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Chapter 1 Accounting Changes and Error Corrections

Overview

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1.100 There are three broad categories of accounting changes:

- a. changes in an accounting principle,
- b. changes in an accounting estimate, and
- c. changes in the reporting entity.

Corrections of errors are not accounting changes.

1.101 An overall presumption in financial statement preparation is that the accounting principles adopted by an entity will be applied consistently from period to period. However, entities sometimes change accounting principles to use a preferable method of accounting. Changes in accounting principles are generally recorded through retrospective application to prior year financial statements. In some cases, changes may be recorded on a prospective basis. Disclosures are required in the year of the change. (However, when a change is required by a new accounting standard that prescribes specific transition guidance, those requirements should be followed when accounting for and reporting the change.)

1.102 Changes in accounting estimates are common in practice and result from new events or occur as an organization gains more experience or obtains additional information. Changes in estimates are reported in the period the estimate is revised or in both the current and future periods if the change affects future periods.

1.103 A change in reporting entity is a change that results in financial statements that are, in effect, the statements of a different entity. Changes in reporting entity are generally limited to changes in the organizations or subsidiaries that are included in combined or consolidated financial statements. Changes in reporting entity are accounted for by retrospective application to financial statements of

prior periods.

1.104 When an error is discovered in previously issued prior period financial statements, an adjustment to correct the error, referred to as a *prior period adjustment*, may be necessary. Net asset balances at the beginning of the period should be restated for the effects of prior period adjustments. In addition, if the financial statements of the affected prior periods are presented, the components of the change in net assets, net assets, and other affected accounts of those prior periods should be restated. Certain disclosures about the adjustments and their effects on the prior period change in net assets are required in the year in which the adjustments are made.

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