

What Are Prior Period Errors?

Worksheet

A prior period error is corrected retrospectively by restating prior period comparatives and adjusting the opening balance of retained earnings for the earliest period presented.

Questions

1. How should a material prior period error be corrected?
 - A) Prospectively, in the current period only
 - B) Retrospectively, restating prior comparatives
 - C) Ignored if immaterial to next year
 - D) By adjusting only the cash flow statement
2. Which of these is a prior period error, not a change in estimate?
 - A) Revising a machine's useful life
 - B) Applying the wrong depreciation method contrary to policy for years
 - C) Updating the bad debt rate with new default data
 - D) Changing warranty cost estimates
3. A \$40,000 error is corrected with a 25% tax rate. What is the net retained earnings adjustment?
 - A) \$40,000
 - B) \$30,000
 - C) \$10,000
 - D) \$50,000
4. What financial statement line absorbs the retrospective correction of a prior period error?
 - A) Current year revenue
 - B) Opening retained earnings of the earliest period presented
 - C) Cash and cash equivalents
 - D) Share capital
5. A company discovers it forgot to record \$40,000 of depreciation expense two years ago. The tax rate is 25%. How is this corrected?
6. An audit reveals inventory was overstated by \$60,000 last year due to a counting error. Tax rate is 20%. What is the retained earnings adjustment?
7. A company changes its estimate of a machine's useful life from 10 to 6 years. Is this a prior period error?
8. Define: What is a prior period error?
9. Define: How is a prior period error corrected?
10. Define: Is a change in estimate the same as a prior period error?

Answer Key

1. B) Retrospectively, restating prior comparatives - IAS 8 requires retrospective restatement of comparatives for material prior period errors.
2. B) Applying the wrong depreciation method contrary to policy for years - Applying a method inconsistent with the stated accounting policy is an error, not a judgment-based estimate revision.
3. B) $\$30,000 - 40,000 (1 \times 0.25) = \$30,000$.
4. B) Opening retained earnings of the earliest period presented - The correction adjusts the opening balance of retained earnings for the earliest comparative period.
5. Prior period error = $\$40,000$ (understated expense) Net-of-tax adjustment = $40,000 (1 \times 0.25) = \$30,000$ Restate opening retained earnings down by $\$30,000$ and correct the comparative income statement
6. Prior period error = $\$60,000$ (overstated asset) Net-of-tax adjustment = $60,000 (1 \times 0.20) = \$48,000$ Reduce opening retained earnings by $\$48,000$ and restate the comparative balance sheet
7. New information about the asset's condition drove this reassessment This is a change in accounting estimate, not an error Applied prospectively only - no restatement of prior years
8. A mistake or omission in previously issued financial statements from misusing reliable information available at the time.
9. Retrospectively - by restating comparative figures and adjusting opening retained earnings.
10. No - an estimate change is applied prospectively; an error is corrected retrospectively.

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