

Draft Comment Letter

Comments should be submitted by 14 October 2013 to commentletters@efrag.org

[Date]

International Accounting Standards Board
30 Cannon Street
London EC4M 6XH
United Kingdom

Dear Sir/Madam,

Re: Exposure Draft ED/2013/8 Agriculture: Bearer Plants

On behalf of the European Financial Reporting Advisory Group (EFRAG), I am writing to comment on the Exposure Draft (ED/2013/8) *Agriculture: Bearer Plants* (proposed Amendments to IAS 16 and IAS 41), issued by the IASB on 26 June 2013 (the 'ED').

This letter is intended to contribute to the IASB's due process and does not necessarily indicate the conclusions that would be reached by EFRAG in its capacity as advisor to the European Commission on endorsement of definitive IFRS in the European Union and European Economic Area.

Our detailed comments and responses to the questions in the ED are set out in the Appendix. To summarise,

- EFRAG believes that the IASB should consider broadening the scope of the amendments as this could improve the quality of financial reporting by better reflecting the business model of entities;
- EFRAG agrees that bearer plants before and after maturity should be accounted for under IAS 16 *Property, Plant and Equipment*;
- EFRAG notes also that the growing phase of different bearer plants may differ significantly and therefore recommends, as a practical expedient, to define the maturity date as the date of the first harvest of commercial value; and
- EFRAG thinks that disclosures required by IAS 16 are appropriate for bearer plants and believes that disclosures of non-financial information should not be required in the financial statements.

If you would like to discuss our comments further, please do not hesitate to contact Robert Stojek or me.

Yours faithfully,

Françoise Flores
EFRAG Chairman

APPENDIX

Notes to constituents

- 1 *IAS 41 Agriculture sets out accounting rules for agricultural activities, which are defined as the management by an entity of the biological transformation of living animals or plants (biological assets) into agricultural produce or into new biological assets. The measurement model of that standard was developed based on a single principle that the biological transformation is best reflected by fair value measurement. Therefore, all biological assets, including agricultural produce, regardless of their use and nature, are measured at fair value (less point-of-sale costs). The underlying argument is that fair value changes in biological assets have a direct relationship to changes in expectations of future economic benefits to the entity.*
- 2 *For disclosure purposes however, IAS 41 recognises two types of biological assets – consumable biological assets and bearer biological assets. Consumable biological assets are held to be grown and either sold as biological assets or harvested as biological produce. Bearer biological assets are used to grow other biological assets or agricultural produce. The specific disclosures for bearer biological assets are an acknowledgement of the diverse nature of biological assets.*
- 3 *The single measurement model has been criticised by some standard-setters, investors and other users of financial statements. They argued that bearer biological assets do not undergo further biological transformation, and their use is very similar to the use of plant or machinery.*
- 4 *In November 2011 the Asian-Oceanian Standard-Setters Group (AOSSG) submitted a request to the IASB for a short-term revision of accounting model used for bearer biological assets. The submission was supported with a research paper of the Malaysian Accounting Standards Board (MASB). Even though bearer biological assets are not similar in nature to plant or equipment, the similarities in how they are used, provided support for accounting for them under IAS 16.*
- 5 *The IASB discussed the issue in 2012 and 2013, and on 26 June 2013 it published the Exposure Draft Agriculture: Bearer Plants – Proposed amendments to IAS 16 and IAS 41 (the 'ED') which:*
 - (a) *will apply to bearer plants only;*
 - (b) *will require to account for bearer plants under the cost or revaluation model of IAS 16; and*
 - (c) *will require to account for agricultural produce growing on bearer plants under the fair value model of IAS 41.*

Question 1: Scope of the amendments

The IASB proposes to restrict the scope of the proposed amendments to bearer plants. The proposals define a bearer plant as a plant that is used in the production or supply of agricultural produce, which is expected to bear produce for more than one period and is not intended to be sold as a living plant or harvested as agricultural produce, except for incidental scrap sales.

Under the proposals, if an entity grows plants both to bear produce and for sale as living plants or agricultural produce, apart from incidental scrap sales; it must continue to account for those plants within the scope of IAS 41 at fair value less costs to sell in their entirety (for example, trees that are cultivated for their lumber as well as their fruit).

Do you agree with the scope of the amendments? If not, why and how would you define the scope?

Notes to constituents

6 *The IASB has considered four alternative scopes of the amendment:*

- (a) *biological assets that are used for more than one period:*
 - (i) *only in the production or supply of agricultural produce;*
 - (ii) *that are predominantly used in the production or supply of agricultural produce;*
- (b) *only plants that are used for more than one period:*
 - (i) *only in the production or supply of agricultural produce; and*
 - (ii) *that are predominantly used in the production or supply of agricultural produce.*

The IASB observed that a predominant use model would be more complex to implement, and that applying a cost model to livestock might become too complex. Therefore, the IASB decided that the amendments should apply only to plants that are used for more than one period, and only in the production or supply of agricultural produce (see (b)(i) above).

EFRAG's response

EFRAG believes that the IASB should consider broadening the scope of the amendments as this could improve the quality of financial reporting by better reflecting the business model of entities.

7 The IASB decided to limit the scope of the amendment to bearer plants only, rather than bearer biological assets in general. Paragraphs BC10 to BC15 of the ED note that the scope was reduced due to the anticipated greater difficulty of application (including additional judgement) and complexity that would result from applying of the model to a broader range of biological assets. EFRAG will liaise with the IASB and consult separately to reach its own assessment of those anticipated difficulties.

8 Moreover we think that the IASB has limited the scope of the amendments to bearer plants, without sufficiently exploring the merits that a broader scope could bring, such as:

- (a) Business models involving bearer biological assets are economically similar (regardless of whether they use bearer plants or other biological assets) in that the bearer assets do not undergo further biological transformation and that the entity only sells the produce. Introducing a different accounting treatment for bearer plants reduces comparability of financial information;
 - (b) The scope should rely on the predominant use of the biological assets as this would allow entities to reflect better the economic substance of their activities, as it does not rely on a bright line distinction based on (nearly) exclusive use as a bearer asset.
 - (c) The concerns about the reliability of measurement of fair value apply to all bearer biological assets and not just to bearer plants. Hence, as broader scope of the amendments would be appropriate in their view.
- 9 Finally, EFRAG believes that in reconsidering the scope of the amendments the IASB should specifically take account of fact patterns that involve bearer plants that continue to undergo biological transformation and livestock used for breeding.

Question to constituents

- 10 Do you believe that it is feasible to apply the IAS 16 cost model to bearer biological assets in general? If so, please explain why you believe this does not result in undue complexity.

Question 2: Accounting for bearer plants before maturity

The IASB proposes that, before bearer plants are put into production (i.e. before they reach maturity and bear fruit), they should be measured at accumulated cost. This would mean that bearer plants are accounted for in the same way as self-constructed items of machinery.

Do you agree with this accounting treatment for bearer plants before they reach maturity? If not, why and what alternative approach do you recommend?

Question 3: Accounting for bearer plants before maturity

Some crops, such as the sugar cane, are perennial plants because their roots stay in the ground to give the next period's crop. Under the proposals, if an entity keeps the roots to bear produce for more than one period, the roots would meet the definition of a bearer plant.

The IASB believes that in most cases the effect of accounting for the roots separately under IAS 16 would not be material; and, as a result, the IASB does not believe that specific guidance is required.

Do you think any additional guidance is required to apply the proposals to such perennial crops? If so, what additional guidance should be provided and why?

Notes to constituents

- 11 *The IASB decided to include bearer plants within the scope of IAS 16. The IAS 16 guidance will be used without modification except for paragraph 22A, which should clarify that, 'construction' referred to in IAS 16, should be read as also 'covering activities that are necessary to cultivate bearer plants'.*

EFRAG's response

EFRAG supports the use of an accumulated cost measurement model for immature plants within the limited scope of the amendment.

To avoid divergence in practice, EFRAG recommends, as a practical expedient, to define the maturity date as the date of the first harvest of commercial value.

- 12 EFRAG agrees that active markets for immature plants often do not exist. In addition, we believe that applying to growing plants valuation techniques that rely heavily on unobservable inputs is neither reliable nor useful.
- 13 Consequently, EFRAG agrees with the idea that the IAS 16 cost-accumulation model is more relevant and reliable for immature bearer plants, and will provide useful information.
- 14 EFRAG notes however that the growing phase of bearer plants differs depending on the type of plant and may not be similar at all to the construction phase of property, plant and equipment. Under the IAS 16 guidance, for an item of property, plant and equipment, the process of 'bringing to the location and condition necessary for it to be capable of operating in the manner intended by management' is verified by the test-runs and final approval of management.
- 15 We believe that assessing whether bearer plants are mature is less straightforward, as they mature gradually depending on season, weather and other factors. We also note that some specific bearer plants like the roots of perennial plants (e.g. bamboo, sugar cane and herbs) grow along with the first agricultural produce, and are left behind after the first harvest to allow the agricultural produce to grow back during the following season.
- 16 Absent clear guidance for determining when bearer plants are mature (i.e. the cut-off date for accumulation of direct costs); we believe that there would be considerable scope for divergence in practice. EFRAG therefore recommends, as a practical expedient, to define the maturity date as the date of the first harvest of commercial value. We believe that the practical expedient would ensure consistent application of the standard in practice.

Question 4: Accounting for bearer plants after maturity

The IASB proposes to include bearer plants within the scope of IAS 16. Consequently, entities would be permitted to choose either the cost model or the revaluation model for mature bearer plants subject to the requirements in IAS 16. All other biological assets related to agricultural activity will remain under the fair value model in IAS 41.

Do you agree that bearer plants should be accounted for in accordance with IAS 16?

Why or why not? If not, what alternative approach do you recommend?

Notes to constituents

- 17 *The IASB proposes to require that bearer plants are accounted for under the cost model or the revaluation model of IAS 16 without any significant modifications. The entities may elect to use either the cost or the revaluation model for bearer plants.*

EFRAG's response

EFRAG agrees that mature bearer plants should be accounted for under the cost model or the revaluation model of IAS 16.

- 18 EFRAG agrees with the observations that bearer plants in general after reaching maturity do not undergo further significant biological transformation. We also agree that most bearer plants are used in a way that is very similar to the use of property, plant and equipment.
- 19 Therefore EFRAG supports the IASB proposal to apply the cost model or the revaluation model of IAS 16 to bearer plants that are within the scope of the amendment.
- 20 EFRAG notes also that paragraph 31 of IAS 16 only permits the use of the revaluation model when fair value can be measured reliably. Therefore, EFRAG is satisfied that the proposals in the ED do not raise concerns regarding the reliability of financial information.

Question 5: Additional guidance

The IASB proposes that the recognition and measurement requirements of IAS 16 can be applied to bearer plants without modification.

Are there any requirements in IAS 16 that require additional guidance in order to be applied to bearer plants? If so, in what way is the current guidance in IAS 16 insufficient, and why?

EFRAG's response

EFRAG thinks that additional guidance is required to apply the accounting models of IAS 16 to bearer plants.

- 21 EFRAG believes that the accounting models of IAS 16 can be applied to bearer plants. However, as noted in our responses to Questions 2 and 3 above, there are a number of aspects specific to bearer plants on which the IASB would need to provide additional guidance or clarification.

Question 6: Fair value disclosures for bearer plants

Do you think either of the following types of disclosures about bearer plants should be required if they are accounted for under the cost model in IAS 16 - why or why not:

- (a) disclosure of the total fair value of the bearer plants, including information about the valuation techniques and the key inputs/assumptions used; or
- (b) disclosure of the significant inputs that would be required to determine the fair value of bearer plants, but without the need to measure or disclose the fair value of them?

Notes to constituents

- 22 *Paragraph 79(d) of IAS 16 notes that users of financial statements, when the cost model is used, may find information about the fair value of property, plant and equipment useful when it is differs materially from the carrying amount.*

EFRAG's response

EFRAG thinks that no additional fair value disclosures should be required for bearer plants.

- 23 The current fair value measurement model of IAS 41 has the following shortcomings:
- (a) the fair value of bearer plants is generally determined based on model that require a significant degree of management judgement, as active markets for such assets are not often available;
 - (b) users of financial statements tend to eliminate reported profits and losses related to the fair valuation of bearer plants as, in their opinion, information about operating performance (such as gross margin on sales or asset turnover) and cash flows is much more useful for financial analyses than fair value; and
 - (c) the changes in fair value will never be realised as the bearer plants themselves are generally not sold, except for scrap.
- 24 EFRAG therefore believes that requiring additional disclosures would not be appropriate as this would be inconsistent with the basic premise underlying these amendments. Furthermore, we note that this would not be consistent with the disclosure requirements that apply to other items that are accounted for under IAS 16.

Question 7: Additional disclosures

Many investors and analysts consulted during the user outreach said that instead of using the fair value information about bearer plants they use other information, for example, disclosures about productivity, including age profiles, estimates of the physical quantities of bearer plants and output of agricultural produce. They currently acquire this information via presentations made to analysts, from additional information provided by management in annual reports (for example, in the Management Commentary) or directly from companies.

Do you think any disclosures for bearer plants, apart from those covered in Question 6, should be required in addition to those in IAS 16? If so, what and why?

EFRAG's response

EFRAG thinks that the disclosure of non-financial information should not be required in the financial statements.

- 25 The IASB, in recent discussions relating to Conceptual Framework, considers disclosures as the source of information that should supplement the primary financial statements and that should focus on resources, obligations and other claims of an entity. Such supplementary information may include unrecognised assets, liabilities, claims, risks, and methods, assumptions and judgements that affect amounts presented in the primary financial statements.

- 26 EFRAG agrees that non-financial data, such as age profiles or physical estimates, may be useful for investors and other users of financial statements. However, EFRAG does not agree with the idea that this information should be disclosed in the financial statements of an entity. We also note that there is a potentially infinite range of non-financial metrics and non-GAAP measures that exist about the activities of entities in general. Therefore, we think that general purpose financial statements are not the right place for providing comprehensive information on all aspects of an entity, and that they should concentrate on financial information.

Question 8: Transition provisions

The IASB proposes to permit an entity to use the fair value of an item of bearer plants as its deemed cost at the start of the earliest comparative period presented in the first financial statements in which the entity applies the amendments to IAS 16. The election would be available on an item-by-item basis. The IASB also plans to permit early application of the amendments to IAS 16 and IAS 41.

Do you agree with the proposed transition provisions? If not, why and what alternative do you propose?

Notes to constituents

- 27 *The IASB proposes a full retrospective approach in accordance to IAS 8 Accounting Policies, Changes in Accounting Estimates and Errors for the amended requirements for annual periods beginning on or after the effective date of the amendment. Early application is permitted.*
- 28 *The entities may elect however to measure an item of bearer plants at its fair value and use the fair value as its deemed cost.*

EFRAG's response

EFRAG supports the transitional provisions proposed for the amendment.

- 29 EFRAG supports the retrospective approach as it improves comparability between financial statements.
- 30 Furthermore, we do not object to the option that allows an entity to use fair value as the deemed cost of bearer plants when the amendments are first applied, as this would provide for continuity in the financial statements of the reporting entity (i.e. the opening balance at deemed cost would equal the previously recognised carrying amount of those assets).

Question 9: First-time adopters

The IASB proposes that the deemed cost exemption provided for an item of property, plant and equipment in IFRS 1 *First-time Adoption of International Financial Reporting Standards* should also be available for an item of bearer plants.

Do you agree with the proposed transition provisions for first-time adopters? If not, why and what alternative do you propose?

Notes to constituents

- 31 *Under IFRS 1, a first-time adopter of the amended requirements for bearer plants may elect to measure the deemed cost of any item of bearer plants at its fair value at the date of transition to IFRS.*

- 32 *The entity may also elect to use a previous GAAP revaluation at, or before, the date of transition to IFRSs as deemed cost at the date of revaluation, if the revaluation was, at the date of revaluation, broadly comparable to:*
- (a) *fair value; or*
 - (b) *cost or depreciated cost in accordance with IFRSs, adjusted to reflect, for example, changes in a general or specific price index.*

EFRAG's response

EFRAG supports the deemed cost exemption in IFRS 1 for bearer biological assets.

- 33 EFRAG supports retrospective application of the new requirements for the first-time adopters of IFRS.
- 34 The IASB provides a relief for the first-time adopter using IAS 16. We agree that first-time adopters should be allowed to apply the deemed cost approach to any item of bearer plants at fair value at the date of transition to IFRS.

Question 10: Other comments

Do you have any other comments on the proposals?

- 35 EFRAG does not have any further comments.