

Impact of Ind AS 41: Agriculture on Tea Industry

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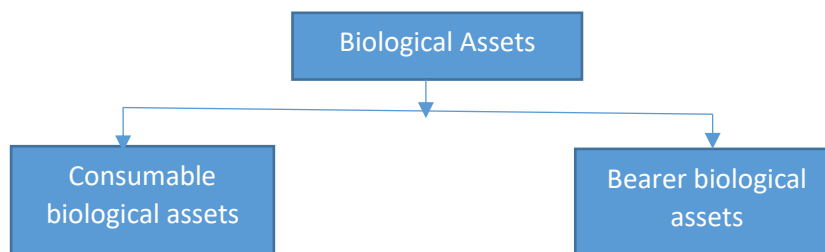
The Ministry of Corporate Affairs ('MCA') issued a press release on January 2, 2015 announcing a roadmap for the implementation of Ind- AS based on a company's net worth. This is in accordance with the finance minister's maiden budget speech indicating that the Indian Accounting Standards (Ind-AS) be adopted mandatorily beginning FY 2016-17 and voluntarily from FY 2015-16.

Ind AS comprises 40 accounting standards that provide extensive guidance and entail a significant change in the financial reporting framework used by Indian companies to report their financial results. Their adoption requires a detailed level of analysis for which companies may need to invest substantial amounts of time to ensure compliance.

With respect to agricultural sector, before the introduction of the Companies (Indian Accounting Standards) Rules, 2015, there was no specific accounting literature in India (previous GAAP) that required recognition of biological or bearer plant and hence no accounting for such items was made in the financial statements.

Indian Accounting Standard 41 – Agriculture [Ind AS 41] set outs the accounting treatment and disclosures relating to agricultural activity. Some of the key definitions are as follows:

Biological Asset	A living animal or plant.
Bearer Plant	A living plant that: <ul style="list-style-type: none"> a) is used in the production or supply of agricultural produce; b) is expected to bear produce for more than one period; and c) has a remote likelihood of being sold as agricultural produce, except for incidental scrap sales.
Agricultural produce	Is the harvested product of the entity's biological assets.
Biological transformation	Comprises the processes of growth, degeneration, production, and procreation that cause qualitative or quantitative changes in a biological asset
Agricultural activity	Is the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets.



The biological assets are categorised into consumable biological assets and bearer biological assets.

- *Consumable biological assets* are those that are to be harvested as agriculture produce or sold as biological assets.
- *Bearer biological assets* are those other than consumable biological assets. Bearer biological assets are not agricultural produce but, rather, are held to bear produce.

All biological assets other than bearer plants are usually measured at fair value less costs to sell, with the change in the carrying amount reported as part of profit or loss from operating activities. ***Bearer plants are measured in accordance with Ind AS 16, 'Property, plant and equipment'.***

In this article, changes in the accounting brought about by Ind AS 41 in respect of Tea Industry has been highlighted. A Company engaged in the manufacturing of tea would now be required to recognize bearer plants, biological assets and agricultural produce separately in its financial statements and measure those assets that were hitherto not necessary in previous GAAP.

I. Bearer Plants: Tea Bushes-

Tea Bushes that produces tea leaves are to be recognised as a bearer plant because they are used solely to grow produce over several periods and the manner in which the entity derives economic benefits from such bushes are similar to a production plant. The key points to be considered on transition to Ind AS are:

- A bearer plant shall be accounted for as Property, Plant and Equipment (PPE) under Ind AS 16 and measured at cost under previous GAAP or fair value as deemed cost at the date of transition.
- The land on which the bearer plants are growing would either be a freehold or leasehold land. Hence, the cost of the freehold or leasehold land needs to be separated from the estate development cost (currently being capitalised as a part of fixed assets). Such estate development cost along with cost of new planting and development would now form part of the cost of the bearer plant.
- Depending upon the location of estates, environmental conditions, trends in replanting, etc. such bearer plants are required to be depreciated over their useful life, after deducting the residual value. Further such Bearer plants would also have to be assessed for impairment under Ind AS 36.

Impact Analysis:

Companies that adopts the fair value of bearer plants as the deemed cost would have an impact by way of increased depreciation in the future years. This increased depreciation will be off-set by the increased

capitalisation cost in respect of replanting costs which meet the definition of PPE. Such costs under previous GAAP were treated as revenue expenses.

II. Biological Assets: Tea Leaves (yet to be plucked) -

The produce growing on the bearer plants (e.g., tea leaves) which are yet to be harvested will be a biological asset. The key points to be considered on transition to Ind AS are:

- i. A biological asset is measured at fair value less costs to sell in accordance with Ind AS 41.
- ii. The tea leaves on the tea bushes, being biological assets, would pertain to those leaves that are yet to be plucked as of a reporting date (depending upon the plucking cycle of the Company which may range from 7 days to 15 days).
- iii. The tea leaves will ultimately be detached from the bearer plants and may be normally sold separately, thereby having a market value of its own. The existence of active market for green leaves could determine the potential fair value of the underlying biological asset of the leaves on the tea bushes.

Impact Analysis

- a. Ind AS requires entities to recognize all assets and liabilities whose recognition is required by Ind AS. No specific first time adoption exemption has been provided in Ind AS 41. Since biological assets were generally not recognized in the previous GAAP, these will have to be identified and recognized in the opening Ind AS balance sheet, i.e., on the date of transition. Corresponding effect would need to be given in retained earnings. This will result in an increase in the net worth of the Company.
- b. Biological assets are required to be measured at the end of every reporting period at its fair value less cost to sell. Gain or loss arising from a change in the fair value less costs to sell is to be recognised in the profit and loss for the period in which it arises.

III. Agricultural produce: Tea Leaves (plucked)-

Once the tea leaves are harvested or plucked, such leaves are identified as agricultural produce after harvest that is further processed to produce black tea. The key points to be considered on transition to Ind AS are:

- i. The agricultural produce is required to be measured at fair value less costs to sell as per Ind AS 41. Such measurement is the cost at that date when applying Ind AS 2 Inventories or another applicable Standard.
- ii. Fair value is determined as per Ind AS 113 wherein three widely used valuation techniques: market approach, cost approach and the income approach are being addressed.
- iii. Considering the valuation perspective, the Company can either use prices and other relevant information generated by market transactions involving identical or comparable (i.e., similar) assets, liabilities or a group of assets or liabilities or discount future cash flows (income and expenses) to its present value.

Impact Analysis:

- a. A Company may apart from the use of “own leaf” also purchases green leaf from small growers, referred to as “bought leaf” for use in the production of black tea, thereby having a ready market available for green leaf.
- b. Therefore, considering similar relevant observable inputs, the “own leaf” of the Company may be valued at the price of the “bought leaf. Such valuation of “own leaf” at the price of “bought leaf” shall have negligible impact on the financial statements of the Company as the opening and the closing inventories of the tea leaves as on the reporting date shall be more or less same depending upon the plucking cycle of the Company.
- c. The tea leaves (plucked) are required to be measured at the end of every reporting period at its fair value less cost to sell. Gain or loss arising from a change in the fair value less costs to sell is to be recognised in the profit and loss for the period in which it arises.

Tax Impact

Under Ind AS 12 “Income Taxes” recognition of bearer plant and biological assets and measuring the same using fair value as deemed cost will have an impact on deferred taxes. ICDS does not recognises bearer plants.

Our insights:

The shift from the historical cost convention to increased use of fair value and increased focus over substance rather than the legal form of the underlying transaction has impacted every company and industry sector. The adoption of Ind AS requires the retroactive restatement of certain historical period information presented within a company’s first set of Ind AS-based financial statements.

These changes will provide better insights on companies and will facilitate the benchmarking of the financials of Indian companies with global peers, thereby improving the accessibility of Indian companies to foreign funding.

However, companies will have to invest time and effort into preparing for the extensive data requirements and disclosures. They will have to start discussing disclosures on significant judgments and estimates in more detail, including what goes behind the reported numbers. Successful Ind AS implementation will require a thorough strategic assessment, a robust step-by-step plan, alignment of resources and training, effective project management as well as smooth integration of the various changes into normal business operations.

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