



Ch-Ch-Ch-Changes

BY MICHELE MARK LEVINE

On May 20, 2021, the Governmental Accounting Standards Board (GASB) issued an Exposure Draft (ED) titled Accounting Changes and Error Corrections. With this ED, GASB is looking to bring more consistency to the reporting and disclosure of events that result in changes to previously reported information or potentially distort trend analysis. The clarity will likely be welcomed by most interested parties, although the additional reporting and disclosure requirements may not be welcome by all preparers. For those with opinions—pro or con—GASB is soliciting public comments on the proposals, which are due by August 31, 2021.

The scope of the ED includes proposed definitions of, and accounting and reporting standards for, (1) accounting changes, including changes in accounting principles, changes in accounting estimates, and changes to or within the financial reporting entity; as well as for (2) corrections of errors in previously issued financial statements. The ED also clarifies that the first-time adoption of GASB generally accepted accounting principles (GAAP) is neither an accounting change nor an error correction.

One key aspect of the ED is a proposed disclosure requirement for a schedule disclosing the effects of accounting changes and error corrections on beginning position, effectively serving

as a crosswalk from previously issued financial statements to the adjusted and/or restated financial statements (“crosswalk schedule”).

Changes in accounting principle

The ED proposes defining a change in accounting principle as the application of an accounting principle to transactions or other events (hereafter collectively referred to as “transactions”) of a similar type that are different from—and preferable to—the accounting principle previously applied to that type of transaction.

The proposed definition of a change in accounting principle excludes initial adoption and application

of an accounting principle to transactions that:

- Are clearly different in substance from those previously occurring,
- Are occurring for the first time, or
- Were previously insignificant in their effect.

Also excluded from the definition of a change in accounting principle are (1) implementations of new authoritative GAAP pronouncements and (2) changes from the application of a non-GAAP accounting principle to the application of a GAAP accounting principle, for transactions and events that were previously significant—the latter being error corrections, which are separately addressed in the ED and discussed below.

Changes that must be justified as being preferable to the previous practice (including changes in accounting principle and changes in estimation methodologies, discussed below) must be preferable based on the qualitative characteristics of financial reporting in GASB's conceptual framework, which are:

- Understandability,
- Reliability,
- Relevance,
- Timeliness,
- Consistency, and
- Comparability.¹

A change in an accounting principle (other than a change that results only in reclassification in financial statements, which are discussed below), absent specific transition guidance,² is proposed to be accounted for retroactively, by:

- Restatement of financial statements for each individual prior period presented, by applying the newly adopted accounting principle ("new principle"), if practicable; and
- Restatement of the beginning net position, beginning fund balance, or beginning fund net position, as applicable (hereafter collectively termed "beginning position") for the cumulative effect, if any, of the change

on prior periods, to earliest period presented applying the new principle. That earliest period will be either:

- The earliest period presented, or
- The earliest period for which it is practicable to apply the new principle, if later.

This proposal would represent a change from the current authoritative guidance on the accounting for changes in accounting principle, which requires adjusting the beginning position in the period of the change for the cumulative effect of changing to a new principle.³

Required disclosures for a change in an accounting principle, absent specific transition guidance, are proposed to be composed of:

- The nature of the change, including identification of the financial statement line items (other than totals and subtotals) affected,
 - The reason for the change, including why the new principle is preferable, except when implementing new GAAP (because the new GAAP is assumed to be preferable), and
 - The reason it is not practicable to restate prior periods presented, if applicable.
- Additionally, the effect of the change is proposed to be included in the crosswalk schedule discussed below.

Changes in accounting estimate

A change in accounting estimate is proposed to be defined as one that results from changes to the inputs (such as data, assumptions, and measurement methodologies) used to determine the accounting estimate, which is an output.

A change in an accounting estimate is proposed to be accounted for prospectively, by recognizing the effects of the change in the reporting period in which the change occurs. This does not represent a change from the current authoritative guidance on the accounting for changes in estimates,⁴ but it does more clearly state that the classification includes changes in estimation methodologies, which are

now sometimes erroneously treated as changes in accounting principles.

Required disclosures for a change in an accounting estimate are proposed to be composed of:

- The nature of the change, including identification of the financial statement line items (other than totals and subtotals) affected, and
- The reason for the change, if the change is the result of a change in measurement methodology, including why the new methodology is preferable, as discussed above.

Changes to or within the financial reporting entity

A change to or within the financial reporting entity is proposed to be defined as one that results from:

- The addition or removal of a fund, including from a government's blended component units (CUs),
- A change in the presentation of a governmental or enterprise fund as major or nonmajor,
- The addition or removal of a CU (note exclusions, discussed below), or
- The change in presentation of a CU (blended versus discrete).

A change to or within the financial reporting entity is proposed to exclude:

- Acquisitions, mergers, and transfers of operations that result in the addition or removal of a discretely presented CU, and
- CUs reported because of the reporting government's noninvestment majority equity interest.

A change to or within the financial reporting entity is proposed to be accounted for by adjusting the beginning position for the effect of the change, as if the change occurred as of the beginning of the reporting period.

Current GAAP include changes in the reporting entity as a special type of change in accounting principle,⁵ which requires restatement of prior periods when they occur.⁶ Current GAAP more narrowly defines this category,

however, limiting it to changes in which legal entities are included in the reporting entity, rather than also including changes within the entity (such as changes in the presentation of a governmental or enterprise fund from major to nonmajor or vice versa, and the addition or removal of funds). The proposal to include such fund reclassifications would call attention to and require explanation of events that routinely occur as a result of governments annually applying the quantitative test for major funds.

Proposed disclosure requirements for a change to or within the financial reporting entity include the nature and reasons for each change, and the effect of the change is proposed to be included in the crosswalk schedule discussed below.

Error corrections

Accounting errors are proposed to be defined as resulting from mathematical mistakes, mistakes in the application of accounting principles, or the oversight or misuse of facts that existed at the time the financial statements were issued, specifically those about conditions that existed as of the financial statement date, that could reasonably be expected to have been obtained and taken into account at that time.

A correction of an error (other than a correction that results only in reclassification in financial statements, which are discussed below) is proposed to be accounted for retroactively by restating financial statements for each individual prior period presented, and for restating the beginning position for the earliest period presented, for the cumulative effect of the change on periods prior to the first period presented. This does not represent a change in the currently required accounting for corrections of errors in previously issued financial statements.⁷

Disclosure for an error correction is proposed to require the inclusion of:

- The nature of the error and its correction, including identification of the financial statement line items (not sub/totals) affected.

- The effect of the correction on the change in net position, fund balance, or fund net position, as applicable, of the prior period.

Additionally, the effect of the error correction is proposed to be included in the crosswalk schedule, discussed below.

Accounting and disclosure for changes in accounting principle and corrections resulting in reclassification only

Changes and corrections that have no effect on beginning position are proposed to be reported by applying the reclassification to all prior periods presented for an error correction, or for all prior periods, if practicable, for a change in accounting principle.

Required disclosures under these circumstances are proposed as follows:

- For changes in accounting principle,
 - The nature of, and reason for, the accounting change, including why new principle is preferable (except when implementing new GAAP), and
 - The reason why reclassification of prior periods presented for an accounting change is not practicable, if applicable, or
- For an error, the nature of the error and its correction.

Display of the aggregate effect of accounting changes and error corrections

The ED proposes to require that the aggregated amount of adjustments of beginning position from all accounting changes and error corrections be displayed for each financial statement column, excluding totals. This would be a new requirement for preparers.

Crosswalk schedule

The ED proposes to require governments to disclose, in a table that reconciles beginning balances, as previously reported, to beginning balances, as restated for each financial statement column (excluding totals), for the following occurrences during the period that resulted in restatement (unless separately displayed in the financial statements):

- Each change in accounting principle,
- Each change to or within the reporting entity, and
- Each error correction.

Governments would disclose each of the above items separately for each reporting unit, combined to avoid unnecessary duplication. This would also be a new requirement for preparers.

Required and other supplementary information (RSI and SI)

The ED proposes to require that:

- For periods that are included in both the basic financial statements (BFS) and RSI/SI, the reporting in RSI/SI should follow that in the BFS, and
 - For periods present in RSI/SI but not in the BFS, information should not be restated for changes in accounting principles, but
 - Should be restated for error corrections.

When prior period information in RSI is inconsistent with current period information because of an accounting change, an explanation for that inconsistency should be provided. An explanation in MD&A should reference the related note disclosure.

Current GAAP do not directly address restatement of RSI and SI, and the proposal to require restatement of all prior periods in the case of an error correction may be a burden to preparers.⁸

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¹ It is noteworthy that these characteristics may be at odds with each other. For example, a change to using estimates rather than awaiting final actual results when measuring unavailable revenue in a governmental fund may be justified as being preferable based on timeliness, while a change from using estimates to awaiting final actual results may be justified as being preferable based on reliability.

² Such as in transition guidance in new GASB pronouncements.

³ GASB Cod. Sec. 2250.139-.140.

⁴ GASB Cod. Sec. 2250.146-147.

⁵ GASB Cod. Sec. 2250.134.

⁶ GASB Cod. Sec. 2250.149.

⁷ GASB Cod. Sec. 2250.123-124.