

STAFF PAPER

November 2012

IFRS Interpretations Committee Meeting

Project	IAS 41 <i>Agriculture</i> and IFRS 13 <i>Fair Value Measurement</i>		
Paper topic	Valuation of biological assets using a residual method		
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This paper has been prepared by the staff of the IFRS Foundation for discussion at a public meeting of the IFRS Interpretations Committee. Comments made in relation to the application of an IFRS do not purport to be acceptable or unacceptable application of that IFRS—only the IFRS Interpretations Committee or the IASB can make such a determination. Decisions made by the IFRS Interpretations Committee are reported in IFRIC *Update*. The approval of a final Interpretation by the Board is reported in IASB *Update*.

Introduction and purpose of this paper

1. In April 2012, the IFRS Interpretations Committee (the Interpretations Committee) received a request seeking clarification on paragraph 25 of IAS 41 *Agriculture*. This paragraph permits the use of a residual method to arrive at the fair value of biological assets that are physically attached to land, if the biological assets have no separate market but an active market does exist for the combined assets.
2. The purpose of this paper is:
 - (a) to provide a summary of the issue, as well as the Interpretations Committee's discussions to date;
 - (b) to report the results of the discussions on IAS 41 at the September 2012 IASB meeting and at the October 2012 IFRS Advisory Council (the Advisory Council) meeting; and
 - (c) to recommend to the Interpretations Committee that it should not add this issue to its agenda (see Appendix A for the proposed wording for the tentative agenda decision).

Summary of the issue

3. Paragraph 25 of IAS 41 addresses the fair value measurement of biological assets that are physically attached to land (emphasis added).

Biological assets are often physically attached to land (for example, trees in a plantation forest). There may be no separate market for biological assets that are attached to the land but an active market may exist for the combined assets, that is, the biological assets, raw land, and land improvements, as a package. An entity may use information regarding the combined assets to measure the fair value of the biological assets.

For example, the fair value of raw land and land improvements may be deducted from the fair value of the combined assets to arrive at the fair value of biological assets.

4. Paragraph 27 of IFRS 13 *Fair Value Measurement* requires that a fair value measurement of a non-financial asset must take into account its highest and best use:

A fair value measurement of a non-financial asset takes into account a market participant's ability to generate economic benefits by using the asset in its *highest and best* use or by selling it to another market participant that would use the asset in its highest and best use.

5. The submitter's concern is that using the fair value of the land (ie based on its highest and best use as required by IFRS 13) in applying the residual method in IAS 41 might result in a minimal or nil fair value for the biological assets when the current use of the land is different from its highest and best use. This causes tension between IAS 41 and IFRS 13 when using the residual method.
6. According to the submitter, there are mixed views in their jurisdiction on the application of paragraph 25 of IAS 41. Some think that the value of raw land to be deducted from the fair value of combined assets should be the value of the land in its current use. Others think that the value of raw land should be its fair value, which would reflect the land's highest and best use in accordance with IFRS 13.

Interpretations Committee's discussions to date

7. The Interpretations Committee first discussed this issue at its May 2012 meeting¹, with the May 2012 IFRIC *Update*² reporting (excerpted) that:

The Committee observed that it is unlikely that the residual method will be appropriate if it returns a nil or minimal value for the biological assets.

The Committee decided not to propose an amendment to IFRSs in respect of this issue, and asked the staff to bring back proposed wording to the next meeting for a tentative agenda decision.

8. At its September 2012 meeting, the Interpretations Committee discussed the proposed wording for its tentative agenda decision prepared by the staff³, but decided to await the results of the IASB's discussions on IAS 41 before it issued a tentative agenda decision on this issue. Below is an excerpt from the September 2012 IFRIC *Update*⁴:

The Interpretations Committee observed that, in the situation submitted, the land in the asset group would provide maximum value to market participants on a stand-alone basis and used in a manner different from its current use (ie if it were used at its highest and best use). The valuation premise in IFRS 13 requires that the fair value of the other assets within the asset group, including biological assets and land improvements, must also reflect their use on a stand-alone basis because on that basis the asset group as a whole provides maximum value to market participants. Consequently, the fair value of the biological assets might be minimal or nil when the residual method is used. However, the Interpretations Committee also noted that IAS 41 does not require the use of the residual method.

The Interpretations Committee noted that the IASB will discuss at its September 2012 meeting whether to add a limited-scope project on IAS

¹ Agenda Paper 13 <http://www.ifrs.org/Meetings/Pages/IFRSInterMay12.aspx>

² <http://www.ifrs.org/Updates/IFRIC-Updates/Documents/IFRICUpdateMay12.pdf>

³ Agenda Paper 7 <http://www.ifrs.org/Meetings/Pages/IFRSInterSept12.aspx>

⁴ <http://media.ifrs.org/IFRICUpdateSep12.pdf>

41 for bearer biological assets to its technical agenda. Consequently, the Interpretations Committee decided to await the results of the IASB's discussions before the Interpretations Committee issues a tentative agenda decision on this issue.

The staff will inform the Interpretations Committee of the results of the IASB's discussions at the November Interpretations Committee meeting so that the Interpretations Committee can decide how to finalise this issue.

Discussions on IAS 41 at the September IASB meeting

9. At its September 2012 meeting⁵, the IASB confirmed its intention to add a limited-scope project on bearer biological assets to its agenda, with the September 2012 IASB *Update*⁶ reporting that:

At the May 2012 meeting, the IASB decided to give priority to developing a proposal to amend IAS 41 for bearer biological assets. This was in response to comments received on the IASB's Agenda Consultation. Most respondents who mentioned agriculture, especially those in the plantation industry, asked the IASB to undertake a limited-scope project to address concerns they have in relation to bearer biological assets.

Consequently, at the September 2012 meeting, the IASB staff presented a proposal recommending that the IASB should add a limited-scope project on bearer biological assets to its agenda. All IASB members supported undertaking such a project. The proposal, and the IASB's tentative decision, will be discussed at the next meeting of the IFRS Advisory Council.

The IASB was also provided with a staff analysis of the main issues that will need to be addressed by the project, including the preference

⁵ Agenda paper 13 <http://www.ifrs.org/Meetings/Pages/IASB-September-2012.aspx>

⁶ <http://media.ifrs.org/IASBSep2012.html#IAS-41>

expressed by respondents to the Agenda Consultation that mature bearer biological assets should be accounted for in accordance with the requirements in IAS 16 *Property, Plant and Equipment* rather than IAS 41. The IASB noted the analysis but did not make any decisions.

Next steps

The IASB will start discussing the issues listed in the proposal in forthcoming meetings. The proposal will also be presented in October 2012 to the IFRS Advisory Council.

Discussions on IAS 41 at the October IFRS Advisory Council meeting

10. The IASB staff asked the Advisory Council at its October 2012 meeting to provide comments on the IASB's decision to add a limited-scope project on IAS 41 for bearer biological assets to the IASB's technical agenda. There was strong support from the Advisory Council for undertaking the project and developing an Exposure Draft.
11. According to the staff paper⁷ for that meeting, the project is estimated to be completed fairly quickly. The main milestones include June 2013 for publication of the Exposure Draft, first quarter 2014 for publication of final revisions to IAS 41 and year 2015 for the effective date of the revisions.

⁷ Agenda Paper 2 and 2a

<http://www.ifrs.org/Meetings/Pages/IFRS-Advisory-Council-Meeting-October-2012.aspx>

Staff analysis

12. IAS 41 distinguishes between bearer and consumable biological assets for disclosure purposes, although IAS 41 has a single accounting treatment for both biological assets. Paragraph 44 of IAS 41 states:

Consumable biological assets are those that are to be harvested as agricultural produce or sold as biological assets. Examples of consumable biological assets are livestock intended for the production of meat, livestock held for sale, fish in farms, crops such as maize and wheat, and trees being grown for lumber. Bearer biological assets are those other than consumable biological assets; for example, livestock from which milk is produced, grape vines, fruit trees, and trees from which firewood is harvested while the tree remains. Bearer biological assets are not agricultural produce but, rather, are self-regenerating.

13. As mentioned in this paper, the IASB has tentatively decided to undertake a limited-scope project on *bearer* biological assets. The biological assets specified in the submission to the Interpretations Committee are biological assets that are physically attached to land. We think that there are two types of biological assets that are physically attached to land:

- (a) bearer biological assets (eg grape vines); and
- (b) consumable biological assets (eg timber).

14. If the IASB decides to propose an amendment to IAS 41 to require that *bearer* biological assets shall be measured in accordance with IAS 16 *Property, Plant and Equipment*, an entity will not need to measure the fair value of bearer biological assets that are physically attached to land if the entity chooses the cost model. We acknowledge that fair value will still be required in some situations (eg when the entity compares the carrying amount and the recoverable amount⁸ of the biological assets to recognise and measure an impairment loss).

⁸ IAS 36 *Impairment of Assets* defines recoverable amount as the higher of an asset's or cash-generating unit's fair value less costs of disposal and its value in use.

15. However, the fair value of consumable biological assets that are physically attached to land will need to be measured irrespective of the amendments to IAS 41. Our understanding is that the fair value measurement of such biological assets is relatively straight-forward. They generally get separated from the land when being sold in the principal (or most advantageous) market, which indicates that they derive a higher value when being used on a stand-alone basis⁹.
16. Consequently, we think that the IASB's decision to proceed with the IAS 41 project would likely lead to *bearer* biological assets physically attached to land being measured using the cost model in IAS 16. And it is our understanding from our discussions with valuation professionals that the fair value measurement of *consumable* biological assets physically attached to land is not problematic currently.
17. However, the issue still remains, albeit less frequently, as to how to measure a biological asset attached to land when the highest and best use of the land is not its current use and the use of the residual method leads to a minimal or nil fair value for the biological asset.
18. We presented two views to the Interpretations Committee at its September meeting. One view is that recognising a minimal or nil fair value of biological assets under the residual method would provide useful information to investors about management's use of the entity's resources. Another view is that the results obtained from using the residual method is not appropriate if that method returns a minimal or nil fair value for the biological assets. The Interpretations Committee members had mixed views as to which would be a reasonable interpretation of the interaction between IFRS 13 and IAS 41.
19. In our view, this issue is broader than just for biological assets and is about the application of the valuation premise for all non-financial assets when the highest and best use of an asset (such as land) within an asset group is not its current use.

⁹ For example, trees grown for timber are likely to generate higher cash flows when they are separated from the land than when they are planted in the land (although cutting down the tree changes the characteristics of the tree and the costs of converting it to the alternative use as timber would be taken into account).

20. We think that the fact that the Interpretations Committee discussed this issue twice (in May and September) but has not reached a consensus indicates that there needs to be more guidance on applying the highest and best use concept in IFRS 13. We have discussed this issue with the IASB's fair value measurement project team and they informed us that they plan to develop a chapter on highest and best use in the IFRS 13 educational material in the future.

Staff recommendation

21. On the basis of the analysis above and our discussions with the fair value measurement project team, we recommend to the Interpretations Committee that it should not add this issue to its agenda and issues a tentative agenda decision. Proposed wording for the tentative agenda decision is in Appendix A of this agenda paper.

Question for the Interpretations Committee

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Does the Interpretations Committee agree with the staff recommendation and the proposed wording for its tentative agenda decision?

Appendix A—Proposed wording for tentative agenda decision

IAS 41 *Agriculture* and IFRS 13 *Fair Value Measurement*—Valuation of biological assets using a residual method

The IFRS Interpretations Committee (the Interpretations Committee) received a request seeking clarification on paragraph 25 of IAS 41. This paragraph permits the use of a residual method to measure the fair value of biological assets that are physically attached to land, if the biological assets have no separate market but an active market exists for the combined assets.

The submitter's concern is that using the fair value of the land (ie based on its highest and best use as required by IFRS 13) in applying the residual method in IAS 41 might result in a minimal or nil fair value for the biological assets when the current use of the land is different from its highest and best use.

The Interpretations Committee noted that the IASB has tentatively decided to undertake a limited-scope project on IAS 41 to address the accounting for bearer biological assets. The Interpretations Committee also noted that guidance on the application of highest and best use concept in IFRS 13 will form part of the educational material for IFRS 13.

Consequently, the Interpretations Committee [decided] not to take this issue onto its agenda.