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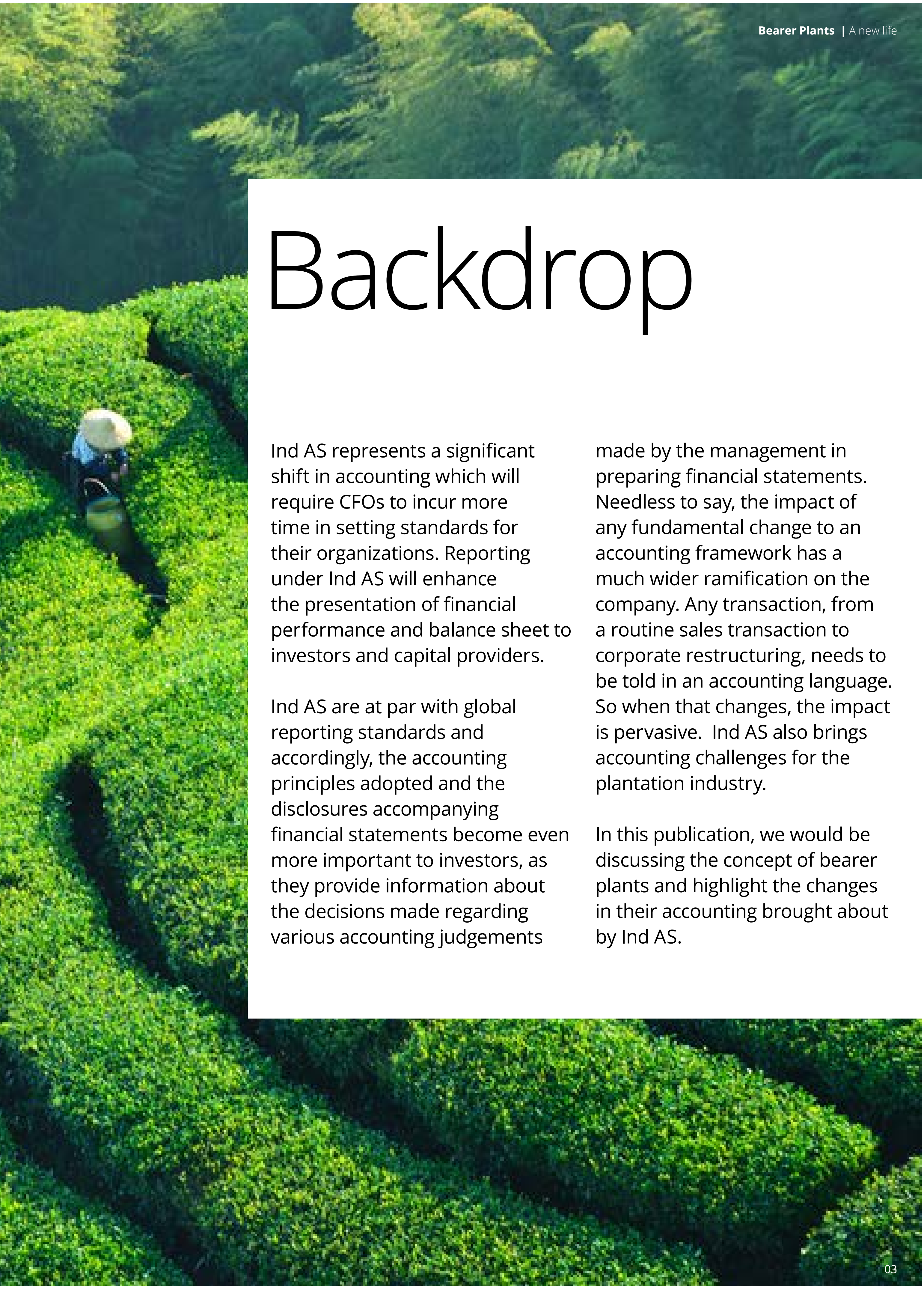
Bearer Plants

A new life

July 2016



Backdrop

Ind AS represents a significant shift in accounting which will require CFOs to incur more time in setting standards for their organizations. Reporting under Ind AS will enhance the presentation of financial performance and balance sheet to investors and capital providers.

Ind AS are at par with global reporting standards and accordingly, the accounting principles adopted and the disclosures accompanying financial statements become even more important to investors, as they provide information about the decisions made regarding various accounting judgements made by the management in preparing financial statements. Needless to say, the impact of any fundamental change to an accounting framework has a much wider ramification on the company. Any transaction, from a routine sales transaction to corporate restructuring, needs to be told in an accounting language. So when that changes, the impact is pervasive. Ind AS also brings accounting challenges for the plantation industry.

In this publication, we would be discussing the concept of bearer plants and highlight the changes in their accounting brought about by Ind AS.

The Era before Ind AS

With respect to bearer plants, before the introduction of the Companies (Indian Accounting Standards) Rules, 2015, there was no specific accounting literature in India that dealt with agriculture. Therefore, all costs that were incurred towards development of the estates were normally capitalized and disclosed as Estate & Development under tangible assets and generally not depreciated. Costs incurred on replanting were generally treated as an expense in the Statement of Profit and Loss. Products that were the result of processing after harvest were considered as inventory.

Ind AS

- A bearer plant is a living plant that (defined under IND AS 16):
  - is used in the production or supply of agricultural produce;
  - is expected to bear produce for more than one period; and
  - has a remote likelihood of being sold.

Examples of bearer plants

Sugarcane roots that produce standing sugar cane

Coffee plants that produce cherry

Oil palms that produce oil palm fruit

Tea bushes that produce the tea leaves.

Cotton plants that produce seed cotton.

If plants have more than one potential use, then these plants are not bearer plants and should be accounted in accordance with IND AS 41 at fair value. Crops such as paddy, wheat are not bearer plants because these do not bear produce for more than one period.

Accounting for bearer plants

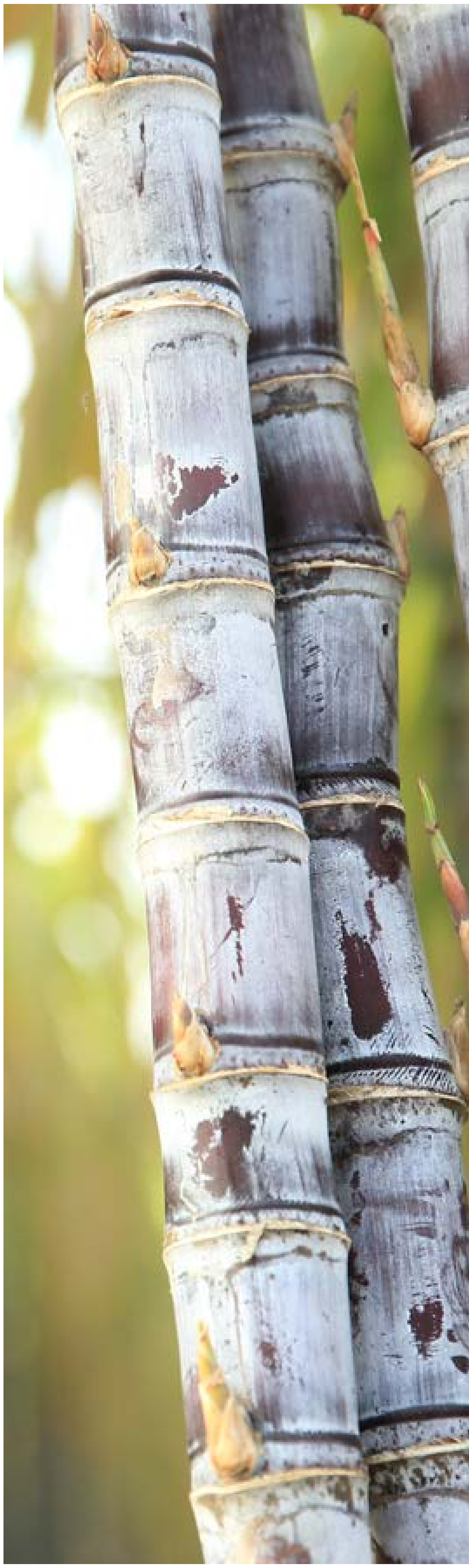
A. Property, plant and equipment

Where an item is a bearer plant, the plant and its produce will have different accounting treatments. A bearer plant should be accounted for as property, plant and equipment (PPE) in accordance with Ind AS 16. Therefore, companies will now be required to measure bearer plants initially at cost and will thereafter have an option to apply either the cost or the revaluation model.

Why consider bearer plants as PPE?

Bearer plants are used solely to grow produce over several periods and therefore meet the definition of PPE. The use of bearer plants to produce agricultural produce is similar to the use of machinery to manufacture goods. The manner in which an entity derives economic benefits from bearer plants and a production plant is similar. Further, the progressive decline in the future earning potential of a bearer plant over its life is also similar to other depreciable assets, for example, plant and machinery. The land upon which bearer plants are growing, the structures used to support their growth and the agricultural machinery are measured in accordance with Ind AS 16. Although bearer plants are dissimilar in form to plant and machinery, similarities in how they are used supports accounting for them in the same way[1].

1. Guidance drawn from IAS 16:BC 64 to 67



What to look for?

Land on which the bearer plants are growing would either be freehold or leasehold land. Given that estate development costs currently disclosed as fixed assets could encompass acquisition costs of freehold land, cost of planting new bushes and trees (e.g., shade trees) etc., companies would be required to separate the value of freehold land from the rest of the estate development, where applicable. Cost of new planting and development would form part of cost of the bearer plants.

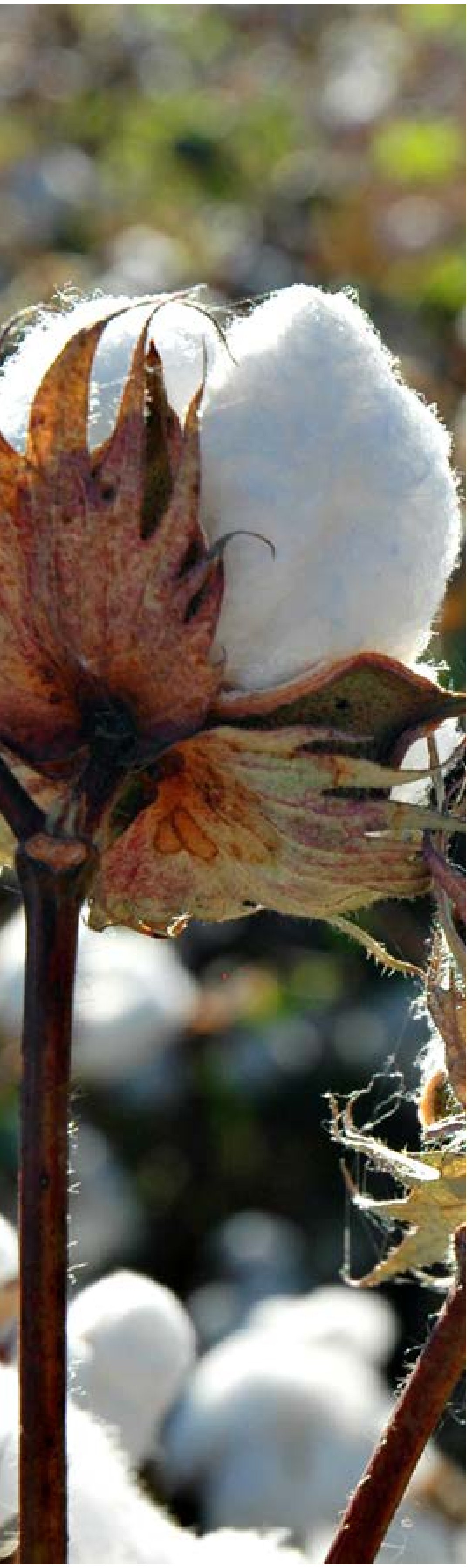
Agricultural activity is a continuous process, meaning that older plants are continuously removed from service and replaced. When using a cost model, it is critical to have this process discrete[2]. Therefore what is unit of measure becomes critical for companies to identify, it could be a planting cycle or an area. The unit of measurement would help an entity to decide how to aggregate individual plants for the purpose of determining a measurable unit of bearer plants.

Given that items in PPE (including bearer plants) are required to be depreciated over their useful life, judgement is required to determine the useful life of the bearer plants. These are driven by the location of the estates, environmental conditions, the level of upkeep and maintenance, amongst other factors. Trends in replanting would also assist in determination of useful life. Determination of useful life therefore is an important management estimate in this industry.

To determine the depreciable amount of the bearer plant, its residual value is required to be deducted. Judgement needs to be exercised for determining such residual value.

Bearer plants under Ind AS 16 would also have to be assessed for impairment under Ind AS 36 "Impairment of Assets". In applying a value-in-use model, significant judgement may be involved for bearer plants; for example, in differentiating between cash inflows or outflows that are expected to arise from improving or enhancing the asset’s performance and expenditure that would be operating costs such as fertilizer. There could also be difficulties in determining cash inflows, in particular in estimating the price at which each future harvest might be sold .

2. Guidance drawn from IAS 16:80



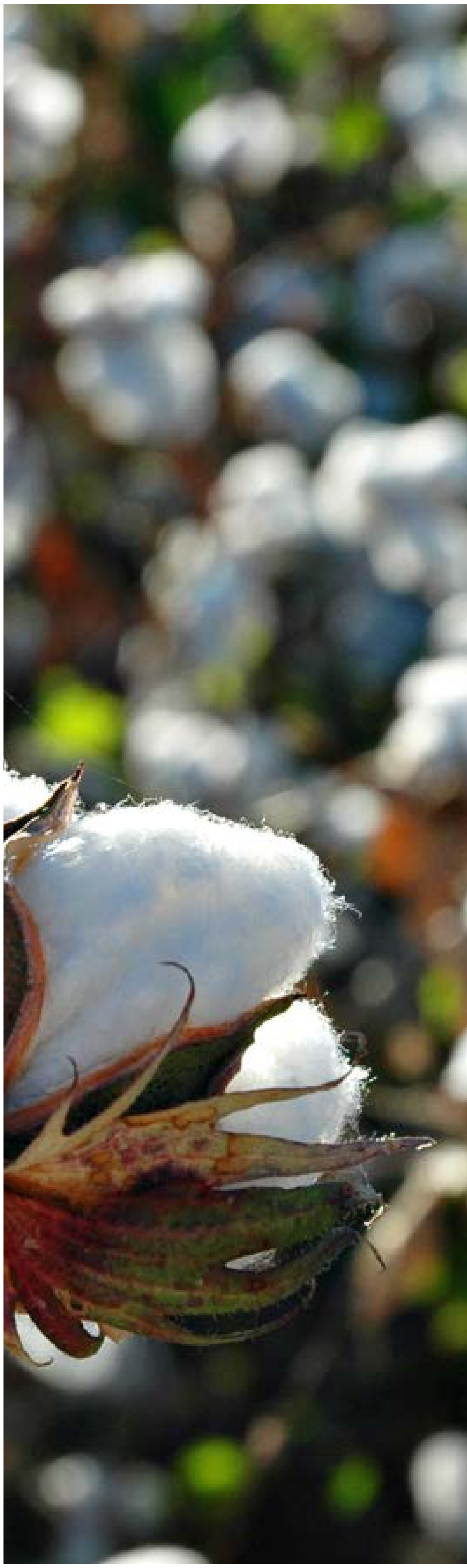
B. Bearer plants that are yet not mature

Before the bearer plants are in the location and condition necessary to be capable of operating in the manner intended by management, i.e. before they reach maturity and bear produce, they are accounted for as self constructed items of property, plant and equipment – akin to capital work in progress. This requires measurement at accumulated cost.

Determination of point of maturity requires application of judgement. A tea bush may start to yield produce after three years, but reaches optimum yield generally after four years, which is when the bearer plant is capitalized.

What to look for?

For bearer plants, costs capitalization should cease when the bearer plants reach maturity. Judgement may be needed to identify when bearer plants reach maturity. Thereafter costs will cease to be capitalized and depreciation will commence. Further, many bearer plants will require significant costs to be incurred during the growth stage after the initial costs of planting, as well as subsequent costs after they reach maturity. Some costs may be capital in nature and some may be maintenance expenditure. Judgement will need to be applied to determine which costs may be capitalized. For e.g., costs that are normally capitalized in a tea plantation would comprise cost of the saplings in the nursery and their maintenance, costs of uprooting, costs of re-planting, mulching, shading of tea plant, weed control, bush framing etc. Costs that are normally maintenance in nature would comprise costs of pruning, pest and disease control, manuring etc. It may be noted that currently nursery is being treated as a current asset and disclosed either under inventory or under other current assets. But going forward, it will have to be considered as a capital work in progress as this would represent the expenditure incurred for the bearer plant.



C. On transition to Ind AS

Per Ind AS 101 – First time adoption of Ind AS, an entity may elect to measure an item of PPE at the date of transition to Ind ASs at its fair value and use that fair value as its deemed cost at that date. A first time adopter may elect to use a previous GAAP revaluation of an item of PPE at, or before, the date of transition to Ind ASs as deemed cost at the date of the revaluation, if the revaluation was, at the date of the revaluation, broadly comparable to (a) fair value or (b) cost or depreciated cost in accordance with Ind ASs, adjusted to reflect, for example, changes in a general or specific price index. Where there is no change in its functional currency on the date of transition to Ind ASs, a first time adopter to Ind ASs may elect to continue with the carrying value for all of its PPE as recognized in the financial statements as at the date of transition to Ind ASs, measured as per the previous GAAP and use that as its deemed cost as at the date of transition after making necessary adjustments.

It is expected that companies may adopt the following, on transition to Ind AS:

01. Recognize the bearer plant.
02. Where the existing estate development cost includes land, separate land cost from the estate development cost and recognize the land either as property, plant and equipment or a lease arrangement depending on the nature of holding the land. If the land is recognized as property, plant and equipment an election can be made to carry it at cost as per the Previous GAAP or at fair value on the transition date as deemed cost.
03. Measure the bearer plant at cost under Previous GAAP or at fair value as deemed cost at the date of transition.
04. Adopt the cost or revaluation model thereafter.
05. Capitalize replanting costs which meet the definition of PPE after transition date.
06. Determine remaining useful life for depreciation.
07. Test for impairment.

D. Impact of Ind AS 12 – Income taxes on bearer plant accounting

Ind AS 12 is based on the balance sheet liability method, as against the income statement liability method under AS 22 – "Accounting for taxes on income". Concept of timing and permanent differences has been replaced with temporary differences. Therefore, when a company recognizes a bearer plant and measures the same using fair value as deemed cost, there may be an effect on deferred taxes. ICDS does not recognize bearer plants.

E. Accounting Standards (for entities not applying IND AS) applicable for years commencing on or after April 1, 2016

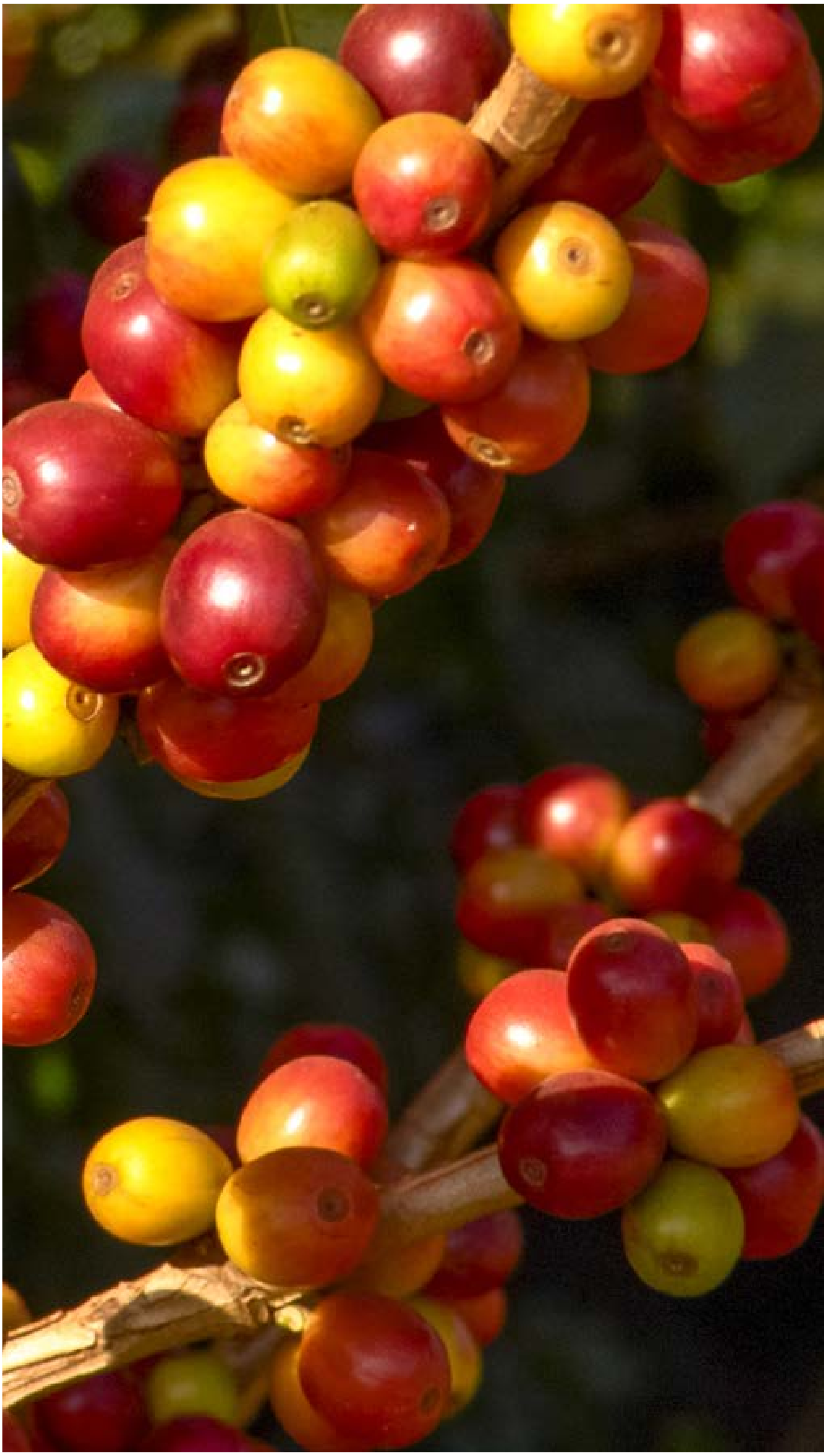
The Ministry of Corporate Affairs has notified Companies (Accounting Standards) Amendment Rules, 2016. Accounting Standard 10 has been amended to include bearer plants as an item of PPE.

Companies may deduct the value of land from the total estate development costs to determine the value of bearer plants. Such bearer plants would be required to be depreciated over their remaining useful life.

Income tax does not recognize bearer plants and therefore it is unclear at this point of time, how these will be considered by the tax authorities.

F. Our insights

Companies would be well advised to carefully choose deemed cost options that are provided to a first time adopter, after assessing impact not only on the current financial statements but also keeping in mind the impact an option could have over future earnings. For e.g., companies that adopt the fair value of bearer plants as the deemed cost would have an impact by way of increased depreciation in the future years. Given that the internal financial controls system will primarily revolve around the accounting framework, it is very critical for companies to revisit their risk control matrices and ensure robust documentation over the controls they exercise (for e.g., determination of unit of measurement, useful life, fair value assumptions per Ind AS 113 etc.), specially review type controls. Listed companies that are in Phase I of the Ind AS roadmap or those who have early adopted would require to ensure appropriate recognition, measurement and adoption of Ind AS 101 for first quarter reporting.



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