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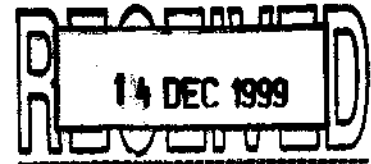
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Sir Bryan Carsberg
Secretary-General
International Accounting Standards Committee
166 Fleet Street
London EC4A 2DY
United Kingdom.

Dear Bryan

Comments on E65 "Agriculture"

Thank you for the opportunity to comment on Exposure Draft E65 "Agriculture". The comments of the Australian Accounting Standards Board and the Public Sector Accounting Standards Board of the Australian Accounting Research Foundation are included in the attached.

Should you wish to discuss the comments further or require clarification of any issues raised, please contact Angus Thomson on 61 (3) 9524 3618 or Robert Keys on 61 (3) 9524 3624.

Yours sincerely

Ken Spencer
Chairman
Australian Accounting Standards Board

Ian Mackintosh
Chairman
Public Sector Accounting Standards Board

COMMENTS ON ISSUES ARISING FROM E65 "AGRICULTURE"

Consistent with our comments on the draft Exposure Draft "Agriculture" considered by the IASC at the June 1999 meeting, we continue to support the general thrust of the ED to the extent that it proposes requiring:

- living assets to be measured at current value
- changes in current value to be recognised in the income statement (as part of profit or loss from operating activities) in the periods in which the changes occur
- the deemed cost of non-living produce harvested from living assets to be the current value of the produce at the date of harvest.

However, we continue to have some concerns about how these requirements have been worded in the draft ED, and some concerns about some of the other requirements proposed in the draft ED.

I Scope of the draft ED (Question 1)

We agree that the final Standard should not address further processing of agricultural produce and believe that the guidance in E65 for distinguishing between agricultural activity and further processing is adequate.

Individual biological assets

The reference to "flock of sheep" and other groups of biological assets in the table in paragraph 6 could confuse some readers because it is inconsistent with the individual biological asset focus of the ED. Similarly, paragraph 7 refers to a forest rather than trees in a forest. We believe that the Standard to be developed from E65 should be consistent with an individual biological asset focus.

Other agricultural assets

We believe that the scope of the Standard should be limited to biological assets and the initial measurement of agricultural produce sourced from biological assets (per paragraph 1(a) and (b) of E65). We would prefer that issues relating to other agricultural assets were addressed in other Standards. For example, we would prefer that issues relating to government grants were addressed in IAS 20 "Accounting for Government Grants and Disclosure of Government Assistance".

Leased biological assets

We note that E65 explicitly excludes biological assets leased under an operating lease from its scope. We note that the current value of rights over a biological asset that are obtained through an operating lease directly correlates with changes in the current value of the underlying biological asset. Accordingly, consistent with the requirements relating to biological assets proposed in E65, we believe that rights to specific biological assets (whether obtained through finance or operating lease arrangements) should be included in the scope of the Standard, and treated as if they are biological assets. That is, to the extent that the lessee of a biological asset controls the future economic benefits embodied in the biological asset

during the lease term, we believe that the lessee has an asset that should be required to be accounted for in accordance with the Standard. Similarly, to the extent that the lessor of a biological asset controls the future economic benefits embodied in the biological asset that are expected to be derived subsequent to the end of the lease term, we believe that the lessor has an asset that should be required to be accounted for in accordance with the Standard.

Consistent with this view, we believe that IAS 17 "Leases" should be amended to explicitly state that IAS 17 does not apply to lease agreements to use biological assets. We note that IAS 17 already excludes "lease agreements to ... use natural resources" which could be interpreted to include biological assets. Accordingly, we do not believe that it would be a major change for IAS 17 if it were to be amended to make it explicit that it does not apply to lease agreements to use biological assets.

Living assets held ready for sale

We note that the definitions section of E65 (paragraph 9) appropriately results in most living assets that are held primarily for profit being included within the scope of the proposals. However, living assets that are held ready for sale (that is, no longer held for the purpose of biologically transforming them, for example live sheep in transit and cattle held ready for slaughter) are, we believe, inappropriately excluded from the scope – by virtue of paragraph 1(a) which refers only to biological assets used in agricultural activity. If they are excluded from the scope of the Standard, we note that the Standard would not provide guidance on how to account for the biological assets between when they cease to be used in agricultural activity (for example, when they become held for slaughter) and when they become agricultural produce (for example, when they are slaughtered).

We believe that paragraph 35(b) is inconsistent with the definition of "agricultural produce" in paragraph 9, because that definition refers to "harvested product", and "harvest" is defined (also in paragraph 9) to exclude living assets. We also note that although paragraph 35(b) addresses biological transformation, it does not acknowledge that significant price change could take place despite the fact that significant biological transformation will not.

2 Fair value (Questions 2, 3 and 5)

We continue to believe that the most relevant and reliable measure of living assets is the net market value of those assets, and that a reliable estimate of net market value can be determined for agricultural produce at point of harvest and for biological assets. Where those living assets are traded in an active and liquid market, the observed market price less, where relevant, pre-sale costs and point-of-sale costs is the best indicator of net market value. In the absence of an active and liquid market, professional judgement is required in determining net market value.

Active and liquid markets

We believe that the characteristics of a market that gives rise to a price that can be used as a basis for determining fair value should be described as an active and liquid market, because that description addresses both the frequency of transactions in a market and the number of buyers and sellers that are entering into those transactions. We do not believe that the

definition of active market in paragraph 10 of E65 adequately captures the notions of both active and liquid.

Furthermore, we note that the definition of "fair value" includes a reference to "knowledgeable" whereas the definition of "active market" does not. Despite this, paragraph 24 notes that a market price in an active market is the most reliable measure of fair value. To address our concern, we suggest that the definition of "active market" be amended to include the notion of knowledgeable buyers and sellers.

Point-of-sale costs

We do not believe that living assets should be carried at amounts that exceed the net proceeds that would result from disposing of them. Therefore, we believe that living assets should be measured at their market price observed in an active and liquid market (as explained in E65) less point-of-sale costs.

Accordingly, we agree that biological assets should be measured at fair value at each balance sheet date only where point-of-sale costs are immaterial.

Examples

We believe that inclusion of examples of the application of the fair value guidance would help to ensure that the most relevant and reliable measure of future economic benefits is used to represent biological asset values, in the absence of observable prices in active markets. An example could be included that illustrates the circumstances where a value that is based on the currently available proceeds from harvesting immature trees in a forest that are intended to be held to maturity would be preferable to a value that is based on net present values.

Cost

We believe that paragraph 23 should clarify that although transaction (buying) costs (such as transport costs from the market to the entity's property) may be included in the initial amount recognised, they would be written-off at the next balance sheet date as a result of the assets being measured at fair value at that date. This would apply even to biological assets acquired at the balance sheet date.

We believe that fair value can always be determined for agricultural produce at point of harvest and for biological assets. In certain circumstances, cost may be the best indicator of fair value. Accordingly, consistent with paragraph 20, we do not believe that paragraph 17(b) should refer to cost, as to do so may confuse some readers.

3 Treatment of the change in fair value (Questions 4, 9 and 10)

We agree that the change in fair value of biological assets should be recognised entirely in net profit or loss for the period. We believe that both the physical and price change components are part of profit or loss from operating activities.

Split physical and price components

We do not believe that the change in carrying amount of biological assets should be split between physical and price components. We hold this view on the basis that the benefit that would be derived from the split does not outweigh the cost of determining the split. We do not believe that information about the split would be useful to users of financial reports, even if it can be determined reliably.

In relation to encouraging the physical/price split, we suggest that the physical/price dichotomy may be difficult to apply in some cases. For example, if fair value is determined using net present value techniques, it is unclear how the effect of the discount rate “unwinding” would be treated. We suggest that the dichotomy be “physical” and “other”.

It is unclear to us whether the effect of harvesting agricultural produce is included as part of physical change under E65 (the comments under question 9 of the Invitation to Comment suggest that it is, although paragraphs 52 to 57 do not explicitly mention it – indeed, paragraph 55(c) suggests that physical change only includes the results of biological transformation). As noted in section 12A below, we believe that the value of the harvested agricultural produce would provide useful information to users of financial reports and should be disclosed separately. As E65 is worded, that information would not be disclosed separately if changes due to harvesting are included in the disclosure proposed by paragraph 61(c).

The effect of purchases of biological assets

We have concerns about recognising purchases of living assets in the income statement as expenses (“tree seedlings purchased and used” in Note 4 of example 2 of Appendix A) and an equal amount of revenues (increase in the fair value of uncut forest stocks during the period) rather than recognising them as directly giving rise to biological assets – as would be required by paragraph 32.

4 Agricultural land (Question 6)

We believe that IAS 16 should apply to agricultural land.

5 Government grants (Question 7)

As noted in issue 1 above, we would prefer that issues relating to government grants were addressed in IAS 20 “Accounting for Government Grants and Disclosure of Government Assistance”. We agree that government grants should be recognised as revenue in the income statement.

We agree that government grants, including unconditional government grants received in respect of a biological asset should be recognised as income. We note that this treatment is consistent with the conceptual framework.

We do not believe that conditional government grants should necessarily be treated differently from unconditional government grants. We believe that grants should be recognised as

revenue when they meet the Framework recognition criteria. We do not agree with E65 to the extent it proposes adopting a different approach for "conditional" grants.

6 Components of biological assets (Question 8)

We believe that the proposal set out in E65 is the appropriate way to accomplish the objective of providing information about the nature and stage of production of biological assets.

7 Components of change in fair value (Question 9)

As noted in Issue 3 above, we do not believe that 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.

8 Analysis of expenses (Question 11)

In relation to paragraphs 59 and 60, we believe that the requirements in IAS 1 provide sufficient guidance on the presentation of expenses. We do not believe that it is necessary for the Standard to explicitly address this issue.

9 Disclosure in general (Question 12)

In relation to paragraph 64(a), we do not believe that it is necessary to require disclosure of the measurement base used to determine fair value where market prices observed in active markets have been used.

10 Present value sensitivity disclosure (Question 13)

We continue to believe that information about the sensitivity of present values would be useful to users, despite the fact that our constituents have advised us that a requirement to disclose such information that is used to determine fair value is onerous. We believe that it is sufficient for the Standard to require disclosure of the assumptions made in determining net present value, and to encourage disclosure of a sensitivity analysis.

11 Transitional provisions (Question 14)

We agree with the transitional provisions as drafted.

We note that the reference in paragraph 69 to agricultural produce may confuse some readers as agricultural produce would not be measured at current fair value (it is only measured at fair value at date of harvest for the purpose of determining a deemed cost).

12 Other comments (Question 15)

12A Agricultural produce

The effect of harvesting agricultural produce

We interpret the combined requirements of paragraphs 37 and 61(c) as requiring the effect of harvesting of produce from biological assets (whether consumable or bearer) to be accounted for in the same way as the sale of a biological asset (that is, as a credit to the biological asset account). We believe that this treatment would only be practicable for consumable biological assets (where the harvested produce entirely replaces the biological asset) as in that case the biological asset is effectively revalued to fair value immediately prior to harvest, which is then "closed" to the inventory account. Any difference between that amount and the fair value of the produce at point of harvest would be recognised in profit or loss. We do not believe that this treatment would be practicable for bearer biological assets (where the biological asset continues to exist after harvest). To satisfy the proposals in E65 (in particular paragraph 61(c)), it would be necessary to determine the fair value of the biological asset immediately prior to harvest and the fair value immediately after harvest. We believe that would be onerous, particularly for bearer biological assets. We also believe that the effect of harvesting should be treated the same, whether from consumable or bearer biological assets.

Accordingly, we believe that the Standard should require the fair value of harvested produce (less harvesting costs) to be recognised and disclosed as revenue [we believe that information about the fair value (at the date of harvest) of produce provides useful information]. We note that this would mean that the effect of harvesting of produce on the fair value of biological assets would be reflected in the amount recognised in net profit or loss in accordance with paragraph 22.

Although net profit or loss is not distorted by the "double counting" of the amount disclosed as revenue (due to the counteracting effect of the amount disclosed as expense), if our view expressed immediately above is adopted, we continue to believe that the Standard should include guidance on (or at least acknowledge) the potential for the double counting of the amount disclosed as revenue that results from the treatment of agricultural produce – once when produce is grown and then when the produce is sold. Similarly, the Standard should acknowledge that triple counting could occur (once when grown, then when the produce is harvested and again when the produce is sold). We believe that unless additional guidance is provided in the Standard, the basis for the amount of revenue recognised in accordance with the Standard would be unclear.

Treatment of harvesting costs

We agree that the deemed cost of all home-grown agricultural produce should be the current value of the produce immediately after it is harvested. Consistent with IAS 2, we believe that harvesting costs should be absorbed directly into the cost of inventory, and not recognised in profit and loss until the inventory is sold. Accordingly, we believe that only the difference between the current value of the produce immediately after harvest and harvesting costs should be recognised in profit and loss. The current value of the produce immediately after harvest should be recognised as inventory immediately after harvest.

12B Intangible assets

We do not object to encouraging intangible assets that are related to agriculture to be measured at fair value if there is an active market for the intangible assets but note that, given the one-off nature of most intangible assets, it would be rare that an active market would exist.

If the encouragement is included in the Standard, we believe that the Standard should include commentary that explains why biological assets are required to be measured at fair value despite the absence of an active market for the biological assets but intangible assets related to agriculture are not permitted to be measured at fair value.

12C Other Comments

- (a) Paragraph 9: the definition of “harvest” treats “the removal of a living plant from agricultural land for replanting (such as for horticultural purposes)” as “agricultural produce” rather than as “biological assets”. We believe that to the extent biological transformation is still taking place (for example, because the rootball of the plant is kept in soil) the plant is a biological asset (see also our comments on the scope above).

The definition of biological assets states that “biological assets include those controlled through ownership and those controlled through a legal or similar arrangement and that are recognised as assets under other International Accounting Standards”. We understand that the intention is to scope out biological assets under operating leases (Issue 1 above notes our disagreement with that exclusion). However, we note that, as drafted, the definition does not effectively exclude “biological assets controlled through a legal or similar arrangement and that are not recognised as assets under other International Accounting Standards”.

- (b) Paragraph 32: for completeness, paragraph 32 should be amended to make it clear that proceeds from the sale of biological assets are deducted from the carrying amount of the assets.

We note the use of the term “carrying amount” in paragraph 32 is inconsistent with its definition. Because carrying amount is the amount recognised in the balance sheet, it does not make sense to add to that amount to derive the carrying amount.

The reference to the number of units of biological assets in paragraph 32 implies a quantitative rather than qualitative measure of biological assets. Furthermore, given the difficulty of prescribing a consistent treatment of costs as expenses or assets, we believe that the Standard should not attempt to prescribe which costs are expensed and which costs are capitalised. Rather, we believe that the Standard should require disclosure of the policy adopted in capitalising or expensing costs associated with biological assets. To illustrate the difficulty of interpreting paragraph 32: Are vet fees paid for delivering a calf “costs of producing biological assets” or “costs that increase the number of units of biological assets”?

- (c) Paragraph 37: we note that paragraph 37 implies that the decrease in the fair value of biological assets immediately after harvest would be recognised as an expense. It seems to repeat the requirement contained in paragraph 22. We are concerned that some could interpret the two paragraphs as requiring the double counting of the decrease in fair value.

Furthermore, the reference to “net change in fair value” should be amended to read “net change in fair value of biological assets from which produce has been harvested”.

It is unclear to us why paragraph 37 only addresses the change between the last balance sheet date and the point of harvest. What about acquisitions since the last balance sheet date that are subsequently harvested? It is also unclear to us whether the reference to “point of harvest” in paragraph 37 refers to immediately before or immediately after harvest.

- (d) Paragraph 64(b): we believe that the names and qualifications of independent valuers should be required to be disclosed.
- (e) Example 1 of Appendix A, section 7(b) and Example 2 of Appendix A, section 7(c): we believe that for illustrative purposes, it would be useful to show the calculations of the increase in the fair value of biological assets attributable to:
 - (i) physical change (as per the formula in paragraph 56); and
 - (ii) change in per-unit fair values (as per the formula in paragraph 57).
- (f) Example 2 of Appendix A, section 7(c): we do not believe that the presentation of a reconciliation that combines trees and felled logs is consistent with the proposed requirements in paragraph 61.