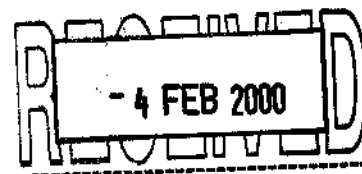


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Dear Sir

**E65 Agriculture**

We appreciate the opportunity to respond on behalf of the worldwide practice of PricewaterhouseCoopers to the recent exposure draft on agriculture.

Agriculture is an important industry in many parts of the world and we believe it is appropriate for the International Accounting Standards Committee to develop a standard on this topic.

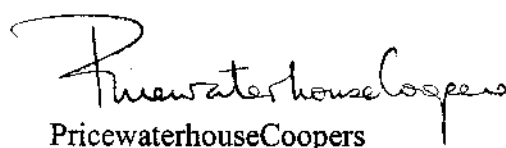
In principle we support the move to measuring biological assets at fair value at each balance date. However, we are concerned about the reliability (and therefore the comparability) of the values reported. We therefore believe it imperative that as much guidance as possible be given on how fair value should be ascertained.

Consistent with our submission on E64 *Investment Property*, we believe it is important for the Board to agree on the future of the reporting of financial performance before finalising this standard.

Our detailed comments on the discussion questions are set out in the appendix to this letter.

We would be pleased to discuss further matters raised in our response. Should you wish to do so, please contact Steve Todd in our Auckland, New Zealand office (telephone +64 (9) 355 8232).

Yours faithfully,

  
PricewaterhouseCoopers

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**Question 1 – Scope: further processing after harvest (paragraphs 4 – 7 and 36)**

*Do you:*

- (a) *agree that the final Standard should not address the further processing? If so, do you believe that the guidance in paragraphs 4 – 7 for distinguishing between agricultural activity and further processing is adequate; or*
- (b) *believe that the final Standard should address further processing? If so, what method of accounting do you propose?*

We agree with (a) - that the final Standard should not address accounting for agricultural produce after harvest.

However, we have some concerns IAS 2 may not deal adequately with certain types of agricultural produce and their output, such as wine, which can take several years before it is ready for sale. Clearly IAS 2 will need to be reconsidered as the fair value model is developed.

**Question 2 – Biological assets: measure at value (paragraphs 21 and 36)**

*Do you believe:*

- (a) *all biological assets should be measured at each balance date at fair value and agricultural produce should be measured at fair value at the point of harvest;*
- (b) *biological assets should be measured at cost until harvested, and then agricultural produce should be measured at fair value at the point of harvest; or*
- (c) *all biological assets and agricultural produce should be measured at cost?*

*If you prefer (b) or (c) above, please explain how cost would be determined.*

In principle we agree with (a). However, we are concerned that valuation methodologies will be inconsistently applied. Such inconsistencies would bring into question the reliability of the values carried in balance sheets. We comment further in question 3 below.

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**Question 3 – Reliability of fair value measurement (paragraphs 21 – 31)**

*Do you believe that:*

- (a) a reliable estimate of fair value can be determined for (i) biological assets and (ii) agricultural produce at point of harvest;*
- (b) a reliable estimate of fair value can usually be determined, and even if, at times, fair value cannot be determined to a very high degree of precision, neither can cost, and on balance an estimate of fair value should be required; or*
- (c) fair value sometimes cannot be determined reliably, and the cost basis should be used? If this is your view, please identify circumstances in which fair value cannot be determined reliably and explain, in such cases, (i) how cost could be determined reliably and (ii) how cost of biological assets and agricultural produce is relevant to the user of the financial statements of an enterprise engaged in agricultural activity.*

While we believe that in most circumstances a reliable estimate of fair value will be available, there will clearly be instances where this is not so. Primarily this will occur where there is no active market. For these circumstances we believe the IASC may need to give more prescriptive guidance, in an effort to avoid either the use of an inappropriate valuation methodology, or the varying application of specific methodologies (for example, by the use of different assumptions).

Paragraphs 24 to 31 of the exposure draft illustrate the range of methodologies that may need to be applied to arrive at fair value. In practice, it may well be that an even greater range of options will be necessary.

In addition to the choice of valuation methodology, there is further scope for variation in valuation as a result of the assumptions adopted. This may be particularly marked for biological assets with longer growing cycles, such as forestry. In this instance, if a present value model were adopted, assumptions might include price at harvest, discount rate and date of harvest. Relatively minor changes in any one of these assumptions could result in significant variations in the resulting estimate of fair value.

In summary, we believe there is a real need for further guidance and more examples to illustrate the application of that guidance. Without this, we believe there will be significant inconsistencies among the enterprises applying the standard.

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We also have some particular concerns with the guidance contained in the exposure draft, as follows:

- *Determination of fair value by reference to market prices.* The way paragraphs 24 and 25 are presented seems to imply that pre-sale disposal costs should not be deducted from the market price if the assets are to be sold in a local market. However, paragraph 30 clearly states that fair value should always be the highest price obtainable by the entity, net of costs. While there may be additional disposal costs associated with distant markets, the costs of disposal in a local market may still be significant: for example, auction fees.
- *Use of average prices and alternative markets.* We believe that there may be situations where it would be more appropriate to use an average price rather than the price obtainable in the local market on a particular day. Individual markets may be shallow or imperfect because of localised factors. In addition, prices on a particular day may be affected for example by inclement weather, or a strike by local abattoir workers.
- *Existence of hedging contracts.* IAS 39 does not apply to forward sales contracts for agricultural produce (settled by delivery of the produce). We believe it is essential that some guidance be given in the standard on how the existence of forward sales and similar contracts should be accounted for.
- *Valuation of immature biological assets.* Paragraph 27 suggests that one method of valuing immature biological assets attached to agricultural land is to deduct the value of the raw land from the fair value of the combined land and biological assets. If this were done the value of any land improvements, for example, irrigation systems, would be included in the value of the biological assets. We do not believe this is appropriate, as value should be attributed to all components.

**Question 4 – Fair value change in net profit or loss (paragraph 22)**

*If biological assets are measured at fair value, do you believe that the change in fair value should be:*

- (a) *reported entirely in net profit or loss for the period;*

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- (b) *reported entirely in equity until the asset is sold or consumed, at which time it should be removed from equity and reported in net profit or loss for the period;*
- (c) *reported entirely in equity until harvest, at which time it should be removed from equity and reported in net profit or loss for the period;*
- (d) *reported in net profit or loss only to the extent of the physical change component; the price change component should be reported directly in equity until the asset is sold or consumed (or possibly until harvest); or*
- (e) *reported entirely in equity and, thereafter, never reported in net profit or loss for any period?*

*Alternatives (b), (c), and (d) all would report some or all of the change in fair value of biological assets in equity, with 'recycling' into net profit or loss triggered by a 'realisation' event such as harvest, sale, or consumption. If you support one of those alternatives, please indicate clearly whether you do so because you do not believe that fair values can be measured reliably prior to a 'realisation' event or because you do not believe that the change in fair values of biological assets prior to realisation is the most appropriate indicator of the performance of an enterprise engaged in agricultural activities.*

Consistent with our submission on E64, we believe that it is essential that the Board agree on the philosophies of the reporting of financial performance before finalising this standard. We are concerned that inconsistency of reporting financial performance should not be introduced by each specific standard adopting a different basis.

#### Question 5 – Definition of fair value (paragraph 24)

*Do you believe that:*

- (a) *price in an active market in the asset's intended location of sale or use is always the best measure of fair value; or*
- (b) *sometimes price in such a market should be adjusted to determine fair value? If so, under what circumstances and how should such market price be adjusted?*

We agree that in general (a) should apply, so long as the relevant market is truly "active" at the time of valuation (see our response to question 3).

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**Question 6 – Agricultural land: follow IAS 16 (paragraph 38)**

*Do you believe that:*

- (a) *IAS 16 should apply to agricultural land;*
- (b) *all agricultural land should be measured at fair value, either separately or as part of a combined group that includes the land and related bearer biological assets;*
- (c) *only agricultural land that is part of a combined group that includes the land and related bearer biological assets should be measured at fair value;*
- (d) *enterprises should be permitted or encouraged to measure agricultural land at fair value, but not required; or*
- (e) *all agricultural land should always be carried at cost, that is, the revaluation alternative of IAS 16 should be prohibited?*

We agree that agricultural land should be outside the scope of this standard, so that IAS 16 or the standard resulting from E64 might apply.

**Question 7 – Government grants (paragraphs 41 – 44)**

*Do you:*

- (a) *agree that the grant should be recognised as income immediately if it is unconditional;*
- (b) *believe that the grant should be amortised into income over the life of the biological asset (if this Exposure Draft was silent on this matter, amortisation would automatically become the requirement under IAS 20, Accounting for Government Grants and Disclosure of Government Assistance); or*
- (c) *believe that the grant should reduce the carrying amount of the asset so that the carrying amount is below fair value of the biological asset? If so, would that reduction continue as long as the asset is held? Would it be amortised?*

Our response to E64 supported the basis proposed in E65 for government grants. However, we do not believe that government grants for agriculture are any different to government grants for other activities. We therefore believe that accounting for

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government grants should be by reference to IAS 20. Our preference would therefore be for the Board to reconsider IAS 20 rather than provide special rules in individual standards.

**Question 8 – Components of biological assets (paragraph 46 – 47)**

*Do you believe that:*

- (a) *the proposal set out in this Exposure Draft is the appropriate way to accomplish the objective of providing information about the nature and stage of production of biological assets;*
- (b) *separate disclosure of quantified consumables and bearer components of the carrying amount of each group of biological assets should be required;*
- (c) *separate disclosure of the quantified mature and immature components of each group of consumables and each group of bearer biological assets should be required; or*
- (d) *subdivisions of biological asset other than a consumable-bearer split and a mature-immature split might provide better information about an enterprise's biological assets in some or all cases and, if so, which type of subdivision(s) and in which case(s)?*

We agree with the proposals in the exposure draft. At this stage, we do not believe it would be appropriate to be too prescriptive with respect to the form that the disclosure should take.

**Question 9 – Components of change in fair value (paragraphs 52 – 58)**

*Do you believe that if the production cycle is longer than one year:*

- (a) *an enterprise should be required to disclose separately the components of the change in fair value of its biological assets due to physical changes and price changes;*
- (b) *an enterprise should be encouraged, but not required, to disclose separately the physical and price components of the change in fair value of its biological assets;*  
*or*

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- (c) *separate reporting of the physical and price change components should be prohibited because they usually cannot be measured reliably?*

We agree with (b) - that the components of the change in fair value attributable to physical and price changes should not be accounted for separately and that disclosure of these components should be encouraged, but not required.

**Question 10 – Guidance on components of change in fair value (paragraphs 56-58)**

*If you answered Question 9 either 'a' or 'b' (that is, you believe an enterprise should be either required or encouraged to separate the physical and price components of the change in fair value), do you believe that:*

- (a) *the guidance for making the split in paragraphs 56 – 58 is adequate; or*  
 (b) *the guidance for making the split in paragraphs 56 – 58 is inadequate and, if so, how would you modify it?*

We agree with (a) - that the guidance provided in the exposure draft is adequate.

**Question 11 – Analysis of expenses (paragraphs 59 – 60)**

*Would you:*

- (a) *require classification by nature of expense;*  
 (b) *encourage but not require classification by nature of expense; or*  
 (c) *allow each enterprise to decide whether to classify by nature or function?*

We can see no reason for the proposed standard to require anything different to IAS 1, which permits either. Therefore we agree with (c).



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**Question 12 – Disclosures in general (paragraphs 44 – 67)**

*Paragraphs 44 – 67 propose various disclosures about agricultural activities. Questions 8 – 10 address some specific disclosures. In addition to your responses to those questions, do you believe that the disclosures proposed in those paragraphs:*

- (a) are about right;*
- (b) are excessive (please indicate which one(s) you would eliminate and reasoning);*  
*or*
- (c) are insufficient (please indicate your proposed addition(s) and reasoning)?*

We believe that requiring the disclosure of risk management strategies and unsustainable activities (paragraph 64 (f) and (g)) could be viewed as excessive absent similar requirements for other industries. We should prefer to see such considerations addressed by the IASC “across the board” rather than simply for one industry.

**Question 13 – Present value sensitivity disclosure (paragraph 64(c))**

*Do you believe that:*

- (a) such sensitivity disclosure should be required (and, if so, please indicate what type of disclosure should be required); or*
- (b) such sensitivity disclosure should not be required?*

We believe that requiring disclosure of sensitivity would be excessive.

**Question 14 – Transition: Follow IAS 8 (paragraph 69)**

*Do you believe that:*

- (a) both the benchmark and the allowed alternative treatments under IAS 8 should be permitted when an enterprise adopts this Standard;*
- (b) only the benchmark of IAS 8 should be allowed by this Standard;*
- (c) only the allowed alternative of IAS 8 should be allowed by this Standard;*

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- (d) *the adjustment to biological assets to adopt this Standard should be amortised over the estimated remaining life of the biological assets; or*
- (e) *some other transition is appropriate (please specify)?*

We agree with (a) that IAS 8 should be followed. The question of continuing to allow alternatives in IAS 8 should be separately addressed.

#### Question 15 – Matters not covered by a specific question

*The foregoing questions do not deal with all of the principles proposed in this Exposure Draft. If you disagree with a proposed principle, we particularly invite you to explain the reasons for your disagreement and to propose and defend an alternative principle that the IASC Board should consider.*

##### *Definitions*

We are concerned that the definition of “Biological Assets” does not conform to the definition of an asset under the Framework. The part of the definition of asset in the Framework that deals with future economic benefits that are expected to flow to the enterprise is omitted. Conversely, the definition of biological assets in the exposure draft includes comments relating to the meaning of control. We recommend that the definition of biological assets be “assets that are living animals and plants”. “Assets” could then be defined separately in an identical manner to that in the Framework, or a guidance paragraph could refer the reader to the Framework definition.

##### *Costs incurred*

We believe there may be circumstances where additional guidance is needed to determine whether certain events constitute a disposal and creation of a new asset, or the continuation of an old asset. For example, this can happen when a new grapevine is grafted onto the base of an old one that has been cut down (where the old variety is no longer in demand).

We presume that the alternative treatment permitted under IAS 23 *Borrowing Costs* of capitalising interest should not be allowed where biological assets are measured at fair value. We believe the standard should make this clear. However, we can imagine circumstances where it may be appropriate to capitalise interest costs to biological assets. This might include where a cost is used as an approximation of fair value (see paragraph

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26 (f) of the exposure draft). Again, we believe the standard should make it clear whether this is possible and if necessary amend IAS 23.

A further issue with respect to the capitalisation of interest potentially arises on agricultural produce after harvest. For example, where wine is made from self grown grapes. Paragraph 17 of IAS 23 specifies that a capitalisation rate should be applied to "expenditures on that asset". Somewhere, it should be made clear in this context whether "expenditures" means only the sum of cash expenditures made in relation to the wine, or also includes the fair value of the agricultural product at date of harvest.

*Further guidance*

We note that the recent Australian standard AASB 1037, *Self-Generating and Regenerating Assets* contains considerably more guidance than E65. Certain parts of that additional guidance, particularly Appendix 3, would be very useful in the final standard and we recommend that the Board carefully review the guidance contained in the Australian standard with a view to reproducing it in the International standard.