
IFRS 18: Advancing the Relevance and Utility of Financial Statements for Stakeholders

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Abstract:

Purpose: The main objective of the article is to present the main changes in the presentation of financial statements resulting from IFRS 18 that will affect financial reporting for periods beginning from 2027. The changes in the structure and content of financial statements are considered from the perspective of the needs of potential investors as well as other stakeholders.

Design/Methodology/Approach: The main research method involved in this paper is desk research (scientific literature, reports, accounting standards, financial reports). The author also used deductive method analysing the content of accounting standards and supporting materials. Reasoning was conducted using inductive and deductive method.

Findings: The paper shows that changes in the structure of IFRS's financial statements are focused on the increasing value for investors and that they improve financial performance reporting. IFRS 18 has introduced an obligation to disclose more subtotals in the income statement as well as information about management-defined performance measures. On the other hand it has not defined any of popular non-GAAP measures. In the opinion of the author this accounting standard may still have a positive impact on transparency of financial statements reducing additional disclosures alongside with the presumed improvement in the quality of the financial result presented in the income statement.

Practical Implications: The considerations may constitute an impact for the preparers of financial statements under IFRS to improve the informative value of the financial statements. The presentations of the main solutions resulting from IFRS 18 (as compared to IAS 1) may be of great importance as it allows readers from EU countries to familiarize themselves with these changes before they are officially published as Official Journal (after the changes are adopted by European Commission).

Originality/Value: The paper presents the main changes introduced by IFRS 18 that should enhance the information value of financial statements. There is still more than two years before this IFRS comes into force, but familiarisation of preparers of financial statements with its requirements might be helpful. It always take time to prepare to new regulations.

Keywords: Financial statements, financial reporting, usefulness, accounting standards, non-GAAP measures.

JEL codes: M40, M41, M48.

Paper type: Research paper.

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1. Introduction

The objective of financial statements is to provide financial information about companies to different stakeholders. The information should be useful for them in making decisions about e.g., buying and selling or holding equity, providing loans etc., (IFRS Foundation, 2018). One might say that financial statement is the primary means of communication with stakeholders. That is why a structure and content of financial statements are an important focus of accounting regulations.

In the light of International Financial Reporting Standards the rules of preparing and presenting financial statements are covered by IAS 1 *Presentation of Financial Statements* (IFRS Foundation, 2024a) that was first issued in 1997 (it replaced IAS 1 *Disclosure of Accounting Policies*). Since then IAS 1 has been amended many times to take account of changing user expectations and the changing economic environment in which companies operate.

Although there were quite significant amendments of IAS 1 in 2007, 2011 and 2014, IASB did not reconsider many matters. The research project *Primary Financial Statements* was added to research agenda in 2014 instead (IFRS Foundation, 2018). The project was devoted to changes in IAS 1 and IAS 7 *Statement of Cash Flows* and finally a new accounting standard IFRS 18 *Presentation and Disclosure in Financial Statements* (IFRS Foundation, 2024b) was issued in April 2024.

This accounting standard should be applied by companies reporting under IFRS for reporting periods beginning on or after 1 January 2027. The aim of this paper is to present the most significant changes in financial reporting resulting from IFRS 18 as compared with IAS 1 and to consider the impact of these changes on the usefulness of the financial statements. The main changes of IAS 1 (especially those improving informative value of financial statements) and summary of other proposed amendments have been also presented.

2. Literature Review

Investors seems to constitute the most significant users of financial statements. It is their decisions that affect the level of capital provided to companies. Investors generally make their decisions on the basis of opinions formulated by a wide range of analysts. Financial analysts are aware of the differences between accrual accounting and cash flows generated by companies (Liapis and Thalassinou, 2013).

For this reason, it is not only the results presented directly in the financial statements that are of interest to investors, but also other measures of performance, among which EBIT (Earnings Before Interests and Taxes) and EBITDA (Earnings Before Interests, Taxes, Depreciation and Amortization) are of particular importance. Non-GAAP measures seems to be very useful for financial analysts even as an indicator

of accounting quality (CFA, 2016) and there are research papers that shows non-GAAP earnings more informative than GAAP earnings (Marques, 2017).

The most popular non-GAAP measures are EBITDA, free cash flow, adjusted EBITDA, net debt, adjusted EPS and EBIT (CFA, 2016).

IFRS does not prohibit companies from presenting additional measures (non-GAAP measures) outside financial statements. PriceWaterhouseCoopers published the results of their review of financial statements of companies across Europe (PwC, 2006) in the first year of required IFRS reporting in European Union (IFRS reporting is required when preparing consolidated financial statements by companies listed on regulated market).

The survey revealed that companies voluntarily present non-GAAP income measures such as EBITDA (and similar) – 44% in the sample of 1300 companies, profit excluding non-recurring items – 34% in the sample of 1300 companies and 26% in the sample of 250 companies and operating profit/EBIT – 96% in the sample of 250 companies, although there were differences among different countries (PwC, 2006).

They investigated also different terms used by companies for income measures excluding non-recurring items. The survey revealed that there were rather territory than pan-European trends (as far as the Netherlands and Belgium is considered no companies reported such measures as a separate line in income statement, while in Spain and Denmark around 10% of companies presented such a separate line).

There were also different terms used by companies for these measures, the most common: results excluding exceptional items, results before non-recurring items, current operating income and underlying profit.

Non-GAAP measures seems to solve information constraints resulting from accrual accounting (which is the basis for GAAP measures). Many various authors conducted the critical analysis of accrual financial measures analysed from the perspective of monetary measures (Wilson, 1986; Ciesielski, 1999; MacDonald, 1999; Cal and Jefferson, 2004; Trigkas *et al.*, 2019; Balios *et al.*, 2021).

The EBITDA measure, which is a kind of synonym for operating cash flow, i.e. the cash flow generated by a company's core activities, is considered to be particularly useful (Pratt, Reilly, and Schweis, 1998; King, 2001; Grant and Parker 2002; Brockman and Russell, 2012) although there also its limitations noticed by other authors (Ciesielski, 2016; Trainer and Guske, 2015).

There is currently no single generally accepted methodology for calculating this measure, although usually EBIT is the basis for its calculation. EBIT is also not yet explicitly defined, but is most often equated with operating profit. For example,

under Polish accounting regulations, operating profit is an obligatory reported subtotal in the income statement. IAS 1, on the other hand, does not indicate such 'partial' results of operations.

Moreover, IAS 1 does not make a clear distinction between core and non-core activities (that results in operating and non-operating earnings), which poses a significant problem and makes it difficult to compare the performance of different companies, which may adopt different approaches to the presentation of results relating to results being thought of as having lower persistence than other components of company's earnings and other transactions (usually referred to as special items).

This is why according to some authors special items seems to be the factor that decrease the quality of earnings (Donelson, Jennings, and McInnis, 2011).

The choice of how to present special items (as a separate line item on the income statement or aggregated within another line item) had been widely discussed by Riedl and Srinivasan (2006), who investigated if manager discretion regarding presentation within financial statements reflects the companies' underlying economic performance or opportunistic motivations.

Finally, their findings suggest that manager discretion in the presentation of special items primary reflects economic motivations (Riedl, Srinivasan, 2006). Previous studies conducted by other authors revealed also that presenting operating earnings, non-operating earnings and other special items improves forecasts, what might be important for investors as it could improve the predictive value of financial statements (Fairfield, Sweeney, and Yohn, 1996).

The changes in the structure and content of financial statements had been discussed for many years. IASB ((International Accounting Standards Board) has carried out a number of projects to improve the information presented in the financial statements. IAS 1 (as published in 2007) is the effect of the first stage of common project of IASB and FASB (Financial Accounting Standards Board – organization that prepares and issues accounting standards for listed companies in USA).

The project resulted in improvements of IAS 1 issued in 2007 when new element of financial statement was introduced – the statement of comprehensive income (that comprises of information provided earlier by "old" income statement (profit and loss account) and information concerning revenues and costs that are presented as the changes of equity).

This project as well as the issues concerning the change in the form of financial statements' presentation are the subject of research and interest of many authors, as for example: Walińska (2009) - with regard to the change in the presentation of the balance sheet, Gierusz (2007, 2010) - who proposed a new format for the income

statement. Finally, this project was postponed in 2010 after publishing staff drafts of further changes (IASB, 2008a; IASB, 2008b; IASB, 2010a; IASB, 2010b).

But standard setters have been aware of the importance of non-GAAP metrics for investors (Rapoport, 2016; Golden, 2017; Black, Christensen, Ciesielski and Whipple, 2018). The need for further changes in the structure and content of the financial statement seemed to be obvious.

The new research project *Primary Financial Statements* was added to research agenda of IASB in 2014 (IFRS Foundation, 2018). The project was devoted to changes in IAS 1 and IAS 7 *Statement of Cash Flows* and finally a new accounting standard IFRS 18 *Presentation and Disclosure in Financial Statements* (IFRS Foundation, 2024b) was issued in April 2024.

Before the new standard had been issued, the proposals resulting from agenda papers on *Primary Financial Statements* and exposure drafts, was the point of interest of many authors who also published their opinions on proposed amendments as well as their own proposals (Elkins, Entwistle, 2018; Hellman, Carenys, Gutierrez, 2018; Baksas, Stenheim, 2019).

3. Research Methodology

The main research method involved in this paper is desk research (scientific literature, reports, accounting standards, financial reports). The author also used deductive method analysing the content of accounting standards and supporting materials. Reasoning was conducted using inductive and deductive reasoning.

4. Rules of Financial Statements' Presentation Under International Financial Reporting Standards

4.1 IAS 1 and Projects of Its Improvements

The choice of primary users of financial statements and the dispute over priority in financial reporting is ongoing and unresolved (Śnieżek, 2024). Some of the most significant users of financial statements are capital providers. Within capital providers, one can distinguish between individual and institutional investors as well as banks.

Investors, unlike financial institutions, do not usually have the opportunity to obtain detailed information on the asset and financial situation of the entity whose shares they intend to buy (or sell). They must therefore rely on the information presented in the financial statements.

IAS 1 (IFRS Foundation, 2024a) is the basis for presentation of general purpose financial statements (statements useful to a wide range of users in making economic

decisions). In details, financial statements provide information is to provide information about the financial position, financial performance and cash flows. A complete set of financial statements consists of a statement of financial position, a statement of profit or loss and other comprehensive income, a statement of changes in equity, a statement of cash flows, notes including material information about accounting policy and other explanatory information. As information concerning cash flows seems to be of great importance to different stakeholders there is a separate accounting standard IAS 7 *Statement of Cash Flows* (IFRS Foundation, 2024d).

Despite International Financial Reporting Standards regulates the measurement and recognition of many accounting items in great details, they fail to describe the structure and content of financial statements in similar details. Moreover, investors and financial analysts seems to be interested in other metrics than only those obligatory disclosed in financial statements. The accounting standard setters are aware of the expectations of financial statements' users and there is almost an ongoing process of improvements to requirements for presentation of financial statements.

Amendments of IAS 1 that has been issued since 2007 resulted in a moderate improvement of usefulness of financial statements but still there were no additional metrics introduced. Moreover, there are not many items that should be presented as separate line items in the profit and loss section or the statement of profit or loss apart from those resulting from IFRS 9 *Financial Instruments* and IFRS 17 *Insurance Contracts*. One could have hoped in 2008 that the common project of IASB and FASB would result in more informative, more comparable and standardized set of financial statements.

According to this project the objectives of the financial statements should be: to provide a consistent financial picture of the entity's activities, to provide disaggregated information in a manner that is useful for forecasting future cash flows, and to assist users of the report in assessing the entity's liquidity and financial flexibility. To ensure consistency, it had been proposed that entities should classify revenue, expenses and cash flows into the same sections and categories of the individual components of the financial statements as the related assets and liabilities are classified into.

Within these sections, the following were highlighted: business section, financing section, income taxes and discontinued operations. Unfortunately, on June 24 2010, IASB and FASB effectively discontinued this project, deciding to engage in additional outreach activities before finishing and publishing an exposure draft (there were published only staff draft on 1 July 2010 to seek informal comment) (IAS Plus, 2024).

4.2 IFRS 18 – The Process of Its Development and the Most Important Changes as Compared to IAS 1

The new research project *Primary Financial Statements* was added to research agenda of IASB in 2014. Actually, the title of the project was changed to *Primary Financial Statement* in 2015 (firstly it was *Performance reporting*) and respondents identified this project as priority and recommended focusing on the statements of financial performance (IFRS Foundation, 2015a; IFRS Foundation, 2015b).

The scope of the project (that here will be targeted improvements mainly to the presentation of financial performance) was agreed in December 2016 (IFRS Foundation, 2016). Exposure Draft *General Presentation and Disclosures* was published in December 2019 (IFRS Foundation, 2019). Most respondents to the Exposure Draft agreed with the proposals, although they suggested to include more non-GAAP measures. Finally, a new accounting standard devoted to presentation of financial statements IFRS 18 *Presentation and Disclosure in Financial Statements* was issued in April 2024.

IFRS 18 will be used for reporting periods beginning from 1 January 2027. The changes in IFRS 18 as compared to IAS 1 are focused mainly on the statement of profit or loss, as the IASB noticed strong demand for improvements to financial performance reporting. This finding is in line with results of many past surveys that showed that the income statement is the most influential of the financial statements (EFRAG, 2013) and operating income and other income-based metrics are considered very useful (EFRAG, 2009).

In details there was identified a need for improvements in relation to: subtotals in the statement of profit and loss, aggregation and disaggregation and management-defined performance measures (non-GAAP measures) That is why it has not introduced any changes to statement presenting comprehensive income and statement of changes in equity, and there are only limited changes to specific requirements for statement of cash flows and statement of financial position.

The main changes introduced by IFRS 18 are as follows:

- two new defined subtotals were added to statement of profit or loss: operating profit or loss, profit or loss before financing and income taxes;
- income and expenses in the statement of profit or loss should be classified in one of five categories: operating, investing, financing, income taxes, discontinued operations.

Operating profit or loss comprises all income and expenses classified in the operating category, while profit or loss before financing and income taxes is the sum of (a) operating profit or loss and (b) all income and expenses classified in the investing category. It must be highlighted that this new subtotal is not described as

EBIT (they say EBIT is not the best way to compare companies with varied financing structures and such description could be misleading) but according to the opinion of the IASB these subtotals would increase comparability between companies (IFRS Foundation, 2024c).

Operating category has not been defined directly. Requirements of classification of income and expense to other categories make it possible to say, that income and expenses from the main business activity of a company are classified as operating (excluding any income and expenses from investments accounted for using the equity method). In addition, operating category includes all income and expenses that are not classified by an entity in the other categories including such income or expenses that are volatile or non-recurring.

IFRS 18 introduced an obligation to disclose in the notes to the statement of profit or loss information about all measures that are management-defined performance measures. First, IFRS 18 defines management-defined performance measure as a subtotal of income and expenses that: (a) an entity uses in public communications outside financial statements, (b) an entity uses to communicate to users of financial statements management's view of an aspect of the financial performance of the entity as a whole, and (c) is not listed in IFRS 18, or is not specifically required to be presented or disclosed by another standard.

There must be explained what aspect of financial performance is communicated by each measure, how each measure is calculated and there shall be disclosed a reconciliation between the management-defined performance measure and the most directly comparable subtotal.

Moreover, entity is obliged to disclose information that management-defined performance measures are not necessarily comparable with measures sharing similar labels or descriptions provided by other entities.

Referring to management-defined performance measure it must be highlighted that they can be only such measures that are subtotals of income and expenses. That is why any financial ratio can not be considered as management-defined performance measure (an entity may use financial ratios in public communication but such disclosures are outside the scope of IFRS 18).

There is also stated what types of communications outside financial statements may be considered as public communication for the purposes of IFRS 18 and particularly management-defined performance measure. Public communications include management commentary, press releases and investor presentations.

On the other hand, public communications exclude oral communications, written transcripts of oral communications and social media posts.

5. Conclusions

The rules for presenting financial statements under International Financial Reporting Standard have been evolving for many years. They are focused on the increasing of usefulness of financial statements for its users. IFRS 18 can be considered as another step in this direction although there is probably still far from expectations of financial analysts. On the other hand, financial analysts are not the only category of stakeholders.

Standards setters are aware of the fact the different non-GAAP measures cannot be defined precisely and it is probably not possible to make them comparable among different companies. That is why IFRS 18 has not introduced for example EBIT or EBITDA as obligatory subtotals in the statement of profit or loss.

Unfortunately, there has not been paid much attention to the aspect of special items (non-recurring items) and still many disclosures are subject to the subjective assessment of the management (they have to use judgement to determine whether to present line items or disclose items in the notes).

There is still a need for future changes as IFRS 18 has not introduced changes in other elements of a financial statement. The distinction of individual categories of income and expenses is in line with the concept of the previous IASB/FASB project, but these categories have not been incorporated into the statement of financial position. One can hope that IFRS 18 is not the end of changes in the structure and content of financial statements.

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