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Oil Palm Plantations- Accounting for Fresh Fruit Bunches (FFB)

By MASB secretariat
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Given the importance of the Oil Palm industry to some jurisdictions, accounting issues, particularly fair value measurement, associated with the industry have been the focus of considerable attention over recent years from a range of stakeholders including directors of listed plantation entities. This article seeks to provide directors with an update on the requirements for measuring fresh fruit bunches (FFB) at fair value.

Is it unreasonable for the accountants to ask for fair values?

As directors of palm oil plantation entities know only too well, one of the key inputs to maximising oil quality and quantity and hence revenue from subsequent sale is to harvest FFB at the peak of ripeness. The harvester considers a number of observable factors such as colour, moisture and the number of loose fruit drops under the bearer tree to determine maturity stage and hence when to harvest.

It may not be surprising that many palm oil plantation entities directors questioned the practicality of an accounting standard for Agriculture requiring FFB which is still maturing, and is yet to be harvested at balance date, to be measured at fair value.

Background History

In December 2000, IAS 41 *Agriculture* was issued, which became effective for financial reporting years ending on or after 1 January 2003. At the time of its release, IAS 41 aroused considerable concern amongst preparers in some jurisdictions, including Malaysia and other major palm oil producing countries, because oil palms were within the, 'biological asset', and required to be measured at fair value. Many preparers expressed concerns that the fair value of oil palms could not be reliably determined due to the way in which palm oil plantations are developed.



In November 2011, when the Malaysian Accounting Standards Board (MASB) issued the MFRS Framework, a fully IFRS-compliant framework, it permitted entities coming within the scope of IAS 41 to be classified as Transitioning Entities (TE). These TE were allowed to defer applying IAS 41 for a limited period, i.e. until completion of a review of IAS 41 by the IASB in June 2014.

This review was the result of representations by the MASB and others, and resulted in the IASB issuing amendments to IAS 41 applicable for reporting periods beginning on or after 1 January 2016. The MASB then mandated that these TE to migrate to the MFRS Framework by 1 January 2018. The amendments resulted in bearer plants, such as oil palms, being reclassified as property plant and equipment and consequently being measurable at cost under IAS 16 *Property, Plant and Equipment*.

However, FFB growing on oil palms continue to be classified as biological assets under IAS 41, separate from the trees themselves, and the FFB shall be measured at fair value.

In response to further requests concerning the ability to reliably determine the fair value of FFB, the IFRS Interpretations Committee published a decision in June 2017 among others that :



the reference to 'clearly unreliable' in IAS 41 indicates that, to rebut the presumption (i.e. that the fair value can be measured reliably for a biological asset), an entity must demonstrate that any fair value measurement is clearly unreliable;



if an entity encounters significant practical difficulties, this does not necessarily mean that any fair value measurement of produce is clearly unreliable;



differences in supportable assumptions (which might result in significantly different valuations) is not evidence of significant practical difficulties; and



the matter did not warrant being added to the standard-setting agenda.

Are there still issues to be resolved?

As entities impacted by IAS 41 will now be completing two financial reporting periods since it became mandatory, the MASB has recently conducted a review of policies and practices adopted by Malaysian entities in relation to fair valuing FFB.

The framework for fair value measurement is MFRS 13 *Fair Value Measurement* which applies when another MFRS, in this case MFRS 141, requires the application of fair value. MFRS 13 establishes a three-level fair value hierarchy based on the degree to which fair value can be determined by observable inputs :

- Level 1 involves applying observable quoted prices in an active market for identical assets and liabilities that the entity can access at the measurement date;
- Level 2 involves applying other observable inputs, such as quoted prices for similar assets in either active market or market that are not active or other data values; and
- Level 3 involves applying unobservable inputs, and might involve some form of modelling.




Under MFRS 13, entities shall use observable information to the extent feasible in measuring fair value. MFRS 13 also requires entities to disclose the level of the fair value hierarchy within which the fair value measurements are categorised in their entirety (Level 1, 2 or 3). For the level 2 and level 3 measurements, MFRS 13 further requires disclosure of the valuation technique (s) and inputs used in the fair value measurement.

The review conducted by the MASB covered the financial statements of 28 listed plantation entities, with 27 identified to be using Level 3 estimation, whilst the other entity did not identify the relevant Level.

When considering observable inputs to determine the fair value of the FFB, 21 entities considered the oil content of all unripe FFB over periods ranging from 10 days to 2 months before harvest with a further 3 entities considering oil content 3 months prior to harvest.

Three of the entities utilised the present value of net cash flows expected to be generated from the sale of the FFB to calculate fair value. One entity utilised the cost approach.

Of the 27 entities using Level 3 estimation reviewed by MASB:

-  8 disclosed quantitative information about significant unobservable inputs and included a narrative description of sensitivity of the fair value measurement;
-  4 disclosed only quantitative information about significant unobservable inputs; and
-  6 disclosed only a narrative description of the sensitivity of fair value measurement to changes in unobservable inputs.

The remaining 9 entities disclosed no quantitative information about significant unobservable inputs nor a narrative description of sensitivity of the fair value measurement.

Whilst these findings indicate there is significant scope for some entities to improve their disclosures, the amounts of FFB for the sample selected were less than 1% of total assets for 24 entities and between 1% and 3% for the other 4 entities. Accordingly, the absence of disclosure may be due to preparers considering materiality.





Conclusion

It is now some 20 years since IAS 41 was first released. During that time appropriate amendments have been made in recognition of concerns expressed by preparers and other stakeholders and mandatory implementation deferred in Malaysia until such amendments became applicable. Whilst some directors may still have reservations about the original requirement to measure FFB at fair value, it appears that the requirements as they now stand are reasonable and are being successfully implemented.

The fact that the Level 3 option is available and was selected by 96% of entities in the sample (i.e. 27 of the 28 companies) suggests it is reasonable for the accountants to ask for fair values and that it is practicable to adhere to the standard using observable and unobservable inputs in a similar way to the harvester estimating FFB maturity.