

# New accounting standard for reporting forest values

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Currently, there is no financial reporting standard in New Zealand that encompasses all agricultural activities and assets which show natural value increase, including forestry. In April 2002, the Financial Reporting Standards Board (FRSB) issued ED-90, an Exposure Draft of a Standard for the accounting treatment and financial statement disclosures related to agricultural activity. ED-90 was based on the International Accounting Standard IAS 41 and proposed no significant departures from IAS 41.

Respondents to ED-90 (including the NZIF Forest Valuation Working Party) generally supported the idea of harmonisation and acknowledged the need for a standard on biological assets. However they expressed significant concerns regarding the practical implementation of the Standard, in particular:

- the ability of entities to determine fair value and the subjectivity of such values;
- the impact of fluctuations on financial performance;
- the difficulties of measuring the value of land separately from crops; and
- the compliance costs anticipated.

In March 2004 the FRSB, in line with its policy of adopting international standards, decided to adopt IAS 41 Agriculture instead of following ED90 implementation. Application of the standard will be to annual accounting periods beginning on or after 1 January 2007 (or, in the case of entities choosing to adopt it early, annual accounting periods beginning on or after 1 January 2005).

It is still unclear what entities will have to report under the new standard. The Ministry of Economic Development (MED) is currently reviewing the financial reporting structure in New Zealand. The MED has released (15 March 2004) a Discussion Paper which considers the financial reporting structure in New Zealand and addresses the issue of "who is required to report?" Copies of the Discussion Paper and further details of the objectives of the review are available at [www.med.govt.nz](http://www.med.govt.nz).

The MED proposals, if adopted, would give relief to many smaller entities currently subject to full financial reporting requirements. An entity would generally be "small" for the purposes of the Financial Reporting Act if it did not exceed two of the following:

- more than \$5 million in assets;
- more than \$10 million in revenue; and
- more than 20 full-time equivalent employees.

The FRSB is seeking comments from constituents on the adoption of proposed NZ IAS 41. However it is likely that only limited change will be able to be accommodated. The Accounting Standards Review Board (ASRB) has instructed the FRSB that they should essentially adopt IAS and has restricted the changes that can be made. The FRSB cannot:

- reduce the IAS disclosure requirements (but can increase them) for at-profit entities;
- alter measurement requirements for at-profit entities; or
- provide additional guidance material for at-profit entities.

The International Accounting Standards Committee (IASC) has an International Interpretations / Urgent Issues Group that can be asked to allow additional guidance. In the longer term it may be possible to get changes to IAS 41.

The NZIF Forest Valuation Working Party is preparing a submission to ICANZ on the adoption of IAS 41 – we are concerned that the accounting standard articulates with the NZIF Forest Valuation Standards. The standard will have a major impact on forest accounting in New Zealand, particularly the requirement for any change in forest value to be treated as income.

The major issues that we have are:

1. "Fair Value" is a vague term and will not generate comparable valuations on balance sheets because concepts of "value to the (owning) business" basis are likely to be allowed. The "accounting for value change" approach of IAS41 will of itself do nothing to remove incompatibility between forest values calculated and reported by business entities.
2. Because the valuation basis is vague, the underlying philosophy for tax provisioning is correspondingly undefined. Accounting only partially recognises the time value of money in tax calculations and it is likely that forest tax provisioning for forests is poorly understood by most accountants who do not tackle it frequently. It is likely that the balance sheet value less the forest tax provision will not equal a realistic "tax paid market value" to the owner.
3. The new approach that forests are to be valued

annually and accounted as such sounds reassuring but may be misleading to many stakeholders especially in situations where the owner needs to sell but the forest has been valued on a "fair value in use" and not on a market value basis.

4. Accountants generally do not have the expertise to attempt forest value calculations, even "value to business" and "Fair Value" calculations.

5. We are uneasy about two practical issues.

a. Most "valuations" will show abrupt annual fluctuation (especially those for export forests). The scale of fluctuation will be unacceptable to

managers who will respond by adjusting "fair valuation" rules (e.g. by adopting long run price averages, smoothed cuts etc.) to smooth the annual indicated profit. This destroys the utility of a valuation approach.

b. There are many small and smallish owners for who the cost of a valuation (as NZIF knows it) is prohibitive - even if there are size threshold exemptions to accommodate them. The response will be a whole lot of poor "valuation" practices, which will undermine the "proper" approach we have striven to establish. The IAS41 standard does not say who should value a forest and the level of expertise or independence required.

## letters

# Selective harvesting

Sir,

In two recent articles in your journal, our operation at Woodside Forest, Coopers Creek, has been used in discussion of the pros and cons of selective harvesting. This would be acceptable if the information published was correct, but unfortunately, this was not the case. I feel therefore that it is necessary for me to put the record straight.

Grant Rosoman in the August 2003 issue of this journal, in answer to a letter by John Purey-Cust, refers to our operation as restoration forestry. We have not undertaken any restoration forestry but rather are managing an area of regrowth beech which has re-established naturally after being destroyed by logging and fire in the 1890s. Nick Ledgard, in his letter in the February 2004 issue, in response to a question raised at a field day, discusses our operation and offers his explanations as to why we are able to operate on a smaller scale than they are at Mt. Barker. He describes our operation as unique and gives a number of reasons e.g.

- *That our timber is being harvested and processed using our own customised equipment.* This is incorrect. Apart from a trailer that we had specifically designed and constructed, I can't think of any item related to our harvest which could be regarded as 'customised equipment'.
- *That our operation is carried out by a family living on site* – presumably as a captive labour force. I wish he was correct but unfortunately this ceased to be so at least seventeen years ago when the last of our children left home. I'm afraid that like most farmers of our age, we rely on our own input and that of hired labour and contractors.

Perhaps Nick could have given a more feasible

explanation by noting that the forest type, forest management and economic potential of Mt. Barker and Woodside are as different as chalk and cheese. At Woodside, we have a total production area of 100 hectares (70 hectares of beech and 30 hectares of radiata pine) c.f. 380 hectares for Mt. Barker. In both the beech and the pine, we have adopted a selection silvicultural system where harvest criteria are based on the individual tree diameters. The system is described in Harley and Smith "Foundations of Silviculture" as a modification of 'economic selection cutting'. When steady state is reached using this system, the volume production from our radiata pine alone is likely to equate with the total predicted annual cut from Mt. Barker, and judging by the article on Mt. Barker in Country-Wide, January 2004, our average net value per m<sup>3</sup> is likely to be at least six times as much.

Nick Ledgard states that low impact harvest regimes such as we carry out at Woodside are virtually impossible to implement cost effectively and that the main reason is that in N.Z. we don't have harvesting crews with skills or equipment to practise such systems. In our experience, this is incorrect. We have no trouble employing contractors with the appropriate skills – being on the spot no doubt ensures a high quality of work. Further, when one is taking a total living off a property and foots the bill for management costs from the proceeds of sales, one is more motivated to employ the right people for the right job, at the right price. And, believe me, these people are there. It is a different story perhaps if your main income is independent of the forest operation. As Nick points out about his operations in the Country-Wide article, "we're not in it for the money – we've got the luxury of playing around with it".

JA Wardle