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Sunčica Milutinović
Faculty of Economics in Subotica
University of Novi Sad
Subotica, Republic of Serbia

suncica.milutinovic@ef.uns.ac.rs
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NEW CATEGORIZATION OF INCOME AND EXPENSES IN THE STATEMENT OF PROFIT OR LOSS

Abstract: Investors and other users of information from financial statements demand relevance, credibility and transparency in the presentation of entity's financial statements. They are also interested in greater comparability between financial statements, both between different entities, and between financial statements of an entity from several different periods. Their requirements are recognized in the new International Financial Reporting Standard 18 - Presentation and disclosure in financial statements. The aim of the paper is to familiarize with the new approach in the presentation of the statement of profit or loss that will result after the application of the newly adopted standard starting in 2027. With the entry into force of IFRS 18, there should be an improvement in the structure of the statement of profit or loss, and improvement of the comparability of information on the entity's financial performance. The standard will also introduce new specific requirements for disclosure of management-defined performance measures, and criteria with detailed instructions for (dis)aggregation of financial statements' items. The application of the new provisions from IFRS 18 will enable entities to make their financial statements a truer picture of their operations and financial performance. In this way it will be responded to investors' demand for better information about entities' financial performance. The paper is primarily intended for theoreticians and practitioners in the field of accounting and auditing, regulatory bodies, investors, as well as for all interested parties who use information from financial statements when making business decisions.

Keywords: IFRS 18, IAS 1, financial performance, operating, financing, investing

1. INTRODUCTION

The International Accounting Standards Board (hereinafter: IASB) completed its work on improving the usefulness of information presented and published in financial statements on April 9, 2024. The result is the new standard IFRS 18 - Presentation and Disclosure in Financial Statements (hereinafter: IFRS 18) announced as the most significant change in the presentation of financial performance in the last 20 years and requires all entities applying IFRS to review the overall structure of the statement of profit or loss. The objective of IFRS 18 is to set requirements for the presentation and disclosure of information in general purpose financial statements to ensure that they provide relevant information that fairly represents the entity's assets, liabilities, equity, income and expenses (IFRS, 2024a, 1).

IFRS 18 will be effective for annual reporting periods beginning on or after 1 January 2027. Earlier application is permitted and must be disclosed in the notes to the financial statements. When it enters into force, it will replace the currently valid IAS 1 - Presentation of financial statements (hereinafter: IAS 1). Some of the requirements from IAS 1 will be moved to IAS 8 - Accounting Policies, Changes in Accounting Estimates and Errors and to IFRS 7 - Financial Instruments: Disclosures. In order for IAS 8 to reflect the expanded content, the IASB will change its name to Basis of Preparation of Financial Statements when IFRS 18 becomes effective. Therefore, with the entry into force of the completely new IFRS 18, the amended IAS 8 with a new name will also enter into force. IFRS 18 will be applied retrospectively to comparative periods by applying the amended IAS 8. Entities will be required to restate comparative period information and disclosure reconciliations for each item shown in the statement of profit or loss for comparative periods immediately preceding the current and cumulative current periods.

The aim of the paper is to introduce the new categorization of income and expenses in the statement of profit or loss that will be introduced upon the start of the application of the newly adopted standard. The paper explains the improvements in the reporting of entities on financial performance and the improvements in the structure of the statement of profit or loss that are expected by all entities in IFRS jurisdictions all over the world starting from 2027.

2. IMPROVEMENTS IN ENTITY'S REPORTING ON FINANCIAL PERFORMANCE UNDER IFRS 18

At first glance, the new standard may seem simple, setting a new requirement for the presentation of the statement of profit or loss and providing new definitions and disclosures regarding management-defined performance measures that have so far been outside the IFRS realm. However, the details of these new requirements may lead to potential challenges that entities will need to address to properly implement the new standard and ensure a smooth transition. Entities should start preparing for the introduction of IFRS 18 well before 2027. Entities should start preparing for the introduction of IFRS 18 well before 2027. Potentially sweeping changes compared to the current IAS 1 can have a significant impact on an entity's financial statements, so preparation for the application of IFRS 18 is already considered a priority in over 100 IFRS jurisdictions worldwide. The newly adopted IFRS 18 includes very detailed technical content with almost 600 pages of text, taking into account the official materials of the IASB (Meirelles Salotii, 2024, 429).

The successful introduction of IFRS 18, as with any other new IFRS, will entail significant challenges and will lead to an increase in the entity's costs in terms of software adaptation, development of new tools, changes in key performance indicators, updating of internal procedures and information systems, as well as expenditure on training and education of employees (Milutinović, 2025, 310). However, the improvement in the quality of financial statements and other long-term benefits of applying IFRS 18 should outweigh the initial implementation costs, according to the cost constraint (IASB, 2018, 2.39-2.43) for useful financial reporting (in the other words, the benefit of providing financial information should outweigh the cost of gathering and reporting that information).

The auditing company KPMG (KPMG, 2024, 3) categorizes the changes in the new standard as a form of reshaping of the presentation of financial statements, highlighting three key requirements:

1. Changes in the structure of the statement of profit or loss: a more detailed statement (without changes in the result) that includes new categories and subtotals.
2. Management-defined performance measures are part of the audited financial statements. This will increase the credibility of some key performance indicators.
3. Improvement of requirements for information aggregation, i.e. greater disaggregation of information.

IFRS 18 by introducing three new requirements to improve entity's reporting on financial performance provides investors, primary and other users of general purpose financial statements a better basis for analyzing and comparing entities. IFRS 18 will not impact the recognition or measurement of items in the financial statements; or which items are presented in other comprehensive income or how (PWC, 2024).

Before going into the details of each of the aforementioned requirements introduced by IFRS 18, a summary of the key differences between IAS 1 and IFRS 18 will be presented in Table 1. For a comprehensive understanding of the new IFRS 18 and its implications for financial reporting, the best starting point is a comparison with the standard that will be valid until the entry into force of IFRS 18.

Table 1: Key differences between the old and new standard

Differences	IAS 1	IFRS 18
Content of the statement of profit or loss	Flexible, entities (or the legislator) can define the statement of profit or loss form themselves.	A more detailed statement of profit or loss, without changes in the result, which includes new categories (operating, financing, and investing) and mandatory subtotals.

Subtotals in the statement of profit or loss	There are no mandatory subtotals.	Two new mandatory subtotals: "operating profit or loss" and "profit or loss before financing and income taxes".
Cost overview	A function (e.g. cost of goods sold, overhead) or the nature of the cost (e.g. depreciation, earnings) could be used.	Encourages clearer classification using mandatory categories. Introduce guidance and disclosures relating to presentation of operating expenses by nature, by function or both.
Management-defined performance measures	N/A	They should be disclosed in the notes separately and with explanations. This will increase the credibility of some key performance indicators and their transparency. As they are part of the mandatory disclosures, they will be subject to audit.
Classification of interest and dividends	They can be variously classified into operating, financing or investing.	Standardized: interest expense is financing, interest income is investing.
Aggregation and disaggregation	Flexible, leads to inconsistent financial reporting.	Enhanced requirements on aggregation and disaggregation to avoid over-generalization or unnecessary detail. Primary financial statements - greater aggregation, notes - greater disaggregation of information.
Flexibility	Different formats/forms are allowed which reduces comparability.	A strict format/form ensures better comparability between entities.

Source: By author and partially modified from BD Chatterjee (2025)

Currently, there is no exact structure of the statement of profit or loss. Entities choose their own subtotals to include in this statement. They often report operating profit or loss, but the way they calculate operating profit or loss varies from entity to entity, thus reducing comparability. One IASB study of 100 entities found that over 60 reported the amount of operating profit, using at least nine different ways to calculate it (IFRS, 2024b). IFRS 18 introduces three new defined categories for income and expenses - operating, financing, and investing - to improve the structure of the statement of profit or loss and requires all entities to provide new defined subtotals, including operating profit. The improved structure and new subtotals will give investors, primary and other users of general purpose financial statements a consistent baseline for analyzing entity's financial performance and facilitate comparisons across entities (Milutinović, 2025, 312).

All items of income and expenses in the reporting period must be included in the statement of profit or loss. They should then be classified into one of five categories in the statement of profit or loss (IASB, 2024, 47):

1. Operating category,
2. Investing category,
3. Financing category,
4. Income tax category, and
5. Discontinued operations category.

The classification of items into these categories can differ depending on the main business activity of the entity (PWC, 2024).

3. IMPROVEMENTS IN THE STRUCTURE OF THE STATEMENT OF PROFIT OR LOSS

An illustration of the new statement of profit or loss structure is shown in Table 2. The first three categories are completely new. In order to eliminate potential misconceptions at the outset, it is important to point out that these new categories are not aligned with the categories from a statement of cash flows. The above categories are complemented by the requirement to present subtotals and totals for the following three categories: "operating profit or loss," "profit or loss before financing and income taxes" and "profit or loss" (Chan, 2024). All entities are required to follow the same classification requirements for the new classification of income and expenses, with some modifications for entities that invest in assets as a main business activity (such as investment entities, investment property entities and insurers) and entities that provide financing for customers as a main business activity (such as banks) (Deloitte, 2024).

Table 2: Categories in the new statement of profit or loss structure

	Categories	Statement of profit or loss structure of entities whose main business activity is not property investment or customers financing	
New categories	Operating	Income	X
		Operating expenses (analyzed by nature, function or both as appropriate)	(X)
	New required subtotal	Operating profit or loss	X
	Investing	Share of profit or loss of equity-accounted investees	X
		Income from other investments	X
		Interest income from cash and cash equivalents	X
	New required subtotal	Profit or loss before financing and income tax	X
	Financing	Interest expense on borrowings and lease liabilities	(X)
		Interest expense on pension liabilities	(X)
		Profit or loss before income taxes	X
	Income taxes	Income taxes expense	(X)
		Profit or loss from continuing operations	X
	Discontinued operations	Profit or loss from discontinued operations	X
		Profit or loss	X

Source: Adapted from KPMG (2024, 8)

The operating category includes all income and expenses included in the statement of profit or loss that are not classified in the investing, financing, income taxes or discontinued operations categories. In other words, the operating category is the default category that includes, but is not limited to, income and expenses from the main business activities of the entity. Income and expenses from other business activities, such as income and expenses from additional activities, are also classified in the operating category if those incomes and expenses do not meet the requirements for classification in one of the other categories. Some entities might decide that classifying some expenses by nature and other expenses by function provides the most useful structured summary of their expenses. IFRS 18 requires companies that present expenses classified by function to disclose the amount of depreciation, amortization, employee benefits, impairment losses and write-downs of inventories included in each line item in the operating category of the statement of profit or loss. This information is disclosed in the notes and provides investors with additional information about operating expenses to help them forecast future cash flows in changing economic conditions (IFRS, 2024c, 13).

The investing category includes income and expenses from:

- Investments in associated entities, unconsolidated subsidiaries and joint ventures;
- Cash and cash equivalents;
- Other assets that individually generate a return and mostly independent of other (other) resources of the entity.

Income and expenses classified in the investing category include income and expenses arising from the initial and subsequent measurement of assets, including assets derecognition, as well as additional costs that can be directly attributed to the acquisition and disposal of assets (such as transaction costs and cost of goods sold). Examples of income and expenses that are required to be classified in the investing category are:

- The share of profit of asociates and joint ventures accounted for using equity method;
- Interest income from debt investments;
- Dividends from equity investmets;
- Rental income and fair value gains or losses from investments properties.

The financing category includes income and expenses from liabilities arising from transactions involving the raising of finance, whether or not those transactions involve only the raising of finance. Liabilities arising from transactions involving only raising of finance include debt instruments settled in cash and bonds that will be settled through the transfer of the entity's own shares (so-called convertible bonds). Liabilities arising from transactions that do not involve only the raising of finance include obligations for goods or services and liabilities under leases (Milutinović, 2025, 314). Examples of income and expenses that are required to be classified in the financing category are:

- Income and expenses resulting from the initial and subsequent measurement of liabilities, including liabilities derecognition;
- Additional costs directly attributable to the occurrence and settlement of obligations, such as transaction costs.

The income taxes category comprises tax expense or tax income included in profit or loss applying IAS 12 - Income Taxes and any related foreign exchange differences. *The discontinued operations category* comprises income and expenses from discontinued operations as defined in IFRS 5 - Non-current Assets Held for Sale and Discontinued Operations (Deloitte, 2024). Data on this category allow users insight into income and expenses that will not be present in future business activities (Stojanović, 2024, 44).

In the changed structure of the statement of profit or loss, apart from the three new categories into which it is necessary to classify income and expenses, there are also two new required subtotals also shown in Table 2. These subtotals are "operating profit or loss" and "profit or loss before financing and income taxes". *Operating profit or loss* is the subtotal calculated as the difference between all income and expenses classified in the operating category. It is important to note that this subtotal includes, but is not limited to, income and expenses from the entity's main business activities. Operating profit or loss is a defined term under IFRS 18 that applies to all entities and enables users to better understand financial performance and compare operating profit or loss between entities. Unlike IAS 1, which did not explicitly require that all entities show operating profit or loss in their statement of profit or loss structure, IFRS 18 not only requires the presentation of this subtotal, but defines which income and expenses make up this subtotal.

Profit or loss before financing and income taxes represents a subtotal consisting of the total operating profit or loss and all income and expenses classified in the investing category. Given the new definitions of the financing and investing categories, this subtotal may differ from the commonly used earnings before interest and tax (EBIT) measure (Grant Thornton, 2024, 3). IFRS 18 allows entities to present additional subtotals, but includes specific requirements for the presentation of additional items and subtotals. This is permitted only when necessary to provide a most useful structured summary of the entity's income and expenses. An useful structured summary will provide an understandable overview of the entity's recognized assets, liabilities, income, expenses, equity and cash flows and allow users to make comparisons between entities and between reporting periods for the same entity and identify key areas where they might want to get more information from the notes (Grant Thornton, 2024, 15).

Table 3: New categorization of income and expenses depending on the main business activity of the entity

Entity	Manufacturer A	Manufacturer B	Retail bank	Retail and investment bank	Insurer	Investment property company	Investment entity
Main business activities	Manufacturing and sales of goods	Manufacturing and sales of goods and providing financing to customers	Providing financing to customers	Providing financing to customers and investing in financial assets	Investing in financial assets	Investing in non-financial assets	Investing in subsidiaries, associates and joint ventures
Interest income on cash and cash equivalents	Investing	Operating	Operating	Operating	Operating	Investing	Investing
Interest income on loans to customers	Investing	Operating	Operating	Operating	Investing	Investing	Investing
Fair value gains/losses on investments in debt or equity instruments	Investing	Investing	Investing	Operating	Operating	Investing	Investing
Gains/losses on investment property	Investing	Investing	Investing	Investing	Investing	Operating	Investing
Share of profit or loss of equity-accounted investees	Investing	Investing	Investing	Investing	Investing	Investing	N/A
Gains/losses on investments in subsidiaries/associates/ joint ventures measured at fair value	Investing	Investing	Investing	Investing	Investing	Investing	Operating
Interest expense on borrowings	Financing	Operating	Operating	Operating	Financing	Financing	Financing
Interest expense on defined benefit liability	Financing	Financing	Financing	Financing	Financing	Financing	Financing

Source: Adapted from KPMG (2024, 24)

Entities with specified main business activities are a new category. IFRS 18 identifies two types of these business activities:

- Investing in assets as a main business activity, and
- Providing financing to customers as a main business activity.

An entity may have one or more main business activities. To classify income and expenses into operating, investing and financing categories, an entity needs to assess whether its main business activity involves investing in assets or financing customers. If this is the case, they are entities with specified main business activities, such as banks, insurers or investment property companies. If this is not the case, then the operating category includes income and expenses arising from the performance of entities' main business activity that is not specified main business activity according to

IFRS 18. Table 3 shows examples of income and expenses categorization depending on the main business activity of the entity.

There is no doubt that there is a need for future amendments to IFRS 18, as it has not introduced significant changes to the other individual primary financial statements. For example, the new categorization of income and expenses presented in the statement of profit or loss is not implemented in the statement of financial position. Also, as previously mentioned, these new categories are not aligned with the categories from the statement of cash flows. Therefore, one can hope that the newly adopted IFRS 18 is not the end of changes in the structure and content of financial statements (Czajor, 2024, 273).

4. CONCLUSIONS

The aim from which the IASB started when adopting the new IFRS 18 was to provide investors and other users of general purpose financial statements with a clearer insight into the entity's financial performance and to improve the transparency of these statements. The newly adopted standard contains numerous novelties in relation to IAS 1, the standard that will be replaced upon entry into force, but the most notable are the novelties in the statement of profit or loss: three new income and expenses categories (operating, investing, financing), two new mandatory subtotals (operating profit or loss, profit or loss before financing and income taxes) and entities with specified main business activities.

Expectations from the application of the new IFRS 18 go in the direction of greater standardization of financial reporting, improvement of comparability between financial statements of entities, provision of more useful structured summaries to investors and other users of financial statements. The synergistic effect of the aforementioned expectations would be manifested in increasing confidence in financial statements. Bearing in mind that IFRS 18 contains clear guidelines related to the form and content of financial statements, which in the Republic of Serbia is prescribed by legal accounting regulations and by-laws, the very content of the new standard is primarily important for competent authorities whose scope is the adoption of the mentioned regulation. The first steps should be taken by the legislators and to incorporate the provisions from the new standard into the new law and regulations in the field of accounting. Only after that, those liable to prepare financial statements in the Republic of Serbia, i.e. entities, will be able to indirectly (through legal accounting regulations and by-laws) apply the newly adopted guidelines from IFRS 18.

Today, when there is less than a year and a half left until the start of IFRS 18 application, it is crucial to understand the following: firstly, awareness of the existence of far-reaching consequences for the quality of financial reporting if timely preparations for the introduction of the provisions of the new standard are not started; secondly, the importance of the existence of a proactive approach of competent authorities (legislators) and entity’s management in joint work with accountants, auditors and IT experts during the period of harmonization and adaptation of all resources to the provisions of the new standard.

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