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International Accounting Standards Board

INFORMATION FOR OBSERVERS

Board Meeting:	**21 June 2007, London**
Project:	**Annual Improvements**
Subject:	**IAS 41 – Discount rate for fair value calculations (Agenda paper 12K)**

1. The staff has identified that the following issue would be most appropriately resolved via the annual improvements process.

   Issue: Should IAS 41, *Agriculture*, be amended to require a post-tax discount rate to be used when calculating fair value using expected net cash flows?

Staff recommendation

2. The staff recommends that the Board:

   - should add this issue to the annual improvements project; and
   - should amend IAS 41 as proposed in paragraph 12 of this paper.

Background

3. The staff has been notified of an apparent conflict in the guidance in IAS 41. It relates to the guidance about which discount rate should be used to calculate the fair value of biological assets when using expected net cash flows as the basis for the calculation.

IAS 41 guidance

4. Paragraph 20 of IAS 41 states:

   ‘In some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances, an entity uses the present value of expected net cash flows from the asset discounted at a current market-determined **pre-tax** rate in determining fair value.’ (emphasis added).

5. However, fair value is generally viewed as a post-tax concept. This view is one of the key distinguishing features, for example, between value in use (which is a pre-tax concept) and fair value when determining an asset’s recoverable amount for impairment testing purposes under IAS 36.

6. The results of the fair value case study conducted for Phase II of the Business Combinations project suggested (implicitly) that the view that fair value is a post-tax concept is widely held.

7. The requirement in IAS 41 for the pre-tax discount rate to be used arose from a request from the Steering Committee during the standard’s development. The reason given at the time for the use of the pre-tax rate was for consistency with the requirements of IAS 36, *Impairment of Assets*, and IAS 37, *Provisions, Contingent Liabilities and Contingent Assets*.

8. However, the requirement for the use of a pre-tax discount rate by IAS 36 is for the calculation of value in use rather than the calculation of fair value. IAS 37 does not specify the measurement of provisions at fair value. It requires provisions to be measured at the best estimate of the expenditure required to settle the present obligation at the balance sheet date (IAS 37, paragraph 36).

This guidance suggests an entity-specific value rather than a fair value is required.

Analysis

9. The requirement in IAS 41 to use a pre-tax discount rate to calculate fair value appears to conflict with the general view that fair value is a post-tax concept and does not achieve the consistency intended with other standards. Amending IAS 41 to require the use of a post-tax discount rate would address this apparent conflict.

Staff recommendation

10. The staff recommends that IAS 41 be amended as proposed in paragraph 12 to require that a post-tax discount rate be used when calculating fair value using expected net cash flows.

11. **Does the Board agree?**

Drafting

12. The staff recommends that IAS 41 should be amended as follows:

Recognition and measurement

…

20 In some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances, an entity uses the present value of expected net cash flows from the asset discounted at a current market-determined ~~pre~~post-tax rate in determining fair value.

Basis for Conclusions on Proposed Amendments to IAS 41 Agriculture

This Basis for Conclusions accompanies, but is not part of, the draft amendments.

Reclassification

BC1 The Board has identified an apparent conflict in the guidance in IAS 41. It relates to the guidance on which discount rate should be used to calculate the fair value of biological assets when using expected net cash flows as the basis for the calculation.

BC2 Fair value is generally viewed as a post-tax concept and so the discount rate used when calculating a fair value using expected cash flows should be a post-tax discount rate. However, IAS 41 currently requires the use of a pre-tax discount rate to calculate fair value.

BC3 The Board has decided to address this conflict by amending IAS 41 to require the use of a post-tax discount rate when calculating fair value.