Project	***Annual Improvements* Project – 2010 - 2012 cycle**
Topic	**IAS 41 *Agriculture* – Illustrative Examples - presentation of revenue in the profit or loss account**

Purpose of this paper

1. The purpose of this paper is to present for discussion a request received by the IFRS Interpretations Committee to clarify the disclosure requirements as reflected in Illustrative Example 1 of IAS 41 *Agriculture*.
2. This paper:
   (a) Provides background information on the issue;
   (b) Analyses the issue within the context of IFRSs;
   (c) Makes a staff recommendation an assessment of the proposed amendment against the criteria for inclusion in *Annual Improvements*; and
   (d) Asks the Interpretations Committee whether they agree with the staff recommendation.

The issue

3. The submission (to be found in Appendix A) asserts that the Illustrative Example 1 of the standard is unclear in its presentation in the Statement of comprehensive income, and that this lack of clarity has resulted in divergence in practice. The staff understand from the submission that constituents following

the example may omit revenue from their Statement of comprehensive income, and that there may be confusion around separating out revenue and fair value movements.

4. The submission requests that the Committee consider amending the example referred to above to clarify the presentation required (its suggested amendment to the Statement of comprehensive income can be found in Appendix A).

Staff analysis and view

5. IAS 41 prescribes the accounting treatment for biological assets (a living animal or plant)[1] during the process of biological transformation (processes of growth, degeneration, production and procreation)[1] and for the initial measurement of agricultural produce (the harvested product of the entity's biological assets)[1] at the point of harvest.

6. It prescribes principles for recognition and measurement of biological assets and agricultural produce, and accounting of the associated gains and losses that arise as a result (inter alia). It *does not apply* to the processing and eventual sale of agricultural produce after the point of harvest, nor the sale of biological assets. It states that the principles in other relevant IFRS standards should be applied in this regard[2].

7. Paragraph A1 and A2 of the Illustrative examples state the following in respect of Example 1:

> 'A1 Example 1 illustrates how the disclosure requirements of this Standard might be put into practice for a dairy farming entity. This Standard encourages the separation of the change in fair value less costs to sell of an entity's biological assets into physical change and price change. That separation is reflected in Example 1.
>
> A2 The financial statements in Example 1 do not conform to all of the disclosure and presentation requirements of other Standards. Other approaches to presentation and disclosure may also be appropriate.'

[1] IAS 41 paragraph 5

[2] IAS 41 paragraph 3

8. The staff think that Example 1 was not intended to be a complete illustration of the presentation and disclosure of all the figures included in the example. It was trying to achieve a specific objective, as stated in paragraph A2, above.

9. However, the submission asserts that the example is being used by constituents as something more complete than intended, and diversity is resulting in the way the principles of IAS 41 are applied.

10. The staff think that there is insufficient information provided in Example 1 for consistent guidance to be drawn from it. The staff therefore suggest the following possible courses of action:

    (a) Remove the example from the Standard altogether,

    (b) Strengthen the caveat worded in paragraph A2, to (i) highlight that the example should not be used as a complete illustration of presentation and disclosure, and (ii) specify that it does not illustrate the disclosure of revenue from the sale of agricultural produce, as required by IAS 18 *Revenue*, or

    (c) Re-work the example to provide a fact pattern upfront and more complete presentation and disclosure.

11. The staff think that option (a) above may not be helpful to constituents, since constituents seem to be using the example.

12. Option (b) would not improve the completeness of the information provided in the example, but it may encourage constituents to use the example in the manner it was intended, or not use it at all. This may reduce the current diversity in practice.

13. The staff think that reworking the example to provide support to the principles of IAS 41 (option (c) would not be an efficient way of reducing the reported diversity in practice. IAS 41 is narrowly scoped. It deals with particular aspects of Agriculture, and it refers the reader to other IFRSs for guidance on more

generic matters such as accounting for land, intangible assets, inventories and revenue.

14. The staff think that Example 1 was designed to illustrate specific principles in the standard, hence paragraphs A1 and A2 were included. It was not intended to be complete. The staff think that reworking the example to provide a complete fact pattern, and full presentation and disclosure of all the figures included in the fact pattern may be at odds with the narrow scope of the standard. Also, the staff think that such a task would not provide a benefit worthy of the effort involved.

Staff recommendation

15. The staff recommend option (b) be followed, subject to the successful assessment of the proposed amendment against the proposed *Annual Improvements* criteria – see analysis below.

Annual Improvements criteria assessment

Assessment against the proposed new criteria

16. The IFRS Foundation has exposed for public comments proposed enhanced criteria for issues to be included in *Annual Improvements* as part of an amendment to the Due Process Handbook. The comment period ends 30 November 2010.

17. The staff proposes an assessment of the inclusion of the issue against the proposed enhanced criteria reproduced in full below. Note that all criteria (a)-(d) must be met to qualify for inclusion in annual improvements:

Proposed new criteria	Staff assessment of the proposed amendment
(a) The proposed amendment has one or both of the following characteristics: (i) clarifying—the proposed amendment would improve IFRSs by:	Amending paragraph A2 will address an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. It will achieve this by confirming in paragraph A2 the intention behind Example 1,

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• clarifying unclear wording in existing IFRSs, or • providing guidance where an absence of guidance is causing concern. A clarifying amendment maintains consistency with the existing principles within the applicable IFRSs. It does not propose a new principle, or a change to an existing principle. (ii) correcting—the proposed amendment would improve IFRSs by: • resolving a conflict between existing requirements of IFRSs and providing a straightforward rationale for which existing requirement should be applied, or • addressing an oversight or relatively minor unintended consequence of the existing requirements of IFRSs. A correcting amendment does not propose a new principle or a change to an existing principle, but may create an exception from an existing principle.	and that Example 1 was not intended to include a complete set of financial statements. a
(b) The proposed amendment has a narrow and well-defined purpose, ie the consequences of the proposed change have been considered sufficiently and identified.	(b) The staff think the proposed amendment has a narrow and well-defined purpose – it is limited to entities engaged in agricultural activity, as envisaged in IAS 41. No consequential amendments are considered necessary.
(c) It is probable that the IASB will reach conclusion on the issue on a timely basis. Inability to reach agreement on a timely basis may indicate that the cause of the issue is more fundamental than can be resolved within annual improvements.	(c) The staff think that if the Interpretations Committee reach a conclusion on a timely basis, it is likely that the Board will do the same.
(d) If the proposed amendment would amend IFRSs that are the subject of a current or planned IASB project, there must be a pressing need to make the amendment sooner than the project would.	(d) There is no current or planned Board project to review IAS 41.

18. Following the analysis in the table above, in the staff's opinion, the proposed amendment satisfies the *Annual Improvements* criteria. The staff have included the proposed amended wording in Appendix A.

Questions for the Committee
1. Does the Committee agree with the staff's recommendation to amend the wording of paragraph A2 of IAS 41? 2. Does the Committee agree with the inclusion of the proposed amendment in the Annual Improvements cycle for 2010-2012? 3. Does the Committee have any comments on the proposed amendment in Appendix A?

Appendix A – Draft amendment to IAS 41 *Agriculture*

A1 This appendix includes drafting of the proposed amendment. It is based on the text included in the most recently issued standards (including the *Improvements to IFRSs* issued in May 2010). New text is underlined and deleted text is struck through.

Proposed amendment to IAS 41 *Agriculture*

Paragraph A2 is amended (new text is underlined).

Illustrative examples

These examples, which were prepared by the IASC staff but were not approved by the IASC Board, accompany, but are not part of, IAS 41. They have been updated to take account of the changes made by IAS 1 Presentation of Financial Statements *(as revised in 2007) and* Improvements to IFRSs *issued in 2008 <u>and 2012</u>.*

A1 Example 1 illustrates how the disclosure requirements of this Standard might be put into practice for a dairy farming entity. This Standard encourages the separation of the change in fair value less costs to sell of an entity's biological assets into physical change and price change. That separation is reflected in Example 1. Example 2 illustrates how to separate physical change and price change.

A2 The financial statements in Example 1 do not conform to all of the disclosure and presentation requirements of other Standards<u>, and should not be considered an illustration of a complete set of financial statements</u>. Other approaches to presentation and disclosure may also be appropriate. <u>For example, it does not illustrate the disclosure of revenue from the sale of agricultural produce, as required by IAS 18 *Revenue*.</u>

Basis for Conclusions on proposed amendment to IAS 41 *Agriculture*

This Basis for Conclusions accompanies, but is not part of, the proposed amendment.

Changes as a result of *Improvements to IFRSs* (2012)

BC1 The Board noted that Example 1 of the Illustrative examples that accompany IAS 41 was resulting in diversity in practice, as constituents were applying the illustration more broadly than it was intended to be applied. Example 1 was intended to illustrate the specific principles as presented in IAS 41, and it was not intended to include a complete set of financial statements.

Therefore, as part of *Improvements to IFRSs* issued in [month] 2012, the Board decided to amend the wording in paragraph A2, to clarify that the intention behind Example 1.

Appendix B – Request for inclusion in the *Annual Improvements* project

IAS 41 IE #1
Edits to illustrative example #1

B1 We have observed different interpretations of the presentation of revenue and changes in fair value of biological assets on the face of the Statement of comprehensive income based on illustrative example #1. The illustrative example #1 in IAS 41 uses the example of a dairy farm and has the following two lines of fair value gains:

a. Fair value of milk produced; and
b. Gains arising from changes in fair value less estimated point-of-sale costs of dairy livestock;

B2 Some observations on the illustrative example are:

a. There is no revenue line item in the Income Statement. We believe that this could be potentially misleading for the preparers that would assume that no revenue has to be recorded for the sale of biological assets and agricultural produce.
b. The largest amount represents the “fair value of milk produced”, which could be interpreted as either the result of the initial recognition in inventories or the sale of agricultural produce. We believe the Board’s intention was that this line was deemed to reflect the amount of revenue from sales of the milk produced. We think it would be helpful to describe this line as revenue.
c. We believe the example could be clearer in demonstrating that revenue could arise both from sale of agricultural produce and from sale of the biological assets. This change would be particularly beneficial in other industries that have as main activity the sale of the biological asset.
d. In note 3 of the illustrative example, there is a reduction due to sales in the reconciliation of the biological assets balance. We are unsure why this amount does not appear in the income statement.

B3 See [below] for proposed edits to the Statement of comprehensive income in illustrative example #1 [amended text is struck through and new text underlined].

Statement of comprehensive income

XYZ Dairy Ltd **Statement of comprehensive income**	**Notes**	**Year ended 31 December 20X1**
~~Fair value of milk produced~~		~~518,240~~
Sales of agricultural produce (milk)		218,120
Sales of biological assets (dairy livestock)		124,800
Fair value gains on initial recognition of milk produced		75,320
Gains arising from changes in fair value Less costs to sell of dairy livestock	3	39,930
		558,170
Inventories used		(137,523)
Staff costs		(127,283)
Depreciation expenses		(15,250)
Other operating expenses		(197,092)
		(477,148)
Profit from operations		**81,022**
Income tax expense		(43,194)
Profit/comprehensive income for the year		**37,828**