

8. A discussion on the 'farm audit' proposal in the Mid Term Review of the CAP

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8.1 Introduction

The European Commission's Mid Term Review (MTR) of the CAP's Agenda 2000 proposes to introduce farm audits. As PACIOLI is an expert group, resulting from a former EU concerted action, with experts in farm accounting, FADN, Information Systems and micro economic policy analysis, it was seen as appropriate to use some of the time in the workshop PACIOLI X (early December 2002 in Italy) to discuss this proposal. We first describe the proposal in the MTR and then report the main remarks from the discussion with experts. These remarks have been elaborated afterwards by the reporting author.

8.2 Proposal

The MTR is presented by the Commission as a step 'towards a policy that pleases everybody'. It notices that consumer confidence in food and agriculture is (partly) lost. Transparency of on-farm processes will help to restore consumer confidence. To make cross-compliance of CAP payments with required standards trustworthy.

In a speech (11 July 2002 at the 13th congress of international farm management at Wageningen) mr. Fischler mentioned two purposes of such a farm audit:

- to help farmers meeting required standards of modern agriculture;
- win back the trust of consumers.

8.3 Issues from the discussion

The topics raised in the open discussion at the workshop focussed on three main issues:

- the feasibility of a farm audit;
- the effects of a farm audit;
- the effect for the FADN.

We take these one by one.

The feasibility of a farm audit

- First of all it is not so clear from the MTR what has to be audited:
 - that there has been no fraud in requesting and spending the payments (compare audits on the paying agencies or the European Social Fund);

- that the cross compliance obligations have been fulfilled ?
- that the farm works conform the good agricultural practice protocol ?
- ISO 14000 on environmental impact?
- Corporate Social Responsibility (people / profit / planet?)

It seems logic not to start with the last two options that are for the moment more theoretical. But a choice seems necessary between contractual cross compliance issues and good agricultural practice on the farm in total. The second seems necessary from the point of view of transparency.

- Is it technically possible to audit a farm? For larger farms (like in the candidate countries), who have often their own farm-based bookkeeper, it seems to be possible (at least in the classical sense of an audit on the accounts). The literature has doubts on small farms with collusion problems, without a good administrative system in which tasks are separated. However in farms integrated in the market economy this is less and less a problem. In the Netherlands in the early nineties a big project was carried out to investigate the auditability of small family farms for their mineral accounts. The conclusion was that it was possible and farms were obliged to have an audit of their financial and mineral accounts integrated.
- It is unclear from the MTR proposal who should do the auditing. There is a free, specialised market for audits with financial accountants and companies as SGS and (in Germany) DLG providing these services. In compliance audits for organic farming and Eurep-Gap the latter type of organisations does the work. Financial accountants can be of interest if financial flows have to be checked. It could be a big market, and it is not so attractive to have it done by government agencies (need quite some staff, not in line with more responsibility for the sector/food chains; costs are nearly automatically for the government instead of the sector).
- A system of inspection upon inspection could be useful, where the private sector does the first level of audits (auditing the farms) and a government agency checks the auditors. From the Netherlands however it was reported that this asks for a certain mind set with the government agencies. This system was proposed in the Dutch mineral accounting system with the aim to keep costs low (the mineral and financial accounts could then be integrated and audited at one time, also leading to better checks) and to have them paid by the farmers. In practice however the government agency involved did not use the audit statements (that then became an unnecessary burden) and had the work done by its own staff (becoming bigger and bigger). They also started to use other (earlier) deadlines the tax offices, which increased costs for farm accountants as they had to turn to their files twice.
- It is unclear what the cost could be. If this is rather high the proposal will certainly be seen more as an administrative burden than as a support to help farmers meeting future standards. In the Netherlands quite some research work is carried out to see in how far the administrative burden can be decreased, also by putting 'the farmer and his data central' instead of at periphery of data-chains that have different data definitions for every product chain and government regulation. In Denmark the administrative burden is also seen as an important issue.

The effects of a farm audit

- In advance the effects are not so clear. For large central European farms an advantage could be that the on-farm bookkeeper gets professional support. In a Czech project on creating the FADN it became clear that some farms (and the FADN) had quality problems with their bookkeepers. Good ones left for the scarce labour market in Prague. Farm managers came from a production background and found it problematic to advice these specialist employees. So an audit could help.
- It is not so clear how an audit as such could help transparency, unless something is published or available on demand.
- A farm audit looks a logical next step: in the sixties Commissioner Mansholt introduced obliged farm accounting as a 'cross compliance' measure in investment plans. A modern farmer should have accounts, otherwise he was not worth the credit. That idea met resistance too, but was maintained. Against that background it is not so strange that Commissioner Fischler now introduces farm audits for modern farms.
- Strange enough no literature is known to the experts in which the effects of obliged accounts have been evaluated. References on the use of accounting systems and accounting software exists, with a big debate in how far (obliged) systems make better farmers.
- Costs of an audit are smaller (per unit of production) on larger farms, so there is a size effect.

The effect for the FADN

The FADN benefited in the past from the obliged farm accounting. How about the farm audit idea?

- It can lead to an additional database that can be used as an administrative input for FADN (compare databases on cattle movements or IACS).
- It could lead to additional databases that can perhaps replace RICA/FADN, especially if not only data on subsidies and cropping patterns are gathered, but also some data on yield and farm family income. Note however that companies like SGS very often not build up database systems as they are afraid to be obliged to hand over individual data to the government (tax).
- The FADN itself could report if a farm is or has been audited and with which result (e.g. '2 minor mistakes').

Overall conclusion: a very interesting proposal that is in line with modernisation of farming. However quite some questions remain on the content of the proposal and its technical and political feasibility. In any case it could make sense to start a project with further discussion and experimentation on the farm audit option.

9. Environmental accounting in Italian farming: a stepwise approach towards the Total Economic Value

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Abstract

The paper presents a step-wise enterprise approach to environmental accounting in agriculture. It starts with conventional balance sheets: income statement - profit and loss of four agricultural enterprises following usual accounting principles. A second step separates environmental/recreational activities from conventional ones, i.e. agricultural products and timber, from recreational services. A third step outlines near market values, as perceived by the entrepreneurs that is private values - hidden assets and liabilities. A fourth step opens up to public goods/bad and externalities making possible a quantification of welfare variation - public effects. This last step aims at incorporating non-market benefits and costs, or, at least, providing a framework for their incorporation, as far as they can be shown in monetary terms, or other means. Satellite accounts and addenda including physical/biological aspects can therefore be used. The methodology, though enlarged to environmental/social issues, remains strictly based on accounting principles. It has to be clear that the model is linked to specific aims: management and, above all, local public policy. In fact economic value does not exist in the 'abstract', it must be related to practical clear stated objectives, otherwise it is just mere growing of data.

Keywords: Environmental accounting, Stepwise procedure, Farming

9.1 Introduction

This paper illustrates a stepwise procedure for environmental accounting in agriculture. Traditional accounting principles are maintained throughout the various steps of the proce-

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depletion allowing, however, to take into account environmental effects - public goods and bads as well externalities¹ linked to farming.

The environment is conceived *latu sensu* including physical aspects (e.g. soil and water), nature and landscape recreation.

The scope of the paper is to provide a viable procedure useful to both private entrepreneurs and public decision-makers. The various steps mark the passage from private to public interests and the related objective functions from the traditional net income to an environmentally adjusted net income a proxy of people welfare.

Recent developments of environmental accounting at national level are outlined, stressing how a true environmental accounting needs local farms references. It is therefore proposed a stepwise procedure starting with traditional accounting (balance sheet and income statement) integrated step by step with the consideration of public goods/bads and externalities. Specific, real world examples of accounting are also reported. It is therefore tested how the proposed methodology is able to encompass various goods and bads as well externalities linked to farming.

9.2 From macro (national) to micro (enterprise) environmental accounting

Environmental accounting has been developed since the 60s - 70s at national level to answer growing worry about the state of the environment and the exhaustion/depletion of natural resources. Nordhaus e Tobin (1972) proposed to calculate the so called Net Economic Welfare, adjusting the national income according to the state of natural resources. Consumption of natural capital and environmental stewardship costs should have been taken into consideration (Lutz, 1993). Guidelines to adjust national accounts have been therefore provided (United Nations, 1968). A support towards environmental accounting, as a tool to verify sustainable management of natural resource, has been provided by Brundtland Committee (1987) and the Rio Summit (1992). More environmentally aimed approaches have been therefore proposed (Peskin and Lutz, 1993). The manual for national accounts produced by the United Nations (System of National Account - SNA, 1993) has been particularly significant and accepted by the European Union: European System of National and Regional Accounts - ESA (EUROSTAT, 1995).

The reference to conventional enterprise accounting

Environmental accounting carries on two features and needs (to a large extent ignored up to now by national accounts): from one side making reference to local (enterprise) level, from the other, consequently, the adoption of traditional enterprise accounting. Incidentally this approach was regarded as unavoidable by Daly (1988), supporting Fisher's old national dividend in opposition to Keynes calculation of national income. He states: 'had the national accounts developed in accordance with Fisher's concepts, their extension to cover environmental services and ecological and geological capital depletion would have been

¹ Public goods (bad) are supposed to be external effects of which the manager is aware and willing to provide, meanwhile externalities are unintended.