FARM ACCOUNTING STANDARDIZATION MANUAL

A MANUAL OF FARM ACCOUNTING TERMINOLOGY, REPORTING POLICIES, AND RATIOS

The Farm Accounting Standardization Review Committee

FARM ACCOUNTING STANDARDIZATION MANUAL

A MANUAL OF FARM ACCOUNTING TERMINOLOGY, REPORTING POLICIES, AND RATIOS

The Farm Accounting Standardization Review Committee

Catalogue Number CC213-5/1991E
ISBN 0-662-18883-7

Published by the Farm Accounting Standardization Review Committee
c/o Research and Planning Division
Farm Credit Corporation
434 Queen Street
Ottawa, Ontario
Canada
K1P 6J9

Telephone (613) 996-6606
Fax (613) 943-8681

Numéro de catalogue CC213-5/1991F
ISBN 0-662-96903-0

Publié par le Comité d'uniformisation de la comptabilité agricole
a/s la Division de la recherche et de la planification
Société du crédit agricole
434, rue Queen
Ottawa (Ontario)
Canada
K1P 6J9

Téléphone (613) 996-6606
Fax (613) 943-8681

FARM ACCOUNTING STANDARDIZATION MANUAL

A MANUAL OF FARM ACCOUNTING TERMINOLOGY,

REPORTING POLICIES, AND RATIOS

TO ENHANCE SOUND FARM MANAGEMENT PRACTICES

Prepared By

DELOITTE & TOUCHE

Prepared for

FARM ACCOUNTING

STANDARDIZATION REVIEW COMMITTEE

May, 1991

TABLE OF CONTENTS

ACKNOWLEDGEMENTS

The authors would like to thank those whose contribution of time and effort helped create this manual. We are particularly grateful to the 120 key participants across Canada who diligently worked alongside us providing insight and ideas. The organizations these individuals represented are listed in Appendix III.

We would also like to acknowledge the sponsor, Employment and Immigration, Canada and the study administrators, Ontario Ministry of Agriculture and Food and Farm Credit Corporation.

Special thanks is extended to two groups in particular who supported us behind the scenes in an administrative role. Wendy Kardash and Diane Adshead in Edmonton for their patience and perseverance throughout. And Diane Decoste and her staff in Montreal for their exemplary work in translating our words and thoughts to French.

Deloitte & Touche

FOREWORD

Generally accepted accounting principles in Canada are formulated by the Accounting Standards Committee of the Canadian Institute of Chartered Accountants. In developing principles, the Committee recognizes that no rule of general application can be phrased to suit all circumstances and that professional judgement must be exercised in the determination of what constitutes fair presentation or good practice in particular cases.

This Farm Accounting Standardization Manual has been developed to provide practical and professional interpretations of accounting principles as they apply to agricultural producers in Canada. Guidance is provided on a wide range of accounting topics that are of specific interest to the agricultural industry. It should be noted, however, that certain conclusions of this manual are not in accordance with generally accepted accounting principles. These deviations have been appropriately identified in the introduction to the manual.

The initiative in developing this comprehensive guidance is welcomed as a major contribution to enhancing the quality of financial reporting for this important industry sector.

John H. Denman, CA
Director, Accounting Standards
The Canadian Institute of Chartered Accountants
March, 1991

INTRODUCTION

Background to the Study

Farm accounting terminology, reporting policies and ratios often vary from province to province, from institution to institution, and even within institutions themselves. Consistent use should simplify agricultural accounting, enhance farm management practices and streamline lending policies.

Farm Credit Corporation (FCC) entered into an agreement with Deloitte & Touche/Samson Belair to develop an industry consensus on farm financial accounting terminology, reporting policies and ratios. The project is funded by Employment and Immigration Canada in conjunction with the Canada-Ontario Agricultural Employment Committee.

The principal objectives of the study are to:

- encourage consensus in collecting and analyzing farm financial information;
  and
- develop a manual of farm financial terminology, reporting policies and ratios.

Study Goals

One of the goals of this study is to prepare a reference book of agricultural financial accounting reporting policies, terms and ratios that can be easily accessed and understood by farm managers, lenders, economists, accountants, farm extension specialists, academics, and other parties interested in the agricultural industry.

Farm managers and farm extension specialists would use this reference source to assist in preparing financial statements or for interpreting financial statements prepared by others. Lenders and economists would use this book to better understand the underlying assumptions used in the valuation of assets recorded on a financial statement. Accountants would use this reference book to assist in preparing financial statements that are consistent with accepted industry practice.

But this project does not end here. The Industry Consensus project assumes the process of standardization is dynamic and ongoing. Work in this area will continue for some time, through a review committee process to monitor ongoing changes in the area of agricultural accounting terminology and reporting policies. Small, persistent strides towards uniform financial disclosure will, hopefully, over time, result in consistent accounting practices for the agricultural industry.

Study Focus and Limitation

At the same time, this project is not all encompassing. For the most part, its focus is on financial statement disclosure (terms and policies) and ratio analysis. In other words, it seeks consensus on: i) the terms used in financial statements; ii) the policies adopted in determining the numbers that appear in the financial statements; and iii) the ratios that use financial statement amounts.

This project does not address concerns related to basic record-keeping principles such as single entry versus double entry bookkeeping or manual versus computerized records.

Generally Accepted Accounting Principles

The inconsistency between certain current accounting practices in the agricultural industry and accounting practices in other industries presents a problem. This dilemma manifests itself in the wide diversity of farm accounting policies and terms used today. For instance, the present practice within the industry of valuing productive assets at market, or at the lower of cost and market, or, alternatively, at original cost with no adjustment for depreciation, deaths, births, etc., is an example of this diversity. Many groups, including producers, lenders and accountants, have indicated that these diversities cause confusion and interpretation problems. They have expressed the view that a more standard approach is needed.

The Industry Consensus Study is intended to provide guidance on uniform accounting practices in the agricultural industry. However, this Industry Consensus Study, resulting in this Farm Accounting Standardization Manual, is not a unique endeavour. The Canadian Institute of Chartered Accountants (CICA), with their 1986 Research Study, "Accounting and Financial Reporting by Agricultural Producers", is a notable example of previous work in this field of study. See Appendix IV for additional reference sources.

The study participants recognize that the CICA is the organization authorized to establish financial accounting standards in Canada. These standards are set out in the CICA *Handbook*. To that end, the suggested definitions, ratios and policies that follow in this document attempt to adhere to and expand upon the CICA's recommendations on generally accepted accounting principles (GAAP) for general purpose financial statements. Nevertheless, there are certain suggestions in the present manual that do not comply with GAAP. In summary these suggestions are:

- GAAP recommends that inventories be valued at the lower of cost and net realizable value. This manual suggests valuing inventory at net realizable value.

- This manual suggests valuing productive assets at market value. GAAP requires that such long-term assets be reported at cost.

- According to a recent pronouncement by the CICA, intangible assets such as quota should be amortized. This manual suggests that quota should not be amortized.

The above suggestions are not intended to override any recommendation of the CICA for general purpose financial statement reporting. They are intended to provide alternative reporting policies for special purpose financial statements that are prepared for agricultural producers.

It is expected that the three issues outlined above will be studied by the Farm Accounting Standardization (FAS) Review Committee. This Committee has been established to provide an ongoing review of farm accounting issues. It is hoped that the differences between the recommendations of the CICA and the suggestions presented in this manual can soon be further reduced.

FUTURE DIRECTION AND COMMITMENT

The greatest benefit of the Industry Consensus Study does not rest with the production of this Consensus Manual, but rather with its adoption within the industry. It is not the mandate of the Consensus Study to require adoption or legislate use of this Manual and its contents. Instead, it is hoped that the agricultural industry will take a lead role in promoting both the Consensus Document's content and its use.

The mandate of the Farm Accounting Standardization Review Committee is to work toward standardization and consensus on any unresolved issues and provide a forum for discussion of particular items as they arise.

Consensus is an ongoing and evolving process. The appropriateness of current recommendations will be determined by the ever changing conditions and needs in the industry.

CONSENSUS

One of the primary goals of the Industry Consensus Study was to facilitate a general agreement of opinion, a consensus, on specific definitions, reporting policies and ratios.

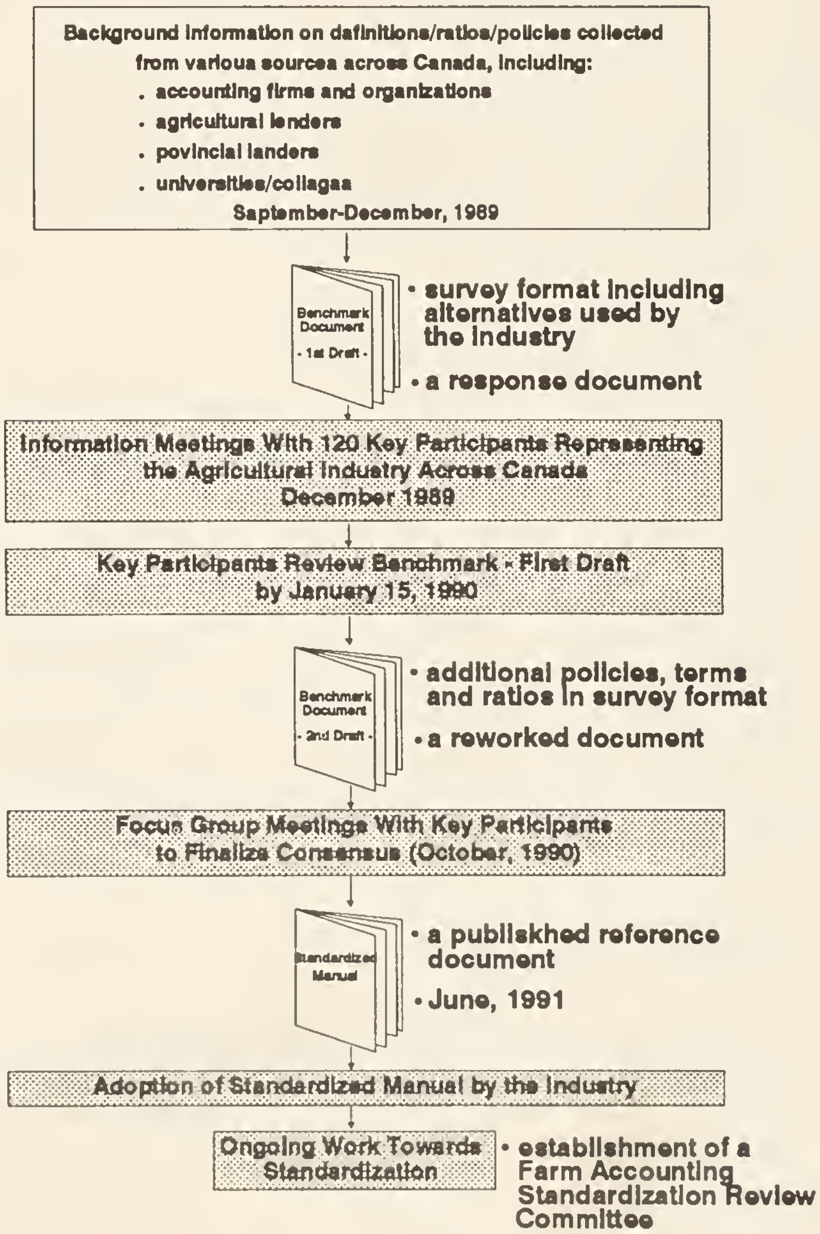
In order to achieve a credible consensus, it was necessary to approach and enlist the input of key members within the agricultural industry. Appendix III lists those individuals and organizations (key participants) who were extensively involved throughout the course of the study. These key participants represent all regional sectors of Canada. It is apparent from the list that producers, economists, lenders, accountants, farm extension specialists and academics were fairly represented.

Any process that attempts to reach decisions by consensus nearly always involves an element of compromise. This study was no exception. In December, 1989, the first draft of this document was circulated to the key participants. After these participants reviewed the document, it was returned to the Study Directors. The Directors analyzed the comments noted by the key participants and revised the document a second time. This second revision was circulated in March, 1990 to the participants for their review. Again the document was returned and analyzed. A third document, circulated in September, 1990, was reviewed by the participants. Finally, nine focus groups were held across Canada in October, 1990 to discuss the remaining unresolved issues.

In addition to the information received from the focus groups, seven separate newsletters were sent to the key participants and other interested parties. These newsletters summarized the study results to date and solicited feedback on issues that remained unresolved at the time. The final document has been prepared by utilizing all of the foregoing items of feedback information.

The study process spanned 18 months and required a significant amount of compromise to reach a general agreement. A consensus (or general agreement) was considered, in most cases, to be at least 90% in favour of a specific issue. In the end the study was successful by achieving consensus on the definitions, policies and ratios that follow.

Figure 1 CONSENSUS PROCESS



HOW TO USE THE MANUAL

One of the important goals in developing this manual was to provide a "user-friendly" format. Hopefully, such a format would encourage the use and acceptance of the ideas contained in the manual. In order to achieve this goal, the present manual has been organized into the following sections:

- Financial Statements;
- Definitions;
- Reporting Policies;
- Ratios;
- Appendices (including example financial statements); and
- Index.

Words that appear in more than one place in the document have been cross-referenced. Two comprehensive indexes can be found at the back of the manual.

Financial Statements (Section 1)

This section explains the various financial statements and includes example formats of the balance sheet and statements of income, owner's equity and changes in financial position. In addition, a brief discussion of cash versus accrual accounting and cost versus current value accounting is included. This section will provide the reader with an overview of financial statement format and theory. (An example projected cash flow statement is presented in Appendix II.)

Definitions (Section 2)

This section presents an alphebetized list of accounting terms. The definitions should be interpreted in the context of the introduction to this section.

Each definition included in this manual is followed by a "clarification" that, in some cases, relates the definition to a practical situation by way of an example. In addition, the clarification section may expand upon the ideas and words included in the definition in an effort to enhance understanding.

Reporting Policies (Section 3)

This section lists various agricultural reporting policies in alphabetical order. Reporting policies deal with issues such as whether quota should be valued at cost or market, or whether certain land improvements should be depreciated.

A brief introduction to each reporting policy precedes a recommendation. In some cases a discussion of alternative reporting policies is presented. Where useful, an example has been provided to expand upon the discussion.

The reporting policies section is designed to assist readers at all levels of accounting expertise.

Ratios (Section 4)

This section defines several ratios commonly used in agricultural finance. Ratios are used to compare and evaluate the financial results of a business with itself and with other businesses. An extensive discussion of ratios, including limitations, is included.

The ratios are organized alphabetically and by category (e.g., liquidity, profitability, etc.). The definition of each ratio is followed by a brief clarification and an outline of the ratio's limitations.

Ratios express a comparison of two or more elements of financial information. The assumptions used in determining this financial information may rely upon one or more definitions and reporting policies.

Index

Two indexes are included in the manual. The first index lists all items in alphabetical order. This index will indicate multiple page numbers if the item is addressed more than once in the manual. This index will be most useful when addressing a specific topic.

The second index is a Financial Statement index, with items organized alphabetically according to five financial statements (balance sheet, statement of income, statement of owner's equity, statement of changes in financial position, and projected cash flow statement). Items will appear under more than one heading in this index if they relate to more than one financial statement. This index will be most useful in understanding the context of certain terms used on financial statements.

1.0 FINANCIAL STATEMENTS

1.1 Introduction

The following discussion addresses general uses and limitations of financial statements in addition to general principles of accounting.

Appendix I presents several examples of financial statements.

1.2 Importance of Financial Statements

Financial statements convey certain information to their readers and thereby serve a useful purpose. For instance, financial statements portray a record of wealth at a particular date. By comparing the wealth at two different dates, a significant indication of management's success can be determined. Add a record of inflows and outflows of cash, goods, and services in the period, and the reader is provided with a basis on which to judge management's effectiveness. An explanation of the gains and losses is provided by analyzing these inflows and outflows in terms of their causes and effects. Finally, a careful consideration of past gains and losses will assist in predicting consequences of future actions.

Thus, accounting is a useful decision-making tool for management, owners, creditors, policy makers, and others interested in the reporting entity.

Related Items: Example Financial Statements, Appendix I; Definition of Financial Accounting, page 32.

1.3 The Financial Reporting Entity

1.3.1 Background: Financial statements report financial information for a specific entity. The entity may be a farm business such as a corporation or sole proprietorship. To assist the reader in understanding the financial information, it is essential that the statements depict the entity and explain its form.

1.3.2 Concern: It is important that the readers of financial statements recognize the accounting entity; therefore, the accounting entity should be clearly defined. In agriculture, the accounting entity is frequently an unincorporated business (sole proprietorship) in a specific location. Other types of agricultural accounting entities include corporations, partnerships, and cooperatives. It is most desirable to have separate financial statements for each entity.

An additional concern relates to the use of financial statements. One of the benefits of a financial statement is the opportunity to compare the operating results and financial position of a specific business with similar businesses operating in the same industry or commodity group. This comparison is difficult, if not impossible, when the financial affairs of the owners are not segregated from those of the business, or when the reporting entity is not clearly outlined.

1.3.3 Recommendation and Disclosure: The financial reporting entity should be clearly stated in the financial statements. The type of business (partnership, corporation, etc.) should be disclosed in the financial statements. Whether the individual owner's personal financial affairs are included in the financial statements should also be disclosed. However, it is strongly suggested that the financial affairs of the individual should be disclosed separately from the financial affairs of the business. In the event the financial details of the individual are required, a separate personal financial statement for the individual should be prepared.

As an alternative to a separate personal financial statement, the preparer of the financial information might choose to record the personal assets, liabilities and revenue/expense transactions as separate items on the business financial statements in such a manner as to clearly segregate personal data from business data. However, the latter method would not be acceptable in respect to a corporation. Furthermore, this latter method is certainly not a preferred approach for other types of businesses either, due to the reasons of comparability discussed earlier.

1.4 Types of Financial Statements

This Industry Consensus Study deals with financial accounting reporting policies and terminology. It is fitting, therefore, to discuss four commonly used financial statements:

- Balance sheet;
- Statement of income;
- Statement of owner's equity; and
- Statement of changes in financial position.

This section of the manual addresses the purpose of each of the financial statements. Certain underlying assumptions used in the preparation of the particular financial statement are discussed. An example of the particular financial statement is presented. (An example projected cash flow statement is presented in Appendix II.)

1.4.1 Balance Sheet: The purpose of a balance sheet is to describe the assets, the liabilities, and the equity of a farm business at a particular point in time. Usually, assets are listed first in descending order of expected realization. Liabilities are listed next in descending order of expected discharge. Finally the owner's equity is reported.

In valuing the assets on a balance sheet, there is often dispute over whether the assets should all be valued at cost or market. The following section addresses this issue.

Cost Versus Current Value

The two most common methods of accounting for assets and liabilities disclosed on a balance sheet are the historical cost method and the current value method.

Under the historical cost method, goods and services acquired by a business are reported on the balance sheet at an amount of money that equals the amount that has actually been exchanged (in most cases paid) for the good or service.

The current value method, on the other hand, reports assets at amounts that reflect the impact of changes in the prices of goods and services. It often attempts to consider the changes in general price levels. In other words, the assets are measured and reported at current rather than historic prices. Assets are valued at these revised amounts each time a balance sheet is prepared.

It is generally understood that the historical cost method is the accepted financial accounting method in the agricultural industry. This method is definite, verifiable and immediately determinable. The cost method, however, does not give a true indication of the resources available to the business in that the values of assets are not updated.

The current value method does update those values but it may also create problems. For instance, if an asset is not regularly traded, determining a current value may prove difficult. Furthermore, short-term, volatile changes in the price or value of an asset may result in misleading financial performance information.

For these reasons, the historical cost method is considered an appropriate basis of valuation for financial accounting. However, the merits of the current value method may warrant disclosing asset amounts at current market values. Accordingly, recommendations and examples of

suggested additional market value disclosure is discussed in the Reporting Policy section entitled Supplementary Disclosure, page 59.

In spite of the above, exceptions to the historical cost method exist within the agricultural industry today, and include valuing inventory and productive assets at current market values. Exceptions to the historical cost method exist within other industries as well. For instance, valuing inventory at the lower of cost or net realizable value, or writing down the value of an asset (such as an investment) where a decline in value is considered other than temporary, are two generally accepted accounting principles. Neither principle adheres to the strict interpretation of valuing assets at historical cost.

The above exceptions, however, are not sufficient to undermine the broad principle that assets and liabilities should be valued at historical cost. The terms and policies that follow in this document assume this basic principle unless otherwise indicated. (See the example balance sheet page 12.)

Related Items: Definition of Asset, page 21; Balance Sheet, page 23; Historical Cost , page 34; Liability, page 35; Market Value, page 38; Net Realizable Value, page 54; Owner's Equity, page 40; Partners' Capital, page 40; Shareholders' Equity, page 42.

1.4.2 Statement of Income: The purpose of a statement of income is to disclose the revenues and expenses of a business over a period of time (usually one year). Revenues are usually listed first, followed by expenses. There is no generally accepted method used to determine the order of the revenue and expense items listed on the statement.

Within the industry, there is some confusion as to whether transactions should be reported on the cash or accrual basis. The following is intended to clarify this point of concern.

Cash Versus Accrual

As discussed in the above "balance sheet" section, the historical cost method of reporting is a generally accepted accounting principle. Under the historical cost method, two bases of reporting may be followed: the cash basis or the accrual basis.

- Under the **cash basis**, revenues and expenses are reported in the period in which the related cash is received and paid.

- Under the **accrual basis**, such revenues and expenses are reported in the period in which they have been earned or incurred, respectively, regardless of when the cash is received or paid.

If the users of financial statement information were willing to wait until the end of the life of a business, it would be relatively easy to determine the net income or loss. This information would be determined by calculating the amount of cash remaining after all assets were sold and all liabilities discharged. In reality, users of financial information require a more regular and periodic disclosure of a business' net income.

This periodic disclosure is only accurate when the expenses incurred by the business are matched against the revenues earned - for instance, when the cost of market livestock inventory is matched in the year against the revenue earned from selling the market livestock inventory. This measurement, or matching process, is achieved when the accrual basis, not the cash basis, of reporting is used.

For this reason, the financial terms and policies that follow in this manual assume the accrual basis of reporting is used in preparing financial

EXAMPLE BALANCE SHEET

(The terms on this Balance Sheet are defined elsewhere in this manual.)

CATTLE AND SWINE PRODUCER
BALANCE SHEET
APRIL 30, 1990

ASSETS

		1990	1989
CURRENT ASSETS			
Accounts receivable		$ 30,879	$ 7,533
Deposits - hedging account		3,178	1,918
Inventory			
Livestock	664,267		
Feed and fuel	132,725	796,992	758,525
Prepaid expenses		12,483	11,689
		843,532	779,665
LONG TERM ASSETS			
Production animals		144,850	109,450
Investment in cooperative		50,000	47,000
Fixed assets		1,294,171	1,279,686
TOTAL ASSETS		$2,332,553	$2,215,801

LIABILITIES AND OWNER'S EQUITY

	1990	1989
CURRENT LIABILITIES		
Bank indebtedness	$ 694,519	$ 547,524
Accounts payable	54,117	49,159
Current portion of long-term debt	44,399	60,847
	793,035	657,530
LONG-TERM LIABILITIES		
Long-term debt	382,518	403,055
	1,175,553	1,060,585
OWNER'S EQUITY	1,157,000	1,155,216
TOTAL LIABILITIES AND OWNER'S EQUITY	$2,332,553	$2,215,801

statements in accordance with generally accepted accounting principles (GAAP).

The cash basis of reporting has been generally used only in the preparation of a statement of income for tax purposes. Any terms that are used specifically for tax purposes, for the most part, are not dealt with in this manual, because this manual deals with financial reporting of accounting information, which is distinct from tax reporting requirements.

It is worth noting that this study does not consider the issue of whether or not farm managers should convert their periodic bookkeeping to an accrual basis. The cash basis of bookkeeping provides adequate information to generate accrual basis financial statements.

The conversion of a cash basis financial statement to an accrual basis financial statement is not difficult. In the most basic cases, the conversion is accomplished by recording accounts receivable, accounts payable and inventory on the balance sheet with an appropriate offsetting entry to the statement of income. In addition, depreciation on fixed assets is reported on the statement of income.

Net Income Versus Net Farm Income

Net income is considered in simple terms to represent the excess of revenue over expenses of the business entity. Sources of revenue earned and expenses incurred by the particular business from activities other than farming (e.g., surface lease rent), should be distinctly segregated.

Although the non-farm revenues and expenses will be segregated, they should still be included in the net income figure reported on the statement of income. Thus, the method of determining the net income of a farm business will be consistent with the method used for other businesses. By segregating non-farm revenues and expenses, the reader will be able to distinguish what is, or is not, specifically farm revenue and expense from the detail on the statement.

Net Income Versus Taxable Income

Net income is distinct from taxable income. Net income represents the excess of revenues over expenses. Taxable income (an income tax term) represents the excess of taxable revenue over tax-deductible expenses prepared on a basis in accordance with the Income Tax Act.

Because taxable income is not necessarily an amount determined in accordance with GAAP, it seldom appears on the financial statements. For this reason, further discussion of taxable income is not included.

The example statement of income presented on page 14, is one of many acceptable formats. The example statement of income, for instance, groups costs according to whether or not they vary directly with the volume of production (i.e., variable versus fixed). In some cases it may be difficult to distinguish between costs that are fixed and those that are variable, and, therefore, some other format would be preferable.

Related Items: Definition of Accrual Basis of Accounting, page 20; Cash Basis of Accounting, page 25; Depreciation, page 31; Expense, page 31; Fixed Cost, page 27; Net Income, page 38; Revenue, page 41; Statement of Income, page 43; Variable Cost, page 27.

1.4.3 Statement of Owner's Equity/Partners' Capital/Retained Earnings: Owner's equity could be simply described as the accumulated balance of net income earned by the business each year. Owner's equity is increased by owner's contributions and decreased by owner's withdrawals.

EXAMPLE STATEMENT OF INCOME

(Many of the terms appearing on this Statement are defined elsewhere in this manual.)

CATTLE AND SWINE PRODUCER
STATEMENT OF INCOME
YEAR ENDED APRIL 30, 1990

	1990	1989
REVENUE		
Market cattle	$ 817,460	$ 710,100
Swine	423,000	256,150
Subsidies	80,890	92,000
Gain on hedging account	1,260	---
Custom work	76,694	54,000
Increase in accounts receivable	23,346	(10,928)
Change in inventory - livestock	13,517	(4,486)
Increase in value of production animals due to quantity	30,000	36,064
	1,466,167	1,132,900
VARIABLE COSTS		
Market cattle purchases	762,150	421,000
Swine purchases	311,000	219,250
Feed and supplements	142,000	150,000
Fuel	81,000	53,500
Direct labour	23,150	---
Change in inventory - feed and fuel	(24,950)	---
Freight	32,150	15,750
Veterinary and other	15,000	850
Increase in accounts payable	4,958	31,928
	1,346,458	892,278
CONTRIBUTION MARGIN	119,709	240,622
FIXED COSTS		
Advertising and office	8,248	9,600
Depreciation	91,702	81,200
Insurance	15,000	23,150
Interest on long-term debt	38,007	59,290
Property taxes and rent	15,800	71,900
	168,757	245,140
NET LOSS FROM OPERATIONS	(49,048)	(4,518)
OTHER REVENUE		
Gain on sale of fixed assets	500	6,300
Increase in value of production animals due to price	5,400	---
Rentals	47,883	45,798
Patronage dividends	750	1,200
	54,533	53,298
NET INCOME	$ 5,485	$ 48,780

EXAMPLE STATEMENT OF OWNER'S EQUITY OF A SOLE PROPRIETORSHIP

CATTLE AND SWINE PRODUCER
STATEMENT OF OWNER'S EQUITY
YEAR ENDED APRIL 30, 1990

	1990	1989
OWNER'S EQUITY, BEGINNING OF YEAR	$1,155,216	$1,106,436
OWNER'S WITHDRAWALS	(3,701)	---
NET INCOME	5,485	48,780
OWNER'S EQUITY, END OF YEAR	$1,157,000	$1,155,216

The purpose of the statement of owner's equity is to disclose the changes to the owner's equity account throughout the period being reported upon. (See the example statement of owner's equity below.)

Related Items: Definition of Dividend, page 31; Owner's Equity, page 40; Owner's Withdrawals/Contributions, page 40; Partners' Capital, page 40; Retained Earnings, page 41; Shareholders' Equity, page 42.

1.4.4 Statement of Changes in Financial Position: A statement of changes in financial position (SCFP) discloses the source and use of a business' cash flow. For instance, the cash proceeds from the sale of fixed assets are not recorded on the balance sheet or statement of income (only the gain or loss on such a sale is recorded on the statement of income). A SCFP would, however, disclose these sale proceeds.

The purpose of an SCFP is to report the effects of the business activities on the cash resources of the business. The SCFP should classify the cash flows as either an operating activity, a financing activity or an investing activity.

It is important to distinguish between an SCFP and a projected cash flow statement. An SCFP discloses cash flows on an historical basis (i.e. in the past). A projected cash flow statement reports the estimated changes in financial position for an upcoming period. (See the example statement of changes in financial position, page 17.)

Related Item: Definition of Statement of Changes in Financial Position, page 43. Also see discussion of Projected Cash Flow Statement, Appendix II.

1.5 Relationship of Financial Statements

Implicit to the basic accrual accounting model is the concept sometimes referred to as "coordinated financial statements".

A set of "coordinated financial statements" will possess the characteristic that the four statements previously discussed will mathematically reconcile. The following outline shows how this reconciliation process is accomplished:

- Net income, as disclosed on the statement of income, is added to beginning owner's equity to determine ending owner's equity as reported on the statement of owner's equity.

- Ending owner's equity equals the owner's equity figure disclosed on the balance sheet. Thus, at this point, the statements of income, owner's equity and the balance sheet are reconciled.

- Finally, the statement of changes in financial position reconciles the changes in balance sheet categories by utilizing data from both the balance sheet and statement of income.

All four statements reconcile, hence the term "coordinated financial statements". Whatever the term used to describe this concept, GAAP requires that the financial statements possess this internal reconciliation characteristic.

EXAMPLE STATEMENT OF CHANGES IN FINANCIAL POSITION

CATTLE AND SWINE PRODUCER
STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED APRIL 30, 1990

	1990	1989
OPERATING ACTIVITIES		
Cash from operations		
Net income	$ 5,485	$ 48,780
Add: Depreciation	91,702	81,200
Less: Gain on sale of fixed assets	(500)	(6,300)
Increase in accounts payable	4,958	31,928
(Increase) in accounts receivable	(23,346)	(10,928)
(Increase) decrease in inventories	(38,467)	4,486
Increase in deposits	(1,260)	(1,000)
Increase in investment in cooperative	(3,000)	(3,000)
Increase in prepaid expenses	(794)	(842)
Cash from operating activities	34,778	144,324
FINANCING ACTIVITIES		
Long-term debt advances	37,900	77,000
Long-term debt repayments	(74,885)	(24,741)
Owner's withdrawals	(3,701)	---
Cash (used) provided by financing activities	(40,686)	52,259
INVESTING ACTIVITIES		
Proceeds on sale of fixed assets	32,500	30,700
Purchase of fixed assets	(138,187)	(174,429)
Increase in value of production animals	(35,400)	(36,064)
Cash used by investing activities	(141,087)	(179,793)
(REDUCTION) INCREASE IN CASH FOR THE YEAR	(146,995)	16,790
BANK INDEBTEDNESS BEGINNING OF YEAR	(547,524)	(564,314)
BANK INDEBTEDNESS END OF YEAR	$(694,519)	$(547,524)

2.0 DEFINITIONS

2.1 Introduction

With few exceptions, the following definitions relate to accounting terms normally found on a set of financial statements of an agricultural producer. Many of the definitions are general in nature, e.g. "asset" and "liability" and, in fact, have been defined elsewhere in numerous publications. The original objective, however, in creating the following list of definitions, was to develop a user-friendly or "layman's" glossary that is also technically correct. A consequential problem that arises is that the two aspects of this objective - readability and accuracy - are not always compatible. At times one of these aspects has been sacrificed for the sake of the other, but, on the whole, the following glossary has attempted to strike an effective balance.

The users of this glossary should also keep in mind that many of the following definitions are quite broad in scope. This breadth stems from the necessity that each definition encompass most, if not all, foreseeable circumstances. Therefore to assist readers in interpreting and applying these definitions, a brief "clarification" section has been included for each of the terms.

2.2 Format

The following definitions have been listed in alphabetical order. An index has also been provided which categorizes the definitions based on type of financial statement (e.g., balance sheet, statement of income, etc.).

ACCOUNT PAYABLE

Definition

An amount owing to a creditor (i.e, an amount owed someone else), usually arising from the purchase of goods or services, that is due to be paid within a 12 month period or within the normal operating cycle (where the cycle is longer than a year). These amounts owing are often relatively short term, where payment is normally required in full within a one or two month period.

Clarification

- Examples of accounts payable include amounts owed for property taxes and amounts owed to a supplier on account for fertilizer, fuel, etc.

- Accounts payable are usually classified in the current liabilities section of the balance sheet.

Related Items: Definition of Accrued Liability, page 20; Balance Sheet, page 23; Current Liability, page 36. Also see Reporting Policy on Accounts Payable, page 45.

ACCOUNT RECEIVABLE

Definition

An amount owed to the business usually arising from the sale of goods or services.

Clarification

- Examples include uncollected receipts for grain and livestock sales and custom work. Accounts receivable may also arise from the sale of an asset other than inventory. Examples of this include equipment and buildings.

- Accounts receivable are usually classified as a current asset on the balance sheet.

- Many government subsidies and grants are directly related to the sale of goods or services (e.g., Tripartite Stabilization Program). Accordingly, these subsidies easily fall within the definition of an account receivable. However, certain government subsidies and grants may not be directly related to the sale of goods or services. Nevertheless, there are instances where the anticipated receipt of these particular subsidies should be considered an account receivable.

Related Items: Definition of Asset, page 21; Balance Sheet, page 23; Current Asset, page 22; Revenue, page 41. Also see the Reporting Policy on Account Receivable, page 46; and the example Balance Sheet, page 12.

ACCRUAL BASIS OF ACCOUNTING/REPORTING

Definition

A method of accounting/reporting whereby revenue and expenses are recorded in the period when they are earned or incurred, regardless of when the cash transaction took place.

Clarification

- Unlike the cash basis of accounting, revenues and expenses include changes to inventory, accounts receivable and accounts payable.

- Accrual accounting and reporting attempts to record the financial effects of a transaction in the period in which that transaction occurs, rather than only in the period in which cash is received or paid. The accrual method recognizes that the operations of a business do not always coincide with the cash receipts and disbursements of the period.

Related Items: Definition of Account Payable, page 19; Cash Basis of Accounting, page 25; Expense, page 31; Revenue, page 41. Also see the Reporting Policy on Accounts Payable, page 45; Accounts Receivable, page 46; Inventory, page 53; and the discussion of Accrual Basis Accounting, page 11.

ACCRUED LIABILITY

Definition

An obligation arising from the purchase of goods and services (including the use of money) that, at the date of reporting, have only been partly delivered or performed, have not been billed, and have not been paid for.

Clarification

- An accrued liability is similar in nature to an account payable except that an accrued liability may involve an element of estimation due to the fact that the goods and services have only been partly delivered or performed and have not been billed. Consequently, the liability at the date of reporting will only be a portion of the total liability of providing the complete good or service.

- An accrued liability is usually classified in the current liabilities section of the balance sheet.

- In contrast to an account payable, an accrued liability includes an element of estimation due to the fact that the liability is accumulating with the passage of time.

- An example of an accrued liability is the interest owing on outstanding debt.

Related Items: Definition of Account Payable, page 19; Current Liability, page 36; Debt, page 28. Also see Reporting Policy on Accounts Payable, page 45.

ACCUMULATED DEPRECIATION

Definition

The total amount of the periodic (e.g., annual) depreciation charges to date relating to the fixed assets recorded on the balance sheet.

Clarification

- Accumulated depreciation is used to calculate the net book value of an asset. "Net book value" is defined as the value of an asset that is determined by subtracting the accumulated depreciation from the historical cost of the asset.

Related Items: Definition of Asset, page 21; Depreciation, page 31; Fixed Asset, page 22; Historical Cost, page 34; Net Book Value, page 38.

AMORTIZATION

Definition

The scheduled or systematic reduction of a balance in an account over an appropriate period.

Clarification

- Most often this term applies to long-term liabilities and intangible assets.

- The methods used to amortize an intangible asset are similar to the methods used to depreciate other assets. In fact, the term "amortization" is often used synonymously with the term "depreciation".

- Amortization of a long-term liability involves the periodic reduction of the principal amount by regular debt repayments over time. This debt repayment is usually one of two types.

- The first is characterized by equal payments of principal and interest combined. The total of these amounts is the same each payment, but the portion that represents principal increases with each successive payment.

- The second type is characterized by payments of equal principal amounts with decreasing interest amounts included with each successive payment. In both of the above types, the portion of the payment that represents interest declines as the debt is repaid. The primary difference between the two is that the portion of each payment that represents principal is constant in the second type but is increased in the first.

Related Items: Depreciation, page 31; Intangible Asset, page 22; Long-term Liability, page 36. Also see the Reporting Policy on Depreciable Assets, page 49.

ASSET

Definition

Tangible or intangible item of value owned by the business.

Clarification

- Examples include cash, accounts receivable, inventory, productive assets, equipment, buildings and land.

- An asset also includes an item of value owned by the business but in the possession of others; for example land that is rented to a tenant. As well, an asset can include an item of value owned by others but in the possession of the business; for example a capital lease.

Related Items: Definition of Account Receivable, page 19. Also see the Reporting Policy on Leases, page 55; and the example Balance Sheet, page 12.

ASSET - CURRENT ASSET

Definition

Unrestricted cash and any other asset that, in the normal course of operations, is expected to be converted into cash or consumed in the production process within one year or within the normal operating cycle (where the cycle is longer than a year).

Clarification

- Examples include cash, accounts receivable, feed and other supply inventories, market livestock, produce and prepaid expenses.

- A current asset is similar to a liquid asset. A liquid asset, however, would not include any current asset that is not immediately convertible into cash. An example of such an item would be growing crops.

Related Items: Definition of Account Receivable, page 19; Liquid Asset, page 23.

ASSET - FIXED ASSET

Definition

A tangible asset, which is usually involved in the production of goods and services rather than held for resale. This asset represents a relatively long-term investment that is used for more than one year.

Clarification

- Examples include land, buildings and equipment.

- The term, "fixed asset", is distinct from the term "long-term asset" due to the fact that fixed assets relate only to tangible assets.

Long-term assets include both tangible and intangible assets.

Related Items: Definitions Intangible Asset, page 22; Long-term Asset, page 23.

ASSET - INTANGIBLE ASSET

Definition

An asset that lacks physical substance but, like all other assets, benefits or adds value to the business.

Clarification

- Examples include goodwill, trademarks, leaseholds, mineral rights, and quotas.

Related Items: Definition of Goodwill, page 33. Also see the Reporting Policy on Quotas, page 58.

ASSET - INTERMEDIATE ASSET

Definition

An asset that has a useful life greater than one year and usually not more than ten years. This asset is not usually purchased for resale but is to be used over time to produce saleable products.

Clarification

- Examples include equipment, machinery, breeding livestock and quotas.

Related Items: Reporting Policy on Balance Sheet Classifications, page 47; and Supplementary Disclosure, page 59. Also Definition of Intermediate Liability, page 36.

ASSET - LIQUID ASSET

Definition

Cash or temporary investment readily convertible into cash without disrupting normal operations.

Clarification

- Examples of temporary investments include treasury bills and share certificates held for relatively short terms (i.e., one year or less).

- A liquid asset is similar to a current asset. A liquid asset, however, would not include a current asset that is not immediately convertible into cash. An example of such an item would be growing crops.

Related Items: Definition of Current Asset, page 22; Marketable Security, page 38.

ASSET - LONG-TERM ASSET

Definition

An asset that has a useful life greater than one year. Such an asset, which can be either a tangible or intangible item, is usually not purchased for resale, but is to be used over time to produce saleable products.

Clarification

- Examples include land, buildings, equipment, and productive assets such as a breeding herd, and investments.

- A long-term asset is sometimes referred to as a capital asset.

- When a balance sheet is prepared using three asset classifications - current, intermediate and long-term - the definition of long-term assets would be revised. In such cases, long-term assets include only those assets that have a useful life usually greater than 10 years. The intermediate asset category would include assets having a useful life greater than 1 year and usually not more than 10 years.

Related Items: Definition of Intermediate Asset, page 22; Long-term Liability, page 36. Also see Reporting Policy on Balance Sheet Classifications, page 47; and Supplementary Disclosure - Market Value, page 59.

BALANCE SHEET

Definition

A statement of financial position showing the assets, liabilities and equity of a business at a specific date.

Clarification

- The purpose of a balance sheet is to describe the assets, the liabilities, and the owner's equity of a farm business at a particular point in time. Usually, assets are listed first in descending order of expected realization. Liabilities are listed next in descending order of expected discharge. Finally the owner's equity is reported.

Related Items: Definition of Asset, page 21; Equity Capital, page 31; Liability, page 35; Owner's Equity, page 40. Also see the example Balance Sheet, page 12 and the Reporting Policy on Balance Sheet Classifications, page 47.

CAPITAL

Definition

The total assets available to a business.

Clarification

- As is evident from the definition, the term "capital" refers to the total assets of a business. In contrast, the term "debt capital" refers to the amount of financial resources provided by lenders, usually restricted to long-term debt. The difference between the total assets and the total debt is termed "equity capital".

- The term "owner's equity", "equity" and "equity capital" are often used synonymously.

  Confusion often centres around the use of the term "capital". In some cases it is used to mean the owner's equity or share capital of a business, in other cases it is used to mean the long-term debt of a business, and in still other cases it is used to mean total assets. To reduce the ambiguity surrounding the term "capital", this manual uses the term "capital" to refer to total assets. The term "equity capital" is used here to refer to the owner's equity and "debt capital" refers to long-term debt.

Related Items: Definition of Asset, page 21; Debt Capital, page 29; Equity Capital, page 31; Long-term Debt, page 29; Owner's Equity, page 40; Shareholders' Equity, page 42.

CAPITAL COST ALLOWANCE

Definition

The tax-deductible amount charged to allocate the cost of tangible assets over one or more fiscal periods **for income tax purposes only.**

Clarification

- The mechanics of the capital cost allowance calculation may be similar to the calculation used to determine depreciation. However, it should be kept in mind that the purpose of recording depreciation (i.e., accounting for asset costs) is completely distinct from the purpose for claiming capital cost allowance (i.e., income tax deduction). Accordingly the two amounts may differ.

- The above definition is general and is not intended as a substitute for the definition of capital cost allowance contained in the Income Tax Act.

Related Items: Definition of Depreciation, page 31; Fiscal Period, page 32; Intangible Asset, page 22.

CAPITAL GAIN

Definition

This term is used **for income tax purposes** to define, in most cases, the amount of proceeds on the disposition of a long-term asset in excess of the asset's original cost.

Clarification

- The capital gain amount calculated for income tax purposes is very often different than the gain amount calculated for accounting purposes. (An example would include the capital gain realized on the disposition of a depreciable asset.) Accordingly, "capital gain" is the recommended term to be used in the context of income tax, and "gain" is the term recommended in the context of accounting.

- The above definition is general and is not intended as a substitute for the definition of capital gain contained in the Income Tax Act.

Related Items: Definition of Capital Loss, page 25; Gain, page 32; Long-term Asset, page 23.

CAPITAL LOSS

Definition

This term is used **for income tax purposes** to define, in most cases, the deficiency between the amount of the proceeds on the disposition of a long-term, non-depreciable asset and its original cost.

Clarification

- The capital loss amount calculated for income tax purposes is very often different than the loss amount calculated for accounting purposes. (An example would include the loss amount incurred on the disposition of a depreciable asset.) Accordingly, "capital loss" is the term recommended for use in the context of income tax and "loss" is the term recommended for use in the context of accounting.

- The above definition is general and is not intended as a substitute for the definition of capital loss contained in the Income Tax Act.

Related Items: Definition of Capital Gain, page 24; Long-term Asset, page 23; Loss, page 37.

CASH BASIS OF ACCOUNTING/REPORTING

Definition

A method of accounting/reporting by which revenues and expenses are recorded when cash is actually received or paid, regardless of when the agreement to sell or purchase may have taken place.

Clarification

- Unlike the accrual basis of accounting, revenues and expenses determined on a cash basis do not include changes to inventory, accounts receivable or accounts payable.

Related Items: Definition of Account Payable, page 19; Account Receivable, page 19; Accrual Basis of Accounting, page 20; Expense, page 31; Revenue, page 41. Also see the Reporting Policy on Accounts Payable, page 45; Accounts Receivable, page 46; Inventory, page 53; and the discussion of Cash Basis Accounting, page 11.

CHANGE IN INVENTORY

Definition

This term (used on the statement of income) reflects the amount of the increase or decrease in the total value of inventory from one reporting period to another.

Clarification

- The change in inventory amount is the difference between the opening inventory and the closing inventory for a particular fiscal period. It may be informative to disclose the opening and closing inventory amounts on the statement of income to assist readers in interpreting the change in inventory amount.

Related Items: Definition of Inventory, page 34; Statement of Income, page 43. Also see the Reporting Policy on Inventory, page 53; and the example Statement of Income, page 14.

CONTINGENCY

Definition

An existing condition or situation involving uncertainty as to possible gain or loss to a business that will be resolved when one or more future event occurs (or fails to occur).

Clarification

- Examples of contingencies include guarantees of the indebtedness of others, and threatened litigation.

Related Items: Definition of Contingent Liability, page 26; Gain, page 32; Loss, page 37.

CONTINGENT LIABILITY

Definition

A potential liability that is, at the date of reporting, not certain as to amount or likelihood of existence. The realization of this potential liability will depend upon a future event occurring or, alternatively, depend upon a future event failing to occur.

Clarification

- An example would include the instance where a business guarantees the loan of a third party. This guarantee would be considered a contingent liability to the guarantor.

- The generally accepted accounting principles related to contingent liabilities do not pose any special concerns to the agricultural industry compared to the concerns for other industries. Accordingly this document makes no special reference to the reporting policies for contingent liabilities. Further information on contingent liabilities can be obtained from accounting references such as the Canadian Institute of Chartered Accountants' Handbook.

Related Items: Definition of Contingency, page 26; Liability, page 35. Also see Additional Reference Sources, Appendix IV.

CONTRIBUTION MARGIN

Definition

Contribution margin is the excess of total revenue minus variable costs that directly relate to the business operation.

Clarification

- Revenue mentioned above refers only to the products produced and sold; it does not refer to revenue that is incidental or ancillary to the business operation such as interest.

- Variable costs (sometimes referred to as operating costs) directly related to the business would include input costs such as seed, feed and fertilizer and direct labour and custom work employed specifically to produce a product.

- Unlike gross margin, the calculation of contribution margin does not take into account an allocation of fixed costs.

Related Items: Definition of Fixed Cost, page 27; Gross Margin, page 33; Revenue, page 41; Variable Cost, page 27. Also see Contribution Margin Ratio, page 66; and example Statement of Income, page 14.

COST

Definition

This term refers to the purchase price for goods or services used in the business.

RelatedItem: Definition of Expense, page 31.

COST - DIRECT COST

Definition

This term refers to a cost that can be easily identified with the items produced by the business.

Clarification

- Examples of direct costs include feed, fertilizer and labour employed specifically to produce a product.

Related Items: Definition of Variable Cost, page 27; Indirect Cost, page 27; and Contribution Margin, page 26.

COST - FIXED COST

Definition

A cost that remains relatively unchanged, regardless of the volume of production or activity, within a range of volume.

Clarification

- Examples include building insurance, property taxes, depreciation, and interest.
- The term "fixed expense" is often used synonymously for "fixed cost".

Related Items: Definition of Cost of Goods Sold, page 28; Gross Margin, page 33; and Variable Cost, page 27.

COST - INDIRECT COST

Definition

This term refers to a cost that cannot be easily identified with the items produced by the business.

Clarification

- Examples of indirect costs are advertising, utilities, building insurance, property taxes, and interest.

Related Items: Definition of Direct Cost, page 27; and Fixed Cost, page 27.

COST - VARIABLE COST

Definition

A cost that varies directly with the volume of production or activity. If no production or activity takes place, the variable cost is zero.

Clarification

- Examples include fertilizer, feed and supplements.
- The term "variable expense" is often used synonymously for "variable cost".

Related Items: Definition of Contribution Margin, page 26; Cost of Goods Sold, page 28; Gross Margin, page 33.

COST OF GOODS SOLD

Definition

The cost of products (e.g., market cattle) sold during the year. This cost calculation includes both the production and purchase costs of goods.

Clarification

- The term "cost of goods sold" is not frequently used in most agricultural sectors because of the difficulty in its calculation. This is partly attributable to the fact that the costs incurred in raising livestock, for instance, are difficult to allocate to the particular livestock sold in the year using existing accounting records. Nevertheless, when cost of goods sold is used on the statement of income, it includes the purchase cost of the items that are sold. The cost of goods sold amount may also include an allocation of the hired labour directly employed to raise or produce the items and a further allocation of other costs.

- It is informative to disclose, on the statement of income, the separate component costs included in the cost of goods sold calculation. An example of these component costs for a feedlot may include purchased feeder cattle, direct hired labour, feed and feed supplements, fuel, repairs and depreciation related to the operations of the feedlot.

- In addition, the conversion from cash to accrual will include an adjustment for the change in inventory.

Related Items: Definition of Accrual Basis of Accounting, page 20; Cash Basis of Accounting, page 25; Cost, page 27; Contribution Margin, page 26; Gross Margin, page 33; Revenue, page 41; Statement of Income, page 43.

DEBT

Definition

A sum of money owing by one party (the debtor) to another (the creditor) payable either on demand or at some future time.

Clarification

- Examples include operating loans, mortgages, etc.

Related Items: Definition of Liability, page 35; Loan, page 37; Mortgage, page 38; Operating Loan, page 37.

DEBT - CURRENT DEBT

Definition

A debt, or a portion of a debt, due within the current year or within the normal operating cycle (where the cycle is longer than a year).

Clarification

- An example includes the portion of long-term debt (principal only) due in the upcoming fiscal period (including any portion in arrears).

- The term "current debt" is used synonymously with the term "current liability".

Related Item's: Definition of Current Liability, page 36; Long-term Debt, page 29.

DEBT - INTERMEDIATE DEBT

Definition

An intermediate debt is a debt that has an original amortization period beyond one year from the date of the balance sheet and usually not more than ten years.

Clarification

- Examples of an intermediate debt include loans for equipment and breeding livestock.

- The term "intermediate debt" is used synonymously with the term "intermediate liability".

Related Items: Definition of Amortization, page 21; Intermediate Asset, page 22; Loan, page 37. Also see the Reporting Policy on Balance Sheet Classifications, page 47; and Supplementary Disclosure - Market Values, page 59.

DEBT - LONG-TERM DEBT

Definition

A debt with a maturity date beyond one year from the date of the balance sheet or beyond the normal operating cycle (where the cycle is longer than one year). Long-term debt excludes that portion of the debt principal due within one year (i.e., current debt).

Clarification

- An example of long-term debt is a 15-year mortgage on land.

- The term "long-term debt" is used synonymously with the term "long-term liability".

Related Items: Definition of Balance Sheet, page 23; Long-term Liability, page 36; Mortgage, page 38.

DEBT CAPITAL

Definition

The total financial resources provided by lenders (usually restricted to long-term debt) for the use of the business.

Clarification

- In many cases, owners of a business will contribute personal funds and resources to a business. This contribution is usually considered part of equity capital. However, an exception arises where the contribution is in the form of a loan, for example a shareholder loan. In this case the contribution would correctly be considered part of debt capital.

- The terms "owner's equity", "equity" and "equity capital" are often used synonymously.

  Confusion often centres around the use of the term "capital". In some cases it is used to mean the owner's equity or share capital of a business, in other cases it is used to mean the long-term debt of a business; in still other cases it is used to mean total assets. To reduce the ambiguity surrounding the term "capital", this manual uses the term "capital" to refer to total assets. The term "equity capital" is used here to refer to the owner's equity, and "debt capital" refers to long-term debt as defined above.

Related Items: Definition of Asset, page 21; Capital, page 24; Equity Capital, page 31; Loan, page 37; Long-term Debt, page 29.

DEFERRED CHARGE

Definition

An expenditure, often relating to financing instruments, that is expected to yield benefits for several fiscal periods and accordingly is amortized over these future periods.

Clarification

- This term is seldom used in agriculture.
- For example, the cost of borrowing money is sometimes reported as a deferred charge.

Related Items: Definition of Amortization, page 21; Fiscal Period, page 32; Liability, page 35.

DEFERRED INCOME TAX

Definition

The accumulated amount by which income tax expense reported on the statement of income has been increased or decreased as a result of timing differences. Timing differences referred to here result from the difference between accounting and taxable income. This difference arises as a result of including revenues or expenses in one period in determining net income for accounting purposes, but including them in another period for determining taxable income.

Clarification

- For example, reporting depreciation on the financial statements at an amount different than the capital cost allowance recorded in the tax return could give rise to deferred income taxes.

  Related Items: Definition of Capital Cost Allowance, page 24; Depreciation, page 31; Expense, page 31; Financial Statement, page 32; Revenue, page 41. Also see the Reporting Policy on Depreciable Assets, page 49.

DEPLETION

Definition

A non-cash expense charged periodically to allocate or distribute the cost of a natural resource asset (e.g., a gravel pit) over its estimated useful life. The allocation is based on the reduction in quantity resulting from consumption or removal.

Clarification

- The basis of allocation or distribution should provide a proper matching of the cost of the asset to the benefits/revenue derived from the reduction of the asset.
- For instance, assume a gravel pit originally purchased for $30,000 contained an estimated 5,000 tonnes of gravel. One method of calculating the amount of annual depletion may involve recording $6 per tonne of gravel (30,000 ÷ 5,000) removed from the pit in the fiscal year.
- The concept of recording depletion is similar to that for depreciation.

Related Items: Definition of Asset, page 21; Cost, page 27; Depreciation, page 31; Expense, page 31; Revenue, page 41. Also see the Reporting Policy on Depreciable Assets, page 49.

DEPRECIATION

Definition

A non-cash expense charged periodically to allocate or distribute the cost of a long-term asset over its estimated useful life.

Clarification

- The basis of allocation or distribution should provide a proper matching of the cost of the asset to the benefits/revenue derived from the use of the asset.

Related Items: Definition of Cost, page 27; Expense, page 31; Long-term Asset, page 23; Revenue, page 41. Also see the Reporting Policy on Depreciable Assets, page 49.

DIVIDEND

Definition

An amount of retained earnings, declared by the board of directors of a corporation for distribution to its shareholders in proportion to their relative shareholdings.

Clarification

- The term "dividend" refers to the cash or cash equivalent amount paid to the shareholders. The amount of the dividend reduces the retained earnings of the company.

- Farm producers who are members or customers of a cooperative often receive all or a portion of the cooperative's net income. This allocation is often termed a patronage dividend.

Related Items: Definition of Net Income, page 38; Retained Earnings, page 41. Also see the Reporting Policy on Cooperatives, page 48; and the example Statement of Retained Earnings, Appendix I, page v.

EQUITY CAPITAL

Definition

The interest of the owner in the assets of a business. This is represented by the excess of the total assets over the total liabilities.

Clarification

- The term "owner's equity", "equity" and "equity capital" are often used synonymously.

  Confusion often centres around the use of the term "capital". In some cases it is used to mean the owner's equity or share capital of a business, in other cases it is used to mean the long-term debt of a business; in still other cases it is used to mean total assets. To reduce the ambiguity surrounding the term "capital", this manual uses the term "capital" to refer to total assets. The term "equity capital" is used here to refer to the owner's equity and "debt capital" refers to long-term debt.

Related Items: Definition of Asset, page 21; Capital, page 24; Debt Capital, page 29; Liability, page 35; Long-term Debt, page 29; Owner's Equity, page 40; Shareholders' Equity, page 42.

EXPENSE

Definition

A cost generally identifiable with the business operations during the fiscal period.

Clarification

- Examples include regular operating costs such as interest and wages, as well as depreciation.

- "Variable expense" and "fixed expense" are two terms often used synonymously with "variable cost" and "fixed cost".

Related Items: Definition of Cost, page 27; Depreciation, page 31; Fixed Cost, page 27; Revenue, page 41; Variable Cost, page 27.

FINANCIAL ACCOUNTING

Definition

The development of accounting information using established accounting principles in order to summarize the financial position and operating results of a business.

Clarification

- Financial accounting involves the recording and interpretation of the overall financial position and operating results of a business. For instance, recording the daily transactions of a business and preparing financial statements for use by creditors would be considered financial accounting.

Related Items: Definition of Financial Statement, page 32; Management Accounting, page 37.

FINANCIAL STATEMENT

Definition

A formal accounting statement that usually includes a balance sheet, statement of income, statement of owner's equity and a statement of changes in financial position.

Related Items: Definition of Balance Sheet, page 23; Financial Accounting, page 32; Statement of Changes in Financial Position, page 43; Statement of Income, page 43. Also see the Financial Statement section beginning on page 9, and Appendix I.

FISCAL PERIOD

Definition

A period of time for which financial statements are usually prepared for a business.

Clarification

- A fiscal period, one year in duration, is called a "fiscal year".

- The fiscal year may not necessarily coincide with the calendar year.

Related Items: Definition of Financial Statement, page 32.

GAIN

Definition

An increase in equity as a result of a transaction other than an increase that results from equity contributions.

Clarification

- The gain amount calculated for accounting purposes is very often different than the capital gain amount calculated for income tax purposes. An example would include the gain amount realized on the disposition of a depreciable asset. Therefore, "gain" is the term recommended for use in the context of accounting and "capital gain" is the term recommended for use in the context of income tax.

- Examples of gains for accounting purposes include "net income" and "gain on disposal of assets". In order to avoid confusion arising from the use of the word gain to describe these two instances, the following is recommended. Net income should be used to refer to a situation where revenues exceed expenses during a fiscal period. (See the definition of net income.) Gain on disposal of assets should be used to refer to an amount equal to the excess of the sale proceeds over the net book value of a fixed asset.

Related Items: Definition of Capital Gain, page 24; Equity Capital, page 31; Expense, page 31; Gain, page 32; Net Income, page 38; Revenue, page 41.

GOING CONCERN CONCEPT

Definition

The concept that a business will continue in operation indefinitely and that assets are therefore valued on the basis of their continued use as distinct from their market or liquidation value.

Related Items: Definition of Asset, page 21; Market Value, page 38.

GOODWILL

Definition

Goodwill is an intangible asset, the value of which is related to the value of a business in excess of the sum of the fair market value of the net assets.

Clarification

- The term "net assets", referred to above, represents the total assets (excluding goodwill) in excess of the total liabilities.

- Goodwill is generated from such things as high community standing, good strategic location, superior management, higher than normal earnings, reputation in the industry, etc.

Related Items: Definition of Asset, page 21; Intangible Asset, page 22; Liability, page 35.

GROSS MARGIN

Definition

Gross margin is the excess of total revenue over cost of goods sold.

Clarification

- In the past, the term "gross margin" was used in agriculture to represent the excess of total revenue over variable costs. However, most other industries use the term "gross margin" to represent revenue minus cost of goods sold. In order to enhance consistency in use between agriculture and other industries, the term "contribution margin" is suggested as an alternative term to represent revenue minus variable costs.

- The calculation of gross margin using cost of goods sold is seldom used in agriculture.

- Gross margin indicates funds available to cover unallocated fixed costs, returns to operator and family labour, and returns to owner's/shareholder' equity.

- Revenue mentioned above refers only to the products produced and sold; it does not refer to revenue that is incidental or ancillary to the business operation such as interest.

- The term gross margin is often used synonymously with the term gross profit.

Related Items: Definition of Contribution Margin, page 26; Cost of Goods Sold, page 28; Fixed Costs, page 27; Revenue, page 41; Variable Cost, page 27. Also see Gross Margin Ratio, page 66.

HISTORICAL COST

Definition

The total expenditures made by a business to develop or acquire title to an asset, including any installation or alteration costs incurred to put the asset into service.

Clarification

- Under the historical cost method goods and services acquired by a business are reported on the balance sheet at an amount of money that equals the amount that has actually been exchanged (in most cases paid) for the good or service.

Related Items: Definition of Balance Sheet, page 23; Cost, page 27. Also see the discussion of Historical Cost Accounting on page 10.

INCOME-IN-KIND

Definition

The estimated monetary value received for a product or service for which no cash is exchanged.

Clarification

- An example of income-in-kind would be the value of grain exchanged for custom combining in a barter transaction.

- Often revenues and expenses relating to a barter transaction are not reported as income-in-kind. Instead the revenues and expenses are described according to the asset exchanged or service rendered (e.g., grain revenue, custom combining, etc.).

- Where goods or services of the farm business are consumed or used personally, the market value of these goods and services should be reported as revenue. The term used to describe this revenue might be "goods consumed personally" or "personal consumption".

Related Items: Definition of Asset, page 21; Expense, page 31; Market Value, page 38; Revenue, page 41. Also see the Reporting Policy on Barter Transactions, page 48.

INVENTORY

Definition

Inventory consists of items of tangible property which are held for sale in the ordinary course of business, or are in the process of production for such sale, or are to be directly consumed in the production of goods or services.

Clarification

- Examples include feed, seed, farm supplies, and market livestock.

- Inventory is classified as a current asset on the balance sheet.

Related Items: Definition of Balance Sheet, page 23; Current Asset, page 22. Also see the Reporting Policy on Inventory, page 53.

LEASE

Definition

An agreement whereby the owner of an asset (lessor) conveys the right to use this asset to someone else (lessee), usually for a specified period of time, in return for some form of consideration.

Related Items: Definition of Asset, page 21. Also see the Reporting Policy on Leases, page 55.

LEASE - CAPITAL LEASE

Definition

A lease that, from the point of view of the lessee, transfers substantially all of the benefits and risks incident to ownership of property to the lessee. The term of the lease usually extends in excess of one year, and the lease contract may provide for transfer of ownership of the leased asset at the end of the lease term.

LEASE - OPERATING LEASE

Definition

A lease in which the lessor retains substantially all the benefits and risks incidental to ownership of the asset.

Clarification

- The term of an operating lease often does not extend for more than one year, and the lease contract often does not provide for transfer of ownership of the leased asset at the end of the lease term.

LEVERAGE

Definition

The relationship between the total liabilities and the equity of a business. The higher the ratio of debt to equity, the greater is the leverage.

Clarification

- This term implies that net income may be subject to greater fluctuations when a business is financed with debt versus equity.

Related Items: Definition of Debt, page 28; Equity Capital, page 31; Net Income, page 38. Also see the Debt to Equity Ratio, page 64.

LIABILITY

Definition

A liability is an obligation of a business arising from a past transaction that is to be paid in the future (including the delivery of goods and services in the future for which consideration has already been received).

Clarification

- Examples include accounts payable, operating loans, long-term debt, etc.

- The term "debt" is often used interchangeably with the term "liability".

Related Items: Definition of Account Payable, page 19; Debt, page 28; Long-term Debt, page 29; Operating Loan, page 37.

LIABILITY - CURRENT LIABILITY

Definition

A liability that will be payable within the current year or within the normal operating cycle (where the cycle is longer than a year).

Clarification

- Examples include accounts and notes payable within the year. Another example is the portion of long-term debt (principal only) due in the upcoming fiscal period (including that portion in arrears.)
- The term "current liability" is often used synonymously with the term "current debt".

Related Items: Definition of Account Payable, page 19; Current Debt, page 28; Long-term Debt, page 29; Note Payable, page 39.

LIABILITY - INTERMEDIATE LIABILITY

Definition

An intermediate liability is a liability that has an original amortization period beyond one year from the date of the balance sheet and usually not more than ten years.

Clarification

- Examples of intermediate liabilities include loans for equipment and breeding livestock.
- The term "intermediate liability" is used synonymously with the term "intermediate debt".

Related Items: Definition of Amortization, page 21; Intermediate Asset, page 22; Intermediate Debt, page 29; Loan, page 37. Also see the Reporting Policy on Balance Sheet Classifications, page 47; and Supplementary Disclosure - Market Values, page 59.

LIABILITY - LONG-TERM LIABILITY

Definition

A liability with a maturity beyond one year from the date of the balance sheet, or beyond the normal operating cycle (where the cycle is longer than one year). A long-term liability excludes that portion of the debt principal and any other liability due within one year (i.e., current liability).

Clarification

- Examples include mortgages and equipment loans.
- The term "long-term liability" is often correctly used synonymously with the term "long-term debt".
- When a balance sheet is prepared using three liability classifications - current, intermediate and long-term - the definition of long-term liability would be revised. In such cases, the long-term liability includes any liability that has an original amortization period usually beyond ten years.

Related Items: Definition of Amortization, page 21; Balance Sheet, page 23; Current Liability, page 36; Intermediate Liability, page 36; Long-term Asset, page 23; Mortgage, page 38. Also see the Reporting Policy on Balance Sheet Classifications, page 47.

LIQUIDITY

Definition

Liquidity is often measured by the ability of the business to convert assets into cash or to obtain cash to meet current liabilities and other financial commitments.

Related Items: Definition of Asset, page 21; Current Liability, page 36; Liquid Asset, page 23. Also see the Acid Test Ratio, page 62; and Current Ratio, page 63.

LOAN

LOAN - DEMAND LOAN

Definition

A debt on which payment in full could be demanded at any time upon lender's notification pursuant to the terms of the loan contract.

RelatedItem: Definition of Debt, page 28.

LOAN - OPERATING LOAN

Definition

Cash advanced to a business to pay for operating costs. This loan usually provides for repayment within one year or the normal operating cycle.

Clarification

- Examples include loans to purchase feeder livestock and supplies.

- An operating loan is usually classified as a current liability on the balance sheet.

Related Items: Definition of Balance Sheet, page 23; Cost, page 27; Current Liability, page 36.

LOSS

Definition

A decrease in equity as a result of a transaction other than a decrease that results from distributions of equity.

Clarification

- The loss amount calculated for accounting purposes is different than the capital loss amount calculated for income tax purposes. (An example for accounting purposes would include the loss amount incurred on the disposition of a depreciable asset). Therefore, "loss" is the term recommended for use in the context of accounting and "capital loss" is the term recommended for use in the context of income tax.

- Examples of losses include "net loss" and "loss on disposal of assets". In order to avoid confusion arising from the use of the word loss to describe these two instances, the following is recommended: Net loss should be used to refer to a situation where expenses exceed revenues during a fiscal period. Loss on disposal of assets should be used to refer to an amount equal to the excess of the net book value over the sale proceeds of a fixed asset.

Related Items: Definition of Capital Loss, page 25; Equity Capital, page 31; Fixed Asset, page 22; Gain, page 32; Net Loss, page 38.

MANAGEMENT ACCOUNTING

Definition

The preparation and interpretation of accounting information in a manner designed to assist a manager in planning and controlling the operations of the business.

Clarification

- Management Accounting is directed towards providing information to assist management in making internal business decisions. This is in contrast to financial accounting which provides information primarily to external users such as creditors. An example of management accounting includes a lease versus purchase analysis for an additional or replacement tractor.

RelatedItem: Definition of Financial Accounting, page 32.

MARKET VALUE

Definition

The most probable price in terms of money which an asset should bring in a competitive and open market under all conditions required for a fair sale, with buyer and seller each acting prudently and knowledgeably.

Clarification

- The term "fair market value" is often used synonymously with the term "market value".

RelatedItem: Definition of Asset, page 21.

MARKETABLE SECURITY

Definition

A bond, share certificate or other similar item that can be readily converted into cash.

Clarification

- Examples of a bond include a treasury bill and a guaranteed investment certificate (GIC).
- An example of a share certificate is a document that evidences ownership in, say, General Motors of Canada.

RelatedItem: Acid Test Ratio, page 62.

MORTGAGE

Definition

A conveyance of a legal interest in property from one person to another as a security for the payment of a debt or the discharge of some other obligation. The security is redeemable on the payment or discharge of such debt or obligation.

RelatedItem: Definition of Debt, page 28.

NET BOOK VALUE

Definition

The value of an asset that is determined by subtracting the accumulated depreciation (or amortization) from the historical cost of the asset.

Related Items: Definition of Accumulated Depreciation, page 21 ; Amortization, page 21; Asset, page 21; Historical Cost, page 34. Also see the Reporting Policy on Depreciable Assets, page 49.

NET INCOME / LOSS

Definition

The excess of revenues over expenses for a given period of time. If expenses exceed revenue, the difference is called net loss.

Related Items: Definition of Expense, page 31; Gain, page 32; Loss, page 37; Revenue, page 41. Also see the example Statement of Income, page 14.

NET WORTH

Definition

The difference between the market value of the assets and the market value of the liabilities (less any costs of disposition).

Clarification

- Net worth represents an estimate of the amount of money that the owner would receive if all the owner's assets were disposed of and all the liabilities were discharged.

Related Items: Definition of Asset, page 21; Financial Statement, page 32; Historical Cost, page 34; Liability, page 35; Market Value, page 38; Net Worth Statement, page 39; Owner's Equity, page 40. Also see the discussion on Cost versus Current Value, page 10.

NET WORTH STATEMENT

Definition

A statement summarizing the net worth of an individual and the individual's business at a point in time.

Clarification

- Assets are valued at estimated market value and liabilities are subtracted from the asset values to provide an estimate of net worth.

Related Items: Definition of Asset, page 21; Liability, page 35; Market Value, page 38; Net Worth, page 39.

NOTE PAYABLE

Definition

A liability in the form of a promissory note which is a formal written promise by the borrower to pay a certain amount on demand or at a certain future date.

Related Items: Definition of Account Payable, page 19; Liability, page 35. Also see the Reporting Policy on Accounts Payable, page 45.

NOTE RECEIVABLE

Definition

An asset in the form of a promissory note which is a formal written promise to be paid a certain amount on demand or at a certain future date.

Related Items: Definition of Account Receivable, page 19; Asset, page 21. Also see the Reporting Policy on Accounts Receivable, page 46.

OVERHEAD

Definition

Expenses which cannot be directly attributed to individual units of production or service but are essential to the business.

Clarification

- Examples include property taxes and building insurance.

Related Items: Definition of Expense, page 31; Fixed Cost, page 27.

OWNER'S EQUITY

Definition

This term refers to the ownership interest in the business. Owner's equity equals assets minus liabilities and could be considered to be the owner's claim against the assets of the business. Owner's equity is increased by the owner's contribution of assets to the business and decreased by the owner's withdrawals from the business. Owner's equity is also increased by the accumulated net income of the business.

Clarification

- The term "owner's equity" is often used on the financial statements of an unincorporated business to indicate the ownership interest of the sole proprietor. A similar term, "partners' capital" is used on the financial statements of an unincorporated business to indicate the ownership interest of the partners. Finally, the term "shareholders' equity" is used to indicate the ownership interest of an incorporated business.

Related Items: Definition of Asset, page 21; Financial Statement, page 32; Historical Cost, page 34; Liability, page 35; Market Value, page 38; Net Income, page 38; Net Worth, page 39; Partners' Capital, page 40; Sole Proprietorship, page 42; Shareholders' Equity, page 42. Also see the discussion on Cost versus Current Value, page 10.

OWNER'S WITHDRAWALS / CONTRIBUTIONS

Definition

The amount of cash or other assets withdrawn from, or contributed to, a business by the owner.

Clarification

- The withdrawals and contributions by the owner are not considered part of either the expense or the revenue of the business. Instead they represent either a change in the liabilities or a change in the equity capital of the business, depending upon the type of business entity (e.g., partnership versus corporation) and the terms of the contribution (e.g., purchase of shares versus loan). In the case of sole proprietorship, a withdrawal/ contribution by the owner is recorded as a decrease/increase in the owner's equity.

Related Items: Definition of Asset, page 21; Equity Capital, page 31; Expense, page 31; Liability, page 35; Owner's Equity, page 40; Sole Proprietorship, page 42; Revenue, page 41. Also see the example Statement of Owner's Equity, page 15.

PARTNERS' CAPITAL

Definition

This term often refers to the ownership interest in a partnership. Partners' capital equals assets minus liabilities and could be considered to be the partners' claim against the assets of the business.

Clarification

- Partners' capital is <u>increased</u> by the partners' net contribution of assets to the business and net income. Partners' capital is <u>reduced</u> by the partners' net withdrawals of assets from the business and net losses.

Related Items: Definition of Asset, page 21; Liability, page 35; Net Income/Loss, page 38; Owner's Equity, page 40; Owner's Withdrawals/Contributions, page 40; Shareholders'

Equity, page 42. Also see the example Partnership Financial Statement, Appendix I, page xxi.

PREPAID EXPENSE

Definition

An operating expenditure, other than an outlay for inventory, which is expected to yield its benefits in the future and in the meantime is carried on the balance sheet as an asset to be charged to expense when utilized.

Clarification

- Examples include the unexpired portion of building insurance premiums and property taxes. Another example is fall applied fertilizer.

Related Items: Definition of Asset, page 21; Balance Sheet, page 23; Expense, page 31. Also see the Reporting Policy on Prepaid Expenses, page 57.

PROJECTED CASH FLOW STATEMENT

Definition

This statement shows expected future sources of cash from operations, capital sales, owner contributions and borrowings. It also shows anticipated cash utilization for business expenses, loan payments, capital purchases and owner withdrawals from the business.

Related Items: Definition of Owner's Withdrawals/Contributions, page 40. Also see the example Projected Cash Flow Statement, Appendix II.

RETAINED EARNINGS/DEFICIT

Definition

The accumulated balance of net income in excess of net losses of an incorporated business after any dividends and other appropriate charges or credits. A negative retained earnings balance is termed "deficit".

Clarification

- Retained earnings are reported as part of shareholders' equity on the balance sheet.

Related Items: Definition of Balance Sheet, page 23; Dividend, page 31; Net Income/Loss, page 38; Shareholders' Equity, page 42. Also see the example Statement of Retained Earnings, Appendix I, page v.

REVENUE

Definition

The value of all goods produced and/or sold and all services rendered during the fiscal period from the operation of the business.

Clarification

- Revenue may include amounts earned from investments (e.g., interest and dividends). However, it is informative to separately disclose these ancillary revenue amounts apart from the revenue earned from the operations of the farm business.

- As well, revenue includes realized increases in equity (e.g., gain on the sale of a fixed asset). However, revenue would not include an increase in equity arising from contributions to the business by the owner(s).

- In converting from a cash to an accrual reporting format, an adjustment for the increase or decrease in accounts receivable should be included in the revenue section of the income statement. This should be done only to the extent the account receivable is in respect to current items such as inventory sold or services rendered.

- In addition, the conversion from cash to accrual may also involve an adjustment for the increase or decrease in the inventory of marketable products. This adjustment is often included in the revenue section of the Statement of Income. Separate disclosure of this adjustment in revenue is informative. Changes in the inventory of supplies (i.e., inputs) may best be disclosed in the expense section of the statement of income.

Related Items: Definition of Account Receivable, page 19; Accrual Basis of Accounting, page 20; Cash Basis of Accounting, page 25; Equity Capital, page 31; Expense, page 31; Fiscal Period, page 32; Inventory, page 34; Revenue, page 41; Statement of Income, page 43. Also see the Reporting Policy on Accounts Receivable, page 46; Inventory, page 53; and the example Statement of Income, page 14.

SHARE CAPITAL

Definition

The ownership interest in an incorporated company that is represented by the shares of that corporation.

Clarification

- Share capital is included in the shareholders' equity section of the balance sheet.

RelatedItem: Definition of Shareholders' Equity, page 42.

SHAREHOLDERS' EQUITY

Definition

The excess of the net book value of the assets of an incorporated company over the value of its liabilities.

Clarification

- Shareholders' equity equals assets minus liabilities and could be considered to be the owner's claim against the assets of the business.

- "Shareholders' equity" is a term similar to the terms "owner's equity" and "partners' capital", except that shareholders' equity applies to incorporated businesses only.

Related Items: Definition of Asset, page 21; Liability, page 35; Net Book Value, page 38; Owner's Equity, page 40; Partners' Capital, page 40.

SOLE PROPRIETORSHIP

Definition

An unincorporated business wholly owned by one person.

Clarification

- This is the most common form of farm business entity.

Related Items: Definition of Owner's Equity, page 40. Also see the example Financial Statements for a Sole Proprietorship, Appendix I, page xii.

STATEMENT OF CHANGES IN FINANCIAL POSITION

Definition

This statement shows sources of cash from business operations, asset sales, owner contributions and borrowings over the past fiscal year. It also shows cash utilization for business operations, loan payments, asset purchases and owner's withdrawals from the business over the same period.

Related Items: Definition of Owner's Withdrawals/Contributions, page 40. Also see the example Statement of Changes in Financial Position, page 17.

STATEMENT OF INCOME

Definition

A financial statement summarizing the revenue and the expense, and indicating the net income (or net loss) for a defined accounting period, usually the fiscal year of a business.

Related Items: Definition of Expense, page 31; Fiscal Period, page 32; Net Income/Loss, page 38; Revenue, page 41. Also see the example Statement of Income, page 14.

WORKING CAPITAL

Definition

The difference between current assets and currents liability.

Related Items: Definition of Current Asset, page 22; Current Liability, page 36.

3.0 REPORTING POLICIES

3.1 Introduction

The following reporting policies relate to accounting issues that usually arise in preparing and analyzing the financial statements of an agricultural producer. In creating these policy recommendations, the level of accounting expertise of the producer and the relative complexity of the producer's accounting records were key considerations.

The majority of the recommendations are similar to those used by other industries (e.g., accounts receivable and depreciable assets). However, agriculture often presents unique challenges to preparers of financial information. For instance, accounting for the value of raised animals, or estimating the amount receivable from known government subsidy programs can be particularly difficult.

For this reason, certain of the following recommendations may differ slightly from the policies recommended for other industries. However, these differences are all meant to enhance the cause of practicality and usefulness.

ACCOUNTS PAYABLE

Background

In many situations, the purchaser gains title to or possession of an asset, supply, or service used in the operations of the business (e.g., fertilizer, custom work, utilities) before payment is made.

Recommendation and Disclosure

Under the accrual method of accounting, the amount owing is reported in the fiscal year when the transaction takes place even though the payment may not be made until the following year. These amounts owing to the creditor for other than long term financing are recorded as accounts payable.

For example, an account payable would be reported in the following instance:

> *A farm business is preparing a financial statement for December 31, 1990. On December 29, 1990 the farm purchased 2,000 litres of fuel for $600. The farmer paid cash for the fuel on January 31, 1991.*
>
> *On the financial statement date (December 31), the farm business had incurred a liability. Therefore, $600 should be reported as an account payable on the Balance Sheet.*

Accounts payable are reported on the balance sheet under the "current liabilities" section when payment for these goods and services is due within the next fiscal year.

Related Items: Definition of Account Payable, page 19; Asset, page 21; Balance Sheet, page 23; Current Liability, page 36; Fiscal Period, page 32. Also see the discussion on Accrual Reporting, page 11; and the example Balance Sheet, page 12.

ACCOUNTS RECEIVABLE

Background

Under the accrual method, revenues should be reported when realized or when the right to other money (e.g., government grants) has been obtained.

For example, an account receivable would be reported in the following instance:

> *A farm business is preparing a financial statement for December 31, 1990. On December 30, 1990, the farm sold and delivered 10 head of cattle to a neighbour for $10,000. The neighbour paid cash for the cattle on January 10, 1991.*
>
> *On the financial statement date (December 31), the farm business had realized a sale. Therefore, $10,000 should be reported as revenue on the statement of income. An equal and offsetting amount should be reported as an account receivable on the balance sheet due to the fact that the money had not been received by December 31.*

General Financial Statement Disclosure

Accounts receivable represent an asset owned by the business. Accordingly the receivable amount should be reported on the balance sheet as either a current or a long-term asset, depending on the expected date of collection.

In addition it is informative to the readers of financial statements if a brief description of the various accounts receivable is recorded in the notes to the financial statements.

Often there may be a delay between the date a product is shipped and the date the product is sold in the distant market.

Where a sale has been made by the producer and title to the assets has passed to the purchaser, report the sale as revenue and report the related receivable. However, where an asset has been shipped to the purchaser but an agreement for sale has not been made, the asset should not be considered sold and therefore remains as part of inventory. No receivable would be reported because the seller of the asset still retains ownership.

Recommendations Regarding Sales at Undetermined Prices

This policy relates to shipments made to cooperatives, marketing agencies, etc., for which final payment has not been received but title to the goods has passed from the producer to the buyer.

Where shipments are made to cooperatives, title to the goods usually passes from the producer to the cooperative. Where there is an accurate indication of the final settlement amount to be paid to the producer, an account receivable, with the equivalent credit to revenue, should be reported.

Where there is no accurate indication of the final settlement amount, an estimate of market value less any costs of disposition of the product (e.g., insurance), at or about the planned date of settlement should be made. This estimate should then be used to determine the amount of the account receivable and the equivalent credit to revenue.

It is advisable that the notes to the financial statements disclose the specifics of the estimated accounts receivable related to the settlement amounts. Details such as the amount of produce and the estimated unit selling price would be informative to financial statement users.

Some argue that where there is no accurate indication of the final settlement amount, no amount should be recorded as an accounts receivable. Under this method, greater accuracy may be achieved by waiting for the cooperative to advise the producer of the settlement amount. However, the handicap of not reporting a current account receivable could outweigh the benefit of greater accuracy. In addition, the lack of consistency among the financial statements of various producers could be confusing to the

Subsidies and Grants

The agricultural industry has a number of government subsidies and grant programs available to it. The amount of the subsidy or grant should be reported as an accounts receivable only when both the <u>right</u> to receipt in the future and the estimated <u>amount</u> is determinable with a high degree of certainty.

The equivalent credit should be recorded as revenue if the subsidy relates to current items such as product sales (grain, cattle, etc.). Alternatively, if the subsidy relates to long-term assets such as equipment and buildings (dugouts, tractors, etc.), the equivalent credit should be offset against the cost of the related asset.

It is helpful for financial statement users if a description of the specific grants included in the accounts receivable amount are disclosed in the notes to the financial statements.

Often, a producer may have a supportable right to a grant, but the amount of the grant cannot be determined due to any number of factors. For instance, a government grant program may have a history of announcing grant amounts that differ significantly from the actual payout amount. As well, certain grant programs may announce a total grant or subsidy amount but not indicate how the total grant will be allocated to the individual producer. Because of the uncertainty related to many government grant programs, the amount of the subsidy or grant should not be recorded as an account receivable if the amount of the grant cannot be determined. It is useful in such cases to record the details of the grant or subsidy in the notes to the financial statements.

Related Items: Definition of Account Receivable, page 19; Asset, page 21; Balance Sheet, page 23; Current Asset, page 22; Financial Statement, page 32; Fiscal Period, page 32; Inventory, page 34; Long-term Asset, page 23; Revenue, page 41. Also see the Reporting Policy on Cooperatives, page 48; Inventory, page 53; the discussion of Accrual Reporting, page 11; and the example Balance Sheet, page 12.

BALANCE SHEET CLASSIFICATIONS

Balance sheet items are most often segregated between those that are current and those that are not current (e.g., long-term) in nature. Current items are those that are expected to be realized or discharged within the next year or within the next operating cycle when the cycle is longer than one year. Items that are not current, such as fixed assets and long-term liabilities, are those that will not be realized or discharged in the next year (or in the normal operating cycle where the cycle is longer than a year).

The most meaningful method of disclosing these current and non-current balance sheet items is achieved with presentation of current assets/liabilities firstly, with subtotals and the remaining assets/liabilities in the order of their expected liquidity and discharge, respectively. (See the example Financial Statements in Appendix I.)

Some argue that financial statements should present current assets/liabilities firstly, intermediate assets/liabilities secondly, and finally long-term assets/liabilities. This disclosure, it is argued, will provide certain users of financial information with the appropriate detail. However, if the balance sheet properly segregates long-term assets and liabilities into the major headings on the balance sheet, the appropriate detail will be available to these users.

For instance, long-term assets such as machinery and equipment should be disclosed separately from such assets as land and buildings. In addition, other long-term assets such as productive assets (e.g., breeding livestock) and quota should both be disclosed separately in the financial statements. It is necessary to disclose, in the notes to the financial statements, the principal portion of long-term debt that is due in each of the next five years.

If this separate disclosure is made, the users of financial statements should have an adequate breakdown of the various assets and liabilities to properly analyze the financial statements.

Although the "two-category" (current and long-term) balance sheet is preferred, the widespread use of the "three-category" (current, intermediate, long-term) balance sheet cannot be ignored. For this reason the three-category approach should be considered an acceptable approach in cases where the preparer of the financial statement believes the additional segregation of categories is significantly more informative to the reader. Where a three-category approach is used, the basis for determining the intermediate asset and intermediate liability classifications should be disclosed in the notes to the financial statements.

Related Items: Definition of Asset, page 21; Balance Sheet, page 23; Current Asset, page 22; Current Liability, page 36; Financial Statement, page 32; Intermediate Asset, page 22; Intermediate Liability, page 36; Liability, page 35; Long-term Asset, page 23; Long-term Liability, page 36. Also see the Reporting Policy on Supplementary Disclosure, page 59, and the example Balance Sheet, page 12.

BARTER TRANSACTION VALUATION

Background

Barter transactions represent the purchase or the sale of an asset or a service without the exchange of cash. For instance, the sale of fertilizer in exchange for the purchase of cattle is considered a barter transaction.

Recommendation

The value of the asset received will equal the market value of the asset given up in exchange at the time of the transaction. Accordingly, report the asset received and the asset given up at market value.

Related Items: Asset, page 21; Income-in-kind, page 34; Market Value, page 38.

COOPERATIVES - INVESTMENT IN COOPERATIVES

Background

Investment in cooperatives is generally made to obtain an economical source of supply or marketing service and not on the expectation of a return on investment.

Cooperatives tend to have the following characteristics:

- Capital is provided by initial cash investment in the form of a member loan or the purchase of shares.

- All or a portion of the cooperative's net income may be allocated to members on the basis of their pro rata share of the total current year's purchases or sales of the cooperative. This allocation is usually referred to as a patronage dividend. Along with the initial investment of cash, capital may be provided to the cooperative by reinvestment of these patronage dividends.

- The sale of the investment is usually restricted (other than a sale back to the cooperative).

Examples of marketing cooperatives include the wheat pools, dairy pools, and certain marketing boards. Supply cooperatives include organizations whose purpose is to provide products or services to members, and often also non-members, at reasonable prices. The members benefit by securing a source of supply or a market for their products, and hopefully by sharing in the profits of the cooperative.

Recommendation

The cost method of accounting for investment in cooperatives has been the most prevalent in Canada.

Under this method, investment in cooperatives is recorded at cost (equal to the purchase price of the investment), then adjusted for net income allocated by the cooperative, plus or minus any further investment or withdrawal by the producer.

For example, a business pays a $5 fee to obtain a membership in a supply cooperative. At the end of the year the supply cooperative allocates the net income and issues a patronage dividend to the business of $90. Of the $90, $40 is paid as a cash withdrawal to the business and $50 is retained by the cooperative as a patronage loan.

The financial statements of the business would report the $5 payment as a long-term asset - "Investment in Cooperative". The patronage dividend of $90 would be recorded as follows: $90 would be recorded as "patronage dividend" revenue; $50 would be recorded as an increase in the "Investment in Cooperative"; and the balance, $40, would be recorded as an increase to the cash account on the balance sheet.

COOPERATIVES - PATRONAGE DIVIDENDS

Background

Patronage dividends consist of the distributed net income of the cooperatives. They are usually based on the producers' share of the total sales or purchases made through the cooperative.

Recommendation and Financial Statement Disclosure

The accepted financial statement presentation for these allocations is to show the patronage dividend as other revenue, distinct from operating revenues.

Related Items: Definition of Capital, page 24; Dividend, page 31; Financial Statement, page 32; Long-term Asset, page 23; Net Income, page 38; Revenue, page 41. Also see the example Balance Sheet, page 12; and the example Statement of Income, page 14.

DEPRECIABLE ASSETS

Background

Depreciable assets are those assets held for long-term use rather than for resale in the normal business operations and which deteriorate in value with use or become obsolete with the passage of time. They include buildings, machinery, equipment, and vehicles.

Generally, depreciable assets are originally recorded at cost, then depreciated over their estimated useful life. The cost of an asset would include the purchase price and all costs of installation. Where an asset is constructed by the producer, all costs of direct materials, hired labour, supplies, and services, as well as a reasonable portion of the fixed costs, should be capitalized.

Recommendation

When properly calculated, depreciation is intended to match the cost of an asset with the benefits that the asset produces over time. Depreciation charged should be based on the original cost of the asset, the estimated useful life of the asset and, where a straight-line method of depreciation is used, the asset's estimated salvage value.

For example, a farm business purchases a tractor for $24,000 cash. The estimated useful life of the tractor is 15 years. At the end of 15 years the estimated salvage value of the tractor is $2,000.

The straight-line depreciation calculation would be as follows:

Cost	*$24,000*
Less: Salvage Value	*(2,000)*
Depreciation Base	*$22,000*

Annual Depreciation Amount = Depreciation Base/Useful Life (Years) = $22,000/15 = $1,467

Many farm businesses use a diminishing balance method. Under this method, an annual depreciation rate is applied to the depreciable assets. The rate chosen should properly match the cost of the asset with the benefits produced by the asset.

An example calculation of depreciation based on the diminishing balance method using the facts in the previous example is as follows:

Cost	*$24,000*
Depreciation Rate (Assumed)	*x 30%*
Annual Depreciation	*$ 7,200*

In the second year, the depreciation calculation is:

Depreciation Base ($24,000 minus $7,200)	*$16,800*
Depreciation Rate	*x 30%*
Annual Depreciation	*$ 5,040*

Financial Statement Disclosure

The amount of depreciation should be recorded in the statement of income. The basis of depreciation (e.g., straight-line or diminishing balance method) should be disclosed in the notes to the financial statements.

Related Items: Definition of Asset, page 21; Capital Cost Allowance, page 24; Cost, page 27; Depreciation, page 31; Gain, page 32; Loss, page 37; Statement of Income, page 43. Also see the example Statement of Income, page 14.

FORWARD AND FUTURE CONTRACTS AND OPTIONS

Introduction

Producers often attempt to protect their businesses from the unpredictable fluctuations in the market for products sold or goods purchased by the use of forward and futures contracts. Reporting policies related to forward contracts are relatively straight-forward and are discussed in detail below.

Future contracts can take the form of a hedging contract or a speculative contract. The reporting policies related to both these forms of futures contracts are outlined below, following the discussion on forward contracts. Finally, certain reporting policies related to options are briefly mentioned.

FORWARD CONTRACTS

Background

Forward contracts are formal private contracts between producer and supplier, or producer and customer for future delivery, or acceptance of future delivery of a specified product. An example of a forward contract would be a contract between an agricultural producer and a canola crushing plant whereby the producer has, prior to the harvest, agreed to sell as much seed as he can produce on his farm at the current market price. In this case, if the crop fails and no seed is harvested, no obligation exists to deliver the product.

Recommendation

Several approaches to accounting for forward contracts are used, depending on various factors.

1. Where the seller has delivered the product or control of the product has been transferred to the buyer, then the contract should be treated as a sale. Where no price has been fixed at the reporting date, an estimate should be used for the amount receivable from the buyer. (The estimate may be based, for example, on the board or listed price for a similar product).

2. If the product has not been delivered or its control has not been transferred to the buyer, it should not be treated as a sale but as inventory of the seller and valued at the contract price (not the market price).

3. Where penalties, discounts, fines, or bonuses are associated with the contract and the amounts can be reasonably estimated, these should be included in determining net income, provided the seller has delivered the product or control of the product has been transferred to the buyer.

See the Disclosure section below following the discussion of options.

FUTURES CONTRACTS

Background

A futures contract is an agreement between a producer and a member of a regulated commodity exchange with a specified future date for delivery to execute a buy or sell order for a specific quantity and quality of product to be delivered at a specific point in time.

An example of a futures contract would be a contract through a commodity broker to sell December wheat at $156/tonne. The quantity is set at 100 tonnes on the Winnipeg Commodity Exchange with a specified future date for delivery. On the future date, the seller and buyer are obligated to fulfil the contract regardless of the circumstances. This is usually done by a payment equal to the difference between the current price and contract price. The following recommendations discuss futures hedging contracts separate from futures speculative contracts.

FUTURES CONTRACTS - HEDGING CONTRACT

A transaction where there is reasonable assurance that the producer is able to, and will, undertake the purchase or sale of a commodity in the future, and this is paralleled by a futures contract, is considered a hedge. From the standpoint of the market transaction, no gain or loss will result because the actual results of buying or selling the commodity will offset the result of the settled futures contract.

For example, it is June and a farm manager has a crop of wheat in the field. The current cash market price for wheat is $110.00 per tonne. If the price goes up between *now and January when the farm manager plans to sell, he/she will gain. On the other hand, if the price goes down during that time, he/she will lose.*

To protect against a possible price decline, the farm manager could hedge the crop by selling a corresponding amount of wheat in the futures market and buy it back later when it is time to sell the crop in the cash market. If the cash price declines by harvest, any loss incurred upon sale of the crop will be offset by a gain from the hedge in the futures market (ignoring basis).

(The above example outlines an instance where a farm manager sold into the futures market and bought back later. It is also possible to buy into the futures market and sell later.)

Recommendation

In the case of a hedge, producers who report their inventory at market value should include gains or losses on both open and closed contracts in the determination of net income. This is because any increase or decrease in the value of the contract is offset by reported fluctuations in the value of the inventory.

For example, assume in June that the cash market price for wheat and the futures market price are equal at $112.00 per tonne. To protect against a price decline, the farm manager sells a wheat crop in the futures market, intending to buy back the wheat in the futures market in January.

During the period between June and December 31, when the farm manager prepares his/her financial statement, the cash market price for wheat drops by $20.00 per tonne. However, ignoring basis and commissions, the manager has gained $20.00 per tonne on the hedge. The value of inventory at December 31 ($92.00 per tonne) plus the gain on the hedge ($20.00 per tonne) equals the $112.00 price the farm manager wished to protect.

On the other hand, producers who report their inventory at the lower of cost or net realizable value should defer recognition of gains or losses on open contracts until the commodity to which the hedge relates is actually sold. Gains or losses on closed contracts should, of course, be included in the determination of net income.

FUTURES CONTRACTS - SPECULATIVE CONTRACT

Recommendation

Where the futures contract is purely speculative (where it does not meet the conditions of a hedge), the anticipated losses should be included in net income at the financial statement date whether or not the transaction has been realized, but gains should be reported only on the date of the actual transaction.

OPTIONS

As an alternative to a futures contract, a producer might purchase an option. An option gives the holder the right (but not the obligation) to sell or buy a futures contract at a certain price and during the time specified by the option contract.

For example, a producer might purchase an option to sell a futures contract on a commodity such as soybeans. The option would give the producer the right to sell the contract to the writer of the option at a specific price during any time prior to the expiry date on the option.

If the price of the futures contract had fallen prior to the expiry date of the option, the holder would exercise the right of the option and sell the contract to the writer at the option price. Alternatively, if the price of the contract had risen by an amount greater than the cost of the option, the holder would benefit by allowing the option to expire and selling the contract at the higher price.

Recommendation

For a producer, an option is a partial safeguard against unfavourable changes in input or output prices. The option should be reported as follows:

- The cost of the option should be recorded as a prepaid expense;

- If the option is exercised, the cost of the option is included in the cost of the items purchased or sold as the case may be;

- If the option expires, it should be written off as an expense for that year;

- Where, at year end, an option has not expired but it appears that it will not be exercised, the option should be written off as an expense for that year. This is because the option provides little economic benefit to the farm business and therefore presentation of the option as an asset may be misleading.

Financial Statement Disclosure of Forward and Futures Contracts and Options

The details related to forward and futures contracts and options, such as the nature of the assets to which the contract relates and the method of accounting for the contracts, should be disclosed in the notes to the financial statements.

Related Items: Definition of Account Receivable, page 19; Cost, page 27; Gain, page 32; Financial Statement, page 32; Inventory, page 34; Loss, page 37; Market Value, page 38; Net Income, page 38. Also see the Reporting Policy on Accounts Receivable, page 46; Inventory page 53; and the example Statement of Income, page 14.

INVENTORY

Background

Inventory consists of items of tangible property held for sale such as market livestock and produce such as fruit, vegetables and grain. It also includes items such as fertilizer, seed, feed, and fuels that are held for the production of of saleable products. As well, inventory includes items in the process of being produced for sale; for example standing crops, feeder livestock, and unharvested fruits and vegetables. Items such as breeding stock and perennial plants would not be considered inventory because their production period is greater than one year. Assets of this nature are classified as productive assets.

Recommendation and Financial Statement Disclosure

Due to the saleable nature of most agricultural inventory (i.e., most products have a reliable market) and the ease of obtaining a market price (i.e., many products have quoted prices), the valuation method recommended for inventories is a market-based approach.

The market-based method, more specifically termed **net realizable value method**, refers to valuing inventory at the current market price of the product less any anticipated cost of disposition (see the next section). This market based method is recommended for the following reasons:

- Market price data is often readily available for most products;

- Use of a market-based method is established within the industry;

- Financial statement users often find a market-based method more relevant than a cost-based method of valuation due to the fact that the inventory is to be sold, usually within one year.

Inventory should be reported as a current asset on the balance sheet. The following information should be disclosed in the notes to the financial statements:

- The basis of valuation (i.e., net realizable value - see following page);

- A description of the major categories with the dollar amounts (disclosure of the unit prices, quantities and grades of the inventory is optional but is preferred by many readers of financial statements);

- The fact that the inventory has been pledged as security for loans, if applicable.

Net Realizable Value

As mentioned earlier, net realizable value is the specific term that refers to valuing inventory using market prices. Net realizable value is determined by calculating the market price for the product at the delivery destination less all anticipated costs of disposition.

The market price can be determined from various sources. For instance quoted daily prices are available for "traded" commodities. For other commodities, local dealers, trade publications and crop reporting services are a few of the many sources available to determine market prices.

The costs of disposition would include handling and packaging costs, transportation costs and selling expenses such as commissions.

As a cautionary note, it should be kept in mind that the grade of farm produce may have a large impact on the market price. Due to the difficulty, at times, of estimating the grade of produce, it is suggested that, where applicable, the notes to the financial statements disclose grades used in valuing the inventory.

In addition, market prices are often volatile. It is suggested that estimates should be conservative to avoid overstatement of net income and current assets.

Exceptions

One common exception to valuing inventory at net realizable value would be the instance of growing crops. Due to the high degree of estimation involved in determining the cost to harvest this produce, it is recommended that growing crops be valued at the cost of the inputs. Where the crop is insured and the insured value is higher than the total cost of inputs, then the higher insurance value should be used.

There may be other exceptions to the general recommendation of valuing inventory at net realizable value. Nevertheless, these exceptions, like the instance of growing crops, should involve conservative estimates and the basis of valuation should be adequately disclosed in the notes to the financial statements.

Alternative

A common method of valuing inventory outside the agriculture industry is the "lower of cost or net realizable value" method. This method involves determining the cost of the inventory and reporting this value unless the net realizable value is lower.

Conclusion

To determine cost, a producer must allocate to the inventory the dollar value of expenses associated with the production or purchase of the inventory. The lower of cost or net realizable value method provides a conservative and accurate valuation of inventory. However, for many producers this is difficult to determine using current accounting records. It is unrealistic to expect that producers will be able to comply with the requirement to determine inventory cost at this time. Therefore, a market-based method is recommended. Nevertheless, the issue of a consistent valuation method between agriculture and other industries is one which should be addressed in the future.

Related Items: Definition of Asset, page 21; Balance Sheet, page 23; Cost, page 27; Current Asset, page 22; Expense, page 31; Financial

Statement, page 32. Also see the Reporting Policy on Productive Assets, page 57; and the discussion of Cost versus Current Value Accounting, page 10.

LAND IMPROVEMENTS - PERMANENT LIFE IMPROVEMENTS

Recommendation

Permanent life improvements include expenditures required to make land suitable for general agricultural use. (Examples include clearing, levelling, terracing.) These expenditures should be recorded at historical cost. Such expenditures should not be depreciated, because they have, in most cases, an indefinite useful life.

LAND IMPROVEMENTS - LIMITED LIFE IMPROVEMENTS

Recommendation

Limited life improvements include expenditures to land which have a definite useful life. (Examples include fences and drainage systems.) Expenditures on limited life improvements should be recorded at historical cost and depreciated over the estimated useful life of the improvement.

LAND IMPROVEMENTS - ANNUAL COSTS

Recommendation

Annual costs such as weed control and fertilization should be expensed in the year that they occur. Although these expenditures may benefit both current and future periods, most of the benefit is realized in the year of application. Therefore, expensing these items in the current year is most practical.

Related Items: Definition of Expense, page 31; Depreciation, page 31; Historical Cost, page 34. Also see Reporting Policy on Depreciable Assets, page 49.

LEASES

CAPITAL LEASE

Background

A capital lease is a lease that transfers substantially all of the risks and benefits associated with ownership to the lessee. For example, any one of the following criteria may indicate the existence of a capital lease:

- there is reasonable assurance that the lessee will obtain ownership of the leased asset by the end of the lease term. This may be evidenced by a bargain purchase option or an asset transfer clause;
- the lease term is of such duration that the lessee will receive substantially all of the economic benefits expected to be derived from the use of the asset (e.g., 75% or more of the asset's useful life);
- the lessor is assured of regaining his investment in the leased property and of earning a return as a result of the lease agreement. This instance would occur when the present value of the minimum lease payments are equal to, or substantially all (e.g., 90% or more) of the market value of the leased asset.

An example of a capital lease follows:

- *A farmer leases a $30,000 tractor from a machinery dealer for five years at $650 per month. At the end of five years the tractor will be returned to the dealership. The tractor has an estimated useful life of six years. The dealership's interest rate is 15% per year.*

- *This is considered to be a capital lease because, although the asset must be returned to the dealer (i.e., no transfer of ownership), the lease term is greater than 75% of the asset's useful life (5 years/6 years = 83%). In addition, the present value of the minimum lease payments exceeds 90% of the market value of the asset. (The present value of the minimum lease payments equals $27,322 which is 91% of market value of the tractor.)*

Present Value

The concept of present value rests on the assumption that a dollar today is worth more than a dollar tomorrow. In other words, the value of a lease payment this year is worth more than the same lease payment next year. Therefore it is necessary to discount the value of future lease payments.

Recommendation and Financial Statement Disclosure

Capital leases should be shown as an asset and as a liability. More specifically, on initiation of the lease, the asset is recorded at an amount equal to the present value of the minimum lease payments with an offsetting charge to liabilities for the obligation.

As lease payments are made, they are allocated to i) a reduction of the obligation, ii) interest expense, and iii) any related executory charges. The asset is periodically and systematically depreciated, usually on a basis consistent with the producer's depreciation policy for other similar assets.

The notes to the financial statements should disclose the term of the lease and other relevant facts related to the lease.

OPERATING LEASE

Background

An operating lease is an agreement between a lessor and lessee whereby the lessee is permitted to make use of an asset for a specified period of time in return for payments to the lessor. The lessor retains the risks and benefits of ownership of the asset.

Examples include land leases, some equipment and machinery leases, and building leases. Any lease which is not a capital lease is an operating lease.

Recommendation and Financial Statement Disclosure

Payments for operating leases should be expensed in the period to which the lease benefit relates. The rental costs should be included in expenses of the farm operation on a straight-line basis over the life of the lease unless another rational basis of lease amortization is more representative of the time period of benefit.

The notes to the financial statements should disclose the terms of the lease and other relevant facts related to the lease.

Related Items: Definition of Amortization, page 21; Asset, page 21; Depreciation, page 31; Expense, page 31; Lease, page 35; Liability, page 35; Market Value, page 38. Also see Reporting Policy on Depreciable Assets, page 49; and Additional Reference Sources, Appendix IV.

PREPAID EXPENSES

Often services and supplies are purchased that are not fully utilized in the current year. Examples include items such as property taxes, rent and insurance premiums that are paid for in the current fiscal year and relate not only to that current year, but also to a future year. Another example is fall applied fertilizer.

Recommendation

The portion of the purchase cost that relates to the future year (the unexpired portion) represents a future benefit to the business and accordingly should be recorded as a current asset on the balance sheet. The equivalent credit should be recorded as a reduction of the related expense on the statement of income.

Related Items: Definition of Balance Sheet, page 23; Cost, page 27; Current Asset, page 22; Expense, page 31; Prepaid Expense, page 41; Statement of Income, page 43.

PRODUCTIVE ASSETS

Background

For agricultural reporting purposes, productive assets are assets that grow and reproduce and include producing plants, trees and vines as well as production livestock.

Producing plants include biennial and perennial plants, trees and vines, e.g., fruit trees and vines, berries, and tame hay. They are primarily plants which do not perish when their crop is harvested.

Production livestock consists of animals acquired or developed for the production of progeny (i.e., breeding livestock), or the production of a livestock product. Examples include commercial cattle, dairy cattle, horses, birds, bees, and hogs.

Recommendation and Financial Statement Disclosure

The recommended approach to valuing a productive asset is at market value. Estimates of market value should be conservative to avoid over-optimistic asset values.

A productive asset should be reported as a long-term asset on the balance sheet when a two-category approach is used. When a three-category approach is used, the productive asset, in most cases, should be reported as an intermediate asset.

The change in the market value of the productive asset from the beginning of the current fiscal year to the end should be reported on the statement of income.

This change in value is primarily composed of two components; the first is the change in value due to an increase or decrease in the total quantity of productive assets. The second is the change in value due to an increase or decrease in the market price of the productive assets. These two components should each be separately disclosed on the income statement. It is preferable to disclose the change component related to market price in a section of the income statement separate from the revenue for the sale of farm produce.

In addition, the notes to the financial statements should disclose the following:

- The basis of valuation (i.e., market value).
- A description of the major categories (e.g., dairy cattle, trees, vines, etc.) with the dollar amounts (disclosure of the unit prices and quantities is optional) is suggested.
- The fact that the assets have been pledged as security for loans, if applicable.

Alternative

The depreciated cost method is considered an alternative method of valuing productive assets. Under this method, the assets would be valued at the original cost to purchase or produce, then depreciated over their estimated reproductive/useful life.

This method has been advocated by many, but is difficult to implement. The primary difficulty relates to accounting for the cost of development and growth of the productive asset.

Conclusion

- The answer to whether a market value approach provides more or less reliable and relevant accounting information than a cost based approach is not clear. Admittedly a market value approach involves a degree of estimation in determining market prices. However, a cost based approach also requires a degree of estimation in determining, for example, a suitable overhead allocation percentage and depreciation factor.

- A cost based method of valuation would be preferable were it not for the practical difficulties in implementing such an approach. Therefore valuing productive assets at market value is recommended.

- In the near future this valuation issue should be revisited, perhaps by a "Farm Accounting Review Committee", to research a practical and acceptable cost based method.

Related Items: Definition of Asset, page 21; Balance Sheet, page 23; Cost, page 27; Depreciation, page 31; Fiscal Period, page 32; Intermediate Asset, page 22; Long-term Asset, page 23; Market Value, page 38; Statement of Income, page 43. Also see the Reporting Policy on Balance Sheet Classifications, page 47; the example Statement of Income, page 14; and the discussion on Cost versus Current Value Accounting, page 10.

QUOTA VALUATION

Background

A quota is essentially a license, or a right, to sell a certain amount of a specific commodity. This right is regulated by marketing boards. Some quotas (such as milk) are transferable and therefore have a value associated with them. In other cases, the quota can only be used by the producer to whom it has been granted; it cannot be sold or transferred. In still other situations, the quota may be attached to a specific tangible asset such as a parcel of land or a building. In this case, when the asset is no longer capable of contributing to production, the attached quota ceases to have a recognizable value.

Recommendation and Financial Statement Disclosure

Quota should be valued at cost without a reduction for amortization. The quota value would only be adjusted if all or part of the quota were sold or a permanent decline in value occurred. (The quota value should not be written up in value except where an appraisal of the entire business has been performed as a result of a reorganization.)

Quota is an intangible asset that should be reported on the balance sheet as either a long-term or intermediate asset, depending upon the individual circumstances.

The notes to the financial statements should disclose, where applicable, production amounts (e.g., number of litres held) and other relevant information related to quotas.

(In addition, the "supplementary disclosure" schedule, discussed elsewhere in this section, should disclose, where available, the market value of the quota.)

Alternative

The amortized cost method is an alternative method of quota valuation. Using this method the quota is initially recorded at original cost then amortized over its estimated useful life.

Amortizing a quota over a period of years properly matches the costs of the quota with the benefits received from ownership. However, the increasing transferability of quotas between producers in the industry has meant that many are subject to increases and decreases in value. Consequently, defining an amortization period is often arbitrary.

Conclusion

Record a quota at cost with no amortization. However, where significant and relatively permanent declines in market value below cost have occurred, the quota should be written down to the new lower market value.

Related Items: Definition of Amortization, page 21; Cost, page 27; Intangible Asset, page 22; Intermediate Asset, page 22; Long-term Asset, page 23; Market Value, page 38. Also see the Reporting Policy on Balance Sheet Classifications, page 47; and Supplementary Disclosure - Market Values, page 59.

SUPPLEMENTARY DISCLOSURE - MARKET VALUES

An overriding premise of generally accepted accounting principles (GAAP) is the historical cost concept. This concept incorporates the premise that assets should be valued in the financial statement at the amount determined by the original purchase transaction. Although there are exceptions to this general concept within certain specific policies that comprise GAAP, the historical cost concept still remains a fundamental principle.

However, users of financial statements (particularly lenders) are very concerned about the current market value of the assets of a farm business. Lending covenants often refer to the market or realizable value of a farm's assets. Hence, a balance sheet prepared in accordance with the historical cost concept may provide insufficient information to these users.

As an example, agricultural land values may be significantly lower when valued at historical cost rather than market, but, a lender, for instance, may be interested in the market value of the land to determine the net worth of a farm business. If the balance sheet discloses this land at cost only, the lender will be required to find this information elsewhere.

The following disclosure should not cause a significant increase in the effort needed to prepare the financial statement. This is because the market value of an asset is already required to determine if the asset cost should be written down to market to comply with GAAP (e.g., long-term assets and inventory). Furthermore, accountants currently disclose market values for certain assets in the financial statements (e.g., investments).

Recommendation and Financial Statement Disclosure

The financial statement should disclose, by way of a schedule in the notes to the financial statements, the market values of the assets and liabilities. The format of this statement should be similar to that of the balance sheet. A three-category approach (current, intermediate, and long-term), is preferable to a two category approach (current and long-term), for this supplementary schedule.

This schedule should clearly identify the values contained in the schedule as being determined on a market value basis. In addition, the method used to determine market values (e.g., appraisal, discussion with owner, review of sales data, etc.) should be noted on the schedule.

Related Items: Definition of Asset, page 21; Balance Sheet, page 23; Financial Statement, page 32; Historical Cost, page 34; Inventory, page 34; Liability, page 35; Long-term Asset, page 23; Market Value, page 38; Net Worth, page 39. Also see discussion of Cost versus Current Value, page 10; the Reporting Policy on Balance Sheet Classifications, page 47; and the example Financial Statement Supplementary Disclosure, Appendix I, page x.

4.0 *RATIOS*

4.1 Introduction

Financial ratios are a comparison of two or more elements of financial data. They are usually expressed as percentages (xx%) or as a comparison to one (xx:1). By expressing financial data in this manner it is possible to compare and evaluate the financial aspects of a business from one accounting period to the next. It also facilitates a comparison of the financial aspects of one business with those of other businesses.

4.2 Use of Ratios

Ratios are most meaningful when comparing the current year's financial measures with the same measures from earlier years. While it is also useful to compare a business with others in the industry, it is important to realize that no two businesses are alike.

A ratio is only as good as the information used to prepare it. Improperly prepared financial statements will certainly produce misleading financial measures which, in turn, will lead to improper decisions.

4.3 General Limitations in Using Ratios

Ratio analysis is one financial tool that will assist in managing and analyzing a business, but a proper analysis requires more than that. Consequently, complete reliance upon such financial measures is a very unsound business practice.

The following limitations should be kept in mind when developing and interpreting ratios.

Asset Valuation

Nearly all ratios will depend upon the values of the assets. The worth of an asset using historical cost as the valuation basis may differ significantly from the value of the same asset using a market value basis. In many cases, asset valuation will involve a significant degree of estimation. The ratios that depend on asset values should be interpreted with these factors in mind.

Business Type

Different business types, such as a cattle ranch versus a vineyard, have different risk factors, capital requirements, business cycles, etc. The acceptable range of debt to equity for a poultry operation may be significantly higher than the acceptable range for a cereal grain operation. Certain ratios that are meaningful to one type of business may not be as meaningful to another type. For instance, the gross margin ratio may not be as meaningful when analyzing a cow-calf operation as it would be in analyzing a grain or feeder operation. Therefore, comparison of financial measures between business types should allow for these inherent differences.

Business Size

Ratios tend to remove size as an influencing factor by expressing the financial data using a common denominator. Nevertheless the sheer size of a business will inevitably have an impact on the relationship of certain financial measures. For instance, the value of unpaid labour that is used in certain ratios may be as much as 50% of the net income of a small business but may only represent 5% of the net income of a relatively larger business.

Although business size is an important factor to be considered, it does not necessarily follow that "big is better" or that "small is optimal".

Business Cycle

The value of assets and liabilities fluctuates in accordance with such factors as the business cycle. Comparing the financial ratios of two businesses of the same type is most meaningful when financial data prepared at the same date are used. In this way the point in the business cycles will not affect the comparability between the two businesses.

4.4 Format

The ratios in this section have been categorized according to four financial criteria: (1) liquidity; (2) solvency; (3) profitability; and (4) financial efficiency. Each ratio is defined, then briefly discussed for clarification purposes. Finally, the limitations of each ratio are included to ensure the user is not misled.

4.5 Categorization of Ratios

The four financial criteria used to categorize the ratios should be explained:

Liquidity: The ability of a business to meet financial obligations as they come due in the ordinary course of business.

Solvency: The financial measures that gauge the amount of debt of a business relative to the amount of owner's capital invested in the business.

Profitability: The extent to which a business is able to generate profit from the utilization of the business resources.

Financial Efficiency: The extent to which a business is able to utilize its resources efficiently.

4.6 Liquidity Ratios

ACID TEST RATIO/QUICK RATIO

$$\text{Acid Test Ratio} = \frac{(\text{Cash} + \text{Marketable Securities} + \text{Accounts Receivable} + \text{Inventory Readily Available for Sale})}{\text{Current Liabilities}}$$

Clarification

- The acid test (quick) ratio is a measure of the proportion of cash (or cash equivalents) to current liabilities. Unlike the current ratio, the quick ratio does not include inventories and other assets which may not be easily converted to cash without disrupting the normal business operations.

- The ratio provides the user with a measure of the business' liquidity in the form of its ability to meet current liabilities as they come due, regardless of sales efforts.

Limitations

- The value of the ratio may vary depending upon the production cycle (for example, a business calculating the ratio during planting season may obtain a significantly different result than if the ratio is calculated during harvest).

- The desired value of the ratio will vary by business type (for example, the desired value of the ratio for a dairy operation will be different than the desired value for a grain operation).

- This ratio also does not predict the timing nor the adequacy of future cash flows.

Related Items: Definition of Account Receivable, page 19; Current Liability, page 36; Inventory, page 34; Marketable Security, page 38.

CURRENT RATIO/WORKING CAPITAL RATIO

$$\text{Current Ratio} = \frac{\text{Current Assets}}{\text{Current Liabilities}}$$

Clarification

- The current ratio measures a business' ability to meet financial obligations as they come due without disrupting normal operations.

- This ratio is sometimes expressed in the form - xx:1 (e.g., 2:1).

- If the ratio is greater than 1, the business is considered to be liquid. A ratio of less than 1 may indicate a potential liquidity problem.

Limitations

- See the discussion of the acid test ratio for the limitations that apply equally to this ratio.

Related Items: Definition of Current Asset, page 22; Current Liability, page 36; Working Capital, page 43.

DEBT STRUCTURE RATIO

$$\text{Debt Structure Ratio} = \frac{\text{Current Liabilities}}{\text{Total Liabilities}}$$

Clarification

- This ratio measures the proportion of total debt due and payable within the current year or within the normal operating cycle (where the cycle is longer than a year). This ratio in conjunction with the current ratio will provide information on the relative solvency of the business.

- A high debt structure ratio may indicate liquidity problems.

Limitations

- A business with a relatively low value of long-term liabilities may have a high debt structure ratio. In this case the business may in fact have no solvency problems. Therefore it is necessary to interpret this ratio in conjunction with the value of liabilities and cash flows from the operations.

Related Items: Definition of Current Liability, page 36; Debt, page 28; Liability, page 35; Long-term Liability, page 36.

4.7 Solvency Ratios

DEBT TO ASSET RATIO/DEBT RATIO

$$\text{Debt Ratio} = \frac{\text{Total Liabilities}}{\text{Total Assets}}$$

Clarification

- The debt ratio is a measure of the extent of creditor financing used by the business. It measures the proportion of total assets financed by debt. The higher the value of the ratio, the higher the financial risk.

Limitations

- The desired value of the ratio will depend on the variability of the net income of the business, and other factors such as the risks associated with production.

Related Items: Definition of Asset, page 21; Debt, page 28; Liability, page 35; Net Income, page 38.

DEBT TO EQUITY RATIO/LEVERAGE RATIO

$$\text{Debt to Equity Ratio} = \frac{\text{Total Liabilities}}{\text{Owner's Equity}}$$

Clarification

- The debt to equity ratio is a measure of the extent to which the creditors have financed the business compared to the owners. The higher the value of the ratio, the greater the proportion of financing that has been provided by the creditors.

- "Shareholders' equity" or "partners' capital" are terms that replace "owner's equity" if the ratio is calculated for a company or partnership respectively.

Limitations

- The desired value of the ratio will depend on the income variability of the business and other factors such as the risks associated with production. In other words, a business with high income variability or business risk would desire a lower ratio.

Related Items: Definition of Debt, page 28; Liability, page 35; Owner's Equity, page 40; Partners' Capital, page 40; Shareholders' Equity, page 42.

EQUITY RATIO

$$\text{Equity Ratio} = \frac{\text{Total Owner's Equity}}{\text{Total Assets}}$$

Clarification

- The equity ratio is a measure of the extent of leverage being used by the business. The Equity Ratio measures the proportion of total assets financed by the owners, as opposed to those financed by creditors. The higher the value of the ratio, the more resources supplied by the owners and less by creditors, and, in most cases, the more solvent the business.

- "Shareholders' equity" or "partners' capital" replace "owner's equity" if the ratio is calculated for a company or partnership respectively.

Limitations

- The desired value of the ratio will depend on the variability of the net income of the business, and other factors such as the risks associated with production.

Related Items: Definition of Asset, page 21; Leverage, page 35; Net Income, page 38; Owner's Equity, page 40; Partners' Capital, page 40; Shareholders' Equity, page 42.

4.8 Profitability Ratios

CAPITAL TURNOVER RATIO

$$\text{Capital Turnover Ratio} = \frac{\text{Revenue}}{\text{Total Assets}}$$

Clarification

- This ratio indicates the extent to which a business utilizes its assets to generate revenue. The higher the ratio, the better the assets are being used to generate revenue.

- In practice, this ratio is sometimes expressed as

$$\text{Capital Turnover Ratio} = \frac{\text{Total Assets}}{\text{Revenue}}$$

In these cases the lower the ratio, the better. The fact that this ratio is not consistently calculated on the same basis will limit comparison of the ratio values between different businesses.

Limitations

- The desired value of the ratio will vary significantly by business type.

- Revenues cover an accounting period, while total assets represent a specific point in the accounting period. Therefore the ratio may be misleading in the event that total assets fluctuate significantly in one direction (either up or down) in the accounting period.

Related Items: Definition of Asset, page 21; Capital, page 24; Revenue, page 41.

RETURN ON ASSETS

Return on Assets =

$$\frac{\text{(Net Income Before Income Taxes + Interest Expense - Value of Unpaid Family and Operator Labour)}}{\text{Average Total Assets for the Period}} \times 100$$

Clarification

Average Total Assets for the Period =

$$\frac{\text{Total Assets (beginning of Year) + Total Assets (end of year)}}{2}$$

- This ratio is a measure of return on investment. Specifically it shows the business' ability to earn a return on its total assets. Income before interest and income taxes is used because interest is considered part of the return on the investment of the creditor, while income taxes are determined by factors other than the efficient use of resources.

- The higher the value of the ratio, the greater the return on assets.

- The value of unpaid family and operator labour is sometimes estimated based on the amount of owner's withdrawals for family living. Regardless of how this value is determined, it should be reasonable in light of the value in the local marketplace for the similar work that is performed by the operator and family.

Limitations

- The degree of estimation involved in determining the value of unpaid family and operator labour may influence the usefulness of this ratio.

- This ratio does not consider the unrealized gains that may be present in the value of assets such as farm land. Therefore, it should be kept in mind that the value of this ratio for a farm operation will likely be lower than a similar ratio value calculated for non-farm investments such as stocks and bonds.

Related Items: Definition of Asset, page 21; Expense, page 31; Gain, page 32; Net Income, page 38; Owner's Withdrawals, page 40.

RETURN ON OWNER'S EQUITY

Return on Owner's Equity =

$$\frac{\text{Net Income - Value of Unpaid Family and Operator Labour}}{\text{Average Owner's Equity}} \times 100$$

Clarification

Average Owner's Equity =

$$\frac{\text{Owner's Equity (beginning of year) + Owner's Equity (end of year)}}{2}$$

- This ratio provides a measure of the return to the owner on his investment in the business. It is sometimes referred to as return on investment.

- The higher the value of the ratio, the greater the return on investment.
- See the return on assets ratio for a discussion of value of unpaid family and operator labour.
- "Shareholders' equity" or "partners' capital" would replace "owner's equity" when the ratio is calculated for a company or partnership respectively.

Limitations

- As with certain other ratios, this ratio does not consider the unrealized gains that may be present in the value of assets such as farm land. Therefore, it should be kept in mind that the value of this ratio for a farm operation will likely be lower than a similar ratio value calculated for non-farm investments such as stocks and bonds.
- As mentioned above, the higher the value of the ratio, the greater the return on investment. However, a high value for this ratio may signify a highly leveraged business. Therefore, interpretation of the significance of this ratio should be made in conjunction with other ratios.

Related Items: Definition of Asset, page 21; Gain, page 32; Net Income, page 38; Owner's Equity, page 40; Partners' Capital, page 40; Shareholders' Equity, page 42.

4.9 Financial Efficiency Ratios

CONTRIBUTION MARGIN RATIO

$$\text{Contribution Margin Ratio} = \frac{\text{Contribution Margin}}{\text{Revenue}}$$

Clarification

- This ratio, like the gross margin ratio, measures the financial efficiency of the business in terms of funds generated directly from operations. The higher the ratio, the more efficient the business.

Limitations

- The desired value of this ratio depends on the business type. For instance, a feedlot operation would be expected to have a lower ratio value than a cow-calf operation.
- In determining the contribution margin ratio for a particular farm enterprise (e.g., grain operation), only those revenues and expenses that apply to the farm enterprise should be used. For instance, revenue earned on marketable securities such as long-term treasury bills would not be included in the revenue figure used to determine the contribution margin ratio for a grain operation.

Related Items: Definition of Expense, page 31; Contribution Margin, page 26; Marketable Security, page 38; Revenue, page 41. Also see the Gross Margin Ratio, page 66.

GROSS MARGIN RATIO

$$\text{Gross Margin Ratio} = \frac{\text{Gross Margin}}{\text{Revenue}}$$

Clarification

- This ratio measures the financial efficiency of a business in terms of the funds generated directly from operations. The higher the ratio value, the more efficient the business.
- In determining the gross margin ratio for a particular farm enterprise (e.g., grain

operation), only those revenues and expenses that apply to the farm enterprise should be used. For instance, revenue earned on marketable securities such as long-term treasury bills would not be included in the revenue figure used to determine the gross margin ratio of a grain operation.

Limitations

- The desired value of this ratio depends on the business type. For instance, a feedlot operation would be expected to have a much lower ratio value than a cow-calf operation.

Related Items: Definition of Expense, page 31; Gross Margin, page 34; Marketable Security, page 38; Revenue, page 41. Also see the Contribution Margin Ratio, page 66.

INTEREST COVERAGE RATIO

Interest Coverage Ratio =

$$\frac{\text{Net Income Before Income Taxes} + \text{Interest Expense}}{\text{Interest Expense}}$$

Clarification

- The interest coverage ratio, also termed times-interest-earned ratio, is one of the most widely used ratios for analyzing the ability of a business to pay the interest on debt. Interest is added back in the numerator to arrive at a figure which represents the earnings of the business before any allocations are made for debt financing.

Related Items: Definition of Debt, page 28; Net Income, page 38.

VARIABLE COST PER DOLLAR OF REVENUE RATIO

$$\text{Variable Cost/\$ of Revenue} = \frac{\text{Variable Costs}}{\text{Revenue}}$$

Clarification

- This ratio measures the efficiency of the business. One minus the value of this ratio indicates the amount that each additional dollar of revenue will contribute towards fixed costs and net income.

Limitations

- Various costs such as feed, seed, fertilizer, and livestock purchases are generally considered to be variable costs. However, other costs such as paid labour, fuel, and repairs may have a fixed and a variable component. It is therefore apparent that the types of costs that are considered to be variable may be different from one operation to another. Thus, the interpretation of this ratio when comparing between similar operations, should be carefully considered.

Related Items: Definition of Cost, page 27; Fixed Cost, page 27; Net Income, page 38; Revenue, page 41; Variable Cost, page 27.

APPENDIX I - EXAMPLE FINANCIAL STATEMENTS

Name of Business	Type of Entity	Reference
Cattle and Swine Producer Ltd.	**Corporation**	
Balance Sheet		I - iii
Statement of Income		I - iv
Statement of Retained Earnings		I - v
Statement of Changes in Financial Position		I - vi
Notes to Financial Statements		I - vii
Supplementary Schedule - Market Value		I - x
Cattle and Swine Producer	**Proprietorship**	
Balance Sheet		I - xii
Statement of Income		I - xiii
Statement of Owner's Equity		I - xiv
Statement of Changes in Financial Position		I - xv
Notes to Financial Statements		I - xvi
Supplementary Schedule - Market Value		I - xix
Cattle and Swine Producer Partnership	**Partnership**	
Balance Sheet		I - xxi
Statement of Income		I - xxii
Statement of Partners' Capital		I - xxiii
Statement of Changes in Financial Position		I - xxiv
Notes to Financial Statements		I - xxv
Supplementary Schedule - Market Value		I - xxviii

Note:

The following financial statement examples are only one of many acceptable forms used in the industry today. In many cases, disclosure of more or less information may be appropriate, depending on the circumstances. As well, amounts shown in these example statements may not be indicative of the customary relationships between accounts.

CATTLE AND SWINE PRODUCER LTD.

FINANCIAL STATEMENTS

The following example financial statement represents an incorporated business (i.e., a company). A balance sheet, and statement of income, retained earnings and changes in financial position have been presented along with the notes to the financial statements.

EXAMPLE BALANCE SHEET OF A COMPANY

CATTLE AND SWINE PRODUCER LTD.
BALANCE SHEET
APRIL 30, 1990

ASSETS

		1990	1989
CURRENT ASSETS			
Accounts receivable (Note 2)		$ 30,879	$ 7,533
Deposits - hedging account		3,178	1,918
Inventory: (Note 3)			
Livestock	$664,267		
Feed and fuel	132,725	796,992	758,525
Prepaid expenses		12,483	11,689
		843,532	779,665
LONG-TERM ASSETS			
Production animals (Note 4)		144,850	109,450
Investment in cooperative (Note 1)		50,000	47,000
Fixed assets (Note 5)		1,294,171	1,279,686
TOTAL ASSETS		$2,332,553	$2,215,801

LIABILITIES AND SHAREHOLDERS' EQUITY

	1990	1989
CURRENT LIABILITIES		
Bank indebtedness	$ 694,519	$ 547,524
Accounts payable	54,117	49,159
Current portion of long-term debt	44,399	60,847
	793,035	657,530
LONG-TERM LIABILITIES		
Due to shareholders (Note 7)	150,000	150,000
Long-term debt (Note 6)	382,518	403,055
	1,325,553	1,210,585

SHAREHOLDERS' EQUITY

	1990	1989
SHARE CAPITAL (Note 8)	500	500
RETAINED EARNINGS	1,006,500	1,004,716
	$2,332,553	$2,215,801

EXAMPLE STATEMENT OF INCOME OF A COMPANY

CATTLE AND SWINE PRODUCER LTD.
STATEMENT OF INCOME
YEAR ENDED APRIL 30, 1990

	1990	1989
REVENUE		
Market cattle	$817,460	$710,100
Swine	423,000	256,150
Subsidies	80,890	92,000
Gain on hedging account	1,260	---
Custom work	76,694	54,000
Increase (decrease) in accounts receivable	23,346	(10,928)
Change in inventory - livestock	13,517	(4,486)
Increase in value of production animals due to quantity	30,000	36,064
	1,466,167	1,132,900
VARIABLE COSTS		
Market cattle purchases	762,150	421,000
Swine purchases	311,000	219,250
Feed and supplements	142,000	150,000
Fuel	81,000	53,500
Direct labour	23,150	---
Change in inventory - feed and fuel	(24,950)	---
Freight	32,150	15,750
Veterinary and other	15,000	850
Increase in accounts payable	4,958	31,928
	1,346,458	892,278
CONTRIBUTION MARGIN	119,709	240,622
FIXED COSTS		
Advertising and office	8,248	9,600
Depreciation	91,702	81,200
Insurance	15,000	23,150
Interest on long-term debt	38,007	59,290
Property taxes and rent	15,800	71,900
	168,757	245,140
NET LOSS FROM OPERATIONS	(49,048)	(4,518)
OTHER REVENUE		
Gain on sale of fixed assets	500	6,300
Increase in value of production animals due to price	5,400	---
Rentals	47,883	55,798
Patronage dividends	2,750	3,900
	56,533	65,998
NET INCOME BEFORE INCOME TAXES	7,485	61,480
INCOME TAXES	2,000	12,700
NET INCOME	$ 5,485	$ 48,780

EXAMPLE STATEMENT OF RETAINED EARNINGS OF A COMPANY

CATTLE AND SWINE PRODUCER LTD.
STATEMENT OF RETAINED EARNINGS
YEAR ENDED APRIL 30, 1990

	1990	1989
RETAINED EARNINGS BEGINNING OF YEAR	$1,004,716	$ 955,936
DIVIDENDS	(3,701)	---
NET INCOME	5,485	48,780
RETAINED EARNINGS, END OF YEAR	$1,006,500	$1,004,716

EXAMPLE STATEMENT OF CHANGES IN FINANCIAL POSITION OF A COMPANY

CATTLE AND SWINE PRODUCER LTD.
STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED APRIL 30, 1990

	1990	1989
OPERATING ACTIVITIES		
Cash from operations		
Net income	$ 5,485	$ 48,780
Add: Depreciation	91,702	81,200
Less: Gain on sale of fixed assets	(500)	(6,300)
Increase in accounts payable	4,958	31,928
Increase in accounts receivable	(23,346)	(10,928)
(Increase) decrease in inventories	(38,467)	4,486
Increase in deposits - hedging account	(1,260)	(1,000)
Increase in investment in cooperative	(3,000)	(3,000)
Increase in prepaid expenses	(794)	(842)
Cash from operating activities	34,778	144,324
FINANCING ACTIVITIES		
Long-term debt advances	37,900	77,000
Long-term debt repayments	(74,885)	(24,741)
Dividends	(3,701)	---
Cash (used) provided by financing activities	(40,686)	52,259
INVESTING ACTIVITIES		
Proceeds on sale of fixed assets	32,500	30,700
Purchase of fixed assets	(138,187)	(174,429)
Increase in value of production animals	(35,400)	(36,064)
Cash used by investing activities	(141,087)	(179,793)
(REDUCTION) INCREASE IN CASH FOR THE YEAR	(146,995)	16,790
BANK INDEBTEDNESS BEGINNING OF YEAR	(547,524)	(564,314)
BANK INDEBTEDNESS END OF YEAR	$(694,519)	$(547,524)

EXAMPLE NOTES TO FINANCIAL STATEMENTS OF A COMPANY

CATTLE AND SWINE PRODUCER LTD.
NOTES TO FINANCIAL STATEMENTS
APRIL 30, 1990

1. Summary of Significant Accounting Policies

Basis of presentation

These financial statements include only such assets and liabilities, revenue and expenses as are related to the operation of the business.

Inventories

All inventories are reported at net realizable value.

Production Animals

Production animals are reported at market value.

Investment in Cooperative

The investment in a cooperative is reported at cost plus any patronage dividends allocated, but not paid, to the company by the cooperative.

Fixed Assets

Fixed assets are carried at cost. Depreciation on buildings and equipment is provided on a diminishing balance basis at the following annual rates.

Equipment	20%
Buildings	10%

2. Accounts Receivable

	1990	1989
Contract barley	$30,000	$3,000
Miscellaneous	879	4,533
	$30,879	$7,533

EXAMPLE SUPPLEMENTARY SCHEDULE - MARKET VALUE

CATTLE AND SWINE PRODUCER LTD.
LIST OF ASSETS AND LIABILITIES AT MARKET VALUE
APRIL 30, 1990

		1990	1989
CURRENT ASSETS			
Accounts receivable		$ 30,879	$ 7,533
Deposits - hedging account		3,178	1,918
Inventory:			
Livestock	$664,267		
Feed and fuel	132,725	796,992	758,525
Prepaid expenses		12,483	11,689
		843,532	779,665
INTERMEDIATE ASSETS			
Production animals (Note 4)		144,850	109,450
LONG-TERM ASSETS			
Investment in cooperative		60,000	50,000
Fixed assets		2,500,000	2,000,000
TOTAL ASSETS		$3,548,382	$2,939,115
CURRENT LIABILITIES			
Bank indebtedness		$ 694,519	$ 547,524
Accounts payable		54,117	49,159
Current portion of intermediate and long-term debt		44,399	60,847
		793,035	657,530
INTERMEDIATE LIABILITIES			
Loan for production animals		18,351	---
LONG-TERM LIABILITIES			
Due to shareholders		150,000	150,000
Long-term debt		364,167	403,055
		1,325,553	1,210,585
NET WORTH		2,222,829	1,728,530
		$3,548,382	$2,939,115

Note: Estimates of market values were determined by discussion with the manager.

CATTLE AND SWINE PRODUCER

FINANCIAL STATEMENTS

The following example financial statement represents an unincorporated business owned by a sole proprietor. A balance sheet, and statements of income and owner's equity and changes in financial position have been presented along with the notes to the financial statements.

3. Inventory

	1990			
	# of Head	Unit Price/ 100 lbs	Average Weight (lbs)	Value
Market livestock	662	$87.25	1,150	$664,267
		Unit Price	Quantity (lt.)	
Fuel		$0.40	56,812	22,725
	Type	Unit Price	Quantity (tons)	
Feed	Silage	$20.00	5,500	110,000
				$796,992

4. Production Animals

	1990		
	# of Head	Unit Price	Value
Swine	173	$ 349.65	$ 60,490
Cattle	60	$1,406.00	84,360
			$144,850

5. Fixed Assets

	1990			
	Cost	Accumulated Depreciation	1990 Net	1989 Net
Equipment	$ 185,713	$108,923	$ 76,790	$ 83,238
Buildings	516,879	193,669	323,210	437,762
Land	894,171	---	894,171	758,686
	$1,596,763	$302,592	$1,294,171	$1,279,686

6. Long-term Debt

Mortgage payable Interest at bank prime + 1%, payable $30,000 principal annually, due 1997, secured by land	$229,000	$259,000
Loan payable R. B. Bank Interest at 9%, payable in semi-annual instalments of $18,950 principal and interest, due 1998, secured by production animals	197,917	204,902
	426,917	463,902
Less current portion of long-term debt	(44,399)	(60,847)
	$382,518	$403,055

Principal payments due in each of the next five years are as follows:

1990	$47,900
1991	$31,182
1992	$31,182
1993	$31,182
1994	$31,182

7. Due to Shareholders

The amount due to shareholders is unsecured and non-interest bearing. Although the amount due to shareholders is payable on demand, they have indicated that they do not intend to call for payment during the year ended April 30, 1991. Consequently, the full amount has been shown as a long-term liability.

8. Share Capital

Authorized share capital of the company is as follows:

35,000 Class A, non-voting, preference shares. Each share of this class is entitled to a non-cumulative annual dividend of $0.08 per share.

4,000 Common shares

Issued and fully paid:

500	Common shares.	$500

EXAMPLE BALANCE SHEET OF A SOLE PROPRIETORSHIP

CATTLE AND SWINE PRODUCER
BALANCE SHEET
APRIL 30, 1990

ASSETS

		1990	1989
CURRENT ASSETS			
Accounts receivable (Note 2)		$ 30,879	$ 7,533
Deposits - hedging account		3,178	1,918
Inventory: (Note 3)			
Livestock	$664,267		
Feed and fuel	132,725	796,992	758,525
Prepaid expenses		12,483	11,689
		843,532	779,665
LONG-TERM ASSETS			
Production animals (Note 4)		144,850	109,450
Investment in cooperative (Note 1)		50,000	47,000
Fixed assets (Note 5)		1,294,171	1,279,686
TOTAL ASSETS		$2,332,553	$2,215,801

LIABILITIES AND OWNER'S EQUITY

	1990	1989
CURRENT LIABILITIES		
Bank indebtedness	$ 694,519	$ 547,524
Accounts payable	54,117	49,159
Current portion long-term debt	44,399	60,847
	793,035	657,530
LONG-TERM LIABILITIES		
Long-term debt (Note 6)	382,518	403,055
	1,175,553	1,060,585
OWNER'S EQUITY	1,157,000	1,155,216
TOTAL LIABILITIES AND OWNER'S EQUITY	$2,332,553	$2,215,801

EXAMPLE STATEMENT OF INCOME OF A SOLE PROPRIETORSHIP

CATTLE AND SWINE PRODUCER
STATEMENT OF INCOME
YEAR ENDED APRIL 30, 1990

	1990	1989
REVENUE		
Market cattle	$ 817,460	$ 710,100
Swine	423,000	256,150
Subsidies	80,890	92,000
Gain on hedging account	1,260	---
Custom work	76,694	54,000
Increase in accounts receivable	23,346	(10,928)
Change in inventory - livestock	13,517	(4,486)
Increase in value of production animals due to quantity	30,000	36,064
	1,466,167	1,132,900
VARIABLE COSTS		
Market cattle purchases	762,150	421,000
Swine purchases	311,000	219,250
Feed and supplements	142,000	150,000
Fuel	81,000	53,500
Direct labour	23,150	---
Change in inventory - feed and fuel	(24,950)	---
Freight	32,150	15,750
Veterinary and other	15,000	850
Increase in accounts payable	4,958	31,928
	1,346,458	892,278
CONTRIBUTION MARGIN	119,709	240,622
FIXED COSTS		
Advertising and office	8,248	9,600
Depreciation	91,702	81,200
Insurance	15,000	23,150
Interest on long-term debt	38,007	59,290
Property taxes and rent	15,800	71,900
	168,757	245,140
NET LOSS FROM OPERATIONS	(49,048)	(4,518)
OTHER REVENUE		
Gain on sale of fixed assets	500	6,300
Increase in value of production animals due to price	5,400	---
Rentals	47,883	45,798
Patronage dividends	750	1,200
	54,533	53,298
NET INCOME	$ 5,485	$ 48,780

EXAMPLE STATEMENT OF OWNER'S EQUITY OF A SOLE PROPRIETORSHIP

CATTLE AND SWINE PRODUCER
STATEMENT OF OWNER'S EQUITY
YEAR ENDED APRIL 30, 1990

	1990	1989
OWNER'S EQUITY, BEGINNING OF YEAR	$1,155,216	$1,106,436
OWNER'S WITHDRAWALS	(3,701)	---
NET INCOME	5,485	48,780
OWNER'S EQUITY, END OF YEAR	$1,157,000	$1,155,216

EXAMPLE STATEMENT OF CHANGES IN FINANCIAL POSITION OF A SOLE PROPRIETORSHIP

CATTLE AND SWINE PRODUCER
STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED APRIL 30, 1990

	1990	1989
OPERATING ACTIVITIES		
Cash from operations		
Net income	$ 5,485	$ 48,780
Add: Depreciation	91,702	81,200
Less: Gain on sale of fixed assets	(500)	(6,300)
Increase in accounts payable	4,958	31,928
Increase in accounts receivable	(23,346)	(10,928)
(Increase) decrease in inventories	(38,467)	4,486
Increase in deposits - hedging account	(1,260)	(1,000)
Increase in investment in cooperative	(3,000)	(3,000)
Increase in prepaid expenses	(794)	(842)
Cash from operating activities	34,778	144,324
FINANCING ACTIVITIES		
Long-term debt advances	37,900	77,000
Long-term debt repayments	(74,885)	(24,741)
Owner's Withdrawals	(3,701)	---
Cash (used) provided by financing activities	(40,686)	52,259
INVESTING ACTIVITIES		
Proceeds on sale of fixed assets	32,500	30,700
Purchase of fixed assets	(138,187)	(174,429)
Increase in value of production animals	(35,400)	(36,064)
Cash used by investing activities	(141,087)	(179,793)
(REDUCTION) INCREASE IN CASH FOR THE YEAR	(146,995)	16,790
BANK INDEBTEDNESS BEGINNING OF YEAR	(547,524)	(564,314)
BANK INDEBTEDNESS END OF YEAR	$(694,519)	$(547,524)

EXAMPLE NOTES TO FINANCIAL STATEMENTS OF A SOLE PROPRIETORSHIP

CATTLE AND SWINE PRODUCER
NOTES TO FINANCIAL STATEMENTS
APRIL 30, 1990

1. Summary of Significant Accounting Policies

Basis of presentation

These financial statements include only such assets and liabilities, revenue and expenses as are related to the operation of the business.

Salaries and interest

No provision has been made in these financial statements for salaries to the owner or interest on his investment.

Income taxes

No provision has been made in these financial statements for income taxes as the net income is taxed in the hands of the owner.

Inventories

All inventories are reported at net realizable value.

Production animals

Production animals are reported at market value.

Investment in cooperative

The investment in cooperative is reported at cost plus any patronage dividends allocated, but not paid, to the business by the cooperative.

Fixed assets

Fixed assets are carried at cost. Depreciation on buildings and equipment is provided on a diminishing balance basis at the following annual rates.

Equipment	20%
Buildings	10%

2. Accounts Receivable

	1990	1989
Contract Barley	$30,000	$3,000
Miscellaneous	879	4,533
	$30,879	$7,533

3. Inventory

	1990			
	# of Head	Unit Price/ 100 lbs	Average Weight (lbs)	Value
Market livestock	662	$87.25	1,150	$664,267
		Unit Price	Quantity (lt.)	
Fuel		$0.40	56,812	22,725
	Type	Unit Price	Quantity (tons)	
Feed	Silage	$20.00	5,500	110,000
				$796,992

4. Production Animals

	1990		
	# of Head	Unit Price	Value
Swine	173	$ 349.65	$ 60,490
Cattle	60	$1,406.00	84,360
			$144,850

5. Fixed Assets

	1990			
	Cost	Accumulated Depreciation	1990 Net	1989 Net
Equipment	$ 185,713	$108,923	$ 76,790	$ 83,238
Buildings	516,879	193,669	323,210	437,762
Land	894,171	---	894,171	758,686
	$1,596,763	$302,592	$1,294,171	$1,279,686

6. Long-term Debt

Mortgage payable		
Interest at bank prime + 1%, payable $30,000 principal annually, due 1997, secured by land	$229,000	$259,000
Loan payable R. B. Bank		
Interest at 9%, payable in semi-annual instalments of $18,950 principal and interest, due 1998, secured by production animals	197,917	204,902
	426,917	463,902
Less current portion of long-term debt	(44,399)	(60,847)
	$382,518	$403,055

Principal payments due in each of the next five years are as follows:

1990	$47,900
1991	$31,182
1992	$31,182
1993	$31,182
1994	$31,182

EXAMPLE SUPPLEMENTARY SCHEDULE - MARKET VALUE

CATTLE AND SWINE PRODUCER
LIST OF ASSETS AND LIABILITIES AT MARKET VALUE
APRIL 30, 1990

		1990	1989
CURRENT ASSETS			
Accounts receivable		$ 30,879	$ 7,533
Deposits - hedging account		3,178	1,918
Inventory:			
Livestock	$664,267		
Feed and fuel	132,725	796,992	758,525
Prepaid expenses		12,483	11,689
		843,532	779,665
INTERMEDIATE ASSETS			
Production animals		144,850	109,450
LONG-TERM ASSETS			
Investment in cooperative		60,000	50,000
Fixed assets		2,500,000	2,000,000
TOTAL ASSETS		$3,548,382	$2,939,115
CURRENT LIABILITIES			
Bank indebtedness		$ 694,519	$ 547,524
Accounts payable		54,117	49,159
Current portion of intermediate and long-term debt		44,399	60,847
		793,035	657,530
INTERMEDIATE LIABILITIES			
Loan for production animals		18,351	---
LONG-TERM LIABILITIES			
Long-term debt		364,167	403,055
		1,175,553	1,060,585
NET WORTH		2,372,829	1,878,530
		$3,548,382	$2,939,115

Note: Estimates of market values were determined by discussion with the manager.

CATTLE AND SWINE PRODUCER PARTNERSHIP

FINANCIAL STATEMENTS

The following example financial statement represents an unincorporated partnership. A balance sheet and statement of income, partners' capital and changes in financial position have been presented along with the notes to the financial statements.

EXAMPLE BALANCE SHEET OF A PARTNERSHIP

CATTLE AND SWINE PRODUCER PARTNERSHIP
BALANCE SHEET
APRIL 30, 1990

ASSETS

		1990	1989
CURRENT ASSETS			
Accounts receivable (Note 2)		$ 30,879	$ 7,533
Deposits - hedging account		3,178	1,918
Inventory: (Note 3)			
Livestock	$664,267		
Feed and fuel	132,725	796,992	758,525
Prepaid expenses		12,483	11,689
		843,532	779,665
LONG-TERM ASSETS			
Production animals (Note 4)		144,850	109,450
Investment in cooperative (Note 1)		50,000	47,000
Fixed assets (Note 5)		1,294,171	1,279,686
TOTAL ASSETS		$2,332,553	$2,215,801

LIABILITIES AND PARTNERS' CAPITAL

	1990	1989
CURRENT LIABILITIES		
Bank indebtedness	$ 694,519	$ 547,524
Accounts payable	54,117	49,159
Current portion of long-term debt	44,399	60,847
	793,035	657,530
LONG-TERM LIABILITIES		
Long-term debt (Note 6)	382,518	403,055
	1,175,553	1,060,585
PARTNERS' CAPITAL	1,157,000	1,155,216
TOTAL LIABILITIES AND PARTNERS' CAPITAL	$2,332,553	$2,215,801

EXAMPLE STATEMENT OF INCOME OF A PARTNERSHIP

CATTLE AND SWINE PRODUCER PARTNERSHIP
STATEMENT OF INCOME
YEAR ENDED APRIL 30, 1990

	1990	1989
REVENUE		
Market cattle	$ 817,460	$ 710,100
Swine	423,000	256,150
Subsidies	80,890	92,000
Gain on hedging account	1,260	---
Custom work	76,694	54,000
Increase in accounts receivable	23,346	(10,928)
Change in inventory - livestock	13,517	(4,486)
Increase in value of production animals due to quantity	30,000	36,064
	1,466,167	1,132,900
VARIABLE COSTS		
Market cattle purchases	762,150	421,000
Swine purchases	311,000	219,250
Feed and supplements	142,000	150,000
Fuel	81,000	53,500
Direct labour	23,150	---
Change in inventory - feed and fuel	(24,950)	---
Freight	32,150	15,750
Veterinary and other	15,000	850
Increase in accounts payable	4,958	31,928
	1,346,458	892,278
CONTRIBUTION MARGIN	119,709	240,622
FIXED COSTS		
Advertising and office	8,248	9,600
Depreciation	91,702	81,200
Insurance	15,000	23,150
Interest on long-term debt	38,007	59,290
Property taxes and rent	15,800	71,900
	168,757	245,140
NET LOSS FROM OPERATIONS	(49,048)	(4,518)
OTHER REVENUE		
Gain on sale of fixed assets	500	6,300
Increase in value of production animals due to price	5,400	---
Rentals	47,883	45,798
Patronage dividends	750	1,200
	54,533	53,298
NET INCOME	$ 5,485	$ 48,780

EXAMPLE STATEMENT OF PARTNERS' CAPITAL

CATTLE AND SWINE PRODUCER PARTNERSHIP
STATEMENT OF PARTNERS' CAPITAL
YEAR ENDED APRIL 30, 1990

	B. Johnson	M. Killam	TOTAL
PARTNERS' CAPITAL, BEGINNING OF YEAR	$577,608	$577,608	$1,155,216
WITHDRAWALS	(3,000)	(701)	(3,701)
NET INCOME	2,742	2,743	5,485
PARTNERS' CAPITAL, END OF YEAR	$577,350	$579,650	$1,157,000

EXAMPLE STATEMENT OF CHANGES IN FINANCIAL POSITION OF A PARTNERSHIP

CATTLE AND SWINE PRODUCER PARTNERSHIP
STATEMENT OF CHANGES IN FINANCIAL POSITION
YEAR ENDED APRIL 30, 1990

	1990	1989
OPERATING ACTIVITIES		
Cash from operations		
Net income for the year	$ 5,485	$ 48,780
Add: Depreciation	91,702	81,200
Less: Gain on sale of fixed assets	(500)	(6,300)
Increase in accounts payable	4,958	31,928
Increase in accounts receivable	(23,346)	(10,928)
(Increase) decrease in inventories	(38,467)	4,486
Increase in deposits - hedging account	(1,260)	(1,000)
Increase in investment in cooperative	(3,000)	(3,000)
Increase in prepaid expenses	(794)	(842)
Cash from operating activities	34,778	144,324
FINANCING ACTIVITIES		
Long-term debt advances	37,900	77,000
Long-term debt repayments	(74,885)	(24,741)
Withdrawals	(3,701)	---
Cash (used) provided by financing activities	(40,686)	52,259
INVESTING ACTIVITIES		
Proceeds on sale of fixed assets	32,500	30,700
Purchase of fixed assets	(138,187)	(174,429)
Increase in value of production animals	(35,400)	(36,064)
Cash used by investing activities	(141,087)	(179,793)
(REDUCTION) INCREASE IN CASH FOR THE YEAR	(146,995)	16,790
BANK INDEBTEDNESS BEGINNING OF YEAR	(547,524)	(564,314)
BANK INDEBTEDNESS END OF YEAR	$(694,519)	$(547,524)

EXAMPLE NOTES TO THE FINANCIAL STATEMENTS OF A PARTNERSHIP

CATTLE AND SWINE PRODUCER PARTNERSHIP
NOTES TO THE FINANCIAL STATEMENTS
APRIL 30, 1990

1. Summary of Significant Accounting Policies

Basis of presentation

These financial statements include only such assets and liabilities, revenue and expenses as are related to the operation of the business partnership.

Salaries and interest

No provision has been made in these financial statements for salaries to the partners or interest on their investment.

Income taxes

No provision has been made in these financial statements for income taxes as the net income is taxed in the hands of the partners.

Inventories

All inventories are reported at net realizable value.

Production animals

Production animals are reported at market value.

Investment in cooperative

The investment in cooperative is reported at cost plus any patronage dividends allocated, but not paid, to the business by the cooperative.

Fixed assets

Fixed assets are carried at cost. Depreciation on buildings and equipment is provided on a diminishing balance basis at the following annual rates.

Equipment	20%
Buildings	10%

2. Accounts Receivable

	1990	1989
Contract barley	$30,000	$3,000
Miscellaneous	879	4,533
	$30,879	$7,533

3. Inventory

	1990			
	# of Head	Unit Price/ 100 lbs	Average Weight (lbs)	Value
Market livestock	662	$87.25	1,150	$664,267
		Unit Price	Quantity (lt.)	
Fuel		$0.40	56,812	22,725
	Type	Unit Price	Quantity (tons)	
Feed	Silage	$20.00	5,500	110,000
				$796,992

4. Production Animals

	1990		
	# of Head	Unit Price	Value
Swine	173	$ 349.65	$ 60,490
Cattle	60	$1,406.00	84,360
			$144,850

5. Fixed Assets

	1990			
	Cost	Accumulated Depreciation	1990 Net	1989 Net
Equipment	$ 185,713	$108,923	$ 76,790	$ 83,238
Buildings	516,879	193,669	323,210	437,762
Land	894,171	---	894,171	758,686
	$1,596,763	$302,592	$1,294,171	$1,279,686

6. Long-term Debt

Mortgage payable		
Interest at bank prime + 1%, payable $30,000 principal annually, due 1997, secured by land	$229,000	$259,000
Loan payable R. B. Bank		
Interest at 9%, payable in semi-annual instalments of $18,950 principal and interest, due 1998, secured by production animals	197,917	204,902
	426,917	463,902
Less current portion of long-term debt	(44,399)	(60,847)
	$382,518	$403,055

Principal payments due in each of the next five years are as follows:

1990	$47,900
1991	$31,182
1992	$31,182
1993	$31,182
1994	$31,182

EXAMPLE SUPPLEMENTARY SCHEDULE - MARKET VALUE

CATTLE AND SWINE PRODUCER PARTNERSHIP
LIST OF ASSETS AND LIABILITIES AT MARKET VALUE
APRIL 30, 1990

		1990	1989
CURRENT ASSETS			
Accounts receivable		$ 30,879	$ 7,533
Deposits - hedging account		3,178	1,918
Inventory:			
Livestock	$664,267		
Feed and fuel	132,725	796,992	758,525
Prepaid expenses		12,483	11,689
		843,532	779,665
INTERMEDIATE ASSETS			
Production animals		144,850	109,450
LONG TERM ASSETS			
Investment in cooperative		60,000	50,000
Fixed assets		2,500,000	2,000,000
TOTAL ASSETS		$3,548,382	$2,939,115
CURRENT LIABILITIES			
Bank indebtedness		$ 694,519	$ 547,524
Accounts payable		54,117	49,159
Current portion of intermediate and long-term debt		44,399	60,847
		793,035	657,530
INTERMEDIATE LIABILITIES			
Loan for production animals		18,351	---
LONG-TERM LIABILITIES			
Long-term debt		364,167	403,055
		1,175,553	1,060,585
NET WORTH		2,372,829	1,878,530
		$3,548,382	$2,939,115

Note: Estimates of market values were determined by discussion with the manager.

APPENDIX II - PROJECTED CASH FLOW STATEMENT

The projected cash flow statement is a useful tool to assist lenders and farm managers in developing financing alternatives. By forecasting the timing of cash receipts and disbursements, it helps the farm manager to determine if his/her business will remain within approved lines of credit or if additional loans may be required.

The following projected cash flow statement example is one of many accepted versions used to project a business' cash flow. However, a projected cash flow statement should be interpreted in conjunction with an operating budget that supports crop/livestock production and marketing plans.

Further discussion of an operating budget is beyond the scope of this study and has only been referred to here as a point of general information.

CATTLE AND SWINE PRODUCER
PROJECTED CASH FLOW STATEMENT
FOR THE SIX MONTHS ENDING OCTOBER 31, 1990

	Total	May	June	July	August	Sept.	October
Projected Cash Inflow:							
Swine Sales	$285,086	$50,000	$15,086	$ 60,000	$60,000	$50,000	$50,000
Market Cattle Sales	564,000	42,100	155,300	157,000	168,600	41,000	
Subsidies	40,900	8,100	5,800	6,700	6,700	6,800	6,800
Other Revenues	3,200	551	514	600	500	500	535
Total	893,186	100,751	176,700	224,300	235,800	98,300	57,335
Projected Cash Outflow:							
Market Cattle Purchases	181,000		49,500			73,000	58,500
Swine Purchases	67,400						67,400
Purchased Feeds	55,000	9,000	9,000	9,000	9,000	9,500	9,500
Property Taxes	14,300	14,300					
Direct Labour	30,000	5,000	5,000	5,000	5,000	5,000	5,000
Drugs and Veterinary	1,200	200	200	200	200	200	200
Custom Work	3,900	3,900					
Small Tools and Supplies	2,400	400	400	400	400	400	400
Gas and Oil	9,000	1,500	1,500	1,500	1,500	1,500	1,500
Repairs - Machinery	3,000		1,000		1,000		1,000
Repairs - Buildings	1,200	200	200	200	200	200	200
Shipping and Marketing	12,500	1,700	1,700	1,700	4,000	1,700	1,700
Miscellaneous Supplies	1,898	300	300	300	300	300	398
Rent	32,013	33,713	7,800				(9,500)
Owner's Withdrawals	1,800	263	300	300	300	300	337
Operating Loan Interest	31,000	6,100	6,400	6,000	4,800	3,700	4,000
Long-Term Debt and Interest Payment	61,200	1,600	44,300	3,300	1,600	1,600	8,800
Total	508,811	78,176	127,600	27,900	28,300	97,400	149,435
Net Cash Generated	384,375	22,575	49,100	196,400	207,500	900	(92,100)
Opening Cash on Hand	---	---	---	300	1,700	4,200	100
Opening Operating Loan	(694,519)	(694,519)	(671,944)	(623,144)	(428,144)	(223,144)	(218,144)
Total Funds Required	(310,144)	(671,944)	(622,844)	(426,444)	(218,944)	(218,044)	(310,144)
Closing Cash on Hand Required	2,000	---	300	1,700	4,200	100	2,000
Operating Loan Required	(312,144)	(671,944)	(623,144)	(428,144)	(223,144)	(218,144)	(312,144)

APPENDIX III - KEY PARTICIPANTS

We would like to thank all the key participants for their willingness to be involved in the consensus process, and their commitment to the success of the study. The key participants in the Industry Consensus study represent the following organizations or agencies:

Agriculture Canada
Agricultural Credit Corporation of Sask.
Alberta Agricultural Development Corporation
Alberta Agriculture
Alberta Cattle Commission
Alberta Treasury Branch
Alberta Wheat Pool
Appraisal Institute of Canada
Bank of Montreal
Bank of Nova Scotia
Banque Nationale du Canada
B.C. Cattlemen's Association
B.C. Fruit Producers' Association
B.C. Ministry of Agriculture & Fisheries
Campbell & Company
Canadian Bankers Association
Canadian Cattlemen's Association
Canadian Egg Marketing Agency
Canadian Farm Women's Education Council
Canadian Horticultural Council
Canadian Imperial Bank of Commerce
Canadian Institute of Chartered Accountants (CICA)
Centralia College of Agricultural Technology
Certified General Accountants Association
Christian Farmers Federation of Ontario
Clews and McIntyre
Collins Barrow
Comité de références économiques en agriculture du Québec CREAQ
Coopérative Fédérée de Québec
Credit Union Central of Manitoba
Credit Union Central of Saskatchewan
Credit Union Deposit Guarantee Corporation
Deloitte & Touche
Doug Eckel, F.C.A. of B.D.O. Ward Mallette
Ed Braun & Associates
Farm Credit Corporation
Farm Debt Review Board
Fédération de l'Union des producteurs agricoles du Québec
Fédération des caisses populaires du Québec
Fédération des syndicats de gestion agricole du Québec
Groupe Olympia
Heronbrook Group/Carl Moore
Holmes, Cartier & Company Ltd.
Institut de technologie agro-alimentaire de La Pocatière
Institut de technologie agro-alimentaire de Saint-Hyacinthe
J. Douglas Stewart Professional Corporation
James Wardenburg
Keystone Agriculture Producers
La Confédération des caisses populaires et d'économie Desjardins du Québec
Lakeland College
Lee F.A.R.M. Services
MacDonald College
Manitoba Agriculture
Manitoba Agricultural Credit Corporation
Manitoba Mediation Board
Meyers Norris Penny & Co.
Ministère de l'Agriculture, des Pêcheries et de l'Alimentation du Québec
National Farm Products Marketing Council
Newfoundland Department of Rural, Agriculture and Northern Development

New Brunswick Department of Agriculture
Nova Scotia Agricultural College
Nova Scotia Department of Agriculture and Marketing
Office de la langue française
Office du crédit agricole du Québec
Ontario Agricultural Standing Committee of Canadian Bankers Association
Ontario Agricultural Training Institute
Ontario Federation of Agriculture
Ontario Milk Marketing Board
Ontario Ministry of Agriculture and Food - O.M.A.F
Ordre des comptables agréés du Québec
Parker-Quine
Peat Marwick & Thorne
PEI Department of Agriculture
PEI Lending Authority
Peter Lubka
Régie des assurances agricoles du Québec
Revenue Canada Taxation
Royal Bank of Canada
Saskatchewan Department of Agriculture
Saskatchewan Pork Producers' Marketing Bd.
Saskatchewan Stock Growers Association
Saskatchewan Wheat Pool
Secretary of State of Canada
Siga Informatique Inc.
Sill Streuber Fiske & Co.
Société du crédit agricole du Canada
Société québécoise d'initiatives agro-alimentaires-SOQUIA
Statistics Canada
Toronto Dominion Bank
Unifarm
Université Laval
University of Alberta
University of British Columbia
University of Guelph
University of Manitoba
University of Saskatchewan
Ward & Uptigrove
Westburn Consultants
Western Canadian Wheat Growers Association

APPENDIX IV - LIST OF ADDITIONAL REFERENCE SOURCES

Title	Publisher
CICA Handbook	The Canadian Institute of Chartered Accountants
Accounting and Financial Reporting by Agricultural Producers	The Canadian Institute of Chartered Accountants
Terminology for Accountants	The Canadian Institute of Chartered Accountants
Statement of Position 85-3 - Accounting by Agricultural Producers and Agricultural Cooperatives	American Institute of Certified Public Accountants, Inc.
Recommendations of the Farm Financial Standards Task Force	The American Bankers' Association

ALPHABETICAL INDEX

Ratios

FUNCTIONAL INDEX

Balance Sheet

Statement of Income

Statement of Owner's Equity

Statement of Changes in Financial Position