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THE ACCOUNTANT AND FARM MANAGEMENT ADVICE*

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The purpose of accounting is two-fold. First to record and summarize economic transactions for a given period, and second to interpret the account as an aid for making management decisions. Before we examine a more rational blend of the two ingredients of accounting it is necessary to examine the framework of principles and procedures within which accountants work. However, this discussion is primarily intended to demonstrate how more accountants serving agriculture can overcome their pre-occupation with recording and summarizing, virtually aimed at assessing tax liability, and extend their influence to render professional advice to management.

Economic transactions fall into two accounting groups; cash movements during the period and estimates or valuations at the close of the period. Faithful recording of cash transactions is rendered complex by movements in price, characteristic of a dynamic environment. Estimates or valuations are necessary to record the capital charges imputed for the period. While certain conventions have been established governing both the treatment of cash and the basis of valuation, judgment and experience play a dominant part in their application.

Accounting Principles

In spite of a history dating back to Egyptian times considerable controversy surrounds accounting theory. One professional group seeks consistency and comparability in financial statements to guide decisions affecting commerce generally. They vigorously claim that at present there are no "generally accepted principles of accounting". To them accounting is a heterogeneous grab-bag of unrelated practices, hard to learn, hard to teach, hard to use, and hard to explain or justify.[1]

This group considers that urgent formulation of principles to govern current best practice will resolve pressing practical issues, and that a clear statement of the direction in which accounting should move in the next few years is necessary.

Another professional group claims with equal force that through time accounting has produced generally accepted principles on which differences of opinion can be admitted, but that adequate identification and classification of these principles will resolve these differences. This group claims that accounting rules should not be imposed on business without the participation of management in developing them. "Accounting principles must be flexible enough to meet the demands of reality, thus permitting the adoption of appropriate methods that will make

* The author wishes to acknowledge the helpful comments and suggestions made on earlier drafts by W. McD. Herr, R.C. Jensen and W. F. Musgrave.

1 Cannon, Arthur M., Discussion Notes on "The Basic Postulates of Accounting", *Journal of Accountancy*, February 1962.

accounting relevant and responsive to the particular entity and particular corporation rather than some nameless, faceless mass".[2]

Australian practice states principles as conventions which are supported by the familiar doctrines of consistency, conservatism, disclosure and materiality.[3] Without detailing these conventions and without discussing their influence on Australian accounting practice, it is fair to say that further development and refinement are urgently necessary. Suffice it to say that throughout the world it is possible for two accountants applying the same "generally accepted principles" to records of the same business to arrive logically and with the same measure of accuracy at widely differing results.

This apparent inconsistency would probably be due to one or more of the following:—

(a) Price level changes accounted for by one and ignored by the other,
(b) Differing methods of valuing stock,
(c) Variation of opinion as to whether some expenditure is capital or revenue, e.g., is research cost to be charged against current revenue or spread over a number of years?
(d) Methods of charging depreciation.

The practitioner uses judgment developed by training and experience in the application of accounting conventions. There is little or no doubt that further standardisation of accounting practice would improve the use and interpretation of business accounts. Recent company events in this country justify the strenuous efforts being made by the accounting profession throughout the world to evolve accounting principles. Informative accounts are needed not only to aid management in making the best possible decisions but also for the benefit of shareholders and directors as well. The effective reporting of accounts whether for a farm or non-farm business is an unresolved problem of which the profession is continually aware.

Principles which could lead to more effective accounting have been developed by Sprouse and Moonitz who have been leading research in this field for the American Institute of Accountants.[4] The radical nature of the suggested principles has to date prevented any official blessing but has stimulated thinking on the subject throughout the profession in the U.S.A. As in any field it is hoped that, in the future, areas of accounting causing debate are reduced, or at least when such debate occurs the basis for any judgment is more fully understood.

Despite these problems accounting will continue to influence the way in which individuals make a living, the way production is organized to supply goods and services, and the way these goods and services are shared among different people.

[2] Savoie, Leonard M., "Accounting Improvements, How Fast, How Far?", *Harvard Business Review,* July/August 1963, p. 144.

[3] Yorston, R. K., Smyth, E. B. and Brown, S. R., *Accounting Fundamentals,* Law Book Co., Sydney, 1959, pp. 3-8.

[4] Sprouse, Robert T., Moonitz, Maurice, Summary from "A Tentative Set of Broad Accounting Principles for Business Enterprises", *The Journal of Accountancy,* May 1962.

Development of Farm Accounting

The term "Farm Accounting" encompasses book-keeping, cost studies, farm cost accounting, farm records and, in so doing, calls upon all the analytical techniques of accounting. The earliest historical record of Farm Accounting as a specialist section of the general accounting field is contained in *Robert Loder's Farm Accounts, 1610 to 1620.*[5] While farm accounting has a 350 year history it has shown little development outside the main stream of accounting in general, perhaps because, traditionally, the agricultural entity has been a small business unit depending more on effort than on thought for ultimate success. It was not until the late nineteenth century, and the beginning of the twentieth century, when the pressures exerted upon agriculture in a growing economy became apparent, that interest in accounting in both Western Europe and U.S.A. became at all widespread.

In Australia, the practising accountant had no great demand for his services from the farming community until farm income and taxation liability rose substantially in the 1940's. Subsequent growth in rural accounting has followed the increasing burden of taxation. The upsurge of prices in the early 1950's introduced a death duty problem which further strengthened this demand for the services of the qualified accountant. Thus while the past two decades have seen a remarkable increase in the importance of farm accounting, taxation and death duty problems have been the dominant concern. However it is through management of these problems that the accountant has been introduced to the wider field of farm management.

As is generally recognized, taxation influence has unduly biassed farm accounting practice. The profit shown in current accounts is too often the income on which tax is being assessed and seldom approaches a business measure of net return. Taxation legislation has, in practice, decided the basis of valuation of livestock, has encouraged violation of the normal accounting distinctions between capital and revenue, and has fixed depreciation rates such that the asset values shown after deduction of these claims have little relationship to actual values.[6] Superimposed on these deviations from the path of accounting virtue is the lack of sufficiently well defined farm accounting principles. All too often, the criterion for choosing between alternative accounting procedures is the possible effect on tax liability, to the virtual exclusion of the way the decision may affect farm operation.

Orienting Australian farm accounting practice towards management will not be easy. Needless to say any reduction in the emphasis on tax considerations would help. The right exercised by the Commissioner of Taxation, under discretionary powers conferred on him, to virtually determine all farm balance dates at 30th June could perhaps be challenged.[7] This stricture has the effect in many instances of matching

[5] *Robert Loder's Farm Accounts, 1610-1620,* edited by G. E. Fussell for the Royal Historical Society.

[6] Regardless of the source data employed for farm business analysis, serious problems arise in classifying both inputs and outputs into categories, and in carrying out the accounting procedures. For a discussion see Johnson, Glenn L. "Classification and Accounting Problems in Fitting Production Functions to Farm Record and Survey Data" in E. O. Heady, *et. al.* (eds.), *Resource Productivity Returns to Scale and Farm Size.* Iowa State University Press, Ames, Iowa, 1956.

[7] S.18 (1) *Income Tax and Social Services Contribution Assessment Act,* 1936-1962.

the expenses of one production period with the income of another, thereby making annual accounts almost meaningless. In addition the concentration of work created by this arbitrary and common tax return date limits the number of farmers who receive their annual results reasonably close to the end of the financial year and thereby gain full benefit of any message which may be contained in the accounts for subsequent planning. Obviously, flexibility in choice of tax balance dates would eliminate the cost and avoid the necessity of preparing separate accounts for varying periods to satisfy both the needs of management and of tax assessment.[8]

The considerable increase in farm asset values which has accompanied the growth of agriculture has encouraged farmers to enter into arrangements to minimise death duties. Unfortunately such schemes often restrict management. To illustrate, suppose a farmer transferred his land to trustees for the benefit of his children. Unless the trust deed gives power to borrow, the trustees could only develop the property out of that portion of annual profit represented by cash.

It is worth noting that the lack of demand for other than routine accounting to cater for state imposts is reflected in the fact that the examination syllabus of neither of the major professional bodies[9] nor the University *Calendar* of any Australian University[10] with a Department of Accountancy includes discussion of Farm Accounting. Consequently the country practitioner relies on his own practical experience and the adaptation of his basic accounting knowledge for the development of a routine service for his rural clients. Moreover subjects complementary to the accounting field such as Commercial Law do not usually include discussion of land tenure legislation, valuation law, or the law governing the marketing of agricultural commodities. Familiarity with these is as essential to the country practitioner as is the Sale of Goods Act, hire purchase law and the law of contracts.

[8] "The Commissioner will accede to changes of balance date for companies which are subsidiaries of, or closely associated with, overseas companies which balance on a day other than 30th June. This is because overseas company laws frequently require that related companies should have a common balancing date and if the request was refused would be faced with heavy and unproductive accounting expenditure to comply with the double standard"—Extract from letter from Commissioner of Taxation, Canberra, dated 21st January, 1964.

[9] Australian Society of Accountants, *Syllabus of Examinations* (Pastoral enterprises only are mentioned), April 1963.

The Institute of Chartered Accountants in Australia, *Examination Handbook*, November 1962 (No mention).

[10] 1963 *Calendar*, Australian National University—no description of course.
1963 *Calendar*, University of Tasmania—no description of course.
1963 *Calendar*, University of Sydney—refers to rural enterprises.
1964 Faculty of Arts and Commerce *Handbook*, University of Queensland—no reference.
1963 *Calendar*, University of Melbourne—no reference.
1963 *Calendar*, University of Western Australia—no reference.
1963 *Calendar*, University of Adelaide, Financial Accounting refers to accounts of pastoralists only—no reference on reading list.
1963 *Calendar*, University of N.S.W. refers vaguely to pastoral and rural enterprises in Accounting II, though the B.Com. (Wool) course includes only Accounting I.
1963 *Calendar* of Monash University not available.

The University of New England has no Department of Accountancy though it has sponsored a Research Fellowship in Farm Accounting.

Certainly farm accounting is confronted by the problems common to all accounting such as valuation of inventories, charging appropriate depreciation, and segregation of capital and revenue. While current practice can cope with these kinds of problems, other problems posed are virtually unique to farm accounting. For example, while cash capital expenditure may be readily indicated in the asset accounts, the value of the operator's own development effort is not so readily estimated. The accountant needs to know how to handle these other problems if the year-end records are to provide information on which management decisions can be based.

The foregoing suggests that if accountants are to extend their influence in the farm management field a greater understanding of agriculture and the principles of farm accounting may need to be acquired by some practitioners. At the same time fictitious valuation rates and net returns, imposed by taxation, should be confined to the return where they belong. This of course involves extra cost which will no doubt be transferred to the client. Some accountants in Australia are now successfully implementing such procedures but substantially more needs to be done.

The Present State of Professional Services

We have seen that farmers have readily sought accountants' services to compute their tax obligations and to keep their tax payments to a minimum. However the need for an accounting service designed to give management advice will not develop until it can be demonstrated that such a service is profitable. This implies that the farming community as well as accountants must be able to recognize the potential of such service. At present both parties are generally unaware of the contribution accountancy can make to controlling costs or maximising profit.

Clients can be divided into three main groups:—

1. The largest group seeks only a simple tax return to be prepared from the information they have provided.
2. The next group has double-entry accounts prepared. Such accounts are more accurate for tax purposes and do trace most balance sheet variations from one year to the next. However these accounts have little management value as the result is presented as assessable income, not trading profit. Conversion of the assessable income to a trading profit is possible and relatively simple. This group is substantial in overall numbers.
3. This quite small group have accounts prepared suitable for the guidance of management and receive a report analysing the results. This client invariably requires a budget. My observations over the past twelve months lead me to suspect that the majority of this group seek the same accounting information with which they are familiar in the management of other industries or occupations, They are investors with experience outside agriculture rather than farmers.

Preparation of tax returns must be based on cheque butts and bank-statements. Closing livestock numbers and natural increase figures are supplied by the farmer as are details of amounts owing and amounts due at the balance date. More detailed accounts (as for groups 2 and 3) require, in addition, receipted statements covering payments made, together with details of sales of produce and livestock. In these cases, the general implications of the accounting result may well be discussed but there is no denying that for most clients the major interest is the amount of income tax payable and frequently potential death duties.

Death duty problems require a free, frank and confidential discussion of the circumstances and objectives of both the farm and the family. The close relationship engendered by such an intimate business association, fostered by the mounting complexity of the farm business, has led to an increasing demand for the services of the accountant. He is frequently appointed trustee under a will, or attorney during periods of sickness or absence. The preparation of applications for additional credit, arranging objections to rating values, advising on insurance requirements or farm administration are but some of the services commonly rendered. All of these are to be welcomed as contributing to a greater realization on the part of the farmer of the contributions the accountant can make to his decisions.

In addition preparation of a profit budget in the last few months of the year to ascertain possible tax liability and the possible effect of immediate expenditure on this liability, is requested by more and more farmers. Requests for advice on the purchase of equipment or sale of stock often follows after discussion of the tax implications of such action.[11] Such requests invariably bring the accountant to grips with the problem of managing the farm. As this association develops so must the accountant feel the deficiencies of farm accounting and the severe lack of comparative data. A number of accountants are engaged in collating data for homogeneous groups of their own clients. However, many practitioners claim they have insufficient clients to derive such information and look to the universities and government agencies to provide such information or standards. Accounting techniques used in other industries for analysing both technical and financial efficiency are being increasingly adapted to agriculture. The use of various budgets to strengthen existing weaknesses and test alternative courses of action is not uncommon.

These developments are proceeding in accordance with the individual inclinations of the country practitioner who operates in an isolated environment. Neither his professional organization nor agricultural institutions have provided the educational stimulus or research needed to weld these individual experiments into a cohesive effort. Without such effort it is difficult to envisage a general appreciation, let alone realization, of the contribution accountancy can make to the farm managerial process in the forseeable future.

Accounting for Farm Management

Farm management requires the same clear, concise and current accounting information that management requires and uses in other industries. However the unique characteristics of agriculture place restrictions on the use of accountancy methods and pose special problems. For example, characteristics of farming ensure that its products can-

[11] While it is not contended that the accountant is well placed to advise on such purchases, perhaps those investigating farm management decision-making should recognize the influence of the accountant on his client in these and similar matters.

not be measured or controlled with the same accuracy that the manufacturer can expect. For this reason both physical and financial information is required. Partly because of a relatively slow turnover, there are only a small number of annual transactions to be recorded. The average farm account would involve approximately three hundred cash transactions per year including those for personal living. In addition to lack of numbers, many transactions are of a joint nature hence measurement of the contribution of each enterprise to total profit is virtually impossible.

These as well as other considerations impart to farm accounting a different character from non-farm accounts. These unique features need to be recognized in the following appraisal of the three different applications of farm accounting which follow.

Department of Agriculture

Many organizations are actively engaged in giving farm management advice; the most extensive are the various State Departments of Agriculture. Their work in the fields of research and education is well known and my appraisal is directed to their efforts in encouraging farmers to keep physical and financial records which form a basis for farm management advice. Departmental advisory officers do not usually have the economic realities of the individual farm revealed to them as starkly as they are, for example, to club advisers. From the accountant's point of view, the most significant development in the various departments, is the availability of record books. To my mind these record books must be regarded with some concern as they so complicate the issue as to create confusion as to what is a desirable minimum of recording on the farm. Surprisingly enough this can be very little. Practically all farmers operate a trading bank account and seldom make significant payments in cash. Cheque butts and bank statements are essential to the maintenance of accurate financial records but the inclusion of payments made in cash and the ponderous recording of "contra" entries in a record book will only cause difficulty to even the most enlightened operator.

The emphasis placed on the "tax assistance" made possible by completing the record book tends to limit the information available for management. While the terminology used is based on the tax return, consistency is not apparent from book to book. Meaningful farm accounts require information on physical production hence, above all else, it is important that adequate provision be made to record this. For example on the farm use of the record book issued by the N.S.W. Department of Agriculture[12] has demonstrated that this important feature, is in fact inadequate. A single column recorded the very significant volume of both livestock and produce yet separate columns were provided for the less significant value.

Merely entering itemized receipts and payments which are already included in cheque butts and bank statements is pointless and repetitive "busy work". The inclusion of a simple cash budget would highlight the importance of production records, while totalling receipts and payments during the course of the year would permit comparison with the

[12] *Farm Record Book—Wheat-Sheep Districts,* Division of Marketing and Agricultural Economics, Department of Agriculture, New South Wales.

various budgeted totals and would give point to the maintenance of a simple cash book. The book issued by the Victorian Department of Agriculture[13] contains instructions for analysing the results. However these will lack effectiveness in the absence of some means whereby comparisons with standards or other farms are possible. The accounting detail required by all record books appears stilted and theoretical with the result that the objective of practical assistance in making management decisions is not often attained, while the methods used are somewhat sophisticated for those without an introduction to accounting.[14]

Farm Management Clubs

The most intensive management advice tendered in Australia is that of the advisers employed by Farm Management Clubs. Detailed consideration of this type of organization will emphasize the underlying importance of accountancy. Co-operative farm management groups were introduced to Australia in 1955. They can be traced back to the German experimental groups of 1921,[15] which consisted of neighbouring farmers combining to employ, from their own resources, a fully qualified agricultural graduate. Initially he carried out experimental work aimed at helping members overcome problems arising from the attrition of farm size. Not surprisingly, it was soon realized that technical efficiency alone did not make a holding financially sound. The farming year 1929-30 saw a process of change begin with emphasis shifting to the examination of the farm as a business unit. Farm management was appreciated as having a basic connection with net profit and business solvency. This led to the analysis of a yearly balance sheet which expressed farm productivity as net profit. Comparison of these results within the groups enabled advisers to define possible weakness in individual management. Experiments were then carried out to assist in studying the weaknesses so revealed.

In Australia an initial duty of the adviser is to collate and analyze the economic and production figures of his group members.[16] This not only enables him to become acquainted with district farming methods and problems but also to closely identify himself with members thereby creating in them confidence in his ability. Such confidence is important as detailed data collection must include information on the ultimate goals of each member. In obtaining this information and in subsequent assistance he gives to members the adviser must have access to accounting records. Clearly his task is easier if he obtains relevant data from the accountant rather than performing the task himself.

The work of a club adviser is virtually impossible without the account-

[13] *Farm Records and Accounts for sheep, cattle, pig and cropping enterprises,* Agricultural Economics Branch, Department of Agriculture, Victoria.

[14] *Farm Record Book,* South Australia Department of Agriculture. A well set out publication containing a practical cash record and a useful set of production records. It suffers from rather much detail and absence of the simple cash budget referred to above.

[15] Kahsnitz, H. G., "The Private Advisory Groups, their organization and co-operation with the official Agricultural Advisory bodies from the standpoint of Agricultural Management". *Farm Planning and Budgeting Services in Farm Management Advisory Work, Report on training course.* O.E.E.C., pp. 164-178.

[16] Beale, C. I. A., "Private Extension Services for Australia", *Farm Policy,* No. 3, December 1961.

ing and production records of members. The adoption by members' accountants of current accounting conventions and their use of a common terminology would relieve the adviser of much tedious account reconstruction. In the absence of such common practice, reconstruction of accounts is essential to comparisons between properties. The information so obtained is invaluable in an evaluation of observed farming methods as well as assisting in the identification and solution of problems.

While advisers make use of accounting data and techniques, few have had training in recording and summarising economic transactions. Understandably they find it difficult to recognize data prepared by an accountant as suitable for interpretation. On the other hand, many of the analytical techniques they use have their counterpart in accounting but are unrecognized by many practising accountants who lack training in farm management and agricultural economics. A close relationship between the adviser, accountant, and farmer seems to offer a very useful way to extend farm management advice to agriculture. Consistency in techniques and terminology may be the most important step in achieving this.

The Accountant and Farm Management Advice

The multiplicity of firms constituting agriculture ensures that the rural accountant has repeated contact with all the various aspects of the farm business. This should provide in time a well developed knowledge of farming practice and problems. Further, the accountants' training and background should provide an insight to the associated managerial problems. Such a wide experience together with the close farmer-accountant relationship should put the accountant in a strong position to advise and assist the individual farmer.

We have seen that the country accountant is not perhaps as well equipped to give assistance to management decisions as is his city colleague. Nor can accountancy assist with technical problems of management outside the understanding of the individual farmer. To overcome this, more practitioners are employing qualified farm advisers. A number of others, particularly in Queensland, are co-operating with the Department of Agriculture to provide a form of farm management service. This promising development is highlighting the need for, and the benefit of, accounts prepared to assist the managerial process. There is no reason why the farm management consultant and farm accountant should not be regarded as providing complementary skills for the purpose of farm advisory work.

In fact those accountants who fail to extend their rural practice to include farm management advice could find their practice diminishing. For some the rate of diminution could well be accelerated by a general lack of clarity in presentation of accounts, symptomatic of identification of the assessable income figure, as trading profit.

Mechnisation of the accountant's office is developing quickly and new developments in this field are bringing with them the possibility of firms combining to create service bureaux to process data prepared in more isolated areas. Such re-organization should not only enable realization of economies of scale and employment of specialists for particular services, but also provision of facilities for collating comparative data quickly and at reasonable cost.

Taxation will always remain a dominating element in accounting services. However increased use of accounting skills in defining and solving management problems will make other accounting services important, and in my opinion, events are moving in the direction of making them important.

Other Uses of Farm Accounts

In addition to individual farm management advice the need for comparative accounting data in applied farm management has been expressed by your society and by others. The activities in data collection of, among others, the U.K. Universities and the land grant Universities in the U.S.A. are well known.

Essentially farm management data must be collected from accounts which are consistent and comparable from accountant to accountant for both terminology and end-of-year estimates. Without this the data generated by accounts is next best to useless. Some accountants are collecting such data from within their own practice to arrive at some measures of performance. While such standards have disadvantages there is no denying their intelligent use produces useful guidance to individual clients. The small size and joint costs of the average farm firm makes the collection of meaningful data for individual enterprises very difficult. As management improves, so the use of records will become more appreciated and more intensive.

It is interesting to note that a report of a sub-committee of this society[17] on the shortcomings of Australian farm financial statistics ignores the farm data available in the many accountants' offices in Australia. It does direct its attention to the need for more facts and suggests extension of present sample surveys and use of tax data. While the present professional accountant must stand or fall by the service he gives, the economist has every reason to give greater attention to the methods at present used in compiling basic data and encourage anything which promises to overcome the taxation bias.

The present B.A.E. sheep survey could be made more intensive by persuading accountants to complete annually, with the consent of the client, detailed summaries of the production and financial results of properties within the same classification as those already in the survey. Such a system is in operation in New Zealand where data auxiliary to that collected by field officers of the New Zealand Meat and Wool Board's Economic Service is obtained. This assists in making an, at present, extensive survey more intensive and provides a check on the original sample used.

The problems and deficiencies of accounting for a business as small as a farm must be reflected in the accuracy of any agricultural statistics based on accounts. Improvement in accounting would no doubt permit those statistics to be used with more confidence.

[17] Gruen, F. H., Campbell, K. O., Crawford, Sir John, "Report on Shortcomings of Australian Farm Financial Statistics and Desirable Improvements", *The Australian Journal of Agricultural Economics,* Vol. 6, No. 2, December 1962, p. 81.

Conclusion

There is ample evidence that Australia is making significant contributions to discussion and solution of the many problems confronting the accounting profession. Unfortunately this cannot be said of farm accounting. Indeed it could be said that Australian farm accounting is only now showing signs of emerging from a sleep which would be a credit to Rip van Winkle.

The accountant has effective access to the farmer, but gaps in training, and the isolation of country practitioners prevent full advantage being taken of this. In addition the bias towards taxation problems must be overcome if farm accountancy is to contribute to the management process. Any move in the desired direction would be greatly assisted by current developments in the processing of accounting information.

A market does appear to be developing for the provision of farm accounts in a form more suitable for the use of the farm manager and his adviser. From my own experience in New Zealand, and observation in Australia, the price for such accounts need not be prohibitively high. Finally, I would go so far as to suggest that it is a necessary condition for the continued growth and success of the farm management advisory profession, that rural accountancy in Australia produces such accounts.