Abstract

This book reviews the academic literature on accounting restatement and analyses and discusses findings obtained using a sample of publicly listed European companies (tracked by Audit Analytics) which have adopted the International Financial Reporting Standards (IFRSs) and restated their financial statements between 2016 and 2020. In the first chapter, the author examines the evolution of allowed treatments for correction of errors under different versions of accounting standards in accordance with the IFRSs and Italian generally accepted accounting principles, respectively. In the second chapter, measures utilized to examine the seriousness of a single restatement event are introduced, along with the sample analysed in this book. The chapter also investigates trends in and the characteristics of different sources of misstatements and highlights the differences in comparison with those reported in the United States context. In chapter 3, attention is primarily focused on country level. More specifically, it offers an overview of cross-national and national European literature on restatement occurrences, and studies the distribution and seriousness of restatements by nation, year and industry. Finally, chapter 4 deals with key audit matters (KAMs), which represent one of a series of improvements to the content of expanded auditors' reports. It tests whether KAMs have a forewarning effect for the specific financial statement accounts identified by determining the ability to precede related future restatements.

Overall, this book might be seen as a guide for graduate students or early career academics who are considering studying the under-investigated but fascinating topic of accounting restatement in the European context.

Chapter 1

Treatment for the correction of errors: The discipline of retrospective application

RÉSUMÉ: 1.1. Introduction. – 1.2. The three versions of IAS 8. – 1.2.1. The 1978 version. – 1.2.2. The 1993 version. – 1.2.3. The 2003 version. – 1.3. The latest three versions of OIC Accounting Standard 29. – 1.3.1. The 2005 version. – 1.3.2. The 2014 and 2016 versions. – 1.4. Concluding remarks.

1.1. *Introduction*

In this chapter, the author focuses on the treatment for the correction of errors under the International Financial Reporting Standards (IFRSs) and Italian generally accepted accounting principles (GAAPs). The latter are issued by the Organismo Italiano di Contabilità (OIC), which has been the national standard setter since the end of 2001. In particular, the latest three versions of International Accounting Standard (IAS) 8 and OIC Accounting Standard 29 [1] are examined, and the relative application is presented. Additionally, and more germane to the purpose of this study, the arguments in favour of and against the decisions to support the restatement of the comparative information, in line with the benchmark treatment, or the inclusion in the net income for the discovery period, according to the alternative treatment, are analysed. The balance of the chapter follows the outline given below.

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[1] In particular, OIC Accounting Standard 29 pertains to "cambiamenti di principi contabili, cambiamenti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio", *i.e.*, changes in accounting policies, changes in estimates, correction of errors, extraordinary events and operations, and events after the balance sheet date.

First, the 1978, 1993 and 2003 versions of IAS 8 are introduced, with the relative guidance of Italian scholars when there was a free choice of treatment, and illustrative examples on disclosure are provided for cases of retrospective restatement. Following this, the three most recent versions of OIC Accounting Standard 29 (2005, 2014 and 2016) and the OIC reasons behind the initial choice to mandate the alternative treatment and the contrasting perspectives of Italian scholars are explained. Finally, the concluding remarks identify the contributions of the chapter, and the appendix shows the adoption of alternative treatment to correct prior period errors.

1.2. *The three versions of IAS 8*

1.2.1. *The 1978 version*

The first version of IAS 8 – *Unusual and Prior Period Items and Changes in Accounting Policies* – was approved in October 1977 and issued in February 1978 by the International Accounting Standards Committee, and it became operational for financial statements that covered periods beginning on or after 1 January 1979. [2] An error or omission relative to one or more prior periods, discovered in a subsequent period, required financial adjustments, which were referred to as prior period items.

More specifically, the accounting standard defined prior period items as "charges or credits that arise in the current period as a result of errors or omissions in the preparation of financial statements of one or more prior periods". [3] Two treatments were allowed for correction, *i.e.*, the adjustment to opening retained earnings or the inclusion as unusual items in the net income, both in the discovery period, but the standard did not provide guidance in relation to this choice. In the case of the first treatment, the comparative information was required to be amended accordingly to incorporate corrections, while in the second case, additional pro forma information may have been disclosed. [4]

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[2] INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE (1978). *IAS 8 – Unusual and Prior Period Items and Changes in Accounting Policies*, par. 24.

[3] *Ibidem*, par. 3.

[4] *Ibidem*, par. 12. "*Whichever method is adopted, there is full disclosure of the amount and nature of the prior period items*". *Ibidem*, par. 13.

In Italy, Zanda, Lacchini and Onesti [5] explicitly supported the latter treatment for two reasons. First, in the Italian accounting tradition, reserves, including retained earnings, were created with the aim of defending legal capital against losses. [6] Second, the most prominent Italian academics, namely, Zappa, [7] De Dominicis [8] and Amodeo, [9] among others, advocated the inclusion of the extraordinary items, including prior period items, in the determination of net income or loss for the discovery period, which supports the "all-inclusive concept" view entirely. [10] For example, the authors emphasised

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[5] ZANDA, G., LACCHINI, M., & ONESTI, T. (1991). *Elementi straordinari, elementi relativi ad esercizi precedenti, variazioni delle politiche contabili e delle stime: Il loro riflesso sul conto economico. Rivista dei Dottori Commercialisti*, No. 3, pp. 511-531.

[6] ZAPPA, G. (1927). *Le Valutazioni di Bilancio con Particolare Riguardo ai Bilanci delle Società per Azioni*. Milan, Italy: Istituto Editoriale Scientifico, p. 238; ONIDA, P. (1970). *La Logica e il Sistema delle Rilevazioni Quantitative d'Azienda (2nd Edition)*. Milan, Italy: Giuffré, p. 200; ONIDA, P. (1974). *Il Bilancio d'Esercizio nelle Imprese. Significato Economico del Bilancio. Problemi di Valutazione (4th Edition)*. Milan, Italy: Giuffré, p. 467. This view is past-oriented as reserves have also future-oriented functions, *e.g.*, self-financing. CAVALIERI, E. (1983). *Le Riserve nell'Economia dell'Impresa (Riserve di Bilancio, Riserve Operative, Riserve di Ricettività)*. Padua, Italy: Cedam, p. 31.

[7] ZAPPA, G. (1943). *Il Reddito di Impresa (2nd Edition)*. Milan, Italy: Giuffré, p. 279. Onida recognized that the distinction between ordinary and extraordinary items, being a matter of subjective judgement, could result in a loss of comparability. ONIDA, P. (1974), *op. cit.*, p. 50.

[8] DE DOMINICIS, U. (1964). *Lezioni di Ragioneria Generale (Vol. II). Capitale, Costi, Ricavi e Reddito, part I (2nd Edition)*. Bologna, Italy: Azzoguidi, pp. 261-262.

[9] AMODEO, D. (1964). *Ragioneria Generale delle Imprese*. Naples, Italy: Giannini, pp. 640-641.

[10] This view supported that "*all changes in the measurement of assets and liabilities, except those arising from capital transactions and dividend distributions, are included in the income statement in the period in which they are discovered or determined to be measurable and in which they meet the criteria for reporting revenues, expenses, gains, and losses. To the extent to which such changes would have been reported in a prior period if they had been known to exist at that time and had met the criteria of measurability and verifiability, they do not represent measurements of the firm's activity of the current period. Under the current operating concept of income, such items would be excluded from the income statement because they cannot be matched with current revenues nor do they represent gains or losses of the current period*" and should be reported directly in shareholders' equity as changes to retained earnings. Consequently, in the United States, where extraordinary items were included in the income statement, the correction of accounting errors by restatements had constituted an exception to the all-inclusive concept of income view. The author concluded that "*there is merit, however, in classifying items in the income statement according to the type of activity or event giving rise to the item and according to the period when the major activity occurred. There is no merit in allocating such corrections or extraordinary items over future periods*". HENDRIKSEN, E.S.

that in the tradition of accounting in Italy, bad debt expenses, which relate to events and transactions in the current or prior periods, are recognized in the net income of the period in which the uncollectible estimate is made. [11]

1.2.2. *The 1993 version*

The second version of IAS 8 – *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* – was effective for financial statements covering periods beginning on or after 1 January 1995. It was originally issued by the International Accounting Standards Committee in December 1993 [12] and replaced the abovementioned version of IAS 8 – *Unusual and Prior Period Items and Changes in Accounting Policies*. The treatment differentiated based on fundamental and nonfundamental errors.

Fundamental errors were defined as "errors discovered in the current period that are of such significance that the financial statements of one or more prior periods can no longer be considered to have been reliable at the date of their issue". [13] In particular, "errors may occur as a result of mathematical mistakes, mistakes in applying accounting policies, misinterpretation of facts, fraud or oversights". [14]

(1970). *Accounting Theory (Revised Edition)*. Homewood, IL: R.D. Irwin, pp. 197-198. In contrast, other Italian scholars who advocated the inclusion of prior period items in the extraordinary items for the discovery period are Vivarelli, Coppa and D'Ippolito. VIVARELLI, A. (1986). *I Componenti Straordinari del Reddito d'Impresa*. Cagliari, Italy: CUEC, p. 7; COPPA, R. (1988). *I Componenti Straordinari di Reddito nell'Economia e nel Bilancio delle Imprese*. Turin, Italy: Giappichelli, pp. 91-92; D'IPPOLITO, T. (1961). *La Contabilità in Partita Doppia ed il Bilancio di Esercizio, nelle Aziende di Produzione* (*5th Edition*). Palermo, Italy: Abbaco, p. 101. As anticipated by Bertini, Italy has implemented the Fourth Council Directive (78/660/EEC) by the Council of the European Communities, which separated ordinary from extraordinary items in the format of income statements as a result of the enactment of Legislative Decree 127/91. BERTINI, U. (1980). *Il progetto di S.p.A. europea e la IV Direttiva*. In AMADUZZI, A. *et al.* (Eds.), *La Contabilità delle Imprese e la IV Direttiva CEE*. Milan, Italy: Etas libri, pp. 281-288.

[11] SCAGNELLI, S.D., DI TRANA, M.G., & VENUTI, F. (2019). *Introduction to Financial Accounting: Concepts, Cases and Exercises* (*2nd Edition*). Turin, Italy: Giappichelli, p. 115.

[12] CONSIGLIO NAZIONALE DEI DOTTORI COMMERCIALISTI (1995). *Principi Contabili Internazionali IAS 1995-1996*. Milan, Italy: Il Sole 24 Ore Libri, p. 230.

[13] INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE (1993). *IAS 8 – Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, par. 6.

[14] *Ibidem*, par. 31.

Compared with the preceding version, the accounting standard specified in detail the two treatments for the correction of fundamental errors that relate to prior periods by providing an illustrative appendix. The benchmark treatment required the restatement of comparative financial statements and the adjustment to opening balance of retained earnings in the earliest year presented.[15] On the one hand, this method favours consistency, a faithful representation of transactions and other events that occur in the period, and the comparability of data over time, given that the amount of correction is included within the net profit or loss for the prior period.[16] On the other hand, it reduces readers' credibility in the statements and improves the preparers' and audit's cost due to additional disclosure as multiple financial years might be involved.[17] An entity was required to report "(a) the nature of the fundamental error; (b) the amount of the correction for the current period and for each prior period presented; (c) the amount of the correction relating to periods prior to those included in the comparative information; and (d) the fact that comparative information has been restated or that it is impracticable to do so".[18]

In contrast, the allowed alternative treatment incorporated the amount of the correction into the reported net profit or loss for the discovery period so that comparative statements were not restated but required the disclosure of proforma comparative information unless it is impracticable to provide this.[19] It did not bring the adjustment within the definition of an extraordinary item, which is included in the determination of profit and loss from ordinary activities.[20] Dis-

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[15] "*Therefore, the amount of the correction that relates to each period presented is included within the net profit or loss for that period. The amount of the correction relating to periods prior to those included in the comparative information in the financial statements is adjusted against the opening balance of retained earnings in the earliest period presented*". *Ibidem*, par. 35.

[16] MAUTZ, D.R., JR., SHOULDERS, C.D., & SMITH, M.C. (1996). *Reporting accounting changes and fundamental errors: A teaching note. Accounting Education*, Vol. 5, No. 4, pp. 367-388; INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003). *IAS 8 – Accounting Policies, Changes in Accounting Estimates and Errors*. London, United Kingdom: IFRS Foundation, par. BC11.

[17] AMERICAN ACCOUNTING ASSOCIATION FINANCIAL ACCOUNTING STANDARDS COMMITTEE (2004). *Response to FASB Exposure Draft: Accounting changes and error corrections. Accounting Horizons*, Vol. 18, No. 4, pp. 255-261.

[18] INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE (1993), *op. cit.*, par. 37.

[19] *Ibidem*, par. 38.

[20] FRANCIA, L. (2000). *I componenti straordinari di reddito: Un tentativo di confronto e coordinamento fra i principi contabili italiani e gli international accounting standards. Rivista Italiana di Ragioneria e di Economia Aziendale*, No. 5-6, pp. 236-254.

closure requirements included "(a) the nature of the fundamental error; (b) the amount of the correction recognised in net profit or loss for the current period; and (c) the amount of the correction included in each period for which pro forma information is presented and the amount of the correction relating to periods prior to those included in the pro forma information. If it is impracticable to present pro forma information, this fact should be disclosed". [21] The CONSOB (the Italian national enforcer) and Bank of Italy had instructed the use of the alternative treatment for listed firms in Italy and prescribed pro forma disclosures to supplement current statements as if retroactive restatement were applied. [22] Regarding accounting scholars, Romagnoli [23] tended to prefer the adoption of the alternative treatment, except when errors severely distort the current income financial statements, while Pisani, [24] who interpreted the Fourth Council Directive (78/660/EEC) less narrowly, recommended the benchmark treatment but allowed the alternative method when reserves are insufficient to cover the error amount.

Finally, the correction of nonfundamental errors, which constituted a residual category compared to fundamental errors, was normally included in the determination of net profit or loss for the discovery period. [25]

1.2.3. *The 2003 version*

IAS 8 – *Accounting Policies, Changes in Accounting Estimates and Errors* – which is effective for financial statements covering periods beginning on or after 1 January 2005, was issued by the International Accounting Stand-

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[21] INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE (1993), *op. cit.*, par. 40.

[22] BELLANDI, F. (2012). *Dual Reporting for Equity and Other Comprehensive Income under IFRSs and US GAAP*. Chichester, United Kingdom: John Wiley & Sons, p. 179. The reasons behind this choice were included in the 2005 version of the OIC Accounting Standard 29, subsequently explained in par. 1.3.1.

[23] ROMAGNOLI, I. (1996). *Alcune riflessioni in merito al trattamento contabile degli errori relativi ad esercizi nei bilanci di esercizio delle imprese. Rivista Italiana di Ragioneria e di Economia Aziendale*, No. 5-6, pp. 287-299.

[24] PISANI, M. (1999). *Adattamento di «voci» relative all'esercizio precedente e applicazione retrospettiva di cambiamenti nelle politiche contabili e correzione di errori determinanti. Rivista Italiana di Ragioneria e di Economia Aziendale*, No. 11-12, pp. 604-621.

[25] INTERNATIONAL ACCOUNTING STANDARDS COMMITTEE (1993), *op. cit.*, par. 31.

ards Board in December 2003.[26] It removed the optional treatment regarding the correction of prior period errors, which are defined as "omissions from, and misstatements in, the 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 authorized 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".[27]

Potential errors relative to the current period, which are discovered in the same period, are corrected before the date that the financial statements are authorized for issue. However, at times, material errors are not discovered until a subsequent period, which requires the amendment of comparative information presented in the financial statements for this subsequent period. An entity must correct all material prior period errors, immaterial errors made intentionally to achieve a particular presentation of the financial statements, financial performance or cash flows,[28] and cumulative immaterial errors that become material to the current-period financial statements[29] as if these had never occurred.[30] More specifically, these prior period errors are corrected "retrospectively in the first set of financial statements authorized for issue after their 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".[31]

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[26] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), *op. cit.*, par. 54. An earlier application was permitted if disclosed.

[27] *Ibidem*, par. 5.

[28] *Ibidem*, par. 41.

[29] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2017). *IFRS Practice Statement 2: Making Materiality Judgements*. London, United Kingdom: IFRS Foundation, par. 80. The concept of fundamental error was eliminated in the International Accounting Standards Board's Improvements Project. CHAUDHRY, A., FULLER, C., COETSEE, D., RANDS, E., BAKKER, E., VAN DER MERWE, M., YEUNG, P., VARUGHESE, S., MCILWAINE, S., & BALASUBRAMANIAN, T. (2016). *Wiley 2016: Interpretation and Application of International Financial Reporting Standards*. Chichester, United Kingdom: John Wiley & Sons Inc., p. 128.

[30] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), *op. cit.*, par. 5.

[31] *Ibidem*, par. 42.

Furthermore, in accordance with IAS 34 – *Interim Financial Reporting* – if not reported in the most recent annual financial report, the corrections of prior period errors require disclosure in the interim financial reporting.[32]

The following steps are followed to restate prior period financial statements:

1. "Adjust the carrying amounts of assets and liabilities at the beginning of the first period presented (beginning of the preceding period) in the financial statements for the amount of the correction on periods prior to those presented in the financial statements.
2. Offset the amount of the adjustment in Step 1 (if any) by adjusting the opening balance of retained earnings (or other components of equity or net assets, as applicable to the reporting entity) for that period.
3. Adjust the financial statements of each individual prior period presented for the effects of correcting the error on that specific period (referred to as the period-specific effects of the error)".[33]

Example of the correction of a material error under the benchmark treatment

In March 20X9, after the group's consolidated financial statements for the year ending on 30 June 20X8 had been approved for issue, management identified inconsistencies in the calculation of depreciation expenses, which resulted in overstatements of depreciation expenses for the years ending on 30 June 20X7 and 30 June 20X8 of € 1,800,000 and € 1,000,000, respectively. Assume no income tax rate. The adjustments concerning the line items of previously published affected financial statements due to the correction of errors in the first set of financial statements authorized for issue after their discovery are set out below:

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[32] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2000). *IAS 34 – Interim Financial Reporting*. London, United Kingdom: IFRS Foundation, par. 15B.

[33] CHAUDHRY, A., FULLER, C., COETSEE, D., RANDS, E., BAKKER, E., VAN DER MERWE, M., YEUNG, P., VARUGHESE, S., MCILWAINE, S., & BALASUBRAMANIAN, T. (2016), *op. cit.*, Chichester, United Kingdom: John Wiley & Sons Inc., p. 129.

• Financial year 20X7

Statement of financial position	30/06/20X7 (as reported)	Adjustments	01/07/20X7 (as restated)
Noncurrent assets			
Property, plant and equipment	6,000,000	1,800,000	7,800,000
Equity			
Retained losses	(80,000,000)	1,800,000	(78,200,000)

• Financial year 20X8

Statement of comprehensive income	30/06/20X8 (as reported)	Adjustments	30/06/20X8 (as restated)
Depreciation and amortization expenses	(5,010,000)	1,000,000	(4,010,000)
Loss for the year	(5,000,000)	1,000,000	(4,000,000)

Statement of financial position	30/06/20X8 (as reported)	Adjustments	30/06/20X8 (as restated)
Noncurrent assets			
Property, plant and equipment	7,000,000	2,800,000	9,800,000
Equity			
Retained losses	(85,000,000)	2,800,000	(82,200,000)

Note: To conserve space, prior period adjustments are shown for the most relevant financial statement line items affected.

Consequently, the error does not influence the net income in the year of discovery.[34] An entity must report the nature of the error, the amount of the correction on each line item of affected financial statements, including the per-share amounts, for each prior period presented and the amount of the

[34] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), *op. cit.*, par. 46. For the corrections that arise from the allowed alternative treatment specified in the 1993 version of IAS 8, please see the appendix to this chapter. Further illustrations are shown in the appendix provided in the 1993 version of IAS 8 and Giunta and Pisani's work. GIUNTA, F., & PISANI, M. (2001). *Cambiamenti nelle politiche contabili e correzione di errori determinanti: Spunti per una rilettura dell'art. 2423-ter del codice civile. Rivista dei Dottori Commercialisti*, No. 2, pp. 185-228.

correction at the beginning of the earliest prior period presented.[35]

IAS 1 – *Presentation of Financial Statements* – also requires disclosure in the statement of changes in equity of the total adjustment to each component of equity that resulted from the corrections of errors[36] for each prior period and the beginning of the period and a third statement of financial position at the beginning of the preceding period.[37]

Disclosure in the statements of changes in equity under the benchmark treatment

On 30 June 20X1, revenue was overstated by € 1,323,000. This error was discovered when preparing the financial statements as of 30 June 20X3. Assume no income tax rate. The statements of changes in equity as of 30 June 20X3 should be presented as follows:

Statements of changes in equity	Contributed Equity	Accumulated Losses	Option Reserve	Total
At 1 July 20X1 – previously reported	381,000,000	(78,200,000)	18,000,000	320,800,000
Correction of error	–	(1,323,000)	–	(1,323,000)
At 1 July 20X1 – restated	381,000,000	(79,523,000)	18,000,000	319,477,000
Profit/(Loss) for the period	–	(1,800,000)	–	(1,800,000)
Total comprehensive Income/(Loss) for the period	–	(1,800,000)	–	(1,800,000)
At 30 June 20X2	381,000,000	(81,323,000)	18,000,000	317,677,000
At 30 June 20X2 – previously reported	381,000,000	(80,000,000)	18,000,000	319,000,000
Correction of error	–	(1,323,000)	–	(1,323,000)
At 30 June 20X2 – restated	381,000,000	(81,323,000)	18,000,000	317,677,000
Profit/(Loss) for the period	–	(1,500,000)	–	(1,500,000)

(continued)

[35] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), *op. cit.*, par. 49.

[36] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2007). *IAS 1 – Presentation of Financial Statements*. London, United Kingdom: IFRS Foundation, par. 110.

[37] *Ibidem*, par. 10(f).

Total comprehensive Income/(Loss) for the period	–	(1,500,000)	–	(1,500,000)
At 30 June 20X3	381,000,000	(82,823,000)	18,000,000	316,177,000

Given the value attributed to truly comparable data, IAS 8 addresses the limitations and impracticability exemption with respect to retrospective restatements [38] whose circumstances should be communicated and the “description of how and from when the error has been corrected”. [39] In contrast, immaterial prior period errors, if not made intentionally to achieve a particular presentation, do not undermine the compliance with the IFRSs and might be corrected by adjusting the current period financial statements (out-of-period adjustments). [40] This latest version casts light on the International Accounting Standards Board’s and Financial Accounting Standards Board’s commitment to harmonize the released accounting standards. [41]

[38] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2003), *op. cit.*, par. 49. The limitations and impracticability with respect to the retrospective restatement are explained from parr. 43 to 48 and from parr. 50 to 53.

[39] *Ibidem*, par. 49.

[40] INTERNATIONAL ACCOUNTING STANDARDS BOARD (2017), *op. cit.*, par. 74. Bellandi pointed out that IFRSs do not provide specific guidance concerning the correction of prior period immaterial, unintentional errors. BELLANDI, F. (2018). *Materiality in Financial Reporting. An Integrative Perspective*. Bingley, United Kingdom: Emerald Publishing Limited, pp. 249-250. In such cases, refer to the 2003 version of IAS 8, parr. 10 to 12. The United States GAAPs differentiated the reporting for the corrections of errors: (a) error material to the misstated financial statements is corrected by restating and reissuing previously published financial statements, and users are notified by filing an 8-K form (“Big R” Restatement); (b) error immaterial to the financial statements in which it was committed, whose correction in the current period would distort current period financial statements, is corrected by revising prior comparative financial statements in the current period financial report and adjusting the opening balance of retained earnings (“little r” restatement); and (c) error immaterial to the financial statements in which it was committed, whose correction in the current period would not distort current period financial statements, is corrected by adjusting the current period financial statements (out-of-period adjustment). CHOUDHARY, P., MERKLEY, K., & SCHIPPER, K. (2021). *Immaterial error corrections and financial reporting reliability. Contemporary Accounting Research*, Vol. 38, No. 4, pp. 2423-2460.

[41] BLOOM, R., & FUGLISTER, J. (2006). *SFAS 154: Accounting changes and error corrections. The CPA Journal*, Vol. 76, No. 3, pp. 44-47.

1.3. *The latest three versions of OIC Accounting Standard 29*

1.3.1. *The 2005 version*

The Italian Civil Code does not explain the treatment for the correction of errors. The first version of OIC Accounting Standard 29,[42] ratified on 4 October 2000 and issued in February 2001, introduced methods for reporting errors in financial statements. It was replaced by a new version on 13 July 2005 for three reasons. First, the third version of IAS 8 required the elimination of a section that had reported a comparison between OIC Accounting Standard 29 and the second version of IAS 8, and wording related to this needed to be removed. Second, there were tax legislation changes that required changes to the standard. Third, amendments were necessary due to the issuance of the OIC Accounting Standard 1,[43] which had been approved on 25 October 2004, and the updated appendix.[44] The treatment for the correction of errors, however, remained unchanged.

An accounting error was defined as a "mistake or a failure in applying accounting policies if, at the time of preparing the prior period financial statements, the use of the information or data for a fair treatment was available. Errors may occur as a result of mathematical mistakes, misinterpretations of facts and oversight in the collection of information and data available for fair treatment".[45]

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[42] CONSIGLIO NAZIONALE DEI DOTTORI COMMERCIALISTI & CONSIGLIO NAZIONALE DEI RAGIONIERI (2001). *Principio Contabile No. 29, cambiamenti di principi contabili, cambiamenti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio*. Milan, Italy: Giuffré, p. 42.

[43] OIC (2004). *Principio Contabile No. 1, i principali effetti della riforma del diritto societario sulla redazione del bilancio d'esercizio*. Milan, Italy: Il Sole 24 Ore Libri.

[44] OIC (2005). *Principio Contabile No. 29, cambiamenti di principi contabili, cambiamenti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio*. Milan, Italy: Il Sole 24 Ore Libri, p. 983.

[45] *Ibidem*, par. C.II.a (my translation). This definition is restricted to errors committed unintentionally. COLUCCIA, D., COSENTINO, A., FONTANA, S., GIORNETTI, A., MOSCARINI, F., SOLIMENE, S., & SURA, A. (2018). *Gli effetti delle deroghe conseguenti al principio di rilevanza nel bilancio di esercizio*. In ADAMO, S., FELLEGARA, A.M., INCOLLINGO, A., & LIONZO, A. (Eds.), *La "Nuova" Informativa di Bilancio. Profili Teorici e Criticità Applicative dopo il D. Lgs. 139/2015 e i Nuovi Principi OIC*. Milan, Italy: FrancoAngeli, pp. 100-124. In relation to the diverse definitions of accounting errors formulated by Italian scholars, please read FERRERO, G. (1965). *Le Determinazioni Economico-Quantitative d'Azienda*. Milan, Ita-

Based on severity, errors were classified as fundamental or nonfundamental. An error was classified as fundamental when its significance undermined the reliability of the previously published financial statements affected. The accounting standard did not explain in detail the definition of reliability, which is tied to several error characteristics, such as qualitative and quantitative nature. Finally, errors that could have prejudiced stakeholders of the company were classified as fundamental.[46]

Any error committed in prior periods was reflected in the net income in the period of discovery in line with the "formal balance sheet continuity" principle, which implied that previously issued financial statements should never be restated. Consequently, the comparative statements of prior periods were unaffected by the adjustments, with one exception.[47]

The correction of nonfundamental errors, which were a residual category compared with fundamental errors, was required in the discovery period by adjusting the affected balance sheet item and attributing the error correction to the "extraordinary items – net income components related to prior periods"[48] as related to prior periods.[49] More specifically, an extraordinary loss

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ly: Giuffré, p. 153 and CATTANEO, M. (1959). *Le Misurazioni di Azienda. Aspetti di errore, di indeterminazione, di incertezza*. Milan, Italy: Giuffré, p. 209. In Italy, scholars often categorized errors as either formal (reclassification) or substantial (over- or understatement). GIUNTA, F., & PISANI, M. (2001), *op. cit.*, p. 188. Facchinetti and Montani broadened the classification by examining the following factors: (a) causal (among which, honest incompetence, internal control weaknesses and intentional misstatement); (b) chronological (errors relating to the current period that become known before the final approval of the financial statements by shareholders, prior period errors with no impact on the net income of the discovery period and prior period errors that impact the net income of the discovery period); (c) data entry (among which, omissions, duplications and entry reversals); and (d) whether or not the errors impact the taxable net income in the misstatement period. FACCHINETTI, I., & MONTANI, D. (2002). *Gli Errori nelle Scritture Contabili. Prevenzione, Individuazione e Rettifica. Trattamento Civilistico e Fiscale.* Milan, Italy: Il Sole 24 Ore Libri, pp. 137-158.

[46] OIC (2005), *op. cit.*, Milan, Italy: Il Sole 24 Ore Libri, par. C.II.c.

[47] *Ibidem*, par. C.III.

[48] *Ibidem*, par. C.IV.a (my translation).

[49] MACCHIONI, R. (2002). *I Componenti Straordinari di Reddito nell'Informazione di Bilancio*. Padua: Italy, Cedam, p. 126; OIC (2005). *Principio Contabile No. 12, composizione e schemi del bilancio di esercizio di impese mercantili, industriali e di servizi*. Milan, Italy: Il Sole 24 Ore Libri, p. 418. As reported by Dezzani, this is in line with the Fourth Council Directive (78/660/EEC). DEZZANI, F. (1979). *Il bilancio d'esercizio e la IV direttiva CEE. Rivista dei Dottori Commercialisti*, No. 4, pp. 912-936.

was recorded if the error overstated earnings, while an extraordinary gain was recorded if the error understated earnings.[50]

In contrast, the accounting standard supported the following three theoretically possible methodologies to correct fundamental errors: "(a) adjusting the reserves amount [an equity item]; (b) including the correction of the error in the determination of net profit or loss for the discovery period; or (c) reissuing previously published financial statements".[51]

In relation to the first typology, it did not seem to be applicable in Italy given that the attribution of error correction to the reserves would imply that it was not included in the determination of the net profit or loss for the discovery or past periods, in contrast with the principle of the accrual basis of accounting.[52] Moreover, the adjustment of reserves is also in contrast with the aforementioned principle of "formal balance sheet continuity". Substantially, even if the opening balance sheet corresponded to the closing balance sheet of the immediate prior period, the subsequent reserve adjustment would imply the contrary.[53] Finally, in Italy, movements in specific reserves require approval by the company's shareholders[54] in the general meeting. Giunta and Pisani,[55] on the contrary, pointed out that for

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[50] GIUSSANI, A., NAVA, P., & PORTALUPI, A. (2014). *Il Memento Pratico. Contabile*. Milan, Italy: Ipsoa-Francis Lefebvre, p. 1016; COLLINI, P., & QUAGLI, A. (2004). *La Determinazione dei Componenti Straordinari del Reddito*. In MARCHI, L. (Ed.), *Contabilità d'Impresa e Valori di Bilancio*. Turin, Italy: Giappichelli, pp. 409-428.

[51] OIC (2005). *Principio Contabile No. 29, cambiamenti di principi contabili, cambiamenti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio*. Milan, Italy: Il Sole 24 Ore Libri, par. C.IV.b (my translation).

[52] In countries where accrual basis of accounting is an underlying assumption, restatement of financial statements is permitted. CARAMEL, R., & COOPERS & LYBRAND (1994). *Il Bilancio delle Imprese: La Nuova Disciplina secondo le Norme d'Attuazione delle Direttive Europee*. Milan, Italy: Il Sole 24 Ore Libri, p. 260.

[53] "*Retroactive application of equity items has been traditionally prohibited in certain jurisdictions, mainly where accounting standards have a legal derivation, e.g., Italy or Germany*". Moreover, Belgium, Finland, France, Luxembourg, Norway, Spain, Sweden and Switzerland have adopted the same position, with certain exceptions. BELLANDI, F. (2012), *op. cit.*, Chichester, United Kingdom: John Wiley & Sons, p. 179.

[54] OIC (2005). *Principio Contabile No. 29, cambiamenti di principi contabili, cambiamenti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio*. Milan, Italy: Il Sole 24 Ore Libri, par. C.IV.b.1.

[55] GIUNTA, F., & PISANI, M. (2001), *op. cit.*, pp. 185-228.

comparability, the Italian Civil Code mandated adjustment of comparative financial statements, which improve the informative value;[56] this implies the use of the benchmark treatment.[57] The authors also argued that the principle of "formal balance sheet continuity" in Italy, by which the opening balance sheet for each financial year must correspond to the closing balance sheet for the preceding financial year, refers exclusively to the beginning balances at the start of the reporting period. As such, after this process, the reserves might be adjusted.

The second methodology seemed to be the most practicable: for formal continuity, the correction of fundamental errors corresponded to the correction used for nonfundamental errors.[58] The inclusion in the extraordinary items disclosed separately in the net income format is aimed, among others, at having a better understanding of firm financial performance[59] and firm value[60] to enhance comparability within a given entity over time and among entities that operate in the same industrial sector.[61]

Finally, in rare circumstances, fundamental errors committed in the preceding financial year(s) may also have made the resolution that approved such financial statements null and void[62] because the accounts did not give

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[56] VIGANÒ, E. (1973). *L'informazione esterna d'impresa. Rivista dei Dottori Commercialisti*, No. 3, pp. 562-588.

[57] MAUTZ, D.R., JR., SHOULDERS, C.D., & SMITH, M.C. (1996), *op. cit.*, pp. 367-388. Potito argued that one of the main purposes of consistency is to improve comparability over time, which, as a matter of fact, is impaired by the presence of fundamental errors for Pisani. Besta was among the first eminent Italian accounting academics to advocate the comparability of financial information across reporting periods. POTITO, L. (1971). *Considerazioni intorno al concetto di "consistency". Rassegna Economica*, Vol. 35, No. 4, pp. 775-797; PISANI, M. (1999), *op. cit.*, pp. 604-621; BESTA, F. (1920). *La Ragioneria Generale (Vol. 3, 2nd Edition)*. Milan, Italy: Vallardi, p. 608.

[58] OIC (2005). *Principio Contabile No. 29, cambiamenti di principi contabili, cambiamenti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio*. Milan, Italy: Il Sole 24 Ore Libri, par. C.IV.b.2.

[59] CARAMIELLO, C. (1979). *Note sui conti annuali delle società commerciali secondo il contenuto della IV direttiva CEE. Rivista dei Dottori Commercialisti*, No. 1, pp. 163-173.

[60] Guatri evidenced that the matter is how the extraordinary items amount is distributed over time. GUATRI, L. (1994). *La Valutazione delle Aziende: Teoria e Pratica dei Paesi Avanzati a Confronto (4th Edition)*. Milan, Italy: Egea, p. 137.

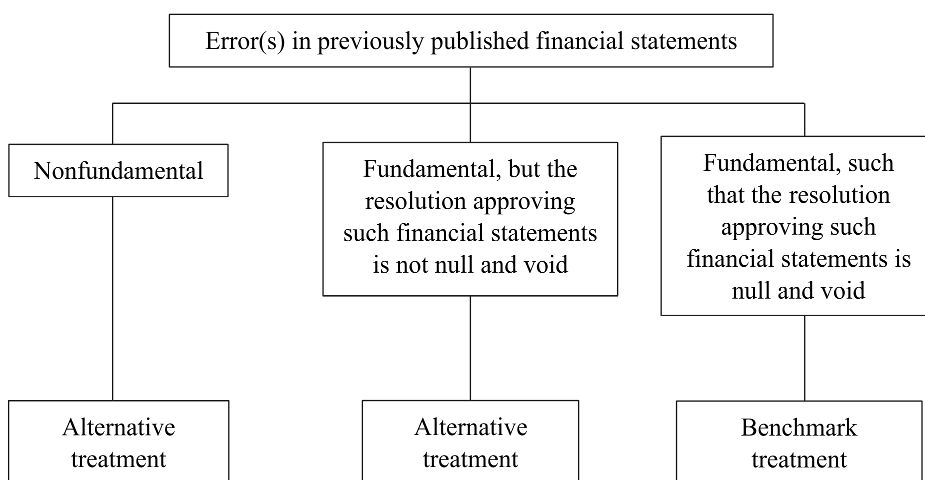
[61] LACCHINI, M. (1989). *I Componenti Straordinari di Reddito: Una prospettiva*. Turin, Italy: Giappichelli, pp. 7-9.

[62] OIC (2005). *Principio Contabile No. 29, cambiamenti di principi contabili, cambia-*

a true and fair view.[63] In such a case, the reissuance of previously published financial statements in which the error occurred and those following is needed.

Figure 1.1 summarizes the OIC Accounting Standard 29 treatment for the correction of errors.

Figure 1.1. – *Summary of the treatment mandated by the 2005 version of OIC Accounting Standard 29.*



Disclosure requirements were different based on error severity. For nonfundamental errors, information on corrections did not need to be provided.[64] For fundamental errors, disclosure needed to include: "(a) the nature of the error; (b) the amount of correction for the current period and the amount of correction that would have been necessary that relates to prior periods in which the error was committed; (c) the fact that comparative information of

menti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio. Milan, Italy: Il Sole 24 Ore Libri, par. C.IV.b.3.

[63] AVI, M.S. (2017). *The "tax-true and fiscally-fair" principle in Italian financial reporting. Academy of Accounting and Financial Studies Journal*, Vol. 21, No. 3, pp. 1-22.

[64] OIC (2005). *Principio Contabile No. 29, cambiamenti di principi contabili, cambiamenti di stime contabili, correzione di errori, eventi e operazioni straordinari, fatti intervenuti dopo la data di chiusura dell'esercizio*. Milan, Italy: Il Sole 24 Ore Libri, par. C.V.a.