

Stage 3–

Changing accounting policies and
accounting estimates,
correcting prior period errors and
reflecting changes in
circumstances:

the BigChange case study



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The BigChange Case Study

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This material has benefited greatly from the feedback and comments from people attending a series of workshops on the Framework-based approach to teaching International Financial Reporting Standards (IFRS) organised by the IFRS Foundation and others and from peer review by a number of anonymous reviewers.

On 2 February 20x6 you are shocked awake by the headline in *Ye Olde World Business Times*¹ ‘**BigChange CFO arrested for ‘cooking the books!’**’ You read on, thinking this cannot be true—only yesterday, after months of agonisingly carefully analysing all publicly available information about BigChange’s prospects, you invested half of your life savings in BigChange shares.

Denial rapidly gives way to anxiety—‘how much have I lost?’—and your anxiety turns to anger as you read how BigChange’s management have fraudulently awarded themselves millions in performance bonuses on the basis of falsified results. ‘Why was this fraud allowed to happen?’

The fraud simply involved inflating income by accounting for an imaginary teak plantation, the harvesting of which is expected to begin in 30 years. The ‘performance’ of the plantation was critical to your decision to invest in BigChange.

The ensuing forensic investigation quantified the financial effect of the fraud *per year* over the 4-year period 20x2 to 20x5 at:

- YoW\$50 million income increase in the fair value of BigChange’s imaginary teak plantation; and²
- YoW\$5 million expense executive remuneration performance bonus expense.

Because the arrested CFO (Mr Shady Character) and the audit partner (Ms Dis Repute), with whom he colluded to conceal the fraud, invested their ill-gotten gains wisely, BigChange is virtually certain to recover the stolen money from them.

¹ The names of individuals, entities and places in this case study are fictitious. Any resemblance to people, entities or places is purely coincidental.

² Ye Olde World dollar, a fictitious currency.

Financial reporting

In accordance with the Ye Olde World Stock Exchange listing requirements, BigChange prepares its financial statements in accordance with IFRS.

BigChange's 31 December 20x5 annual financial statements are approved for issue on 31 January 20x6. Those financial statements are presented in Ye Olde World dollar (YoW\$) which is also BigChange's functional currency.

With effect from 1 January 20x6, to comply with *Agriculture: Bearer Plants (Amendments to IAS 16 and IAS 41)*, BigChange changes from measuring its palm-oil bearer biological assets from fair value less costs to sell (in accordance with IAS 41 *Agriculture*) to the historical cost model (in accordance with IAS 16 *Property, Plant and Equipment*). Financial information:

Date	Fair value less costs to sell	Cost model ³	Difference
	YoW\$ millions	YoW\$ millions	YoW\$ millions
31/12/20x3	10	8	2
Costs incurred	4	4	
Change in fair value	1		1
31/12/20x4	15	12	3
Costs incurred	8	8	
Change in fair value	2		2
31/12/20x5	25	20	5
Costs incurred	3	3	
Change in fair value	12		12
31/12/20x6	40	23	17

Land and buildings

BigChange manufactures widgets in a property (land and building) that it owns (Property A). It also owns another virtually identical property, the carrying amount of which it recovers through rental income (Property B).

BigChange acquired both its properties on 1 January 20x1 for YoW\$175 million each (including YoW\$30 million of refundable purchase taxes per *building*). At the time of acquiring the properties BigChange:

³ For simplicity, in this example, we have assumed that the bearer-plants are not depreciated because they are not yet in a condition necessary to be capable of operating in the manner intended by management.

- determines that YoW\$25 million is attributable to each plot of land, therefore YoW\$150 million is attributable to each building;⁴
- estimates the useful life (and the remaining economic life) of the buildings to be 30 years; and
- estimates the residual value of the buildings to be nil.

Improving the usefulness of its financial statements

Following the teak plantation scandal, in early 20x6 BigChange hires Mr Fixit (a leading consultant on presentation of financial statements) to advise BigChange on how to improve the usefulness of its IFRS financial reporting so as to better enable primary users of financial statements to make their own projections about the nature, timing and amount of BigChange's future resource flows.⁵

Following Mr Fixit's recommendations, BigChange makes the following changes in reporting its performance for the quarter ending 31 March 20x6:

- the measurement model of the property within the scope of IAS 40 *Investment Property* changed from the cost model to the fair value model;
- the measurement model of the property within the scope of IAS 16 *Property, Plant and Equipment* changed from the cost model to the revaluation model;
- the formula for assigning cost to its widget inventories changed from the first-in, first-out (FIFO) formula to the weighted average cost formula; and
- the classification of dividends received changed from operating activities to investing activity cash flows.

Unintentionally reclaimed purchase tax

Investigations also revealed that BigChange had in January 20x1 unintentionally (due to management misunderstanding the law) claimed reimbursement from Ye Olde World tax authorities of YoW\$30 million purchase tax on the purchase of each of its buildings. BigChange did not qualify for such reimbursement because the reimbursement applies only to new buildings. On 20 February 20x6 *Ye Olde World Business Times* headline read '*BigChange's new recipe—crooking the taxman!*' Following this scandal BigChange's share price tumbles further as many shareholders dump BigChange shares and publicly distance themselves from the company.

⁴ of the YoW\$175 million paid for each property.

⁵ Existing and potential investors, lenders and other creditors who cannot demand information from BigChange.

Earthquake

In late 20x6, just as BigChange's share price is rising in response to its rebranding, an earthquake occurs for the first time in recorded history in Ye Olde World. While neither of BigChange's buildings is damaged by the earthquake, the presence of seismic activity in the area causes BigChange to reconsider the estimated economic life of its buildings. Consequently, when measured from 31 December 20x6, BigChange now expects the economic life of its buildings to be only 20 years.

Change in use of Property B

On 1 January 20x7, when the lease agreement expired, the tenant vacated Property B and BigChange occupied the property to expand its manufacturing operations to satisfy the increased demand for widgets.

Fair value of land and buildings

BigChange's buildings are situated in an industrial park (in which there are about 500 similar factory buildings) on the outskirts of the main city in Ye Olde World. The price at which land and buildings in Ye Olde World is sold is publicly available information (from a government agency website). Using this information BigChange measures the fair value of each of its properties (land and buildings) as follows:

<i>Date</i>	<i>Land</i>	<i>Building</i>	<i>TOTAL</i>
	<i>YoW\$ millions</i>	<i>YoW\$ millions</i>	<i>YoW\$ millions</i>
31/12/20x3	50	200	250
31/12/20x4	50	170	220
31/12/20x5	55	225	280
31/12/20x6	10	145	155

Income tax

In December 20x6 Ye Olde World Government unexpectedly changes the corporate income tax to which BigChange is subject from 20 per cent to 10 per cent with effect from 1 January 20x7. The single tax rate continues to apply to all taxable income (ie including capital gains). Tax depreciation on buildings is determined using the straight-line method to a residual value of nil over 20 years. Capital gains are taxed only when realised.

Some questions for class discussion

1. What are the concepts for:
 - (a) accounting policy;
 - (b) accounting estimate;
 - (c) error; and
 - (d) changes in classification arising from a change in the use to which an asset is put?
2. Are the main principles specified in IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* consistent with the objective of IFRS financial information?
 - (a) retrospective application for a changes of accounting policy;
 - (b) retrospective restatement for the correction of a prior period error; and
 - (c) prospective recognition for a change in an accounting estimate.
3. Is the requirement (ie an exception from the retrospective application principle) specified in paragraph 17 of IAS 8, which deals with a change in accounting policy from the cost model to the revaluation model for its property, plant and equipment, consistent with the *Conceptual Framework*?
4. Why do you think IAS 40 *Investment Property* (and other Standards) provides so much application guidance to specify accounting for the change in classification of assets?⁶
5. Identify in BigChange's financial information any:
 - (a) changes in accounting estimates;
 - (b) changes in accounting policies;
 - (c) changes in classification arising from a change in the use to which an asset is put; and
 - (d) corrections of prior period errors.
6. When preparing its 20x6 annual financial statements, does it matter in which order BigChange determines the financial effects of the change in accounting policy, the change in accounting estimate and the correction of the prior period error relating to each of its buildings?
7. Do you agree with Mr Fixit's suggestions for improving the usefulness of BigChange's financial information? If so, why? If not, why not?
8. If BigChange was also a property developer, could BigChange elect, as its accounting policy, to account for property inventory using the fair value model? If not, could BigChange nevertheless voluntarily disclose the fair value of such property inventory?
9. In a future period, could BigChange revert to the cost model for its properties (land and buildings) classified as investment property and as property, plant and equipment?

⁶ See paragraphs 57–65 of IAS 40.

10. If BigChange's 31 December 20x5 annual financial statements had been approved for issue on 31 March 20x6 (rather than on 31 January 20x6), would your answer to any of the questions above change?

11. Assume BigChange applies the *IFRS for SMEs* (instead of IFRS) and the measurement basis it uses for its investment property changes from the cost model to the fair value model because BigChange for the first time judges that from now on, without undue cost or effort, it can measure the fair value of its investment property. Is the change in measurement basis a change in accounting policy, a change in accounting estimate or something else?