



ASSOCIATION FOR
INVESTMENT MANAGEMENT
AND RESEARCH

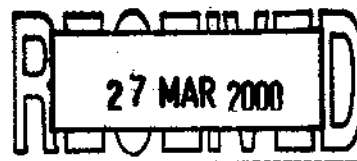
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March 21, 2000

Sir Bryan Carsberg
The Secretary-General
International Accounting Standards Committee
167 Fleet Street
London, EC4A 2ES
United Kingdom

CL 62



Re: Proposed IAS, *Agriculture* (E65)

Dear Sir:

The Financial Accounting Policy Committee (FAPC) of the Association for Investment Management and Research (AIMR)¹ is pleased to respond to the International Accounting Standards Committee's (IASC) Proposed International Accounting Standard, *Agriculture* (E65). The FAPC is a standing committee of AIMR, charged with maintaining liaison with and responding to the initiatives of bodies, which set financial accounting standards and regulate financial statement disclosures. The FAPC also maintains contact with professional, academic, and other organizations interested in financial reporting.

General Comments

The FAPC commends the IASC and its Steering Committee for promulgating a comprehensive and operational accounting standard related to agricultural activities. This is virtually unprecedented in accounting policy formulation. The proposed standard encompasses economic activities that are complex and diverse in form, yet similar in nature and substance, in a thorough and complete manner. This should ensure that financial statements appropriately reflect similar accounting treatment for situations that represent the same economic reality. We also believe that this proposal should ultimately result in a final international accounting standard that sets a precedent for measuring other economic activities at fair value.

We agree with the primary principle underlying the proposed standard: namely, that all biological assets and agricultural produce be measured at fair value. We strongly support the proposed disclosures of agricultural activities related to the changes in (1) components of biological assets and (2) the fair value of these components. These detailed, supplemental disclosures and descriptive, illustrative examples will provide the financial statement user with critical

¹The Association for Investment Management and Research is a global, not-for-profit membership organization of over 39,000 investment professionals from 70 countries worldwide. Through its headquarters in Charlottesville, Virginia, and 89 member Societies and Chapters throughout the world, AIMR provides global leadership in investment education, professional standards, and advocacy programs.

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information and data that are necessary for him/her to assess properly the performance of agricultural enterprises. We believe that the proposal will also improve comparability among different agricultural enterprises.

Scope

Under the proposed standard, fair value accounting treatment is recommended for (1) biological assets during the period of growth, procreation, and degeneration, and (2) the initial measurement of agricultural produce at the point of harvest. Such fair value measurement ensures consistency through the point of transfer between two classes of agricultural assets (biological and harvested). However, the scope of the proposed standard excludes further processing of agricultural produce after harvest.

The FAPC agrees with the scope of E65 in that it only covers accounting treatment and measurement of biological assets during various stages through the point of harvest. We believe that the harvested assets should be treated as raw materials; the accounting treatment for the conversion of such assets into marketable inventories is defined in International Accounting Standard No. 2, *Inventories*.

Measurement of Biological Assets

The proposed measurement under E65 would be fair value for all biological assets at (1) each balance sheet date and (2) the time of harvest for agricultural produce. The FAPC agrees conceptually with the proposed fair value measurement for all biological assets and agricultural produce. We believe that fair value measurements provide users of financial statements with more relevant data as compared to historical costs. Furthermore, the inclusion of all biological assets and agricultural products in the scope of the proposal will provide consistent accounting treatment for similar economic transactions and activities.

Reliability of the Fair Value Measurement

E65 presumes that the fair value of biological assets and agricultural produce at the point of harvest can be determined reliably. The Committee concluded that markets exist for most biological assets individually, or in groups. Oftentimes, a market exists for similar, though not identical, biological assets. Prices in these markets provide a basis for determining the fair values of most biological assets and agricultural produce at the point of harvest. In the absence of market prices, other accepted methodologies exist for estimating fair values of biological assets

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and agricultural produce. These include sector benchmarks, net present value of expected cash flows, and net realizable values.

The FAPC concurs with the IASC's conclusion that fair values of biological assets and agricultural produce can be measured reliably in most cases within existing markets. Over the past several years, the consolidation of agricultural markets and increased use of technology has reshaped these marketplaces. Consequently, there are many active and efficient markets for agricultural produce and, to a lesser extent, biological assets. Some of these markets may become more active and efficient as a result of implementation of this proposed standard. When markets do not exist, we believe that alternative methods, such as net present value of expected cash flows, can be used to reliably obtain or estimate fair value. However, there are instances in which fair value cannot be determined reliably. In such cases, historical cost should continue to be employed. We believe that the IASC should develop specific criteria that highlight cases in which fair value cannot be derived reliably. This will limit an enterprise's ability to circumvent the fair value framework.

As we mentioned previously, historical cost measures of biological assets and agricultural produce are less relevant, and in some cases less reliable, than fair value measures. Fair value measurements enhance the ability of financial statement users to accurately assess and analyze the amounts, timing, and uncertainty of expected cash flows.

Fair Value Change in Net Profit or Loss

The proposed standard requires that the change in the fair value of biological assets should be recognized in net profit or loss in the period in which it occurs. The FAPC concurs with this proposed accounting treatment. We have always expressed reservations about the potential for "recycling" unrealized gains and losses that are initially recognized in either comprehensive income (i.e., statement of non-owner movements in equity) or shareholders' equity in one accounting period into the profit and loss statement in subsequent periods. Gains or losses, whether realized or unrealized, should be recorded in the profit and loss statement in the period in which they occur.

Definition of Fair Value

The IASC concluded that if an active market exists for a biological asset at the reporting date in the location in which the asset is intended to be sold or used, then that market price is the most reliable measure of the fair value of the asset. The FAPC concurs with the Committee's conclusion that the most reliable measure of the fair value of biological assets and agricultural

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produce is the market price as determined in the location in which the asset is intended to be sold or used. Valuations for the same biological asset or agricultural produce will vary between different market locations due to disparate market environments and conditions, which may result from regulatory, transportation, or seasonal differences.

Measurement of Agricultural Land

Agricultural land will be measured in accordance with IAS 16, *Property, Plant, and Equipment*, since no special accounting standards applied to agricultural land are being proposed in E65. Under IAS 16, agricultural land is carried at (1) cost subject to a write-down for impairment or (2) fair value. However, under the proposed standard, biological assets attached physically to agricultural land (such as, crops and trees) would be recognized and measured at fair value separately from the land.

As mentioned in a previous comment, we believe that biological assets should be measured at fair value, even though these assets are attached physically to the agricultural land. Measuring agricultural land at fair value is more complex than measuring biological assets or agricultural produce at fair value because agricultural land may have several possible uses. Use of the land for agricultural activities may not be optimal. Hence, a diverse range of values for the land could be derived.

In our prior comment letter, addressing the Draft Statement of Principles, *Agriculture*,² we stated that enterprises should not use fair valuation of agricultural land in their financial statements because there are too many imperfections in the markets. However, the FAPC's views on this matter have shifted over time toward the use of fair value. Some members of our committee would rather have the fair value of the agricultural land reflected on the balance sheet with supporting disclosures that indicate how the fair value was determined. These members believe that it is more important to receive relevant information about the land's value than information that reflects historical cost. Although fair value reflects a more reliable measurement, it fails to provide financial statement users with pertinent information about the condition of the land. For example, there are other potential uses of the land or shifts in the marketplaces that may affect the land's value in the future.

Overall, the FAPC recommends strongly that, at a minimum, the fair value of the land should be a required disclosure if the land is measured at historical cost in accordance with IAS 16. Additional disclosures regarding the (1) methodology used in determining the fair value and (2) key assumptions should also be required in the final standard.

² Comment letter to Sir Bryan Carsberg, Secretary-General, International Accounting Standards Board, dated May 6, 1997.

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Government Grants

The FAPC supports approach (b) for recognizing grant income over the life of the biological asset as required under IAS 20, *Accounting for Government Grants and Disclosures of Government Assistance*. We do not support approach (a) because the immediate recognition of grant income is not consistent with the recognition of expenses related to the biological assets. We believe that approach (c) would create a mixed-attribute fair value model by reducing the carrying amount of the biological asset by the government grant amount. Although such grants may have an effect on the measurement of fair value, we believe they should not be deducted from the determined fair value of the asset. The FAPC has historically supported the disaggregation of such accounting information.

Components of Biological Assets

The FAPC urges the Board to require disclosure of certain information regarding an enterprise's biological assets. We recommend that biological assets be separated into two classes: (1) consumable and (2) bearer. Each class of asset has a different agricultural purpose. If the two classes were grouped together, then their combined fair values would mask changes in values due to (1) physical changes in the agricultural assets or (2) changing market conditions that affect each class in a unique manner. Consequently, the agricultural activities and performance of an enterprise would be less transparent to financial statement users. In addition, we agree that the two classes should be divided into those based on more discrete categories of development or maturity. Financial statement users will have the necessary information in which to evaluate properly the potential risks associated with these biological assets during various stages of maturation.

Components of Change in Fair Value

The change in the fair value of an enterprise's biological assets is caused, in part, by physical changes (including biological growth, degeneration, procreation, and harvesting) and, in part, by unit price changes in the market. The FAPC supports strongly approach (a), which requires an enterprise to disclose separately the components of the changes in fair value of its biological assets. Analysts realize that variations in productive activities, as well as changes in market prices are very different observable events that can affect the fair value of agricultural assets. Physical changes caused by weather, disease, etc. directly improve, or diminish, the future economic benefits of producing agricultural assets. Consequently, we believe that changes in fair

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value should be separated into components reflecting: (1) an increase or decrease in the value of biological assets due to acquisition or sales, (2) biological changes in the assets held, (e.g., growth, degeneration, procreation, and harvesting), and (3) changes in market prices. Financial statement users use this information to assess properly an enterprise's performance and financial position.

We believe that paragraphs 56-58 of the proposed standard provide adequate guidance for determining the components of change in fair value. Moreover, we agree with the guidance provided in paragraph 58 that neither requires nor encourages such a separation for agricultural systems that have a production cycle of one year or less.

Analysis of Expenses

The proposed standard encourages classification by nature. An analysis of expenses classified by nature would include items such as fertilizer, wages and salaries, and depreciation. However, an alternative classification by function (e.g., cost of sale, selling expenses, administrative expenses) is also allowed under IAS 1, *Presentation of Financial Statements*.

The FAPC prefers the classification by nature of the expense because it provides more transparent information regarding the agricultural costs involved. This specificity allows the financial statement user to (1) better understand the nature of the agricultural activities and (2) determine the future expected cash flows of these activities more accurately.

Disclosures

The FAPC supports strongly the proposed disclosures in E65. We believe that the illustrative examples shown in the proposed standard provide appropriate guidance for agricultural enterprises to both report and disclose their activities. We strongly believe that financial statement users need such detailed disclosures and data regarding the measurement of agricultural assets to:

- (1) understand the methodology underlying the fair value measurements;
- (2) determine the degree of reliability that can be placed on the fair values used by agricultural enterprises to measure biological assets and agricultural produce; and
- (3) assess and compare the performance and financial conditions among different agricultural enterprises.

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Present Value Sensitivity Disclosure

If net present values have been used to determine the fair value of biological assets or agricultural produce, paragraph 64(c) requires disclosure of the discount rate and number of years over which future cash flows have been estimated. The FAPC has always supported the use of sensitivity analysis, or stress tests, to assess the potential impact on valuations due to changes in key assumptions, such as the discount rate. Analysts and investors use such analysis to (1) assess the comparability of information and (2) determine the extent to which future changes in key assumptions may affect the present value of an asset.

We recommend that the sensitivity analysis should disclose the effect of both a 1% increase and a 1% decrease in the discount rate used to determine the present value of the expected future cash flows. The FAPC believes that this is an appropriate range of change that will enable analysts and investors to compare both the performance and financial conditions of agricultural enterprises that use different discount rates in calculating the present value, or fair value, of similar assets.

Transition

Under the proposed standard, an enterprise will apply the transition provisions underlying IAS 8, *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies*, upon its initial adoption of the final Agriculture Standard. IAS 8 permits the choice of two accounting treatments for an adjustment to the previous carrying amounts of biological assets and agricultural produce.

To promote comparable and consistent information across different enterprises, the FAPC has traditionally supported one effective date and the use of one transition method in applying a new accounting standard. We prefer an effective date at the beginning of the fiscal year to ensure that interim reports, which reflect accounting changes applicable to that year, provide information with better predictive quality than those that require transitional accounting changes to be reflected in yearend reports. Additionally, we prefer the alternative treatment of applying the new Standard retrospectively (unless the amount of the prior period adjustment cannot be reasonably determined). This treatment would reflect an adjustment to the previous carrying amount of biological assets and agricultural produce in net profit or loss for the period; restated prior period data would be presented on a pro forma basis, unless this is not practical.

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Concluding Remarks

The Financial Accounting Policy Committee appreciates the opportunity to comment on the International Accounting Standards Committee's (IASC) Proposed International Accounting Standard, *Agriculture* (E65). If the IASC Board or its staff have questions or seek amplification of our views, we would be pleased to answer any questions or provide additional information you might request.

Sincerely,



Gabrielle U. Napolitano, CFA
Chair
Financial Accounting Policy Committee



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Associate, Advocacy
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