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WHAT DOES THE IMPLEMENTATION OF IFRS FOR SMEs BRING FOR AGRICULTURAL ENTERPRISES?

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Abstract

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Agricultural activity is largely different from other activities that the entities perform in order to achieve profit. Unlike other business entities, agricultural produce is significantly dependent on natural climatic conditions, and therefore a particular specialization of agricultural produce depends on geographic location. Agricultural producers use every form of business organization, from small farms to large publicly held corporations. Although most entrepreneurs working in agriculture are small and medium enterprises, the specifics of agriculture are significantly reflected in the financial reporting intended primarily for large corporations traded on the capital markets. Aim of this paper is to review the possibilities of implementation of the provisions relating to agriculture in the frame of IFRS for SMEs into practice of entities concerned whose object is agricultural production and to recommend appropriate application in practice. There are designed specific procedures of recording in relation to the nature of biological assets and agricultural produce and ways of measurement in this paper. The nature of biological assets is considered as distinguishing criterion (consumable assets, bearer assets and consumable assets with long production cycle).

agricultural activity, IFRS for SMEs, biological assets, agricultural produce

Around half of the EU's land is farm. Farming is important for the EU's natural environment. According to the European Commission (2007) rural areas represent 91% of the territory of 27 European Union Member States and are home to more than 56% of its population. It makes the rural development policy the policy of primary importance. Agriculture and forestry has still crucial importance for land use and management of natural resources in rural areas of the EU and as a platform for economic diversification in rural areas. Agricultural activity is largely different from other activities that the entities perform in order to achieve profit. Unlike other business entities, agricultural produce is significantly dependent on natural climatic conditions, and therefore a particular specialization of agricultural produce depends on geographic location. Another fact which greatly influences the range and quality of agricultural produce, especially in the case of crop production, is high dependence on weather conditions and other factors (pests, diseases, etc.) that can be affected by intervention of human factor only to a limited extent. Another uninfluenced factor can be biological nature of agricultural produce – biological properties, such as the growing season, reproductive cycle, etc., which often exceed the length of one year, must be respected. Specificity of agricultural produce can be also the fact that some products are also consumed by the farm itself.

Agricultural producers use every form of business organization, from small farms to large publicly held corporations. According to the IASB (2008) most business organizations involved in agricultural activity are small, independent, cash and tax focused, family-operated business units, often perceived as not being required to produce general purpose financial statements. According to EC (2010)

there were 7.3 million commercial agricultural holdings in the EU-27 in 2007, with a further 6.4 million small holdings. The total farm labor force in the EU-27 was the equivalent of 11.7 million full-time workers, of which 9.0 million worked on commercial holdings. Agriculture remains very much a family-oriented activity in the majority of Member States; almost four fifths (78%) of the total agricultural labor force were farm holders or members of their family. The main exceptions were Slovakia (44%) and the Czech Republic (27%), where there is a different ownership structure compared with the majority of Member States. Although most entrepreneurs working in agriculture are small and medium enterprises, the specifics of agriculture are significantly reflected in the financial reporting intended primarily for large corporations traded on the capital markets. Aim of this paper is to review the possibilities of implementation of the provisions relating to agriculture in the frame of IFRS for SMEs into practice of entities concerned whose object is agricultural production and to recommend appropriate application in practice.

METHODS AND RESOURCES

The requirement for proposal of specific methodologies for the recording of biological assets, biological transformation and agricultural production and the associated costs is based on the nature of IFRS for SMEs, which is focused mainly on presenting data on the financial position and performance of an entity in the form of statements, but not on the process of processing of input data, which must necessarily precede the preparation of financial statements. The proposed methodological procedures should be treated as potential ways of processing information. These procedures may be, to some extent, influenced by the established methodological procedures of national GAAP, unless they are contrary to the provisions and spirit of the IFRS for SMEs, therefore no alternative procedures cannot be rejected.

The theoretical bases generally deal with the need of recording and reporting of agricultural assets, biological transformation and agricultural production with regard to specifics of agriculture. This issue is now satisfactorily resolved for entities that are liable to report under full IFRS and usually treatment in national GAAP[1], which are mostly destined for entities of SMEs type and their significant contribution to overall structure of enterprises[2], is inadequate. Given this fact the paper is focused on the potential implementation of the IFRS for SMEs, which significantly reflects the specifics of agricultural reporting into EU legislation and also into selected countries.

In the next section the paper deals with specific provisions of Section 34 – Special Industries IFRS for SMEs and their applications in enterprises engaged in agricultural activities. The object of study is to assess the suitability of the fair value measurement for biological assets and agricultural production (the IFRS for SMEs – Section 34 uses the term agricultural produce instead of agricultural production, furthermore will be used the term in accordance to this standard) in respect to the fundamental principles of the standard (the costs on obtaining information must be lower than its benefits and practical application must not unduly burden the entity). In addition there are designed specific procedures of recording in relation to the nature of biological assets and agricultural produce and ways of measurement. The nature of biological assets is considered as distinguishing criterion (consumable assets, bearer assets and consumable assets with long production cycle).

Theoretical background

The system of financial reporting IAS/IFRS responds to the specifics of business activities in agriculture through IAS 41 – Agriculture, which has been in force since 2003. It took quite a long time before the IASC Council proceeded to the preparation of a standard draft that would apply to agriculture. From its inception until 1994, the Council completely ignored questions relating to the specifics of farming, which was based on fact presented in IAS41 – BC5 (IASB, 2008) that most business entities operating in agriculture are a small family-controlled units that focuses mainly on cash flows and taxes, even though the IASC joined the project on agriculture to its existing program in 1974.

The IASC supposed that the standard on agriculture in view of its specifics would not be widely used. But there were also arguments in favor of the preparation of accounting standard, which would consider the specifics of agriculture in recognition, measurement, recording and reporting transactions in agriculture. It was especially the expansion of possibilities of access to foreign capital for these businesses. Other arguments under the IASC were the international trend towards deregulation, an increasing number of issues of securities placed abroad and investment growth,

1 In the Czech Republic there is not, under Czech accounting standards, specific regulation for reporting of agricultural activities. In France, the chart of accounts includes only accounts relating to agricultural production, in Great Britain there is no special regulation for the reporting of agricultural activity (expected by 2013, implementation of IFRS for SMEs as a national GAAP), in the U.S. theme 905 Agriculture, which does not contain standards, only guidelines, is included in frame of codification since 2008.

2 According to http://ec.europad.eu/enterprise/policies/sme/index_cs.htm over 20 mil. of SMEs operates in the European Union currently – it represents 99% of all enterprises.

which contributed to the commercialization of agricultural activities.

The first impulse to create a comprehensive standard that addresses agriculture was the Council decision in 1974 to include this issue among its current projects and in 1994, the IASC decided to develop an international accounting standard on agriculture. Since 1996 IASC had been working on the project supported by World Bank concerning accounting in the agricultural sector. In 1999 the E 65 – Agriculture was issued. This Esposure Draft (ED) was based on a different approach to agricultural assets measurement and agricultural activity reporting. IASC received many Comment letters concerning this ED. The designed approach to the reporting of biological assets and biological transformation process was criticized by many respondents, especially by European Commission (EC). EC did not support E 65 – Agriculture. In a view of EC (2000), the draft failed in three fundamental fronts: conceptual underpinning, logical consistency and practicability. The draft of standard was criticized that was relied upon unproved assumptions (existence of efficient markets for biological assets at all stages of growth, possibility of relatively reliable measurement of biological transformation for reporting purposes), and application to all agricultural activity on the same basis. E 65 was not in accord with the European Accounting Directives, especially the fair value measurement of biological assets. This approach was incompatible with the EC IV Directive requirements.

Despite to the strong criticism of E 65 – Agriculture, a special standard concerning the agricultural produce – IAS 41 – Agriculture was issued in February 2001. The Standard prescribes the special accounting treatment for initial measurement of biological assets, agricultural produce at the point of harvest, special treatment for accounting for agricultural activity and for disclosure. This standard is designed for listed companies traded on registered capital markets, which also carry on agricultural activity. In the world there are a number of major companies[3] whose business is also agricultural produce, but their total share in number of farms is insignificant. Most agricultural businesses are represented by small and micro enterprises (family farms), as demonstrates previous text. Due to the very specific features of agricultural production and the high proportion of SME-type enterprises engaged in agriculture, it is appropriate that also financial reporting systems designed for these businesses would reflect the specifics of agriculture.

Despite the fact that the European Union Regulation which mandates the adoption of International Financial Reporting Standards in the consolidated statements of listed companies also gives member states the option to permit or require non-listed companies to prepare their accounts in accordance with EU-adopted IFRS almost small and medium entities use national GAAP. Studies conducted in South Africa (Stainbank, 2008) confirm that the cost of compliance with full IFRS exceed the benefits in the case of SMEs, while internationally, this has also been recognized in the United States of America and in the United Kingdom. On the other hand, Levin and Travis (1987) advocated that the financial statements of SMEs prepared under national GAAP tell only half the story about private companies. The financial statements of SMEs are not necessarily utilised for budgetary and related forecast purposes. The principal role of SME financial reporting is considered to be used for retrospective and confirmatory purposes (Baskerville and Cordery, 2006). According to McMahon (1998) the financial information of SMEs is utilised for evaluation the success of past decisions and in determining the present position. Sian and Roberts (2009) found out that tax authorities are the key users of SME financial statements. In their opinion, the contents and format of SME financial statements are influenced by the disclosure requirements of tax authorities, and not by accounting regulators.

Research made by Baker, Noonan (1995) and Demartini (2005) demonstrated, that SMEs are not a homogenous group and these entities should be differentiated into groups as medium sized entities, small entities and micro entities. In the research made by Kirsch and Meth (2007) SMEs were categorized in relation to their size and users in the following way:

- smaller SMEs. They are managed by their owner and they have banks as main user of their financial statements, and the financial statements have a verification role as well;
- "bigger" SMEs. They have usually external shareholders who demand information in a form of comparable financial statements and the financial statements have a verification role;

3 Examples can be following, AACo (Australian Agricultural Co, Ltd). – beef cattle company listed on New York Stock Exchange (NYSE), Associated British Food – sugar cane plantation listed on London Stock Exchange (LSE), Chiquita Brands International – bananas and other agriculture produce – listed on NYSE, Christian Dior, SA – vienyards (listed on LSE, NYSE Euronext (Paris)), Del Monte Foods Company – fruits and vegetables (listed on NYSE), HJ. Heinz Company – seed and vegetables (listed on NYSE), LVMH (Luis Vuitton Moet Hennessy) vienyards – listed on LSE and NYSE Euronext, Mondi – forestry (listed on LSE), Pernod Ricard SA – vineyards (listed on NYSE Euronext), Plum Creek Timber Company – timber industry (listed on NYSE), Unilever – oil palm and tea plantations (listed on LSE), West Fraser Timber Co Ltd. – timber industry (listed on NYSE).

- big SMEs with primarily external shareholders. They are dependent on financial information with predictive value for making decisions.

Kirsch and Meth (2007) in respect to these differing needs of users conclude that restriction should have been made in the scope of IFRS for SME.

Deaconu, Popa, Buiga, Fulop (2009) do not recommend an unique standard for SMEs for all accounting systems (e.g. IASB) because of the cultural diversity that has stronger impact within the SMEs that usually have no international links and no strong need for a common language (we have a different opinion when talking about big multinational companies). They also support this by the results obtained from the questionnaire processing in the case of Romania.

Recommendation 2003/361/EC regarding the SME definition which was adopted in May 2003 also categorized SMEs into three groups:

- medium-sized enterprises with less than 250 employees and the turnover below € 50 million and/or balance below € 43 million;
- small enterprises with more than 50 people and the turnover below € 10 million and/or balance below € 10 million;
- micro enterprises with less than 10 employees and the turnover below € 2 million and/or balance below € 2 million.

Each group of SMEs category differs in many ways. There is the most significant difference in the field of regulation of financial reporting in many countries. SMEs have the option of filling abbreviated reports with reduced level of disclosure.

Different information needs of financial statements users of individual groups of SMEs cannot meet one single financial reporting system designed for the whole this heterogeneous group. Based on the identification of barriers in the business in the European single market, the IASB has been entrusted with the preparation of a harmonized system of financial reporting for SMEs. The result of five-year effort was issuing of IFRS for SMEs, which, however, does not respect the heterogeneity of the group of companies known as SMEs. The IFRS for SMEs is a self-contained standard of about 230 pages tailored for the needs and capabilities of smaller businesses. The IFRS for SMEs is separate from full IFRSs and is therefore available for any jurisdiction to adopt whether or not it has adopted the full IFRSs. It is also for each jurisdiction to determine which entities should use the standard. It is built on an IFRS foundation. Many of the principles in full IFRSs for recognizing and measuring assets, liabilities, income and expenses have been simplified, topics not relevant to SMEs have been omitted, some accounting policies options in full IFRSs are not allowed because a more simplified method is available to SMEs and the number of required disclosures has been significantly reduced. The IFRS for SMEs does not address following topics covered in full IFRS:

- Earnings per share;
- Interim financial reporting;
- Segment reporting;
- Special accounting for assets held for sale.

The IFRS for SME is aimed at millions of companies, which represent over 99% of all companies all over the world. There are over 25 million private sector enterprises in Europe, over 20 million in the USA. 66 jurisdictions have already IFRS for SME adopted or stated a plan to adopt (Bohušová, 2011).

The definition of SMEs in IFRS for SMEs does not include quantified size criteria for SMEs determination and do not differentiate among medium, small and micro entities. It is not feasible to develop quantified tests that would be applicable and long-lasting in all countries which could use this standard. In deciding which entities should be required or permitted to use the IFRS for SMEs, jurisdiction may prescribe quantified size criteria in each particular country[4]. The IASB approach focuses on "the typical SME" with about 50 employees. It is a quantified size test for defining SME but, rather, to help it decide kind of transactions, events and conditions that should be explicitly addressed in the IFRS for

4 For example: Industry Canada (available on http://sbinfocanada.about.com/od/businessinfo/g/SME.htm) uses a definition based on the number of employees. Goods-producing firms are considered "small" if they have fewer than 100 employees, while for service-producing firms the cut-off point is seen as 50 employees. Above that size, and up to 499 employees, a firm is considered medium-sized. The term "SME" is used to refer to all businesses with fewer than 500 employees, while firms with 500 or more employees are classified as "large" businesses.
The Companies Act 2006 in UK (available on http://www.imolin.org/doc/amlid/UK_Companies_Act_2006.pdf) defines a SME for the purpose of accounting requirements. According to this a small company is one that has a turnover of not more than £ 6.5 million, a balance sheet total of not more than £ 3.26 million and not more than 50 employees. A medium-sized company has a turnover of not more than £ 25.9 million, a balance sheet total of not more than £12.9 million and not more than 250 employees. In Japan, capital or total amount of investment together with the workforce is used to define SMEs, but even though the same criteria are used, thresholds that apply to each element not only vary by sector but also by criteria (Lindner, 2005 – available on http://unstats.un.org/unsd/industry/meetings/eg2005/AC105-22.PDF). The US has chosen to set size standards for each individual NAICS coded industry. This variation is intended to better reflect industry differences (less than 500 employees for for most manufacturing and mining industries (U.S. Small Business Administration, 2002 – available on http://www.sba.gov). Germany has limit of 255 employees (HGB – available on http://www.gesetze-im-internet.de/hgb/BJNR002190897.html).

SMEs. There could arise any problem, because IFRS for SMEs could not be suitable for all kinds of entities in the SMEs spectrum, especially for very small entities (micro entities). This kind of entities prepares financial statements especially for taxation purposes. The close linkage between the tax and accounting regimes in several Member States would also result in the preparation of an additional set of accounts. Under these conditions the three tiered reporting framework as shown in the table could be suggested. Approaches of the application in the UK, Ireland and South Africa show in favor of this proposal. The Accounting Standards Board (ASB) in the UK is presently consulting on a new three tier reporting framework to replace current UK GAAP (O'Keeffe, Hackett, 2011). The results of the field testing of ED of IFRS for SME provided evidence of the suitability of the proposed IFRS for SMEs help to identify any aspects which may need modification. According to Stainbank (2008) SAICA embarked on a questionnaire survey addressed to both owners of small and micro entities and small practitioners to assess the need for a South African Micro GAAP framework. This provided further evidence on whether there is a need for a third tier financial reporting standards.

Implementation of IFRS for SME

In 2010, the European Commission decided to seek the opinion of the EU financial statements users on the IFRS for SME. In spite of some resistance, there is majority support for Europe's plan to adopt the new standard, which is currently scheduled to be introduced for small and medium companies. There are the most significant proponents of IFRS for SME implementation. They are the United Kingdom and Ireland (ACCA, 2011), (Burke, Quigley, Regan, 2011). According to Simon (2010), in the UK the adoption of IFRS for SMEs is a high priority and is likely, subject to final confirmation, to be mandatory for fiscal years beginning on or after January 1st 2012. This means that affected companies will need to prepare an IFRS opening balance sheet on 1st January 2011. However, indications from the ASB are that this timeline will slip by one year, meaning adoption of IFRS or IFRS for SMEs will be required from 1 January 2013. The ASB is proposing that accounting in the UK should take the form of a three-tier reporting structure as well.

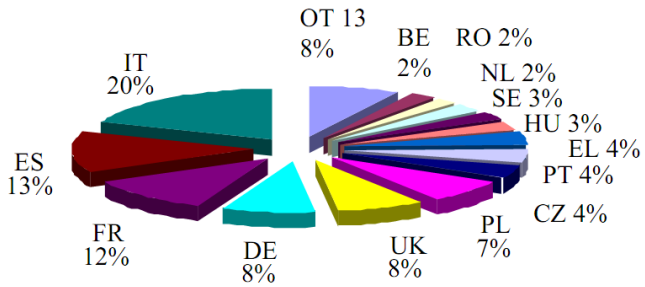
On the other hand, there is some reluctance to adopt IFRS from SME within Europe[5]. Reluctance in Europe owes much to objections from France and Germany. At the EU's headquarters in Brussels, debate revolves around whether to make the new rules voluntary or mandatory. Germany and France both rely on their accounting systems for tax collection, which is fuelling reluctance to support the standards. Fig. 1 provides representation of individual member countries from the total number of SMEs in the EU documents the importance of this view.

The adoption and successful implementation of the IFRS for SMEs is burdened by, amongst other possible factors, not only a lack of formalities but also the variety of definitions and different classification for SMEs by different countries. As a result the comparability of SMEs is not always possible.

I: *The proposal of EU reporting framework*

Tier	Accounting regime	Type of entity
1	Full IFRS	Listed companies
2	IFRS for SMEs	Non-publicly accountable companies
3	National GAAP	Micro-entities or small entities

Source: Bohušová, 2011



1: *Representation of individual member countries from the total number of SMEs in the EU*
Source: Tudor, A. T., Mutiu, A.

5 According to Christodoulou (2010) Pacter's survey also revealed reluctance from a number of nations. Joining France and Germany on the list was Netherlands, Poland, Malta, Slovenia and Switzerland (http://www.accountancyage.com/aa/news/1775891/sme-standards-set-adoption-globe).

In some countries the possible effects or issues associated to IFRS for SMEs implementation were empirically studied, by regulatory bodies, accountancy firms, professional bodies or researchers. For example, a field-testing conducted in France by Mazars (2007) concludes that the application of the IFRS for SMEs in France is highly accepted. Another filed-testing done in France by the Conseil National de la Comptabilite concludes that French SMEs do not need this standard. The contrasting results are explained through the population's dimension and the lack of representativeness (the results are not generalisable). This is only one case which underlines the need for a substantiated strategy for IFRS for SMEs implementation on solid empirical studies (Albu, Albu, Fekete, 2010).

RESULTS

In most of EU-countries the implementation of IFRS for SMEs has not taken place yet. There were performed analyses of financial reporting system, which are used in selected countries with a focus on reporting of biological assets and agricultural produce with an analysis of potential impacts on their reporting after the potential implementation of IFRS for SMEs. From the analysis of financial reporting systems undertaken in selected countries (Elad, Herbohn, 2011), results that financial reporting systems used for small and medium-sized businesses in the U.S., Great Britain, France or the Czech Republic do not reflect significantly the specifics of agricultural produce. The only country which puts emphasis on the characteristics of agriculture, in its national financial reporting system, has been Australia since 1998[6].

At present also IFRS for SMEs reacts to the specifics of agriculture. IFRS for SMEs could replace the national systems of financial reporting for small and medium companies in future. In IFRS for SMEs there is a section devoted to agriculture, Section 34 – Specialised Activities. Treatments for recognition, recording and reporting of biological assets, biological transformation and agricultural produce use analogous approaches as in IAS 41 in respect of the fundamental requirements for financial reporting under IFRS for SMEs (costs may not exceed the benefit from obtained information and efforts invested in order to obtain such information should not be excessive).

IFRS for SMEs defines the basic concepts in relation to agricultural activities, which are:

- Biological asset: a living animal or plant;
- Agricultural produce: the harvested product of biological assets[7].

IFRS does not require the fair value less costs to sell in the same extent as IAS 41 for SMEs evaluation in order to methodological procedures in relation to agriculture would reflect above mentioned requirements. In accordance with section 34, an entity involved in agricultural activity measures biological assets at fair value less cost to sell where such fair value is readily determinable without undue cost or effort. Where fair value cannot be determined without undue cost or effort, the entity measures such assets at cost less any accumulated depreciation and any accumulated impairment losses.

The agricultural produce harvested from biological assets is measured at fair value less estimated costs to sell at the point of harvest. Increases and decreases in fair value are reported as under IAS 41. Gains or losses on initial recognition and from change in fair value are recognized in profit or loss of the period[8].

IFRS for SME in Section 34.2 (a) requires using fair value in measurement of biological assets. An entity using this IFRS for SME that is engaged in agricultural activity shall determine its accounting policy for each class of its biological assets. 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 the cost model for all other biological assets. Agricultural produce harvested from biological assets shall be measured at fair value less estimated costs to sell at the point of harvest. Such measurement of the cost at that date when Section 13 Inventories is applying or other sections of IFRS for SMEs.

In determining fair value, an entity shall consider by IFRS for SME the following:

(a) 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 entity has access to different active markets, the entity shall use the price existing in the market that it expects to use. If an active market does not exist, an entity uses one or more of the following, when available, in determining fair value:

(i) the most recent market transaction price, provided that there has not been a significant change in economic circumstances between the date of that transaction and the end of the reporting period;

(ii) market prices for similar assets with regulation to reflex differences; and

(iii) sector benchmarks such as the value of an orchard expressed per export tray, bushel, or

6 AASB 1037 SGARAs
7 IFRS for SMEs Glossary
8 IFRS for SMEs 34 paras 4–6, 8–9

hectare, and the value of cattle expressed per kilogram of meat.

(c) In some cases, the information sources listed in (a) or (b) may suggest different conclusions as to the fair value of a biological asset or agricultural produce. An entity considers the reasons for those differences in order to achieve the most reliable estimation of fair value within a relatively narrow range of reasonable estimates.

(d) In some circumstances, fair value may be readily determinable without undue cost or effort even though market determined prices or values are not available for a biological asset in its present condition. An entity shall consider whether the present value of expected net cash flows from the asset discounted at a current market determined rate results in a reliable measure of fair value.

The main reasons for departure from the historical cost to fair value could be found in low information capacity of historical costs and in distribution of higher profit to owners due to undervaluation of assets. In the case of agriculture it could be considered on the contrary. Users were skeptical to lot of information, as for use of fair value in relation to agriculture in comments to the Exposure Draft of IAS 41 – Agriculture, which is based on the similar principles. Fair value measurement was considered to be too academic, and to be an inappropriate method of measurement for biological assets (Herbohn, 2006). Booth and Walker (2003) were focusing on measurement of biological assets in viticulture in Australia and they stressed practical difficulties in valuating biological assets at fair value separately from the land on which they are located. Some preparers and auditors of the financial statements of SMEs engaged in agricultural activities are against the fair value measurement in agriculture (IFRS for SME, BC, 2009). In their opinion the 'fair value through profit or loss' model is burden for SMEs, particularly when applied to biological assets of those SMEs operating in inactive markets or developing countries. The presumption that fair value can be estimated for all biological assets and agricultural produce is unrealistic with respect to biological assets of some SMEs. According to EC (2000) fair value measurement is not in accord with the European Accounting Directives. The accounting Directive still sets out an historical accounting model for measurement (excluding certain financial instruments).

In opinion of opponents of fair value measurement in agriculture, SMEs should be permitted to use a 'cost-depreciation-impairment' model for all such assets. The IASB did not support this approach. According to IASB, not only fair value is generally regarded as a more relevant measure in agriculture, quoted prices are often readily available, markets are active, and measuring cost is actually more burdensome and arbitrary because of the extensive allocations required. Managers of most SMEs that undertake agricultural activities say that they manage on the basis of market prices or other measures of current value rather than historical costs. Users also question the meaningfulness of allocated costs in this industry. There is an active market for biological assets and agricultural produce at the point of harvest. This is the best evidence of fair value of biological assets or agricultural produce. The problem arise in case of the measurement of agricultural produce a few month or even some years before the point of harvest. An active market exists only for mature products. Regardless of the measurement basis (costs or fair value) a jump in the value of biological assets will occur at some time.

Entities are required to use the fair value through profit or loss model only when fair value is readily determinable without undue cost or effort. In other case SMEs should follow the cost-depreciation-impairment model.

Initial recognition of biological assets

Biological assets are measured at the fair value less cost to sell for the initial recognition. A biological assets shall be measured at its cost only on initial recognition for biological assets for which market-determined prices or value are not available and alternative estimates of fair value are unreliable. The initial losses usually arise. The purchase costs of biological asset is often higher than their fair value less cost to sell, transaction expenses create a loss. In the case that biological assets determined for biological transformation are purchased, there is a gain or loss on remeasurement to fair value less cost to sell. In practice it is usually the initial losses, as the fair value is reduced by estimated cost of sales and assets entering into the process of biological transformation are usually purchased at a price approaching to their fair value.

The birth of new breeding animals represents a special case of recognition of biological assets. The gain could arise in generation of a new biological asset, for example calf or piglet and its recognition. There is no new born animals market (active market exists for animals from a certain age). It is the main reason against fair value measurement for this purpose. Most of national GAAPs require application cost for agricultural produce measurement. It is not possible to measure cost of newborn animal reliable in these systems. Therefore cost is not used for this purpose and reporting units use sector benchmarks, i.e. the value of animal expressed per kilogram of meat, etc.

Measurement after recognition

A lot of subsequent costs relating to agricultural activity are incurred during the biological transformation process. They could include planting, weeding, irrigation, feeding, harvesting or slaughtering costs. Some of these costs are capitalized under many national GAAPs, especially those relating to the development of immature plants or livestock up to productive stage. The other expenditures are expenses in the period

when incurred. IFRS for SME does not prescribe any treatment of subsequent costs on biological assets presenting. It is up to management judgment to determine the way of their recording, or which costs are suitable for capitalization. There are different ways of recording of biological assets and agricultural produce in accordance with IFRS for SMEs. It can be assumed that in a particular country the actual recording of process of biological transformation will be significantly influenced by the used methods of recording under a national GAAP, such as in the Czech Republic there is used a capitalization method of costs incurred into the costs of agricultural assets and agricultural produce.

There are two main groups of biological assets: consumable biological assets, which are harvested as agricultural produce (livestock for the production of meat, livestock held for sale, crops as maize or wheat, trees grown for timber) and bearer biological assets which are biological assets other than consumable biological assets (livestock for milk production, grape vines, fruit trees). Assets in this group are not agricultural produce, but they are self-regenerating.

In case of biological produce harvested from consumable assets are biological assets converted into agricultural produce, which is measured at FVLCS. The difference between the measurement of biological assets and FVLCS of agricultural produce is reported as a gain or loss. Expenses incurred in relation to the harvest of biological produce are recognized as an costs or may be capitalized similarly as expenses incurred during the transformation of biological assets. The amount of recorded gain or loss and the income statement structure depend on the method of reporting costs incurred in relation to the harvest. In the authors' opinion cost impairment model measurement can be recommended for agriculture assets that are not in condition suitable for implementation (during the biological transformation) there is no active market. The FVLCS measurement would be burdensome and the information value of this measurement would not have a significant benefit for an entity.

In contrast to consumable assets, during the harvest of agricultural produce from bearer assets, biological assets remain to the entity, but their value after the harvest mitigates due to separation of agriculture produce from these assets. Agricultural produce in the form of fruit, milk, hops, etc. is measured at FVLCS and there is gain. The authors in this case recommend the measurement of bearer assets through cost-depreciation-impairment model. Also Aryanto(2011) does not consider bearer biological assets to be appropriate for the measurement at FVLCS.

FVLCS measurement and recognition of differences in the changes of FVLCS in profit or loss would lead to misleading information. This is due to the revenue associated with these assets will never be earned and realized. Examples of biological assets that are not held for capital appreciation or sale are stud cows and laying hens. Both animals in this example are the biological assets that are used only in order to produce other biological assets. In the case of laying hens, when the hens are still laying eggs, the increase in fair value does not reflect the unrealized income because it will never be realized. Also, after these hens no longer lay eggs, they are usually disposed because they have no more value.

Consumable biological assets with long production cycle

There is a major problem – how the standard should be applied to forest assets. The reported value of standing timber should reflect FVLCS. Land, as distinct from the trees growing on the land, is accounted for under section 17 – Property, Plant and Equipment of IFRS for SMEs. Section 34 allows different methods in determining the fair value estimate: market value is preferred but if reliable market-based prices are not available, fair value is the present value of expected net cash flows from the asset discounted at a current market rate (the "discounted cash flows or DCF" method). In some situations historical cost is an allowed treatment. A key conclusion of PWC study (2009) is that few of the studied companies have used market-based prices for standing timber. Net present value arrived at a DCF-modelling is by far the most common method of determining fair value by business entities reporting under full IFRS. The main reason provided for using discounted cash flow methods is the lack of active markets for large plots of forest land, implying a lack of reliable quoted market prices for standing timber. Some companies have stated that newly planted trees are carried at cost, which is deemed to be an indicator of their fair value. Argiles, Slof (2001) and Elad (2004) concluded that the contribution of methodology of agriculture reporting under IFRS is mainly conceptual and requires additional tools for implementation in practice, like some form of accounting plan.

SUMMARY

The fact that the IFRS for SMEs was prepared as a tool to harmonize financial reporting of SMEs type can be appreciated. It is important that the IASB has found farming so different from other activities performed in order to achieve profit, that treatments for recognition, recording and reporting of biological assets, biological transformation and agricultural produce would reflect the specifics of this activity. The IFRS for SMEs devoted to agriculture a section 34 – Special industries. The main objective

of this section is the application of special treatments that reflect the specificities of agriculture, while allowing easy and cost-effective application in practice.

Application of IFRS for SMEs can be largely influenced by national GAAP and therefore problems with the application of standards can vary in the individual countries. The authors focused on the application of IFRS for SMEs in agriculture, mainly because there have not been extensive experience with application of full IFRS (IAS 41) in agriculture. From the limited number of previously performed analysis (Argilés, Slof, 2001), (Elad, Herbohn, 2011), (Booth, Walker, 2003) and others results that the application of IAS 41 in entities engaged in agricultural activity yielded significant differences in the financial statements, significant annual changes in the value of assets, significant annual changes in the value of profits due to transition to a different way of reporting of biological assets, biological transformation and agricultural produce. These differences were mainly caused by a change in methodology of measurement – the transition to fair value, since in all countries that were examined, the measurement was based on historical costs. IFRS for SMEs is a requirement for fair value measurement that is more liberal and major criteria for deciding whether to use fair value measurement for biological assets, biological transformation and agricultural produce, are considered the costs of obtaining information and benefits of relevant information. For this reason one can induce that in areas where fair value is readily ascertainable, the entity will move to fair value, in other cases will continue to use historical cost as a valuation basis.

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