

Capitalization of Costs in livestock operations: a need in search of the truth and a step closer to the adoption of NIC 41¹.

Written by: **Lic. Gerardo Mendoza Delgado** (Esp., MSc.)

Director of Agroinformática C.A. - Venezuela since 1994

Farm taxes and ag. accounting firm

Professor of agricultural accounting

Táchira Catholic University since 1999

Producer of Milk and Buffalo Meat

gerardo.mendoza@agroinformatica.com.ve

gmendoza@ucat.edu.ve

gerar.mendoza@gmail.com

*Article prepared for the Business Management Blog for
The Deusto University in San Sebastian, Spain*

The accounting in cattle businesses, wherein the product to be sold lives a physiologic period of time from its birth up until its sale of over a year, should capitalize the financial burden for its operation through the absorption costing method. In other words, allotting all indirect and direct expenditures related to the livestock operation to biological assets in stock, based on the equivalent in weight of the biomass and the natural phases of growth: pre-natal, rearing, raising and fattening².

The methodological dissociations that exist in this regard, wherein the discretionary nature of fiscal officials and the accounting professional's creativity opens an unintelligible as well as dangerous gap, with one side as the accuracy of the information and the other as the technical feasibility for its attainment. If these opposite sides are not able to come together, it is very difficult to obtain sensible results that would be useful for decision making purposes, administrative tracking systems and the calculation of a reliable taxable base.

The reasons that support this accounting policy can be summarized basically in 3 premises. The first one is the long life of the product in process, which goes beyond one

¹ Spanish acronym for the International Norm for Agricultural Accounting.

² See methodology in book published by the author of this article: CONTABILIDAD PECUARIA y COSTOS GANADEROS. First edition, Sin limite Book Store, Mérida Venezuela. 2007.
www.agroinformatica.com.ve

year in the ranch, amount of time that can reach up to 3 years in the case of male animals or 8 to 12 years in the case of females in production. This makes it impossible to apply the traditional accounting principle of association of income and expenditures. The second reason refers to the need of a reliable result, which should be not only sensible but also real, in order to guarantee a healthy financial management based on accounting records (and not only in the cash flow), useful information to measure competitiveness and a financial analysis for a transparent relationship with the business' funds providers. Lastly, to guarantee an objective result for a just taxation.

In those countries wherein the production cycles for cattle go beyond a financial year, the capitalization of costs in biological assets is essential. This is not true for minor species, or for livestock businesses in which the process is barely a year, for example the intensive livestock production of Argentinean beef, the intensive livestock production of North American beef, the cow-calf³ production centers or any other operation wherein a precocity in life cycles of the cattle for sale has been achieved genetically.

The difference in the accounting book values for biological assets in production units wherein the capitalization of cost method is applied and those that do not apply it is significant. The differences are accumulated over the years and the accounting information reveals more truths about the business itself, taking into account that the differences in value for assets with capitalized costs produce deferred earnings for the business within the first few years, and these should be analyzed as long term assets and not as inventory. In this case, the NIC 41 represents a risk because it distorts the accounting and tax information creating results that would cause the payment of direct taxes in advance or in excess, if the ranch is a tax payer.

Therefore, both ends of the spectrum in the livestock accounting can be brought together and attain a more sincere scene through the use of accounting records that would inspire trustworthiness in agricultural sectors worldwide that are considering adopting the NIC 41 in order to enjoy the advantages of the “*fair value*” and to achieve the objective of the NIIF: equal status for financial statements around the world and countable harmonization once and for all.

What do you think?

May 27th, 2008
ESTE, Deusto University
San Sebastian
Spain.

³ Cow-calf: Productive cycles where the animal born is sold before it is weaned.