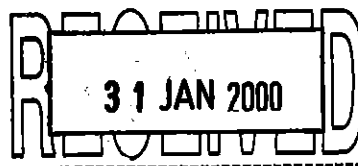




Institute of
CHARTERED ACCOUNTANTS
of New Zealand

CL 2-9



31 January 2000

Sir Bryan Carsberg
Secretary-General
International Accounting Standards Committee
167 Fleet Street
London EC4A 2ES
UNITED KINGDOM

Dear Bryan

SUBMISSION TO THE IASC ON E65: AGRICULTURE

This submission on the International Accounting Standards Committee's Exposure Draft E65: *Agriculture* has been prepared by the Institute of Chartered Accountants of New Zealand ("the Institute"). In preparing this submission, the Institute has drawn on the experience of members who have been closely involved with the development of New Zealand's financial reporting standards.

This submission is in two parts. Part I provides a summary of the Institute's view on the major issues raised in the Exposure Draft. Part II addresses the specific questions raised in the Invitation to Comment that accompanied the Exposure Draft.

If you have any questions regarding this submission, please do not hesitate to contact me on (telephone 64-4-474-7862, facsimile 64-4-472-6282, or e-mail april_mackenzie@icanz.co.nz).

Yours sincerely

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INSTITUTE OF CHARTERED ACCOUNTANTS OF NEW ZEALAND

SUBMISSION TO THE IASC ON E65: *AGRICULTURE*

I MAJOR ISSUES

The Institute of Chartered Accountants of New Zealand ("the Institute") generally agrees with the proposals made by the International Accounting Standards Committee ("IASC") in E65: *Agriculture*. As the foundation of our submission, the Institute agrees with the IASC's contentions in Appendix B that:

- there is considerable international diversity in the accounting treatment of agricultural enterprises, and this is compounded by the frequent exclusion of agricultural activities and assets from existing international and local accounting standards;
- agricultural activities are sufficiently similar to warrant treatment under the one accounting standard;
- the nature of agricultural activity makes coverage under existing standards problematic; and
- the increasing level of international trade in agricultural produce justifies the introduction of an appropriate International Accounting Standard ("IAS").

For these reasons, the Institute is supportive of the introduction of a standard that deals specifically with agriculture.

There are, however, some areas within the Exposure Draft where we believe that additional guidance may be warranted, and some areas where we are unable to support the IASC's position.

This section of the Institute's submission examines the major areas where we consider that comment is warranted. More detailed responses to the majority of the matters raised in this section of our submission are contained within Part II of the submission.

Separation of Biological Assets From Agricultural Land

As outlined in our response to question 6, the Institute considers that agricultural land and biological assets are separately identifiable assets, and that agricultural land should not be accounted for under an agricultural standard. The Institute considers that agricultural land is most appropriately accounted for under IAS 16: *Property, Plant and Equipment*, and that the alternative treatment under IAS 16 should be encouraged for all agricultural land.

Measurement at Fair Value

As outlined in our responses to questions 2, 3 and 5, the Institute considers that fair value is the most appropriate measurement base for both biological assets and agricultural produce at the point of harvest, and that reliable estimates of fair value can be obtained for both of these categories of assets. The Institute further considers that, where an active market exists for an homogenous biological asset at the location in which the asset is intended to be sold or used, then that market price is the best measure of fair value.

However, the Institute also considers that the following two matters require the attention of the IASC:

- The users of a reporting entity's financial statements are entitled to an assurance as to the reliability and verifiability of fair value assessments. For unique biological assets, market price may not be readily available to provide the best measure of fair value. In such circumstances, the Institute considers that assurance is best provided by a requirement for valuation to be undertaken by an independent valuation expert (or, as a minimum, by a valuation expert who is employed by the reporting entity, as long as the basis of valuation has been subject to a review by an independent valuation expert).
- The requirement for measurement at fair value at every balance sheet date may be onerous for interim financial statements if the IASC adopts the Institute's recommendation regarding valuation by independent valuation experts. The Institute considers that IAS 34: *Interim Financial Reporting* will require amendment to allow for Directors' valuations in interim financial statements.

Recognition of Changes in Fair Value

As outlined in our response to question 4, the Institute notes that the manner in which changes in the fair value of biological assets are reported will significantly impact on the reported net income of reporting entities. We also note that the proposed reporting of all changes in fair value through net operating profit or loss for the period will constitute a significant change for many jurisdictions, including New Zealand. In New Zealand physical changes are currently reported in operating profit or loss for the period, while price changes are reported in the second performance statement.

The Institute considers that the issue of the recognition of the change in the fair value of biological assets is linked to the international adoption of one performance statement, which the IASC will examine in its Reporting Financial Performance project. Prior to the international resolution of the reporting of financial performance, those jurisdictions that use two financial performance statements should be required to separate out the components of change in fair value. No component of the change in fair value should be recognised directly to equity. For those jurisdictions with one performance statement, the Institute considers that all of the change in the fair value of biological assets should be reported through operating profit or loss. However, when this occurs, the Institute considers that the separate disclosure of physical and price changes has information value for the users of financial reports, and should consequently be mandated.

Recreational Forests

As outlined in our response to question 15, the Institute is concerned that non-productive forests, such as recreational forests, do not appear to receive coverage within existing International Accounting Standards, as they are specifically excluded from E65, and appear to be excluded from IAS 16. The Institute considers that guidance on recreational forests should be provided either through IAS 16, or within the final standard on agriculture.

II COMMENTS ON DISCUSSION ISSUES RAISED

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?

The Institute of Chartered Accountants of New Zealand (“the Institute”) understands that many jurisdictions consider that agricultural activity cannot be separated from the processing of biological assets after harvest, and that any attempt to do so creates an artificial demarcation point.

However, while recognising this perspective, the Institute considers that biological transformation is a process which is unique to agriculture, and which is fundamentally different to manufacturing. Further to this, there is, for most biological assets, a clear demarcation point that occurs at harvest; at this point the agricultural activity ceases, and the activities associated with processing begin. Many of the activities associated with the processing of biological assets are essentially the same as those activities associated with any form of manufacturing, and it consequently appears appropriate that such activities should fall within the scope of IAS 2: *Inventories*. As a consequence of these arguments, the Institute considers that coverage of agricultural activity under a separate standard is warranted, and that the processing of agricultural produce should not be addressed within a standard on agriculture.

Finally, the Institute considers that the guidance provided in paragraphs 4 to 7 is, on the whole, useful, although the word “further” in the term “further processing” in paragraph 4 is redundant, and should consequently be removed.

Recommendation

The Institute supports option (a), and agrees that the final standard should not address the processing of biological assets.

Question 2 – Biological Assets: Measure at Fair Value (paragraphs 21 and 36)

Do you believe:

- (a) all biological assets should be measured at each balance sheet 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.

While the Institute acknowledges that some commentators may perceive historical cost as being more reliable than fair value, we consider that, when analysing the performance of management in relation to biological assets, historical cost may not provide the users of financial reports with information that is decision-useful. The Institute considers that, when biological transformation occurs, the historical cost method of valuation relies on significant numbers of assumptions, which means that fair value is more able to provide reliability than is historical cost.

Further to this, the Institute considers that significant biological transformation can occur in one reporting period. Reporting entities will want to capture the additional value created in a reporting period, and the most appropriate way to do this is to measure fair value at the beginning and the end of the period, and to then determine the difference so as to calculate the increase or decrease in value.

Similarly, the Institute considers that agricultural produce at the point of harvest is in a situation where it will either be processed or sold, and that, in both of these circumstances, valuation at fair value seems appropriate.

Finally, the Institute considers that, in terms of the guidance provided:

- On the whole, paragraphs 23 to 31 provide appropriate guidance.
- In paragraph 26 (c) the reference to “dairy farm” should be removed, as a dairy farm is not a biological asset.
- In paragraph 30 the word “highest” should be removed. Paragraph 10 defines fair value as “the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm’s length transaction”. This is not necessarily the highest price that is obtainable by a reporting entity. In addition, the Institute notes that paragraphs 29 to 38 of E64: *Investment Property* provide guidance on fair value measurement considerations, and that this guidance indicates that fair value is the value likely to be obtained given prevailing market conditions, rather than the highest price that can be obtained. The Institute considers that the guidance provided in E64 on fair value measurement is appropriate, and that much of it could be effectively replicated in E65.

Recommendation

The Institute supports option (a), and agrees that all biological assets should be measured at fair value, and that all agricultural produce should be measured at fair value at the point of harvest.

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.

The Institute notes that active markets generally exist for biological assets, and for agricultural produce at the point of harvest, making reliable estimates of fair value generally obtainable.

Although we acknowledge that it is more difficult to calculate fair value for unique biological assets, or where active markets do not exist, we consider that:

- paragraphs 24 to 30 provide useful valuation guidance;
- as noted in our response to question 5, annual independent valuations should be mandated for unique biological assets.

As a consequence, the Institute considers that reliable estimates of fair value for biological assets and for agricultural produce at the point of harvest are generally obtainable.

Recommendation

The Institute supports option (a), and agrees that a reliable estimate of fair value can be determined for both biological assets and agricultural produce at the point of harvest.

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;
- (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.

The Institute is opposed to the reporting of changes in the fair value of biological assets through equity.

The Institute notes that the manner in which the changes in the fair value of biological assets are reported will have significant consequences for the reported net income of reporting entities. The Institute also notes that the proposal to report the change in fair value entirely through operating profit or loss will constitute a significant change for many jurisdictions, including New Zealand. In New Zealand, changes in the value of biological assets have, to date, been divided into physical changes (which appear in net operating profit or loss) and price changes (which appear in the second performance statement for New Zealand, the Statement of Movements in Equity). The primary reason for the separate disclosure of physical and price changes has been the perception that agricultural price cycles are both volatile and outside the control of management, and that it would consequently be inappropriate to assess the performance of management on the basis of price changes. Preparers of financial statements on this basis consider that the information that is provided is the most appropriate way to report on the performance of management in relation to biological assets, and that it provides users of the financial statements with the most reliable information.

However, the Institute is aware that there are arguments for reporting all of the changes in the fair value of biological assets through operating profit or loss for the period:

- Many industries operate in conditions where price fluctuations are common. For example, the investment property market can experience price volatility, yet the recently released E64 mandates the reporting of changes in the fair value of investment property through net profit or loss for the period, despite the fact that such changes are entirely due to price changes.
- Management makes decisions regarding which markets to involve the reporting entity in, and, as a consequence of this, exposure to price changes can be reasonably attributed to management. However, the fact that biological assets grow means that management is unable to prevent the assets moving from one market to another.

Although the Institute acknowledges that these arguments have some validity, we consider that reporting all of the changes in the fair value of biological assets in operating profit or loss will only be appropriate for jurisdictions that have adopted one performance statement. We note that currently IAS 1: *Presentation of Financial Statements* allows the use of a second performance statement for items of income, expense, gain and loss that are required by other standards to be recognised in equity. As other items are able to be reported in this second performance statement, the Institute considers that it is appropriate that the price change component of fair value changes in biological assets be reported in this manner.

Thus, for those jurisdictions that have two performance statements, the Institute considers that the reporting of physical changes in operating profit or loss, and of price changes in the second performance statement, is appropriate, and should be mandated. When a jurisdiction adopts one performance statement, reporting entities within that jurisdiction should report all of the change in the fair value of biological assets through net operating profit or loss. However, as noted in our response to question 9, the Institute considers that the separate disclosure of physical and price changes has information value, and should consequently be mandated for reporting entities that report all of the change in the fair value of biological assets through operating profit or loss.

The Institute notes that the IASC is currently establishing a project on the reporting of financial performance. We consider that, when this project has been finalised, it will be appropriate to review the final agriculture standard to ensure that changes in the fair value of biological assets are reported in the most appropriate manner.

Recommendation

The Institute considers that, in jurisdictions where one performance statement has been adopted, the change in fair value of biological assets should be reported entirely in operating profit or loss for the period. However, in these jurisdictions the separate recognition of physical and price changes should be mandated, as it adds information value to the financial statements. In other jurisdictions, the Institute considers that reporting entities should report physical changes in operating profit or loss, and price changes in the second performance statement.

Question 5 – Definition of Fair Value (paragraph 24)

This Exposure Draft concludes 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, that market price is the most reliable measure of the fair value of that asset. 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?

The Institute notes that many biological assets are homogenous products and that, consequently, where an active market for a biological asset exists, the price in that market will be the most reliable measure of fair value.

However, where a biological asset is unique, and its value is consequently linked to its individual characteristics (such as a stud animal), market prices for similar biological assets may not provide the most reliable measure of the fair value of that asset. In such circumstances, the Institute considers that determination of fair value will require the expertise of an independent valuation expert, and that this should be mandated. This valuation expert can either be independent of the reporting entity, or employed by the reporting entity, as long as the basis of valuation has been subject to a review by an independent valuation expert. In addition, the Institute considers that, once valuation by an independent valuer has been mandated, guidance should be provided on the frequency with which valuations are conducted. As E65 states that fair value should be reported at each balance sheet date, the Institute considers that guidance should be provided on the manner of valuation of biological assets in interim financial statements. The Institute considers that this would be most appropriately achieved by an amendment to IAS 34: *Interim Financial Reporting*. The Institute notes that paragraph 5.6 of New Zealand's FRS-24: *Interim Financial Statements* allows either estimates or revaluations in interim financial statements for non-current assets that are required to be revalued on an annual basis. The use of estimates is justified on the basis of cost and timeliness, and the use of such estimates must be disclosed in the notes to the financial statements. The Institute considers that similar provisions would be appropriate in an amendment to IAS 34.

As an aside, the Institute also notes that paragraph 7 of Appendix 3 of IAS 34 states in part that, for those interim revaluations under IAS 16 "an enterprise may rely on professionally qualified valuers at annual reporting dates though not at interim reporting dates". This implies that an enterprise may not use professionally qualified valuers at interim reporting dates. The Institute assumes that this implication is unintended, and assumes that the IASC meant to imply that an entity that uses professional valuers at annual valuations does not have to do so for interim financial statements. The Institute consequently recommends that the wording of this paragraph be altered accordingly.

Recommendation

The Institute supports option (a), and agrees that, where an active market exists for an homogenous biological asset at the reporting date and in the location in which the asset is intended to be sold or used, then that market price is the most reliable measure of fair value. However, the Institute considers that some unique biological assets should be valued by an independent valuation expert (or by a valuation expert employed by the reporting entity, as long as an independent valuation expert has reviewed the basis of the valuation) on an annual basis. Finally, the Institute considers that IAS 34 should be amended to permit interim financial statements to contain estimates of the value of unique biological assets that have been valued by an independent valuation expert on an annual basis, as long as the use of estimates is disclosed in the notes to the financial statements.

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?

The Institute considers that agricultural land is an asset that is separately identifiable from biological assets, and that agricultural land meets the definition of property, plant and equipment. The Institute consequently considers that agricultural land should not be accounted for under the final standard on agriculture, and should instead be accounted for under IAS 16.

The Institute also considers that the alternative treatment under IAS 16 (carrying the asset at its revalued amount, which is fair value at the date of revaluation less any subsequent accumulated depreciation) should be encouraged for all assets used in agricultural activity (including land). The Institute considers that this is particularly the case when paragraph 27 of E65 (biological assets are physically attached to agricultural land) applies.

Recommendation

The Institute supports option (a), and agrees that agricultural land should not be accounted for under the final standard on agriculture. The Institute agrees that IAS 16 should apply to agricultural land, and considers that the alternative treatment under IAS 16 should be encouraged.

Question 7 – Government Grants (paragraphs 41 – 43)

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 were 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 the fair value of the biological asset? If so, would that reduction continue as long as the asset is held? Would it be amortised?

The Institute considers that a government grant should be recognised immediately as income if it is unconditional.

However, the Institute considers that it is inappropriate to refer to government grants in a standard on agriculture, for the following reasons:

- Government grants are a funding issue, and not an investing issue, and need to be addressed through a revenue standard. Addressing government grants in an asset standard would constitute matching based recognition, which conflicts with the IASC framework.
- The IASC's recently released E64 specified that government grants would not be dealt with within the scope of the Exposure Draft. It is inconsistent of the IASC to not include government grants in an Exposure Draft dealing with one type of asset (investment property), but to include government grants in an Exposure Draft dealing with another type of asset (biological assets).

As a consequence of these considerations, the Institute considers that all references to government grants (including paragraphs 1 (c) and 67) should be removed from the final standard.

Further to this, the Institute considers that a review of IAS 20: *Accounting for Government Grants and Disclosure of Government Assistance* is warranted. The IASC has recently published the G4+1 Group discussion paper on non-reciprocal transfers, which proposes the separate recognition of grants as revenue and of grant expenditure as expenses. We consider that this paper will serve as an appropriate basis for a review of IAS 20 by the IASC.

Recommendation

Although the Institute supports option (a), we consider that all references to government grants should be removed from E65. The Institute also considers that a review of IAS 20 is warranted.

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 the quantified consumable 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 consumable and each group of bearer biological assets should be required; or
- (d) subdivisions of biological assets 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)?

The Institute considers that the suggested disclosures provide information that is relevant to the users of a reporting entity's financial statements. The Institute considers that the subdivision of bearer and consumable biological assets into groups of mature and immature assets provides information for the users of financial statements that is particularly useful in predicting future cashflows, and that its disclosure should consequently be mandated. The Institute is also concerned that not mandating the provision of such information will result in significant information disparities between those reporting entities that do provide such disclosures, and those reporting entities that do not.

Recommendation

The Institute agrees with option (a), and considers that the disclosures required in paragraphs 46 and 47 are an appropriate way to accomplish the objective of providing information about the nature and stage of production of biological assets. The Institute considers that the disclosure of this information has significant information value for the users of financial statements, and that paragraph 47 should consequently be mandated.

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

As stated in our response to question 4, the Institute considers that the separate recognition of the components of change in fair value that are attributable to physical changes and to price changes should be required for entities that have two performance statements.

For those reporting entities that do report all of the change in the fair value of biological assets through operating profit or loss for the period, the Institute considers that separate disclosure of the components of the change in the fair value of biological assets has information value for the users of financial statements. The Institute acknowledges that some commentators may consider that the requirement to determine the components of the change in fair value in this manner is onerous. However, New Zealand experience indicates that the benefit of separate disclosure (relevance to readers of financial statements) far outweighs the cost (which is minimal due to the fact that the information has already been gathered when undertaking fair value calculations).

As a consequence of these considerations, the Institute considers that, for biological assets with a production cycle that is longer than one year, separate disclosure of the components of change in fair value that are attributable to physical changes and to price changes should be mandated.

Recommendation

The Institute supports option (a), and considers that the reporting entity should be required to separately disclose the components of the change in fair value of its biological assets due to physical changes and price changes.

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?

The Institute agrees with the guidance provided in paragraphs 56 to 58. The Institute also agrees that the first example under paragraph 57 is accurate.

However, the Institute considers that the second example under paragraph 57 requires deletion or correction. In accordance with paragraph 57 the fair value change is still 50 based on the opening 10 animals. The fair value change cannot, by definition, be affected by the purchase of an animal part way through the reporting period. If this example is to be retained, we consider that the analysis should be changed to the following, which will tie in with the paragraph 61 reconciliation components:

Fair value of herd (group) at 1 January (10 x 100)	1,000
Purchase (at carrying amount – 1 x 120)	120
Increase in fair value due to physical change:	
10 x (120 – 105)	150
Increase in fair value due to unit fair value change:	
10 x (105 – 100)	<u>50</u>
Fair value of herd (group) at 31 December (11 x 120)	1,320

Recommendation

The Institute considers that the guidance provided on the components of change in fair value in paragraphs 56 to 58 is adequate. However, the Institute considers that the second example following paragraph 57 requires alteration, as indicated above.

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?

The Institute considers that classification of expenses by nature provides more useful information on expenses that would be expected to vary with the level of activity than does classification of expenses by function.

Recommendation

The Institute agrees with option (b), and considers that the final standard should encourage, but not require, the classification of expenses by nature.

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)?

The Institute considers that the guidance provided in paragraphs 44 to 67 is appropriate, with the following exceptions:

- The current/non-current asset differentiation that is described in paragraph 45 is not as helpful as the mature/immature differentiation that is required in paragraph 47. The Institute considers that the mature/immature demarcation will not always correspond exactly with the current/non-current demarcation, and that the former provides more information.

- In paragraph 63, we consider that the second sentence onwards should constitute guidance rather than mandatory provisions. Although the disclosures that are detailed in paragraph 63 outline the sort of information that will assist in meeting the purposes of IAS 1, the Institute considers that it may be inappropriate and unnecessarily onerous to require all of these disclosures.
- In paragraph 64 (g), the wording is so wide that it may encompass decisions that have not yet been made. We consider that this guidance should only relate to areas where decisions have been made, and that consequently the word “discontinued” would be more appropriate than the word “unsustainable”.
- As stated in our response to question 7, the Institute considers that paragraph 67 should be removed as it belongs under a revised IAS 20.

Question 13 – Present Value Sensitivity Disclosure (paragraph 64(c))

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. Some have suggested that if present values are used the Standard should also require disclosure of an indication of the sensitivity of the present value measurement to changes in assumptions. 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?

The Institute notes that, when undertaking present value calculations to determine fair value, E65 proposes the requirement to disclose both the discount rate and the number of years. The Institute notes that this does not provide sufficient information to enable the users of financial statements to make calculations such as sensitivity analyses.

The Institute considers that the following options exist for information disclosure:

- Require no disclosure regarding the information used to prepare present value calculations. The Institute considers that this will reduce the decision usefulness of the financial statements for users of those statements.
- Require the disclosure of key pieces of the information that was used to prepare present value calculations, as currently occurs in the Exposure Draft. The Institute considers that the key pieces of information requiring disclosure are the discount rate and the number of years over which future cash flows have been estimated, as these pieces of information will enable users of the financial statements to partially determine whether the reporting entity’s assessment of the riskiness of the venture aligns with their assessment of its riskiness.

- Require the disclosure of an analysis of the sensitivity of the present value calculations to changes in the assumptions on which such calculations are based. The Institute considers that this information would be most useful if, as a minimum, it provided a ranking of the assumptions underlying the present value calculations in terms of the sensitivity of the calculations to each assumption.
- Require the disclosure of all information that was used in the present value calculations. This will allow the users of the financial statements to undertake any calculations that they deem necessary. However, the Institute considers that this level of disclosure is not practical.

On balance, the Institute considers that the disclosure of the discount rate and the number of years over which future cash flows have been estimated should be required. The Institute also considers that reporting entities should be encouraged, but not required, to provide sensitivity disclosures as outlined above.

Recommendation

The Institute supports option (b), and considers that, where net present value calculations have been used to determine the fair value of biological assets or agricultural produce at the point of harvest, sensitivity disclosures should be encouraged, but should not be required.

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;
- (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)?

The Institute considers that the requirement to measure biological assets and agricultural produce at fair value will constitute a significant change for many jurisdictions. As a consequence of this, it is likely that, for many reporting entities, there will be a significant one-off impact as a result of the application of the standard. Given this, the Institute considers that the resulting adjustment should be to retained earnings, so as to ensure that there will be no distortion of the operating profit or loss for the period.

Recommendation

The Institute supports option (b), and considers that the benchmark treatment under IAS 8: *Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies* should be mandated when a reporting entity adopts this standard.

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.

The Institute considers that the following matters require additional attention:

Definition of Agricultural Produce

The Institute is concerned that the wording of paragraph 35 (b) may not convey the meaning intended by the IASC.

The discussion of agricultural produce in paragraph 35 (b) could be interpreted in either of the following two ways:

1. Agricultural produce should be recognised when the biological asset is mature. Thus, for example, grapes would be recognised as agricultural produce when the vines on which they are growing are mature, rather than when the grapes are picked.
2. A biological asset should be recognised as agricultural produce when the biological asset becomes mature and is held with the intention of sale. This would only be the case for a consumable biological asset, where the biological asset itself becomes agricultural produce. An example of this would be beef cattle that are sufficiently mature to be sent to the abattoir, but have not yet been sent.

The Institute assumes that the IASC intends for only the second meaning to be construed, but considers that this intention is not currently effectively conveyed.

The Institute considers that the primary reasons for this intention not being adequately conveyed are the use of the term “harvest”, and the inconsistency of discussion between paragraph 35 (b) and paragraph 9. In paragraph 9 agricultural produce is defined as “the harvested product of the enterprise’s biological assets awaiting sale, processing, or consumption”. Harvest is defined in paragraph 9 as “the detachment of agricultural produce from the biological asset ... the removal of a living plant from agricultural land for sale and replanting ... or the cessation of a biological asset’s life processes”. In the opening sentence of paragraph 35, the description of agricultural produce is, in substance, identical to the definition in paragraph 9, while the discussion in paragraph 35 (b) states that mature biological assets held with the intention of sale are to be recognised as agricultural produce. This is problematic, as the definition of agricultural produce specifically states that it must be harvested, yet mature biological assets held with the intention of sale do not meet the definition of harvested.

The Institute considers that this inconsistency could be avoided by changes to the paragraph 9 definition of harvest, so that either:

- The existing definition of harvest is expanded, so that it specifically includes mature consumable biological assets held for sale; or
- Harvest is defined separately for bearer biological assets and for consumable biological assets. For a bearer biological asset, harvest could be defined as the separation of agricultural produce from the biological asset. For a consumable biological asset, harvest could either be defined as the point at which management decides that a mature consumable biological asset will be held with the intention of sale, or as the point at which management ceases its agricultural activity in relation to a consumable biological asset and holds it with the intention of sale.

With harvest defined in either of the ways indicated above, the paragraph 9 definition of agricultural produce as “the harvested produce of the enterprise’s biological assets awaiting sale, processing, or consumption” clearly includes produce from both bearer and consumable biological assets. In addition, the wording of paragraph 35 (b) will need to be changed, as a biological asset that is mature and intended for sale is not a biological asset.

Biological Assets Used for Non-Productive Purposes

Paragraph 7 of E65 states that biological assets that are primarily used for non-productive purposes (such as for recreational, residential or environmental protection use) do not fall within the scope of E65. The Institute considers that, while it appears clear from the definitions contained in paragraph 9 that this is indeed the case, it may be appropriate within the scope of paragraph 7 to provide further guidance as to which standard(s) such classes of assets are to be accounted for under. For most such assets, it would seem appropriate to account for them under IAS 16.

However, the Institute is concerned that non-productive forests, such as recreational forests, which are a significant asset for many reporting entities in New Zealand, do not appear to receive coverage within existing International Accounting Standards. As previously noted, they are specifically excluded from E65, which the Institute agrees is appropriate. However, paragraph 2 of IAS 16 specifically excludes “forests and similar regenerative natural resources” from the

scope of IAS 16, which suggests that non-productive forests are consequently excluded from coverage within IAS 16. While it may not be the intention of the IASC that this exclusion from IAS 16 occur, the current wording of IAS 16 does not make this apparent. Consequently, the Institute recommends that either:

- paragraph 2 of IAS 16 be amended to make it clear that non-productive forests are not excluded from IAS 16; or
- the standard under which non-productive forests are to be covered be identified, and reference to it be made within paragraph 7 of E65.