

Date:

4 February 2000

Your Ref:

Our Ref:

REL/JP/74-2000

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

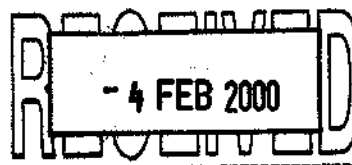
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The Institute of  
Chartered Accountants  
in England & Wales



Chartered Accountants' Hall  
PO Box 433, Moorgate Place  
London EC2P 2BJ

Telephone: 0171 920 8100  
Fax: 0171 920 0547  
DX 877 London/City  
<http://www.icaew.co.uk>



Dear Sir Bryan

**Agriculture (E65)**

I enclose the Institute's memorandum of comment in response to the IASC exposure draft on Agriculture (E65), issued in July 1999, together with a copy of our comments on the draft statement of principles on agriculture issued in December 1996. We have also sent a copy of our memorandum of comment to the Accounting Standards Board for information.

I am sorry we were not quite able to meet your 31 January deadline. If it would be helpful to discuss any matters arising from our response, please let me know.

Yours sincerely

Robert E Langford  
Head of Financial Reporting  
Direct Dial Tel. 8552  
Email: [JParkins@icaew.co.uk](mailto:JParkins@icaew.co.uk)



INVESTOR IN PEOPLE

Gloucester House, 399 Silbury Boulevard, Central Milton Keynes MK9 2HL  
Telephone: 01908 248100 Fax: 01908 691165 DX 31427 Milton Keynes

Brussels Office Telephone: 00 322 230 3272 Fax: 00 322 230 2851

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**The Institute of  
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Chartered Accountants' Hall  
PO Box 433, Moorgate Place  
London EC2P 2BJ

Telephone: 020 7920 8100  
Fax: 020 7920 0547  
DX 877 London/City  
<http://www.icaew.co.uk>

**MEMORANDUM OF COMMENT TO THE INTERNATIONAL  
ACCOUNTING STANDARDS COMMITTEE  
ON THE PROPOSED INTERNATIONAL ACCOUNTING STANDARD ON**

**AGRICULTURE**

**Introduction**

1. We have reviewed the exposure draft of a proposed international accounting standard on agriculture (E65) issued by the IASC in July 1999 and our comments are set out in this memorandum. We deal first with some general matters. We then respond to the specific questions raised in the exposure draft. In view of the possible implications for UK accounting, we are sending a copy of this memorandum to the Accounting Standards Board in accordance with our usual practice.
2. In April 1997, following our review of a draft statement of principles on agriculture issued by the IASC in December 1996, we prepared a memorandum of comment to the CCAB International Accounting Committee. We understand that this was reflected in the CCAB's comments submitted to the IASC but, for ease of reference, a copy of the memorandum is enclosed.

**General**

3. The use of fair values has considerable merit in relation to the agriculture sector where historical costs may bear little or no relation to the value that has been achieved during a period. However, the Board should recognise that, for some parts of the sector, particularly for those with a high cost base and short production cycles, there will only be small differences between fair value and historical costs. In these circumstances, the benefits of additional information may not outweigh the incremental effort involved.
4. In addition, we are concerned that:
  - Where most agricultural businesses are owner-managed, as in the UK, we believe that the proposals will have limited application (paragraphs 5 and 6).



INVESTOR IN PEOPLE

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Telephone: 01908 248100 Fax: 01908 691165 DX 31427 Milton Keynes

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- The use of fair values assumes an active market, which may not exist for some immature biological assets and unharvested agricultural produce (paragraph 7).
  - Where market prices are used, the impact of any significant post balance sheet price movements needs to be considered (paragraph 7).
5. As we mentioned in our previous memorandum, our comments are framed from the perspective of the UK, where agricultural activities are generally of a short-term nature and are carried out by small entities, most of which are owner-managed. Only about 3% of agricultural holdings are incorporated entities. The operating cycle is usually relatively short, typically between one and 2-3 years. Input costs are high in comparison with those in some other countries, with the result that the costs of achieving biological transformation are largely reflected in historical cost financial statements. In such circumstances, the benefits of the additional information provided by fair values may not justify the effort involved, although their use may be appropriate in countries where the agricultural cycle is longer or input costs are less significant.
  6. Under the allowed alternative treatment in IAS 16, property may be carried at a revalued amount and the same approach is available under UK GAAP. Carrying biological assets at fair value, however, as proposed in E65, would be a fundamental change in approach, for which we do not believe there is strong demand amongst users of accounts. We continue to be concerned about the identification of users of the financial statements of agricultural entities and their needs. In our experience, owner-managers are well aware of current values on a day-to-day basis and do not look to historical financial statements for such information. In the absence of better evidence of user needs, we are not convinced that the current proposals are the most appropriate way in which the accountancy profession can help the agricultural industry at large.
  7. We acknowledge that fair values are increasingly used in place of cost for accounting purposes, for example in accounting for financial instruments, retirement benefits and investment properties. However, it is not clear why the process of biological transformation justifies the use of fair values in accounting for agricultural activities rather than other industries. In our view, activities with more predictable realisable values, such as professional services and short-term construction contracts, would be more appropriate for extension of the fair value concept than agriculture, which is very dependent on markets. Where market prices are volatile, or where there are only thin markets, for example in immature biological assets and unharvested agricultural produce, realisable market values may vary significantly from fair values at the balance sheet date. Users of accounts should therefore be alerted to the uncertainties that may be involved in reporting fair values.

## **SPECIFIC QUESTIONS**

### ***Q1. Scope: further processing after harvest (paragraphs 4-7 and 36)***

*The exposure draft does not deal with further processing of agricultural produce after harvest. Those processes are regarded as 'manufacturing'*

*activities to which accounting standards for inventories apply.*

*Do you:*

- (a) *agree that the final standard should not address the further processing? If so, do you believe that the guidance in paragraph 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?*
8. Alternative (a). We consider that the proposed standard should not deal with the accounting treatment to be adopted for produce which is further processed after harvest. Although, in some cases, the same entity will be involved in both activities (e.g. the production of milk and cheese, or growing grapes and making wine) we consider that, once the biological transformation process has stopped and an enterprise has a marketable product, the fair value from the initial process becomes the input cost to the secondary, and completely separate, activity. However, this may require an amendment to the international accounting standard on inventories as the treatment of harvested agricultural crops appears to be excluded from IAS 2 (paragraph 3).
9. We agree that the proposed guidance for distinguishing between agricultural activity and further processing is adequate.

**Q2. - 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.*

10. In some cases, we believe that, as a result of market fluctuations, reliable measures of the fair values of biological assets and agricultural produce at the point of harvest may not be available until the items concerned are sold. This needs to be borne in mind when applying the guidance in paragraph 30 that fair value is the highest value obtainable by the enterprise, net of costs. We agree that cost-based measures that ignore market values do not measure performance to the point of potential yield, particularly in accounting for livestock, which normally ignores forage costs. Where market value is

significantly higher than cost, we do not believe it should be reflected in the carrying amount unless there is an immediate market for the product so that realisation at the higher amount is relatively certain.

11. In principle, we accept alternative (a), i.e. that all biological assets for which an active market exists should be measured at each balance sheet date and that agricultural produce should be measured at fair value at the point of harvest. We would have more difficulty in supporting the measurement of biological assets at fair value if an active market does not exist. In such a case, we note that paragraph 26(f) of E65 would permit cost to be used as a surrogate for fair value. However, we would not limit this to biological assets for which little biological transformation has taken place or the impact of the biological transformation on market price is not expected to be material.

**Q3. - Reliability of fair value measurement (paragraph 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 statement of an enterprise engaged in agricultural activity.*
12. We support alternative (c) because of the difficulty of determining fair value of growing crops prior to harvest and the problems of valuing livestock held for breeding purposes. In such cases, we believe that cost, including direct costs and related overheads, provides the best measure of value without including unrealised profit.

**Q4. - 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?*
13. If the standard that follows E65 requires measurement at fair value, we believe that, in the context of financial statements prepared in accordance with current international accounting standards, changes in fair value should be reported in equity until the asset is sold or consumed, when it should be transferred to net profit or loss for the period, i.e. alternative (b).
14. Looking further ahead, we consider that changes in fair value of agricultural assets should be recognised as part of total performance; consequently, if the IASC was to adopt a single performance statement, we would support their inclusion in the statement with other value changes. This would avoid “recycling”, to which we are generally opposed.
15. In each case, the presentation should identify the effect of changes in fair value, in order to avoid creating an expectation that value changes are already reflected in cash flows available for payment of dividends or tax.

**Q5. - Definition of fair value (paragraph 24)**

*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?*
16. We support alternative (a) on the basis that price “in an active market in the intended location of sale” will reflect costs such as the transport costs of bringing the biological asset to market. Where the product attracts a sales-based subsidy, we consider that fair value should reflect that subsidy. This would be consistent with paragraph 30, being the highest price obtainable by the enterprise.

**Q6. - 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 or IAS 16 should be prohibited?*
17. We agree with alternative (a), i.e. that IAS 16 should apply to agricultural land, although we note that, as in the case of other property, the availability of an allowed alternative, permitting the use of cost or remeasurement at a revalued amount, will not assist comparability. The use of IAS 16 would enable agricultural buildings to be measured with the related land. However, it may be appropriate to provide additional guidance on the treatment of agricultural tenancies that enable long term occupation without ownership, sometimes for an indefinite period of time.
18. We also note that, where an active market exists for trading intangible assets such as production quotas, these may be remeasured at the fair value of expected future economic benefits, in accordance with IAS 38. The existence of a quota may also affect the value of cattle.

**Q7. - Government grants (paragraphs 41-44)**

*If a government grant is received in respect of a biological asset carried at fair value, do you consider:*

- (a) *that the grant should be recognised as income immediately if it is unconditional;*
  - (b) *that the grant should be amortised into income over the life of the biological asset; or*
  - (c) *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?*
19. We support the proposed treatment of grants set out in paragraph 41. Under UK GAAP, alternative (c) is not available and it has been accepted practice to take credit over the relevant period of production, thus matching income with expense. However, in view of the many different purposes for which grants are intended, we acknowledge that the existence and satisfaction of any related conditions provide more clearly defined criteria on which to determine the accounting treatment.

**Q8 - Components of biological assets (paragraph 46-47)**

*The exposure draft proposes that an enterprise should describe the nature and stage of production of each group of biological assets, either in the form of a narrative description in the notes or as an analysis of the carrying amount of the biological assets between those that are consumable and those that are bearer, further subdivided between those that are mature and those 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 bearer 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)?*
20. We support alternative (b) on the grounds that the other alternatives provide more detailed information than would be required by most users and would be onerous for agricultural entities, particularly smaller entities, to provide.

**Q9 - 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?*
21. Alternative (b). We believe that an enterprise should be encouraged, but not required, to disclose the physical and price components of the change in fair value of its biological assets.



**Q10. - 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?*

22. Alternative (a).

**Q11. - 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*
- (c) allow each enterprise to decide whether to classify by nature or function?*

23. Alternative (b). We note that, whilst IAS 1 permits a choice, classification by nature of expense is already adopted widely within the UK agricultural industry.

**Q12. - 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 these 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)?*

24. Some of the disclosures proposed in paragraphs 44-67 are impracticable and of questionable relevance. In this category, we would include:
- (i) Reconciliation of changes in carrying amount of biological assets (paragraph 61)
  - (ii) Restrictions on title and biological assets pledged as security (paragraph 64(d))
  - (iii) Unsustainable activities with estimated date of cessation (paragraph 64(g))

On the other hand, the proposed standard says little about providing a narrative commentary on the main events that may have an impact on the financial statements and any significant changes that are foreseen.

**Q13. - 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?*
25. In principle, we support the discounting of future cash flows as a method of estimating fair value but we believe that the application of discounting needs more study before it is used generally, for example as regards treatment of the unwinding of a discount. We recognise that long-term agricultural processes, such as forestry, may be better reflected by adopting the proposals in E65 but the resulting values would be very sensitive to different assumptions about the growing period to extraction, market prices per cubic metre of timber and appropriate discount rates. The resulting values should therefore be tested against figures from other sources, such as market transactions in similar forestry assets.
26. With the possible exception of forestry, net present values are not commonly used to value UK agricultural activities. Whilst we agree that assumptions are material to understanding accounts, there are many other items where assumptions are used in making estimates but are not disclosed. Consequently, we do not support the proposed requirement to disclose discount rates and the number of future years' cash flow used to determine the fair value of biological assets or agricultural produce.

*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 (to apply the standard retrospectively to reflect an adjustment to the previous carrying amounts as an adjustment of retained earnings, and to restate comparative information) and an alternative (to apply the standard retrospectively and to reflect an adjustment to the previous carrying amounts in net profit or loss for the period, and not to restate comparative information).*

*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)?*

27. Whilst we consider it would not assist comparability to allow an option, we believe it would be difficult for IASC to adopt a more stringent treatment for agricultural entities than is available for other entities under IAS 8. Consequently, we support alternative (a).

**Q15. - Other matters**

*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.*

28. There are no other principles in the exposure draft with which we disagree.
29. In response to Question 6 above, we have commented on the possible need for guidance on the treatment of agricultural tenancies that enable long-term occupation without ownership, sometimes for an indefinite period of time. We have also referred to the possible relationship between the existence of a production quota and the value of cattle.

30. We welcome the proposed requirement in paragraph 64(f) to disclose, for each group of biological assets, the specific risk management strategies adopted. This is consistent with this Institute's commitment to raise the profile of risk reporting. However, we do not believe that such disclosures should be exclusive to biological assets and we therefore look forward to the introduction of a similar requirement in future international accounting standards.

REL/JP/IASCE65

4 February 2000

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29 April 1997

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The Institute of  
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PO Box 433, Moorgate Place  
London EC2P 2BJ

Telephone: 020 7920 8100  
Fax: 020 7920 0547  
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**MEMORANDUM OF COMMENT TO THE CCAB INTERNATIONAL ACCOUNTING COMMITTEE  
ON THE IASC DRAFT STATEMENT OF PRINCIPLES ON  
AGRICULTURE**

**Introduction**

1. We have reviewed the draft statement of principles on agriculture issued by the IASC in December and our comments are set out in this memorandum. We deal first with a number of general points on the draft statement. We then comment on the specific issues on which views are invited. Finally, we refer to certain other matters that will need to be considered in developing an international accounting standard on the subject.
2. Our comments are framed from the perspective of the UK where agricultural activities are generally of a short-term nature. The established accounting practices, based on the historical cost concept, are consistent with the nature of the activities; thus maturity is normally seen within two or three years, as in the case of livestock, and frequently follow an annual cycle, such as in the case of most seasonal crops and horticulture. This basis is well established for financial reporting and tax purposes and we are not aware of users, such as the banks or the revenue authorities, calling for a change in the treatment.

**GENERAL**

3. Our principal concerns on the draft statement are that:
  - The use of fair value is not justified in the case of most short-term agricultural activities (paragraphs 4 to 8).
  - Agriculture is not an appropriate type of business for introducing earlier recognition of profit, before it is realised through sale of the product, in place of the present, more prudent, historical cost approach (paragraph 4).
  - If the proposed principles were applied to short-term agricultural activities, the effect would in most cases be to take profit only slightly earlier than under the historical cost approach, whereby the profit is accounted for on disposal (paragraph 4 and 5).
  - The proposed use of a statement of non-owner movements in equity would not be consistent with the way in which items are allocated between the profit and loss account and the statement of total recognised gains and losses in the UK; the resulting



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complexity is likely to cause confusion to users of the accounts of agricultural enterprises (paragraph 4).

- Valuations may not be sufficiently reliable for use in financial statements and the benefit will often fall short of the cost. This problem would be exacerbated by the lack of an international consensus on agricultural valuation standards (paragraphs 5 and 17).
  - It will not usually be appropriate to adopt a class of biological assets as the unit of measurement rather than the assets making up that class (paragraph 14).
  - Tariffs and subsidies will continue to have the effect that comparisons between agricultural enterprises in different countries are unreliable (paragraph 34).
4. Except for forestry and plantations, which generally have a longer life than most forms of agriculture, we believe that there is no strong case for agriculture to be singled out, amongst medium term businesses, for the use of fair values and the consequent earlier recognition of profit in preparing financial statements. Little understanding seems to have been shown for the practical difficulties involved, in that the large majority of agricultural enterprises are very small and yet the proposals would make financial reporting for such businesses more complex than for the generality of manufacturing and trading enterprises. Linkage with the IASC's Framework for the preparation and presentation of financial statements (mentioned in paragraph 9 of the draft statement) is very weak. There seems to have been little attempt to identify users of the financial statements of agricultural enterprises or their particular needs, for which the existing historical cost basis of accounting is, in our view, generally adequate.
  5. The proposed use of fair values for all agricultural assets and produce would be highly subjective and would lead to audit difficulties. Reliability, a key quality of information provided in financial statements, would be threatened by the dependence on "management intention" in dealing with measurement issues. There are difficulties in arriving at a reliable short-term measure of profit in a business such as agriculture, where market prices are prone to rapid, and sometimes quite severe, fluctuation. The proposals in the draft statement do not provide a satisfactory way of addressing these problems. In most cases, the benefit of obtaining the information would not be commensurate with its cost. As a practical matter, it should also be noted that there are no agreed international standards for agricultural valuations.
  6. Similar measurement problems arise in the case of other business activities that result in income or expenses but are not completed at the accounting dates. An allocation of the expected outcome therefore has to be made. The difficulty of reaching agreement on interim financial reporting is evidence of the considerable problems caused by such issues.
  7. Consequently, we believe that all relatively short-term agricultural activities should be excluded from the proposals. In this context, we would define short-term activities as those in which the biological transformation processes affecting the principal assets involved have a span of less than three years. For such activities, the accounting treatment should be based on the use of historical cost. We believe that the use of fair value for measuring biological assets might also apply to the biotechnology assets of pharmaceutical companies, unless

pragmatic criteria are established for departing from historical cost, based on the timescales involved.

8. By excluding short-term processes, the proposals for use of fair values would clearly apply to most forms of forestry and plantations but would not apply to a large majority of agriculture. We accept that there would be a conceptual inconsistency between the accounting treatment of the two different groups of activities but this would largely reflect their fundamental differences in nature. We also recognise that the financial statements of an enterprise with a mixture of activities will incorporate the use of different measurement bases. However, the use of such combinations is common in non-agricultural enterprises and is recognised in the IASC Framework.
9. We note that the scope of the proposals does not specifically include horticultural activities, in which there are important issues, such as the fact that flower bulbs, seed corn and seed potatoes are living organisms. We also believe that it may be helpful to divide biological assets between those that are effectively "fixed assets" and produce income, such as animals kept for their produce, e.g. dairy herds, and those assets that are the produce, such as store cattle or pigs..

## SPECIFIC ISSUES

10. It should be noted that in the following paragraphs, in commenting on each of the specific issues, we have restricted the application of the question to long-term agricultural processes, as proposed in paragraph 7 above.

## Introduction

*Q1. Do you agree that IASC should issue an International Accounting Standard on agriculture?*

11. We recognise that agriculture is a topic that is particularly important for developing countries and we note the diversity of accounting practices in relation to forestry, plantations and livestock. However, we are not convinced that there would be sufficiently widespread support in the UK for the proposed international accounting standard on the subject to be reflected in national accounting guidelines, or that any improvements in the quality of financial statements would result.

*Q2. Does the Steering Committee's characterisation of agriculture (paragraphs 13-17) conform to your understanding of the sector?*

12. In broad terms, we have no problems with these introductory paragraphs. We assume that horticulture would fall within the category of biological assets but this should be clarified.

*Q3. A number of implications flow from the Steering Committee's description of agriculture (paragraph 18). Do you agree that:*

- (a) *biological transformation is a significant event that, under an accrual basis of accounting, should be recognised and reported in the period in which it*

*occurs;*

- (b) *the effect of changes in substance brought about by biological transformation is best revealed by reference to the changed state of the biological asset;*
  - (c) *the items to be accounted for should be the class of animals or plants rather than the individual animal or plant; and*
  - (d) *active and efficient markets generally exist for both biological assets and agricultural produce?*
13. We do not agree with parts (a) and (b) of the question. Whilst we accept that biological transformation is normally a significant event or process, we believe that its transient or spasmodic nature may be such that it cannot be measured with sufficient reliability for recognition in financial statements on an accrual basis. In some cases, it would be misleading to imply an active market for the produce. For example, pigs are only marketable at certain weights; consequently, their survival to the next marketable stage is assumed but should not be anticipated. It may be appropriate in such circumstances to consider the use of non-financial measures, such as the numbers of animals or the acreage of plant that have reached particular stages in their biological transformation.
14. Part (c) of the question is broadly acceptable, although there may be a number of different interpretations as to what constitutes a 'class'. For instance, when a valuer has regard to the market, an individual head basis, rather than a herd basis, is likely to be used. As regards part (d), we agree that active and efficient markets exist in several countries for both biological assets and agricultural produce. However, there will always be countries, instances and items where this is not the case and the proposals need to cater for these circumstances.

### Scope

- Q4. *Do you agree that the Principles established can generally be applied to:*
- (a) *all agricultural activities; and*
  - (b) *agricultural enterprises required to produce general purpose financial statements(Principle 1)?*
15. We consider that this proposal is only acceptable in the limited case of long-term agricultural activities, for the reasons set out in paragraphs 4 to 7 above.
- Q5. *The Steering Committee is committed to assessing the need for practical guidelines to accompany a Standard to facilitate wider adoption of recommended accounting principles. Is there a need for such guidance? Should such guidelines be initiated at the international or national level?*
16. There will certainly be a need for practical guidance if the proposals are developed as an international accounting standard. However, we suggest that the standard should be



as complete as possible as regards the way in which it should be implemented. The development of ancillary guidance should then be dealt with at a national level.

17. There will also need to be detailed guidance for the valuers who will form an essential part of the process. Areas of potential difficulty include the valuation of growing crops, the valuation of livestock at particular points of their life e.g. unweaned/weaned young, maiden gilts (sows), different categories of pigs (porkers, cutters, baconers). The development of guidance on such matters should be based on internationally agreed principles.

### **Definitions**

- Q6. Do the definitions of agriculture, biological transformation, biological assets and agricultural produce clarify the subject and boundary of this Draft Statement of Principles (paragraph 23)?*
18. As stated in paragraph 7 above, application of the proposed standard should be restricted to long-term agricultural activities, in which case it will be necessary to provide an appropriate definition. Whilst we have not identified any particular problems with the proposed definitions, we are concerned that they may be difficult to apply. The ancillary guidance mentioned in paragraph 16 above should therefore include appropriate clarification, such as examples of items that are included within and excluded from, each category. We do not consider it helpful to define agricultural produce as a non-living product.

### **Biological assets**

- Q7. Do you agree that fair value measurement of expected future benefits at each balance sheet date achieves greater relevance than historical cost (Principle 3)? Are fair value measurements sufficiently reliable for financial reporting purposes?*
19. We have considerable difficulty with Principle 3. We accept that the accounting treatment of long-term agricultural assets, such as forestry and plantations, normally needs to reflect fair values rather than historical cost. (An exception is where trees are grown over a short cycle, typically two years, for marketing as an alternative fuel or for sale as Christmas trees.)
20. In the UK, forestry is carried out for two main purposes. Some areas are grown for commercial cropping. Due to the climate, the timescale involved is often long, 35 to 40 years for softwoods and longer for hardwoods. Other areas of woodland are planted and maintained for amenity reasons, either to provide recreational facilities or a habitat for wildlife.
21. Where woodlands are to be harvested commercially, the crop is normally carried at historical cost until it reaches the point of maturity at which it starts to have a commercial value, possibly more than 20 years after planting. At this stage, a reasonably reliable evaluation of the crop value can usually be made. The woodland is then valued by projecting the potential future yield, which is discounted to net present value, taking account of the proceeds of thinnings and clear felling as well as costs of

maintenance. However, the discount rate selected can have a very significant effect on the resulting valuation.

22. Increasingly, there is a trend towards establishing and managing areas of woodland on a sustainable basis from which a small percentage (less than 5%) is harvested each year by clear felling and replanting (or re-establishment). The total volume and age of timber remain substantially the same at each accounting date. In that instance, there is an argument for the forest to be treated as a fixed asset; the annual surplus is the income derived from the sale of thinnings less the cost of maintenance and replanting (or re-establishment).
23. In the case of activities where the biological transformation processes affecting the principal assets involved are generally completed within a three year cycle, typically those other than forestry and plantations, we do not agree that fair value measurement is appropriate for use in financial statements. Whilst it may be more relevant than the use of historical cost, fair value measurement is too unreliable for such purposes. Consequently, in paragraph 36 of the draft statement and elsewhere, we would strongly recommend the exclusion of those activities where the economic benefit is expected to be realised by a sale, or the "maturity" of an animal, following its change of status to a "bearer", within three years of the accounting date. Thus maturity occurs when a biological asset commences its production process on the completion of its biological transformation.

*Q8. Should the primary indicator of fair value be net market value (Principle 4)?*

24. In the case of long-term agricultural assets, we agree that, if there is a need to depart from the use of historical cost, market value is the only basis on which to base fair value, assuming that a ready market exists for the asset concerned. Even in circumstances where we would accept the use of fair value, we have reservations about the references to net market value, particularly as regards the evidence available on which to base market prices. Paragraphs 50 (first sentence) and 53 also need to be restricted to crops that have actually been severed, i.e. are cut and ready, or close to being ready, for market.

*Q9. Do you believe that periodic independent external validation of the determination of fair value should be required if present value measurement methods are used by management (paragraph 57)? If so, how frequently?*

25. Where present values are required to be used, in the case of long-term assets, some form of periodic external validation will be necessary. However, as mentioned in paragraph 4 and 5 above, we have severe doubts as to the appropriateness and practicality of using fair values. In any event, there is a risk that the benefits of such an exercise will not be commensurate with its cost. Exemptions for smaller enterprises would almost certainly be required. We do not consider it necessary for an international accounting standard to specify the frequency of any independent validation, as the appropriate frequency will vary according to the circumstances.

*Q10. Do you agree that the change in carrying amount for a group of biological assets should be allocated between:*

- (a) *the change attributed to differences in fair values between balance sheet dates; and*
  - (b) *the physical change in biological assets held (Principle 5)?*
- Q11. *If you believe that the change in carrying amount should be split (question 10), how should the components of the change in carrying amount be determined (paragraphs 64-65)?*
- Q12. *If you believe that the change in carrying amount should be split (question 10), where should the components be recognised:*
- (a) *both components in the income statement;*
  - (b) *the operating gain in the income statement and the holding gain in the statement of non-owner movements in equity (Principles 6 and 7); or*
  - (c) *both components in the statement of non-owner movements in equity (Principles 6 and 7)?*

*[Exposure Draft E53, Presentation of financial statements, proposes that a complete set of financial statements include a statement of non-owner movements in equity, which reports items of income and expense that are not, under International Accounting Standards, required to be recognised in the income statement.]*

26. For convenience, we deal with Questions 10, 11 and 12 together. We are broadly content with the proposed disclosure although analysing the changes in carrying amount within the proposed sub-divisions will in many cases be impossible. Even if the proposed analysis was practicable, it would impose a considerable burden on preparers and will increase audit costs where the agricultural enterprise is a company. As mentioned in paragraph 4 above, we believe that the IASC needs to be particularly careful to ensure that the resulting information is readily understandable by users.
27. We agree that some additional disclosure is necessary as value changes are not wholly attributable to management performance and there may be compensating effects between growth and market prices. However, our main concerns with Principles 6 and 7 are with the subjectivity involved in making the necessary allocation, particularly as one part of the change in carrying amount is reflected in the income statement, the other being taken to the statement of non-owner movements in equity. It is also unclear why agriculture should be singled out for such detailed analysis, bearing in mind that a similar breakdown of changes in value is not required for other value-based enterprises.
28. Principle 5 refers to the change in carrying value of a *group* of biological assets. In the case of dairy herds, we consider that it would be very difficult to analyse the value of the herd and the total change in market value without considering the value of each individual animal.

- Q13. Do you agree that biological assets should be classified as a separate class of asset (Principle 11)?*
29. Yes, although in some countries this may have legal implications. For instance, under the EC Fourth Directive, the asset classification to be adopted within the balance sheet is narrowly defined and biological assets would presumably need to be shown as a sub-category of stocks, under the heading "work in progress".
- Q14. Do you agree that the change in carrying amount attributable to biological transformation should be disclosed (Principle 16 (c))?*
30. Principle 16 proposes the disclosure of a number of items in respect of each sub-class of biological asset. However, the proposed disclosure requirements in paragraph 87 are excessive. Sub-paragraph (c), for example, could involve very extensive disclosures. The disclosures proposed in sub-paragraphs (d), (e), (f) and (g) could be complex and will require to be clarified by providing implementation guidance, particularly in the case of (f) risk management strategies and (g) unsustainable activities. The disclosures in sub-paragraphs (d), (e), (f) and (g) should also be restricted so as to relate to the enterprise as a whole, rather than each sub-class of biological asset.

#### **Agricultural produce**

- Q15. Do you agree that agricultural produce should be measured at each balance sheet date at fair value (Principle 17)?*
31. If, as we suggest, the proposals are restricted to long-term agricultural assets and on the basis that the change in fair value is dealt with in the statement of non-owner movements in equity rather than the income statement, we would have no difficulty with this concept. However, as already mentioned, we do not consider that the proposed treatment should be applied to short-term agricultural assets.
32. In any event, there are some cases in which it would be inappropriate to measure agricultural produce at fair value. For such treatment, it must exist separately and be marketable. The example in paragraph 94 is misleading in that, if the unshorn fleece cannot be identified separately and there is no market for it, it should not be recognised as an asset. If it remains within the proposals, paragraph 92 should also be amended to refer to the need for some means of measuring the asset's existence as part of its bearer.

#### **Agricultural land**

- Q16. In land-based agricultural systems, the Steering Committee encourages enterprises to use fair valuation of agricultural land. Given the relationship between agricultural land and biological assets, should this encouragement in fact be a requirement (Principle 21)?*

33. No. We do not support a mandatory requirement to include agricultural land at a fair valuation, as market values often show considerable fluctuations over a relatively short period. However, we believe that it would be appropriate for enterprises to be encouraged to include agricultural land at 'open market value for existing use' which should be periodically updated. We envisage that valuation would be carried out at least every 10 years but we do not consider it necessary for a standard to specify the frequency. 'Alternative use' valuations would not be appropriate and should only be included in financial statements if there is an agreement for disposal or a committed change of use. It would be helpful to clarify that, in the case of a tenant farmer, where the land is rented, changes in value are not relevant to the enterprise.

#### **OTHER MATTERS**

34. Paragraph 17 (c) states that active and efficient markets for produce ensure that willing buyers and sellers have unlimited access. It should be emphasised that, as mentioned in paragraph 17 (d), the existence of government intervention through such devices as tariffs and quota systems, may distort the markets. In Europe, for instance, items such as milk quotas have a significant value and may qualify for treatment as an intangible asset. The proposed definitions of agricultural assets should therefore include licences and quotas of this nature.
35. For the reasons already mentioned, we consider that Principle 12 should exclude short-term consumable and immature products less than 3 years old. It will be necessary to distinguish between forestry and other consumables, which should therefore continue to be included on a historical cost basis. This would thus exclude short-term biological assets from the items set out in Principle 12.

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