Accounting Changes

Change of Principle

- GAAP to GAAP
  - No change if events occur for the 1st time or if previously immaterial
  - If the principle followed was not acceptable or incorrectly applied, this is an error
- Ways to deal with corrections
  - Retroactive: recast financials of prior years
  - Current: cumulative effect computed and placed on income statement after extraordinary items
  - Prospective: no change
- Cumulative Effect or “catch up” method → GAAP
  - Show effect on income statement (prior periods- cumulative)
  - Don’t restate prior periods
  - Pro-forma and related EPS on face of the income statement
  - Journal entry includes the account, deferred tax asset or liability and cumulative effect of change in principle
  - Income statement has a pro-forma section (as if)
  - This is useful for trends; in a separate schedule or in notes
- Retroactive
  - Recast statements- adjust Retained Earnings of earliest year presented
    - Inventory method
    - Long term construction contracts
    - To or from “full cost”- extractive industries
- Prospective
  - Change to LIFO method
    - Base year inventory for all subsequent LIFO calculations is opening inventory in year method is adopted (don’t restate)

Change of Estimate

- Types of changes
  - Uncollectible Receivables
  - Inventory Obsolescence
  - Useful lives and salvage values
  - Periods benefited by deferred costs
  - Liabilities for warranty costs
  - Mineral resources
  - Handled prospectively (no change or “catch up”)
- If there is a question about whether it is a principle or estimate change → choose estimate
- Careful estimates later proved incorrect are not errors

Change in Entity

- Restate for prior periods