

ACCOUNTING TREATMENT FOR FOREST MANAGEMENT UNIT

The issues:

Facts of the Matter

Company A proposes to acquire Company B, a company which had entered into a Sustainable Forest Management License Agreement with the State Government. Pursuant to the License Agreement, the State Government has granted permission to Company B for a period of 100 years to plant, rehabilitate and harvest forests under the principles of sustainable forest management and environmental conservation for economic, environmental and social purposes, in a certain Forest Reserve area, in consideration of the payment of all dues and royalties by Company B to the Government ("Forest Management Unit").

In order to determine the fair value of the identifiable assets acquired in accordance with FRS 3 "Business Combination", a valuation was conducted by an independent valuer to ascertain the fair value of the Forest Management Unit.

The valuation has determined the fair value of the Timber Rights and Planting Rights accruing to Company B with the following basis of valuation:-

- 1) In valuing the permission for harvesting the timbers ("Timber Rights"), the valuer has considered the total amount of available timber, the amount that can be extracted, i.e. the net yield per hectare, the organisational capacity to profitably extract the targeted amount; and
- 2) In valuing the permission for planting and rehabilitating the forest ("Planting Rights"), the valuer has adopted the comparison method i.e. compared the property with similar properties that were sold recently and those that are currently being offered for sale in the vicinity

Question

In the consolidation of Company A's financial statements in the acquisition of Company B, to determine whether:-

- 1) the Forest Management Unit (at fair value) is a tangible asset; and
- 2) the classification of Forest Management Unit as Biological Asset is appropriate.

Current Practice:

There are no MASB approved accounting standards in respect of a Forest Management Unit.

A company is currently capitalises the right to harvest logs from an acacia magnium plantation and the replanting of acacia magnium and acacia hybrid on a sustainable basis as tangible asset.

Reasons to address the issue:

The issue is imminent and widespread, and is raising practical concern as to how to synchronize future applications.

**Malaysian Institute of Accountants
Financial Reporting Standards Implementation Committee (FRSIC)**

Proposed Consensus:

Reference is made to MASB ED50 "Agriculture" to assess whether the fair value in relation to the Timber Rights qualify to be capitalised as biological assets with physical substance.

In accordance to MASB ED 50 para 10, an entity shall recognize a biological asset or agriculture produce when, and only when:

- a) the entity control the asset as a result of a past event;
- b) it is probable that future economic benefit associated with the asset will flow to the entity; and
- c) the fair value or cost of the asset can be measured reliably.

Based on interpretation of the standards, the Forest Management Unit qualifies for recognition as a Biological asset which in turn is as a tangible asset of the company, as the license agreement gives the company the right to use forest for a period of 100 years. Therefore, the company has control over the asset. The future economic benefit of the use of forest will flow to the company and the fair value of the asset can be measured reliably based on professional valuation.