audited		Mixed views, complex presentation may reduce understandability, most directly comparable subtotal posing practical challenges	Increased cost for all industries. Cost relief provided for tax effects but not NCI
	U	Improved, additional information will be provided, in a single note	Improved, information will be audited	Improved, additional information will be provided allowing comparability	Improved, additional information will be provided allowing comparability	Increased benefit - Reconciliation and effects on tax and NCI provide additional very important information for users

ENDORSEMENT CRITERIA ANALYSIS (reminder)
Grouping of information

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand ability	Cost/Benefit balance
Analysis of expenses by nature when presenting by function for: *1. depreciation 2. amortisation 3. employee benefits 4. impairment losses and reversals 5. write downs and their reversals of inventory*	P	Questionable – presentation by function is well established internationally – why the need for additional information? Reduced for Insurance industry*	Reduced due to the estimation involved (possibility to provide the total amount of cost and not only expense amount which was accounted for in PL (i.e. including capitalised cost))	Questionable due to the possibility to estimate and due to issues with the systems (nature of costs might change over different levels within the entity). Consolidation processes established normally only for by function.	Questionable es	Increased cost for all industries presenting by function or having mixed presentation. Additional cost for the Insurance sector* and Banking sector **
	U	Improved – deemed helpful for cash flow projections. Defined five expense line items selected for the analysis are deemed the most relevant for users to allow better analysis of the financial statements (acceptable compromise); regret that cost of sales were not defined	Overall improved even if total cost may be presented (including expense amount accounted for in PL and capitalised amount accounted for in BS)	Improved, allowing better comparability between the entities for the line items disclosed considering the existing diversity in practice highlighted by users.	Overall improved, but potential challenges in reconciling cost amounts disclosed in the notes to the expense amounts presented in the P&L amounts were noted.	Improved, transparency of the information is enhanced (acceptable compromise) Appreciated to provide information even for mixed presentation

* Insurance industry argument that IFRS 17 requirements do not leave a choice to present by nature as majority of the P&L line items are defined by IFRS 17 (i.e. insurance service cost etc). Another concern was raised on the split between expenses attributable to the insurance expense vs non-attributable – such a split would be complex, costly and many entities do the split based on the allocation key, therefore subject to the estimation.

** Banking sector needs to provide additional reconciliations in order to comply with the regulatory requirements (ex. presentation of the PL based on the country-imposed or regulator-imposed template) and would have additional costs as those reconciliations / disclosures would need to be adjusted to align with IFRS 18 new PL presentation and notes.

ENDORSEMENT CRITERIA ANALYSIS (reminder)
Grouping of information

EFRAG

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand ability	Cost/Benefit balance
Aggregation and disaggregation principle and concept of "useful structured summary"	P	Improved, additional subtotals are allowed to meet the objectives of the financial statements and allowing an entity to present its PL using the structure which best reflects its activity (notwithstanding defined categories and subtotals)	Question was raised whether it allows to condense information	Overall improved, however the structure (notwithstanding defined subtotals) can vary	Expected to be improved as entity is able to present its PL using the structure which best reflects its activity (as long as required categories and defined subtotals are presented)	Helpful to bring the right focus into the financial reporting. Appreciated clarification there is no need to present defined line items within the PL when not material or deemed not relevant for an entity
	U	Overall considered helpful to focus on the important information, however certain concerns on the possibility to have very condensed presentation on the face of PL, which is expected to be compensated by additional disclosures within the notes. Request to include in the endorsement advice a request to re-assess the concept during the upcoming PIR.	Overall improved, concerns on the possibility to have very condensed presentation should be mitigated by aggregation / disaggregation guidance and additional disclosures in the notes.	No significant impact compared to IAS 1 noted	Expected to be improved overall considering guidance on roles of the FS and notes, aggregation and disaggregation.	Expected to be improved as entities would present more useful information by applying enhanced guidance to determine where and how to present and disclose information in the FS and the level of detail required. Some expressed concerns on the possibility that the concept might be used to justify a very condensed presentation

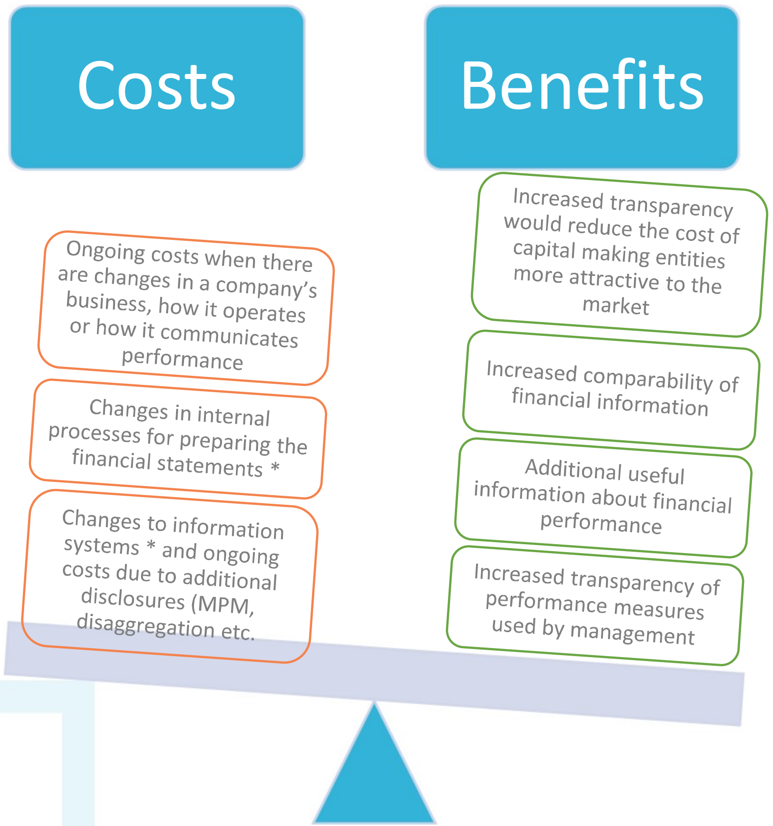
ENDORSEMENT CRITERIA ANALYSIS (reminder)
Other changes & transition

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand ability	Cost/Benefit balance
Restatement of any comparative period	**P**	Improved in regard to the quality of information provided and considering impacts on the audit opinion		Improved	Improved in regard to the quality of information provided, homogeneous information for all periods presented	Increased cost for any additional comparative period presented
	U	Improved in regard to the quality of information provided		Improved comparability with previous periods (only way to analyse developments)	Improved as it provides homogeneous information for all periods presented under IFRS 18	Improved benefits by having comparative periods restated
FV option under IAS 28.18 – different interpretation of IAS 28.18 and increased volatility in the P&L	**P**	Mixed views, diversity in practice noted, limited applicability of FV option for Financial and Insurance companies		Mixed views, diversity in practice, assessment is driven by the criteria in IAS 28.18 instead of driven by the assessment of the business model		Increased costs associated with the re-assessment of applicability of IAS 28 or fair value measurement
	U	General support for the option provided as users usually estimate the FV of those investments separately. Increased volatility in the P&L is not a relevant factor to prevent specific classification requirements		No significant impact specific to the issue. Comments addressed in section dedicated to equity accounted for investments	No significant impact specific to the issue. Comments addressed in section dedicated to equity accounted for investments	

ENDORSEMENT CRITERIA ANALYSIS (reminder)
Other changes & transition

Users (U) and Preparers (P) views		Relevance	Reliability	Comparability	Understand ability	Cost/Benefit balance
Limited changes to cash flow statement	P			Improved, reducing diversity in practice (by limiting accounting policy choice)	Mixed views, risk of misleading related to the same labelling of categories in the statement of CF and PL	May induce costs related to changes necessary in the IT systems
	U			Improved, reducing diversity in practice (by limiting accounting policy choice)	Mixed views, risk of misleading related to the same labelling of categories in the statement of CF and PL	Overall improved, although some additional aspects should be reconsidered by the IASB in the future

PRELIMINARY COST-BENEFIT ANALYSIS OF IFRS 18 REQUIREMENTS
(reminder)



* Banking and insurance sector – reconciliation to regulators-imposed structure as extra cost

COST MITIGATIONS IN IFRS 18

- **Reliefs for undue cost** or effort for classification in the statement of profit or loss of:
  - gains or losses on derivatives not designated as hedging instruments applying IFRS 9 *Financial Instruments*; and
  - foreign exchange differences.
- **Accounting policy choice** for companies that provide financing to customers as a main business activity
- **Equity-accounted investments**
  - introduction of a specified subtotal "operating profit or loss and all income and expenses from investments accounted for using the equity method", which is not MPM
  - option to change measurement method at transition by applying IAS 28.18.
- **Disclosure of operating expenses by nature**
  - limiting the requirement to disclose specified expenses by nature to five
  - amounts disclosed for nature expenses may be the cost incurred for the period
- MPMs – Scoping → **Rebuttable presumption** in the definition of MPMs
- MPMs – reconciliation → **Simplified approach** to calculating income tax effects for each reconciling item disclosed in MPM reconciliations