

## STAFF PAPER

January 2018

## IASB Meeting

Project	Taxation in fair value measurements (IAS 41)		
Paper topic	Potential annual improvement		
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## Introduction

1. The IFRS Interpretations Committee (Committee) received a request to consider amending IAS 41 *Agriculture* to remove the reference to cash flows for taxation from paragraph 22 of the Standard.
2. The Committee discussed this request at its meeting in September 2017—see [Agenda Paper 3](#) from that meeting. The Committee recommended that as part of the next Annual Improvements Cycle, the Board propose an amendment to paragraph 22 of IAS 41 to remove the requirement to exclude cash flows for taxation when measuring fair value.
3. This paper is structured as follows:
  - (a) background information;
  - (b) the Committee’s decision to recommend an amendment to IAS 41;
  - (c) transition requirements; and
  - (d) staff recommendation.

## Background information

### *History of the relevant requirements*

4. Paragraph 12 of IAS 41 generally requires entities to measure biological assets at their fair value less costs to sell.

5. In May 2008, the Board issued *Improvements to IFRSs*, which amended paragraph 20 of IAS 41 (2008 amendment). Before this amendment, paragraph 20 required entities to use a current market-determined pre-tax rate to discount cash flows when measuring the fair value of biological assets. Paragraph 22 of IAS 41 required the entity to exclude cash flows for taxation. Paragraph 22 says:
- An entity does not include any cash flows for financing the assets, taxation, or re-establishing biological assets after harvest (for example, the cost of replanting trees in a plantation forest after harvest).
6. Accordingly, entities using a discounted cash flow technique to measure the fair value of biological assets used pre-tax cash flows and a pre-tax discount rate.
7. The 2008 amendment removed the requirement in paragraph 20 of IAS 41 for entities to use a pre-tax rate to discount cash flows. The Board's considerations in removing the requirement to use a pre-tax discount rate are explained in paragraph BC6 of the Basis for Conclusions on IAS 41, which says:
- The Board noted that a willing buyer would factor into the amount that it would be willing to pay the seller to acquire an asset (or would receive to assume a liability) all incremental cash flows that would benefit that buyer. Those incremental cash flows would be reduced by expected income tax payments using appropriate tax rates (ie the tax rate of a market participant buyer). Accordingly, fair value takes into account future income taxes that a market participant purchasing the asset (or assuming the liability) would be expected to pay (or to receive), without regard to an entity's specific tax situation.
8. Nonetheless, the Board did not amend paragraph 22 of IAS 41 to delete the reference to cash flows for taxation. Therefore, after the amendment, IAS 41 required an entity to use pre-tax cash flows but did not require the use of a pre-tax discount rate. IAS 41 did not include any requirements relating to the discount rate.

9. In May 2011, the Board issued IFRS 13 *Fair Value Measurement*, which defines fair value and contains the requirements for measuring fair value. As a consequence, the Board deleted paragraphs 17–21 and paragraph 23 of IAS 41. The Board did not delete paragraph 22 (reproduced in paragraph 5 of this paper) because it contains specific requirements for entities measuring the fair value of biological assets.

### ***What do the existing requirements say?***

10. When measuring fair value, paragraph 11 of IFRS 13 requires an entity to take into account the characteristics of an asset if market participants would take those characteristics into account when pricing the asset at the measurement date.
11. IFRS 13 does not specify whether an entity uses pre-tax inputs or post-tax inputs. Paragraph B14(d) of IFRS 13 requires an entity to use internally consistent assumptions about cash flows and discount rates, stating:
- ...after-tax cash flows should be discounted using an after-tax discount rate. Pre-tax cash flows should be discounted at a rate consistent with those cash flows...
12. Paragraph 22 of IAS 41 requires an entity that measures the fair value of a biological asset using a present value technique to exclude the effect of tax when estimating the cash flows. Applying IFRS 13, the entity would use a discount rate consistent with those cash flows.

### ***Findings from outreach***

13. In order to gather information about the matter described in the request, we sent requests to members of the International Forum of Accounting Standard-Setters, securities regulators, the large accounting firms and an international valuation body.
14. The request asked those participating to provide information, based on their experience, about:
- (a) how prevalent discounted cash flow techniques are for valuing biological assets;

- (b) the methodologies and inputs used to perform discounted cash flow valuations, in particular how entities reflect tax in their valuations; and
  - (c) whether the requirements in paragraph 22 of IAS 41 influence which valuation method an entity applies.
15. Respondents said entities generally use a discounted cash flow technique for measuring the fair value of agricultural produce that (i) has a maturity of longer than 12 months, such as forestry assets; or (ii) is a perennial crop, such as palm oil fruits.
16. Most respondents said when using discounted cash flow techniques, entities use internal projections of future productivity of biological assets in estimating future cash flows. Three respondents said in their experience, most entities include tax cash flows in this estimate—this is because it is difficult for entities to determine a pre-tax discount rate. However, they are aware of a few entities that exclude tax cash flows. One respondent said in its experience, entities do not include tax cash flows when measuring the fair value of biological assets.
17. Half of respondents said they would support an amendment to paragraph 22 of IAS 41 to remove the reference to cash flows. One respondent said it would disagree with a proposal to delete the word ‘taxation’—that respondent did not however provide a reason for this view. Other respondents did not express an opinion on this matter.

### **The Committee’s decision to recommend an amendment to IAS 41**

18. The Committee discussed the request at its meeting in September 2017. It considered whether the matter in the request meets the Committee’s agenda criteria set out in paragraphs 5.16–5.17 of the *Due Process Handbook*, and the form of any proposed standard-setting activity.
19. The Committee concluded that the matter meets its agenda criteria to add a standard-setting project to the agenda. The Committee therefore recommended that the Board propose an amendment to paragraph 22 of IAS 41 to remove the requirement to exclude cash flows for taxation when measuring fair value.

20. The Committee also considered the criteria for annual improvements set out in paragraphs 6.11-6.14 of the *Due Process Handbook*. The Committee concluded that the proposed amendment to paragraph 22 of IAS 41 would correct a relatively minor oversight or conflict between existing requirements and, thus, would meet the criteria for annual improvements. This is because:
- (a) it would appear that the Board's intention with respect to the 2008 amendment was to permit entities to include tax cash flows in measuring fair value using discounted cash flow techniques. Therefore removing 'taxation' from paragraph 22 would be consistent with that intent.
  - (b) such an amendment would also be consistent with the principles and requirements in IFRS 13, which allow an entity to use different methods to measure fair value—ie IFRS 13 does not specify whether an entity includes or excludes tax cash flows when using discounted cash flow techniques to measure fair value.

### Transition requirements

21. If a proposed amendment to a Standard does not contain specific transition requirements, paragraph 19(b) of IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors* requires an entity to apply that amendment retrospectively.
22. Retrospective application of the possible amendment to paragraph 22 of IAS 41 to exclude tax cash flows when measuring fair value might require an entity to remeasure fair values determined in the past. This may not be possible without the use of hindsight by an entity and, thus, we think it is worth considering whether to provide relief from retrospective application in this circumstance.
23. As explained in paragraphs BCZ85 and BC94 of IAS 36 *Impairment of Assets* the Board observed that, in theory, discounting post-tax cash flows at a post-tax discount rate and discounting pre-tax cash flows at a pre-tax discount rate should give the same result, as long as the pre-tax discount rate is the post-tax discount rate adjusted to reflect the specific amount and timing of the future tax cash flows.

The Board's findings in its research project on discount rates did not change this conclusion.

24. Accordingly, in theory, there would be no change to previous fair value measurements even if an entity were to apply the possible amendment retrospectively. We acknowledge, however, that respondents to our outreach request said some entities have difficulty in determining a pre-tax discount rate and this could cause fair value measurements to be different.
25. If entities encounter difficulties in determining previous fair value measurements because it is not possible without the use of hindsight, we think those difficulties would mean that retrospective application would be impracticable, as defined in paragraph 5 of IAS 8:
- Applying a requirement is impracticable when the entity cannot apply it after making every reasonable effort to do so. For a particular prior period, it is impracticable to apply a change in an accounting policy retrospectively or to make a retrospective restatement to correct an error if:
- (a) the effects of the retrospective application or retrospective restatement are not determinable;
  - (b) the retrospective application or retrospective restatement requires assumptions about what management's intent would have been in that period; or
  - (c) the retrospective application or retrospective restatement requires significant estimates of amounts and it is impossible to distinguish objectively information about those estimates that:
    - (i) provides evidence of circumstances that existed on the date(s) as at which those amounts are to be recognised, measured or disclosed; and
    - (ii) would have been available when the financial statements for that prior period were authorised for issue from other information.
26. Paragraphs 23–27 of IAS 8 say that when it is impracticable to determine the effects of a change in accounting policy on comparative information, an entity

applies the new accounting policy from the earliest date practicable. In the case of a change to fair value measurement, that earliest date might be the effective date of the possible amendment.

27. We think that, because of the potential use of hindsight and the theoretical similarity in fair value measurement, entities should be required to apply any possible amendment to IAS 41 prospectively, ie only to fair value measurements of biological assets determined after the effective date. We also recommend permitting early application of the amendment.

### **Staff recommendation**

28. In summary, the Committee recommends that, as part of the next Annual Improvements Cycle, the Board propose an amendment to paragraph 22 of IAS 41 to remove the requirement to exclude cash flows for taxation when measuring fair value.
29. We recommend that the Board propose to require entities to apply the amendment prospectively to the determination of fair value measurements of biological assets after the effective date.

#### **Questions for the Board**

1. Does the Board agree with the Committee's recommendation to propose, as part of the next Annual Improvements Cycle, an amendment to paragraph 22 of IAS 41 to remove the requirement to exclude cash flows for taxation when measuring fair value?

If the answer to Question 1 is 'yes', does the Board agree with the staff recommendation to require entities to apply the amendment prospectively to the determination of fair value measurements of biological assets after the effective date, with earlier application permitted?