

Agriculture, Section 3041 — Background Information and Basis for Conclusions

Foreword

In November 2019, the Accounting Standards Board (AcSB) released AGRICULTURE, Section 3041 in Part II of the CPA Canada Handbook – Accounting. The AcSB has approved for publication the contents of this document setting out its rationale for these standards.

Background Information and Basis for Conclusions documents are sources of generally accepted accounting principles, as described in GENERALLY ACCEPTED ACCOUNTING PRINCIPLES, Section 1100 in Part II of the Handbook.

These documents are intended to help readers understand how the AcSB reached its conclusions, but they do not include explanations of requirements or guidance on the application of the relevant Section or Accounting Guideline.

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INTRODUCTION

- 1 This document summarizes considerations that were deemed significant by the members of the AcSB in reaching their conclusions in developing AGRICULTURE, Section 3041. This document sets out the reasons the Board undertook the project to develop this material, the process of research and deliberation, the key decisions made, and the principal reasons for adopting the positions taken and rejecting others. Individual Board members gave some factors greater weight than other ones.
- 2 Nothing in this document is to be taken as overriding the requirements of the Handbook. However, the discussion may help readers understand how the AcSB reached its conclusions in developing the Sections and the Board's intent with respect to interpretation and application of the Sections.

BACKGROUND

- 3 The AcSB has heard that there is diversity in accounting by private enterprises for biological assets and the harvested product of biological assets. This diversity is a result of a lack of specific authoritative guidance for agricultural producers and is causing difficulties for stakeholders in the agricultural sector. To address this diversity, the Board developed proposals after considering extensive input from stakeholders on how to account for agricultural inventories and productive biological assets.
- 4 The agricultural sector is an important part of the Canadian economy and spans a wide range of activities. Statistics Canada reported that in 2016, agricultural and agri-food sectors generated \$111.9 billion in gross domestic product (GDP) and accounted for 6.7 percent of Canada's GDP, and that there were 193,492 farm businesses.¹
- 5 The AcSB issued its Agriculture Discussion Paper (Discussion Paper) in December 2015. The Discussion Paper's objective was to obtain more input from agriculture stakeholders on whether to develop authoritative guidance for the sector, on the issues that authoritative guidance on agriculture should address and how they could be addressed. The Board received 19 comment letters in response to the Discussion Paper.
- 6 In July 2018, the AcSB issued its Exposure Draft, "Agriculture." In developing the Exposure Draft, the Board considered feedback from the Discussion Paper. It carried out extensive consultations with agricultural stakeholders, including 14 cross-country roundtables that reached 127 stakeholders. The Board also held additional discussions with interested groups, including outreach with users of agricultural financial statements. This outreach focused on users who worked closely with agricultural producers, such as lenders at local financial institutions and credit groups, as well as users within government agencies.
- 7 The AcSB also established the Agriculture Advisory Group (Advisory Group) to provide expertise and input to the Board when developing the guidance for the sector. The Advisory Group comprises preparers, financial statement users and auditors, representing a range of industries in the agricultural sector from across the country. The breadth of the Advisory Group's experience provided the Board with insight into the major industries in Canada's agricultural sector (e.g., dairy, cattle, wheat and other grains, fruit and vegetables, hogs, poultry and egg production). The Advisory Group also provided the Board with insight into less common industries (e.g., fish and other aquatic organisms, mink and ginseng). This breadth enabled the Board to develop the guidance in consideration of a large variety of agricultural producers.

APPLICABILITY TO NOT-FOR-PROFIT ORGANIZATIONS

- 8 Not-for-profit organizations (NFPOs) apply the standards for private enterprises in Part II of the Handbook to the extent that the Part II standards address topics not addressed in Part III. Therefore, NFPOs that are agricultural producers are required to apply the guidance in Section 3041. Accordingly, while developing the guidance, the AcSB gave updates on the project to its Not-for-Profit Advisory Committee and provided members of this committee opportunities to highlight any unique considerations for NFPOs applying Section 3041.

EFFECTS ANALYSIS

- 9 Many stakeholders advised the AcSB that there is significant diversity in practice regarding the accounting for biological assets and the harvested product of biological assets. Accordingly, the Board acknowledges that reducing this diversity would result in a change in practice for some enterprises. The following paragraphs highlight the effects of the standard.

Agricultural inventories

- 10 Many agricultural producers currently apply the scope exemption in INVENTORIES, Section 3031, to measure living animals and plants (biological assets) and the harvested product of biological assets (agricultural produce) at net realizable value rather than at cost. The AcSB understands that this scope exemption results in diversity in practice.
- 11 Section 3041 introduces conditions that must be met for agricultural inventories to be measured using the net realizable value model, which limits the circumstances when agricultural inventories can be measured at net realizable value. These conditions may result in a change in practice for some agricultural producers. However, introducing these conditions will improve the quality of the information provided to financial statement users and ensure consistency among agricultural producers regarding when net realizable value is used.
- 12 The AcSB acknowledges that there could be agricultural inventories currently measured at net realizable value that will not meet the conditions in Section 3041. Agricultural producers may have to incur additional preparation costs associated with determining the cost of such inventories compared with their previous accounting treatment. However, the Board has heard from its outreach that cost is a more relevant measure for agricultural inventories that do not have immediate marketability at quoted prices. Accordingly, the Board thinks it is important that agricultural producers are provided with an option to determine the cost of agricultural inventories either using full cost or only input costs (see Determination of cost below).
- 13 The AcSB notes that the option to use only input costs would reduce the costs associated with applying Section 3041, because it eliminates the need for enterprises to develop methodologies for allocating indirect costs. For agricultural producers that choose to determine the cost of agricultural inventories using full cost, the Advisory Group indicated that a one-time cost will likely be incurred when the guidance is applied, to establish methodologies to allocate costs. However, in subsequent years, the methodologies can continue to be applied at little additional cost. In addition, to limit the costs associated with applying Section 3041 to existing assets that meet the definition of agricultural inventories, agricultural producers are permitted, on an asset-by-asset basis, to use the asset's net realizable value as its deemed cost on initial application.

Productive biological assets

- 14 The AcSB understands that under current practice, some productive biological assets are measured at cost and others at net realizable value. Therefore, the requirement to measure all productive biological assets at cost will result in a change in practice for some agricultural producers.
- 15 The AcSB has heard from users that cost is a more relevant measure for productive biological assets. Therefore, a primary effect of the guidance is to enhance the relevance of financial information provided to users. Further, Section 3041 is expected to improve the comparability in financial reporting by agricultural producers, as all productive biological assets will be measured on the same basis. The Board acknowledges that there will be preparation costs associated with adopting Section 3041, such as changing financial ratios as a result of reclassification and communicating the effects of these changes on the financial statements to lenders and other users.
- 16 The AcSB also understands that an agricultural producer may not initially know whether it will use a biological asset in a productive capacity. To reduce the complexity of applying Section 3041 in this situation, the Board included a rebuttable presumption that would allow agricultural producers to account for their biological assets not used in a productive capacity as agricultural inventories. To further reduce the preparation costs involved when the biological asset is subsequently used in a productive capacity, an agricultural producer uses the asset's carrying amount as its deemed cost when reclassifying the asset to productive biological assets.
- 17 The AcSB acknowledges that for agricultural producers with productive biological assets previously measured at net realizable value, there may be additional preparation costs associated with determining the cost of productive biological assets. However, the Board thinks these additional costs to preparers will be outweighed by the benefits that users will receive from an increase in the relevance and comparability of financial information across the different industries in the agricultural sector. Further, to limit the costs associated with applying Section 3041 to existing assets that meet the definition of productive biological assets, agricultural producers are permitted, on an asset-by-asset basis, to use the asset's net realizable value as its deemed cost on initial application.

Conclusion on effects analysis

18 Having considered the effects of applying Section 3041, as discussed above, the AcSB thinks that the standard will result in significant improvements to the financial reporting of enterprises in the agricultural sector.

DEVELOPMENT OF THE STANDARD

- 19 Throughout the development of Section 3041, the AcSB followed its due process. This process included:
- (a) issuance in December 2015 of the Discussion Paper;
 - (b) analysis and consideration of feedback received through written responses to the Discussion Paper (19 comment letters);
 - (c) ongoing input from its Advisory Group, and Private Enterprise Advisory Committee (Committee);
 - (d) issuance in July 2018 of the Exposure Draft;
 - (e) analysis and consideration of feedback received through written responses to the Exposure Draft (13 comment letters);
 - (f) follow-up discussions with respondents and advisory committees to obtain additional feedback; and
 - (g) consultations on the Discussion Paper and Exposure Draft proposals with 197 stakeholders at roundtable events across Canada.
- 20 To test the viability of the proposals in its Exposure Draft, the AcSB conducted field tests with preparers and auditors covering nine industries in the agricultural sector (dairy, cattle, hogs, poultry, berries, field crops, maple syrup, orchard and nursery plants). Field-test participants were asked to answer a series of questions using the facts and circumstances of a specific agricultural producer. The questions were designed to gauge whether the proposals could be applied in practice and whether the Board had achieved the appropriate balance between the costs versus the anticipated benefits of applying the proposals. Specifically, the questions were designed to assess whether:
- (a) field-test participants were able to apply the definitions of agricultural inventories and productive biological assets to classify their assets;
 - (b) the various classification and measurement simplifications the Board provided in Section 3041 were easy to apply without undue use of professional judgment; and
 - (c) the accounting outcome of applying the proposals reflected the Board's intent.
- 21 The AcSB also asked the Advisory Group and the Committee members to perform a fatal-flaw review of the final standard to ensure the guidance is:
- (a) clear in reflecting the Board's intent; and
 - (b) written in a manner that is consistent with other guidance in Part II of the Handbook.
- 22 In developing Section 3041, the AcSB considered the consequences of adopting new guidance relative to the objective of financial statements and the benefit versus cost constraint. As described in FINANCIAL STATEMENT CONCEPTS, paragraph 1000.12, the purpose of financial reporting is to "communicate information that is useful to investors, creditors and other users in making their resource allocation decisions and/or assessing management stewardship." Also, as described in paragraph 1000.13, the Board considered the benefit versus cost constraint which states: "In developing accounting standards, the Board weighs the anticipated costs and benefits of its proposals in general terms to assess whether they are justified on cost/benefit grounds."
- 23 The AcSB received 13 written responses to the Exposure Draft from preparers, joint working groups and public accounting firms. The Board reminds stakeholders that as part of its due process related to Part II of the Handbook, it makes available a public file of materials relating to completed projects, which includes response letters received unless confidentiality is requested.
- 24 Respondents, including participants at meetings, supported the underlying principles in the Exposure Draft. However, some respondents provided additional comments suggesting changes to some of the proposals.
- 25 The specific issues addressed in this project, including the substantive comments received on the Exposure Draft and any changes made in response to those comments, are as follows.

SCOPE

Measurement principle underlying Section 3041

- 26 To develop the agriculture guidance, the AcSB considered the principles and concepts in other accounting frameworks. In doing so, the Board observed that the measurement principles underlying International Accounting Standards (IAS) 41 *Agriculture* and U.S. Financial Accounting Standards Board Accounting Standards Codification (ASC) Topic 905, *Agriculture*, are quite different. IAS 41 measures the biological transformation of assets with a fair value measurement principle that is applied to all biological assets within the scope of the standard, up to the point of harvest. Conversely, ASC 905 applies to the transactions and activities of agricultural producers, and while some choice is provided, the guidance primarily results in measuring biological assets and the harvested product of biological assets at historical cost.
- 27 Users consulted, including the user members of the Advisory Group, supported a principle that measures the transactions and events of an agricultural producer. Users indicated that they think financial statements are more useful when they

provide information about transactions that are realized or realizable, and that information on the biological transformation of an asset is not predictive of an agricultural producer's operating results or productivity.

- 28 Accordingly, the AcSB proposed in the Exposure Draft that the guidance contain an underlying principle to measure an agricultural producer's transactions and events, similar to ASC 905. Respondents agreed with the Board's view that this guidance would be more consistent with the concepts underlying Part II of the Handbook and provide users with information they consider to be more relevant (see Underlying measurement basis below).

Assets within the scope of Section 3041

- 29 The AcSB also looked to other frameworks when considering which assets should be within the scope of the agriculture guidance. Through its preliminary research on this project, the Board heard from stakeholders that IAS 41 would provide a useful starting point for the agriculture guidance. Many stakeholders observed that having a similar scope to IAS 41 would reduce confusion among stakeholders who work across both Parts I and II of the Handbook. However, the Board also observed that IAS 41 excludes from its scope some biological assets and harvested products of biological assets, and therefore requires stakeholders to apply multiple standards in accounting for their agricultural activities. Consequently, the Board thought that directly aligning the scope of Section 3041 to IAS 41 would result in guidance that is overly complex for stakeholders.
- 30 Therefore, while IAS 41 was used as a starting point for determining the scope of Section 3041, the AcSB proposed, and stakeholders agreed, that the scope of Section 3041 should be expanded beyond the scope of IAS 41 to also include:
- (a) bearer plants; and
 - (b) the harvested product of biological assets, until a secondary production process commences to transform the harvested product into another asset.

Stakeholders agreed with the Board's proposal to include bearer plants and the harvested product of biological assets within the scope of Section 3041 if it is used in agricultural production, irrespective of whether it is grown or purchased, because it is simpler for agricultural producers to apply guidance contained within one standard. As a result, the harvested product of biological assets purchased by an agricultural producer for use in its agricultural production is within the scope of Section 3041 because unlike IAS 41, the scope of Section 3041 is beyond the point of harvest (see Purchased harvested product of biological assets below).

- 31 Some stakeholders noted that an agricultural producer may purchase harvested products of biological assets for reasons other than use in agricultural production (e.g., to combine with its own agricultural inventories held for sale to achieve grade or volume specifications). The AcSB thinks that agricultural producers should use their judgment in determining whether such purchases are necessary to complete their agricultural production process, or whether these activities are within the scope of another standard, such as Section 3031, because they more closely resemble activities of commodity brokers, for example.
- 32 As noted in paragraph 3 above, Section 3041 provides guidance to account for an agricultural producer's agricultural inventories and productive biological assets. Assets that result from the secondary production of transforming agricultural inventories are outside the scope of this Section. Such assets are accounted for in accordance with other Sections, such as Section 3031. In Section 3041, the AcSB provides examples of productive biological assets used in the production of agricultural inventories and assets that result from secondary production, to illustrate which assets are within or outside the scope of Section 3041.
- 33 The AcSB also considered whether the forestry industry should be within the scope of Section 3041, specifically considering the unique aspects of Canada's forest lands when making its assessment. The Board understands that there are both privately owned forest lands that are managed for timber production, and Crown lands for which timber rights are granted by the government. Timber rights are accounted for in accordance with GOODWILL AND INTANGIBLE ASSETS, Section 3064. In developing the Exposure Draft, the Board did not identify any factors that would suggest that Section 3041 would be inappropriate for the forestry industry when the forest land is privately owned. Accordingly, the Board proposed that forestry, when the land is privately owned and is managed for timber production, should be within the scope of Section 3041.
- 34 In response to the Exposure Draft, stakeholders in the forestry industry raised concerns about whether the guidance proposed was appropriate for this industry. The AcSB conducted additional consultations with participants in the industry and decided to exclude forestry from the scope of Section 3041. In Canada, most managed forestry activity occurs on publicly owned lands and as a result:
- (a) very few private enterprises engage in forestry activity on private industrial lands; and
 - (b) well-established practices in the forestry industry stem from public policy and regulation.

Purchased harvested product of biological assets

- 35 In developing the Exposure Draft proposals, the AcSB heard that many agricultural producers have both grown and purchased harvested product of biological assets that are not separately tracked. Therefore, applying a different accounting treatment would present practical difficulties. Stakeholders consulted also noted that applying separate guidance to grown and purchased harvested product of biological assets could result in each being measured on different bases for the same or similar items of agricultural inventory. This would not result in relevant information for users of the financial statements.

36 Therefore, the AcSB proposed to include the harvested product of biological assets that is purchased by an agricultural producer for use in agricultural production within the scope of Section 3041 to reflect practical business operations. However, as the scope of Section 3041 applies only to enterprises that undertake agricultural production, enterprises that acquire harvested products of biological assets that are not agricultural producers, such as secondary processors, retailers and broker-dealers, will continue to account for such assets in accordance with other Sections, such as Section 3031. Respondents agreed with the Board's proposal to include the harvested product of biological assets within the scope of Section 3041, irrespective of whether it is grown or purchased, because it is simpler for agricultural producers to apply guidance contained within one standard.

Vertically integrated enterprises

- 37 For a vertically integrated enterprise that undertakes both agricultural production and secondary production, the AcSB expects that some of its assets will be accounted for in accordance with either Section 3041, or other Sections, such as Section 3031, based on when its agricultural production process is complete and when its secondary production process commences.
- 38 When the secondary production process commences to transform an item of agricultural inventory into a different asset, that item is accounted for in accordance with other Sections, such as Section 3031. For example, a vintner that has developed and harvested its own grapes would apply the guidance for agricultural producers to its grapes. When the vintner commences the secondary production of transforming the grapes into wine, it has a new asset because the grapes are consumed when the wine is produced. On the date at which the vintner commences secondary production, the carrying amount of the grapes under Section 3041 is the deemed cost when initially applying Section 3031.

RECOGNITION

- 39 FINANCIAL STATEMENT CONCEPTS, paragraph 1000.24, defines assets as "economic resources controlled by an entity as a result of past transactions or events and from which future economic benefits may be obtained." Paragraphs 1000.39(a)-(b) state that assets are recognized when "the item has an appropriate basis of measurement and a reasonable estimate can be made of the amount involved; and for items involving obtaining or giving up future economic benefits, it is probable that such benefits will be obtained or given up." The AcSB thinks that agricultural inventories and productive biological assets should be recognized in the financial statements when they meet the definition of assets and the recognition criteria in Section 1000. Accordingly, recognition guidance was not proposed in the Exposure Draft beyond referring to the guidance in Section 1000.
- 40 Respondents generally agreed with the AcSB's views, but some suggested that additional guidance should be provided regarding the certainty of future economic benefits of some assets, such as unharvested crops and unborn animals. However, the Advisory Group suggested, and the Board agreed, that enterprises would need to apply judgment in determining when the recognition criteria are met for such assets. Accordingly, no additional recognition guidance is provided. However, the Board observes that agricultural producers that plant crops or breed animals would typically do so with a reasonable expectation that future economic benefits will be obtained from the assets.
- 41 The AcSB acknowledges that there could be costs incurred during the very early stages of agricultural production, such as soil preparation for crops prior to planting. The Board thinks that agricultural producers would also apply judgment to determine when these costs would be recognized as agricultural inventories or productive biological assets by considering the definition of assets and the recognition criteria in FINANCIAL STATEMENT CONCEPTS, Section 1000. When considering how to account for these costs, an agricultural producer would take into consideration the accounting policy choice it made to use either full cost or only input costs in measuring agricultural inventories.

Categories of agricultural inventories and productive biological assets

- 42 The AcSB is of the view that all biological assets and agricultural produce fit into two broad categories: agricultural inventories and productive biological assets.
- 43 The AcSB notes that productive biological assets are akin to property, plant and equipment. Therefore, when developing the definition of productive biological assets, the Board considered the definition of property, plant and equipment in PROPERTY, PLANT AND EQUIPMENT, Section 3061. Similarly, agricultural inventories are akin to inventories. Therefore, the definition of agricultural inventories is similar to the definition of inventory in Section 3031.
- 44 However, due to the short operating cycle of production animals and plants, such as poultry and tomato vines, the AcSB decided to include biological assets held for use in a productive capacity but with short productive lives in the agricultural inventories category.
- 45 The AcSB proposed, and stakeholders agreed, that an agricultural producer would apply these definitions in Section 3041 to determine the appropriate category for each of its biological assets and harvested product of biological assets. Specifically, applying the definitions will require an agricultural producer to consider the use of its assets.

Developing biological assets

- 46 Stakeholders noted that when a biological asset is initially acquired or produced, its intended use may not be known to the enterprise. To address this situation, the AcSB proposed to include a presumption that biological assets not used in a productive capacity are agricultural inventories on initial recognition. The agricultural producer may choose to rebut this presumption when the intention is to develop the asset into a productive biological asset. Respondents and the Advisory Group supported this rebuttable presumption, noting that in many cases this approach will allow the

agricultural producer to choose an accounting treatment that is consistent with its current practice when the use of an asset is not yet known. For example, when an agricultural producer chooses as its accounting policy to measure agricultural inventories using the net realizable value model when the specified conditions are met, a heifer can be measured at net realizable value until it is either sold or used in a productive capacity. When an agricultural producer commences using the heifer in a productive capacity, the change in use guidance applies and the heifer is reclassified from agricultural inventories to productive biological assets using the net realizable value as its deemed cost (see Change in use below).

Change in use

- 47 Stakeholders also noted that a change in use of a biological asset may arise that results in a change of its category under the guidance in Section 3041. Therefore, the AcSB included guidance on how to account for such a change.
- 48 In respect of a change from agricultural inventories to productive biological assets, the AcSB proposed that when a biological asset is reclassified from agricultural inventories to productive biological assets because the asset is now used in a productive capacity, the carrying amount of the item of agricultural inventory at the date of reclassification becomes the deemed cost of the productive biological asset. Respondents agreed that this would eliminate the complexity that would be associated with determining the cost of the productive biological asset when its use changes.
- 49 The AcSB noted that if an agricultural producer was permitted to change from agricultural inventories to productive biological assets and vice versa on a recurring basis, this would potentially subject the financial statements to manipulation. Specifically, an agricultural producer could take advantage of the accounting policy choice to measure agricultural inventories at net realizable value when such measurement would have a positive effect on net income, and conversely reclassify from agricultural inventories to productive biological assets measured at cost when the net income effect would be negative. Therefore, the Board decided, and respondents agreed, that once a biological asset is used in a productive capacity and is determined to be a productive biological asset, the enterprise is prohibited from subsequently reclassifying the asset to agricultural inventories.

UNDERLYING MEASUREMENT BASIS

- 50 In developing Section 3041, the AcSB considered the underlying measurement basis for the measurement of agricultural inventories and productive biological assets. Overall, stakeholders agreed with the Board's view that cost is the underlying measurement basis, for the following reasons:
- (a) Users consulted noted that they make lending decisions for agricultural producers based on normal operating cash flows and earnings, and for this purpose cost is typically more useful. Specifically, cost is quantifiable and verifiable, and therefore provides confirmatory information about past transactions which then has predictive value about future transactions. Users also noted that financial statement information based on cost helps them evaluate an agricultural producer's efficiency, productivity and working capital.
 - (b) Users have indicated that they have access to net realizable value information for agricultural inventories and productive biological assets. Therefore, if an agricultural producer tells them the qualities and quantities of assets, they can use the net realizable value information to determine current value, if they think it is a relevant measure. Conversely, they would not have access to cost information if it was not provided by the agricultural producer. Therefore, measurement at cost provides users with additional information that otherwise would not be available to them.
 - (c) FINANCIAL STATEMENT CONCEPTS, paragraph 1000.48, indicates that financial statements prepared in accordance with Part II of the Handbook are primarily prepared on a historical cost basis.

- 51 The AcSB also agreed with stakeholders, including users, who said that net realizable value is a relevant measurement basis for agricultural inventories, but only under specific conditions (see Conditions for measurement at net realizable value below). The Board acknowledges that when such specific conditions are met, net realizable value can also provide relevant information to users. Exposure Draft respondents supported this proposal.

MEASUREMENT OF AGRICULTURAL INVENTORIES

Accounting policy choice

- 52 As discussed above, the AcSB thinks that cost is a relevant and reliable measurement basis for agricultural inventories and productive biological assets. However, many stakeholders have noted that in some circumstances net realizable value can also be a relevant measurement basis for agricultural inventories. The Board observed that agricultural inventories are often interchangeable, and their prices can be quoted in active markets. Because of these characteristics, agricultural inventories are unlike most other non-financial assets. Therefore, the Board agreed with stakeholders who noted that in some circumstances the characteristics of agricultural inventories support measurement at net realizable value.
- 53 Accordingly, the Exposure Draft proposed that an agricultural producer should have an accounting policy choice to measure the agricultural inventories using either a cost model, or a net realizable value model when the conditions are met (see Conditions for measurement at net realizable value below). Stakeholders responding to the Exposure Draft supported this proposal.
- 54 Agricultural producers may undertake a diverse range of agricultural activities and may have different types of agricultural inventories. There may be circumstances when measurement at cost would provide relevant information for some agricultural inventories, while measurement at current value may be more appropriate for others. Accordingly, the

AcSB proposed, and respondents agreed, that agricultural producers apply the accounting policy choice to measure agricultural inventories of a similar type using either the cost model or the net realizable value model by considering both their nature and use.

- 55 The AcSB acknowledges that this accounting policy choice may result in a lack of comparability across agricultural producers. However, it will reduce the complexity of the guidance for agricultural producers because an enterprise can choose an accounting policy for agricultural inventories of a similar nature and use based on the measurement that would be most appropriate for each (e.g., an agricultural producer with both swine and corn could choose to account for one at cost, and the other at net realizable value). This approach will also result in more consistency in the treatment of different types of agricultural inventories across agricultural producers. Further, applying the accounting policy choice at this level would be consistent with the approach in Section 3031, which requires an enterprise to use the same cost formula for inventories of a similar nature and use.
- 56 The AcSB notes that an agricultural producer may subsequently want to change its accounting policy for agricultural inventories, from using the net realizable value model to the cost model, or vice versa. ACCOUNTING CHANGES, paragraph 1506.06, sets out criteria that must be met for an enterprise to change its accounting policy. Specifically, paragraph 1506.06(b) states that the change can be made only if it "results in the financial statements providing reliable or more relevant information about the effects of the transactions, other events or conditions on the entity's financial position, financial performance or cash flows." As discussed above, the Board thinks cost is a relevant and reliable measurement basis for the measurement of agricultural inventories. Therefore, an agricultural producer is permitted under paragraph 1506.06(b) to change its accounting policy from using the net realizable value model to the cost model. In accordance with Section 1506, such a change would be accounted for retrospectively.
- 57 The AcSB also decided that if an agricultural producer wants to change its accounting policy from using the cost model to the net realizable value model and can demonstrate that net realizable value would provide reliable and more relevant information, it is also be permitted to do so under paragraph 1506.06(b). Such a change in accounting policy is accounted for retrospectively.
- 58 The AcSB acknowledges that there may be circumstances when an agricultural producer has chosen as its accounting policy to measure agricultural inventories using the net realizable value model, but the conditions required to measure agricultural inventories using the net realizable value model are not met (see Conditions for measurement at net realizable value below). In such a circumstance, an agricultural producer accounts for its agricultural inventories using the cost model until the conditions are met and applies the guidance for determining cost (see Determination of cost below). Once the conditions are met, an agricultural producer measures its agricultural inventories using the net realizable value model in accordance with its accounting policy.

Net realizable value

- 59 The AcSB assessed various options for measuring agricultural inventories at current value when conditions are met, including net realizable value and fair value. The Board thinks that net realizable value is well understood by stakeholders as many agricultural producers are currently measuring their biological assets and harvested product of biological assets at net realizable value. Further, net realizable value is an entity-specific value, and therefore provides predictive information for users. Fair value is a market-based measure, and therefore is not as useful for predicting the cash flows and net income of a specific enterprise. Accordingly, the Board proposed, and respondents agreed, that agricultural producers be permitted to measure agricultural inventories at net realizable value when the specified conditions are met.

Conditions for measurement at net realizable value

- 60 The objective of the conditions is to ensure agricultural inventories are measured at net realizable value only when such measurement would provide relevant information to users. In its Exposure Draft, the AcSB sought feedback on the following conditions, contained in FASB's Topic 905, *Agriculture*, for measurement at net realizable value:
 - (a) The product must have a reliable, readily determinable, and realizable market price;
 - (b) The product must have relatively insignificant and predictable costs of disposal; and
 - (c) The product must be available for immediate delivery.
- 61 Regarding condition (a) above, stakeholders agreed that it is important for market prices to be readily determinable for the net realizable value measure to be predictive of future cash flows. Further, when market prices are readily available, net realizable value can typically be determined with less effort than measurement at cost. A market price may be readily available for a product with a specific grade classification. If the price of the product with a different grade class has an observable correlation to the price quoted for the specific grade classification, such product would also be considered to have a readily determinable market price.
- 62 Regarding condition (b) above, stakeholders did not agree that the proposed requirement for costs of disposal to be relatively insignificant would provide more relevant information to users. For example, enterprises that sell agricultural inventories to overseas markets would have more significant costs of disposal. In this case, costs may be reliably measurable and predictable but not relatively insignificant. The AcSB acknowledges that requiring relatively insignificant costs of disposal would limit the extent to which measurement at net realizable value would be permitted for some agricultural inventories even when such information would be relevant to users. The Board notes that this

would be inconsistent with the objective of the conditions, which is to ensure that net realizable value is used to measure agricultural inventories when it would provide users with relevant information. Accordingly, the Board decided that a product's costs of disposal do not need to be insignificant but must be reliably measurable and predictable.

- 63 Regarding condition (c) above, stakeholders said that net realizable value information is primarily relevant when the agricultural inventories can be sold in their current condition. The Board agreed and concluded that this condition is met when there is an active market in which the product can be sold in its present condition, regardless of whether the product will be sold in its present condition. Prior to this point, information about quantities and qualities are not reliable or verifiable, and therefore net realizable value would not provide predictive information about future income and cash flows. However, stakeholders, including members of the Advisory Group, questioned whether the product being available for immediate delivery is the appropriate condition to assess whether assets are ready for sale. For example, some harvested products of biological assets may be subject to additional steps, such as drying, prior to delivery to a customer.
- 64 The AcSB understands that such steps may be undertaken by an agricultural producer to:
- (a) obtain a better price for the product, but are not always mandatory prior to delivery; or
 - (b) bring the product to the condition in which the customer will purchase it.
- 65 The AcSB's intent behind condition (c) is that if there are significant steps that need to be undertaken before the product is available for delivery, the product is not in its location and condition in which it could be sold. The Board understands that there may be instances in which additional activities are undertaken after harvest to complete the agricultural production process of producing a product. An agricultural producer will need to apply judgment in determining whether the product is available for immediate delivery based on the expected activities, and the significance of such activities, that still need to be undertaken before the product can be delivered to the customer.
- 66 Section 3041 includes guidance on determining sources of readily available, reliable and realizable market prices to assist stakeholders with applying the criteria and additional guidance to assist stakeholders in applying judgment to determine whether the product is available for immediate delivery.

Assessing whether the conditions for measurement at net realizable value are met

- 67 When a change in circumstances occurs that results in a change in whether the net realizable value conditions are met, an agricultural producer accounts for such a change in accordance with ACCOUNTING CHANGES, paragraph 1506.08(a). Specifically, paragraph 1506.08(a) addresses such a circumstance, indicating that conditions differing in substance from those previously occurring are not changes in accounting policies. As a result, the AcSB decided that when a change in circumstances causes an agricultural producer to no longer meet the net realizable value conditions, a change to the measurement basis of its agricultural inventories from using the net realizable value model to the cost model would be applied prospectively. If and when the net realizable value conditions are met again, the agricultural producer changes the measurement basis of its agricultural inventories from using the cost model to the net realizable value model in accordance with its accounting policy. For example, a political trade dispute might affect whether there is a readily available, reliable and realizable market price for a specific product, but subsequently the trade dispute gets resolved.

Determination of cost

- 68 Stakeholders have indicated that determining the direct materials associated with agricultural inventories would be relatively straightforward but, for many less sophisticated agricultural producers, the measurement and allocation of indirect costs to the units of production would be onerous. Many stakeholders thought that the cost of preparing this information would not exceed the benefit provided by it, particularly for annual crops.
- 69 These stakeholders specifically noted that the measurement and allocation of direct labour would be onerous for many agricultural producers, particularly owner-managed businesses. For example, the owner and/or family members might be the individuals who carry out the agricultural production activities on several fields of crops and their time is not tracked specifically to each field of crops, or their labour cost may not be measurable if salary is not drawn from the business. As a result, determining the cost of direct labour, and/or identifying a method of allocating direct labour, may be onerous.
- 70 The AcSB observed that a measure of cost that included all direct materials and direct labour, to the extent such costs and an allocation method were readily determinable, would balance the cost of preparing the information with the benefit provided to users.
- 71 Accordingly, the AcSB proposed that agricultural producers should be provided with an accounting policy choice to determine the cost of agricultural inventories using either full cost or only input costs. The Board proposed, and respondents agreed, that input costs should comprise direct materials and direct labour only to the extent direct labour is readily determinable and can be directly related to the items of agricultural inventories produced. For example, labour hired to assist with harvest would be included in input costs.
- 72 In the case of an owner-managed business, if the owner and/or family members' time are not tracked specifically to items of agricultural inventories produced, or their labour costs are not readily determinable, the cost of their labour would be excluded from input costs of agricultural inventories. Users consulted by the Board indicated that while cost is the most

decision-useful measure for agricultural inventories, it was not necessary that the measurement of cost incorporate all elements of cost to be useful. Specifically, users indicated that input costs would provide a reasonable approximation of cost and would be more verifiable than a current value measure based on quantities and qualities that are not yet realizable or observable. Therefore, users were supportive of allowing agricultural producers to determine cost using only input costs.

- 73 The AcSB followed the cost model from Section 3031, in developing Section 3041, allowing agricultural producers the option of full cost. The techniques for the measurement of cost, whether using full cost or only input costs, are also consistent with Section 3031, in that the standard cost method or the retail method may be used for convenience if the results approximate cost. Consistent with the Board's decision to use net realizable value because it is an entity-specific value, the technique for the measurement of cost reflects entity-specific costs and not industry standards. The Board observes that using sources such as published industry estimates of standard costs provides less predictive information about an agricultural producer's operations because the costs are not entity-specific.
- 74 The AcSB notes that while agricultural producers are permitted to make an accounting policy choice to determine the cost of agricultural inventories using only input costs, determining cost using full cost would ultimately provide users with the most decision-useful information. Therefore, to make it easier for an agricultural producer that determines the cost of agricultural inventories using only inputs costs to change its accounting policy to full cost, the Board decided that this accounting policy change may be applied prospectively as defined in ACCOUNTING CHANGES, Section 1506.
- 75 The AcSB also considered whether an agricultural producer should be permitted to change its accounting policy from full cost to only input costs. As noted above, ACCOUNTING CHANGES, paragraph 1506.06, sets out criteria that must be met in order for an enterprise to change its accounting policy, including consideration of whether the change results in the financial statements providing reliable or more relevant information. The Board cannot foresee a scenario when a change from full cost to only input costs would result in reliable or more relevant information about the effects of an agricultural producer's transactions or events. However, stakeholders, including members of the Advisory Group, observed that the Board has decided to provide relief for all agricultural producers who measure agricultural inventories using the cost model. These stakeholders thought an agricultural producer should also not be prevented from changing its accounting policy for determining cost to using only input costs on a retrospective basis if it chooses to do so, and the Board agreed. Accordingly, an enterprise may change its accounting policy for determining the cost of its agricultural inventories from using full cost to using only input costs in accordance with paragraph 1506.09(h).

Consequential amendments to Section 3031

- 76 Prior to the effective date of Section 3041, Section 3031, includes an exemption that allows living animals and plants and the harvested product of biological assets held by agricultural producers to be measured at net realizable value in accordance with well-established practices in the industry, instead of applying the measurement requirements in Section 3031. For annual reporting periods beginning after Section 3041 is effective, living animals and plants and the harvested product of biological assets held by agricultural producers that meet the definition of agricultural inventories will be included in the scope of Section 3041. As discussed above, Section 3041 includes conditions that must be met to measure agricultural inventories at net realizable value. Accordingly, the exemption from Section 3031 that allows living animals and plants and the harvested product of biological assets held by agricultural producers to be measured at net realizable value will no longer be available when Section 3041 is effective.

MEASUREMENT OF PRODUCTIVE BIOLOGICAL ASSETS

Measurement at cost

- 77 As noted above, stakeholders have indicated, and the AcSB agrees, that productive biological assets are akin to property, plant and equipment. Accordingly, the Board proposed, and the majority of respondents agreed, that the accounting treatment for productive biological assets be consistent with the guidance in PROPERTY, PLANT AND EQUIPMENT, Section 3061, and to not provide any specific relief options for determining cost as compared to agricultural inventories. Therefore, such assets will be measured at cost less accumulated amortization.
- 78 The AcSB acknowledges that some stakeholders who currently measure their productive animals at net realizable value continue to have concerns with measuring such assets at cost, noting that there will be additional complexity involved. Further, the Board understands that for many productive animals, current values are widely available and therefore measurement at net realizable value would be less onerous to determine than cost. Some stakeholders also observed that measurement at cost may result in a difference in the measurement of animals born on a farm compared with animals purchased, or similar animals used for different purposes, despite the animals having the same market value.
- 79 However, the AcSB thinks that cost is an appropriate measurement basis for productive biological assets because such assets are held for use in the production process and not intended for sale in the ordinary course of business. Users supported this view, noting that their focus is on the output of productive assets since current value is not relevant information for assets that will not be sold. Users think measuring productive biological assets at current value creates unnecessary volatility in the income statement. Therefore, while many stakeholders hold the view that current value would be simpler to determine for some productive biological assets, ultimately such measurement would not provide users with relevant information.

Amortization

- 80 The AcSB proposed that productive biological assets should be subject to amortization over their useful lives, consistent with the guidance in PROPERTY, PLANT AND EQUIPMENT, Section 3061.
- 81 However, in developing the Exposure Draft, the AcSB also considered stakeholder feedback that the amortization of certain productive biological assets would be too complex, specifically citing concerns regarding assets that are measured and tracked on a group basis (e.g., an orchard or a herd). To address this concern, the guidance in Section 3041 contemplates a scenario when productive biological assets are managed on a collective basis such that the productive capacity of the group does not diminish. In this scenario, an enterprise will not need to amortize the productive biological assets because they are considered to have an indefinite useful life. The Board thinks, and respondents to the Exposure Draft agreed, that this should reduce the complexity of applying the amortization guidance as amortization would not need to be individually tracked for components of productive biological assets (e.g., each animal in a herd).
- 82 When an agricultural producer decides to dispose of a productive biological asset, through either sale or other than by sale, or otherwise ceases to use it in a productive capacity, the asset should be measured at the lower of cost and fair value less costs to sell. This is consistent with the measurement guidance in DISPOSAL OF LONG-LIVED ASSETS AND DISCONTINUED OPERATIONS, Section 3475; however, the productive biological asset will not be classified as held for sale, to simplify the application of Section 3041.

Impairment

- 83 The AcSB proposed that the impairment guidance for agricultural inventories should be similar to the guidance in Section 3031, and stakeholders agreed with this proposal. Therefore, agricultural inventories carried at cost are measured at the lower of cost and net realizable value. For productive biological assets subject to amortization, the impairment guidance in IMPAIRMENT OF LONG-LIVED ASSETS, Section 3063, is applicable. For productive biological assets not subject to amortization, as discussed in paragraph 81 above, Section 3041 includes specific impairment guidance.

CLASSIFICATION AND PRESENTATION

Current assets and liabilities

- 84 CURRENT ASSETS AND CURRENT LIABILITIES, paragraph 1510.03, states the following regarding classification of current assets: "As a balance sheet classification, current assets shall include those assets ordinarily realizable within one year from the date of the balance sheet or within the normal operating cycle, when that is longer than a year."
- 85 The Advisory Group expressed concerns regarding the suitability of the guidance in CURRENT ASSETS AND CURRENT LIABILITIES, Section 1510, for agricultural producers, particularly the use of the term "normal operating cycle". Advisory Group members questioned how this term would be applied by some agricultural producers (e.g., those that have biological assets with growth periods significantly longer than one year). The AcSB thinks that this issue is not unique to the agricultural sector, as there are other sectors that would have assets with normal operating cycles in excess of one year (e.g., aerospace manufacturers). Therefore, the Board decided to not provide additional guidance to agricultural producers regarding the classification of assets as current or long-term beyond what is available in Part II of the Handbook for other private enterprises.

Gains and losses on changes in net realizable value

- 86 Advisory Group members and other stakeholders noted that there is currently significant diversity in practice regarding where gains and losses arising from changes in the net realizable value of agricultural inventories are recorded in the income statement. It was suggested that the AcSB should provide clear guidance in Section 3041 on the presentation of such amounts in order to reduce diversity in this area.
- 87 The AcSB noted that both within Part II of the Handbook and in other frameworks, such as IFRS® Standards and U.S. GAAP, guidance is not provided on the presentation of similar measurement gains and losses. Therefore, including such guidance in Section 3041 would set a precedent. Further, because the lack of guidance on the presentation of gains and losses arising from a change in current value is not unique to agricultural inventories, addressing it would be beyond the scope of Section 3041. Therefore, the Board has decided to not include guidance on the presentation of gains and losses arising from changes in net realizable value of agricultural inventories in Section 3041 and, accordingly, will continue to leave this as an area of professional judgment.

DISCLOSURE

- 88 The objective of the disclosure requirements in Section 3041 is to provide enough information for users to understand the financial statements and be able to make informed inquiries regarding financial statement items or transactions when they require further details. This objective was derived on the premise that disclosure requirements in Part II of the Handbook are developed on the basis that users of private enterprise financial statements can ask for, and generally receive, additional information from the enterprise when needed. The specific objective of the agriculture disclosures is to require an agricultural producer to provide information that enables users to understand the nature of, and the risks associated with, its biological assets and harvested product of biological assets.
- 89 The disclosure requirements in Section 3041 were developed in a manner consistent with the AcSB's process for developing disclosure requirements, which focuses on identifying the information that is useful to users of financial statements and assessing whether the cost of preparing the information would exceed the benefit provided to users. Generally, the disclosure requirements proposed in the Exposure Draft for productive biological assets and agricultural

inventories were consistent with the disclosure requirements in PROPERTY, PLANT AND EQUIPMENT, Section 3061, and Section 3031, respectively. This meant that agricultural producers would not be required to disclose the amount of write-downs, or reversals of write-downs, of agricultural inventories recognized during the period, consistent with Section 3031. Respondents generally supported the Board's proposals regarding disclosure requirements.

Similarly, users consulted as part of the project, which included not only lenders but also creditors and government agency representatives, agreed with the Board's proposals regarding disclosure requirements.

- 90 During the development of the Exposure Draft, some stakeholders, including users and several Advisory Group members, noted that the disclosure of quantities would not be onerous for many agricultural producers, particularly for enterprises with agricultural inventories measured at net realizable value. These stakeholders observed that information regarding quantities would be useful, and the benefit of providing this information would typically outweigh the cost of providing it. Many stakeholders indicated that quantity information was already being provided, and therefore inclusion of quantities as a disclosure requirement would allow agricultural producers to continue their current practice.
- 91 After considering the feedback, the AcSB proposed, and stakeholders agreed, to require an agricultural producer to disclose the quantities of productive biological assets and agricultural inventories when such information is readily determinable. This allows an agricultural producer to disclose quantity information but would not require this disclosure if the cost of doing so would outweigh the benefits the information provided. For example, an agricultural producer with a cattle herd may track and, therefore, have the information available to disclose the quantity of cattle in its herd, whereas an aquaculture producer may not be able to readily determine the number of fish in its pools.

TRANSITION

- 92 In the absence of specific transitional provisions, ACCOUNTING CHANGES, Section 1506, requires amendments to be applied retrospectively, except if impracticable. The AcSB thinks retrospective application of Section 3041 would be useful since it would provide comparable information for the prior period. However, the Board recognizes the challenges of retrospective application, particularly when an agricultural producer changes its measurement basis from net realizable value under its current accounting treatment, to cost when applying the Section. The Board acknowledges that some agricultural producers may not have the historical records necessary to determine cost for agricultural inventories and productive biological assets acquired or developed in prior periods.
- 93 Therefore, the AcSB thinks it is important to provide agricultural producers with relief on transition to Section 3041 for agricultural inventories and productive biological assets measured at cost. Accordingly, the transitional provisions allow agricultural producers to elect to measure agricultural inventories or productive biological assets at the date the Section is first applied using net realizable value as deemed cost. This election may be applied on an asset-by-asset basis.
- 94 The AcSB further acknowledges that some agricultural inventories or productive biological assets may be derecognized, through either sale or disposal, during the fiscal year in which Section 3041 is first applied or during the fiscal year immediately preceding the date at which this Section is first applied. In such cases, the Board notes it could be onerous to determine the effect of applying Section 3041, particularly for those assets held at the beginning of the earliest period presented, only for the assets to be derecognized during either of the periods presented in the first financial statements prepared in accordance with Section 3041. Therefore, the Board is providing relief by not requiring an agricultural producer to make retrospective adjustments for any agricultural inventories or productive biological assets derecognized during the fiscal year in which this Section is first applied or during the fiscal year immediately preceding the date at which this Section is first applied. While this may result in a lack of comparability between the current and comparative periods in the first financial statements prepared in accordance with Section 3041, the Board thinks the cost of applying Section 3041 for the first time should not outweigh the benefit of comparative information provided to users.
- 95 Some agricultural producers that have not previously measured their productive biological assets or agricultural inventories at cost may have the information to determine retrospectively the cost of their assets in accordance with Section 3041. The transitional relief provided to agricultural producers is not mandatory. Therefore, an agricultural producer will have the choice to apply the Section 3041 guidance fully retrospectively if it thinks the benefit of providing full comparative information would outweigh the cost of doing so. Respondents to the Exposure Draft agreed with the AcSB's proposals with regards to transition.

EFFECTIVE DATE

- 96 Respondents to the Exposure Draft agreed with the AcSB's view that the effective date, being fiscal years beginning on or after January 1, 2021, will allow sufficient time for preparers to implement the proposed changes, and to educate users on the guidance. The AcSB acknowledges that this effective date deviates from its usual approach of setting the effective dates for Part II of the Handbook on a two-year cycle. However, the Board thinks it is appropriate to deviate from its usual approach given the relief provided in the transitional provisions, and to provide timely resolution to the diversity faced in the agricultural sector.
- 96A In August 2020 the AcSB deferred the effective date of this standard by one year to alleviate pressure for stakeholders as they navigate challenges and uncertainty created by the COVID-19 pandemic. The standard is now effective for annual financial statements beginning on or after January 1, 2022. Earlier application is permitted and therefore, the deferral of the effective date does not prohibit stakeholders from applying the standard in an earlier fiscal year.

CONSEQUENTIAL AMENDMENTS

- 97 The changes introduced by Section 3041 will have an effect on other Sections. The AcSB decided to clarify that these consequential amendments are applied when Section 3041 is applied, and notes that the amendments should be applied using the same transitional provisions as Section 3041. The rationale for some of the more significant amendments are described throughout the Basis of Conclusions, as well as below.
- FIRST-TIME ADOPTION, Section 1500, and FIRST-TIME ADOPTION BY NOT-FOR-PROFIT ORGANIZATIONS, Section 1501 in Part III**
- 98 The AcSB decided to allow a first-time adopter to measure agricultural inventories and productive biological assets using net realizable value at the date of transition as deemed cost. Without such a provision in Sections 1500 and 1501, first-time adopters would be required to apply Section 3041 retrospectively without any relief, which may be difficult for an agricultural producer that does not have the historical records to determine the cost of its agricultural inventories and productive biological assets.

EXPOSURE FOR COMMENT

- 99 After resolving the issues arising from the exposure draft process, the AcSB considered, as part of its due process, whether the revisions to the proposals should be exposed for comment.
- 100 The revisions have been highlighted in the relevant sections throughout the Basis for Conclusions. These revisions consist of changes and clarifications to reduce complexity, based on feedback received from stakeholders. Other than the changes and clarifications already highlighted in the Basis for Conclusions, only minor drafting changes were made. Therefore, the AcSB decided that there was no need for re-exposure.
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Footnotes

1. These figures include business activity conducted by both public and private enterprises. However, the AcSB understands that the majority of agricultural producers in Canada are privately held.

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