GASB Updates Rules on Accounting Changes & Error Corrections

Distinguishing between a change in accounting principle and a change in estimate can be difficult, but the distinction is critical to applying the correct guidance. GASB research indicated preparer classification challenges among the various adjustment categories and diversity in the related note disclosures. To address these issues, GASB recently released Statement 100, *Accounting Changes and Error Corrections,* which defines the following categories and the prescribed accounting for each:

- Changes in accounting principles
- Changes in accounting estimates
- Changes to or within the financial reporting entity
- Corrections of errors in previously issued financial statements

Effective Date

Statement 100
(early adoption encouraged)

Accounting changes and error corrections made in fiscal years beginning after June 15, 2023

Background

The first guidance on error correction and accounting changes was issued in 1971 and 1977, respectively, and was codified virtually unchanged into GASB Statement 62 in 2010.

Scope

The updates apply to the financial statements of all state and local governmental entities. Statement 62 guidance applied only to governmental activities, business-type activities, and proprietary funds. Statement 100 expands the scope to also include governmental funds and fiduciary funds.

Change in Accounting Principle

Once adopted, an accounting principle should be applied consistently for all transactions and other events of a similar type. A change in accounting principle results from either:

- A change from one GAAP to another GAAP that is justified based on the preferability (understandability, reliability, relevance, timeliness, consistency, and comparability) of the new accounting principle to the previous accounting principle, or
- The implementation of new authoritative accounting or financial reporting pronouncements

A change in accounting principle is the application of an accounting principle to transactions or other events of a similar type that is different from the accounting principle previously applied. The following items are not considered changes in accounting principle. The initial adoption and application of an accounting principle for transactions or other events that are:

- Clearly different in substance from previous transactions or events
- Occurring for the first time
- Previously insignificant in their effect

A change from applying non-GAAP to GAAP to transactions or other events that previously were significant is an error correction.

Reporting

Unless another standard directs otherwise, a change in accounting principle should be reported retroactively by restating financial statements for all prior periods presented, if practicable. Any cumulative effect of the change in accounting principle on prior periods to those presented should be reported as a restatement of beginning net position, fund balance, or fund net position, as applicable, of the earliest period presented. Each individual prior period presented should be restated to reflect the period-specific effects of applying the newly adopted accounting principle.

Statement 62 requires that only the beginning balances of the current period be restated with certain disclosures to show pro forma amounts of what prior periods would have been if the newly adopted accounting principle had been applied. GASB believes this update will result in better consistency and understandability by preparers and auditors.

If restatement of all prior periods presented is not practicable, the cumulative effect should be reported as a restatement of beginning net position, fund balance, or fund net position, as applicable, of the earliest period restated, *i.e.*, for the earliest period for which it is practicable to apply the newly adopted accounting principle.

A government should disclose the following in the financial statements notes for each change in accounting principle:

- The nature of the accounting principle change, including the financial statement line items affected. For new guidance, the pronouncement that was implemented
- Except for the implementation of a new pronouncement, the reason for the change in accounting principle, and the basis of preferability
- If prior periods presented are not restated because it is not practicable to do so, the reason why the restatement is not practicable
- The effects on beginning net position, fund balance, or fund net position, as applicable

Change in Accounting Estimate

Accounting estimates are *outputs* determined based on inputs such as data, assumptions, and measurement methodologies. *Outputs* are amounts that are recognized or disclosed in the basic financial statements and are subject to measurement uncertainty. A change in an accounting estimate occurs when *inputs* change, *e.g.*, a change in circumstance, new information, or more experience.

A change in an accounting estimate that results from a change in the measurement methodology, *i.e.*, a valuation technique, that is used to determine that estimate should be justified based on preferability (understandability, reliability, relevance, timeliness, consistency, and comparability).

Under Statement 62, a preferability justification was not required for a change in measurement methodology. This change may limit the frequency of such changes.

Reporting

Some changes in estimates are covered by specific guidance, *e.g.*, Statement No. 68, *Accounting and Financial Reporting for Pensions*. A change in an accounting estimate, not covered by other guidance, should be reported prospectively by recognizing the change in accounting estimate in the reporting period in which the change occurs. **This is consistent with current guidance in Statement 62.**

A government should disclose the following in the financial statements notes for each significant change in accounting estimate:

- The nature of the change in accounting estimate, including the financial statement line items affected
- If the change in accounting estimate results from a change in measurement methodology, the reason for the change in measurement methodology, and the basis of preferability

Note disclosure for a change in accounting estimate should be made only when the change is significant.

Change to or Within the Financial Reporting Entity

Statement 100 expands the categories from Statement 62 to also include additions or removals of funds resulting from the movement of primary government resources and changes in fund and component unit presentations.

This scope expansion means accounting change guidance will now apply to the reclassification of a fund from a major enterprise fund to a major special revenue fund.

Changes to or within the financial reporting entity result from:

- The addition or removal of a fund that results from the movement of continuing operations within the primary government, including its blended component units
- A change in a fund's presentation as major or nonmajor

- In general, the addition or removal of a component unit to the financial reporting entity. Acquisitions, mergers, or transfers of operations (as defined by Statement 69) that result in the addition or removal of a discretely presented component unit and component units reported pursuant to Statement 90, *Majority Equity Interests*, should not be considered changes to or within the financial reporting entity
- A change in a component unit's presentation as blended or discretely presented

Transactions or other events that could be classified as either a change in accounting principle or a change to or within the financial reporting entity should be considered a change to or within the financial reporting entity.

Reporting

A change to or within the financial reporting entity should be reported by adjusting beginning net position, fund balance, or fund net position, as applicable, for the effect of the change as if the change occurred as of the beginning of the reporting period (not all periods presented). A government should disclose in the financial statements notes the nature of and reason (except for changes in fund presentation for meeting/not meeting quantitative threshold for major funds) for each change to or within the financial reporting entity. In addition, the effects on beginning net position, fund balance, or fund net position, as applicable, should be disclosed.

Error Correction

An error results 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 issued about conditions that existed as of the financial statement date.

Prior-Period Adjustments Eliminated
Statement 62 only explicitly provided that error corrections be reported as prior-period adjustments. GASB research indicated that the term prior-period adjustment is used broadly to refer to any transaction or other event that results in an adjustment to or restatement of prior periods. The term often is used to describe a recognition method rather than a transaction type and is used for any item that is reported retroactively (including changes in accounting principles). Since this statement addresses the transactions or other events that should result in an adjustment to or restatement of prior periods, GASB concluded that a separate category for prior-period adjustments should be eliminated to remove redundancy and alleviate confusion.

Reporting

Statement 100 carries forward the retrospective restatement guidance from Statement 62. A correction of an error in previously issued financial statements should be reported retroactively by restating financial statements for all prior periods presented. There is no practicability exception. The cumulative effect of the error correction on periods prior to those presented should be reported as a restatement of beginning net position, fund balance, or fund net position, as applicable, of the earliest period presented. Each individual prior period presented should be restated to reflect the period-specific effects of correcting the error.

The following should be disclosed in the financial statement notes for each error correction:

- The nature of the error and its correction, including the periods affected by the error and identification of the financial statement line items (excluding totals and subtotals) affected by the correction. The identification of the line item is an expansion to previous guidance
- The effect of the error correction on the change in net position, fund balance, or fund net position, as applicable, of the prior period
- The effects on beginning net position, fund balance, or fund net position, as applicable, should be disclosed

Other Financial Reporting Requirements

The aggregate amount of adjustments to and restatements of beginning net position, fund balance, or fund net position, as applicable, should be displayed for each reporting unit. Previous guidance was silent on this issue, resulting in diversity in practice.

Financial Statement Notes

A government should disclose in the financial statement notes the effects on beginning net position, fund balance, and/or fund net position, as applicable, for each reporting unit of the earliest period restated for the following that occurred during the period:

- Each change in accounting principle (including the implementation of new pronouncements that result in restatement, even if there are specific transition provisions in other pronouncements)
- Each change to or within the financial reporting entity
- Each error correction

The effects should be disclosed in a tabular format that reconciles beginning balances as previously reported to beginning balances as adjusted or restated for each reporting unit. If the government has separately displayed in the financial statements the effects of each accounting change or error correction by reporting unit, those effects need not be repeated in notes to financial statements.

These required note disclosures should be made in the reporting period in which the accounting change occurred, or the error is discovered and corrected. Disclosure included in interim financial statements also should be included in the related annual financial statements. For comparative financial statements, if the prior periods presented were restated in the period in which the accounting change occurred or the error was discovered and corrected, subsequent annual financial statements need not repeat the disclosures.

Required Supplementary Information (RSI) (Including

Management's Discussion & Analysis [MD&A]) & Supplementary Information (SI)

RSI or SI may contain more prior periods than the basic financial statements, and GASB has provided additional guidance on the treatment of the following changes.

<u>Change in Accounting Principle & Financial Reporting Entity</u>

- For reporting periods presented in both the basic financial statements and RSI or SI, information should be presented consistently.
- For prior reporting periods that are **earlier** than those in the basic financial statements, RSI or SI should not be restated.
- If prior period RSI or SI is not consistent with current period information, an explanation of why the information is not consistent should be provided in RSI or SI, as applicable. The MD&A should reference the related footnote disclosure.

<u>Error Correction</u>

- For reporting periods presented in both the basic financial statements and RSI or SI, the RSI or SI should be restated to reflect the error correction.
- If the error affects periods **earlier** than those in the basic financial statements, all affected information should be corrected by restating the information for those prior periods in RSI or SI, if practicable.

Information presented in RSI or SI that is affected by an error should be identified as restated or not restated, as appropriate, and an explanation about the nature of the error should be provided in RSI or SI, as applicable. If it is not practicable to restate the RSI or SI information, an explanation of why it is not practicable to restate should be provided.

Transition & Effective Date

These changes are effective for accounting changes and error correction in reporting periods beginning after June 15, 2023. Early implementation is encouraged.

	Implement for Fiscal Years Ending			
Fiscal Years Beginning After	March 31	June 30	September 30	December 31
June 15, 2023	2025	2024	2024	2024

Conclusion

We will continue to follow this developing situation. If you have questions about these changes, contact one of our professionals today. For more information, visit forvis.com.

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