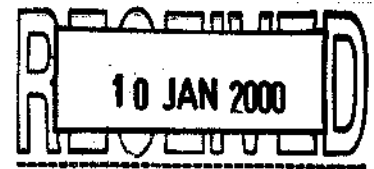


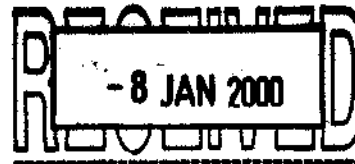


**Canadian Farm Business Management Council
Conseil canadien de la gestion d'entreprise agricole**

75 rue Albert Street, Suite 908, Ottawa, Ontario K1P 5E7 • Telephone: (613) 237-9060 Facsimile: (613) 237-9330



January 6, 2000



CL 3

The Secretary-General
International Accounting Standards Committee
166 Fleet Street
London, EC4A 2DY
United Kingdom

The Secretary-General:

The Canadian Farm Business Management Council respectfully submits the following comments regarding the Proposed International Accounting Standard relating to agriculture (Exposure Draft E65).

The Canadian Farm Business Management Council

To help Canadian agricultural producers identify and share best business practices, the federal government, with input from industry and the provinces, established the Canadian Farm Business Management Council (CFBMC) in 1992.

Recognizing that sound financial reporting is a leading management tool for success, the CFBMC formed the Agricultural Accounting Standardization

Committee (the Committee) supported by various commodity Task Forces to examine the wide variety of accounting and financial reporting practices in Canadian agriculture.

For additional information regarding the CFBMC refer to Appendix A.

Composition of Task Forces

Of prime importance to the Committee was that the Task Forces represent the major day-to-day users of financial statements and consist of individuals possessing practical hands-on knowledge and experience in their particular agricultural specialty, rather than individuals whose knowledge was purely academic or theoretical. Accordingly, the Task Forces included:

- Producers - Knowledgeable farm managers, who require reliable financial information to use as a basis for making informed management decisions on a timely basis.
- Accountants - Individuals representing the accounting profession, chosen because of their practical agricultural accounting experience and proven ability to supply financial advice to agricultural producers.
- Farm Management Specialists - Representatives of government and other institutions, familiar with the practical aspects of

farming, who are in constant contact with producers and understand their day to day needs.

- Farm Economists - Professional agricultural economists, trained to recognize and develop practical benchmarks to enable producers to compare their individual results with farms of comparable type and size and provide government and other agencies with practical data for analytical comparisons.
- Representatives of Farming Organizations - Experienced individuals, possessing knowledge regarding their particular commodity group and able to monitor that the needs for the specialized management information required by that group are fulfilled.

The members of the Agricultural Accounting Standardization Committee and the members of the related commodity Task Force are listed at the beginning of each publication of the *Accounting for Successful Farm Management* series.

Accounting for Inventories and Productive Assets

It was not difficult to conclude that because of inconsistent reporting practices the industry, on a national basis, has been unable to harness the many benefits of effective cost of production analysis and analytical

benchmarking tools that many other industry sectors now use for improving operations. The Committee's research and work focused on developing recommendations for common reporting practices which comply with generally accepted accounting principles (GAAP). These principles were determined using the guidance of the accounting recommendations in the Handbook of the Canadian Institute of Chartered Accountants and related authoritative accounting publications.

Two of the more controversial issues facing the Committee relate to their recommended accounting treatment for:

- productive assets and their presentation as capital assets, and
- the presentation of inventories at the lower of cost and net realizable value (market).

The Committee concluded that for their recommendations to be acceptable the answer lay in finding practical cost-based solutions to the above methods of valuation and reporting. This included the development of commodity-based model financial statements and the development of related templates which would provide a simplified method of calculating inventory and productive asset valuations.

A Series of Publications

The Committee's work has culminated in the release of the *Accounting for Successful Farm Management* series. This series of publications, endorsed by the Canadian Institute of Chartered Accountants, provides guidance for producers engaged in five commodity groups¹ consisting of Dairy, Grains and Oilseeds, Poultry, Beef and Swine. The publication regarding Swine has also received the endorsement of the Canadian Pork Council. The Committee is currently in the process of obtaining endorsements from representatives of the other four commodity groups.

These publications include model financial statements designed to:

- provide information that is useful for farm managers as well as lenders, advisors and potential investors
- support the development of consistent practices so that over time the producers of each commodity can benefit from the best measurement of results, and
- provide for comparability between farms and groups of farms when industry benchmarks become available.

¹ The Committee is presently planning to commence the production of a new series relating to horticulture.

Publications Enclosed

We are enclosing a selection of the publications included in the *Accounting for Successful Farm Management* series in order to provide you with information supporting the conclusions of the Committee on various accounting and reporting issues. The enclosed publications illustrate model financial statements and recommended accounting treatments and methodologies for the following three of the series of five:

- dairy
- grains and oilseeds, and
- beef.

Should the Board require additional materials, please do not hesitate to contact us.

Comments on Exposure Draft E65

Question 1

While the Committee does not agree with the fair market basis of measurement for reasons outlined later, it does agree that the final Standard should not address further processing. The Committee agrees with the Board that such further processing becomes a manufacturing activity, which should not be covered by exposure draft E65. The Committee also agrees that the guidance in paragraphs 4-7 for distinguishing between agricultural activity and further processing is adequate except that in section 6 it would prefer that the word "lumber" replace the word "timber".

Question 2

The Committee agrees with the belief of the Board stated in B7 that the essence of agriculture is found in the unique events and outcomes of biological transformation. However it does not agree with a conclusion, that value changes based on current market provide more relevant information about performance than the traditional cost based method, necessarily follows.

The Committee does not agree with the recognition of fair market value at any time prior to disposal and therefore cannot support the suggestion in B25 (a) that changes in market prices are indicators of management performance.

To illustrate the above comment consider the following simple illustration using an inventory of grain as an example:

At the end of Year 1 a farmer has an inventory of 10,000 bushels of harvested wheat. He assesses this wheat to be grade A, the year-end market price of which is \$1.50 per bushel. The farmer's cost of growing this wheat is \$1.00 per bushel.

When the farmer sells the 10,000 bushels in Year 2 the market price of grade A wheat has dropped to \$1.20 per bushel. It is also determined that because of deterioration the wheat is actually grade B, the market price of which at the time of sale is \$1.10 per bushel.

Using the fair market value approach, the farmer's financial statements for Year 1 will show an inventory of \$15,000 and a profit of \$5,000. For Year 2 the farmer will report a loss of \$4000.

Using the lower of cost and market approach, the farmer's financial statements for Year 1 will show an inventory of \$10,000. In Year 2 the farmer will report the actual profit of \$1000.

The fact that the producer reports a hypothetical profit of \$5,000 in Year 1 because the fair market value method was used is not relevant. Basing management decisions on this information would be misleading. However, basing management decisions on the lower of cost and market method common to almost every other industry, showing a profit of \$1,000 on a completed cycle becomes relevant and meaningful.

The Committee believes that all changes to biological assets and agricultural produce should be measured at the lower of cost and market. In addition, in the rapidly fluctuating markets common to agriculture, for example, as recently experienced in the Canadian pork industry, any recognition of income before the point of sale and before value changes are certain, becomes misleading as a management tool.

The Committee cannot agree with the proposal that biological assets (growing plants and animals, etc.) should be measured at their proportional fair value, i.e. pro rata to their harvested or finished value.

By taking this stand, the Board is proposing fair value as the measurement basis during a period when difficult estimations are required and probably impossible to obtain.

We submit that if considerations of simplicity of application and ease of use are critical to this project, and we agree that they are, the cost-based approach outlined in the *Accounting for Successful Farm Management* series much more closely achieves these goals.

Using a simple example based on the recommended procedures, a farmer with a December year-end growing winter wheat would value his growing crop as a percentage of the current market value of the harvested product. The Committee fails to see how, in an actual situation, any reliable "fair" valuation could be obtained using this method mainly because of the number of unknown factors including:

- the number of bushels eventually harvested
- weather conditions from balance sheet date to harvest including loss of crop by hail
- the grade or quality of the harvest
- fluctuations in market prices
- the deterioration experienced between harvest and shipping, and
- shipping costs.

Likewise the valuation of developing cattle for sale using the method recommended in the exposure draft is similarly impeded by unknown factors including:

- eventual sale weight of the animal
- death loss before the completion of the feeding process
- eventual grade
- fluctuations in market prices, and
- shipping costs.

The above information would be essential if the recommended method is to approximate a true measure of "fair value" or what a third party would actually pay the farmer in each situation for the inventory in process. The Committee points out that in the case of many agricultural products, including a field of growing grain, little or no market would exist until after harvest.

The valuation issues illustrated above pose an even greater problem in situations when agricultural produce is carried on two consecutive balance sheets. An example would include grain farmers who, because of market prices, quotas or personal income tax planning, do not sell their harvested grain inventory until after the end of Year 2. For practical purposes, such agricultural produce would be valued at the end of Year 2 at neither current

market nor actual cost, but at a valuation having no relevance to the producer as a decision making tool.

Section 36 measures agricultural produce at fair value and then deems such measurement to be cost. This seems to be totally incompatible with the arguments in favour of using fair value measurement in the first place. Beyond considerations of simple logic, there does not seem to be any conceptual justification for such an approach.

The Committee feels very strongly that the accounting methodologies and suggested template short-cuts recommended in the *Accounting for Successful Farm Management* series provides a much easier and more logical method for valuing all agricultural produce and biological assets including growing crops and developing animals for sale.

Recognizing the physical process of growth, procreation, degeneration and harvest through the use of cost accounting methodologies including average or standard costing when the use of actual costs is impractical, a cost-based model will:

- accurately and consistently measure contribution margin, net income and working capital
- provide sound basis for management decisions, and

- allow consistent and reliable measurements for industry benchmarking purposes.

For reasons presented above and also in our response to question 3, the Committee disagrees with the Board's conclusion that reliable measures of fair value of biological assets and agricultural produce prior to the point of harvest are available.

B13 states that most agricultural assets trade in active markets inferring that this is one argument for the use of fair market values. The Committee suggests that many businesses in the retail and industrial world, which follow the lower of cost and market approach, also trade in active markets. This does not, therefore, appear to provide a compelling rationale for the adoption of a fair market methodology for the agricultural industry.

Section 13 of the proposed International Accounting Standard states that managed biological transformation is what distinguishes agriculture from other activities. The Committee does not agree that this distinction translates into a requirement to use fair value based accounting within the agricultural sector when cost based solutions similar to the majority of other industrial sectors are available.

In addition, the Committee does not agree with the statements contained in B2. (c) (i) (ii) and (iii) because:

- One of the main obstacles to the use of cost-based solutions for the valuation of both biological assets and agricultural produce arises from the common mistaken perception that such measurement involves time consuming and difficult accounting techniques. Chapter 4 of each of the enclosed publications provides examples of quick and easy solutions to these perceived time consuming and difficult accounting methodologies. Through the use of easy-to-understand templates which draw their input directly from the financial statements or from predetermined average or standard costs, the use of cost-based valuation methods becomes an achievable goal. As outlined above, any estimation problems inherent in such an approach are considerably simpler than those required to implement the fair market methodology proposed by the Board.
- The enclosed publications demonstrate a simple accounting methodology for recording the year-end cost and accumulated amortization of a group of individual assets such as a breeding herd.
- Segregation of assets should not create difficulties in balance sheet classification. Some examples of classification are illustrated in the sample financial statements contained in the enclosed publications.

As observed in B3, it cannot be forgotten that the majority of agricultural enterprises consist of small, family-operated, independent units. These producers require a single set of all-purpose financial statements, prepared in accordance with GAAP, for use when reporting to outside users such as lenders and also as a management tool capable of assisting with the day-to-day decisions needed to give the best possible operating results. It is important that these financial statements meet all their needs. These producers simply cannot afford the luxury of preparing a second set of statements that would not be of any practical use to them in managing their operations.

In summary, the use of any model recognizing financial results based on changes in fair (market) values before the point of sale is not acceptable to the Committee.

Question 3

The Committee believes that fair value cannot always be determined reliably and accordingly the cost basis of valuation should be used. Although current market quotes exist for many biological assets, the Committee disagrees with the suggestion in B21 that value can be measured with reliability. As previously mentioned, the difficulty in determining factors including product grade, disposal costs, storage or shipping losses due to shrinkage,

deterioration from weather, pests, disease, death or spoilage increases the margin for errors in estimations. Additionally, the use of benchmarking as outlined in section 26 (c) to arrive at fair (market) value can be extremely misleading unless standardized financial reporting is followed throughout the industry. The Committee is not convinced that the calculation of accurate fair value of biological assets and agricultural produce is any easier than the calculation of cost using the methodologies outlined in the *Accounting for Successful Farm Management* series.² Much of the methodology included in section 26 would appear to place an undue reliance on estimating techniques, specifically in periods of rapidly changing prices. The recognition of income should not be based on speculation.

In the Committee's opinion, cost based valuations remain the only reasonable basis of determining a meaningful and consistent measurement of income. That is, the valuation of agricultural produce and consumable biological assets at the lower of cost and market and the valuation of bearer biological assets at cost less accumulated amortization. The Committee reached its conclusion for a number of reasons, including:

- this valuation method provides the most useful information to the producer as a basis for making management decisions,

² Refer to Chapter 4 in the enclosed publications for Dairy, Grains and Oilseeds, and Beef.

particularly those relating to the measurement of contribution margin

- cost of production information using cost based input is one of the most meaningful management tools available to today's farm managers
- most users of financial statements are familiar with the lower of cost and market valuation method as it is used in practically all other businesses outside of agriculture, and
- as demonstrated throughout the series of model financial statements, the perceived difficulty of obtaining cost based information for a reasonable expenditure of time and effort no longer becomes an issue.

The Committee acknowledges that inventories of harvested crops and livestock held for sale may be valued at sales price less estimated costs of disposal (net farm price), when all of the following three conditions exist:

- the product has a reliable, readily determinable and realizable market price
- the product has relatively insignificant and predictable costs of disposal, and
- the product is available for immediate delivery.

The Committee believes that situations where all of the above conditions exist are rare.

While the Committee supports the use of net farm price (fair value) when valuing the types of agricultural produce described above when all of the three previously mentioned conditions exist, it suggests these conditions infer that there has to be absolute certainty, as at the balance sheet date, concerning the full realization of the net farm price.

The Committee interprets a "reliable, readily determinable and realizable market price" within the context of the risk associated with the ownership of inventory between the balance sheet and product delivery dates. Risk considerations affecting the ultimate realizable value of harvested crops or livestock held for sale include future factors such as:

- fluctuations in price, grade or disposal costs, and
- storage or shipping losses due to shrinkage or deterioration from weather, pests, disease, death or spoilage.

The Committee suggests whenever one or more of these risks exist as at the balance sheet date, the condition of a "reliable, readily determinable and realizable market price" remains unfulfilled. In such circumstances,

the valuation of inventory at net farm price (fair value) and the resulting income recognition contravene the realization and conservatism principles within GAAP by recognizing income that may never be realized.

The Committee concedes valuation at fair value may occur in situations where this valuation method consistently produces an immaterial impact on reported results of operations, working capital and contribution margin relative to the lower of cost and market method. Under such circumstances, accountants must apply professional judgment in determining the acceptability of this method of valuation.

However, the Committee urges extreme caution in using fair value on the basis of materiality considerations. Appropriate situations may include circumstances where a farm continuously produces and routinely ships output every day or every few days. Usually the product has a relatively short shelf-life, and the length of on-farm storage time is minimal. In addition, the amount of inventory available for immediate delivery remains relatively constant over time and is generally not considered material relative to total assets or annual sales. Examples of such finished products include milk and eggs; and perishable vegetables, fruits or flowers that are produced continuously in greenhouses.

The Committee suggests materiality considerations rarely, if ever, justify the valuation of agricultural produce at fair value where levels of such inventories fluctuate over time in reaction to seasonal production and sales cycles. Some inventories may possess a reasonably long on-farm shelf-life, and shipments may occur intermittently. Examples include harvested grain or oilseed inventories or inventories of potatoes at the balance sheet date. These inventories generally increase following the annual harvest at the end of a growing season. Subsequently, harvested production may be stored and shipped over an extended period. Likewise, in a beef cow operation, the value of inventories being developed for sale is much higher just before the fall sale of calves than before spring birthing. Under such circumstances, the Committee suggests that any materiality decision should focus on potential differences arising from a consistent application of the two valuation methods at each and every period end (i.e., monthly, quarterly or annually) versus simply examining the difference at a single point in time. In other words, the fact that the inventory levels happen to be immaterial at a particular balance sheet date should not, in itself, represent a primary determinant of the decision to adopt fair value pricing.

In those rare circumstances where fair value pricing is used, the Committee recommends full disclosure of the conditions permitting the adoption of this method in the notes to the financial statements.

Simply put, the determination of financial results based on current fair market values, in contrast to valuation at the lower of cost and market; and the measurement of increases in the value of biological assets using market rather than cost methodology does not provide the producer with meaningful information. The example outlined in the response to question 2 supports this conclusion.

Question 4

The Committee recommends that the change in value of biological assets and agricultural produce should be measured on a cost basis. Such a change in value is only relevant as an indicator of the performance of an enterprise engaged in agricultural activities when a sale occurs or, in the case of bearer biological assets, when amortization of cost is recorded. The cost basis of measurement and the recording of sales when they occur reflect the end result of the producer's efforts. In taking this stand, the Committee believes that accounting for biological assets and agricultural produce should follow the same accounting principles as followed in nearly all other industries. It suggests the market value approach is looked upon as a solution to perceived accounting difficulties when recording the cost of these assets. As previously illustrated the recognition of gains, which may

never be realized, is not an acceptable accounting alternative and clouds rather than enhances the measurement of financial performance.

Because of the above comments, the presentation choices given in question 4 become a non-issue.

Question 6

The Committee sees no reason to treat the valuation of agricultural land in any different manner than the accounting treatment of land in practically all other industries, that is, at cost subject to write-down for impairment. Even when such land is used for crop production, the general practice of fertilization assures that value is not eroded as a result of that production. It also supports the concept that biological assets physically attached to land should be recognized and measured separately.

Likewise, the Committee favors the presentation of intangible assets at cost less applicable amortization or write-down and does not agree with the revaluation alternative referred to in section 40.

Some people argue that presentation at fair market value provides financial institutions with better information for credit granting. The Committee

suggests that in any credit-granting scenario, lenders form their own opinion on the value of their collateral.

The Committee concedes that adjustment of land values to current appraised values accompanied by appropriate note disclosure may be acceptable in isolated instances. However, a policy of carrying agricultural land at market value on each successive balance is both meaningless and costly.

Question 7

The Committee agrees that unconditional grants, other than those related to capital or bearer biological assets, should be recorded as income when they are received or become receivable.

Conditional grants should be deferred as a liability until there is reasonable assurance that the conditions will be met.

Grants relating to capital or bearer biological assets should reduce the cost of the related asset. The related asset should be amortized net of the grant.

The Committee believes that the above procedures follow the generally accepted accounting principle of matching costs with revenues.

Question 8

The Committee agrees with the Board that users of financial statements need more detailed information about an enterprise's biological assets and agricultural produce than single total carrying amounts.³

The Committee supports the separate disclosure of the quantified mature and immature components of each group of consumable biological assets and agricultural produce as inventory or inventory in process valued at the lower of cost and market. It supports this method of disclosure even though the cost of production may extend beyond one year including certain nursery stock, calves being developed for sale as yearlings and ginseng. Depending on the length of the development period, inventory in process could be classified as either current or non-current. The Committee also supports the separate disclosure of the quantified mature and immature

³ Refer to the sample financial statements included in each of the *Accounting for Successful Farm Management* publications.

components of each group of bearer biological assets as capital assets valued at cost and amortized over useful life.⁴

After following through the examples contained in section 57 and considering the reconciliation required by section 61, the Committee is concerned that in practice the recommended calculations could well become both difficult and time consuming. Accounting for bearer biological assets as capital assets allows producers to apply an appropriate portion of their costs to each period of production. Ultimately this consistent and reliable approach helps producers control costs, a factor that may be a significant determinant of long-term success.

Question 11

In the chapter describing *Common Accounting and Reporting Issues* included in each of the enclosed publications are recommendations for income and expense classifications and their presentation as either production or other expenses. In addition, the model financial statements included in these publications illustrate suggested income and expense disclosures.

⁴ Except in the case of bearer biological assets with a life span of less than one year i.e. laying hens. Such assets would be classified as inventory.

The Committee recommends that each enterprise chose the classification of expenses by nature or function to best suit the individual management information required. When taking this stand the Committee reiterates the advantages of a standardized approach as described in the enclosed publications.

Question 14

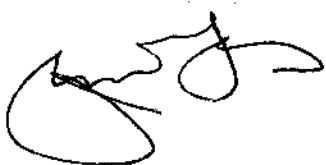
The Committee prefers that only the benchmark of IAS 8 should be allowed by this Standard. It feels restating comparative figures wherever practical provides the reader of financial statements with more meaningful information than making an adjustment to current income.

Questions 5, 9, 10,12 and 13

The Committee has already given its reasons why it does not believe changes in fair value of biological assets prior to realization are the most appropriate indicators of the performance of an enterprise engaged in agricultural activities. It feels that no additional comments are necessary regarding the above questions.

We would like to thank the IASC for providing us the opportunity to reply to Exposure Draft E65. Should you wish to discuss any or all of the above subject matter please do not hesitate to contact us at any time.

Sincerely,




James M. Laws, P.Ag.

Executive Director, CFBMC



David L. Ford, P.Ag.

Project Manager, CFBMC



Ian R. Kinnell, FCA

Resource Accountant, KPMG

Enclosures: Accounting for Successful Farm Management (Grains & Oilseeds, Beef, Dairy)

Appendix A

The CFBMC, which is funded through Agriculture and Agri-Food Canada's Canadian Adaptation and Rural Development (CARD) Fund, serves an important role in developing products and materials as well as facilitating and coordinating farm management activities on a national basis.

Vision

CFBMC envisions a thriving Canadian agriculture industry.

Mission

As a champion for farm management, CFBMC supports Canadian farm managers through building partnerships and facilitating the development and sharing of innovative business ideas.

The CFBMC helps not only individual farm managers, but also other industry stakeholders, such as professional advisors, to improve the management of business issues related to agriculture. Through the development of publications, resource material, software, CD Rom information support tools, electronic databases and research studies, the CFBMC helps the agricultural industry deal more effectively with the many challenges of today's marketplace.

In accomplishing its many initiatives to develop and share business ideas for success, the CFBMC brings together industry and government to address key management issues in agriculture.