

DRAFT ENDORSEMENT ADVICE AND EFFECTS STUDY REPORT ON AGRICULTURE: BEARER PLANTS, AMENDMENTS TO IAS 16 AND IAS 41

INVITATION TO COMMENT ON EFRAG'S ASSESSMENTS

Comments should be sent to commentletters@efrag.org by 5 September 2014

EFRAG has been asked by the European Commission to provide it with advice and supporting material on the limited scope amendments to IAS 16 *Property, Plant and Equipment* and IAS 41 *Agriculture* entitled *Agriculture: Bearer Plants* ('the Amendments'). In order to do that, EFRAG has been carrying out an assessment of the Amendments against the technical criteria for endorsement set out in Regulation (EC) No 1606/2002 and has also been assessing the costs and benefits that would arise from its implementation in the European Union (the EU) and European Economic Area.

A summary of the Amendments is set out in Appendix 1.

Before finalising its two assessments, EFRAG would welcome your views on the issues set out below. Please note that all responses received will be placed on the public record, unless the respondent requests confidentiality. In the interest of transparency EFRAG will wish to discuss the responses it receives in a public meeting, so we would prefer to be able to publish all the responses received.

EFRAG initial assessments summarised in this questionnaire will be amended to reflect EFRAG's decisions on Appendix 2 and 3.

1 Please provide the following details about yourself:

- (a) Your name or, if you are responding on behalf of an organisation or company, its name:

Organismo Italiano di Contabilità

- (b) Are you a:

Preparer User Other (please specify)

National Standard Setter

- (c) Please provide a short description of your activity:

Issuing of national accounting standards, participation in the issuing of IAS/IFRS and technical support to international organizations

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(d) Country where you are located:

Italy

(e) Contact details including e-mail address:

presidenza@fondazioneoic.it

2 EFRAG's initial assessment of the Amendments is that they meet the technical criteria for endorsement. In other words, they are not contrary to the principle of true and fair view and they meet the criteria of understandability, relevance, reliability and comparability. EFRAG's reasoning is set out in Appendix 2.

(a) Do you agree with this assessment?

X Yes No

If you do not, please explain why you do not agree and what you believe the implications of this should be for EFRAG's endorsement advice.

(b) Are there any issues that are not mentioned in Appendix 2 that you believe EFRAG should take into account in its technical evaluation of the Amendments? If there are, what are those issues and why do you believe they are relevant to the evaluation?

No, there are not

3 EFRAG is also assessing the costs that are likely to arise for preparers and for users on implementation of the Amendments in the EU, both in year one and in subsequent years. Some initial work has been carried out, and the responses to this Invitation to Comment will be used to complete the assessment.

The results of the initial assessment of costs are set out in paragraphs 2 - 15 of Appendix 3. To summarise, EFRAG's initial assessment is that the Amendments are likely to reduce the ongoing costs for preparers and result in only insignificant one-off implementation costs. Additionally the Amendments are likely to result in

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cost savings that will outweigh any incremental costs incurred by users to incorporate the new requirements in their analysis.

Do you agree with this assessment?

X Yes No

If you do not, please explain why you do not and (if possible) explain broadly what you believe the costs involved will be?

- 4 In addition, EFRAG is assessing the benefits that are likely to be derived from implementing the Amendments. The results of the initial assessment of benefits are set out in paragraphs 16 - 18 of Appendix 3. To summarise, EFRAG's initial assessment is that users are likely to benefit from the Amendments, as the information resulting from them will increase comparability between entities and enhance their analysis. Additionally, both users and preparers will likely to benefit from reduction of ongoing measurement or assessment costs.

Do you agree with this assessment?

X Yes No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

- 5 EFRAG's initial assessment is that the benefits to be derived from implementing the Amendments in the EU as described in paragraph 4 above are likely to outweigh the costs involved as described in paragraph 3 above.

Do you agree with this assessment?

X Yes No

If you do not agree with this assessment, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

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- 6 EFRAG is not aware of any other factors that should be taken into account in reaching a decision as to what endorsement advice it should give the European Commission on the Amendments.

Do you agree that there are no other factors?

X Yes

No

If you do not agree, please provide your arguments and indicate how this should affect EFRAG's endorsement advice?

Appendix 1

A summary of the Amendments

Background

- 1 IAS 41 *Agriculture* has a single accounting treatment for all biological assets within its scope. Based on the principle that their biological transformation is best reflected by fair value measurement, IAS 41 requires all biological assets related to agricultural activities to be measured at fair value less costs to sell. IAS 41 identifies two classes of biological assets – bearer and consumable biological assets – and distinguishes between them for disclosure purposes.
- 2 Since the issuance of IAS 41, concerns have been raised about the application of fair value measurement to bearer plants. These concerns include the following:
 - (a) Constituents have noted the cost, complexity and practical difficulties of fair value measurement of bearer plants in the absence of markets for those assets, and the volatility from recognising changes in the fair value less costs to sell in profit or loss.
 - (b) Mature bearer plants are no longer undergoing significant biological transformation which is the basis in IAS 41 for fair value measurement. Bearer plants are, by definition, used to grow produce over their productive life, a use similar to that of manufacturing assets.
 - (c) Investors, analysts and other users of financial statements frequently adjust profit or loss to eliminate the effects of changes in the fair values of bearer plants as the information is not considered useful.

What has changed?

- 3 The Amendments define a bearer plant as a living plant that is used in the production or supply of agricultural produce, is expected to bear produce for more than one period and has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.
- 4 The Amendments remove bearer plants from the scope of IAS 41 and include them within the scope of IAS 16 *Property, Plant and Equipment*. As a result, issuers can opt for accounting for bearer plants at cost, and fair value measurement is now an option rather than being mandatory.
- 5 Additionally, the Amendments confirm that produce growing on bearer plants is a biological asset and remains within the scope of IAS 41, carried at fair value less costs to sell.

When do the Amendments become effective?

- 6 The Amendments become effective for annual periods beginning on or after 1 January 2016. Earlier application is permitted.
- 7 The Amendments shall be applied by entities retrospectively in accordance with IAS 8 *Accounting Policies, Changes in Accounting Estimates and Errors*. To simplify the transition, an entity may elect to measure an item of bearer plants using deemed cost as its fair value at the beginning of the earliest period presented in the financial statements for the reporting period in which the entity first applies the Amendments.

Appendix 2

EFRAG's Technical assessment of the Amendments against the endorsement criteria

This appendix sets out the basis for the conclusions reached, and for the recommendation made, by EFRAG on the Amendments.

In its comment letters to the IASB, EFRAG points out that such letters are submitted in EFRAG's capacity of contributing to the IASB's due process. They do not necessarily indicate the conclusions that would be reached by EFRAG in its capacity of advising the European Commission on endorsement of the definitive IFRS in the European Union and European Economic Area.

In the latter capacity, EFRAG's role is to make a recommendation about endorsement based on its assessment of the final IFRS or Interpretation against the technical criteria for the European endorsement, as currently defined. These are explicit criteria which have been designed specifically for application in the endorsement process, and therefore the conclusions reached on endorsement may be different from those arrived at by EFRAG in developing its comments on proposed IFRSs or Interpretations. Another reason for a difference is that EFRAG's thinking may evolve.

Does the accounting that results from the application of the Amendments meet the technical criteria for EU endorsement?

- 1 EFRAG has considered whether the Amendments meet the technical requirements of the European Parliament and of the Council on the application of international accounting standards, as set out in Regulation (EC) No 1606/2002, in other words that the Amendments:
 - (a) are not contrary to the principle of 'true and fair view' set out in Article 4(3) of Council Directive 2013/34/EU; and
 - (b) meet the criteria of understandability, relevance, reliability, and comparability required of the financial information needed for making economic decisions and assessing the stewardship of management.
- 2 EFRAG also considered, based only on evidence brought to its attention by constituents, whether it would be not conducive to the European public good to adopt the Amendments.

Relevance

- 3 Information is relevant when it influences the economic decisions of users by helping them evaluate past, present or future events or by confirming or correcting their past evaluations.
- 4 EFRAG considered whether the Amendments would result in the provision of relevant information – in other words, information that has predictive value, confirmatory value or both – or whether it would result in the omission of relevant information.

Accounting for bearer plants as tangible assets, in accordance with IAS 16

- 5 The Amendments replace fair value measurement accounting for bearer plants with the choice of measurement in IAS 16, i.e. bearer plants will be carried either at cost less accumulated depreciation and impairment model or, only if fair value can be measured reliably, at revalued amount less any subsequent depreciation. EFRAG notes that investors and analysts consulted during the outreach activities performed

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by the IASB reported that the fair value information about bearer plants is of limited use to them, because they are expected to be consumed through use and not be sold. In their opinion, information about operating performance and cash flows is in these circumstances more relevant to their analysis. Constituents reported also that fair value information about bearer plants is not seen as useful without fair value information about the related land, land improvements, agricultural machinery or equipment. Additionally, any sales transactions that take place are likely to be of bearer plants plus land, and therefore separate provision of fair values of bearer plants is not considered to be relevant. Consequently, investors and analysts reported they eliminated changes in the fair value less costs to sell of bearer plants from their analysis.

- 6 EFRAG notes that, in the case of mature bearer plants, future economic benefits arise from producing agricultural produce rather than from biological transformation. Moreover, progressive decline in the future earning potential of a bearer plant over its life is similar to other depreciable assets, such as plant and machinery. Additionally, the land upon which bearer plants are growing, the structures used to support their growth and the agricultural machinery are measured in accordance with IAS 16.
- 7 EFRAG thinks that fair value measurement could lead to adjustments that would not be indicative of future economic benefits from use, all the more so in that there are few, if any, market inputs to support those measurements. Consequently, EFRAG believes that the amendment will contribute to more prudent accounting.

Immature bearer plants

- 8 EFRAG notes that immature bearer plants undergo biological transformation and therefore the IAS 41 fair value model could be applied to them. This biological transformation is not necessarily captured under IAS 16, where the costs associated with the biological transformation are generally significantly less than the value of the biological transformation. EFRAG notes that similar differences between cost and value arise under other activities, and this is not generally considered to invalidate the cost method. We therefore think that a cost model for immature bearer plants will provide relevant information for decision-making.

Growing produce

- 9 The Amendments clarify that the produce growing on bearer plants satisfies the definition of a biological asset and therefore should be measured at fair value less costs to sell.
- 10 EFRAG notes that the change resulting from the Amendments is that the growing produce will be measured separately from the bearer plants. Additionally, in the case of growing produce, future economic benefits are generated mainly through biological transformation. We think, therefore, that separate fair value measurement of the growing produce will provide useful and relevant information to users of financial statements about future cash flows that are expected to be realised through sale.
- 11 We acknowledge concerns, raised by some constituents, related to reliability of the fair value measurement of growing produce before harvesting. We note however, that IAS 41 already addresses those cases in paragraphs 30 to 33 and requires the entity to carry such growing produce at cost and to consider IAS 2 requirements.

Summary

- 12 EFRAG's initial assessment is that the Amendments will result in the provision of information that is no less relevant than that required at present and, moreover, they will not result in the material omission of relevant information hitherto provided in accordance with IAS 41. In EFRAG's opinion, therefore, the Amendments satisfy the relevance criterion.

Reliability

- 13 EFRAG also considered the reliability of the information that will be provided by applying the Amendments. Information has the quality of reliability when it is free from material error and bias and can be depended upon by users to represent faithfully what it either purports to represent or could reasonably be expected to represent, and is complete within the bounds of materiality and cost.
- 14 There are a number of aspects to the notion of reliability: freedom from material error and bias, faithful representation, and completeness.
- 15 During the above mentioned outreach, the IASB acknowledged the concerns about relying on the fair value measurements. Constituents reported that valuations involve significant management judgement and that assumptions vary significantly between companies. An active market for separate bearer plants is rare, and observable market prices generally exist only for bearer plants and the associated land and infrastructure. As a result, the amendments contribute to eliminate circumstances in which fair value estimates of bearer plants could lead to under- or over-estimates, due to the absence of objective data. In doing so they will help entities to make reliable and prudent estimates.
- 16 EFRAG notes that the cost model, available in IAS 16, is widely used by entities when applied to recognition and measurement of the infrastructure associated with agricultural activities. This model is also believed to provide reliable information about the land, plant and equipment supporting this type of agricultural activity. Finally, because IAS 41 contains an exception from fair valuation when an entity is unable to measure fair value of biological assets reliably, a number of preparers already have experience in reliably applying the cost model to bearer plants.
- 17 In EFRAG's final comment letter on the Exposure Draft *Bearer Plants*, EFRAG recommended that, in order to avoid divergence in practice, the IASB should introduce a practical expedient and define the maturity date as the date of the first harvest of commercial value. We note the IASB's willingness, having regard to the variety of types of bearer plants, to rely on entities applying judgement in this area and acknowledge that similar judgements in the application of IAS 16 to other classes of property, plant and equipment have not generally been considered to impair reliability.
- 18 EFRAG's overall initial assessment is that the Amendments would raise no concerns about risk of error or bias; and therefore they satisfy the reliability criterion.

Comparability

- 19 The notion of comparability requires that like items and events are accounted for in a consistent way through time and by different entities, and that unlike items and events should be accounted for differently.
- 20 EFRAG has considered whether the Amendments result in:
- (a) transactions that are economically similar being accounted for differently; or

- (b) transactions that are economically different being accounted for as if they are similar.

Two measurement models of IAS 16

- 21 IAS 16 allows entities to choose between a cost model and a revaluation model. EFRAG notes the concerns raised by constituents relating to cost and complexity of fair value measurement under IAS 41. Consequently, EFRAG expects that most entities will apply the cost model to bearer plants and, therefore, that the choice of accounting policy in IAS 16 is not likely to reduce comparability between entities with bearer plants. Even if a bearer plant could be reliably measured at fair value and the entity decides to apply the revaluation model, paragraph 77(e) of IAS 16 requires information on carrying amount that would have been recognised had the bearer plant been carried under the cost model. EFRAG acknowledges also that currently some cost measurements of bearer plants coexist with fair value measurements, in the circumstances where entities have resorted to the fair value measurement exemption for lack of reliability.

Similar use of bearer plants and other items of property, plant and equipment

- 22 EFRAG notes, in regard to the notion of comparability explained in paragraph 19 above, that the similarities in how bearer plants and property, plant and equipment are used provide support for accounting for them in the same way, despite their dissimilar forms. Under IAS 41 before the Amendments, however, bearer plants are measured at fair value, whereas land, land improvements and agricultural machinery used in the production process of agricultural activities are carried at cost less accumulated depreciation and accumulated impairment. In many cases therefore, the Amendments will have the effect of aligning the accounting for bearer plants with the accounting for the infrastructure supporting those plants. Consequently, accounting for the agricultural activity based on bearer plants under IAS 16 will improve comparability between the producing assets of the entity by accounting for similar assets in similar ways.

Dissimilar use of bearer plants and consumable plants

- 23 EFRAG notes, in reference to unlike items mentioned in paragraph 19 above, that the two classes of plants used in agricultural activities – bearer and consumable plants – differ in the way they convert into cash. Fair value captures biological development and is closely aligned with how the entity expects to convert consumable plants to cash (e.g. through sale). However, bearer plants are expected to convert to cash through their production capacity. EFRAG agrees, therefore, that introducing separate measurement models for different classes of biological plants will improve comparability by ensuring that different activities are accounted for differently.

Transitional provisions

- 24 EFRAG notes that any lack of comparability between entities on initial application resulting from the use of fair value as deemed cost by some but not all entities is just as likely to arise from the aggregation of costs incurred at different dates. Furthermore, EFRAG notes that the use of fair value as deemed cost for bearer plants would mean that an entity reported the same cost base as an entity that acquired bearer plants with the same remaining service potential at the date of transition.
- 25 Therefore, EFRAG's initial assessment is that the Amendments satisfy the comparability criterion.

Understandability

- 26 The notion of understandability requires that the financial information provided should be readily understandable by users with a reasonable knowledge of business and economic activity and accounting and the willingness to study the information with reasonable diligence.
- 27 Although there are a number of aspects to the notion of 'understandability', EFRAG believes that most of the aspects are covered by the discussion above about relevance, reliability and comparability.
- 28 As a result, EFRAG believes that the main additional issue it needs to consider, in assessing whether the information resulting from the application of the Amendments is understandable, is whether that information will be unduly complex.
- 29 EFRAG notes that the Amendments do not involve new concepts or notions and does not introduce any new complexities that may impair understandability. On the contrary, the Amendments require the use of the familiar requirements of IAS 16.
- 30 In EFRAG's view, the Amendments do not introduce any new complexities that may impair understandability. EFRAG's overall initial assessment, therefore, is that the Amendments satisfy the understandability criterion in all material respects.

True and Fair

- 31 As explained above EFRAG's initial assessment is that the information resulting from the application of the Amendments meets the qualitative characteristics of relevance, reliability, comparability and understandability that are necessary to comply with the true and fair view principle. More specifically EFRAG in its initial assessment of relevance and reliability has concluded that the amendments would not be contrary to the concept of prudence.

European public good

- 32 EFRAG is not aware of any reason to believe that it is not conducive to the European public good to adopt the Amendments.

Conclusion

- 33 For the reasons set out above, EFRAG's initial assessment is that the Amendments satisfy the technical criteria for EU endorsement and EFRAG should therefore recommend their endorsement.

Appendix 3

EFRAG's evaluation of the costs and benefits of the Amendments

- 1 EFRAG has also considered whether, and if so to what extent, implementing the Amendments in the EU might result in incremental costs for preparers and/or users, and whether those costs are likely to be exceeded by the benefits to be derived from it / their adoption.

Cost for preparers

- 2 EFRAG has carried out an initial assessment of the cost implications for preparers resulting from the Amendments.

One-off implementation costs

- 3 The Amendments require preparers to apply IAS 16 to bearer plants instead of the fair value measurement model of IAS 41.
- 4 EFRAG notes that IAS 16 is well-known and commonly-understood. EFRAG thinks that it is highly likely that the entities required to implement the Amendments already use IAS 16 models for other items of property, plant and equipment related to agricultural activities including land and tools. These entities will be required to adapt IAS 16 to a new class of property, plant and equipment i.e. bearer plants.
- 5 EFRAG acknowledges that entities may be required to capture or track new information for existing bearer plants i.e. the elements of cost including purchase price and the costs attributable to bringing the asset to the location and condition necessary for it to be capable of operating in the manner intended by management. Although, we understand that some entities already collect this information under the IAS 41 exception to fair value model, for other entities establishing systems to collect this information may be costly.
- 6 If bearer plants have long life cycles, entities could be required to look back several decades in order to obtain the necessary information. The amendments, however, permit the use of fair value as deemed cost for existing items of bearer plants at the beginning of the earliest comparative period presented in the financial statements. EFRAG thinks therefore that initial recognition of bearer plants as items of property, plant and equipment will not result in significant initial costs in establishing the cost of existing bearer plants.

Ongoing costs

- 7 The purpose of the Amendments, amongst others, is to address the cost, complexity and relevance of the provided measurement of bearer plants. The Amendments require the application of IAS 16 instead of the mandatory application of fair value measurement. We think that this change will result in a reduction of ongoing costs to measure bearer plants.
- 8 EFRAG notes also that the produce growing on bearer plants, under the requirements of the Amendments, should be carried at fair value less costs to sell. Under IAS 41 before the Amendments, the agricultural produce was carried together with the bearer plants and recognised separately only at the harvest day. EFRAG expects that measuring the produce at fair value less costs to sell would be less complex and costly than measuring the bearer plants and produce together at fair value less costs to sell because the produce is growing on the bearer plants only for a short period; additionally, there is frequently a market for the produce as it nears harvest.
- 9 EFRAG notes that entities that encounter significant practical difficulties on initial measurement of growing produce may meet the requirements of the exemptions in

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paragraphs 10(c) and 30 of IAS 41. Paragraph 10(c) of IAS 41 states that an entity shall recognise a biological asset only when the fair value or cost of the asset can be measured reliably and paragraph 30 of IAS 41 requires a biological asset to be measured using a cost model if fair value measurement is determined to be clearly unreliable.

- 10 We think, therefore, that the Amendments are not likely to result in an increase in the ongoing costs of measurement of the produce growing on bearer plants compared to the previous IAS 41 measurement model.
- 11 Additionally, EFRAG notes that IAS 16 does not prescribe the unit of measure, or the extent to which items can be aggregated and treated as a single item of property, plant and equipment. In consequence, applying the recognition criteria in IAS 16 to bearer plants will give an entity flexibility, depending on its circumstances, to decide how to aggregate individual plants for the purpose of determining a measurable unit of bearer plants.
- 12 Overall, EFRAG's initial assessment is that the Amendments are likely to reduce the ongoing costs for preparers and, generally result in an acceptable level of implementation costs.

Costs for users

- 13 EFRAG has carried out an initial assessment of the cost implications for users resulting from the Amendments.
- 14 EFRAG notes, that during the IASB's outreach, investors and analysts and other users of financial statements asserted that they adjusted the reported profit or loss to eliminate the effects of changes in the fair values of bearer plants. EFRAG thinks that the Amendments will result in direct provision of useful information for decision-making, and in consequence, will result in reduction of on-going costs for preparers.
- 15 Overall, EFRAG's initial assessment is that the Amendments are likely to result in cost savings that will outweigh any incremental costs incurred by users to incorporate the new requirements in their analysis.

Benefits for preparers and users

- 16 EFRAG has carried out an initial assessment of the benefits for users and preparers resulting from the Amendments.
- 17 EFRAG's initial assessment is that both preparers and users are likely to benefit from the Amendments. The Amendments are likely to reduce the ongoing costs of measurement for preparers and the financial information provided by the preparers is likely to be more relevant for decision making by users.
- 18 Overall, EFRAG's initial assessment is users are likely to benefit from the Amendments, as the information resulting from it will increase comparability between entities and be more useful in their analysis. Additionally, users will likely benefit from a reduction in ongoing assessment costs.

Conclusion

- 19 EFRAG notes that constituents raised issues that the costs of measuring bearer plants at fair value are perceived by many preparers to exceed the benefits to users of financial statements.
- 20 EFRAG's overall initial assessment is that the overall benefits of implementation of the Amendments are likely to outweigh costs associated with the implementation.