

## ***Week 5 - DQ 1***

***What is a change in accounting principle? How do you determine if a change in principle should be reported retroactively, currently, or prospectively? How do these changes affect the financial statements? What experience do you have with change in accounting principle in your organization or an organization you are familiar with?***

### ***Response #1***

A change in accounting principle involves a change from one generally accepted accounting principle to another. To report changes currently, companies report the cumulative effect of the change in the current year's income statement as an irregular item. Retrospective application refers to an application of a different accounting principle to recast previously issued financial statements - as if the new principle had always been used. To report changes prospectively, previously reported results remain. The FASB requires that companies use the retrospective approach because it provides financial statement users with more useful information than the cumulative-effect or prospective approaches.

In the early 1980s the railroad industry switched from the retirement-replacement method of depreciating railroad equipment to more generally used methods such as straight-line depreciation. Using cumulative treatment, railroad companies would have made substantial adjustments to income in the period of change. Many in the industry argued that including such large cumulative-effect adjustments in the current year would distort the information and make it less useful.

### *Response #2*

A change in accounting principle is a change in accounting principles, accounting estimates, or the reporting entity. A change in accounting principle is a change in a method used, for example, an organization may change the basis of inventory pricing from FIFO TO LIFO. If a company is planning to keep previously reported results the same a change in principle should be reported prospectively. If a company is planning to just report the cumulative effect of the change in the current year's income statement as an irregular item the change in principle should be reported currently. Last, if a company is planning to recast previously issued financial statements-as if the new principle had always been used the change in principle should be reported retroactively. When changes occur financial statements are adjusted for each prior period presented. Assets and liabilities carrying amounts are adjusted as of the beginning of the first year presented and offsetting adjustments are made to the opening balance of retained earnings or net assets as of the beginning of the first year presented.

### *Response #3*

A change in accounting principle is a change in accounting principles, accounting estimates, or the reporting entity. A change in accounting principle is a change in a method used, for example, an organization may change the basis of inventory pricing from FIFO TO LIFO. If a company is planning to keep previously reported results the same a change in principle should be reported prospectively. If a company is planning to just report the cumulative effect of the change in the current year's income statement as an irregular item the change

in principle should be reported currently. Last, if a company is planning to recast previously issued financial statements-as if the new principle had always been used the change in principle should be reported retroactively. When changes occur financial statements are adjusted for each prior period presented. Assets and liabilities carrying amounts are adjusted as of the beginning of the first year presented and offsetting adjustments are made to the opening balance of retained earnings or net assets as of the beginning of the first year presented.

#### *Response #4*

A change in accounting principle is a change from one generally accepted accounting principle to another, changes in the accounting estimate, and changes in reporting entity. Determining if the change in accounting principle should be reported as retroactively, currently, or prospectively depends on the nature on the change. To report changes currently the cumulative effect has a difference in prior year's income between the newly adopted and prior accounting method. Reporting changes currently affects the financial statements because the effect of the change on prior years income appears only in the current-year income statement, the change does not apply to prior year income statement. Reporting changes prospectively is when it is impracticable to use retrospective application. This approach affects the financial statements by not changing previously results in which do not reflect the opening balance from change in principal.