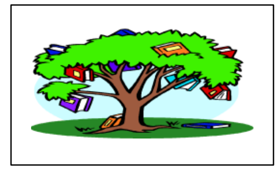
Toward Business Literacy: Accounting Outlines



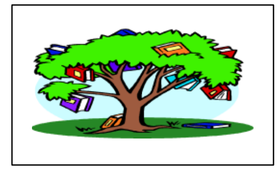
Accounting Changes and Errors

Change of Principle

- GAAP to GAAP
    - No change if events occur for the 1st time or if previously immaterial
    - If the principle followed was not acceptable or incorrectly applied, this is an error
- Ways to deal with corrections
    - **Retroactive**: recast financials of prior years
    - **Current**: cumulative effect computed and placed on income statement after extraordinary items
    - **Prospective**: no change
- Cumulative Effect or "catch up" method → GAAP
    - Show effect on income statement (prior periods- cumulative)
    - Don't restate prior periods
    - Pro-forma and related EPS on face of the income statement
    - Journal entry includes the account, deferred tax asset or liability and cumulative effect of change in principle
    - Income statement has a pro-forma section (as if)
        - This is useful for trends; in a separate schedule or in notes
- Retroactive
    - Recast statements- adjust Retained Earnings of earliest year presented
        - Inventory method
        - Long term construction contracts
        - To or from "full cost"- extractive industries
- Prospective
    - Change to LIFO method
        - Base year inventory for all subsequent LIFO calculations is opening inventory in year method is adopted (don't restate)

Change of Estimate

- Types of changes
    - Uncollectible Receivables
    - Inventory Obsolescence
    - Useful lives and salvage values
    - Periods benefited by deferred costs
    - Liabilities for warranty costs
    - Mineral resources
- Handled prospectively (no change or "catch up")
- If there is a question about whether it is a principle or estimate change→ choose estimate
- Careful estimates later proved incorrect are not errors



Change in Entity

- Restate for prior periods

Error Correction

- APB #20 and FASB #16
- Errors must pass internal controls (1st line of defense) and audit procedures (2nd line of defense)
- Types of errors
    - Non-GAAP to GAAP
    - Mathematical miscalculations
    - Faithless estimate
    - Oversight
    - Misuse
    - Incorrect classification
- Treatment: Prior period adjustments for year of discovery
    - Affects Retained Earnings

Error Analysis

- Questions: What type? Is there an entry needed? Restate financials?
- Counterbalancing→ error offsets or corrected over 2 periods\
    - If books are closed there is no entry
    - If books are not closed, if company is in its 2nd year, an entry is needed to correct current period and beginning Retained Earnings
- Non-counterbalancing→ corrected over more than 2 periods
    - If books are closed, adjust Retained Earnings
    - If books are not closed- make entry for current year and beginning Retained Earnings

Changing To and From the Equity Method

- From the Equity Method
    - Earnings and dividends still remain part of the Carrying Value
    - From equity to the Fair Value→cost basis is Carrying Value at the date of change
- To the Equity Method
    - Retroactive adjustment necessary
    - Adjust carrying amount→ results of operations and Retained Earnings of investor as if equity method has been in effect during all previous periods investment was held
    - Eliminate any balance in unrealized holding gains and/or loss as well as any fair value adjustment