

Changes in Accounting Principles

Introduction

1. The second standard of reporting is:

The report shall identify, in the year of change, voluntary changes in accounting principles that have a material effect on the financial statements. For years subsequent to the year of change, the report shall continue to identify the voluntary changes only if comparability between financial statements presented is affected.

2. The objective of the second standard of reporting is to ensure that there will be appropriate reporting by the independent auditor of voluntary changes in accounting principles.¹ Such reporting by the auditor helps financial statement users focus on those changes in accounting principle that involve the use of judgment by the entity's management.

Identifying Voluntary Changes in Accounting Principles

3. For purposes of this Statement, a voluntary change in accounting principle is a change from one generally accepted accounting principle or method of application to another generally accepted accounting principle or method, for reasons other than the promulgation of an accounting principle by a standard-setting body designated to establish generally accepted accounting principles.^{2,3} The sources of GAAP to which this Statement applies are those described in paragraph 5a-c, of Statement on Auditing

¹ "Change in accounting principle" is a technical accounting term defined in Accounting Principles Board Opinion (APB) No. 20, *Accounting Changes*, as one that results from adoption of a generally accepted accounting principle different from the one used previously for reporting purposes. Pursuant to APB No. 20, 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. This Statement does not modify or interpret the definition of a change in accounting principle or any of the guidance in APB No. 20.

² A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error in previously issued financial statements under APB No. 20, and not a change in accounting principles. For reporting guidance on corrections of errors involving changes in accounting principles, see proposed amendment to Statement on Auditing Standards No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol. 1, AU sec. 508).

³ Early adoption of an accounting principle issued by a standard-setting body designated to establish generally accepted accounting principles, although done voluntarily, is not a voluntary change in accounting principle for purposes of this Statement.

Standards No. 69, *The Meaning of Present Fairly in Conformity with Generally Accepted Accounting Principles*, (AICPA, *Professional Standards*, vol. 1, AU section 411.05 a–c), as amended.

4. Changes in the reporting entity may result in a voluntary change in accounting principle. If the voluntary change in accounting principle has a material effect on the financial statements of the period of change, the auditor should follow the guidance in paragraph 6 of this Statement.

5. An independent auditor may be engaged to report on financial information for an annual period and a subsequent interim period. In some circumstances, accounting principles and practices used in preparing the annual financial information are modified when preparing the interim financial statements.⁴ Those modifications do not constitute changes in accounting principles under APB No. 20, and thus do not fall within the scope of this Statement

Reporting Voluntary Changes in Accounting Principles

6. When financial statements include a voluntary change in accounting principle that has a material effect on the financial statements, such change requires recognition in the independent auditor's report through the addition of an explanatory paragraph following the opinion paragraph.⁵ In subsequent periods, the auditor's report should continue to include the explanatory paragraph if:

- a. The period-of-change financial statements are presented in comparative form with financial statements of other periods, and
- b. Comparability between the financial statements of the periods presented is affected by the use of different accounting principles.

See SAS No. 58, *Reports on Audited Financial Statements*, (AICPA, *Professional Standards*, vol. 1, AU sec. 508.16–.18) for guidance on reporting voluntary changes in accounting principles.

7. Pursuant to SAS No. 58, *Reports on Audited Financial Statements* (AICPA, *Professional Standards*, vol.1, AU sec. 508.50), the auditor should evaluate a change in accounting principle to satisfy himself that (a) the newly adopted accounting principle is a generally accepted accounting principle, (b) the method of accounting for the effect of the change is in conformity with generally accepted accounting principles, and (c) management's justification for the change is reasonable. If (a) the newly adopted accounting principle is not a generally accepted accounting principle, (b) the method of

⁴ See APB Opinion No. 28, *Interim Financial Reporting*.

⁵ This Statement does not preclude an auditor from reporting changes in accounting principles that are not voluntary if, in the auditor's judgment, users of the financial statements would benefit from such reporting. Also, see paragraph 19 of SAS No. 58 (AU sec. 508.19).

accounting for the effect of the change is not in conformity with generally accepted accounting principles, or (c) management has not provided reasonable justification for the change in accounting principle, the auditor should follow the reporting guidance in SAS No. 58, paragraphs .50 through .57.

Effective Date

8. This statement is effective for reports issued or reissued on or after January 1, 2003.