

January 2000

Comments to E65 Agriculture

CL 13

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

I agree with answer (a): The final Standard should not address the further processing. I believe that the guidance in paragraphs 4-7 for distinguishing between agricultural activity and further processing is adequate.

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

I don't agree with answers (a), (b), and (c). From a theoretical point of view there is no difference between biological assets and other assets like machinery, e. g. Biological assets have to be measured in the same manner as property, plant and equipment (IAS 16). Either biological and other assets, both have to be measured at costs (benchmark treatment), or both have to be revaluated (alternative treatment). Different valuations are absolutely inappropriate. As a consequence if the alternative treatment is chosen, changes in fair values have to be considered in the same way (see question 4). If the costs valuation is chosen, costs have to be defined as the sum of all expenses which were needed to enable the asset to generate future economic benefits (i. e. cash flows). For example the costs for a cow is either the expenditure for buying it on the cattle market or the sum of expenses for insemination, birth, hay and other fodder, including the costs for the work of the farmer, until the calf starts producing milk and therefore becomes a cow. Of course the latter calculation works with a lot of assumptions, but this is the same in other industries with their self-produced assets.

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

I don't agree with answers (a), (b), and (c). I believe that a reliable estimate of fair value only exists if there is an active market. Thus for biological assets and agricultural produce at point of harvest, which are traded on an active market, it is possible to give a reliable estimate of fair value. The question is how to measure agricultural produce a few month or even some years before the point of harvest because usually an active market exists only for mature products. Regardless of the measurement basis (costs or fair value) a jump in the value will

occur at some time. I suppose that biological assets and agricultural produce may be measured at fair value if an active market exists and at costs otherwise. But this method is not conform with IAS 16. What is the difference between machinery used in agriculture and biological assets? Why should biological assets be measured at fair value in general and machinery at costs (benchmark treatment) (see also answer to question 2) ?

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

I agree with answer (b). If biological assets and agricultural produce at point of harvest are measured at fair value, changes of fair value have to be reported in the same way as for other assets which are measured at fair value or revalued at balance sheet date (e. g. financial instruments or property, plant and equipment under the alternative treatment). Reporting of changes of fair value in net profit and loss indicates a cash flow which is not just earned and will cause some pressure of stockholders for more dividends. If the IASC decides to measure at fair value it has to ensure that this will not cause a rise in claims for dividends. Showing the change in fair value separately in equity - and not in net profit or loss - informs the stockholder about this fact and represents a firewall to prevent form claims for higher dividends.

Question 5 - Definition of fair value (paragraph 24)

I agree with answer (a). Price in an active market in the asset's intended location of sale or use is always the best measure of fair value.

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

I agree with answer (a). IAS 16 should be applied to agricultural land. There is no reason why agricultural land should be measured in an other way than industrial land. The IASC has to ensure that assets of the same nature have to be measured in the same way. Reading E65 suggests that there is no basic concept for a unique measurement basis. The IASC has to prevent that the balance sheet is a conglomerate of very different measurement basis! Perhaps E65 will cause a discussion about the general basic concept for measurement in IAS-accounting.

Question 7 - Government grants (paragraphs 41-44)

I agree with answer (b). I believe that the grant should be amortised into income over the life of the biological asset. This is the requirement under IAS 20, Accounting for Government Grants and Disclosure of Government Assistance. There is no need to install another accounting treatment for governments grants different from the general treatment under IAS 20.

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

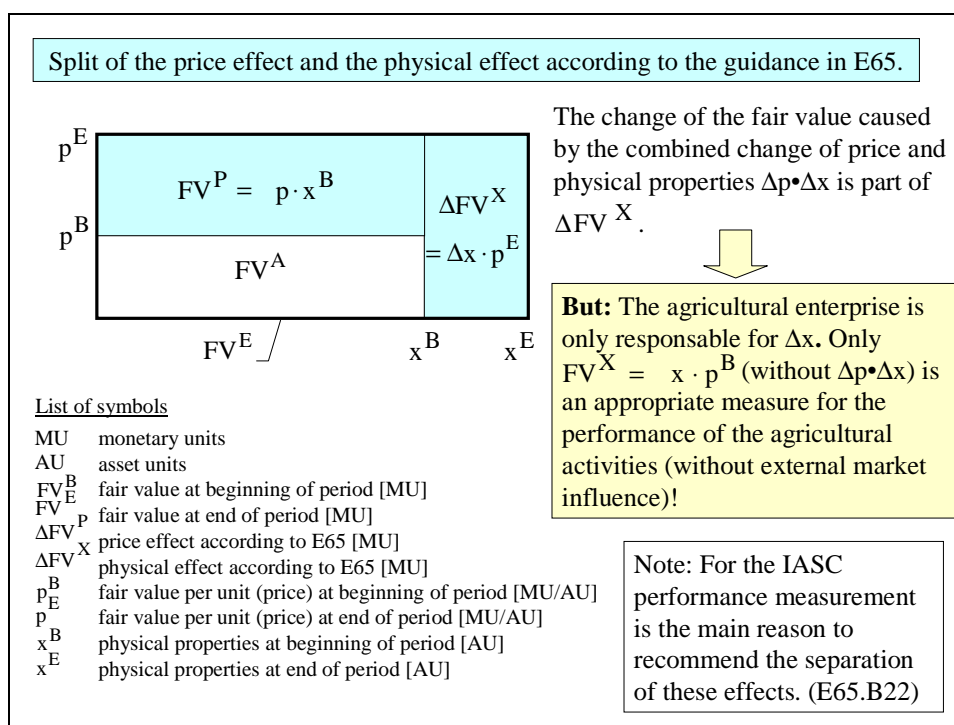
I agree with answer (c). I believe that separate disclosure of the quantified mature and immature components of each group of consumable and each group of bearer biological assets should be required. Consumable and bearer biological assets are of very different nature. Consumable biological assets will cause a cash inflow only once. Bearer biological assets will cause cash inflows for a longer period of time. Thus it is useful to distinguish between these type of biological assets. It is also important to make a difference between mature and immature biological assets. This is similar to the classification in finished and unfinished products in manufacturing. Mature biological assets and finished products are ready to be converted into cash – this is not the case with immature biological assets and unfinished products which still need some effort and expenses.

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

I don't agree with any answer. Components of change in fair value of biological assets should not be disclosed because there is also no separation of components of changes in fair value of other assets. In addition a company has to calculate the physical effect, the price effect and the mixed physical-price effect on the basis of current prices and physical conditions or on the basis of last year's prices and physical conditions. As such a split could be misleading and is not required for any other type of asset, the change in fair value should be shown as a whole only.

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

I agree with answer (b). The guidance for making the split in paragraphs 56-58 is inadequate. Following the guidance provided by E65 the mixed physical-price effect will added to the pure physical effect. Usually agricultural enterprises are not big enough to substantially determine the market price. Therefore the performance of agricultural activities can only be measured by the physical change of biological assets – and this is only the pure physical effect without the mixed physical-price effect. The following figure shows the principle of separation used in the guidance of E65:



In the next figure a separation of the pure price effect, the pure physical effect, and the mixed physical-price effect is suggested:

Example „wood“ with separation of change in fair value (FV) in price (p) effect and physical (x) effect. (MU - monetary units)

	quantity [m ³]	price [MU/m ³]	value [MU]
Beginning (B): Jan 1 st	100	6	600
End (E): Dec 31 st	105	8	840

$FV^E = 840$

$p^E = 8$
 $p^B = 6$

$\Delta FV^P = (8 - 6) \cdot 100 = 200$	$\Delta FV^{X,P} = (105 - 100) \cdot (8 - 6) = 10$
$FV^B = 600$	$\Delta FV^X = (105 - 100) \cdot 6 = 30$

}

Δp given by the market

pure physical effect: 30
 pure price effect: 200
 mixed physical-price effect: 10
 total change: 240

$x^B = 100$ $x^E = 105$
 physical effect according to E65: 40 MU
Better: Separation of the mixed physical-price effect from the pure physical effect or combination of the pure price effect and the mixed physical-price effect.

The second best solution is to show the pure physical effect and the combination of the pure price effect and mixed physical-price effect. This is illustrated in the next figure, which shows the corrections needed for the example of E65.57:

Example for separation of the change in fair value (E65.57) and corrections

A herd of 10 animals is held throughout the financial reporting period. For simplicity, the only physical change is assumed to be the increase in their physical attributes due to ageing from 2 years to 3 years of age.

Data:

Fair value of a 3 year old animal at 1 January	112
Fair value of a 2 year old animal at 1 January	100
Fair value of a 3 year old animal at 31 December	120
Fair value of a 2 year old animal at 31 December	105

But: Measurement of the physical change on the basis of prices at 1 January!

Fair value of herd (group) at 1 January (10 x 100)		1,000			
Increase in fair value due to physical change:					
10 x 105	10 x 100	pure physical effect	1,050		1,000
10 x 120	10 x 112	(performance)	<u>1,200</u>	150	<u>1,120</u> 120
Increase in fair value due to price change:					
10 x 100	10 x 112	pure price effect	1,000		1,120
10 x 105	10 x 120	and mixed	<u>1,050</u>	<u>50</u>	<u>1,200</u> 80
		physical-price effect			
Fair value of herd (group) at 31 December (10 x 120)			1,200		

To summarize the comments to question 10, the guidance in E65 is absolutely inappropriate. As the focus is to show the performance of agricultural activity the pure physical effect has to be reported if the IASC decided to require or to encourage the separate disclosure of these components of change in fair value. The mixed physical-price effect should be disclosed either separately or combined with the pure price effect.

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

In accordance with IAS 1 each enterprise should decide whether to classify the expenses by nature of function (i. e. answer (c)). Additional restrictions in accounting practice for agricultural enterprises should be avoided.

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

The disclosures proposed in paragraphs 44-67 are about right (i. e. answer (a)).

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 sensitivity disclosure of the present value measurement to changes in assumptions should not be required (i. e. answer (b)). There is no reason why agricultural enterprises should disclose more information and additional analysis than other enterprises which also measure some assets by net present values.

Question 14 - Transition: Follow IAS 8 (paragraph 69)

When an enterprise adopts the new standard "agriculture" both the benchmark and the allowed alternative treatments under IAS 8 should be permitted (i. e. answer (a)). Again there is no reason why an agricultural enterprise should be additionally restricted in comparison to other enterprises.

Question 15 - Matters not covered by a specific question

In E65.40 for intangible assets the recommended treatment is revaluation at fair value, which is only the allowed alternative treatment in IAS 38. The benchmark treatment in IAS 38 is measurement at costs. I would prefer a unique qualification of these different methods as benchmark treatment or as allowed alternative treatment in both, the new standard "Agriculture" and in IAS 38.

As a final remark I encourage the IASC not to establish special accounting practises which differ from industry to industry. Especially for general purpose financial statements the accounting principles should be unique over all industries.

Therefore I strongly recommend not to measure biological assets at fair value (question 2), not to report fair value changes in net profit or loss (question 4), to measure agricultural land according to IAS 16 (question 6), to amortise government grants into income over life of the biological asset (question 7), not to disclose components of change in fair value (question 9), to classify expenses either by nature or function in accordance with IAS 1 (question 11), not to disclose a present value sensitivity analysis (question 13), to follow IAS 8 when adopting the new standard "agriculture" (question 14), and to measure intangible assets according to IAS 38.

Furthermore I suggest to change the misleading guidance to calculate the price effect and physical effect (question 10) when the IASC decides to encourage or require the disclosure of components of fair value changes. The mixed physical-price effect must not be included into the physical effect.