

Statement of Financial Accounting Standards No. 40

Note: This Statement has been completely superseded

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Financial Reporting and Changing Prices:
Specialized Assets—Timberlands and
Growing Timber

(a supplement to FASB Statement No. 33)

November 1980



Financial Accounting Standards Board

of the Financial Accounting Foundation

401 MERRITT 7, P.O. BOX 5116, NORWALK, CONNECTICUT 06856-5116

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a supplement to FASB Statement No. 33
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FAS 40: Financial Reporting and Changing Prices: Specialized Assets—Timberlands and Growing Timber

a supplement to FASB Statement No. 33

FAS 40 Summary

This Statement extends the interim provisions in FASB Statement No. 33, *Financial Reporting and Changing Prices*, for the measurement of timberlands, growing timber, and related expenses, in information on a current cost basis. It requires enterprises that present information on a current cost basis to combine measures of those assets and expenses at either historical cost/constant dollar amounts or current cost amounts with current cost measures of other assets and expenses. Statement 33 provides that an enterprise need not present information on a current cost basis if there would be no material difference between that information and information on a historical cost/constant dollar basis. Therefore, an enterprise needs to present information on a current cost basis only if it has significant holdings of inventory, property, plant, and equipment apart from timberlands and growing timber. This Statement applies to fiscal years ended on or after December 25, 1980.

The Board will continue to work with its advisory task group for the forest products industry to develop, as soon as possible, improved methods of measuring the effects of changing prices on this industry.

INTRODUCTION

1. FASB Statement No. 33, *Financial Reporting and Changing Prices*, establishes standards for reporting certain effects of price changes on business enterprises. Statement 33 requires large public enterprises to disclose information on both a historical cost/constant dollar basis and a current cost basis. Current cost information is required for fiscal years ended on or after December 25, 1979, but first presentation of the information can be postponed for one year.

2. If an enterprise does not postpone its first presentation of current cost information, it is required to follow the provisions of Statement 33 for the preparation of that information. Under those provisions inventory, most kinds of property, plant, and equipment and related expenses are measured at current cost amounts but timberlands, growing timber, timber harvested, and certain other specialized assets may be included at historical cost adjusted by either a specific price index or a general price index.

3. The provisions of Statement 33 for the measurement of timberlands and growing timber, in information on a current cost basis, are interim provisions applicable for fiscal years ended before December 25, 1980. This Statement extends those interim provisions. It requires enterprises that present information on a current cost basis to combine measures of timberlands, growing timber, and related expenses at either historical cost/constant dollar amounts or at current cost amounts with current cost measures of other assets and expenses. This Statement permits use of the same approaches as were permitted under the interim provisions of Statement 33 but it also permits the use of other methods of estimating current costs. This Statement provides greater flexibility in measurement because current cost is a broader measure than historical cost adjusted by a specific price index.

4. Statement 33, paragraph 31, provides that an enterprise need not present information on a current cost basis if there would be no material difference between that information and historical cost/constant dollar information. That provision, together with the provisions in this Statement, means that an enterprise needs to present information on a current cost basis only if it has significant holdings of inventory, property, plant, and equipment apart from timberlands and growing timber.

5. This Statement does not set a time limit on the applicability of these interim provisions. However, the Board will work with its advisory task group for the forest products industry to develop improved methods of measuring the effects of specific price changes on timberlands and growing timber; it will issue a Statement to supersede the interim provisions of this Statement as soon as that action is justified by the available evidence.

STANDARDS OF FINANCIAL ACCOUNTING AND REPORTING

Supplement to FASB Statement No. 33

6. Paragraph 53 of Statement 33, as amended by paragraph 12 of FASB Statement No. 39, *Financial Reporting and Changing Prices: Specialized Assets—Mining and Oil and Gas*, is superseded as follows:

This Statement does not contain provisions for the measurement, on a current cost basis, of income-producing real estate and unprocessed natural resources and related depreciation, depletion, and amortization expense for fiscal years ended before December 25, 1980 (paragraph 19). If an enterprise presents information on a current cost basis for a fiscal year ended before December 25, 1980, it may measure those assets and related expenses, at their historical cost/constant dollar amounts or by reference to an appropriate index of specific price changes.

- a. When an enterprise presents information on a current cost basis for fiscal years ended on or after December 25, 1980, it shall measure: *Mineral resource assets* and related depreciation, depletion, and amortization expenses in accordance with the provisions of this Statement for the measurement of property, plant, and equipment and related expenses;

- b. When an enterprise presents information on a current cost basis for fiscal years ended on or after December 25, 1980, it shall measure: *Timberlands and growing timber* (including timber held under cutting contracts) and related expenses at either their historical cost/constant dollar amounts or at current cost or lower recoverable amounts.

7. If an enterprise estimates the current cost of growing timber and timber harvested by adjusting historical cost for the changes in specific prices, those historical costs may either (a) be limited to the costs that are capitalized in the primary financial statements or (b) include all costs that are directly related to reforestation and forest management, such as planting, fertilization, fire protection, property taxes, and nursery stock, whether or not those costs are capitalized in the primary financial statements.

Effective Date and Transition

8. The provisions of this Statement shall be effective for fiscal years ended on or after December 25, 1980.

The provisions of this Statement need not be applied to immaterial items.
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This Statement was adopted by the affirmative votes of five members of the Financial Accounting Standards Board. Messrs. March and Mosso dissented.

Messrs. March and Mosso dissent because there is not adequate reason to delay adoption of the current cost approach proposed in paragraphs 42-44 of the FASB Exposure Draft, *Financial Reporting and Changing Prices: Specialized Assets*. There was substantial support for that approach, particularly for the measurement of income from continuing operations. The principal focus of criticism was on the issue of capitalizing interest on standing timber. Resolution of that issue could easily have been postponed without indefinitely delaying the adoption of current cost measures for income from continuing operations. There are other problems as well, but they are no more severe than the problems in other industries and they could best be resolved, as in other industries, in the context of on-going supplemental reporting. The urgency of getting on with the development of techniques for measuring the erosive effects of inflation on business capital does not permit the leisurely pace exhibited by this Statement.

Members of the Financial Accounting Standards Board:

Donald J. Kirk, *Chairman*
Frank E. Block
John W. March
Robert A. Morgan
David Mosso
Robert T. Sprouse
Ralph E. Walters

Appendix A: BACKGROUND

9. Statement 33, issued in September 1979, does not contain provisions for the measurement on a current cost basis of certain assets and expenses for periods ended on or after December 25, 1980. The Board concluded in Statement 33 that further studies were required to provide a basis for decisions on the applicability to those assets of the requirement to present information on a current cost basis.
10. On April 21, 1980, the Board issued an FASB Exposure Draft, *Financial Reporting and Changing Prices: Specialized Assets*. The Board received 124 letters of comment on the Exposure Draft.
11. In July 1980, the Board conducted a public hearing on the Exposure Draft. Twenty-one organizations and individuals presented their views at the two-day hearing.
12. After issuing the Exposure Draft the Board held five open meetings at which it considered the matters dealt with in the Exposure Draft. In addition, the staff has held meetings with the Forest Products Task Group.
13. This Statement differs from the Exposure Draft principally in that it deals only with timberlands and growing timber and that it contains no requirement for the *separate* disclosure of current cost information for timberlands and growing timber nor any requirement to disclose information about the fair value of timberlands and growing timber. The Board is issuing *separate* Statements dealing with financial reporting and changing prices for (a) mineral resource assets and (b) income-producing real estate.

Appendix B: BASIS FOR CONCLUSIONS

Introduction

14. This appendix reviews considerations that members of the Board deemed significant in reaching the conclusions in this Statement; it includes reasons for accepting certain views and rejecting others. Individual Board members gave greater weight to some factors than to others.
15. Statement 33 requires large public enterprises to disclose supplementary information on a current cost basis. However, it contains only interim provisions applicable to years ended before December 25, 1980 for the measurement of income-producing real estate and unprocessed natural resources. This Statement extends those interim provisions for the measurement of timberlands and growing timber for years ended on or after December 25, 1980.
16. During its deliberations on this Statement, the Board considered the following main possibilities:

- a. Require measurements on a current cost basis
- b. Require information about fair values, defined as the prices that would be accepted as reasonable in transactions between a willing buyer and a willing seller
- c. Continue interim provisions similar to those contained in Statement 33; require measurement, in information prepared on a current cost basis, at either historical cost/constant dollar amounts or at current cost amounts at the option of the preparer
- d. Exempt activities that use timberlands and growing timber from the requirement to present information on a current cost basis.

Current Cost

17. Timberlands and growing timber have certain special features that raise doubts about the usefulness of the type of current cost measures required for other assets. Those special features are of unusual importance in the case of timber but they are not unique to that asset. They arise because timber grows while it is held and because time elapses between planting and maturity.

18. For most assets, information about current costs may be useful because it has a closer and more stable relationship than historical cost to the present value of future cash flows (Statement 33, paragraphs 116-123). Such a relationship is most likely to exist when current cost is measured by a buying price.

19. Some costs of growing timber are not capitalized in the primary statements at the present time. Adjustment of the carrying value of timberlands and growing timber by a specific price index to produce a current cost measurement would probably do little to improve the basis for assessing future cash flows. The development of new procedures for the capitalization of costs might produce a useful measure of current cost, but more work is required to identify improved procedures. The basis for assessing future cash flows might be improved if forest management and similar costs were to be capitalized more comprehensively than at present. Timber takes a long time to grow. Consequently, interest costs or imputed cost of capital also may need to be included in the asset measurement.

20. Information about current costs also may be useful for assessing the ability of an enterprise to maintain its operating capability. For this purpose, expenses should reflect the current cost of resources used or sold during the year. Two cases need to be considered. First, the enterprise may be operating on a sustained-yield basis, with growth approximately equal to the quantity of timber cut. In that case, decisions on what costs should be capitalized make little difference. A change in capitalization procedures, for example, resulting in the capitalization of additional costs, would not significantly affect the amount of income. Expenses for the current year would be reduced by the amount of forest management costs that were to be capitalized but expenses also would be increased by certain forest management costs, capitalized in previous years, and now included at current cost in depreciation, depletion, and amortization expense: the increase would approximately equal the reduction.

21. The second case arises when growth is not equal to the quantity cut. Capitalization procedures then can make a significant difference to income measurement. Improvements in capitalization procedures could give an

expense measurement that was better related to quantities cut and, hence, might provide an improved basis for assessing the maintenance of operating capability. However, further study is required to develop a basis for decisions on capitalization under this approach.

22. Several respondents to the Exposure Draft emphasized the lack of significance of current cost asset measurements obtained under the procedures set out in the Exposure Draft. They favored measurement of income from continuing operations on a current cost basis but thought that information about the current cost of the asset was unreliable and should not be reported. Their comments raise the issue of whether an expense measure can be reliable when the corresponding asset measure is not. After considering the foregoing arguments, the Board decided not to call for measurement of timberlands and growing timber according to the full current cost requirements of Statement 33. It decided that such a requirement should not be imposed until additional work has been undertaken to resolve the difficulties discussed in the preceding paragraphs and until further evidence is available to indicate that the benefits of the information are likely to exceed the costs.

Fair Value

23. Information about the fair value of timberlands and growing timber would be relevant as a basis for assessment of future cash flows. However, some commentators stated that fair values could not be measured with sufficient reliability to justify a requirement for disclosure at the present time. Fair values could be estimated either: (a) by referring to prices at which sales of similar assets had been made or (b) by estimating the net present value of cash flows to be derived from the asset. Application of the first approach would be limited but not excluded because of the absence of sufficient transactions in directly comparable assets. The second approach would depend on estimates of the discount rate, quantities of timber to be harvested in each future year, the future value of logs at the processing point, and future costs of cutting, transportation, and management. Even if quantities were estimable with acceptable reliability, future prices and costs would be highly uncertain, particularly since the processing facility to be used may not exist at the time the computation is made. Accordingly, the Board was not satisfied that fair value would meet the minimum standards of reliability appropriate to inclusion in financial reporting. In addition, some Board members believe that fair value involves a focus on an exit price and, accordingly, has implications that go beyond reporting the effects of changing prices.

24. Some Board members believe that enterprises should be required to present information that would be useful for assessments by users of fair value. They think that the disclosure of information about the quantity of timber on hand, current market prices, and current operating costs may be useful for users while avoiding the danger, in direct reporting of estimated fair value, of giving a misleading impression of reliability. The Board intends to undertake further study of this possibility.

Other Reporting Alternatives

25. The Board considered the exemption of the activities of growing and cutting timber from the current cost reporting requirement. The Board rejected that alternative as an interim provision because of the difficulties in separating the results of various activities in an integrated enterprise and because the proposal would complicate

an analysis of differences between the operations reported on a current cost basis and the operations reported in the primary financial statements.

26. The Board also concluded that it should not permit the measurement of timberlands and growing timber at historical cost/nominal dollars for purposes of disclosures otherwise on a current cost basis. Statement 33 requires current cost measures in constant dollars (which are equal to current dollars). To ensure that all the measures involved in current cost income from continuing operations are in constant dollars, timberlands and growing timber should, at least, be measured in historical cost/constant dollars.

Conclusion

27. The Board concluded that either historical cost/constant dollar amounts or current cost measurements should be permitted as they were in paragraph 53 of Statement 33. Flexibility also would be allowed regarding the method of estimating current costs. In this manner, experimentation may be encouraged without the imposition of the costs of preparing particular computations before sufficient information is available about their usefulness.