CORRECTING ACCOUNTING ERRORS AND ACKNOWLEDGING THEM IN THE EARNINGS TO THE PERIOD

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Abstract: *The accounting information is reliable when it does not contain significant errors, is not biased and accurately represents the transactions and events. In the light of the regulations complying with European directives, the information is significant if its omission or wrong presentation may influence the decisions users make based on annual financial statements. Given that the professional practice sees errors in registering or interpreting information, as well as omissions and wrong calculations, the Romanian accounting regulations stipulate treatments for correcting errors in compliance with international references. Thus, the correction of the errors corresponding to the current period is accomplished based on the retained earnings in the case of significant errors or on the current earnings when the errors are insignificant. The different situations in the professional practice triggered by errors require both knowledge of regulations and professional rationale to be addressed.*

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Introduction

The role of the annual financial statements is to provide users with information which should be useful for them in the decision-making process. But "there are as many truths as recipients of information are and, excluding quality, the reductive effect of each measure is inevitable." [1] The general conceptual framework of IASB, the variant from 2011, presents an overview of the qualitative characteristics of the accounting information as follows:
(a) Fundamental qualitative characteristics:
(a1) relevance;
(a2) exact representation;
(b) Amplifying qualitative characteristics:
(b1) comparability;
(b2) verifiability;
(b3) opportunity;
(b4) intelligibility;

Other qualitative characteristics are added to these features, which, according to OMFP 3055/2009, "constitute the attribute which determine the usefulness of the information offered by financial statements", ranking intelligibility, relevance, credibility and comparability first.
Nevertheless, the professional practice often sees registration, interpretation, omission errors, which can alter one or several qualitative characteristics which the accounting information should meet. The professional lexis comprises the definition of the term "accounting error" [2]:

"The error attributed to an erroneous computation, to the wrong interpretation of information without considering the facts encountered when devising financial statements or due to the adoption of an unacceptable accounting practice". Taking into account the moment and circumstances which triggered the accounting error and the regulations in the field, but also the rationale of accounting professionals, its correction can be accomplished in various ways.

The professional rationale in accounting and the correction of accounting errors

The need for convergence and uniformity in accounting has triggered the effort for normalization, developed on two levels: * legal or regulated normalization
* professional normalization

The object of accounting normalization is represented by the general chart of accounts, the organization of accounting documents and procedures, but, most of all, by the the annual financial statements.

Over the recent period, an increasing number of specialized papers have been analyzing the so called "Bermuda triangle in accounting", comprising the professional rationale, the accounting principles and a rule-based system. "Everybody agrees with a principle-based system, but everybody wants rules to avoid uncertainties. Principles require a rationale, and the rationale is an integral part of financial statements".[3]

The need for certainty and uniformity of financial statements leads to more and more rules, but, at the same time, it is the obligation of accounting professionals devising financial statements and of financial managers to have solid management rationale. The reliability of reasons, as well as any idea rightly defended support professional rationale when it does not defy the normative references accounting professionals resort to.

There is a strong connection between the professional rationale and the socio-economic environment, which has been enhanced once the economic environment developed, culminating with the global economic crisis. The professional rationale can be performed by people who have the necessary knowledge, experience and objective attitude, abilities acquired progressively in order to make the right decisions based on the relevant facts and circumstances. In practice, when accounting professionals correct errors, they need to emphasize the professional rationale as a defining element of their professionalism and independence.

Accounting policies and admitting errors in accounting

The internationalization of accounting is comprised in the tendency towards internationalization and general globalization, as defining features of the 21st century. Internationally, the normalization reference regarding accounting estimates and error correction is IAS8 "Accounting policies, changes in the accounting estimates and errors". In this respect, the standard sets the selection and application criteria for accounting policies, as well as the concept of error, by referring to prior periods as follows:[4]

"The errors of the prior period represent omissions and erroneous declarations included in the financial statements of the entity for one or several prior periods, resulting from the neutralization or wrong use of reliable information which:

(a) was available at the moment when the publication of the financial statements for those periods was authorized;

(b) could have been obtained and reasonably considered when devising and presenting those financial statements.

Such errors include effects of mathematical errors, mistakes in applying accounting policies, negligence or wrong interpretation of facts, and frauds".

In Romania, The Accounting Regulations compliant with the European Directives approved by OMFP no.3055/2009 set the necessity to devise and approve our own accounting policies. Accounting policies consist in a company adopting principles, conventions, rules and practices specific to devising and presenting financial statements. "From another perspective, accounting policies imply options determined by certain interests, compliant with certain principles, rules and conventions regarding the registration, acknowledgement and evaluation of the elements described by the accounting model, the devising and presentation of financial statements." [3]

According to the I.A.S. and the Financial Regulation of the European Union, it is necessary for the management of each legal person to design a set of procedures for all the operations processed, starting from devising the supporting documents and until the trimestrial and annual financial statements have been completed. Given that accounting principles cnnot be unitary or "standardized", they need to be devised by specialists in the economic and technical field, familiar with the activity conducted and with the strategy adopted by the entity. Procedurally, the setting of the accounting principles of an entity as regards an element of the balance resides in choosing a variant out of several admitted ones by legislative and normative acts. In accounting for the method chosen, one needs to start from the peculiar features of the activity of the business and its acknowledgement as basis for keeping the accounts and devising financial statements.

In what follows we present some examples of accounting principles:

-choosing the method to write off capital assets
-reconsidering tangible assets or keeping their historical cost
-capitalizing interest or considering it as expense
-choosing the evaluation method for stocks
- keeping the accounts of stocks by means of the on-going or periodical inventory
-remedying insignificant errors
-capitalizing the surplus from revaluation.

Distinction should be made between accounting policies and accounting estimates. As a result of the inherent uncertainties in conducting activities, some elements of the annual financial statements cannot be evaluated precisely, but only estimated. The estimates in accounting represent rough appraisals or evaluations, given the uncertainty of the size of certain elements, transactions and events acknowledged in financial statements.

Estimates can be performed as regards: uncertain customers, obsolescence of stocks, operating time of depreciable assets etc. The estimating process involves professional rationale based on the latest information available regarding the given event or cause. The freedom in formulating accounting policies and choosing accounting methods, although appreciated from the point of view of the creativity, has to resort to selection and application criteria, according to IAS 8. With respect to the correction of accounting errors, the Romanian regulations include the spirit IAS 8 :

"(4) The correction of the errors corresponding to the current period is accomplished based on the profit and loss account.
(5) The correction of significant errors corresponding to prior periods is accomplished based on retained earnings.
(6) Insignificant errors corresponding to prior periods can be also corrected based on retained earnings. Nevertheless, insignificant errors can be corrected based on the profit and loss account".

According to item number 63 of O.M.F.P. no.3055/2009, the correction of errors found in accounting is accomplished at the date of their detection, the remedial methods differing according to the period the errors refer to.

3. Acknowledging errors in the current earnings

Considering the possibilities to identify them, registration errors in accounting can be divided into two categories:
a) accounting registration errors which can be identified by the lack of congruency in certain values of the checking balance sheet in tabular form for synthetical accounts;
b) accounting registration errors which can be identified by the lack of certain correlations in the values of the checking balance sheet for synthetical accounts and for analytical accounts.

Accounting registration errors which can be discovered by means of checking balance sheets for synthetical accounts

Given the use of information systems in processing the accounting information over the last decade, one can say that the errors which used to occur as regards the checking of the congruency of values in the balance sheet for synthetical accounts have almost been automatically eliminated. The main categories of registration errors which can be identified given the lack of congruency in certain values of the checking balance sheet in tabular form for synthetical accounts are: errors in devising the checking balance sheets, errors in setting the elements connected to the values of the accounts (turnover, sums, final balance accounts), registration errors in the systematic register and errors in setting the sums in the accounting formulae in the chronological register. The operations involved in identifying and eliminating registration errors are performed in reversed order as compared to the one in which the devising of the checking balance sheet used to be performed, which used to raise problems for professional accountants when data were processed manually. The appropriate command of the functions of information systems for automatic data processing in the finance and accounting field and the right management of the specific programme packs exempts professional accountants of these types of errors tributary to the system involving the manual processing of data.

Accounting registration errors which cannot be detected by means of checking balance sheets for synthetical accounts

Balance sheets for synthetical accounts cannot help in detecting errors which change the data in accounts, equally, both in the debts and in the credits.
These categories of errors comprise:
1. accounting registration omissions: they reside in the fact that certain economic operations registered in the documents have been left out in the current acc.
2. compensation errors; they occur when sums from supporting documents are wrongly registered in the account book or in the ledger, in the sense that an additional sum was registered in an account and an equal smaller sum in another, so that, overall, the two errors are mutually compensated.
3. imputation errors; they are due to the registration of right sums, but in accounts which do not correspond to the economic content of that operation.
4. registration errors in the chronological records; they can be generated by several causes, such as the wrong correspondence of certain accounts, the double registration of an economic operation etc.

Accounting errors can impinge on both the balance and the profit and loss account, or either of these two components of the annual financial statements. Those which affect only the accounts of the balance without having an effect over the revenue and expense accounts are mainly due to causes such as: using inappropriate accounts for the operation, omitting the registration of certain material goods or the registration of wrong sums in the accounts. If the errors are found in the same year when they are registered, the remedial action is accomplished either by correcting the initial book-keeping error and the registration of the right operation (correction written in red or black), or by directly registering the operation provided it has not been registered at all. The remediation of the errors included in the current activity, which impinges on the revenue and expense of the period, is accomplished by acknowledging them in the profit and loss account, consequently in the earnings account of the current period.

Exemple1.

A company which is provided with protection and guard services erroneously registered in February 2013 an invoice from the supplier worth 12400 lei, instead of 1240 lei, the correct value. The error is found in March on the date of payment. The company is to remedy the error as follows:

1. The wrong registration of the invoice in February:

%	=	401 Suppliers	12400
628 Expenses with other third party services			10000
4426 Input VAT			2400

2. Correcting by difference the wrongly registered invoice in the month the error was found:

%	=	401 Suppliers	$\boxed{11160}$
628 Expenses with other third party services			$\boxed{9000}$
4426 Input VAT			$\boxed{21600}$

If the error had been discovered in another trimester, fiscal rules stipulate that it is necessary to recalculate the profit tax and to file a rectifying statement for a higher profit tax. From the VAT point of view, there are two situations:

- if the company files the VAT return on a monthly basis, a correction for material errors needs to be performed given that the VAT returned was greater than the one that should have been returned
- if the company files the return on a trimestrial basis, this does not trigger any implication, as the correction is performed within the same trimester.

The errors corresponding to a prior period can be rectified based on either the retained earnings, or the profit and loss account, depending on the significance of the accounting error. As previously mentioned, Romanian accounting regulations which spiritually took over IAS 8 can be divided into significant and insignificant ones. Those omissions or wrong registrations of sums which could influence the economic decisions of someone who uses accounting information are considered significant. For establishing the correct type of errors, a significance threshold is set by means of accounting policies, using the professional rationale. It results that the significance threshold is not identical for all economic entities, but individualized depending on the criteria specific to the company, which may be:

-the turnover
-the number of employees
-the rate of profit
-total assets
-net assets etc.

For example, it is considered significant any sum which exceeds the value of 20 average wages or 5% of the turnover or 3% of the total assets etc. The insignificant errors of the prior periods are those which do not influence the financial and accounting information and they can be rectified based either on the retained earnings, or on the profit and loss account.

Example 2.

A company operating in services discovers in the period N+1, after the financial statements have been approved, that there has been no registration for an invoice worth 4500 lei, excluding VAT, issued by a client. The significance threshold set by the accounting policies specific to the company stipulates that an error is significant if its value is greater than 1% of the company's assets.

The company's assets are worth 850000 lei

1% * 850000 = 8500 lei

Given that the error discovered is under the value of the significance threshold, it will be considered insignificant and will be rectified based on the profit and loss account, and consequently it will be present in the current earnings.

It needs to be remarked that, although accounting regulations allow the correction of insignificant errors from prior periods based on the profit and loss account of the current period, the fiscal influence of the economic and financial operations is set according to the fiscal legislation.

1. Registration of the invoice left out:

4111	=	%	5580
Customers		704 Services rendered and works executed	4500
		4427 Output VAT	1080

2. Calculation of the additional profit tax corresponding to the additional revenue:

4500 * 16% = 720 lei

691 Profit tax expenses	=	441 Profit tax	720

From the fiscal point of view, according to Law 571/2003 regarding the Fiscal Code, the revenues and expenses wrongly registered or left out can be rectified by adjusting the taxable profit of the fiscal period to which they belong and by filing a rectifying statement complying with the stipulations of the Code for Fiscal Procedure.

Acknowledging accounting errors in the retained earnings

Significant errors are those errors which could influence the economic decisions of those who use the financial statements and which exceed the significance threshold according to the accounting policies of the company. The analysis of the situation in which an error is significant or not is accomplished considering the context, the nature and individual or cumulated value of the elements..

Example 3.

After the financial statements have been approved, a wholesale company discovers that a sale invoice worth 6000 lei excluding VAT has been registered twice. The significance threshold set by the accounting policies of the company is 3% of the turnover, which was 185000 lei for the closed period. The company pays VAT and profit tax. At the end of the prior period, it registered profit and paid profit tax.

3%*185000=5550 lei

Therefore, the error detected is over the significance threshold and will consequently be considered significant and rectified based on the retained earnings.

1. Correction of the double invoice registration:

%	=	4111 Customers	7440
1174 Retained earnings from correction of accounting errors			6000
4427 Output VAT			1440

2. Financial management discharge given that the trade markup for this category of goods is 20%.

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371 = 1174 5000

Commodities Retained earnings from correction of accounting errors

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3. The registration of the fiscal incidence on the profit tax as a result of the fact that the company registered the same revenue twice and consequently calculated and registered undue profit tax.

We suppose that the company has a rate of the fiscal result of 17% (relating the taxable profit to the taxable revenue).
Taxable profit corresponding to the error = 1000*0.17 = 170
Profit tax corresponding to wrong operation = 170 * 0.16 = 27.2 lei

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4411 = 1174 27.2

Profit tax Retained earnings from correction of accounting errors

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If the situation brings about an accounting loss, when allocating the profit for the current year or the next year, it is compulsory to cover it before the profit obtained is allocated. The accounting errors detected and corrected, as well as the accounting and fiscal result of the correction operated need to be mentioned in the documents devised for financial statements for the year in which these errors are detected and corrected.

Conclusions

Over the last decades, the development in the accounting system in our country has been performed thoroughly considering the tendencies in Europe and worldwide. Within this process, a primary objective is represented by ensuring the accuracy of the accounting information. The correction of errors corresponding to previous fiscal periods does not bring about changes in the financial statements of these financial years. The comparative information as regards the financial position and performances, its change, respectively, as a result of correcting those errors are presented in the annotations. When setting accounting policies, approaching the correction of accounting errors and, generally, when selecting the accounting treatment, the company does not need to consider only the short term or long term financing objective or fiscal reasons, but reflect the company's image as accurately as possible and ensure the implementation of its future strategy.

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