

CORPORATE FINANCE

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REG. No. 02/00622/06

The Secretary General
 International Accounting Standards Committee
 166 Fleet Street
 London
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Dear Sir or Madam:

Comment on the Draft Agricultural Statement (E65)

Illovo Sugar Limited is Africa's leading sugar producer, with agricultural estates in the following countries:

- South Africa
- Mauritius
- Swaziland
- Malawi
- Mozambique
- Tanzania

The proposed statement will significantly affect our valuation of standing cane. The following questions in the statement have been answered, as they would relate to standing cane and the sugar industry.

DIRECTORS:

R.A. Williams (Chairman) D.G. MacLeod (Managing Director) W.M.A. Buchanan G.J. Clark (Australian) B.P. Connellan

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Member of the
CG SMITH GROUP

Question 1 - Should the statement scope include further processing after harvest

Illovo – no

The statement proposes a consistent approach up to the point of harvest. Would agree that once the cane enters the milling process it is no longer undergoing biological transformation, and the normal manufacturing rules of costing/valuing stock will take over.

Question 2 - Biological assets should be measured at fair value

Illovo – ?

We contend that in certain agricultural industries the biological transformation process is a fundamental element of understanding an enterprise's performance e.g. those industries where the growth cycle is longer than 2 years such as livestock or timber plantations.

However the sugar industry has the problem of valuing 2 parts of the standing cane namely:

- ➔ cane element – harvested every 1-2 years
- ➔ roots portion – life span of 7-12 years

With respect to the cane element, we would tend to agree with the arguments raised in B20 on page 64 of the Exposure Draft, and specifically that the results of biological transformation may never be realised. Unharvested cane is exposed to a number of risks that will affect the ultimate tonnage and sucrose levels. The sucrose price is also extremely volatile. As such the reliability of a fair value measure could be questioned and it would be prudent in respect of mature cane, to place a value equating to the maintenance cost costs incurred to date.

However, to recognise income in advance using a fair value measure, would ultimately have the same affect on the income statement as the cost method, as any incorrect valuations/costings will be adjusted in the next periods income statement on realisation.

For the root portion of the cane, we would agree that a fair value measure would be a better indicator of performance, as the degeneration of the root takes place over a long period of time and the historical method would not accurately reflect this degeneration.

This fair value would be based on the current costs of establishing the roots adjusted for the estimated remaining life of the roots.

Question 3 - Reliability of fair value measure

The ED assumes that the fair value of biological assets and the fair value of agricultural produce at the point of harvest can be determined.

Illovo – yes/no

Difficult to argue otherwise in the sugar industry i.e. for mature unharvested cane we have fairly reasonable estimates of current sucrose prices, sucrose levels and harvest/transport costs. With regards to immature cane the fair value would equate to the current maintenance costs. The fair value of the roots would equate to the actual current costs of planting adjusted for the remaining useful life of the roots. This information would regarding these costs would be available.

There would however be a number of uncertainties i.e.:

- at what point does immature cane become mature cane
- As at September of any season (which runs from April to March); all the fields that have been cut in that season can only be classified as immature cane. The question is what is the category of the uncut cane, as this can have a growing cycle of between 12 & 24 months. As such, the realisation of the fair value is questionable, as the quantity of sucrose recovered would be affected by a number of unknown weather conditions. The volatility of the world sugar price would also affect the final sucrose price paid, and especially as the harvesting of the cane may fall into a totally different season.

Question 4 - Fair value change in net profit or loss

The options given are:

- *The change in the fair value from period to period is taken to the income statement*
- *The change in fair value is kept as part of equity until realised through harvest.*
- *The price change component of the change in fair value is kept as part of equity until realised through harvest*

Illovo – if the fair value method is used we would agree that the change in fair value is taken to profit and loss.

Not to do so would create added complications and potential for manipulation. Ultimately the movements year and year through the income statement, with adjustments for prior year over/under provisions would be very similar to the current historical method used

Question 5 – Definition of fair value

Is price in an active market always the best measure of fair value or can/should we adjust these prices and under what circumstances?

Illovo – yes, although we should be able to adjust these prices, in a prudent manner to the level that we believe is recoverable.

It is agreed that in the sugar industry the sucrose price is a good starting point in determining the fair value of mature unharvested cane. However there are a number of factors that should be taken into account when finalising the price i.e.:

- ➔ Volatility of the market value – as the final sucrose price is not determined until the end of the season, the current domestic and world sucrose price would need to be carefully assessed as this will impact on the final sucrose price.
- ➔ Climatic conditions – factors such a drought; flooding or diseases are always a risk and could significantly affect the sucrose levels in the cane when finally harvested. Reasonable provisions would need to be made for this.

Question 6 – Agricultural land: follow IAS 16 and not to come under the ambit of the new statement

Illovo – agree

The fair value of land is very difficult to determine, as it will vary depending on its use (e.g. cane, timber, and grazing or residential property), and its location. Therefore the fair value of the land is not just be a factor of its agricultural use e.g. Illovo has sugar plantations in Mauritius, and the high value of land is as a result of the shortage of industrial/residential and hotel property on the island. It may be argued that where land can only be used for a specific agricultural activity, than it could be considered to be an integral part of the biological asset and should be measured at fair value. It would be difficult to identify too many examples of this type of land.

Question 7 – Immediate recognition of unconditional Government Grants in income when received

Illovo – no

Difficult to envisage a grant that would be totally unconditional, and would assume that the grant would at least be for performing agricultural activities. In that instance it would be better to amortize the grant over the life of the biological asset for which it was specifically used in order to comply with the ‘matching’ concepts. If the funds received can not be specifically allocated to a particular biological asset/s and is just pooled into the operations of the entity, than it should be recognised as income when received.

Question 8 – Disclosing the components of the biological assets

The statement is basically requiring more disclosure of the various components of the standing cane (specifically maturity) to assist users in forecasting the cash flows, and as such require a description of the nature and stage of production of each group of biological asset.

Illovo – agree that the information is useful, although the exact split should not be specified in the statement. The broad based principles should be set out in the statement, however it should be left to the entity together with the auditors to determine which disclosure is relevant for the users.

Question 9 – Should we separately disclose the physical and value components of the change in fair value of the biological assets.

Illovo – no, it should not be mandatory

The question to split the change in fair value between the price component and the physical component, may be relevant in long term crops e.g. timber, where the user may want to see how value is been created year on year on these long term investments. For crops that are seasonal or are rotated every 1-2 years, this level of information has a limited use, as there shouldn't be significant changes year on year. As such the cost/benefit principle will need to be applied as to whether the information is disclosed.

Question 10 – Guidance on components of change in fair value

Illovo – guidance in statement is adequate, together with the examples.

Question 11 – Should the statement insist the analysis of expense in the financial statements be based on the nature of the expense (e.g. fertilizer, salaries depreciation) and not the function of the expense (e.g. selling, harvesting, administration)

Illovo – enterprise should be encouraged but not forced to analyse the expenses in the financials based on the nature of the expense rather than the function.

The classification of expenses will be a new requirement under IAS, however the manner in which to classify the expenses would need to be taken in light of the other operations of the entity and the users. Illovo has a significant milling operation, and we may determine that the function of the expense is a better method of analysing the operations.

Question 12 – Is the increased disclosure requirements sufficient, excessive or are there other items that would need to be included

Illovo – Certain disclosure are considered to be excessive.

The main issue is that with Illovo having estates in different countries, the disclosure requirements may result in an information overload and may have no benefit to the user. We would only want to report relevant information, and as such the disclosure requirements would need to be assessed in the light of that. These are the following issues/concerns:

Materiality to be emphasised

- ➔ Materiality would need to be factor, when it comes to analysing groups and sub-groups e.g. would not want to go into detailed disclosure in regards to antherium and cattle ranching areas of business, as these are immaterial when compared to standing cane.

Disclosure of ‘specific risks management strategies’

- ➔ This should not be mandatory but encouraged, especially where it is deemed to be standard industry practice to apply these strategies. Normal good farming practices such as spraying and monitoring of fields for disease, installing irrigation where possible, and ensuring adequate drainage systems exist in case of floods; could be

deemed to be a 'risk management strategy'. However the statement is not that clear on what it requires. The example given indicates that one would disclose whether the biological assets are insured, or whether prices are secured using futures/options. For Illovo, other than the Mauritius industry fund, no specific risk management strategies exist, other than normal good farming practices.

The disclosure may also result in a competitive advantage being passed on to our competitors.

Commitments for development of agricultural activities

- ➔ Clarity on this is required. This disclosure should only apply to material amounts committed to expansion programs and this is already disclosed in the financials. The detail and information with regard to normal replanting costs and other standard agronomic practices should not be disclosed.

Reconciliation of movement biological assets?

- ➔ Limited use, especially where there are variety of estates in different industries and locations.

Question 13 – Present value sensitivity disclosure.

If NPV used to determine fair value, should we require disclosure of an indication of the sensitivity of the assumptions used?

Illovo - no

To disclose the sensitivity of each assumption, and to quantify the affects of changes to the assumptions could be encouraged, but may prove to an information overload and should be at the discretion of the preparer.

Question 14 – Transition

The options given in how the transition should be accounted for are:

- *Usual 'change in accounting policy' of adjusting the prior periods*
- *Allowed alternative of the 'change in accounting policy' which to charge the full adjustment with regards to the prior period to the current year*
- *There is also an option to amortise the difference between the carrying value and the fair value over the remaining life of the assets.*
- *Any other method*

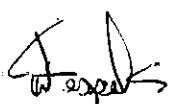
Illovo – the normal rules for a change in accounting policy should be applied with the allowed alternative.

Question 15 – Matters not covered by a specific question

Illovo - No

If there are any queries with regard to the above, please do not hesitate to contact me on ++27 (31) 508 4430, or e-mail 'wwessels@illovo.co.za'.

Yours truly,



Warren Wessels

Corporate Finance Manager