

# Financial Accounting Series

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EXPOSURE DRAFT

## Proposed Statement of Financial Accounting Standards

**Accounting Changes and  
Error Corrections**

**a replacement of APB Opinion No. 20  
and FASB Statement No. 3**

This Exposure Draft of a proposed Statement of Financial Accounting Standards is issued by the Board for public comment. Written comments should be addressed to:

Director of Major Projects and Technical Activities  
File Reference No. 1200-400

Comment Deadline: April 13, 2004



Financial Accounting Standards Board  
of the Financial Accounting Foundation

Responses from interested parties wishing to comment on the Exposure Draft must be *received* in writing by April 13, 2004. Interested parties should submit their comments by email to [director@fasb.org](mailto:director@fasb.org), File Reference 1200-400. Those without email may send their comments to the “MP&T Director—File Reference 1200-400” at the address at the bottom of this page. Responses should *not* be sent by fax.

Any individual or organization may obtain one copy of this Exposure Draft without charge until April 13, 2004, on written request only. Please ask for our Product Code No. E176. For information on applicable prices for additional copies and copies requested after April 13, 2004, contact:

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<p style="text-align: center;"><b>Notice for Recipients of This Exposure Draft</b></p>
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This proposed Statement would change the reporting of certain accounting changes specified in APB Opinion No. 20, *Accounting Changes*. Opinion 20 requires that most changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to the new accounting principle. The proposed Statement would require retrospective application of a newly adopted accounting policy for most changes in accounting principle, including changes in accounting principle required by issuance of new pronouncements. However, the Board may require different transition provisions for changes in accounting principle required by issuance of new pronouncements when it deems such differences to be appropriate. This proposed Statement would require reporting of a change in depreciation, amortization, or depletion method as a change in accounting estimate. Also, this proposed Statement would carry forward guidance for reporting the correction of an error in previously issued financial statements, a change in accounting estimate, a change in the reporting entity, and the reporting and disclosure of accounting changes in interim-period information.

The Board invites individuals and organizations to send written comments on all matters in this proposed Statement. Comments are requested from those who agree with the provisions of this proposed Statement as well as from those who do not.

Comments are most helpful if they identify the specific paragraph or group of paragraphs to which they relate and clearly explain the problem or question. Those who disagree with provisions of this proposed Statement are asked to describe their suggested alternatives, supported by specific reasoning.

## Summary

This proposed Statement would change the reporting of certain accounting changes specified in APB Opinion No. 20, *Accounting Changes*. Opinion 20 requires that most changes in accounting principle be recognized by including in net income of the period of the change the cumulative effect of changing to a new accounting principle. This proposed Statement would require retrospective application for changes in accounting principle, unless it is impracticable to determine either the cumulative effect or the period-specific effects of the change. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, this proposed Statement would require that the new accounting policy be applied to the balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable and that a corresponding adjustment be made to the opening balance of retained earnings (or other appropriate balance sheet caption) for that period. When it is impracticable for an entity to determine the cumulative effect of applying a change in accounting principle to all prior periods, this proposed Statement would require the new accounting principle to be applied as if it were made prospectively from the earliest date practicable.

This proposed Statement would apply to changes in an accounting principle required by issuance of new pronouncements of the Board and other standard-setting bodies, unless a new pronouncement contains specific transition guidance.

This proposed Statement would require that a change in depreciation method be accounted for as a change in accounting estimate and not as a change in accounting principle.

This proposed Statement would carry forward the guidance contained in Opinion 20 for reporting (1) the correction of an error in previously issued financial statements, (2) a change in accounting estimate, and (3) a change in the reporting entity. This proposed Statement would also carry forward the guidance in Opinion 20 on justification for a change in accounting principle. Finally, this proposed Statement would carry forward the guidance contained in FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*.

### Reasons for Issuing This Proposed Statement

In October 2002, the FASB and the International Accounting Standards Board (IASB) undertook a joint project to achieve more comparability in cross-border financial reporting through convergence to a single set of high-quality accounting standards. Each Board reviewed its pronouncements for areas of its generally accepted accounting principles (GAAP) that could be improved by converging with the other Board's GAAP. Reporting of accounting changes was identified as an area in which the FASB could improve its accounting by converging with the IASB's proposed provisions of IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*, found in the IASB Exposure Draft, *Improvements to International Accounting Standards*.

## **How the Changes in This Proposed Statement Would Improve Financial Reporting**

Under the provisions of Opinion 20, most accounting changes are recognized by including in net income of the period of the change the cumulative effect of changing to a new accounting principle. This proposed Statement would improve comparability of financial information between periods presented by requiring retrospective application of all comparative financial statements when reporting most accounting changes. Also, in instances where full retrospective application is impracticable, this proposed Statement would improve comparability of financial information between periods by requiring that a new accounting principle be applied as of the earliest date practicable.

This proposed Statement would require that a change in depreciation, amortization, or depletion method be accounted for as a change in accounting estimate that is effected by a change in accounting principle. The proposed Statement would better reflect the fact that an entity should adopt changes in its depreciation, amortization, or depletion method only in recognition of changes in estimated future benefits of an asset, in the pattern of consumption of those benefits, or in the information available to the entity about those benefits.

Changes in accounting principle required by the issuance of a new accounting pronouncement were not within the scope of Opinion 20. Including those changes in an accounting principle within this proposed Statement would establish retrospective application as the presumed transition method for new accounting standards. Several constituents have suggested such an approach to transition for new standards, which was identified as a potential improvement to standard setting in the *Proposal for a Principles-Based Approach to U.S. Standard Setting*, issued by the FASB in January 2003.

The provisions of this proposed Statement would increase convergence with the proposed international financial reporting standards in accordance with the Board's goal of promoting the international convergence of accounting standards concurrent with improving the quality of financial reporting.

### **Effective Date**

The provisions of this proposed Statement would be effective for accounting changes adopted in fiscal years beginning after December 15, 2004.

**Proposed Statement of Financial Accounting Standards**

**Accounting Changes and Error Corrections**

**a replacement of APB Opinion No. 20 and FASB Statement No. 3**

**December 15, 2003**

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# Proposed Statement of Financial Accounting Standards

## Accounting Changes and Error Corrections

### a replacement of APB Opinion No. 20 and FASB Statement No. 3

December 15, 2003

## INTRODUCTION

1. A change in accounting by a reporting entity may significantly affect the presentation of both financial position and results of operations for an accounting period and the trends shown in comparative financial statements and historical summaries. Therefore, the change should be reported in a manner that will facilitate analysis and understanding of the financial statements. This Statement provides guidance on reporting certain types of accounting changes. This Statement carries forward guidance from APB Opinion No. 20, *Accounting Changes*, and FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*, for reporting the correction of an error in previously issued financial statements, a change in accounting estimate, a change in the reporting entity, and the reporting and disclosure of accounting changes in interim-period information. This Statement also carries forward the guidance in Opinion 20 on justification for a change in accounting principle.

## STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

### Definitions

2. The following terms are defined as used in this Statement:
- a. **Accounting change**—a change in (a) an accounting principle, (b) an accounting estimate, or (c) the reporting entity. The correction of an error in previously issued financial statements is not an accounting change.
  - b. **Accounting pronouncement**—under U.S. generally accepted accounting principles (GAAP), FASB Statements of Financial Accounting Standards, FASB Statements of Concepts, FASB Interpretations, FASB Staff Positions, Emerging Issues Task Force Consensuses, or other pronouncements of the FASB or other designated bodies as described in categories (a)–(d) of AICPA Statement on Auditing Standards (SAS) No. 69, *The Meaning of “Present Fairly in Conformity With Generally Accepted Accounting Principles” in the Independent Auditor’s Report*, as codified in the AICPA Codification of Statements on Auditing Standards, AU Section 411, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*.

- c. **Change in accounting principle**—adoption of a generally accepted accounting principle different from the one used *previously* for reporting purposes; a change in an accounting principle or practice, or the methods of applying them; a change from one generally accepted accounting principle to a more relevant generally accepted accounting principle when there are two or more generally accepted accounting principles that might apply, or when the accounting principle formerly used is no longer generally accepted.
- d. **Change in accounting estimate**—adjustment of the carrying amount of an asset or liability that is the necessary consequence of the assessment, in conjunction with the periodic presentation of financial statements, of the present status and expected future benefits and obligations associated with assets and liabilities. Changes in accounting estimates result from new information or subsequent developments and, accordingly, from better insight or improved judgment.
- e. **Change in accounting estimate effected by a change in accounting principle**—a change in accounting estimate that is inseparable from the effect of a related change in accounting principle (for example, a change in depreciation method).
- f. **Change in the reporting entity**—a change that results in financial statements that, in effect, are those of a different reporting entity. A change in reporting entity is limited mainly to (a) presenting consolidated or combined financial statements in place of financial statements of individual entities, (b) changing specific subsidiaries that make up the group of companies for which consolidated financial statements are presented, and (c) changing the companies included in combined financial statements.
- g. **Error in previously issued financial statements**—an error in financial statements resulting from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error.
- h. **Retrospective application**—application of a new accounting principle to all prior accounting periods as if it had always been used. Retrospective application requires that the cumulative effect of the new accounting principle on periods prior to those presented be reflected in the reported carrying amounts of assets and liabilities as of the beginning of the first period presented and that a corresponding adjustment be made to the opening balance of retained earnings (or other appropriate caption in the balance sheet or statement of position) for that period. All individual prior periods presented are then adjusted to reflect the period-specific effects of applying the new accounting principle.

## Scope

3. This Statement applies to financial statements that purport to present financial position, results of operations or activities, and cash flows in conformity with generally accepted accounting principles. In the absence of specific transition provisions in a newly issued accounting pronouncement, a change in accounting principle effected to conform to the requirements of that pronouncement shall be reported in accordance with the provisions for reporting changes in accounting principle, including the disclosure provisions, in this Statement (paragraphs 19–21). The guidance in this Statement also may be appropriate in presenting financial information in other forms or for special purposes.
4. The correction of an error in previously issued financial statements is not an accounting change. However, it concerns factors similar to those relating to reporting an accounting change. Therefore, the correction of an error in previously issued financial statements is addressed by this Statement.

## Accounting Changes

5. The information provided in financial statements should be both relevant and consistent. When more than one accounting treatment is allowed, management shall consider the principles behind each treatment and, on that basis, choose the accounting treatment that provides financial statement users with the most relevant information about the transactions and events of the reporting entity. Once management has determined the accounting principle that will provide financial statement users with the most relevant information, that principle shall be consistently used to account for similar events and transactions of the reporting entity. This affords financial statement users the most relevant information and allows meaningful comparison of an entity's performance between reporting periods.

## Change in Accounting Principle

6. A change in accounting principle may be necessary in response to issuance of a new accounting pronouncement or a change in an entity's business practices or environment. However, neither (a) initial adoption of an accounting principle in recognition of events or transactions occurring for the first time or that previously were immaterial in their effect nor (b) adoption or modification of an accounting principle necessitated by transactions or events that are clearly different in substance from those previously occurring is a change in accounting principle. A reporting entity shall not make a change in accounting principle unless it can justify the use of an alternative acceptable accounting principle on the basis that the alternative principle is preferable.
7. A change in accounting principle shall be reported by *retrospective application* unless it is impracticable to determine either the cumulative effect or the period-specific effects of the change.

8. When it is impracticable to determine the period-specific effects of an accounting change on one or more individual prior periods presented, the new accounting policy shall be applied to the reported carrying amounts of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable, and a corresponding adjustment shall be made to the opening balance of retained earnings (or other appropriate caption in the balance sheet or statement of position) for that period.

9. When it is impracticable for an entity to determine the cumulative effect of applying a change in accounting principle to all prior periods (as with a change from FIFO to LIFO inventory measurement), the entity shall apply the new accounting principle as if the change was made prospectively as of the earliest date practicable.<sup>1</sup>

10. If a newly issued accounting pronouncement requires certain transition provisions, those provisions shall be used. Absent specific transition guidance for a new accounting pronouncement, a reporting entity shall apply the provisions of this Statement for any required change in accounting principle.

### ***Impracticability***

11. It shall be deemed impracticable to apply the effects of a change in accounting principle retrospectively if any of the following conditions exist:

- a. The effects of retrospective application are not determinable.
- b. Retrospective application requires assumptions about management's intent in a prior period.
- c. Retrospective application requires significant estimates as of a prior period, and it is not possible to objectively determine whether information used to develop those estimates would have been available at the time the affected transactions or events would have been recognized in the financial statements or whether information arose subsequently.

### ***Justification for Change in Accounting Principle***

12. In the preparation of financial statements, there is a presumption that an accounting principle once adopted should not be changed in accounting for events and transactions of a similar type. Consistent use of accounting principles from one accounting period to another enhances the usefulness of financial statements by facilitating analysis and understanding of comparative accounting data (Opinion 20, paragraph 15).

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<sup>1</sup>For example, assume ABC Company changed its accounting principle for inventory measurement from FIFO to LIFO effective January 1, 2004. ABC uses a calendar year-end and had used FIFO inventory measurement since its founding in 1984. ABC has determined that it is impracticable to determine the cumulative effect of applying this change in principle retrospectively because records of inventory purchases and sales are not available for some years. However, ABC has all of the information necessary to apply the LIFO inventory measure on a prospective basis beginning in 2000. Therefore, ABC should present prior periods as if it had (a) carried forward the 1999 ending balance in inventory (measured on a FIFO basis) and (b) begun applying a LIFO inventory methodology to its inventory beginning January 1, 2000.

13. The presumption that an entity should not change an accounting principle may be overcome only if the entity justifies the use of an alternative acceptable accounting principle on the basis that it is preferable. However, a method of accounting that was previously adopted for a type of transaction or event that is being terminated or that was a single, nonrecurring event in the past shall not be changed. For example, the method of accounting shall not be changed for a tax or tax credit that is being discontinued. However, a change in the estimated period to be benefited by an asset, if justified by the facts, may be recognized as a change in accounting estimate (Opinion 20, paragraph 16).

14. The issuance of a new pronouncement by the FASB or by other designated bodies as described in categories (a)–(d) of SAS 69, as codified in AU Section 411, that creates a new accounting treatment, interprets an existing principle, or expresses a preference for an existing accounting alternative is considered sufficient support for making a change in accounting principle, provided that the established U.S. GAAP hierarchy is followed. The burden of justifying other changes rests with the entity proposing the change.

#### **Change in Accounting Estimate**

15. Paragraph 21 of FASB Concepts Statement No. 1, *Objectives of Financial Reporting by Business Enterprises*, states that “estimates resting on expectations of the future are often needed in financial reporting, but their major use, especially of those formally incorporated in financial statements, is to measure financial effects of past transactions or events or the present status of an asset or liability.” Examples of items for which estimates are necessary are uncollectible receivables, inventory obsolescence, service lives and salvage values of depreciable assets, and warranty obligations.

16. A change in accounting estimate shall be accounted for in (a) the period of change if the change affects that period only or (b) the period of change and future periods if the change affects both. A change in accounting estimate shall not be accounted for by restating or adjusting amounts reported in financial statements of prior periods or by reporting pro forma amounts for prior periods (Opinion 20, paragraph 31).

17. One type of change in estimate is a change in accounting estimate that is effected by a change in accounting principle. One example of this type of change is a change in depreciation, amortization, or depletion method (hereinafter referred to as depreciation method). The new depreciation method is adopted in partial or complete recognition of the change in estimated future benefits, the pattern of consumption of those benefits, or the information available to the entity about those benefits. The effect of the change in accounting principle is inseparable from the effect of the change in accounting estimate. Changes of this type often are related to the continuing process of obtaining additional information and revising estimates and, therefore, are considered changes in estimates for purposes of applying this Statement. However, like any other change in accounting

principle, the change in accounting principle that effects the change in accounting estimate must be justified on the basis that it is preferable.<sup>2</sup> (Refer to paragraphs 12–14.)

### **Change in the Reporting Entity**

18. An accounting change that results in financial statements that are in effect the statements of a different reporting entity shall be reported by restating the financial statements of all prior periods presented to show financial information for the new reporting entity for all periods. The amount of interest cost capitalized through application of FASB Statement No. 58, *Capitalization of Interest Cost in Financial Statements That Include Investments Accounted for by the Equity Method*, shall not be changed when restating financial statements of prior periods (Opinion 20, paragraph 34).

### **Disclosures**

19. For all changes in accounting principle:

- a. The nature of and justification for the change in accounting principle shall be disclosed in the financial statements of the period in which the change is made. The justification for the change shall clearly explain why the newly adopted accounting principle is preferable.
- b. When a change in accounting principle has an effect on the current period or any prior period presented, or may have an effect in subsequent periods, the reporting entity shall disclose the following:
  - (1) The effect of the change on each financial statement line item and any per-share amounts affected for the current period and all prior periods presented. Financial statements of subsequent periods need not repeat the disclosures.
  - (2) The amount of any adjustment relating to periods prior to those presented.
  - (3) A statement that comparative information has been retrospectively adjusted or that retrospective application is impracticable because one of the conditions in paragraph 11 exists. If retrospective application is impracticable, the entity shall disclose the reasons therefor, and a description of the alternative method used to report the change (paragraphs 8 and 9).

20. When an entity makes a change in estimate that affects several future periods (such as a change in service lives of depreciable assets), it shall disclose the effect on income before extraordinary items, net income, and related per-share amounts of the current period. Disclosure of the effect on those income statement amounts is not necessary for estimates made each period in the ordinary course of accounting for items such as uncollectible accounts or inventory obsolescence; however, disclosure is required if the effect of a change in the estimate is material (Opinion 20, paragraph 33).

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<sup>2</sup>For example, an entity that changes its method of depreciation must establish that information available about the pattern of consumption of the expected benefits of the asset has changed such that the new method represents a better allocation of the cost of that asset to the periods benefited.

21. When there has been a change in the reporting entity, the financial statements of the period of the change shall describe the nature of the change and the reason for it. In addition, the effect of the change on income before extraordinary items, net income, other comprehensive income, and related per-share amounts shall be disclosed for all periods presented. Financial statements of subsequent periods need not repeat the disclosures (Opinion 20, paragraph 35).

#### **Reporting a Change in Accounting Principle Made in an Interim Period**

22. Changes in an interim or annual accounting principle made in an interim period shall be reported by retrospective application in accordance with paragraph 7 of this Statement. An entity shall not assert that retrospective application of pre-change interim periods of the fiscal year in which the change was made is impracticable.

23. In financial reports for a subsequent (postchange) interim period of the fiscal year in which the new accounting principle is adopted, disclosure shall be made of the effect of the change on income from continuing operations, net income, and related per-share amounts for that postchange interim period (Statement 3, paragraph 11(e)).

24. When a public company that regularly reports interim information makes an accounting change during the fourth quarter of its fiscal year and does not report the data specified by paragraph 30 of APB Opinion No. 28, *Interim Financial Reporting* (as amended), in a separate fourth quarter report or in its annual report, the disclosures about the effects of the accounting change on interim-period financial statements that are required by paragraphs 23–26 of Opinion 28 or by paragraphs 19–21 of this Statement, as appropriate, shall be made in a note to the annual financial statements for the fiscal year in which the change is made (Statement 3, paragraph 14).

#### **Correction of Errors in Previously Issued Financial Statements**

25. Errors in financial statements result from mathematical mistakes, mistakes in the application of accounting principles, or oversight or misuse of facts that existed at the time the financial statements were prepared. In contrast, a change in accounting estimate results from new information or subsequent developments and, accordingly, from better insight or improved judgment. Thus, an error is distinguishable from a change in estimate. A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error for purposes of applying this Statement (Opinion 20, paragraph 13).

26. Any correction of an error in the financial statements of a prior period discovered subsequent to their issuance shall be reported as a prior-period adjustment. Those items that are reported as prior-period adjustments shall, in single-period statements, be reflected as adjustments of the opening balance of retained earnings (or other appropriate caption in the balance sheet or statement of position). When comparative statements are prescribed, corresponding adjustments should be made to the amounts of net income (or changes in net assets) and the components thereof and retained earnings balances (as well as of other

affected balances) for all of the periods reported therein, to reflect the adjustment made to correct the prior-period error (Refer to paragraph 26 of APB Opinion No. 9, *Reporting the Results of Operations*, for required disclosures of prior-period adjustments.) (Opinion 20, paragraph 36 and Opinion 9, paragraph 18).

### **Disclosures**

27. When financial statements are restated to correct an error, the nature of the error shall be disclosed in the period in which the error was discovered and corrected. If the correction has an effect in the current period or any prior period presented, or may have an effect in subsequent periods, the reporting entity also shall disclose the following:

- a. The effect of the correction on each financial statement line item and any per-share amounts affected for the current period and all prior periods presented. Financial statements of subsequent periods need not repeat the disclosures.
- b. The amount of any adjustment relating to periods prior to those presented.
- c. A statement that comparative information has been restated.

In addition, the disclosures of prior-period adjustments and restatements of reported net income required by paragraph 26 of Opinion 9 shall be made.

### **Effective Date and Transition**

28. The provisions of this Statement shall be effective for accounting changes and corrections of errors made in periods beginning after December 15, 2004. This Statement does not change the transition provisions of existing accounting pronouncements that are in the transition phase as of the effective date of this Statement.

<b>The provisions of this Statement need not be applied to immaterial items.</b>
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## Appendix A

### BACKGROUND INFORMATION AND BASIS FOR CONCLUSIONS

#### Introduction

A1. This appendix summarizes considerations that Board members deemed significant in reaching the conclusions in this Statement. It includes reasons for accepting certain approaches and rejecting others. Individual Board members gave greater weight to some factors than to others.

A2. In September 2002, the FASB and the International Accounting Standards Board (IASB) (collectively the Boards) made a commitment to converge the accounting standards of their respective jurisdictions through a long-term convergence plan. As part of that plan, the Boards jointly undertook a short-term project to eliminate certain differences between the accounting pronouncements of the IASB and the accounting pronouncements in effect in the United States. Both Boards agreed to limit the scope of the short-term project to issues for which (a) the Boards' respective accounting pronouncements were divergent; (b) convergence to a high-quality solution would appear to be achievable in the short-term, usually by selecting between the existing standards of either the FASB or the IASB; and (c) the issue was not within the scope of other projects on the current agendas of either Board. The Boards hope that before the European Commission's 2005 target date for adoption of international financial reporting standards (IFRS) by all European Union listed companies, the short-term convergence project will simplify cross-border financial reporting by reducing the number of items required for reconciliation of U.S. generally accepted accounting principles (GAAP) and IFRS.

#### Scope

A3. The Board decided to incorporate the guidance for all accounting changes, including changes made in interim periods, into this Statement to facilitate its objective of codification and simplification of U.S. GAAP. Thus, this Statement supersedes Statement 3 as well as Opinion 20. The Board noted that FASB Statement No. 117, *Financial Statements of Not-for-Profit Organizations*, requires that not-for-profit organizations apply the disclosure and display provisions required by GAAP for accounting changes; therefore, the Board decided to include not-for-profit financial statements within the scope of this Statement.

A4. Under IFRS, entities are required to apply the general guidance for a change in accounting principle when applying a new standard, unless that standard has other specific transition guidance. The Board concluded that including transition for new accounting pronouncements in the scope of this Statement would establish retrospective application as the presumed transition method for new accounting pronouncements. However, the

Board will continue to establish transition guidance that differs from the guidance in this Statement if the Board determines that another method is more appropriate in specific circumstances.

### **Accounting Changes**

A5. In May 2002, the IASB issued its Exposure Draft, *Improvements to International Accounting Standards* (Improvements Exposure Draft), which, among other things, proposed changing the accounting for certain changes in accounting principles to require that those changes be retrospectively applied. The Improvements Exposure Draft also would classify a change in depreciation method for a previously recorded asset as a change in estimate and would require that change be accounted for prospectively. The IASB reaffirmed its position on those conclusions during its redeliberations of the proposed standard.

### **Change in Accounting Estimate**

A6. The Board carried forward in this Statement the general provisions in Opinion 20 for a change in accounting estimate, without reconsideration. Those provisions are convergent with the proposed IASB guidance, with the exception that the proposed IASB standard would account for a change in depreciation method as a change in estimate effected by a change in accounting principle. The Board noted that the information an entity would need to establish a basis for changing the depreciation method of an asset would be obtained by continued observation of actual use of the expected benefits of the asset as compared to previous estimations of the pattern of consumption that formed the basis for the initial depreciation method. Thus, the Board agreed with the IASB conclusion that a change in depreciation method is a change in estimate effected by a change in accounting principle.

A7. The Board noted that because it is a change in estimate, a change in depreciation method should be accounted for prospectively; however, appropriate disclosures would be required for the change in accounting principle that effected the change in estimate. Thus, the Board decided to require that a change in estimate effected by a change in accounting principle be disclosed in the same manner as a change in accounting principle, including disclosures about how the change in principle is justified on the basis that the new principle is preferable.

### **Change in Accounting Principle**

A8. The Board concluded that the retrospective application approach described in the IASB's Improvements Exposure Draft would enhance the interperiod comparability of financial information. The Board decided to converge with the IASB's proposed accounting for accounting changes. The Board noted that, besides the benefit of convergence, restating financial statements as if a newly adopted accounting principle had always been used results in greater consistency among periods. The FASB's conceptual framework describes consistency as one of the important qualitative characteristics of

accounting information. The Board concluded that when accounting changes are made, the comparative accounting data that result from retrospective application of those changes enhance the usefulness of the financial statements, especially by allowing the assessment of trends in financial information.

A9. The Board noted that in some cases, the IASB and the FASB use different terms to describe the same principle (for example, the term *retrospective application* as used by the IASB is synonymous with the term *retroactive restatement* as used in Opinion 20). The Boards believe that whenever possible, it is preferable to use the same terms to reduce the potential for inconsistent application of accounting pronouncements. Thus, the Board decided to use the term *retrospective application* to describe the reporting of a change in accounting principle and to use the term *restatement* only when describing the correction of an error. The Board concluded that terminology would better differentiate between changes in amounts reported for prior periods related to an accounting change and those related to the correction of an error.

### **Exceptions to the General Principle of Retrospective Application**

A10. The Board believes that under certain circumstances it would be impracticable for an entity to determine (a) the period-specific effects of an accounting change on one or more individual periods or (b) the cumulative effect of applying a change in accounting principle to all prior periods. In those instances, the Board decided to require a limited form of retrospective application in order to provide financial statement users with as much comparable financial information as practicable. The Board decided that if it is impracticable for an entity to determine the period-specific effects of a change in accounting principle for all prior periods, the new accounting principle should be applied to balances of assets and liabilities as of the beginning of the earliest period for which retrospective application is practicable, and a corresponding adjustment should be made to the opening balance of retained earnings (or other appropriate caption in the balance sheet or statement of position) for that period. For circumstances for which it is impracticable to determine the cumulative effect of applying a change in accounting principle to all prior periods, the Board decided to require that the entity apply the new accounting principle as if it were made prospectively as of the earliest date practicable.

A11. To enhance consistency of application, the Board decided to provide guidance limiting the use of the impracticability exception. This Statement describes the circumstances under which retrospective application of a new accounting principle would be impracticable and provides an exception to retrospective application for those circumstances. The Board noted that retrospective application would be impracticable if the effects of retrospective application are not determinable, or retrospective application would require assumptions about management's intent in a prior period, and decided to provide an exception to the general principle of retrospective application in those circumstances. The Board also discussed whether retrospective application involving significant estimates made as of a prior period would be impracticable.

A12. Estimation is frequently necessary in order to apply an accounting policy. Estimation is inherently subjective, and estimates are frequently developed after the close of a fiscal period for the purpose of preparing financial statements. Retrospective application of an accounting policy is potentially more difficult if the application of that policy involves the use of estimates, because a longer period has passed since the transaction date. However, in the context of retrospective application, the objective of estimates related to prior periods is the same as the objective of estimates related to current periods. That objective is to make an estimate that reflects the conditions that existed at the date the transaction would have been recognized in the financial statements had the newly adopted accounting principle been applied as of that earlier date. Achieving this objective requires differentiating between information that provides additional evidence about conditions that existed at the transaction date and information about conditions that arose subsequently. For some types of estimates (for example, an estimate of fair value not based on an objectively observable price or objectively observable inputs), it is not practicable to distinguish the information that would have been available about conditions that existed at the transaction date from all other types of information. Therefore, the Board decided that prospective application should be required when retrospective application would involve making a significant estimate for which it is not possible to distinguish information that provides additional evidence about conditions that existed at the transaction date from other types of information.

A13. The Board agrees with the Accounting Principles Board's conclusion that an entity should not change an accounting principle unless the entity can justify the newly adopted accounting principle on the basis that it is preferable. Thus, the Board decided to retain the requirement of Opinion 20 that entities disclose the nature and justification for a change in accounting principle and its effect on income.

### **Disclosures**

A14. The Board noted that it is important to provide financial statement users with information that allows them to distinguish between the effect of a change in accounting principle and other income statement changes. Therefore, the Board decided to continue to require disclosure of the effects of a change in accounting principle. Generally, these disclosures were carried forward from Opinion 20.

### **Change in the Reporting Entity**

A15. The Board carried forward without reconsideration the guidance in paragraphs 12, 34, and 35 of Opinion 20 on changes in the reporting entity. Editorial changes have been made to the guidance carried forward to make it more easily readable within the context of this Statement.

### **Accounting Change in Interim-Period Information**

A16. The Board decided not to permit accounting changes made in interim periods if it is impracticable to distinguish between the cumulative effects on prior years and the effects

on prior interim periods of the year of change. Statement 3 required entities to report an accounting change made during an interim period as if it had been adopted at the beginning of the fiscal year. Therefore, an enterprise making an accounting change in other than the first interim period must have been able to distinguish between the effects on the year of change and the effects on prior years to have met the requirements of Statement 3. The Board noted that accounting changes for which it is impracticable to distinguish between the cumulative effects on prior years and the effects on prior interim periods of the year of change will be rare. Also, the benefit of consistency of annual reporting outweighs the hardship placed on enterprises that are unable to distinguish between the two for a given change.

A17. The Board decided to carry forward the guidance from paragraphs 11(e) and 14 of Statement 3 in order to codify those provisions within this Statement.

### **Correction of an Error**

A18. The Board carried forward without reconsideration the provisions for correction of an error from paragraphs 13, 36, and 37 of Opinion 20. Editorial changes have been made to the sections carried forward to make those sections more easily readable within the context of this Statement. Also, the Board concluded that when an entity restates its financial statements to correct an error, it should disclose that fact so as to distinguish corrections of errors from accounting changes.

### **Effective Date and Transition**

A19. The Board decided to make the provisions of this Statement effective for accounting changes made after December 15, 2004, so that entities based in the European Union that report under U.S. GAAP would implement its provisions prior to the 2005 target date for reporting under IFRS. The Board decided to require prospective application of the provisions of this Statement because it does not believe the benefits of restating previously issued financial statements to retrospectively apply accounting changes made before this Statement was issued outweigh the costs of doing so.

A20. The Board noted that some accounting pronouncements that are in the transition phase might require transition provisions that would no longer exist after issuance of this Statement. For example, the transition provisions for FASB Statement No. 143, *Accounting for Asset Retirement Obligations*, require entities to recognize the cumulative effect of initially applying Statement 143 as a change in accounting principle in accordance with paragraph 20 of Opinion 20. This Statement eliminates the guidance in that paragraph. The Board decided that changing the transition provisions of existing pronouncements would not be cost-beneficial. Thus, the Board decided to exclude from the provisions of this Statement transition provisions of existing pronouncements that are in the transition phase as of the effective date of this Statement. The provisions of Opinion 20 continue to apply to those pronouncements until the transition period is complete.

## **Benefits and Costs**

A21. The mission of the FASB is to establish and improve standards of financial accounting and reporting for the guidance and education of the public, including preparers, auditors, and users of financial information. In fulfilling that mission, the Board endeavors to determine that a proposed standard will fill a significant need and that the costs imposed to meet that standard, as compared with other alternatives, are justified in relation to the overall benefits of the resulting information. Although the costs to implement a new standard may not be borne evenly, investors and creditors—both present and potential—and other users of financial information benefit from improvements in financial reporting, thereby facilitating the functioning of markets for capital and credit and the efficient allocation of resources in the economy.

A22. The Board acknowledges that there will be costs involved in retrospective application related to accounting changes. However, the Board believes that the benefits of more comparable information for comparative financial statements will outweigh any effort that would be required on the part of preparers. Further, the Board notes that this Statement will reduce the number of reconciling items between U.S. GAAP and IFRS, which should reduce the costs of an entity that is required to file a reconciliation from IFRS to U.S. GAAP.

## Appendix B

### AMENDMENTS TO EXISTING PRONOUNCEMENTS

B1. This Statement supersedes the following pronouncements:

- a. APB Opinion No. 20, *Accounting Changes*
- b. FASB Statement No. 3, *Reporting Accounting Changes in Interim Financial Statements*
- c. FASB Statement No. 73, *Reporting a Change in Accounting for Railroad Track Structures*
- d. FASB Interpretation No. 20, *Reporting Accounting Changes under AICPA Statements of Position*.

B2. ARB No. 43, *Restatement and Revision of Accounting Research Bulletins*, Chapter 2A, “Form of Statements—Comparative Financial Statements.” In paragraph 3, as amended by APB Opinion No. 20, *Accounting Changes*, the reference to *APB Opinion No. 20, Accounting Changes* is replaced by *as described in FASB Statement No. 15X, Accounting Changes and Error Corrections*.

B3. APB Opinion No. 22, *Disclosure of Accounting Policies*. In the second sentence of paragraph 14, *APB Opinion No. 20, Accounting Changes* is replaced by *FASB Statement No. 15X, Accounting Changes and Error Corrections*.

B4. APB Opinion No. 25, *Accounting for Stock Issued to Employees*. In the first sentence of paragraph 15, (*APB Opinion No. 20, Accounting Changes, paragraphs 31 to 33*) is replaced by (*FASB Statement No. 15X, Accounting Changes and Error Corrections, paragraphs 15–17 and 20*).

B5. APB Opinion No. 26, *Early Extinguishment of Debt*. In the second sentence of paragraph 22, *paragraph 16 of APB Opinion No. 20* is replaced by *paragraph 13 of FASB Statement No. 15X, Accounting Changes and Error Corrections*.

B6. APB Opinion No. 28, *Interim Financial Reporting*.

- a. In paragraph 24, *APB Opinion No. 20, Accounting Changes* is replaced by *FASB Statement No. 15X, Accounting Changes and Error Corrections*.
- b. Paragraph 25 is deleted.
- c. In the last sentence of paragraph 26, *paragraph 33 of APB Opinion No. 20* is replaced by *paragraph 20 of Statement 15X*.

B7. APB Opinion No. 30, *Reporting the Results of Operations—Reporting the Effects of Disposal of a Segment of a Business, and Extraordinary, Unusual and Infrequently Occurring Events and Transactions*. Paragraph 25 is replaced by the following:

Circumstances attendant to extraordinary items frequently require estimates, for example, of associated costs and occasionally of associated revenue, based on judgment and evaluation of the facts known at the time of first accounting for the event. Each adjustment in the current period of an element of an extraordinary item that was reported in a prior period should be separately disclosed as to year of origin, nature, and amount and classified separately in the current period in the same manner as the original item. If the adjustment is the correction of an error, the provisions of FASB Statement No. 15X, *Accounting Changes and Error Corrections*, paragraphs 25–27 should be applied.

B8. FASB Statement No. 5, *Accounting for Contingencies*. Paragraph 20, as amended by FASB Statement No. 11, *Accounting for Contingencies—Transition Method*, is amended as follows:

- a. In the fourth sentence, (*see paragraph 20 of APB Opinion No. 20*) is deleted.
- b. In footnote \*, *paragraph 31 of APB Opinion No. 20* is replaced by *paragraph 16 of FASB Statement No. 15X, Accounting Changes and Error Corrections*.
- c. In footnote \*\*, *required by paragraphs 19(d) and 21 of APB Opinion No. 20* is deleted.

B9. FASB Statement No. 16, *Prior Period Adjustments*.

- a. In footnote 4, renumbered as footnote 3 by FASB Statement No. 109, *Accounting for Income Taxes*, the phrase *paragraph 13 of APB Opinion No. 20* is replaced by *paragraph 25 of FASB Statement No. 15X, Accounting Changes and Error Corrections*.
- b. Footnote 6 is deleted.

B10. FASB Statement No. 19, *Financial Accounting and Reporting by Oil and Gas Producing Companies*.

- a. In the last sentence of paragraph 30, *paragraphs 31–33 of APB Opinion No. 20, “Accounting Changes”* is replaced by *paragraphs 15–17 and 20 of FASB Statement No. 15X, Accounting Changes and Error Corrections*.
- b. In the last sentence of paragraph 35, *paragraphs 31–33 of APB Opinion No. 20* is replaced by *paragraphs 15–17 and 20 of Statement 15X, Accounting Changes and Error Corrections*.

B11. FASB Statement No. 25, *Suspension of Certain Accounting Requirements for Oil and Gas Producing Companies*.

- a. In the last sentence of paragraph 4, *paragraph 16 of APB Opinion No. 20, "Accounting Changes"* is replaced by *paragraph 13 of FASB Statement No. 15X, Accounting Changes and Error Corrections*.
- b. Footnote 1 is replaced by the following:

Paragraphs 13 and 14 of Statement 15X state in part: "The presumption that an entity should not change an accounting principle may be overcome only if the entity justifies the use of an alternative acceptable accounting principle on the basis that it is preferable. . . . The issuance of a new pronouncement by the FASB or by other designated bodies as described in categories (a)–(d) of SAS 69 [AICPA Statement on Auditing Standards No. 69, *The Meaning of Present Fairly in Conformity With Generally Accepted Accounting Principles*], as codified in AU Section 411, that creates a new accounting treatment, interprets an existing principle, or expresses a preference for an existing accounting alternative is considered sufficient support for making a change in accounting principle, provided that the established U.S. GAAP hierarchy is followed. The burden of justifying other changes rests with the entity proposing the change."

B12. FASB Statement No. 52, *Foreign Currency Translation*. In the parenthetical sentence of paragraph 45, *APB Opinion No. 20, Accounting Changes, paragraph 8* is replaced by *FASB Statement No. 15X, Accounting Changes and Error Corrections, paragraph 6*.

B13. FASB Statement No. 67, *Accounting for Costs and Initial Rental Operations of Real Estate Projects*. In the last sentence of paragraph 12, *paragraph 31 of APB Opinion No. 20, Accounting Changes* is replaced by *paragraph 16 of FASB Statement No. 15X, Accounting Changes and Error Corrections*.

B14. FASB Statement No. 71, *Accounting for the Effects of Certain Types of Regulation*. In the first sentence of paragraph 31, *Opinion 20* is replaced by *FASB Statement No. 15X, Accounting Changes and Error Corrections*.

B15. FASB Statement No. 123, *Accounting for Stock-Based Compensation*.

- a. In the third sentence of paragraph 11, *APB Opinion No. 20, Accounting Changes* is replaced by *FASB Statement No. 15X, Accounting Changes and Error Corrections*.
- b. In footnote 7, *Opinion 20, paragraph 8* is replaced by *Statement 15X, Accounting Changes and Error Corrections, paragraph 6*.

B16. FASB Statement No. 142, *Goodwill and Other Intangible Assets*. In the fourth sentence of paragraph 56, *paragraph 10 of FASB Statement No. 3, Reporting Accounting*

*Changes in Interim Financial Statements* is replaced by paragraph 22 of FASB Statement No. 15X, *Accounting Changes and Error Corrections*.

B17. FASB Statement No. 143, *Accounting for Asset Retirement Obligations*. In the last sentence of paragraph 15, *APB Opinion No. 20, Accounting Changes (paragraph 31)* is replaced by FASB Statement No. 15X, *Accounting Changes and Error Corrections (paragraph 16)*.

B18. FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*.

a. In the first sentence of paragraph 9, *APB Opinion No. 20, Accounting Changes* is replaced by FASB Statement No. 15X, *Accounting Changes and Error Corrections*.

b. Footnote 7 is replaced by the following:

Paragraphs 15–17 and 20 of Statement 15X address the accounting for changes in estimates, including changes in the method of depreciation. Paragraph 11 of Statement 142 addresses the determination of the useful life of an intangible asset.

c. In the second sentence of paragraph 28, *Opinion 20* is replaced by *Statement 15X*.

d. In the first sentence of footnote 24, *or the cumulative effect of a change in accounting principle or both in accordance with Opinion 20* is deleted.

B19. FASB Interpretation No. 1, *Accounting Changes Related to the Cost of Inventory*. Paragraph 5 is replaced by the following:

A change in composition of the elements of cost included in inventory is an accounting change. A company which makes such a change for financial reporting shall conform to the requirements of FASB Statement No. 15X, *Accounting Changes and Error Corrections*, including justifying the change on the basis of preferability as specified in paragraphs 12–14 of that Statement. In applying Statement 15X, preferability among accounting principles shall be determined on the basis of whether the new principle constitutes an improvement in financial reporting and not on the basis of the income tax effect alone.

B20. FASB Interpretation No. 7, *Applying FASB Statement No. 7 in Financial Statements of Established Operating Enterprises*. In the last sentence of paragraph 5, *APB Opinion No. 20, “Accounting Changes”* is replaced by FASB Statement No. 15X, *Accounting Changes and Error Corrections*.

B21. FASB Interpretation No. 18, *Accounting for Income Taxes in Interim Periods*.

- a. The penultimate sentence of footnote 1, as amended by FASB Statement No. 144, *Accounting for the Impairment or Disposal of Long-Lived Assets*, is deleted.
- b. Paragraph 21 and the heading preceding it are deleted.
- c. In the first sentence of paragraph 64, *paragraph 10 of FASB Statement No. 3, "Reporting Accounting Changes in Interim Financial Statements"* is replaced by *paragraph 22 of FASB Statement No. 15X, Accounting Changes and Error Corrections*.