



*The South African Institute of Chartered Accountants
Die Suid-Afrikaanse Instituut van Geoktrooieerde Rekenmeesters*

CL 20

31 January 2000

Sir Bryan Carsberg
The Secretary - General
International Accounting Standards Committee
166 Fleet Street
London EC4A2DY
United Kingdom
Fax : 0015 44 171 353 0562
email : iasc@iasc.org.uk

Dear Bryan

EXPOSURE DRAFT E65: AGRICULTURE

I have set out below the comments of The South African Institute of Chartered Accountants on the exposure draft, E65 Agriculture. In making these comments we have exposed our equivalent of the international exposure draft and have incorporated comments received during that process.

We have divided our response into two sections: matters of principle and our response to the specific questions asked in the Invitation to Comment.

Matters of principle

It would appear from comments received by local respondents that insufficient communication has taken place between preparers and standard setters on the acceptability of the proposed approach. Respondents are of the opinion that a change from the traditional historical cost approach for inventory to fair value has not been adequately motivated and should the fair value approach be retained as the only alternative, a long implementation period would be required. During this period articles should be published in the agricultural media to convince preparers and educate users in the potentially superior accounting proposed in this exposure draft as a matter of urgency.

In our own local consultation process we have not received any support for the proposed approach. All commentators have questioned the appropriateness of the elimination of the cost alternative, both on the basis of consistency with other accounting standards for non-current assets and on the basis of the reliability of the financial information being reported.

In terms of paragraph 83 of the Framework for the Preparation and Presentation of Financial Statements one of the requirements for an asset to be recognised is that it should have a cost or value that can be measured with reliability.

Where fair value is used strict criteria is required to enable intangible assets to be revalued. It will be recalled that in IAS 38 valuations are only permitted when an active market exists. We are of the opinion that the same criteria should be met for biological assets to be shown at fair value and it is this criteria that is seriously being questioned as respondents believe reliable valuations are not available.

The exposure draft assumes that fair value can generally be readily determined when in reality this might only apply in the minority of situations. The exposure draft attempts to address this latter situation by setting out those considerations that need to be taken into account when an active market does not exist. This results in a contradiction of the basic premise that valuation can only be used when it can be reliably determined. Furthermore as it is likely that these considerations would need to be frequently used in practice, inconsistencies and variations in valuations will invariably arise and could result in misleading reporting. These other considerations would not be acceptable in the valuation of intangibles and so it is difficult to motivate why they should be allowed for agricultural products.

In terms of the various standards the benchmark or only allowed treatment for the recognition of certain categories of assets are cost. These include property, plant and equipment, inventories and intangibles, which are all non-monetary assets. It is believed that the same should apply to biological assets, which are also non-monetary assets.

One of the key users of the standard that have been identified is developing countries and countries in transition. It is these countries that are less likely to have an active market to enable the fair value to be determined. In addition these countries are less likely to have sophisticated accounting personnel to ensure the proposed standard is properly applied.

Fair values that are generally available and known are more likely to apply to agricultural produce that has completed its transformation process than items in the process of transformation. In addition even where prices are available these are likely to be of little interest to the less sophisticated farmer, knowing that prices can be volatile and over which he has little influence, and therefore would only become interested in prices as the produce approaches the end of the transformation process. It would be difficult to convince these farmers to use fair values in their financial statements if they do not believe they represent a fair presentation of the values to be realised when the crop is harvested.

Some of the market prices outlined in paragraph 26 are unlikely to be available, either because the information is not publicly available or because such sales occur infrequently. For many products the prices can vary considerably in a short period depending on market conditions, so the estimate of future selling prices in these circumstances must be highly subjective. History shows that prices vary for many reasons, such as climatic conditions and local and international supply and demand situations, all of which indicate that there might be no reliable method of predicting prices that will be obtained at the time of harvesting. In some economies the selling price could be influence by the negotiating abilities of the farmer. In these circumstances it will be extremely difficult for the auditor of the entity to determine whether or not the carrying values of the products are fairly stated.

It may also be difficult to determine whether assets are homogeneous. The same asset might develop differently in different areas, and even if one price was generally available for the assets they are likely to be different in the different growing areas. For example, the soil conditions and availability of water could have a significant impact on the ultimate quality of the produce and the rate at which the product develops. Even if the assets are homogeneous the prices could vary considerably depending on their quality. High quality product might be sold overseas, achieving high prices, with lower quality products achieving lower prices on local markets and it might be difficult during the transformation process to determine the likely quality. In addition different prices could be achieved in the local market depending on the quality; for example poor quality produce or produce damaged during the picking and transportation process might be used in other products, such as jams, achieving a lower selling price than good quality products. The quality and therefore the price might only be determinable at the end of the process. Where a product is likely to be sold could depend on market conditions at the time the transformation process is complete. Significantly different prices could also be achieved depending on whether products are sold individually or in bulk.

Thus based on the above it is believed that there are a number of reasons why fair values should not be the required treatment for agricultural products. Issues such as whether the assumptions made in the preparation of the document are valid needs to be questioned. In addition the reliability of fair values, the approach taken in standards on other assets, the ability of preparers to apply the proposed standard, whether the fair values can be audited and possible future events which could determine the nature, timing and prices of disposal or use are all issues which do not appear to be adequately dealt with in the document.

Bearing in mind all of the above all the respondents were unanimous that a free choice between cost and fair value be allowed in the determination of the value of agricultural produce. There was no support for the proposed approach to only use fair value.

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

Yes we agree that the standard should not address further processing. Whilst paragraphs 4 – 7 deals adequately with the distinction between agricultural activity and further processing, it may not be adequate for new agricultural developments where agricultural and processing take place together or occur in a number of different phases.

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

Because of the problems that can arise in using fair values and, in order to be consistent with IAS 2, Inventories, it is believed that there should be a cost alternative as motivated above.

Where the fair value alternative is used for biological assets and agricultural produce, it should be made clear that fair value excludes transaction costs. This is consistent with the standard on financial instruments and the proposed standard on investment property.

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

We believe that in many cases a reliable estimate of fair value can be determined for agricultural produce at point of harvest, but it is less likely to be achieved for biological assets during the transformation period. In these circumstances the cost basis may be a

more reliably determinant than fair value. If the objective is to provide information regarding future cash flows, the past cash flows are as useful as fair values, which may not translate into cash flows.

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

We believe that the change in fair value should be reported entirely in net profit or loss for the period.

Question 5 – Definition of fair value (paragraph 24)

We believe alternate b is the preferred approach, as the quoted price cannot always be used unadjusted. For example, where prices are inflated due to natural disasters, it would be incorrect to value the produce at the higher prices if it is unlikely that the prices will remain that high until harvesting. Another example is a severe hailstorm that destroys 50% of the apple crop in a market area that causes an increase in prices due to shortages. This pushes the fair value of the bearer biological assets up, but twelve months later when there is a normal crop, prices of bearer biological assets return to normal. It seems inappropriate in these circumstances to report an increase in fair value in the one year and a decrease in the next year. The results fluctuate due to abnormal circumstances and are not the result of management of change.

Shortages or surpluses can cause significant price distortion. Using a 5-year moving average could eliminate some of the distortions.

The circumstances that give rise to an adjustment in fair value should be clearly identified, to ensure that this is no opportunity to manipulate profit.

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

We believe that IAS 16 should be applied to agricultural land.

Question 7 – Government grants (paragraphs 41 - 44)

We believe this standard should not deal with government grants. IAS 20 should be applied by all enterprises. If the treatment in IAS 20 is inappropriate, IAS 20 should be revised.

Question 8 – Components of biological assets (paragraphs 46 – 47)

We support the proposal set out in the exposure draft as being the appropriate way to accomplish the objective of providing information about the nature and stage of production of biological assets. The alternate disclosure should not be required, as it can be difficult to ascertain whether the assets will be consumed or sold in those cases where they have a dual purpose. It can also be difficult to make a distinction between mature and immature, where assets go from immature to mature over a relatively long period.

However, in forestry companies the distinction between mature and immature is important for distinguishing the biological assets that will provide a flow of benefits in the next reporting period from those that will provide benefit periods further into the future.

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

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, if it can be reliably measured.

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

The guidance for making the split in paragraphs 56 – 58 is adequate.

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

Because of the different types of agricultural activities, enterprises should provide an analysis of expenses based on what is considered to be most appropriate to those activities.

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

Some of the disclosures proposed are not required for similar classes of assets and therefore it is not believed that they should be required. This includes in particular the reconciliation of changes in carrying amounts of biological assets.

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

Sensitivity disclosures are rarely given in financial statements, and it should not be required in the proposed statement.

Question 14 – Transition: follow IAS 8 (paragraph 69)

Both the benchmark and the allowed alternative treatments under IAS 8 should be permitted when an enterprise adopts this standard. In South Africa we have eliminated the alternative treatment allowed by IAS 8, but we believe legislative requirements in other jurisdictions may not permit the benchmark treatment.

Question 15 – Matters not covered by a specific question**Paragraph 2**

It is questioned whether or not paragraph 2 is needed. The framework for the preparation of financial statements also deals with this issue.

Pre-sale disposal costs

This term is not defined. In other international standards the term transaction cost is used. It would be preferable if the same approach as in E64 is used. Additional guidance material is given as to what transaction costs are.

Paragraph 62

Paragraph 62 refers to issues that may need disclosure to enhance understanding of changes in fair value, and are relevant to understanding the reported performance for the period. No such disclosure is required for events that may have an impact on future performance. Issues such as the degree to which produce fails to transform as expected, either because of inherent defects, present conditions or as a result of subsequent events (hail, floods, drought, disease, fire etc,) can have a major effect on future income. One of our major paper producers believes this is valuable information, both for preparers and analysts.

Volatility

Where prices are volatile it will lead to volatile values for the biological assets. It is questioned whether it is meaningful to account for these prices knowing that in these circumstances cost would be more reliable. It is doubtful whether the volatile values aid in predicting future cash flow because the fact that a value has increased is not necessarily an indication of the value to be received when the transformation process is complete.

General

Please contact me if you require any further information or explanation about the comments included in this submission.

Yours sincerely

A handwritten signature in black ink, appearing to read 'Erna Swart', with a stylized, cursive script.

Erna Swart

PROJECT DIRECTOR - ACCOUNTING