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THE FARM FINANCIAL STANDARDS TASK FORCE

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Eddy L. LaDue

During the last few years, at least partly as a result of the recent financial problems of farmers and lenders, there has been increasing concern about the lack of standardization of the financial statements and financial analysis ratios used in agriculture. Farmers have complained that lenders are requiring more information and that the kind and format of information requested varies significantly from lender to lender. Lenders have been concerned that the information collected frequently does not accurately represent the financial position or financial performance of the business. More recently development of the Federal Agricultural Mortgage Corporation (Farmer Mac) has necessitated the development of nationwide standards for agricultural loans sold through the secondary market. It was this environment that motivated the Agricultural Bankers Division of the American Bankers Association to establish the Farm Financial Standards Task Force.

ABA invited about 45 members of the United States Agricultural Finance community to be members of the Task Force. The groups represented and the numbers from each group were:

Commercial Bankers	10
Farm Credit System	5
FmHA	2
Insurance Companies	3
Industry (manufacturers)	2
USDA	3
Academicians	11
Accountants	2
Regulators	4
Computer Software	2
ABA Staff	3

Objectives

The basic objective of the Farm Financial Standards Task Force was to identify universally acceptable farm financial standards. Within this overall objective, there were five sub-goals: (1) to develop a set of standardized farm financial statements that could be used by all lenders and possibly incorporated into the Farmer Mac standards or operating procedures, (2) identify financial ratios common to all areas to the country, (3) identify standard methods of calculating the ratios identified, (4) identify content standards and calculation standards for farm financial software, and (5) review and comment on the proposed underwriting standards for Farmer Mac. When you look carefully at these objectives, you can see that they boil down to basically three activities; (1) development of a standardized set of financial statements, (2) identification and definition of a set of financial ratios that could be universally used, and (3) commenting on the Farmer Mac Underwriting Standards. Once you have defined a set of ratios and how they are to be calculated, you have identified the calculation standards for farm financial software.

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I testified for the group on the loan underwriting standards. The effort was done on a relatively short fuse so we were unable to obtain comprehensive input from all members of the committee for the testimony. Leslie Miller of ABA collected what information she could from Task Force members. Dave Kohl and Stan Forbes provided considerable useful input, particularly through reviews of early drafts.

Activities to Date

The committee has met once, in January 1989, in St. Louis. This meeting provided an opportunity for the members of the Task Force to get to know each other and discuss a number of the issues. Much discussion of important issues took place. There was a considerable amount of apparent agreement. Part of the apparent agreement was probably by design. ABA asked Dave Kohl to act as moderator for the program and his encouragement, and the structure of the meeting, pushed towards identification of agreement rather than disagreement. Also, many of the issues were discussed at a fairly superficial level because of the limited amount of time available for any particular issue. The group agreed on generalities where there might be considerable amount of disagreement on the specifics underlining the general statement.

Following that meeting, the group was divided into subcommittees. Three subcommittees were established for work on universal financial reports. Two were assigned the task of universal financial criteria and ratios. Since there was a coordinator for each of the two sets of committees, the structure was effectively two subcommittees with some assistance on the work effort for the coordinators of the two groups.

Each of the two committees was assigned the task of putting together a position that represented the views of the Task Force members on their committees. I served as a subcommittee chairman for the universal financial reports group so I will report on the exact process used by that group. The three subcommittee chairman and the coordinator served as a steering committee for the universal financial reports. The steering committee used the discussion at St. Louis and its own assessment of important topics to develop a list of issues to be dismissed. The issues dealt with everything from very basic questions, such as should the basic principles of GAAP be used as the guiding force of these statements, to very specific issues, such as how PIK certificates should be handled on a balance sheet. After this list of issues was developed, it was distributed to the subcommittee members for their reaction.

Some members of the Task Force took their responsibilities very seriously and responded in detail to the questions raised. However, the overall response rate was quite low. In particular, the response rate was low among average lenders. We had lots of opinions from academicians, government, insurance companies and accountants. We had few responses from average lenders making loans to average or smaller farmers. Few of the commercial bankers responded. I must admit I have considerable concern about the representativeness of the Task Force results under these conditions. We run the risk of being more complicated and more GAAP oriented than the average lender will be willing to live with in the long run.

The collected responses to the issues were used to develop a series of proposed recommendations for the Task Force. These recommendations were then circulated to the entire Task Force. We are now waiting for Task Force reaction.

Plans for the Future

The future time table is as follows:

1. Comments on the proposed Task Force recommendations for both the universal financial reports and the universal financial criteria and ratios are due at ABA on October 9th. These will be compiled by ABA. At this point I am not certain who will be doing this. There will likely be some

input by the subcommittee coordinators. This compilation is to be completed by November 1.

2. A Task Force meeting has been scheduled for November 10-11th in St. Louis just prior to the ABA Agricultural Bankers Conference. At that time, we will be discussing the recommendations to be made by the Task Force and the issues raised in the comments.
3. A discussion of the Task Force recommendations has been scheduled as a part of the ABA Agricultural Bankers Conference. At this point I am uncertain exactly who will be making that presentation. Presumably it will be the subcommittee coordinators. The Task Force chairman, Stan Forbes and/or Leslie Miller of the Ag Division of ABA may also be involved.
4. There may be a 30 to 60 day comment period when input will be accepted from non-Task Force members. Whether this will be used and, if so, how, will likely be determined at the November 10-11th meeting.

Some Observations

There are a number of very "accountant" and "GAAP" oriented people on the Task Force. Many of them are very articulate and forceful. You almost get the impression that some of them must have taken a hippocratic-like oath to support GAAP at all times. The result will be a much more GAAP oriented system than is used in current practice by many institutions. This is not in itself bad. In fact, I think the general direction is very good. I think the GAAP principles do provide a good base from which to start. However, current accounting practice is not the only method or procedure that is consistent with GAAP principles.

The current product as it exists in the proposed Task Force Standards is quite "reasonable". It represents some amount of common sense and considerable compromise on the part of most Task Force members. There is still some risk that the Task Force will be largely ignored. Considerable modification of the proposals can take place between now and the final draft. It would not be the first time that the final drafters have made considerable change in the final recommendations. Those changes could make the proposals more consistent and more user friendly and, thus, usable. Or they could make the system so complex that it will be ignored.

The universal financial statements committee is developing principles not forms. This is counter to the understanding of many people as to the role of the Task Force. However, the time and effort put into the process are just not sufficient to allow development of a good set of forms. The large committee is also unwieldy for such an effort. We also have spent no time and plan to spend no time discussing universal application forms which some people seem to think we are working on.

The principals that the Task Force is developing could be of considerable value to the lenders but will in general be of little value to farmers. Lenders can use the principals to evaluate and modify their financial statement. However, any two sets of forms put together by different lenders, may look considerably different even if they adopt most of the principles set forth.

There was an original intent to add members of farm groups of various subcommittees. However, that intent was never followed up on. At this point I am not convinced that omission marketedly effected the final product. They may have pushed more towards forms and simplicity.

There is one caveat to my statement that there are no forms being developed. Steve Hofing, who is the coordinator for the universal financial reports group, did put together an example set of forms to illustrate some of the principles. This example was basically of Steve's own design with relatively little input from others. However, it is included in the materials that the Task Force is now responding to. I would not be surprised to see those examples become "the forms" that are perceived to represent the Task Force's standards on financial statements.

This entire effort is a low budget consensus approach to developing universal statements and ratios. The Farm Foundation and ABA have both contributed relatively small amounts of funds to the effort. These funds are used primarily for getting some academicians to the meeting, meals and mailing costs. The various lenders have contributed their representatives' participation time and travel. The consensus approach means that no one has really sat down and worked through cases to see how the proposals will actually work. Thus, there is a strong chance that the proposals will contain inconsistencies.

Final Comments

As a final comment, I think the basic idea for the Task Force is excellent. A lot of people in the agricultural finance community strongly support the effort. In fact, one of the problems that the Task Force will likely have is that they will not meet the expectations of many people who strongly support their own conception of the basic idea.

There should be some movement towards uniformity. Publishing a set of principles and ideas should provide a source for many people who are considering the development and use of financial statements and ratios. Uniformity will not occur quickly. The lack of a set of forms that people could adopt directly will delay the initial movement towards uniformity, but does allow people to move towards uniformity on those issues in which they do not have considerable disagreement.

The principles could provide the basis for a group of lenders to get together and design common forms and ratio analysis procedures. However, initiative to get this done will have to come from some source.

I would like to encourage ABA or a group of lenders to follow this Task Force with a smaller committee with appropriate funding to flush out the agreements of the Task Force, correct the inconsistencies that are almost undoubtedly to be included, and possibly work with lenders on adoption of the standards developed.