A "Change in an accounting principle" is changing from one generally accepted accounting principle to another generally accepted accounting principle, or changing the method of application of a particular principle. A change should only be made when the new principle is preferable over the former. When the FASB issues a new pronouncement that expresses preference for a particular principle, justification for a change is demonstrated; otherwise the burden of justification is on the entity. To report higher net income is not justification!

CHANGE IN AN ACCOUNTING PRINCIPLE (General Rule):

Use the Current or Catch-up Approach by:
- a. Reporting current results using the new basis. I.e., use the new method to determine income, balance sheet, etc.
- b. Reporting the cumulative effect of the adjustment in the current income statement between the captions "extraordinary items" and "net income".
- c. Presenting prior period financial statements as previously stated.
- d. Presenting pro-forma (as if) data on any item affected, net income and earning per share for all prior periods presented.
- e. Presenting pro-forma data for the current period income statement, i.e., without the cumulative effect of the change.

There are two exceptions to the general rule:
1. Changes whose cumulative effect is not determinable.
2. Retroactive application of some types of changes.

The change to the LIFO method of inventory valuation usually presents exception number one above, as the necessary detail on inventory valuation for prior years is not available. The APB specified that this type of change is impossible to determine the effect of. Therefore, employ the change to LIFO by:
- a. Not restating prior years' financial statements.
- b. Using opening inventory in the year the method is adopted as the base year inventory.
- c. Disclosing the effect of the change on the current year statements, and reasons for omitting the computation of the cumulative effect and pro forma amounts for prior years.

Use the Retroactive Approach by:
- a. Restating the financial statements of all prior periods presented.
- b. Disclosing in the year of the change the effect on net income and EPS for all prior periods presented.

The following require retroactive treatment:
1. Change from LIFO to any other inventory method.
2. Change to or from full-cost method of accounting by entities in the extractive industries.
3. Change to or from the completed contract method for long-term construction contracts.
5. Change from cost method to equity method for investments in common stock.
6. Change in any or all accounting methods for reports of entities that are "going public" or are seeking to merge with another entity. (Justification is demonstrated in these cases but these changes may be made one time only.)

7. Changes where promulgated GAAP require retroactive treatment as a result of a new accounting standard.

Changing the method of depreciation/amortization for new assets only is not a change in an accounting principle; but disclosure must be made of the change in methods and the effects on income in the year of the change.

When interim financial statements are prepared throughout the year, changes in accounting principles are treated as though they occurred during the first interim period, even if they did not. Thus requiring "retroactive interim treatment" during the current year.

CHANGE IN ESTIMATE:
Employ the current and prospective approach by:
- a. Reporting current and future financial statements using the new estimate.
- b. Presenting prior period financial statements as previously reported.
- c. Not making adjustments to current period opening balances for purposes of catch-up, and not making pro forma presentations.

CHANGE IN ENTITY:
Employ the retroactive approach by:
- a. Restating the financial statements of all prior periods presented.
- b. Disclosing in the year of change the effect on net income and EPS data for all prior periods presented.

CHANGE DUE TO ERROR: (Not considered a change in accounting principle!)
Employ the retroactive approach by:
- a. Correcting all prior period statements presented.
- b. Restating the beginning balance of retained earnings for the first period presented when the error-effects extend to a period prior to the one in which the error was discovered.