

August 29, 2003**FEFO 03-16****RECOGNIZING INCOME AND BUDGETING FOR COUNTER CYCLICAL
PAYMENTS**

The counter cyclical (CC) program authorized under the 2002 Farm Bill can make payments for a program year across two calendar years. For example, payments for the 2003 program year can occur in 2003 and 2004. Many farmers prepare financial statements at the end of the year. At year-end 2003, income from the 2003 program year that will be received in 2004 should be recognized on the 2003 income statement, thereby causing a matching of revenue to expenses. At year-end 2003, however, the amount of CC payments that will occur in 2004 will not be known. Not knowing the amount of future CC payments presents difficult in 1) determining how much revenue to recognize on the 2003 income statement and 2) determining the amount of CC payments to include on 2004 cash flow budgets. This newsletter addresses these two issues. Before discussing these issues, the mechanics and timing of CC payments are described because they have direct impacts on revenue recognition and cash flow budgeting.

Mechanics of CC Payments

CC payments for a crop occur when the market year average (MYA) farm price for the United States is below a trigger price. For 2002 and 2003, trigger prices are \$2.32 for corn, \$5.36 for soybeans, and \$3.34 for wheat. When the MYA price is below the trigger price, the per bushel CC payment equals the trigger price minus the higher of the MYA price or the loan rate. For example, a CC payment for corn occurs when the MYA price is below the \$2.32 trigger price. If the MYA price is \$2.20, which is above the \$1.98 loan rate, the per bushel CC payment equals \$.12 per bushel (\$2.32 trigger price - \$2.20 MYA price). If the MYA price is \$1.90, which is below the \$1.98 loan rate, the per bushel CC payment equals \$.34 per bushel (\$2.32 trigger price - \$1.98 loan rate). There is a cap on CC payments because the higher of the MYA price or the loan rate is used in calculating the payments (see Table 1). For 2002 and 2003, caps are \$.34 for corn, \$.36 for soybeans, and \$.54 for wheat. For 2004 through 2007, caps are \$.40 for corn, \$.36 for soybeans, and \$.65 for wheat.

Timing of CC Payments

CC payments for the 2003 program year are based on the 2003-2004 MYA prices. For corn and soybeans, MYA prices are determined during the months from September, 2003 through August, 2004. This means that the per bushel rate for determining the 2003 CC payment will not be known with certainty until some time after August, 2004. For wheat, the 2003-2004 MYA price

Table 1. Per Bushel Target Prices, Loan Rates, and Maximum Counter Cyclical Payments, 2002-2003.

	Corn	Soybeans	Wheat
	----- \$ per bu. -----		
Target price ¹	\$2.60	\$5.80	\$3.86
Direct payment rate	<u>0.28</u>	<u>0.44</u>	<u>0.52</u>
Trigger price ²	2.32	5.36	3.34
Loan rate ³	1.98	5.00	2.80
Max. counter cyclical payment ^{4,5}	0.34	0.36	0.54

¹ Target prices in 2003 through 2007 are \$2.63 for corn, \$5.80 for soybeans and \$3.92 for wheat.

² Trigger prices equal target prices minus direct payment rates.

³ In 2004 through 2007, national loan rates are \$1.95 for corn, \$5.00 for soybeans, and \$2.75 for wheat

⁴ In 2004 through 2007, maximum counter-cyclical payments are \$.40 for corn, \$.36 for soybeans, and \$.65 for wheat.

⁵ Counter cyclical payments equal the trigger price minus the higher of loan rates or season average prices. Counter cyclical payments can not be less than \$0.

is determined during the months from June, 2003 through May, 2004. This means that per bushel CC payment for 2003 will not be known for certain until sometime after May, 2004.

Farmers can elect to receive advance payments before the actual CC payment is known. For corn and soybeans, advance payments may occur in October during year of harvest and February in the following calendar year. The final payment, if any, is made in the fall following harvest. The 2003 CC payments for corn and soybeans may occur in October, 2003, February, 2004, and in the fall of 2004. Since MYA prices are not known for certain in October, 2003 and February, 2004, the U.S. Department of Agriculture (U.S.D.A.) estimates MYA prices when determining advanced CC payments. Advance CC payments in October will equal 35 percent of projected CC payments. The February payment plus the October payment will not exceed 70 percent of the projected CC payment.

For example, suppose the U.S.D.A. uses a \$2.12 projected MYA price to determine the advanced October, 2003 payment for corn. The \$2.12 projected price means that the projected CC payment is \$.20 (\$2.32 trigger price - \$2.12 projected season average price). The advance CC payment in October equals 35 percent of the \$.20 projected payment, or \$.07 per bushel. Expected prices could change between October and February. If U.S.D.A. uses a \$2.02 MYA price to project CC payments for the February payment, the projected CC payment is \$.30. Seventy percent of this projected payment is \$.21 per bushel. The February payment will be \$.14

per bushel (\$.21 - \$.07 received in October) if the U.S.D.A. decides to pay 70 percent of total projected payments.

2002 CC payments

Producers have not received advanced CC payments for 2002 corn, soybeans, and wheat programs because MYA prices have been projected above trigger prices. As of this writing, final 2002 CC payments have not been estimated. Soybeans and wheat will not have CC payments. There is a possibility that corn could have a small 2002 CC payment of \$.01 to \$.02 per bushel.

Outlook for 2003 CC payments

Considerable uncertainty exists concerning the level of 2003 CC payments. As of August, 2003, midpoints of U.S.D.A. projected range of MYA prices are \$2.20 for corn, \$5.05 for soybeans, and \$3.40 for wheat. If these MYA prices are realized, per bushel CC payments in 2003 will be \$.12 for corn (\$2.32 - \$2.20), \$.31 for soybeans (\$5.36 - \$5.05), and \$.00 for wheat. However, the ranges projected by U.S.D.A are quite large. Moreover, U.S.D.A. will change projections throughout the marketing year. Currently, MYA prices at the low end of the range would result in the maximum CC payment and MYA prices at the high end would result in no CC payment.

To aid in determining the size of CC payments, a *Counter Cyclical Payment Tool* has been developed and placed on *farmdoc* (see <http://www.farmdoc.uiuc.edu/marketing/CounterCyclical/CCP.html>). At the bottom of the sheet, two lines provide projections of CC payments through the marketing year. The first is labeled “Projected CCP based on USDA projected average price” and provides good estimates during the first part of the marketing year. As the marketing year progresses and more monthly prices are obtained, the second projection labeled “Projected CCP based on estimated average price to date” provides good CC estimates later in the marketing year.

Income Recognition

The *Counter Cyclical Payment Tool* can be used to estimate CC payments when preparing year-end financial statements. This estimation is illustrated for a farmer preparing a 2003 income statement and 2003 year-end balance sheet. Suppose the *Counter Cyclical Payment Tool* indicates that a reasonable estimate of the 2003 CC payment for corn is \$.07. Some of this \$.07 may have already been received in an advanced payment in October 2003. If the October payment is \$.02, the farmer can expect to receive \$.05 for the 2003 program year in 2004. The estimated \$.05 per bushel times the base CC bushels will be shown as a receivable on the balance sheet. It would also be shown as revenue on the income statement. For many farmers who prepare “cash-based accrual-adjusted” statements, revenue recognition for CC payments will occur through an accruing adjustment that shows the difference between account receivables at the beginning and end of the year.

Cash Flow Budgeting

Many farmers will prepare cash flow budgets for the 2004 crop year during the winter of 2003. At this point, cash flow estimated for CC payments for the 2003 and 2004 program years need to be made to include on the 2004 cash flow budget.



The 2003 payments can be estimated using the *Counter Cyclical Payment Tool*. Suppose that this tool projects the corn CC payment at \$.10 per bushel and a \$.02 advanced payment has been made in October, 2003. This means that a good projection of payments in 2004 is \$.08 per bushel. Dividing this \$.08 equally between the February and fall payments is a reasonable procedure.

For corn and soybeans, there also could be an advanced payment for the 2004 program year that will be made in October, 2004. The *Counter Cyclical Payment Tool* will not provide an estimate of CC payments for the 2004 crop at the beginning of 2003 when the cash flow budget is being prepared.

The range of the advanced 2004 CC payment, however, is known. The maximum 2004 CC payment is \$.40 for corn and \$.36 for soybeans (note changes in target prices and loan rates (see Table 1)). If CC payments are projected at the maximum, the October, 2004 payment for corn will be \$.14 (\$.40 maximum x 35 percent) and \$.13 for soybeans (\$.36 for soybeans). Hence, ranges of advanced payments are from \$0 to \$.14 for corn and \$0 to \$.13 for soybeans.

The appropriate end of the range depends on new crop prices used in the projections. If new crop prices are below loan rates, CC payments at the higher end of the range are appropriate. If new crop prices are near trigger prices, CC payments near zero are appropriate.

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