

B-15.04

At the beginning of 20X2, Devin Company changed its method of accounting for certain operating expenses. The change in methods shifted from one acceptable method to another acceptable method. Devin Company's accounting department was not sure how to report the effect of the change, and has prepared the following alternative comparative income statements. The first option includes a cumulative effect catch-up adjustment for the change. The second option results in changing the amount of operating expenses previously reported for 20X1. The company faces a 35% tax rate.

Which of the two income statements should be used? What was the dollar impact of the change in method, before and after tax. Did the change impact any years prior to 20X1?

DEVIN COMPANY Income Statement For the Years Ending December 31, 20X1 and 20X2		
	20X2	20X1
Sales	\$ 6,500,000	\$ 5,000,000
Cost of goods sold	<u>3,000,000</u>	<u>2,700,000</u>
Gross profit	\$ 3,500,000	\$ 2,300,000
Operating expenses	<u>2,100,000</u>	<u>1,650,000</u>
Income from continuing operations before income tax	\$ 1,400,000	\$ 650,000
Income tax on income from continuing operations	<u>490,000</u>	<u>227,500</u>
Income from continuing operations	\$ 910,000	\$ 422,500
Cumulative effect of change in method, net of tax	<u>190,000</u>	<u>-</u>
Net income	<u>\$ 1,100,000</u>	<u>\$ 422,500</u>

DEVIN COMPANY Income Statement For the Years Ending December 31, 20X1 and 20X2		
	20X2	20X1
Sales	\$ 6,500,000	\$ 5,000,000
Cost of goods sold	<u>3,000,000</u>	<u>2,700,000</u>
Gross profit	\$ 3,500,000	\$ 2,300,000
Operating expenses	<u>2,100,000</u>	<u>1,357,692</u>
Income from continuing operations before income tax	\$ 1,400,000	\$ 942,308
Income tax on income from continuing operations	<u>490,000</u>	<u>329,808</u>
Net income	<u>\$ 910,000</u>	<u>\$ 612,500</u>