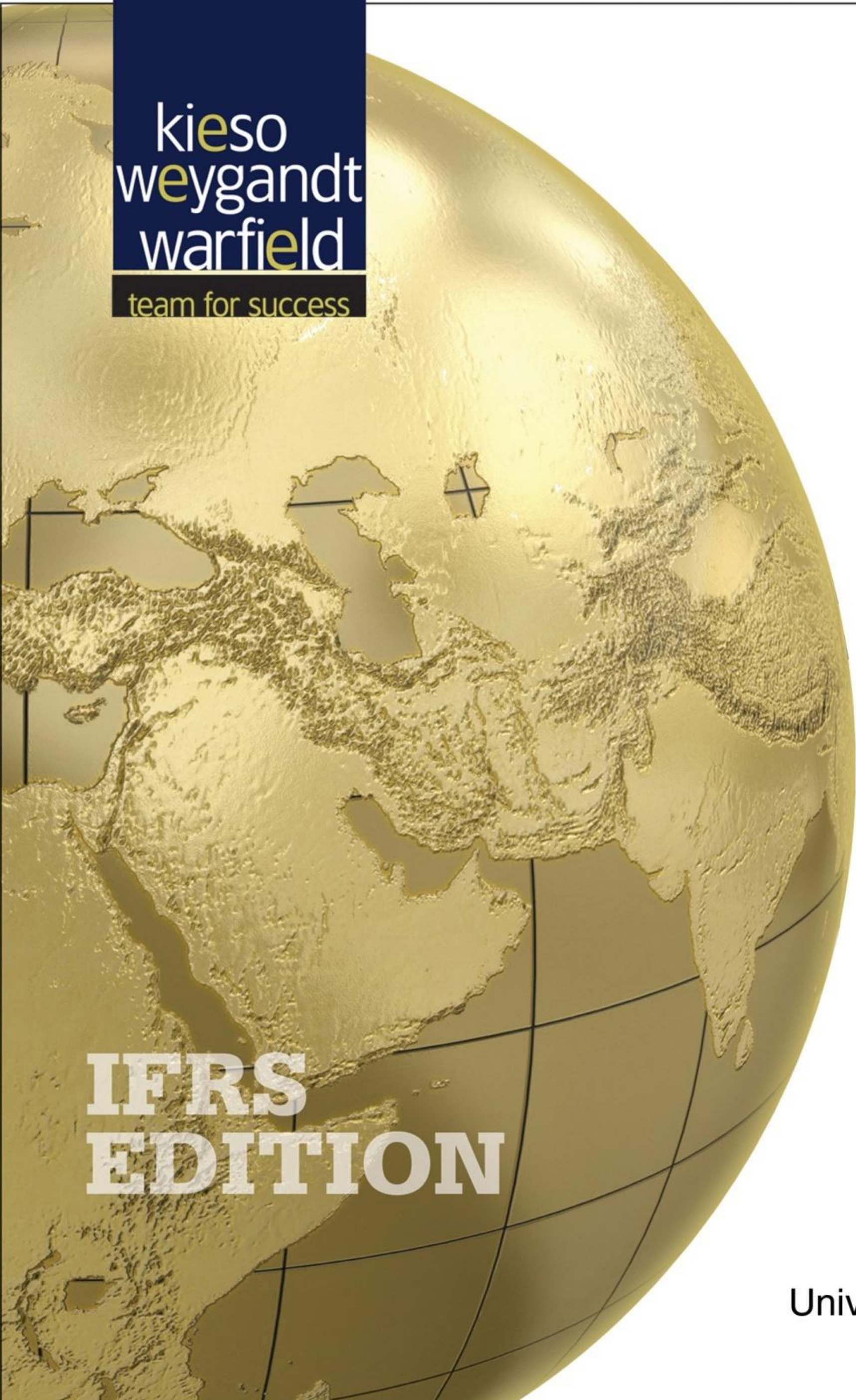
kieso
weygandt
warfield
team for success



INTERMEDIATE ACCOUNTING

SECOND EDITION

Prepared by
Coby Harmon
University of California, Santa Barbara
Westmont College

WILEY

PREVIEW OF CHAPTER 22

Accounting Changes and Error Analysis

Accounting Changes	Changes in Policy	Changes in Estimates	Accounting Errors	Error Analysis
	• Retrospective • Direct and indirect effects • Impracticability	• Prospective • Disclosure	• Example • Summary • Motivations	• Statement of financial position errors • Income statement errors • Statement of financial position and income statement errors • Comprehensive example • Preparation of statements with error corrections

Intermediate Accounting
IFRS 2nd Edition
Kieso, Weygandt, and Warfield

CHAPTER 22

Accounting Changes and Error Analysis

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. **Identify the two types of accounting changes.**
2. Describe the accounting for changes in accounting policies.
3. Understand how to account for retrospective accounting changes.
4. Understand how to account for impracticable changes.
5. Describe the accounting for changes in estimates.
6. Describe the accounting for correction of errors.
7. Identify economic motives for changing accounting policies.
8. Analyze the effect of errors.

ACCOUNTING CHANGES

Accounting Alternatives:

- Diminish the comparability of financial information.
- Obscure useful historical trend data.

Types of Accounting Changes:

1. **Change in Accounting Policy**.
2. **Changes in Accounting Estimate**.

Errors are not considered an accounting change.

CHAPTER 22

Accounting Changes and Error Analysis

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8. Analyze the effect of errors.

CHANGES IN ACCOUNTING POLICY

Change from one accepted accounting policy to another.

Examples include:

- Average-cost to LIFO.
- Cost-recovery to percentage-of-completion method.

Adoption of a new policy in recognition of events that have occurred for the first time or that were previously immaterial is not an accounting change.

CHANGES IN ACCOUNTING POLICY

Three approaches for reporting changes:

1) Currently.

2) Retrospectively.

3) Prospectively (in the future).

IASB requires use of the **retrospective** approach.

Rationale - Users can then better compare results from one period to the next.

CHAPTER 22

Accounting Changes and Error Analysis

LEARNING OBJECTIVES

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8. Analyze the effect of errors.

CHANGES IN ACCOUNTING POLICY

Retrospective Accounting Change Approach

Company reporting the change

1) Adjusts its financial statements for each prior period presented to the same basis as the new accounting policy.

2) Adjusts the carrying amounts of assets and liabilities as of the beginning of the first year presented. Also makes an offsetting adjustment to the opening balance of retained earnings or other appropriate component of equity or net assets as of the beginning of the first year presented.

CHANGES IN ACCOUNTING POLICY

Retrospective Accounting Change: Long-Term Contracts

Illustration: Denson Company has accounted for its income from long-term construction contracts using the cost-recovery method. In 2015, the company changed to the percentage-of-completion method. Management believes this approach provides a more appropriate measure of the income earned. For tax purposes, the company uses the cost-recovery method and plans to continue doing so in the future. (Assume a 40 percent enacted tax rate.)

CHANGES IN ACCOUNTING POLICY

ILLUSTRATION 22-1
Comparative Income Statements for Cost-Recovery versus Percentage-of-Completion Methods

COST-RECOVERY METHOD
DENSON COMPANY
INCOME STATEMENT (PARTIAL)
FOR THE YEAR ENDED DECEMBER 31

	2013	2014	2015
Income before income tax	€400,000	€160,000	€190,000
Income tax (40%)	160,000	64,000	76,000
Net income	€240,000	€ 96,000	€114,000

PERCENTAGE-OF-COMPLETION METHOD
DENSON COMPANY
INCOME STATEMENT (PARTIAL)
FOR THE YEAR ENDED DECEMBER 31

	2013	2014	2015
Income before income tax	€600,000	€180,000	€200,000
Income tax (40%)	240,000	72,000	80,000
Net income	€360,000	€108,000	€120,000

LO 3

CHANGES IN ACCOUNTING POLICY

Data for Retrospective Change Example

ILLUSTRATION 22-2

	Pretax Income from		Difference in Income		
Year	Percentage-of-Completion	Cost-Recovery	Difference	Tax Effect 40%	Income Effect (net of tax)
Prior to 2014	€600,000	€400,000	€200,000	€80,000	€120,000
In 2014	180,000	160,000	20,000	8,000	12,000
Total at beginning of 2015	€780,000	€560,000	€220,000	€88,000	€132,000
Total in 2015	€200,000	€190,000	€ 10,000	€ 4,000	€ 6,000

Journal entry beginning of 2015

Construction in Process	220,000	
Deferred Tax Liability		88,000
Retained Earnings		132,000

LO 3

CHANGES IN ACCOUNTING POLICY

Reporting a Change in Policy

Major disclosure requirements are as follows.

1. Nature of the change in accounting principle.
2. Reasons why applying the new accounting policy provides reliable and more relevant information;
3. For the current period and each prior period presented, to the extent practicable, the amount of the adjustment:
   a) For each financial statement line item affected; and
   b) Basic and diluted earnings per share.
4. The amount of the adjustment relating to periods before those presented, to the extent practicable.

DENSON COMPANY
INCOME STATEMENT (PARTIAL)
FOR THE YEAR ENDED

	2015	2014
		As adjusted (Note A)
Income before income tax	€200,000	€180,000
Income tax (40%)	80,000	72,000
Net income	€120,000	€108,000

Note A: Change in Method of Accounting for Long-Term Contracts. The company has accounted for revenue and costs for long-term construction contracts by the percentage-of-completion method in 2015, whereas in all prior years revenue and costs were determined by the cost-recovery method. The new method of accounting for long-term contracts was adopted to recognize . . . [state justification for change in accounting policy] . . . , and financial statements of prior years have been restated to apply the new method retrospectively. For income tax purposes, the cost-recovery method has been continued. The effect of the accounting change on income of 2015 was an increase of €6,000 net of related taxes and on income of 2014 as previously reported was an increase of €12,000 net of related taxes. The balances of retained earnings for 2014 and 2015 have been adjusted for the effect of applying retrospectively the new method of accounting. As a result of the accounting change, retained earnings as of January 1, 2014, increased by €120,000 compared to that reported using the cost-recovery method.

ILLUSTRATION 22-3
Comparative Information Related to Accounting Change (Percentage-of-completion)

CHANGES IN ACCOUNTING POLICY

Retained Earnings Adjustment

Retained earnings balance is €1,360,000 at the beginning of 2016.

Before Change

DENSON COMPANY
RETAINED EARNINGS STATEMENT
FOR THE YEAR ENDED

ILLUSTRATION 22-4

	2015	2014	2013
Retained earnings, January 1	€1,696,000	€1,600,000	€1,360,000
Net income	114,000	96,000	240,000
Retained earnings, December 31	€1,810,000	€1,696,000	€1,600,000

Retained earnings, January 1, 2014 (percentage-of-completion)	€1,720,000
Retained earnings, January 1, 2014 (cost-recovery)	1,600,000
Cumulative-effect difference	€ 120,000

LO 3

CHANGES IN ACCOUNTING POLICY

Retained Earnings Adjustment

Retained earnings, January 1, 2014 (percentage-of-completion)	€1,720,000
Retained earnings, January 1, 2014 (cost-recovery)	1,600,000
Cumulative-effect difference	€ 120,000

After Change

ILLUSTRATION 22-5

DENSON COMPANY
RETAINED EARNINGS STATEMENT
FOR THE YEAR ENDED

	2015	2014
Retained earnings, January 1, as reported	—	€1,600,000
Add: Adjustment for the cumulative effect on prior years of applying retrospectively the new method of accounting for construction contracts		120,000
Retained earnings, January 1, as adjusted	€1,828,000	1,720,000
Net income	120,000	108,000
Retained earnings, December 31	€1,948,000	€1,828,000

CHANGES IN ACCOUNTING POLICY

Illustration: Cherokee Construction Company changed from the cost-recovery to the percentage-of-completion method of accounting for long-term construction contracts during 2015. For tax purposes, the company employs the cost-recovery method and will continue this approach in the future. (*Hint:* Adjust all tax consequences through the Deferred Tax Liability account.) The appropriate information related to this change is as follows.

	Pretax Income from		
	Percentage-of-Completion	Cost-Recovery	Difference
2014	$780,000	$610,000	$170,000
2015	700,000	480,000	220,000

CHANGES IN ACCOUNTING POLICY

	Pretax Income from		
	Percentage-of-Completion	Cost-Recovery	Difference
2014	$780,000	$610,000	$170,000
2015	700,000	480,000	220,000

Instructions: (assume a tax rate of 35%)

(a) What entry(ies) are necessary to adjust the accounting records for the change in accounting principle?

(b) What is the amount of net income and retained earnings that would be reported in 2015? Assume beginning retained earnings for 2014 to be $100,000.

CHANGES IN ACCOUNTING POLICY

Pre-Tax Income from Long-Term Contracts

Date	Percentage-of-Completion	Cost-Recovery	Difference	35% Tax Effect	Net of Tax
2014	$ 780,000	$ 610,000	170,000	59,500	$ 110,500
2015	700,000	480,000	220,000	77,000	143,000

Journal entry (recorded in 2015)

Construction in Process	170,000	
Deferred Tax Liability		59,500
Retained Earnings		110,500

CHANGES IN ACCOUNTING POLICY

Comparative Statements

		2015	Restated 2014	Previous 2014
Income Statement	Pre-tax income			$ 610,000
	Income tax (35%)			213,500
	Net income			$ 396,500
Statement of Retained Earnings	Beg. Retained earnings		$ 100,000	$ 100,000
	Accounting change			
	Beg. R/Es restated			100,000
	Net income			396,500
	End. Retained earnings			$ 496,500

LO 3

CHANGES IN ACCOUNTING POLICY

Direct and Indirect Effects of Changes

- **Direct Effects -** IASB takes the position that companies should retrospectively apply the **direct effects of a change in accounting policy**.

- **Indirect Effect** is any change to **current or future** cash flows of a company that result from making a change in accounting principle that is applied retrospectively.

CHAPTER 22

Accounting Changes and Error Analysis

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

1. Identify the two types of accounting changes.
2. Describe the accounting for changes in accounting policies.
3. Understand how to account for retrospective accounting changes.
4. **Understand how to account for impracticable changes.**
5. Describe the accounting for changes in estimates.
6. Describe the accounting for correction of errors.
7. Identify economic motives for changing accounting policies.
8. Analyze the effect of errors.

CHANGES IN ACCOUNTING POLICY

Impracticability

Companies should not use retrospective application if one of the following conditions exists:

1. Company cannot determine the effects of the retrospective application.
2. Retrospective application requires assumptions about management's intent in a prior period.
3. Retrospective application requires significant estimates that the company cannot develop.

If any of the above conditions exists, the company **prospectively applies** the new accounting principle.

CHAPTER 22

Accounting Changes and Error Analysis

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CHANGES IN ACCOUNTING ESTIMATE

Examples of Estimates

1. Bad debts.
2. Inventory obsolescence.
3. Useful lives and residual values of assets.
4. Periods benefited by deferred costs.
5. Liabilities for warranty costs and income taxes.
6. Recoverable mineral reserves.
7. Change in depreciation estimates.
8. Fair value of financial assets or financial liabilities.

CHANGES IN ACCOUNTING ESTIMATE

Prospective Reporting

Changes in accounting estimates are reported **prospectively**. Account for changes in estimates in

1. the period of change if the change affects that period only, or
2. the period of change and future periods if the change affects both.

IASB views changes in estimates **as normal recurring corrections and adjustments** and prohibits retrospective treatment.

CHANGES IN ACCOUNTING ESTIMATE

Illustration: Arcadia HS purchased equipment for $510,000 which was estimated to have a useful life of 10 years with a salvage value of $10,000 at the end of that time. Depreciation has been recorded for 7 years on a straight-line basis. In 2015 (year 8), it is determined that the total estimated life should be 15 years with a salvage value of $5,000 at the end of that time.

Required:

- What is the journal entry to correct prior years' depreciation expense?
- Calculate depreciation expense for 2015.

No Entry Required

CHANGES IN ESTIMATE

After 7 years

Equipment cost	$510,000
Residual value	- 10,000
Depreciable base	500,000
Useful life (original)	10 years
Annual depreciation	$ 50,000

x 7 years = **$350,000**

First, establish book value at date of change in estimate.

Statement of financial position (Dec. 31, 2014)	
Property, Plant, and Equipment:	
Equipment	$510,000
Accumulated depreciation	350,000
Book value (BV)	**$160,000**

CHANGES IN ACCOUNTING ESTIMATE

Book value	
Residual value (if any)	
Depreciable base	
Useful life	
Annual depreciation	

Second, calculate depreciation expense for 2015.

Journal entry for 2015

Depreciation expense	19,375	
Accumulated depreciation		19,375

CHANGES IN ACCOUNTING ESTIMATE

Disclosures

A company should disclose the nature and amount of a change in an accounting estimate that has an effect in the current period or is expected to have an effect in future periods (unless it is impracticable to estimate that effect).

Companies need not disclose changes in accounting estimate made as part of normal operations, such as bad debt allowances or inventory obsolescence, unless such changes are material.

CHAPTER 22

Accounting Changes and Error Analysis

LEARNING OBJECTIVES

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7. Identify economic motives for changing accounting policies.
8. Analyze the effect of errors.

ACCOUNTING ERRORS

Types of Accounting Errors:

1. A change from an accounting principle that is **not** generally accepted to an accounting policy that is acceptable.
2. Mathematical mistakes.
3. Changes in estimates that occur because a company did not prepare the estimates in good faith.
4. Failure to accrue or defer certain expenses or revenues.
5. Misuse of facts.
6. Incorrect classification of a cost as an expense instead of an asset, and vice versa.

ACCOUNTING ERRORS

ILLUSTRATION 22-16
Accounting-Error Types

Accounting Category	Type of Restatement
Expense recognition	Recording expenses in the incorrect period or for an incorrect amount.
Revenue recognition	Instances in which revenue was improperly recognized, questionable revenues were recognized, or any other number of related errors that led to misreported revenue.
Misclassification	Include restatements due to misclassification of short- or long-term accounts or those that impact cash flows from operations.
Equity—other	Improper accounting for EPS, restricted stock, warrants, and other equity instruments.
Reserves/Contingencies	Errors involving accounts receivables' bad debts, inventory reserves, income tax allowances, and loss contingencies.
Long-lived assets	Asset impairments of property, plant, and equipment; goodwill; or other related items.

ACCOUNTING ERRORS

ILLUSTRATION 22-16
Accounting-Error Types

Accounting Category	Type of Restatement
Taxes	Errors involving correction of tax provision, improper treatment of tax liabilities, and other tax-related items.
Equity—other comprehensive income	Improper accounting for comprehensive income equity transactions including foreign currency items, revaluations of plant assets, unrealized gains and losses on certain investments in debt, equity securities, and derivatives.
Inventory	Inventory costing valuations, quantity issues, and cost of sales adjustments.
Equity—share options	Improper accounting for employee share options.
Other	Any restatement not covered by the listed categories, including those related to improper accounting for acquisitions or mergers.

Source: T. Baldwin and D. Yoo, "Restatements—Traversing Shaky Ground," Trend Alert, Glass Lewis & Co. (June 2, 2005), p. 8.; and "2012 Financial Restatements," *Audit Analytics* (March 2013).

ACCOUNTING ERRORS

- All material errors must be corrected.
- Record **corrections of errors** from prior periods as an adjustment to the beginning balance of retained earnings in the current period.
- Such corrections are called **prior period adjustments**.
- For comparative statements, a company should restate the prior statements affected, to correct for the error.

Example of Error Correction

Illustration: In 2016 the bookkeeper for Selectro Company discovered an error. In 2015 the company failed to record £20,000 of depreciation expense on a newly constructed building. This building is the only depreciable asset Selectro owns. The company correctly included the depreciation expense in its tax return and correctly reported its income taxes payable.

Example of Error Correction

Selectro's income statement for 2015 with and without the error.

SELECTRO COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED, DECEMBER 31, 2015

ILLUSTRATION 22-17

		Without Error		With Error
Income before depreciation expense		£100,000		£100,000
Depreciation expense		20,000		0
Income before income tax		80,000		100,000
Current	£32,000		£32,000	
Deferred	–0–	32,000	8,000	40,000
Net income		£ 48,000		£ 60,000

What are the entries that Selectro should have made and did make for recording depreciation expense and income taxes?

LO 6

Example of Error Correction

ILLUSTRATION 22-17

SELECTRO COMPANY
INCOME STATEMENT
FOR THE YEAR ENDED, DECEMBER 31, 2015

		Without Error		With Error
Income before depreciation expense		£100,000		£100,000
Depreciation expense		20,000		0
Income before income tax		80,000		100,000
Current	£32,000		£32,000	
Deferred	–0–	32,000	8,000	40,000
Net income		£ 48,000		£ 60,000

Entries Company Should Have Made (Without Error)			Entries Company Did Make (With Error)		
Depreciation Expense	20,000		No entry made for depreciation		
Accumulated Depreciation—Buildings		20,000			
Income Tax Expense	32,000		Income Tax Expense	40,000	
Income Taxes Payable		32,000	Deferred Tax Liability		8,000
			Income Taxes Payable		32,000

ILLUSTRATION 22-18

Example of Error Correction

ILLUSTRATION 22-18

Entries Company Should Have Made (Without Error)			Entries Company Did Make (With Error)		
Depreciation Expense	20,000		No entry made for depreciation		
Accumulated Depreciation—Buildings		20,000			
Income Tax Expense	32,000		Income Tax Expense	40,000	
Income Taxes Payable		32,000	Deferred Tax Liability		8,000
			Income Taxes Payable		32,000

Income Statement Effects

Depreciation expense (2015) is

Income tax expense (2015) is

Net income (2015) is

Statement of Financial Position Effects

Accumulated depreciation—buildings is

Deferred tax liability is

Example of Error Correction

Prepare the proper correcting entry in 2016, that should be made by Selectro.

ILLUSTRATION 22-18

Entries Company Should Have Made (Without Error)			Entries Company Did Make (With Error)		
Depreciation Expense	20,000		No entry made for depreciation		
Accumulated Depreciation—Buildings		20,000			
Income Tax Expense	32,000		Income Tax Expense	40,000	
Income Taxes Payable		32,000	Deferred Tax Liability		8,000
			Income Taxes Payable		32,000

Correcting Entry in 2016

Retained Earnings **12,000**

Example of Error Correction

Prepare the proper correcting entry in 2016, that should be made by Selectro.

ILLUSTRATION 22-18

Entries Company Should Have Made (Without Error)			Entries Company Did Make (With Error)		
Depreciation Expense	20,000		No entry made for depreciation		
Accumulated Depreciation—Buildings		20,000			
Income Tax Expense	32,000		Income Tax Expense	40,000	
Income Taxes Payable		32,000	Deferred Tax Liability		8,000
			Income Taxes Payable		32,000

Reversal

Correcting Entry in 2016

Retained Earnings	**12,000**
Deferred Tax Liability	**8,000**

Example of Error Correction

Prepare the proper correcting entry in 2016, that should be made by Selectro.

ILLUSTRATION 22-18

Entries Company Should Have Made (Without Error)			Entries Company Did Make (With Error)		
Depreciation Expense	20,000		No entry made for depreciation		
Accumulated Depreciation—Buildings		20,000			
Income Tax Expense	32,000		Income Tax Expense	40,000	
Income Taxes Payable		32,000	Deferred Tax Liability		8,000
			Income Taxes Payable		32,000

Correcting Entry in 2016

Retained Earnings	**12,000**	
Deferred Tax Liability	**8,000**	
Accumulated Depreciation—Buildings		**20,000**

Example of Error Correction

Single-Period Statements

Illustration: Selectro Company has a beginning retained earnings balance at January 1, 2016, of £350,000. The company reports net income of £400,000 in 2016.

ILLUSTRATION 22-19
Reporting an Error—Single-Period Financial Statement

SELECTRO COMPANY
RETAINED EARNINGS STATEMENT
FOR THE YEAR ENDED DECEMBER 31, 2016

Retained earnings, January 1, as reported		£350,000
Correction of an error (depreciation)	£20,000	
Less: Applicable income tax reduction	8,000	(12,000)
Retained earnings, January 1, as adjusted		338,000
Add: Net income		400,000
Retained earnings, December 31		£738,000

LO 6

Example of Error Correction

Comparative Statements

Company should

1. make adjustments to correct the amounts for all affected accounts reported in the statements for **all periods** reported.

2. restate the data to the correct basis for each year presented.

3. show any **catch-up adjustment** as a prior period adjustment to retained earnings for the earliest period it reported.

ACCOUNTING ERRORS

Woods, Inc.
Statement of Retained Earnings
For the Year Ended December 31, 2015

Balance, January 1	$	1,050,000
Net income		360,000
Dividends		(300,000)
Balance, December 31	$	1,110,000

Before issuing the report for the year ended December 31, 2014, you discover a $62,500 error that caused the 2013 inventory to be overstated (overstated inventory caused COGS to be lower and thus net income to be higher in 2013). Would this discovery have any impact on the reporting of the Statement of Retained Earnings for 2014? Assume a 20% tax rate.

ACCOUNTING ERRORS

Woods, Inc.

Statement of Retained Earnings

For the Year Ended December 31, 2015

ACCOUNTING ERRORS

Summary of Accounting Changes and Correction of Errors

ILLUSTRATION 22-21

Changes in accounting policy

Employ the retrospective approach by:

a. Changing the financial statements of all prior periods presented.

b. Disclosing in the year of the change the effect on net income and earnings per share for all prior periods presented.

c. Reporting an adjustment to the beginning retained earnings balance in the statement of retained earnings in the earliest year presented.

If impracticable to determine the prior period effect:

a. Do not change prior years' income.

b. Use opening asset balance in the year the method is adopted as the base-year balance for all subsequent computations.

c. Disclose the effect of the change on the current year, and the reasons for omitting the computation of the cumulative effect and amounts for prior years.

⇩ ⇩ ⇩

Summary of Changes and Errors

ILLUSTRATION 22-21

Changes in accounting estimate

Employ the current and prospective approach by:

a. Reporting current and future financial statements on the new basis.
b. Presenting prior period financial statements as previously reported.
c. Making no adjustments to current-period opening balances for the effects in prior periods.

Changes due to error

Employ the restatement 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 occur in a period prior to the first period presented.

CHAPTER 22

Accounting Changes and Error Analysis

LEARNING OBJECTIVES

After studying this chapter, you should be able to:

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3. Understand how to account for retrospective accounting changes.
4. Understand how to account for impracticable changes.
5. Describe the accounting for changes in estimates.
6. Describe the accounting for correction of errors.
7. **Identify economic motives for changing accounting policies.**
8. Analyze the effect of errors.

ACCOUNTING ERRORS

Motivations for Changes of Accounting Method

Why companies may prefer certain accounting methods. Some reasons are:

1. Political costs.
2. Capital Structure.
3. Bonus Payments.
4. Smooth Earnings.

CHAPTER 22

Accounting Changes and Error Analysis

LEARNING OBJECTIVES

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6. Describe the accounting for correction of errors.
7. Identify economic motives for changing accounting policies.
8. **Analyze the effect of errors.**

ERROR ANALYSIS

Companies must answer three questions:

1. What type of error is involved?
2. What entries are needed to correct for the error?
3. After discovery of the error, how are financial statements to be restated?

Companies treat errors as **prior-period adjustments** and report them in the current year as **adjustments to the beginning balance of Retained Earnings**.

ERROR ANALYSIS

Statement of Financial Position Errors

Statement of financial position errors affect only the presentation of an asset, liability, or equity account.

- Current year error - reclassify item to its proper position.
- Prior year error - restate the statement of financial position of the prior year for comparative purposes.

ERROR ANALYSIS

Income Statement Errors

Improper classification of revenues or expenses.

- Current year error - reclassify item to its proper position.
- Prior year error - restate the income statement of the prior year for comparative purposes.

ERROR ANALYSIS

Statement of Financial Position and Income Statement Errors

Counterbalanceing errors will be offset or corrected over two periods.

1. If company **has closed** the books in the current year:

    a. If the error is already counterbalanced, no entry is necessary.

    b. If the error is not yet counterbalanced, make entry to adjust the present balance of retained earnings.

For comparative purposes, restatement is necessary even if a correcting journal entry is not required.

ERROR ANALYSIS

Statement of Financial Position and Income Statement Errors

Counterbalanceing errors will be offset or corrected over two periods.

2. If company **has not closed** the books in the current year:

   a. If error already counterbalanced, make entry to correct the error in the current period and to adjust the beginning balance of Retained Earnings.

   b. If error not yet counterbalanced, make entry to adjust the beginning balance of Retained Earnings.

LO 8

ERROR ANALYSIS

Statement of financial position and Income Statement Errors

Non-Counterbalancing Errors

- Not offset in the next accounting period.
- Companies must make correcting entries, even if they have closed the books.

ERROR ANALYSIS

E22-19 (Error Analysis; Correcting Entries): A partial trial balance of Dickinson Corporation is as follows on December 31, 2015.

	Dr.	Cr.
Supplies	R 2,500	
Salaries and wages payable		R 1500
Interest receivable	5,100	
Prepaid insurance	90,000	
Unearned rent		0
Interest payable		15,000

Instructions: (a) Assuming that the books have **not been closed**, what are the adjusting entries necessary at December 31, 2015?

ERROR ANALYSIS

(a) Assuming that the books have **not been closed**, what are the adjusting entries necessary at December 31, 2015?

1. A physical count of supplies on hand on December 31, 2015, totaled R1,100.

Supplies Expense (R2,500 – R1,100)	1,400	
Supplies on Hand		1,400

2. Accrued salaries and wages on December 31, 2015, amounted to R4,400.

Salary and Wages Expense	2,900	
Accrued Salaries and Wages		2,900

LO 8

ERROR ANALYSIS

(a) Assuming that the books have **not been closed**, what are the adjusting entries necessary at December 31, 2015?

3. Accrued interest on investments amounts to R4,350 on December 31, 2015.

Interest Revenue (R5,100 – R4,350)	750	
Interest Receivable		750

4. The unexpired portions of the insurance policies totaled R65,000 as of December 31, 2015.

Insurance Expense	25,000	
Prepaid Insurance		25,000

ERROR ANALYSIS

(a) Assuming that the books have **not been closed**, what are the adjusting entries necessary at December 31, 2015?

5. R24,000 was received on January 1, 2015, for the rent of a building for both 2015 and 2016. The entire amount was credited to rental income.

Rental Income (R24,000 ÷ 2)	12,000	
Unearned Rent		12,000

6. Depreciation for the year was erroneously recorded as R5,000 rather than the correct figure of R50,000.

Depreciation Expense	45,000	
Accumulated Depreciation		45,000

ERROR ANALYSIS

E22-19 (Error Analysis; Correcting Entries): A partial trial balance of Dickinson Corporation is as follows on December 31, 2015.

	Dr.	Cr.
Supplies	R 2,500	
Salaries and wages payable		R 1500
Interest receivable	5,100	
Prepaid insurance	90,000	
Unearned rent		0
Interest payable		15,000

Instructions: **(b)** Assuming that the books **have been closed**, what are the adjusting entries necessary at December 31, 2015?

ERROR ANALYSIS

(b) Assuming that the books **have been closed**, what are the adjusting entries necessary at December 31, 2015?

1. A physical count of supplies on hand on December 31, 2015, totaled R1,100.

Retained Earnings	1,400	
Supplies		1,400

2. Accrued salaries and wages on December 31, 2015, amounted to R4,400.

Retained Earnings	2,900	
Accrued Salaries and Wages		2,900

ERROR ANALYSIS

(b) Assuming that the books **have been closed**, what are the adjusting entries necessary at December 31, 2015?

3. Accrued interest on investments amounts to R4,350 on December 31, 2015.

Retained Earnings (R5,100 – R4,350)	750	
Interest Receivable		750

4. The unexpired portions of the insurance policies totaled R65,000 as of December 31, 2015.

Retained Earnings	25,000	
Prepaid Insurance		25,000

ERROR ANALYSIS

(b) Assuming that the books **have been closed**, what are the adjusting entries necessary at December 31, 2015?

5. R24,000 was received on January 1, 2015 for the rent of a building for both 2015 and 2016. The entire amount was credited to rental income.

Retained Earnings	12,000	
Unearned Rent		12,000

6. Depreciation for the year was erroneously recorded as R5,000 rather than the correct figure of R50,000.

Retained Earnings	45,000	
Accumulated Depreciation		45,000

GLOBAL ACCOUNTING INSIGHTS

ACCOUNTING CHANGES AND ERRORS

The FASB has issued guidance on changes in accounting policies, changes in estimates, and corrections of errors, which essentially converges U.S. GAAP to IAS 8.

GLOBAL ACCOUNTING INSIGHTS

Relevant Facts

Following are the key similarities and differences between U.S. GAAP and IFRS related to accounting for accounting changes.

Similarities

- The accounting for changes in estimates is similar between U.S. GAAP and IFRS.
- Under U.S. GAAP and IFRS, if determining the effect of a change in accounting policy is considered impracticable, then a company should report the effect of the change in the period in which it believes it practicable to do so, which may be the current period.

Relevant Facts

Differences

- One area in which U.S. GAAP and IFRS differ is the reporting of error corrections in previously issued financial statements. While both sets of standards require restatement, U.S. GAAP is an absolute standard—there is no exception to this rule.
- Under U.S. GAAP, the impracticality exception applies only to changes in accounting principle. Under IFRS, this exception applies both to changes in accounting principles and to the correction of errors.
- U.S. GAAP has detailed guidance on the accounting and reporting of indirect effects. As indicated in the chapter, IFRS (IAS 8) does not specifically address the accounting and reporting for indirect effects of changes in accounting principles.

GLOBAL ACCOUNTING INSIGHTS

On the Horizon

For the most part, U.S. GAAP and IFRS are similar in the area of accounting changes and reporting the effects of errors. Thus, there is no active project in this area. A related development involves the presentation of comparative data. U.S. GAAP requires comparative information for a three-year period. Under IFRS, when a company prepares financial statements on a new basis, two years of comparative data are reported. Use of the shorter comparative data period must be addressed before U.S. companies can adopt IFRS.

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