NEWSLETTER NO. 26

FLORA AND FAUNA – WHAT ABOUT TREES AND POLAR BEARS?

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This newsletter contemplates the natural world, to look at trees, bushes, plants and other flora that may be controlled and managed. We will also look at the animals that municipalities may have, in zoological gardens or as collections, the fauna.

NOTE: This is an issue that came up at the Fall Workshops and on the Q&A Hotline, which we have been asked to address. The reality is that relative to the other assets that your municipality has, these items are generally of insignificant value, a.k.a. peanuts, and should only be addressed AFTER you have dealt with your major facilities and networks, and if you have the time to spare. If you are the CFO for a zoo, then these assets are your core business, and the foregoing caveat does not apply.

Public Sector Accounting Handbook

Section PS3150.03 states that Section PS3150 in toto does not apply to natural resources. For flora and fauna occurring naturally, or in their natural state, they are by definition a natural resource, or a biological resource, and therefore excluded.

The International Public Sector Accounting Standard (IPSAS) 17 has the same definition of a tangible capital asset as PS3150. However, IPSAS 17.05(a) specifically excludes "biological assets" related to agricultural purposes. International Accounting Standard 41 identifies a biological asset as being a living animal or plant.

On the other hand, what about trees that are planted for specific purposes or animals that are part of a collection for exhibition or breeding? Flora can run the gamut from an individual marigold plant to a mature tree, and fauna includes everything from flies and spiders to elephants and polar bears. Let's look at each in turn.

WHAT ABOUT TREES? – AND OTHER FLORA?

Other flora are generally so low in price for the individual item, that you would not even want to bother pooling them. That is assuming that they will last through to next year's growing season, and you think they are not a biological asset. Trees and some larger bushes can be very expensive, and may be around for hundreds of years in certain cases. Are they tangible capital assets, their historical cost to be amortized over their estimated life?

What is the Primary Asset?

Whether for a park, or as part of a forested environmental space or separator, what is the primary asset? It is the land, and any land improvements that you may have made. Or the road reconstruction, when the trees are being planted as part of the related streetscaping. In short, look at the forest as a whole, before you think about the trees. First, account for the land and the surroundings where your trees are located, before you bother to look at the individual trees.

Are Trees a Tangible Capital Asset?

There are two schools of thought on this. One is that they are a biological resource, and not TCAs by definition, since it is hard to quantify any benefits that may directly accrue from planting a tree, and landscaping provides only an intangible aesthetic benefit.

The other school is that planting trees improves the health of the community. They do not differ from other assets whose primary purpose is beautification or the promotion of environmental sustainability. The have a cost, a life expectancy and may even be the focus of an entire group of municipal workers in cases where a municipality has an urban forestry department. Nevertheless, it is possible to argue that they are not "held for use in the production or supply of goods and services, for rental to others, for administrative purposes or for the development, construction, maintenance or repair of other tangible capital assets (PS 3150.05 (a)(i)). To the extent that they might be thought to provide a "service," PS 3150.05 (f) defines **service potential** as "the output or service capacity of a tangible capital asset, and is normally determined by reference to attributes such as physical output capacity, quality of output, associated operating costs, and useful life." A case can be made that trees do not meet this concept of service potential. Therefore, it can be argued that trees are not tangible capital assets based on the definitions in PS 3150.05. Thus it is more congruent with PSAB accounting guidelines to expense all flora, large trees included. There are two situations where a different approach may be appropriate.

Woodlots, trees that are planted on a large scale for lumber, poles or other purposes

This is tree farming, with the output to be turned into usable product(s) for sale or for internal use. These trees would not be tangible capital assets by definition (PS3150.05(iv)). One would record the trees in such a woodlot as inventory – the stock of trees, valued at the historical cost to plant the woodlot. The value at harvest time, less the historical cost, would be net profit, and reported as revenue in the year of harvesting. A common practice in the forestry industry is to revalue the trees each year to reflect current value as they grow.

Remember that the land occupied by a woodlot is a tangible capital asset, and is to be accounted for and reported on in your financial statements.

Trees and bushes planted as a sound or physical barrier

In this case, one might argue that there is a tangible capital asset, namely the barrier, which is no different from a masonry sound wall or chain-link fence, except it has been developed from trees and bushes. While requiring a different type of development and maintenance, it is expected to provide certain services or benefits over a long period of time, thus meeting the definition of a tangible capital asset.

Note that it is the barrier or living fence that is the asset, not the individual trees or bushes. Historical cost will be the total cost of the trees and bushes, plus planting and whatever else was carried out to develop the barrier. This would be amortized over the average life expectancy of the trees and bushes used.

Final Thought

If your municipality has an active, on-going tree planting program now, you currently expense the trees, not capitalize them. Why would you do any differently come 2009? Your annual program expense would be equivalent to what your amortization expense might be if you capitalized the trees. So why bother trying to change for an asset that is insignificant in terms of your total assets?

WHAT ABOUT POLAR BEARS? – AND OTHER FAUNA?

Municipalities have live collections for a variety of reasons. Some maintain zoos, or specialized collections, some have police canine units, and/or mounted units. It will be assumed that each situation has a specific raison d'être, which includes the provision of some defined or expected services and benefits that the animals will provide.

Where an animal is maintained as a mascot or symbol, Wiarton Willie for example, this would be analogous to regarding the animal as a living treasure, and therefore not a tangible capital asset at all. Expense him (or her).

The case for reporting the animals as tangible capital assets

What limited accounting guidelines and standards exist (e.g IPSAS 17.05(a) and IAS 16) specifically indicate that biological assets are **NOT** tangible capital assets.

The one possible exception to this are service animals, such as police dogs and horses, where they are trained to provide specialized services, normally for a specific number of years, before being retired. Such animals could satisfy the definition of a TCA in PS3150.05, and the future benefit stream from them can be identified and estimated, and does accrue to the host organization. The costs of acquisition and training would be amortized over the anticipated service life.

It has been suggested (somewhat facetiously) that this logic could also be applied to inventory police or firefighter recruits as tangible capital assets (amortized over 30 or 35 years!).

The case for expensing the acquisition of animals

It is unlikely that this approach will be questioned, as the life expectancy of animals is far less certain than for inanimate assets, and reflects the unfortunate reality that they may be here today, and gone tomorrow. This approach guarantees that the cost of the collection will never be understated at any point in time, as the costs will be expensed up front.

The downside is that if, for example, you acquire a Galapagos turtle, you will be expensing the costs involved with acquiring it, shipping it from Ecuador and of quarantining it in Canada, in the year of acquisition, for something that may live for 150 years.

The case for recording the animals as inventory

Private sector organizations that have collections of animals, or livestock for commercial purposes, account for their animals as inventory, and record the value of the animals on the Balance Sheet as a non-financial asset – Inventory. This may be appropriate for accounting for animal collections that belong to a zoo or animal park run as a commercial operation.
The accounting process is similar to that for tangible capital assets, as the practice is to record and document each animal, if the operating unit managing the animals has not done so. Historical cost is determined in the same way, including all directly attributable costs in bringing the animal from there to here, and preparing it for service or exhibition. Standard practice is to leave the animal in inventory at unamortized historical cost, until such time as it dies or is transferred out of the collection.

Where animals are bred, so that the population is self-sustaining, the private sector practice is to transfer the historical cost over from the parent to the child, because the child would not be there if the parent had not been acquired in the first place. The parent's historical costs would be increased by any fees and costs directly attributable to the birthing, if there were to be any.

Where the species is multiplying, additional members would have a historical cost equal only to the costs directly attributable to them or their litter, in which case the costs will be allocated out. If such an animal is transferred to another collection elsewhere, by gift or sale, this will be recorded at fair value for the animal at the time of transfer, which will result in recording net profit or net loss on the disposition, as the case may be.

As inventory, there will be no amortization expense calculated on the animals at all. Any adjustments to inventory valuations will result in net income or net expense in the period of the adjustments, as the case may be.

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In newsletter #23, we promised to apply the outline for determining whether a doodad is a tangible capital asset to a specific type of asset, namely municipal drains. This will be covered in our next newsletter.

For more information and resources regarding tangible capital asset management, go to PSAB/Asset Management or contact:

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NOTE: This Newsletter is published to assist you with your implementation of tangible capital asset accounting and with related matters. The Public Sector Accounting Handbook is the only authoritative primary source on matters relating to GAAP, and you should consult with your auditor to resolve specific issues that you may have.