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FINANCIAL REPORTING STANDARDS IMPLEMENTATION COMMITTEE

FRSIC Consensus 12

Sustainable Forest Management Concession Arrangements

Introduction

FRSIC Consensus 12 “Sustainable Forest Management Concession Arrangements” was developed by the Financial Reporting Standards Implementation Committee (“FRSIC”) and issued by the Malaysian Institute of Accountants (“MIA” or “Institute”) on 1 September 2009.

The Consensus contained herein is issued as part of the Institute’s initiatives to promote best practices in compliance with the highest standards in financial accounting.

FRSIC CONSENSUS 12

SUSTAINABLE FOREST MANAGEMENT CONCESSION ARRANGEMENTS

FRSIC Consensus is guidance issued by MIA and shall be regarded as best practice. It should be read in conjunction with the respective applicable accounting standards.

Members of MIA are expected to observe compliance to the consensus issued. In exceptional circumstances where departure is necessary, members shall be prepared to justify the departure.

FRSIC Consensus need not be applied to immaterial items. Nothing in the FRSIC Consensus is to be construed as amending or overriding the accounting standards or other statements adopted or issued by the MASB and other relevant laws.

Background

- 1 In Malaysia, the jurisdiction of forestry matters rests with the Government. Through the respective Forestry Departments, the Government is responsible in forest management, administration, logging regulation, silviculture and rehabilitation.
- 2 The Government may award timber concessions to allow concessionaires to undertake timber harvesting activities for a specific period of time. Conventionally, the timber concessionaires are not obliged to rehabilitate the forests after the timber harvesting activities.
- 3 An alternative arrangement which helps to promote sustainable forest management initiatives implemented in certain jurisdictions is to license forest areas known as Forest Management Units ("FMU") to be managed for a specific period of time ("License Period") under a Sustainable Forest Management License Agreement ("SFMLA"). Under such an arrangement, the Government grants permission to the licensee of SFMLA ("Licensee") over a specific period of time to plant, rehabilitate and harvest timber and other forest produce under the principle of sustainable forest management and environmental conservation for economic, environmental and social purposes within the allocated FMU in consideration of the payment of all dues, fees and royalties by the Licensee to the Government and costs to meet any contractual obligations.

- 4 The forest area allocated for the most part pursuant to the SFMLA comprises of logged forests with very little unlogged pristine forests and hence, there is a need for heavy initial investment in reforestation and silviculture.
- 5 The responsibility of the Licensee to plant and rehabilitate pursuant to the SFMLA is viewed as an extension from a conventional timber concession. Besides having the ability to obtain future economic benefits from harvesting timber and other forest produce, the Licensee possess, among others, the following contractual rights and obligations arising from the SFMLA:

Right

- Establishment of Timber Plantations within the FMU for planting of specific species as approved by the Government

Obligation

- Reforestation and rehabilitation of logged-over forest areas
 - Silvicultural treatment
- 6 Other than the rights licensed to the Licensee pursuant to the SFMLA, all other rights (such as mining and drilling rights) continue to remain vested with the Government. This includes authorisation for right of way within the FMU and authorisation for collection and removal of minor forest produce not granted to the Licensee pursuant to the SFMLA.
 - 7 All of the Licensee's activities in the FMU are regulated by the Government. Permission from the Government is required prior to the commencement of any specific activity at any point of time during the License Period. Besides, timber and other forest produce harvested are subjected to royalty or rent payment to the Government.

The Issue

- 8 The issue addressed in this Consensus is whether the costs incurred by the Licensee within a sustainable forest management concession arrangement shall:
- (a) all be recognised as an intangible asset (similar to a conventional timber concession) in accordance with FRS 138 “Intangible Assets”; or
 - (b) be recognised separately as intangible assets, tangible assets or expenses in accordance with the applicable FRSs.

Consensus and Basis of Consensus

- 9 The Committee decided that the guidance will focus solely on recognition of costs incurred by the Licensee in silvicultural treatment and planting activities within the FMU, as well as payment of dues, fees and royalties by the Licensee to the Government. Such costs are directly associated with the Licensee’s obligations pursuant to the SFMLA in return for the rights to obtain future economic benefits from the FMU operations. This guidance will not be addressing any measurement, presentation or disclosure issues. Similarly, this guidance also does not deal with any issues relating to liability elements pursuant to the SFMLA, as well as any incidental costs and infrastructure that is required to be constructed or acquired by the Licensee to facilitate the FMU operations.
- 10 In a conventional timber concession, a concessionaire holds the right to harvest timber from designated forest reserve over a short period of time in exchange for a lump sum payment to the Government. A timber concession arises from contractual rights (without physical substance) controlled by a concessionaire as a result a past event, from which future economic benefits from the sale of harvested timber are expected to flow to the entity. Hence, a timber concession meets the definition of an intangible asset and should be recognised in accordance with FRS 138 “Intangible Assets”, when the recognition criteria in that FRS are met.
- 11 The Committee noted that the Licensee is obliged to engage in silvicultural treatment and planting activities within and beyond Timber Plantation areas as a condition in the SFMLA.

- 12 In production areas zoned as Timber Plantation areas, the liberty to harvest is usually granted to the Licensee at the commencement of activities. Nevertheless, the permission to harvest in other production areas may be given on a staggered basis, subject to satisfactory fulfillment of contractual obligations on a continuous basis pursuant to the SFMLA.
- 13 The Committee agreed that the planting and silvicultural treatment undertaken by the Licensee constitutes an agricultural activity. Nevertheless, the Licensee may not have control over the biological assets in all circumstances. Although the Licensee may control the biological assets transformed from agricultural activity in the Timber Plantation areas (as the liberty to harvest has been obtained at commencement), such control may not exist for biological assets transformed from agricultural activity in areas beyond the Timber Plantation areas.
- 14 Hence, the costs incurred in the Licensee's agricultural activity shall be recognised in accordance to its identifiable nature, as follows:

Where control over the biological assets is established

- (a) Biological assets in accordance with MASB ED 50 "Agriculture"¹;

Where control over the biological assets could not be established

- (b) Intangible assets in accordance with FRS 138 "Intangible Assets" – if the agricultural activity constitutes a contractual obligation associated with the ability to obtain future economic benefits (for example, subsequent permission for harvesting) and it is probable that the expected future economic benefits will flow to the entity; or
- (c) Expenses – if no future economic benefit is expected to flow to the entity as a result of the agricultural activity.
- 15 The Committee also noted that the conditions stipulated in the SFMLA may attract the payment of dues, fees and royalties by the Licensee to the Government before and/or during the License Period. In general, the Government may impose charges on the Licensee under the following circumstances:
- (a) Consideration for the rights attached to the SFMLA or permission to carry out specific activities during the License Period; and
- (b) Levy on the timber and other forest produce harvested by the Licensee.

¹ The accounting policy for biological assets shall be determined by applying MASB ED 50, the equivalent of IAS 41 "Agriculture", when the Standard becomes effective for application in Malaysia. In the interim, an entity shall use its judgment in developing and applying an accounting policy for biological assets, taking into consideration the provisions contained in Paragraphs 10 – 12 of FRS 108 "Accounting Policies, Changes in Accounting Estimates and Errors".

- 16 Therefore, payment of dues, fees and royalties made by the Licensee shall be recognised as follows:
- (a) Payments which would result in the ability of the Licensee to obtain future economic benefits shall be recognised as intangible assets in accordance with FRS 138; and
 - (b) Levies on harvest shall be recognised as cost of inventories in accordance with FRS 102 "Inventories"

Issuance Date of this Consensus

- 17 This Consensus is issued on 1 September 2009.

References

Framework for Preparation and Presentation of Financial Statements

FRS 102 "Inventories"

FRS 108 "Accounting Policies, Changes in Accounting Estimates and Errors"

FRS 138 "Intangible Assets"

MASB ED 50 "Agriculture"