Think Ahead ACCA

Technical factsheet:

Prior period errors and adjustments

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1. INTRODUCTION

The purpose of this factsheet is to provide guidance on the accounting for and disclosure of prior period errors and adjustments within statutory financial statements. This factsheet will consider the provisions within the Companies Act 2006 and the accounting and disclosure requirements within the related accounting regulations, Financial Reporting Standard 102, *The Financial Reporting Standard Applicable in the UK and Republic of Ireland*, and Financial Reporting Standard 105, *The Financial Reporting Standard Applicable to the Micro-entities Regime*.

2. LEGISLATIVE REQUIREMENTS

The accounting provisions are contained within two pieces of legislation: The Small Companies and Groups (Accounts and Directors' Report) Regulations 2015 and The Large and Medium-sized Companies and Groups (Accounts and Reports) Regulations 2015, along with the Companies Act 2006.

However, there are no specific provisions in respect of prior period errors and adjustments in any of these pieces of legislation.

3. ACCOUNTING STANDARDS

The relevant accounting provisions are contained within three standards:

- FRS 102, *The Financial Reporting Standard Applicable in the UK and Republic of Ireland*
  This standard applies for all entities adopting UK GAAP for accounting periods commencing on or after 1 January 2015 (1 January 2016 for small entities)
- FRS 105, *The Financial Reporting Standard Applicable to the Micro-entities Regime*
  This standard applies for all micro-entities applying the micro-entities regime in the UK for accounting periods commencing on or after 1 January 2016 (1 January 2017 for the Republic of Ireland)
- IAS 8, *Accounting Policies, Changes in Accounting Estimates and Errors*
  This standard applies for all entities adopting International Accounting Standards for accounting periods commencing on or after 1 January 2005.

Definitions

The definition of prior period errors in FRS 102 and FRS 105 is mainly derived from IAS 8 to provide consistency between the standards. FRS 102 states:

'Prior period errors are omissions from, and misstatements in, an entity's financial statements for one or more prior periods arising from a failure to use, or misuse of, reliable information that:

(a) was available when financial statements for those periods were authorised for issue; and

(b) could reasonably be expected to have been obtained and taken into account in the preparation and presentation of those financial statements.

Such errors include the effects of mathematical mistakes, mistakes in applying accounting policies, oversights or misinterpretations of facts, and fraud.'

Errors that aren't considered fundamental are accounted for in the period they are identified.

4. EXAMPLES

(a) *A company had failed to depreciate a class of assets in the past that should have been depreciated. Is the adjustment a prior period adjustment?*

Yes. Correction of this would be treated as a prior period error and adjustment as the company should have depreciated the assets but it did not comply with the accounting policy.

(b) *A company is changing a rate of depreciation. Do I have to go back and amend the previous year accounts with the new rates?*

No. The change in the rate of depreciation charged on a group of assets would be a revision of an accounting estimate and the undepreciated balance would be depreciated equally over the remaining useful life of the individual assets, with no correction of the previous over- or under-depreciation of the assets.

Further details of accounting for prior period errors and adjustments on transition between accounting standards can be found in ACCA's technical factsheet FRS 102 – small company reporting.

The following is an example of a prior period error highlighting how this could be disclosed in a set of statutory accounts:

Statement of changes in equity (SOCIE)

Year ended 30 April 20XX	20XX	20YY
		As restated
	£	£
Profit for the financial year	12,000	14,200
Unrealised surplus on revaluation of certain fixed assets	25,000	–
	37,000	14,200
Prior year adjustment (as explained in note 1)	2,997	–
	39,997	14,200

Note 1: Contracts for services – prior period adjustment

The accounts have been restated to incorporate the impact of a misclassification of a contract for service as work in progress. The change has resulted in profits available for distribution at 30 April 20XX increasing after tax by £2,997:

Summary of the prior year accounting impact	£
Reduction in stock – work in progress	-7,800
Increase in debtors – amounts due under contracts	11,500
Increase in creditors – corporation tax	-703
	2,997

In addition to the above disclosure where corresponding figures have been changed the words ‘as restated’ should be placed under the year heading on all relevant statements and notes.

5. ACCOUNTING AND TAX IMPACT

The general principle in all the applicable standards is that an entity must, to the extent practicable, correct a *material* prior period error *retrospectively* in the first financial statements authorised for issue after its discovery by:

(a) restating the comparative amounts for the prior period(s) presented in which the error occurred, or

(b) if the error occurred before the earliest prior period presented, restating the opening balances of assets, liabilities and equity for the earliest prior period presented.

When it is impracticable to determine the period-specific effects of a material error on comparative information for one or more prior periods presented, the entity shall restate the opening balances of assets, liabilities and equity for the earliest period for which retrospective restatement is practicable (which may be the current period).

Disclosure requirements for small companies using FRS 102 are set out in Section 1A as:

1AC.8 Where the corresponding amount for the immediately preceding reporting period is not comparable with the amount to be shown for the item in question in respect of the reporting period, and the corresponding amount is adjusted, the particulars of the non-comparability and of any adjustment must be disclosed in a note to the financial statements. (Schedule 1, paragraph 7(2))

This is likely to be relevant where there has either been a change in accounting policy or the correction of a material prior period error. Paragraphs 10.13, 10.14 and 10.23 address similar requirements.

1AC.9 Where any amount relating to a preceding reporting period is included in any item in the income statement, the effect must be stated. (Schedule 1, paragraph 61(1))

Disclosure of prior period errors (for entities adopting full FRS 102)

10.23 An entity shall disclose the following about material prior period errors:

(a) the nature of the prior period error

(b) for each prior period presented, to the extent practicable, the amount of the correction for each financial statement line item affected

(c) to the extent practicable, the amount of the correction at the beginning of the earliest prior period presented

(d) an explanation if it is not practicable to determine the amounts to be disclosed in (b) or (c) above.

Financial statements of subsequent periods need not repeat these disclosures.

HMRC guidance for tax treatment of prior period adjustments

Chapter 14 Part 3 CTA 2009 provides that where there is a change from one valid basis on which the profits of a trade are calculated to another valid basis (for example, on a change of accounting policy), an adjustment must be calculated to ensure that business receipts will be taxed once and once only and deductions will be given once and once only. For corporation tax purposes, adjustments are treated as receipts or deductions in computing the trade profits.

That approach will continue to apply for prior period adjustments arising in accordance with accounting standards.

The above applies to changes from one valid basis to another. Where the change is from an invalid basis (such as may occur when a material error is identified in the accounts), UK tax law requires the invalid basis to be corrected for tax purposes in the period it first occurred, with subsequent periods also corrected for tax purposes. Whether tax can be collected or repayments claimed for earlier periods is dependent on the time limits for making or amending self-assessments.

Similar tax rules apply for changes in accounting policies or errors on non-trade items, such as loan relationships, derivative contracts and intangible fixed assets.

6. SOURCES OF INFORMATION

The following legislation should be referred to when required:

- Companies Act 2006
- The Small Companies and Groups (Accounts and Directors' Report) Regulations 2008
- The Companies, Partnerships and Groups (Accounts and Reports) Regulations 2015
- Corporation Tax Act 2009
- Accounting standards can be accessed on the Financial Reporting Council website

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