Michelle Sansom,
Accounting Standards Board,
5th Floor, Aldwych House,
71-91 Aldwych,
London.
WC2B 4HN

30th April, 2012

Dear Michelle Sansom,

Consultation on the Future of Financial Reporting in the UK and ROI

Agricultural Stocktaking

I write on behalf of the Central Association of Agricultural Valuers (CAAV) in response to this consultation paper and, in particular, to its Question 5(a):

> "Whether and, if so, why the proposals for agriculture activities are considered unduly arduous? What alternatives should be proposed?"

The CAAV represents, briefs and qualifies about 2500 professionals who advise and act on the very varied matters affecting rural and agricultural businesses and property throughout Great Britain. Our members are instructed by a wide range of clients, including farmers, owners, lenders, public authorities, conservation bodies, government agencies and charities.

Annual stocktaking valuations form part of this work.

The CAAV does not exist to lobby on behalf of any particular interest but rather, knowing its members will be called on to act or advise both landowners and tenants under developing policies, aims to ensure that they are designed in as practical a way as possible, taking account of circumstances and the very varied matrix of issues that bear on the decisions they will take.

Summary

The CAAV sees no positive or practical purpose in treating agricultural stocks on some larger farming businesses in any different way to all other stocks (including the non-biological stocks on the farm) or to the generality of farm businesses to which this would not apply. It would be preferable to maintain the present basis for stocktaking with the existing very minor exceptions than to create an additional tier of standards with the accompanying additional confusion, especially for those businesses that may move in and out of this regime as well as for those trying to make sense of businesses without knowing clearly which basis has been applied.

The proposals will bring costs that are not matched by benefits to the users of the accounts. These costs are not only the greater professional cost incurred in preparing the stocktakings but also in the intelligibility and reliability of the accounts. The fair value assessments that would be required would often and necessarily be far from reliable given the frequent lack of relevant market evidence as at most balance sheet dates, especially for growing crops.

The model is not seen as appropriate to a sector that overwhelmingly works with an annual cycle of production.

What Has to be Valued?

While it might seem easy to summarise most agricultural stocktakings as being of growing crops, harvested crops and livestock, that would hide an enormous variety of situations.

Livestock may be held for production and for consumption and can be as diverse as cattle and worms, sheep and salmon. There can be very high value embryo transfer and stock held for the breeding potential by sale of semen or eggs. Some production animals will be held in high health status units outside of which they have no value save for meat.

Growing crops are not only cereals, oilseeds and proteins but also grass. There are multi-annual crops such as asparagus or strawberries, bush fruit, top fruit and vines which will generally not have a market value as plants, bushes and trees but their produce is intended to have value once ready and harvested. Timber trees are, by contrast, grown for themselves and, once established may usually have a value as such although intended as long term crop for their best value.

Severed crops will include those that are for sale, for consumption on the holding or in need of further processing on or off the farm to be useful.

Both growing crops and livestock offer examples where the potential subject of the valuation might be considered better described as capital items. Longstanding production herds, orchards, vineyards and trees grown for regular harvests of coppice for energy generation could all be examples.

Applying a fair value approach across all those enterprises is unrealistic, both in that the information that produces may not be helpful to anyone and it requires disproportionate cost since that inherent diversity calls on such a wide range of skills and judgments.

Why Does It Have to be Valued?

The prime motive of most farmers in wanting a stocktaking is usually to have the necessary information to submit a tax return. After that it may have an inter-relationship with their management accounts.

Although agriculture is one of the least geared sectors in the UK economy, it has an important relationship with a limited number of banks, all of which have specialist agricultural departments. Lending decisions are rarely made on the basis of livestock and growing crops alone and any such decision would be based on a much larger view of the business than just a stocktaking as at one date. With volatile prices, a move to fair value is at least as likely to obscure matters as illuminate them.

The Present Position

Agricultural stocktakings are almost universally prepared on the basis of the lower of cost or net realisable value. As this is almost always for annual accounts underpinning tax returns, they commonly follow the guidance of Her Majesty's Revenue and Customs as set out in what is still widely known as BEN 19 but now Business Income Manual 55400 (also on reference IR Help Sheet 232) which goes into the application of these principles. That is further explored by the CAAV in its technical publications for members. All these recognise and draw on SSAPs and relevant court judgments.

Where a quoted trading company has a farming activity, its stocktaking will be prepared to IAS 41 but this arises very rarely. While some other farming businesses have agreed with HMRC on individual approaches to their stocktakings, I am not aware of any businesses that have voluntarily adopted IAS 41 but a few may exist.

The agricultural sector is essentially one of sole traders and partnerships with only a minority of businesses being limited companies and those owned within farming families – as also would be the few Limited Liability Partnerships. There will only be a handful of genuinely corporate concerns. Thus, even at the level of businesses affected by the proposal, many accounts would not be publicly available because they are for private partnerships.

In the nature of small businesses owned by individuals or within families, there are rarely more than three users of the stocktaking:

- the owners of the business – that is the sole trader, the partner or the family members who are shareholders of the company
- the tax authorities (HMRC)
- the bank that lends to the business.

For each, the stocktaking only has meaning as a part of the annual accounts. There is no wider audience.

In a sector that generally has strong balance sheets but a low return on capital and now seeing volatile prices, that established and near-universal basis of the lower of cost and net realisable value builds in a level of production as to a business' value ahead of it achieving intended sales.

Most businesses are engaged overwhelmingly in annual cycles of production, typified by the cycle for say wheat, sown in the autumn and harvested in the following summer or a dairy cow's lactation. Longer term crops, such as fruit, form a small part of the overall sector.

Who Would be Affected by the Proposals?

The CAAV's analysis of the proposals suggests that the proposed extension of IFRS would only apply to a relatively small number of the largest farming businesses – but these will usually be ones of wider commercial importance. The thresholds set would exclude the great majority of businesses but still include:

- the largest farm businesses, especially those with high value cropping or intensive livestock output
- large specialist operations such as stud farms or high value breeding operations where animals might be valued on their income stream

- farms that are part of larger businesses
- farms with a substantial downstream business or diversification within the business.

While many farms might reach the balance sheet threshold (especially as it is understood to be gross, not net) few will reach the turnover threshold (save for higher value produce or great volume) and even fewer the staffing threshold (save where there is processing within the business). In addition, there are businesses where farming and other activities are combined in one set of accounts and so in combination will exceed two of the three thresholds.

Our best estimate, based on a judgment of such data as is available, is that this change would affect no less than 150 businesses and probably not more than 300 with a best guess perhaps in the 225 to 250 range. However, those businesses, by definition, are ones that contribute a much larger share of the country's overall agricultural output, employment and investment. It is thus a matter of substantial concern if their accounts are to include unrealised potential sales values.

Of course, the criteria used mean that some farming businesses (or businesses with farming activities) will move in and of the new basis as a result of marginal changes in their circumstances - most obviously if turnover falls. Relatively few of those affected by the proposal will be securely above the criteria for this not to be a risk.

What it does mean is that a minority of significant businesses will be assessed on a different basis to the great majority of other farming businesses, so reducing comparability between them and requiring further understanding by those who seek to rely on accounts.

With the volatility of prices for farming produce, mostly particularly seen in cereals, the proposals bring wider concerns:

- that they are merely the harbinger of a wider extension of the application of fair value to the sector
- that HMRC will follow such newly established accounting practice in its expectations of tax accounts and so levy tax on assumed profits that may not be realised.

Lack of Useful Data for Crops
For almost all arable farming and horticulture there is no useful market testing of value ahead of harvest for crops that are not sold for themselves. Thus, while it may generally be that forestry trees may usually have a value for their timber or bedding plants for sale, crops being grown for their yield of grain or fruit do not generally have an objective ascertainable value that has meaning in the market. A half grown crop of wheat (our dominant crop) is almost never sold – and it will require further costs and management to bring it to harvest while subject to significant natural risk as to yield. Hypothesising a yield and price is of limited value to anyone reading accounts.

Crops In Store
The proposed basis raises a number of issues for crops in store:

- what is the point of harvest? The point when the crop is severed or the point when it is put in store? As examples:
  - silage – is it grass as cut in the swath or silage after it has passed through the forage harvester and been ensiled?

- grain – in a poor year is it wet grain from the field or grain in store as dried and cleaned for stage and sale?

- the place of necessary costs incurred after harvest such as grain drying and cleaning or silage treatment.
- how to value silage in a clamp for which there is rarely relevant market evidence yet it may be one of the major items on a dairy farm – each clamp may hold a 1000 tonnes
- with homogenous crops like grain that become mixed when in store, how to identify which grain was harvested on what dates for the ascription of relevant prices (even though these prices may not resemble those at which the grain is to be or may be sold subsequently)

Data for Livestock
By contrast, market values for the great majority of farm livestock can be readily ascertained.

The main exceptions are those:

- with a high breeding value for which values are volatile in very limited markets,
- held in very protected high health status units for which their only external value is a cull value that inadequately represents their value in the unit.

Issues will also arise for stud farms.

Government Grants
We understand that the position has now developed so that government grants for schemes (such as agri-environmental agreements) can, as would be sensible, be allocated to the years in which they are received rather than deferred to be recognised at the much later date when they can no longer be recovered. As the earlier approach would have caused significant taxation issues and distorted accounts, such change is welcome.

Practical Consequences
A move from cost to fair value can, in most circumstances, be expected to bring income forward and, without mitigation, that could lead to a substantial increase in the taxation liability of the affected business.

The Costs
Preparing a valuation to the proposed standards with its level of reporting and analysis will clearly impose a higher cost on the businesses affected than the present basis.

Most clients can be expected to seek to use the allowed exemptions where cost is not proportionate to the purported benefit of the information to bypass fair value and use cost instead.

Lenders' Views
The only third party user taking independent decisions on the basis of the overall accounts to which the stocktaking contributes will the bank to which the farmer turns whether for overdraft finance or secured lending. We have conducted an informal survey of the views of the relatively few specialist lenders to this sector.

Perhaps the predominant impression given by their responses is that this issue is well down their list of priorities since most farmers can offer land as security with a much greater realisable value than most stocks may ever have. There is concern about the development of multiple standards.

Banks will take a view on the best information and projections that can be made (if not prepare their own assessment) at the time of the request, and not look to a retrospective assessment prepared for a year-end months past as a key item of information. Their primary interest as regards the operation of the business is in its prospective ability to generate cash to service the loan and meet other commitments. They will look at trends and patterns in stocks rather than absolute figures. While there are different opinions many prefer to see a cost basis used as that is less likely to undercast the final sales figure achieved. With volatile prices, fair value as at one day could easily prove to be an over-estimate of the value that will actually be achieved.

Conclusion

In answering your question 5(a), this letter has set out how the proposals for agricultural activities are unduly arduous, offering no realistic benefit to the limited classes of users of farming accounts at greater cost while multiplying relevant standards for stocktaking with the associated potential for confusion. Although this change is proposed for accounting reasons, it could then have an unfortunate consequential interaction with the tax system.

The alternative is to retain the cost basis used for all other stocks, including those on farms, such as spare parts, fertilisers, chemicals and other items.

Farming, as practised in the United Kingdom does not need, want or warrant the change of approach proposed, being comfortable with the present approach which is seen to have the benefit not only of familiarity but also of prudence.

We are happy to talk over any of these matters in greater detail if that would be of assistance.

Yours sincerely,

Jeremy Moody
Secretary and Adviser
Central Association of Agricultural Valuers.