



HM TREASURY

Financial Reporting Advisory Board Paper

IAS 41: *Agriculture*

Issue:	The application of IAS 41: <i>Agriculture</i> in the context of resource and other accounts covered by the Government Financial Reporting Manual.
Impact on guidance:	The proposed text in Annex A relates to the shadow FReM.
IAS/IFRS adaptation?	Yes – proposed adaptation to take unrealized gains/losses on changes in fair value to equity
IPSAS compliant?	N/A
Interpretation for the public sector?	No
Impact on budgetary regime?	No
Alignment with National Accounts	Yes
Impact on Estimates?	No
Recommendation:	That the Board agree that IAS 41 applies as adapted.
Timing:	Not yet known: depends on decision on date for moving to EU-adopted IFRS.

DETAIL

Background

1. IAS 41: *Agriculture* was issued in December 2000 and became effective from 1 January 2003.

Objective of IAS 41

2. The objective of IAS 41 is to prescribe the accounting treatment, financial statement presentation and disclosures related to agricultural activity. Agricultural activity is the management by an entity of the biological transformation of biological assets for sale, into agricultural produce, or into additional biological assets.

Scope of IAS 41

3. IAS 41 is applied to account for the following when they relate to agricultural activity;
 - a. Biological assets;
 - b. Agricultural produce at the point of harvest; and
 - c. Government grants related to biological assets.
4. IAS 41 does **not** apply to:
 - a. Land related to agricultural activity (IAS 16 *Property, Plant and Equipment* and IAS 40 *Investment Property*);
 - b. Intangible assets related to agricultural activity, e.g. milk quotas (IAS 38 *Intangible Assets*).

Definitions, Initial recognition and measurement

5. A Biological Asset is a living animal or plant. Agricultural produce is the harvested product of the entity's biological assets.
6. An entity will recognise a biological asset or agricultural produce when, and only when:
 - a. the entity controls the asset as the result of past events;
 - b. it is probable that future economic benefits associated with the asset will flow to the entity; and
 - c. the fair value or cost of the asset can be measured reliably.
7. A biological asset is required to be measured on initial recognition and at each balance sheet date at its fair value less estimated point-of-sale costs, except only on initial recognition, and only if market-determined prices or values are not available, in which case the biological asset is measured at cost less any accumulated depreciation and any accumulated impairment losses.
8. Agricultural produce harvested from an entity's biological assets are measured at its fair value less estimated point-of-sale costs at the point of harvest. Fair value measurement stops at harvest, from which point IAS 2 *Inventories* applies.
9. Point-of-sale costs include commissions to brokers and dealers, levies by regulatory agencies and commodity exchanges, and transfer taxes and duties. Point-of-sale costs exclude transport and other costs necessary to get assets to a market.

Guidance on measurement of fair value

10. IAS 41 provides guidance on the measurement of fair value as follows:

- a. contract prices to sell at a future date are not necessarily relevant in determining the fair value of a biological asset or agricultural produce, because fair value reflects the current market rate in which a willing buyer and seller would enter into a transaction;
- b. if an active market exists for a biological asset or agricultural produce then the quoted market price represents the most reliable basis for determining the fair value of the asset. If an active market does not exist then IAS 41 provides alternatives;
- c. in some circumstances, market-determined prices or values may not be available for a biological asset in its present condition. In these circumstances the present value of expected net cash flows should be used, discounted at a current market-determined pre-tax rate;
- d. cost may sometimes approximate fair value when little biological transformation has taken place since initial cost occurrence, or, the impact of the biological transformation on price is not expected to be material.

Gains and losses

11. A gain or loss on initial recognition of biological assets at fair value, and changes in fair value of biological assets during a period are reported in net profit or loss.

12. A gain or loss arising on initial recognition of agricultural produce at fair value (as a result of harvesting) should be included in net profit or loss for the period in which they occur.

Government grants

13. Unconditional government grants related to a biological asset measured at fair value are reported as income when the grant becomes receivable.

14. Conditional government grants related to a biological asset measured at fair value (including where the grant requires an entity not to engage in certain agricultural activity) are recognised as income only when the conditions have been met.

Other issues

15. Whilst agricultural land is accounted for under IAS 16 *Property, Plant and Equipment*, biological assets that are physically attached to land are measured as biological assets separate from the land, e.g. an entity can use information regarding the combined assets to determine fair value for the biological assets.

16. The fair value less estimated point-of-sale costs of a biological asset can change due to both physical changes and price changes in the market. Separate disclosure of physical and price changes is encouraged, but not required.

Disclosure

17. Disclosure requirements include:

- a. the aggregate gain or loss in the period on initial recognition of biological assets and agricultural produce, and change of fair value in the period;
- b. a description of each group of biological assets (narrative or quantified description);
- c. a description of the nature of the entity's activities involving each group of biological assets, and, non-financial measures or estimates of the physical quantities of each biological group of assets at the end of the period, and of physical quantities of output;
- d. the methods and assumptions applied for determining fair value;
- e. information on the existence and carrying amounts of biological assets whose title is restricted, and the carrying amounts of biological assets pledged as security for liabilities,
- f. the amount of commitments for the development or acquisition of biological assets;
- g. financial risk management strategies related to agricultural activity;
- h. a reconciliation of changes in the carrying amount of biological assets, showing separately changes in value, increases due to purchases, decreases attributable to sales, decreases due to harvesting, increases from business combinations and foreign exchange differences.

18. Disclosure of a quantified description of each group of biological assets, distinguishing between consumable and bearer biological assets, or between mature and immature assets, is encouraged but not required.

19. If fair value cannot be measured reliably, and an entity measures biological assets at cost less any accumulated depreciation and any accumulated impairment losses at the end of the period, then additional required disclosures include:

- a. a description of the biological assets;
- b. an explanation of why fair value cannot be measured reliably;
- c. if possible, the range of estimates within which fair value is highly likely to lie;
- d. the depreciation method used;
- e. the useful lives of the depreciation rates used; and
- f. the gross carrying amount and the accumulated depreciation (aggregated with accumulated impairment losses) at the beginning and end of the period.

20. If the fair value of biological assets previously measured at cost now becomes available, certain additional disclosures are required (IAS 41.56).

21. Disclosures relating to government grants include the nature and extent of the grants, unfulfilled conditions and other contingencies, and significant decreases expected in the level of government grants.

Comparison with requirements under UK GAAP

22. There is no equivalent Standard in UK GAAP for the accounting treatment related to agricultural activity, as defined in IAS 41.

23. As an example of existing practice, presently, the Forestry Commission does not separately account for biological assets (trees). Such biological assets are included within Land values (Forest Estate category), which includes bare land, any trees growing on it and roads, and valued under an Existing Use basis. It should be noted that not all forest owned by a body such as the Forestry Commission is for agricultural activity. Forest held for recreational purposes would fall within IAS 16 *Property, Plant and Equipment*

Impact of IAS 41 on public sector accounts

24. IAS 41 is likely to impact on a small number of entities covered by the requirements of the FReM. IAS 41 does require the separate accounting for agricultural activity as defined by the Standard, where currently entities may not separately account for such items. The Standard also requires the use of fair value measurement, however, this is unlikely to produce materially different results from where an Existing Use basis valuation is used, e.g. in trees harvested for timber.

25. IAS 41 also has significant disclosure requirements, detailed in paragraphs 17-21, which will be a new requirement.

Impact on disclosures in resource and other accounts

26. The presentation and disclosure requirements of IAS 41 will be taken into account in developing the format of resource and other accounts in the light of the move to EU-adopted IFRS and other initiatives.

IAS/IFRS compliance

27. An adaptation to IAS 41 is proposed.

28. Recognition of unrealized gains and losses in the operating cost statement increases the volatility of that statement and does not enhance transparency. Both the Forestry Commission and the Department of Agriculture and Rural Development (NI), whose forest assets are held by their respective agencies, reviewed the potential impact of IAS 41 (unadapted) on their accounts. The latter made the point that under IAS 41 'the OCS would be subject to the volatility of market price. As the biological asset value is five times greater than the Net Operating Cost of (the Forest Service), a movement in asset value would have a disproportionate effect on the OCS.' The Forestry Commission in their reply has echoed this view. They estimated that on an IAS 41 basis there would be an unrealized gain of £30.7m going through their 06-07 accounts, an increase of 123% over forecast income. However, they also made the point that there were significant year-on-year falls throughout the 1990s. Forestry is a cyclical business and it is inevitable that falling markets will be encountered again. This could result in matching losses being recognized in later years on the face of the OCS, and gains and losses occurring within the same Spending Review period.

29. The budgetary impact of **unrealized** gains/losses being sent to the OCS rather than through reserves can be negated by specific budgeting rules for those departments. However, this

undermines the principle of a 'clear line of sight' between the estimating process, resource accounts and national accounts.

30. The Board is therefore asked to consider the proposed adaptation to IAS 41 (set out in Annex A) that a gain on the initial recognition and subsequent changes in fair value of biological assets should be taken to reserves rather than included in net profit or loss for the period in which it arises, unless any loss in value exceeds the amount in the reserve surplus for that same asset (in which case the fall in value shall be recognized as an expense in profit or loss).

31. It is also proposed that IAS 41 needs to be further adapted to consider impairment in line with IAS 36 (as adapted). In line with the Consolidated Budgeting Guidance, where there is a reduction in service potential through consumption of economic benefit (e.g. physical damage) this should be treated as an impairment. A similar adaptation has been proposed for IAS 40 *Investment Property*.

IPSAS compliance

32. No IPSAS has been issued dealing with agricultural activity.

Proposed text for the IFRS-based Government Financial Reporting Manual

33. See Annex A for the proposed amendments to the IFRS-based FReM.

Impact on the budgetary regime

34. The proposal (as adapted) will have no effect on the budgetary regime.

Summary and recommendation

35. IAS 41 prescribes the accounting treatment, financial statement presentation and disclosures relating to agricultural activity. IAS 41 will require entities to separately account for agricultural activity where they may not presently do so, and will impose significant disclosure requirements on entities engaged in agricultural activity as defined by the Standard.

36. The Board is asked to agree to the adoption of IAS 41 as adapted.

HM Treasury

12 February 2007

ANNEX A

PROPOSED TEXT FOR THE IFRS-BASED GOVERNMENT FINANCIAL REPORTING MANUAL

IAS 41: *Agriculture*

Applicability

IAS 41 applies as adapted.

Objective of IAS 41

The objective of IAS 41 is to prescribe the accounting treatment, financial statement presentation and disclosures related to agricultural activity. Agricultural activity is the management by an entity of the biological transformation of biological assets for sale, into agricultural produce, or into additional biological assets.

Adaptation of IAS 41 for the public sector context

The following adaptations apply to entities required to prepare their financial statements in accordance with the guidance in this Manual.

Measurement and recognition

- a) A gain arising on initial recognition of a biological asset at fair value less estimated point-of-sale costs and from a change in fair value less estimated point-of-sale costs of a biological asset shall be credited to equity under the heading revaluation surplus. A loss arising on initial recognition of a biological asset at fair value less estimated point-of-sale costs and from a change in fair value less estimated point-of-sale costs of a biological asset shall be included in profit or loss for the period in which it arises, unless it relates to a revalued asset when it shall be recognized against any revaluation surplus for the asset to the extent that the loss does not exceed the amount in the revaluation surplus for that same asset.
- b) Any reduction in service potential through consumption of economic benefit (e.g. physical damage) or deterioration in the quality of the service provided by the asset should be treated in line with IAS 36 (as adapted).
- c) On subsequent disposal of the asset/produce, any revaluation surplus included in equity shall be transferred to the General fund. The transfer from revaluation surplus to general fund is not made through the operating cost statement.