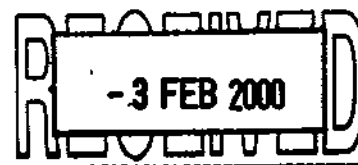


31 January 2000



The Secretary-General  
International Accounting Standards Committee  
166 Fleet Street  
London EC4A 2DY  
United Kingdom

Dear Secretary-General:

This letter contains our response to the Proposed International Accounting Standard, *Agriculture (E65)*. We appreciate the opportunity to respond to the Exposure Draft (ED). Our comments are divided into General Comments and Questions posed in the Exposure Draft.

## General Comments

We believe that the proposal for recognition of biological assets and agricultural produce at fair value has significant advantages over the historical cost model. Some enterprises currently use a fair value model for certain agricultural commodities and we believe that strong arguments exist to conceptually support a fair value model for all agricultural activities. A fair value approach could provide preparers a mechanism to report a relevant picture of the true economics of agricultural assets. The ED in current form, however, has significant weaknesses that require improvement before the full benefits of a fair value model can be realized.

## Definition / Measurement of Biological Assets

Paragraph 21 of the ED states in bold letters "**Biological assets should be measured at each balance sheet date at their fair value**". Paragraph 10 of the ED defines fair value, also in bold letters, as "**the amount for which an asset could be exchanged or a liability settled between knowledgeable, willing parties in an arm's length transaction**". Paragraphs 25 and 30, without the authority of bold letters, restrict the above definitions by stating "If a biological asset will be sold in an active market in another location ... fair value is the market price in that market reduced for pre-sale disposal costs..." and "The intended effect of the guidance in paragraphs 24-29 is that fair value is the highest price obtainable by the enterprise, net of costs." respectively. If the Board's intention is to value all biological assets in the appropriate active market at amounts net of costs, then the bold letter authoritative guidance should clearly state this

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intention. The final standard should incorporate, in bold letters, a more precise definition of how biological assets should be measured such as **"Biological assets should be measured at each balance sheet date at their fair value, net of disposal costs to place the biological assets in the intended market."**

#### Measurability of Fair Value

In most circumstances we believe that fair value of biological assets at the point of harvest will be readily determinable. We also believe that fair value of biological assets can be determined at other stages of production, although accurate values will not be as readily available or determinable. Some large, sophisticated agricultural producers may maintain detailed internal records of their biological assets, including fair value amounts/estimates. Most agricultural producers however do not maintain such detailed records. Without adequate infrastructure and management information systems, requiring full fair value accounting will place significant burdens on many producers to determine fair values of their assets - new information systems, use of valuation experts, addition time, etc. We are concerned that the benefits associated with developing and maintaining a full fair value model in these cases will exceed the costs. As a matter in concept, we support the use of a fair value model but acknowledge that significant implementation issues will occur. If a full fair value model is not adopted, we would encourage preparers to make appropriate fair value disclosures.

#### Recognition of Changes in Fair Value

The ED requires that all changes in fair value of biological assets be recorded in income. Although this requirement may be consistent with a full fair value model, we do not believe immediate recognition of income is the most appropriate treatment given the diverse production cycles that exist in the agricultural industry. Most agricultural producers are in the business to manage biological assets to the point of harvest; generally they do not sell their assets until they have reached 'harvest' stage. Accordingly, the harvest or physical sale (transfer of risks to third parties) associated with the end of the growing cycle and commencement of the processing or consumption phase represents the key economic event for agricultural activities. We believe that it is the harvest or sale that should trigger the recognition of profit / income. For example, bearer and consumable biological assets may require years to mature to the point of harvest. We do not believe that a forestry operation whose

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production cycle is 30 years should record 'profit or loss' in the income statement each year prior to harvest.

We do acknowledge that the value of biological assets generally increases up to the point of harvest and this increase deserves some type of recognition within the financial statements. As a result, we believe that changes in fair value should be recorded in equity on an ongoing basis but 'income' should only be recognized (recycled) when either the biological assets are sold or harvested.

### Separate Accounting for Agricultural Land

The ED proposes that agricultural land be accounted for in accordance with IAS 16, Property, Plant and Equipment. We do not believe land (or any other agricultural / biological asset) should be excluded if a fair value model is adopted. In many situations, land is an integral component of the production cycle and inseparable from the attached biological asset, i.e. fertile land in a Tuscany vineyard. As a result, land should be recorded at fair value in all circumstances, with gains and losses recorded in equity. Although fair value accounting (revaluation) is achievable under IAS 16, we do not believe agricultural enterprises should be given the choice not to use fair value. If preparers are given the choice to use historical cost, comparability of financial information among agricultural enterprises will decrease and the benefits of a complete fair value model for agricultural assets will not be achieved.

### Proposed Title of the Standard

The literal interpretation of agriculture, taken from the Latin word '*agricultura*', is field cultivation. Accordingly, we do not believe that the proposed title - *Agriculture*, provides a clear enough description of the scope of the standard. The scope of the Standard is broader than 'soil' based cultivation activities and therefore the title *Agriculture* is too narrow. Financial statement preparers and users may have different interpretations / definitions of Agriculture around the world, resulting in improper application of the Standard. For example, the raising of fish stock and cultivation of salt-water pearls fall under the scope of the Standard but their inclusion may not be clear solely from the title of the standard. We recommend the use of a more appropriate title that better reflects the scope of the Standard such as *Biological Assets* or *Agricultural Activities and Biological Assets*.

# ARTHUR ANDERSEN

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If you have any questions concerning our comments, please contact G. Michael Crooch at 1-312-507-2339 or Jeannot Blanchet at 1-312-507-6523.

Very truly yours,

A handwritten signature in cursive script that reads "Arthur Andersen". The signature is fluid and extends to the right with a long, sweeping tail.

Arthur Andersen

## Proposed International Accounting Standard Agriculture (E65)

### Questions

#### **Question 1 – Scope: Further Processing after Harvest (paragraphs 4-7 and 36)**

This Exposure Draft would prescribe the accounting treatment for biological assets during the period of growth, procreation, and degeneration, and for the initial measurement of agricultural produce at the point of harvest. The Exposure Draft provides for a consistent basis of measurement (fair value) up to the point of transfer between these two asset classes. However, the Exposure Draft does not deal with further processing of agricultural produce after harvest (processing grapes into wine, wool into yarn, ageing of cut tobacco or meat, and so on). Those are regarded as 'manufacturing' activities to which accounting standards for inventories apply. (IAS 2, *Inventories*, sets out those standards in the context of the historical cost system. IAS 2 recognises that some inventories, including certain agricultural produce, are measured at net realisable value in accordance with well established practices in certain industries.) Do you:

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

**We agree that the ED should not address further processing of biological assets and that the guidance provided in the ED is adequate as to the distinction between agricultural activity and further processing.**

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

This Exposure Draft would require that all biological assets be measured at each balance sheet date at their fair value. This Exposure Draft would also require that all agricultural produce at the point of harvest be measured at its fair value. The Board believes that value changes provide more relevant information about the performance of an enterprise that undertakes agricultural activity than the more traditional historical-cost-based measure of profit or loss. Some agricultural activity, such as the raising of livestock and the growing of timber, takes several or many years from initiation to harvest. The historical cost model looks generally to a sale transaction ('realisation') as the trigger for recognition of performance in net profit or loss. In

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*the context of agricultural activity, however, it is the Board's judgement that the key indicators of performance are the physical processes of growth, procreation, degeneration, and harvest. This is true even for agricultural activity for which the period between initiation and harvest is less than one year. The Board believes, further, that reliable measures of the fair values of biological assets and agricultural produce at the point of harvest are available. And the Board believes that, because of the allocations that would be required in an agricultural context, cost-based measures often are of questionable reliability and usefulness.*

*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.*

**Notwithstanding our concerns over the measurability of fair value and the recognition of changes in fair value (as discussed in the General Comments section and Answers 3 and 4), we support (a) – biological assets measured at fair value at the balance sheet date with agricultural produce measured at fair value at the point of harvest. We believe the arguments for the use of fair value in agricultural activities are stronger than the arguments presented for the use of historical cost. Current practice allows fair value of agricultural produce in situations of readily available / accessible markets. We believe that valuation at fair value of agricultural assets is a natural extension of current practice and is the most appropriate model to adopt.**

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

*The Exposure Draft presumes that the fair value of biological assets and the fair value of agricultural produce at the point of harvest can be determined. Guidance is provided (paragraphs 24-30), including an indication that cost may approximate fair value in certain limited circumstances. The Board reached that conclusion for several reasons. Markets exist for most biological assets individually or in groups. Often, these markets are in the particular location in which the assets to be measured will be sold, though not always. And sometimes the market is for*

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*similar though not identical biological assets. The Board believes that prices in these markets provide a basis for determining the fair values of most biological assets and of most agricultural produce at the point of harvest. Further, in addition to market prices, other accepted methodologies exist for estimating fair values of biological assets and agricultural produce. These include sector benchmarks, net present value of expected cash flows, and net realisable values. As the IASC Framework states, "in many cases, cost or value must be estimated; the use of reasonable estimates is an essential part of the preparation of financial statements and does not undermine their reliability." And, finally, the Board believes that measures of costs of biological assets and agricultural produce are even more likely to be unreliable and lack relevance than fair value measures. 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.*

**We believe that scenario (b) is the most accurate. We believe that fair values can generally be determined for virtually all assets at any point in time, however, because of underlying assumptions or methods of computation, fair value estimates will not be 100% precise. A certain margin of uncertainty however is already intertwined within the historical cost model such as estimated useful life, salvage values and actuarial assumptions used in pension accounting. Therefore we do not believe that the use of fair values will result in less accurate financial information.**

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

*This Exposure Draft proposes that biological assets be measured at fair value and that the change in fair value of biological assets be reported in net profit or loss. In the Board's judgement, the change in fair value of biological assets is the most relevant indicator of the performance of an*

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*enterprise engaged in agricultural activities. 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.*

**Although we conceptually support the use of a fair value model, the ED brings to the forefront many difficult issues that must be resolved on a broader basis, including the subjectivity of fair value determination, recycling and reporting financial performance. We believe changes in fair value generally can be readily determined (as discussed in Answers 2 and 3) but we have difficulties in recognizing changes in fair value immediately in income. We maintain a strong belief that for biological assets and agricultural produce, realization through sale is a key economic event. Uncertainties that surround biological assets (greater subjectivity to weather, disease, destruction, etc.) indicate that transfer of the assets (and risks) through sale are the only definitive indication that an enterprise has realized 'income'. Accordingly, we support recording increases in fair value of biological assets in equity until realized through sale and then 'recycling' the profits in the income statement. We realize that this position denotes a specific interpretation of financial performance but we choose**



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**to take this position until standard setters can resolve the much broader question of the definition of financial performance for all enterprises.**

**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?*

**We believe that fair value is best measured in an asset's intended location of sale or use.**

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

*This Exposure Draft does not establish any special accounting standards for agricultural land. Rather, it would require that IAS 16, Property, Plant and Equipment , be followed. IAS 16 allows agricultural land to be carried at (a) cost subject to a write-down for impairment and (b) fair value. This Exposure Draft proposes, further, that biological assets that are physically attached to agricultural land (for example, crops and trees) be recognised and measured at fair value separately from the land. 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*

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*(e) all agricultural land should always be carried at cost, that is, the revaluation alternative of IAS 16 should be prohibited?*

We believe that agricultural land should fall under the proposed agriculture standard and fair value should be used in all circumstances. An enterprise that applies IAS 16 will have the option, through the alternative treatment, to value agricultural land at fair value but an enterprise is not required to do so. Accordingly, comparability concerns between enterprises might result. In addition, we believe there are numerous examples where it is too difficult or illogical to apply the historical cost method, e.g., land used for wine grape production or for forest product production. In many cases it will be impractical, if not impossible, to separate the value of the land and the underlying bearer assets, such as land and grapevines. A full fair value model will avoid these issues.

## **Question 7 - Government grants (paragraphs 41-44 )**

*If a government grant is received in respect of a biological asset carried at fair value, under this Exposure Draft the grant should be recognised as income initially if it is unconditional. 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?*

**We believe that the proposed standard should not address accounting for government grants but defer to IAS 20, Accounting for Government Grants and Disclosure of Government Assistance.**

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

*The Board believes that users of financial statements need more detailed information about an enterprise's biological assets than a single total carrying amount by broad group of biological*

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*assets. Such detailed information will assist those users in analysing the amounts and timing of prospective cash flows to the enterprise. Therefore, the Board expects that the final Standard on agriculture will require some type of analysis of the total carrying amount of an enterprise's biological assets, either descriptive or quantified or both.*

*This Exposure Draft proposes that an enterprise should describe the nature and stage of production of each group of biological assets. The Exposure Draft states that the disclosure could take the form of a narrative description in the notes or, alternatively, an enterprise may choose to separate quantified measurements of:*

- (a) the carrying amount of the biological assets in the group that are consumable, further subdivided between:*
  - (i) the carrying amount of consumable biological assets in the group that are mature; and*
  - (ii) the carrying amount of consumable biological assets in the group that are immature;*
- (b) the carrying amount of the biological assets in the group that are bearer, further subdivided between:*
  - (i) the carrying amount of bearer biological assets that are mature; and*
  - (ii) the carrying amount of bearer biological assets in the group that are immature.*

*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)?*

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We agree that the proposed standard should require an expanded description of the nature and stage of production of each group of biological assets. These additional disclosures will provide readers relevant information to assess the current state of the biological assets and a better understanding of when these assets will be ready for harvest or sale in the normal course of operations. We recommend that narrative disclosure be optional but numerical disclosures be required. In addition, we believe that numerical disclosure should provide readers with information on unit quantities, not only local currency values.

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

*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 (see paragraphs 52-58). A question arises as to whether enterprises should be encouraged (as this Exposure Draft does) or perhaps required to report the amount of physical and price changes separately if the production cycle is longer than one year. 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?*

We do not believe that such disclosures should be required but would support voluntary disclosure of such information. In many situations the determination of the amounts will be very tedious and time-consuming and therefore the cost-benefit of determining this disclosure would not be justified. We recognize, however, that there is more than one manner to assess the interaction between price and volume, and therefore additional clarification should be incorporated in the proposed standard, if such disclosure is encouraged.

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

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*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?*

**As mentioned above, we believe that additional guidance is needed.**

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

*Should an enterprise with significant agricultural activities be required or encouraged to present an analysis of expenses using a classification based on the nature of the expenses (for example, fertiliser, wages and salaries, and depreciation)? The alternative is classification based on function (for example, cost of sales, selling expenses, administrative expenses). IAS 1 allows enterprises to choose one or the other. This Exposure Draft encourages classification by nature. Would you:*

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

**We believe that the requirements within IAS 1, Presentation of Financial Statements for analysis of expenses are sufficient.**

## **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*

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(c) are insufficient (please indicate your proposed addition(s) and reasoning)?

**Subject to our comments on questions 8-10, we consider the disclosure requirements to be adequate.**

**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?*

**Although sensitivity disclosure could be informative, we believe that the additional burden placed upon preparers to complete the disclosure would outweigh the benefits.**

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

*Under the transition proposal in this Exposure Draft, on initial adoption of the Standard an enterprise will apply the transition provisions in IAS 8, Net Profit or Loss for the Period, Fundamental Errors and Changes in Accounting Policies . IAS 8 allows a benchmark treatment and an alternative:*

- (a) *The benchmark treatment is to apply the new Standard retrospectively (unless the amount of the prior period adjustment cannot be reasonably determined), to reflect an adjustment to the previous carrying amount of biological assets and agricultural produce as an adjustment of retained earnings, and to restate comparative information (unless impracticable).*
- (b) *The allowed alternative treatment is to apply the new Standard retrospectively (unless the amount of the prior period adjustment cannot be reasonably determined), to reflect an adjustment to the previous carrying amount of biological assets and agricultural produce in*

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*net profit or loss for the period, and not to restate comparative information (but present restated prior period data on a pro forma basis unless impracticable).*

*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)?*

**We believe that the benchmark treatment under IAS 8 is the most appropriate treatment for all changes in accounting standards / policies. Notwithstanding, we would support allowing preparers the choice to use either the benchmark or allowed alternative treatments.**

## ***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.*

**We have no further comments.**