South African Institute of Taxation

Specialised Activities

Getting to grips with Section 34 of the IFRS for SMEs dealing with "Agriculture"

YOUR KEY TO THE TAX COMMUNITY

Welcome to today's session!

Accounting for **agricultural activities** per **Section 34 *Specialised Activities*** in the **IFRS for SMEs**

Agenda – points to cover in the webinar

1. Scope of Section 34
   a) Some important definitions to note
2. Agriculture – accounting policy choice
3. Principles of recognition
4. Principles of measurement
   a) Fair value model
   b) Cost model
5. Products resulting from processing agricultural produce
6. Concluding examples

Some important definitions

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.

Agricultural produce is the harvested product of the entity's biological assets.

Biological assets are living animals or plants.

Inventories are assets:

- Held for sale in the ordinary course of business;
- In the process of production for such sale; or
- In the form of materials or supplies to be consumed in the production process or in the rendering of services.

Agriculture
Section 34 Scope

An entity engaged in agricultural activity, shall determine its accounting policy for each class of its biological assets as follows:

a) The entity shall use the **fair value** model for those biological assets for which fair value is readily determinable without undue cost or effort; and

b) the entity shall use the **cost model** for all other biological assets.

It is therefore clear that the fair value model is the preferred measurement.

Scope determination
Example 1 – scope

An entity operates a vineyard, cultivating grapevines to supply wineries with grapes for wine production. As of December 31, 2023, the entity's statement of financial position includes various assets related to its viticultural activities. These assets consist of:

- specialised grape harvesting equipment,
- agricultural software for managing vineyard operations, and
- a designated parcel of land with 5 000 grapevines.

Scope determination
Example 1 – application

Given the nature of its business, the entity falls under the scope of *agricultural activities*, specifically pertaining to the grapevines. These grapevines are considered biological assets, being **living plants** subject to the biological transformation leading to the production of grapes for sale.

Consequently, the entity follows the accounting principles outlined in Section 34 of the IFRS for SMEs to appropriately account for the grapevines.

Scope determination
Example 1 – application

However, certain assets associated with the vineyard are **not classified as biological assets** and are **accounted for differently**. For instance:

- The specialised grape harvesting equipment is accounted for in accordance with Section 17 *Property, Plant and Equipment*.
- The parcel of land is also accounted for under Section 17, and if it is subject to leasing arrangements, Section 20 *Leases* is applied.
- The agricultural software used to manage vineyard operations is accounted for in accordance with Section 18 *Intangible Assets Other Than Goodwill*.
- Furthermore, the harvested grapes are recognised and accounted for after initial recognition following the guidelines provided in Section 13 *Inventories*.

This approach ensures that each category of asset receives appropriate accounting treatment based on its nature and purpose within the entity's overall viticultural operations.

Scope determination
Example 2 – scope

An entity provides security services to local businesses. The security services deploys **guard dogs** and their handlers at the clients' premises. The guard dogs are purchased by the entity when they are puppies and are trained by the handlers who are employees of the entity.

Scope determination
Example 2 – application

Although the guard dogs are biological assets (living animals), the entity **does not account for them** in accordance with Section 34, because it is not engaged in agricultural activity (they are not breeders, managing the biological transformation of the dogs for additional biological assets). The dogs are property, plant and equipment and are accounted for in accordance with Section 17 of the IFRS for SMEs.

The salary payable to the dog handlers as they perform services for the entity constitutes employee benefits. The entity accounts for those benefits in accordance with Section 28 *Employee Benefits*.

Agriculture
Principles of recognition

An entity shall recognise a biological asset or agricultural produce when, and only when:

- The entity **controls** the asset as a result of past events;
- It is **probable** that future economic benefits associated with the asset will flow to the entity; and
- The **fair value or cost** of the asset can be measured reliably without undue cost or effort.

Agriculture
Principles of measurement (fair value)

Biological assets (living plants/animals)

- An entity shall measure a biological asset on initial recognition and at each reporting date at its fair value less costs to sell.
- Changes in fair value less costs to sell are recognised in profit or loss.

Agricultural produce (harvested from an entity's biological assets)

- Shall be measured at its fair value less costs to sell at the point of harvest.
- Such measurement is the cost at that date when applying Section 13 *Inventories* or any other applicable section of the IFRS for SMEs.

Agriculture
Principles of measurement (fair value)

How is fair value determined?

If an active market exists for a biological asset or agricultural produce in its present location and condition, the quoted price in that market is the appropriate basis for determining the fair value of that asset.

If an active market does not exist, an entity uses one or more of the following, when available, to determine fair value:

- The most recent market transaction price (provided there has not been a significant change between the transaction date and the reporting date);
- Market prices for similar assets with adjustments to reflect differences; and
- Sector benchmarks such as the value of an orchard expressed per export tray, bushel or hectare and the value of cattle expressed per kilogram of meat.

Agriculture
Principles of measurement (fair value)

What if there are differences between fair value in an active market vs where an active market does NOT exist?

The entity should consider the **reasons** for those differences, to arrive at the most reliable estimate of fair value within a relatively narrow range of reasonable estimates.

What if no markets exist, but the fair value can be determined without incurring undue cost or effort, especially for biological assets?

The entity shall consider whether the **present value** of expected **net cash flows** from the asset discounted at a **market determined rate** results in a reliable measure of fair value.

Agriculture
Principles of measurement (cost)

Biological assets

- An entity shall measure at cost less any accumulated depreciation and any accumulated impairment losses those biological assets whose fair value is *not readily determinable* without incurring undue cost or effort.

Agricultural produce harvested from an entity's biological assets

- Shall be measured at its fair value less *estimated* costs to sell at the point of harvest.
- Such measurement is the cost at that date when applying Section 13 *Inventories* or any other applicable section of the IFRS for SMEs.

Agriculture
Example 3 – accounting policy choice

An entity cultivates a wide variety of species of slow-growing softwood timber trees in 'natural' forests. The growth cycles of the species range from 10 to 20 years and because of the unique and varied topography of the entity's forests, the growth cycles for individual species vary considerably. The entity is the only entity that cultivates timber in the jurisdiction in which it operates.

The entity manages and maintains its forests by planting saplings (grown in its nursery) to replace harvested trees, nurturing the growth of saplings and removing invasive alien plant species. This optimises timber growth and maintains the integrity of the forest. The entity classifies its softwood timber into two classes: **mature** (five years or older) and **immature** (four years or younger).

The entity harvests trees when they reach harvesting age. The harvested timber (logs) is sold in international timber markets. There is an active market for all of the types of timber that are harvested by the entity.

For each species that the entity harvests from the forest, the entity maintains detailed management records of growth rates, costs to maintain the nursery, planting costs, maintenance costs, felling costs and costs of transporting the logs to market. Based on these historical records, that have been adjusted for recent trends, management forecasts expected future income and expenses by species of tree harvested. In addition, the forecasts help management to determine which species it should propagate and manage for harvest in the future.

Agriculture
Example 3 – application

The entity is engaged in agricultural activity, as defined in the *IFRS for SMEs*.

An **active market** does not exist for the entity's standing softwood **biological assets** in their present location and condition.

However, this does not necessarily mean that the fair value of the standing softwood biological assets cannot be readily determined without undue cost or effort. Consequently, the absence of such an active market does not automatically result in the entity applying the cost model to account for the entity's standing softwood biological assets.

The entity's management must apply its judgement to determine whether the fair value of the entity's standing softwood biological assets can be readily determined without undue cost or effort. In making that judgement, management would consider whether fair value could be measured without undue cost or effort other than by reference to an active market for the entity's standing softwood biological assets in their present location and condition.

For example, management would evaluate whether a reliable measure of fair value is readily determinable without undue cost or effort by reference to the present value of the expected net cash flows from the asset, discounted at a current market-determined rate. In this example, management appears already to have obtained relevant sector benchmarks for management purposes, such as the current market price of harvested logs for each type of softwood under cultivation, as well as many of the inputs required to measure the present value of the expected net cash flows from its standing softwood biological assets (i.e., management has forecasts of expected future income and expenses by species of tree harvested). If the only additional information that is needed to measure fair value is the discount rate to be applied to the forecast cash flows, management will likely assert that fair value is readily determinable without undue cost or effort.

Agriculture

Products resulting from processing agricultural produce

Section 34 *Biological assets*	Section 34 *Agricultural produce*	Section 13/another section *Products that are the result of processing agricultural produce*
Sheep	Sheared wool	Yarn, carpet
Trees in a plantation forest	Felled trees	Logs, lumber
Plants	Harvested cotton	Thread, clothing
	Harvested cane	Sugar, alcohol
Dairy cattle	Milk	Cheese, butter
Pigs	Carcasses	Sausages, cured hams
Bushes	Picked leaves	Tea, cured tobacco
Vines	Picked grapes	Wine, juice, raisins
Fruit trees	Picked fruit	Processed fruit
Cacao trees	Harvested cacao pods and beans	Chocolate liquor, chocolate

Agriculture
Example 4 – cattle farming

An entity in South Africa engages in cattle farming for the fresh meat industry. It slaughters its cattle and processes the meat into cuts before selling to meat wholesaler customers. The entity's statement of financial position at 31 December **2022** reported cattle at their fair value less costs to sell of R10 000. At 31 December **2023**, when the fair value less costs to sell of the entity's herd is R15 000, the entity slaughtered 40% of its herd (10 cattle) incurring slaughter costs of R50. The quoted price of a carcass is R700, with estimated costs to sell at R2 per carcass. On 31 December 2023, the entity also incurs R300 in direct costs for processing the carcasses into meat cuts ready for sale.

For simplicity, the entity does not sell hide, bone, or any other component of the cattle, only the meat. Slaughtering costs are recognised as an expense as they are incurred, and Section 34 does not specify the treatment of these costs.

Agriculture
Example 4 – application

At **31 December 2023**, the entity should:

1. Measure the cattle at R15 000:

- Dr Biological assets carried at fair value through profit or loss: cattle	R5 000	
- Cr Fair value gain (biological assets) (P/L)		R5 000

- *To recognise the increase in fair value of the entity's cattle.*

2. Recognise R50 of Slaughter Costs:

- Dr Slaughter expenses (P/L)	R50	
- Cr Bank		R50

- *To recognise the costs of harvesting, i.e., slaughter (not a cost of sale).*

3. Reclassify R6 000 of Biological Assets to Inventory (Carcasses):

- Dr Inventory (= 10 × (R 700 – R2))	R6 980	
- Cr Fair value gain (on recognition of agricultural produce) (P/L)		R980
- Cr Biological assets carried at fair value through profit or loss: cattle		R6 000(a)

- *To recognise the reclassification of slaughtered cattle at the point of harvest.*
  - *(a) Calculation: R15 000 (fair value less costs to sell of cattle at the date of harvest) × 40% (proportion of cattle slaughtered) = R6 000.*

4. Recognise R300 Meat Processing Costs:

- Dr Inventory	R300	
- Cr Bank or accounts payable		R300

- *To recognise costs of converting carcasses into meat cuts inventory. This cost is considered part of the inventory and is not deducted from the fair value of the carcasses at the point of harvest.*

Once harvested, the meat is accounted for in accordance with Section 13 Inventories. Assuming that, at the end of the period, the entity did not hold any other meat inventory, the closing balance of meat inventory at 31 December 2023 would be R7 280 (calculation: R6 980 fair value less estimated costs to sell of the carcasses + R300 costs of converting the carcasses into meat cuts).

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Thank you for attending!

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