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International Accounting Standards Board

INFORMATION FOR OBSERVERS

IFRIC meeting: **March 2009, London**

Project: **Guidance on discount rate to measure the present value of biological assets when market prices are not available**
IAS 41 (Agenda Paper 5G)

INTRODUCTION

1. In June 2008 the IFRIC received a request asking for guidance on how to determine the discount rate to be used to measure the present value of biological assets on initial recognition, namely plants that have just been planted, when market-determined prices are not available.

2. The constituent is particularly concerned with inappropriate recognition of day-one profit on measurement of the value of such biological assets in such circumstances. Above all, he points out that guidance exists in respect of financial instruments, whereas none is available for this specific issue on the measurement of biological assets.

BACKGROUND

3. Under paragraph 12 of IAS 41 *Agriculture*, biological assets are required to be measured at fair value on initial recognition and at the end of each reporting period. When market-determined prices are not available, the biological asset is measured at the present value of expected net cash flows from the asset discounted at a current market-determined rate as stated in paragraph 20 of IAS 41. Furthermore, in cases in which the fair value cannot be measured reliably, paragraph 30 of IAS 41 permits the asset to be valued at cost less accumulated depreciation only on initial recognition.

4. Also, paragraph 24 of IAS 41 indicates that "Cost may sometimes approximate fair value, […]" and gives two examples of situations in which that might be the case.

STAFF ANALYSIS

5. IAS 41 seems to be sufficiently clear as to how to determine the discount rate, especially considering the amendments made to the standard in the May 2008 *Improvements to IFRSs*. In particular, paragraph 21 was amended to state: "In determining the present value of expected net cash flows, an entity includes the net cash flows that market participants would expect the asset to generate in its most relevant market." Paragraph BC8 of the Basis for Conclusions states: "The Board noted that an entity should consider the risks associated with cash flows from 'additional biological transformation' in determining the expected cash flows, the discount rate, or some combination of the two."

6. Given that the objective of the fair value measurement is clearly stated to be the price market participants would pay for the biological asset in its current condition and location, the use of a discount rate which produced an amount that is obviously different from that price is inappropriate. This conclusion would also be consistent with the fair value measurement guidance in IAS 39, especially that related to day-one gains.

7. Indeed IAS 39 is particularly relevant as its fair value objective is identical to that in IAS 41. Paragraph AG76 of IAS 39 states that "The application of paragraph AG76 may result in no gain or loss being recognised on the initial recognition of a financial asset or financial liability".

STAFF RECOMMENDATION

8. The staff has assessed the issue raised in the submission against the IFRIC agenda criteria as follows:

    a) The issue does not seem to have widespread relevance.

    b) Diversity may appear in the judgement and assumptions used to measure the biological asset and does not arise from different interpretations of the standard's core principles. In that respect, paragraph 47 of IAS 41 requires that "[…] methods and significant assumptions applied in determining the fair value […] of each group of biological asset" be disclosed.

    c) The issue is closely related to the fair value measurement project which the Board is currently dealing with. Therefore, the staff believes that additional guidance from the IFRIC at this time would not be productive.

9. Moreover at its November 2008 meeting, the IFRIC tentatively decided not to add to its agenda an issue requesting guidance on how to determine the discount rate for fair value measurements of financial instruments in illiquid markets.

10. The staff believes that providing guidance with respect to a similar issue in IAS 41 would be inconsistent with this conclusion. In addition, the staff's analysis is that IAS 41 is sufficiently clear as to how to determine the discount rate to measure biological assets and that any guidance would be application guidance and not interpretation.

11. The staff has set out proposed wording for the tentative agenda decision in Appendix A.

QUESTIONS FOR THE IFRIC

12. Does the IFRIC agree with the staff recommendation?

13. Does the IFRIC have any comments on the drafting of the tentative agenda decision?

[Appendix A is omitted from Observer note]