Technical Accounting Alert

IAS 1R and the requirement for a third statement of financial position (balance sheet)

Introduction

The purpose of this alert is to explain the circumstances in which IAS 1 (as revised in 2007) requires an additional statement of financial position (balance sheet).

IAS 1 (as revised in 2007) and primary statements

The title 'statement of financial position' was introduced in the 2007 amendments to IAS 1 in place of 'balance sheet'. Other primary statement titles were also amended (along with more substantive changes). The new titles are not mandatory and we expect that many entities will continue to refer to the balance sheet.

IAS 1 now requires entities to present (as a **minimum**) the following primary statements:

- statement of financial position at the end of the period and end of the comparative period
- statement of comprehensive income for the period and the comparative period
- statement of cash flows for the period and the comparative period
- statement of changes in equity for the period and the comparative period

along with related notes. The 2007 amendments to IAS 1 also introduced a requirement for an additional (third) statement of financial position at the beginning of the comparative period in some circumstances. This TA alert explains those circumstances.

The 2007 amendments to IAS 1 are mostly effective for annual periods beginning on or after 1 January 2009 and are retrospective. Early application is permitted (IAS 1.139 and 139A).

Relevant Australian standards

References in this TA alert are made to standards issued by the International Accounting Standards Board. The Australian equivalent to each standard included in this alert is shown below:

International Standard reference	Australian equivalent standard
IAS 1 Presentation of Financial Instruments	AASB 101 Presentation of Financial Statements
IFRS 8 Operating Segments	AASB 8 Operating Segments
IAS 8 Accounting policies, changes in accounting estimates and errors	AASB 108 Accounting policies, changes in accounting policies and errors

Overview

The IAS 1 requires an additional statement of financial position along with related notes if during the current period the entity:

- Changes one or more of its accounting policies **retrospectively**; or
- Makes a **retrospective** restatement in order to correct an error; or
- Reclassifies items in its financial statements (IAS 1.39).

We will consider each of these scenarios in further detail below.

The view of GT Australia
Grant Thornton Australia's view is that the third statement of financial position is required only if the retrospective change impacts the statement of financial position or its related notes. A retrospective change affecting disclosures or the statement of comprehensive income does not necessitate the need for a third statement of financial position.

This is intended to assist users in assessing trends and making comparisons between periods.

A requirement for an additional statement of financial position is not triggered by:

- Changing an accounting policy prospectively;
- 'Recycling' a gain or loss from other comprehensive income to profit and loss; this is referred to as a 'reclassification adjustment' in IAS 1.92-96.

In practice this means that all material adjustments to previously reported amounts and presentation give rise to the requirement for an additional statement of financial position.

Circumstances requiring third statement of financial position

Retrospective change in an accounting policy

The term 'accounting policies' is defined in IAS 8.5 as:

> 'the specific principles, bases, conventions, rules and practices applied by an entity in preparing and presenting financial statements'.

This is a broad definition. Accounting policies cover the preparation and presentation of financial statements as a whole and are not (for example) restricted to the recognition and measurement of amounts in the primary statements.

IAS 8 requires that voluntary changes of accounting policy are applied retrospectively except where this is impracticable (IAS 8.19(b) and 23). Changes in accounting policies resulting from initial application of an IFRS are also applied retrospectively unless the IFRS specifies prospective application.

Changes in accounting policies should be distinguished from changes in estimates (see IAS 8.32) and also from initial application of accounting policies to new types of transactions or events (see IAS 8.16).

Retrospective change of accounting policy

Examples of retrospective changes in accounting policy that will trigger a need for an additional statement of financial position include:

- A voluntary change in accounting policy such as a switch from proportionate consolidation to equity accounting for investments in jointly controlled entities;
- A change in an accounting policy on adopting a new IFRS (including amendments to an IFRS or a new IFRIC Interpretation) unless the new pronouncement requires prospective application or impacts disclosures only.

Retrospective restatement in order to correct an error

We believe the term 'retrospective restatement' in IAS 1 refers to the correction of a material prior period error. This term is defined in IAS 8.5 as follows:

> 'Retrospective restatement is correcting the recognition, measurement and disclosure of amounts of elements of financial statements as if a prior period error had never occurred.'

Errors must be corrected by retrospective restatement in accordance with IAS 8.42, subject to an impracticability constraint (see IAS 8.43). Accordingly, an additional statement of financial position is normally required when an entity corrects a material prior period error.

Reclassification of an item in its financial statements

We believe the term 'reclassification' should be understood in the same way as IAS 1.41's references to a change in the presentation or classification of items in the financial statements. On making such a change, comparative amounts are also reclassified unless this is impractical. The reclassification triggers a requirement for an additional statement of financial position even if this third statement is not affected.

Reclassification of items in the financial statements

Examples of reclassifications of items that will trigger a need for an additional statement of financial position include:

- A change from a liquidity-based statement of financial position to a current and non-current classification and vice versa (see IAS 1.60);
- A revision of the entity's interpretation of its normal operating cycle resulting in changes in the classification of certain assets and liabilities between current and non-current (see IAS 1.66 and 69);
- A reclassification of certain types of asset, liability, income, expense or cash flow from one primary statement caption to another (e.g. a change in the classification of cash flows relating to some derivatives between the operating and financing sections).

Circumstances not requiring an additional statement of financial position

Prospective changes of accounting policy

IAS 1.39 is clear that the requirement for an additional statement of financial position is triggered by retrospective changes of accounting policy. The requirement does not therefore apply to changes made prospectively.

Prospective changes of accounting policy
Examples of prospective changes in accounting policy that do not trigger a need for an additional statement of financial position include: • A voluntary change in accounting policy that is impracticable to apply on a retrospective basis; • A change in accounting policy on adopting a new IFRS which specifies prospective application such as; • A change from a policy of expensing borrowing costs to capitalisation made in accordance with the transitional provisions of IAS 23 Borrowing Costs (as revised in 2007); • Adoption of the 2008 version of IFRS 3 Business Combinations; • The initial application of a policy to revalue property, plant and equipment or intangible assets in accordance with IAS 16 Property, Plant and Equipment or IAS 38 Intangible Assets. This is treated as a revaluation and therefore dealt with prospectively (IAS 8.17).

Reclassification adjustments

The 2007 amendments to IAS 1 introduced the term 'reclassification adjustments'. These are described in IAS 1.92-96. Reclassification adjustments refer to the 'recycling' of gains and losses initially recorded in other comprehensive income (equity) into profit or loss for specific types of transaction.

Some confusion has arisen as to whether a 'reclassification adjustment' as described in IAS 1.92 has the same meaning as a 'reclassification of items in the financial statements' as referred to in IAS 1.39. In our view these terms have different meanings (although the use of such similar terms is clearly unhelpful).

Accordingly, we consider that reclassification adjustments as referred to in IAS 1.92 do not trigger a requirement for an additional statement of financial position. Reclassification adjustments are a current year item, not a retrospective adjustment of a previous year item.

Reclassification adjustments
Examples of reclassification adjustments (reclassifications of gains and losses from other comprehensive income to profit or loss) include: • Reclassification of gains or losses on sale or impairment of available-for-sale financial assets; • Reclassification of gains or losses on a cash flow hedging instrument from the cash flow hedging reserve as the hedged item affects profit or loss; • Recognition in profit or loss of a foreign currency translation reserve on disposal of a foreign operation. In our view these reclassification adjustments do **not** trigger a requirement for a third statement of financial position.

Situations where retrospective application is impractical

As explained above, IAS 1 and IAS 8 require that reclassifications, most accounting policy changes and error corrections are applied retrospectively except **where this is impractical** (emphasis added) (IAS 1.41, IAS 8.23 and 43). In the case of accounting policy changes and error corrections, the requirement is then to adjust comparative information to apply the new policy or correct the error from the earliest date practicable (IAS 8.25 and 45). These requirements might result in:

- Partially retrospective and partially prospective application of some changes or corrections; and
- Fully prospective application of some changes or corrections.

We expect these situations to be rare. However, if practicability constraints lead to fully prospective application we believe the requirement for an additional statement of financial position does not apply.

Immaterial changes

An entity might make immaterial changes to its accounting policies, classifications etc. In principle, we consider that these immaterial changes do not give rise to a requirement for an additional statement of financial position. Assessments of materiality depend on facts and circumstances and involve professional judgement.

Changes impacting disclosure requirements only are considered by Grant Thornton Australia as immaterial and therefore do not trigger the requirement for the third statement of financial position. For example: first-time adoption of AASB 8 *Operating Segments*.

Practical Consideration

As a practical matter, we anticipate that many entities may decide to include a third statement of financial position every year, even if it is not required in some years. This will enable entities to maintain a more consistent format and layout from one year to the next and may therefore save on design and printing costs.

Further information

For further information on any of the information included in this TA alert, please contact your local Grant Thornton Australia contact or a member of the National Audit Support team at NAS@grantthornton.com.au