Shortcomings of accounting legislation to the needs of the agricultural sector due to its specifics

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Abstract: Agriculture is a very specific area, whose specifics are reflected in the accounting and in the related economic assessment of companies. Czech accounting legislation in its current form does not provide a necessary perspective on the various fields due to their specificity as in the case of the International Financial Reporting Standards (IFRS) and the GAAP. It is reflected in the financial analysis. The IFRS include one standard dedicated only to agriculture and its specifics, IAS 41 Agriculture.

The main problems were found at the level of making calculations, including the animal (to the accounts of fixed assets or inventory), valuation pups or measurement of crop production. This leads to different values in the financial statements of the entities that do not provide a sufficiently fair view of the accounting, and are incomparable both between companies and in time.

In this article the specifics of agriculture, generally applicable legislation in the Czech Republic, its confrontation with IAS 41 are discussed. There are used own processed documents and publications especially from The University of Economics, Prague. The aim is partly to handle the change of Czech accounting legislation, which would lead to the unification of the manner of reporting, enhance the comparability and presentation of the financial statements in the financial analysis of various economic entities from agricultural sector. As supplementary material, the Czech accounting legislation will be confronted with the methods used in countries with the accounting system GAAP.

Key words: Agriculture · Specifics · Accounting standard · Biological assets · Financial statement

JEL Classification: M41 · Q14 · C35

1 Introduction

The Czech accounting legislation deals with general principles and accounting problems which are identical for all branches of the economic activity. Due to the specifics of the farm accounting encounters to irregularities or law unresolved facts that could lead to a distortion of true and fair view of accounting, which is a fundamental principle not only in the Czech Republic. The introduction of a new accounting standard for Czech agriculture would therefore be useful. International financial reporting standards are devoted to specific disciplines in greater detail. For agriculture there is a separate standard IAS 41-Agriculture.

The aim of this paper is to compare Czech and international accounting legislation with needs of practice and to suggest possible extensions of the Czech accounting legislation, which would help farms with accounting. This extension would also lead to the unification of reporting problematic facts and to increase the presentation of the financial statements and more faithful picture of an economic situation of farms.

2 Methods

The Czech accounting legislation and regulations on international accounting standards were used as the main data source. Articles and publications, related to accounting in agriculture mainly by authors Kouřilová, D. Dvořáková, Kopta, Drábková, Pšenčík, Valder, were other sources of information. The article belongs to a theoretical research in the current phase. The main used methods include: analysis of evidence on the issue, the comparison of the Czech accounting system and international accounting standards and the proposal of possible measures that would increase comparability and could reduce distortion of the financial statements of farms.

3 Research results

3.1 Deficiencies in the Czech legislation

During analysing the current legislation and the practical needs several problems were identified that lead to confusion or distortion of financial statements. The main problems include calculations, including the animal in the financial category, valuation of pups and crop production.
Valuation

Methods of valuation of assets are regulated by Decree no. 500/2002 Coll.. There are different methods of valuation in accordance with the method of charging fixed asset. The fixed assets acquired by purchase are valuated at the purchase price, the assets produced internally are valuated at their own costs and the fixed assets acquired free of charge at replacement cost. The situation is similar for stocks. All awards are therefore based on historical prices. Legislation does not pay any attention to the specifics of animals and plants. According to the Czech legislation there is possible to use valuation at replacement cost by the valuation of animals born in own breeding, if it is not possible to determine its own costs incurred in the new-born animal.

The acquisition price may not answer the value of the animal after some time. The problem occurs mainly by individuals who gain the value in the course of life or have valuable genetic traits. The depreciation by these animals also does not make sense. This depreciation reduces their value. (Kouřilová & Drábková, 2009 II)

Agricultural land is valued as well as other fixed assets in our conditions at cost and carried at historical valuations. It is not revaluated at current (market) value, as is the case in accordance with international accounting standards. The quality of land does not affect its value. Land is valued by the locality where the land is situated. High quality soil can have a much lower value than land nearly unusable for agriculture. This leads to distortion of the value of the assets of company. (Valder)

Subsidy

Subsidies for the acquisition of assets affect the amount of the award. The value of assets acquired through subsidies is reduced by their amount. The asset is therefore maintained at a lower value in the accounting. This will also reduce depreciation of the asset and increase the profit. The actual value of the asset can be read in off balance sheet accounts. But they are not a part of the published information. This method of accounting reduces the fidelity of company assets. (Kouřilová & Pšencík & Copt, 2009)

"From a tax perspective, however, there is an obvious reason to reducing the value of the asset purchased for the subsidies. There would be a deduction of depreciation from the subsidies provided by the state. "(K. Dvořáková, 2014)

Inclusion of animal, classification

In fixed assets may be included animals whose usage period is longer than one year and whose value is greater than the threshold set by the entity. Previously, there was the only condition for the inclusion into fixed assets and it was the breeding period of the animal. Cattles, pigs, horses, sheep, goats, donkeys, geese and mules had to be kept in fixed assets. To enable small animals to be included in the fixed assets, the entity must set a low threshold for inclusion or keep animals as a herd (flock). (Dvořáková D., 2012)

But another problem comes with keeping animals as a herd. If the valuation of the animals is at the lower limit of the classification and valuation will be reduced due to the death of an individual, what to do in this case? The animal should be replaced as soon as by the entity, in order to increase the value, or animals must be converted to the inventory account. (Kouřilová & Drábková 2009, I)

The possibility of setting your own limits does not only lead to discrepancies between enterprises, but also can distort the true and fair view of the assets of the company.

Animals in fattening and all young animals are included in current assets (inventories). There are also adult animals included in fixed assets due to a lower valuation than the set limit. These animals may be breeding for longer than 1 year.

Calculations in livestock production

Awards at the costs can be made according to the final or preliminary calculations. Calculation formula is chosen by each entity itself. This can lead in inconsistencies between different companies. The main problem is the determination of the cost of the animal. Newly born animals and additions (weight gain in young animals) are value by using calculations. For newly born animals it is very difficult to determine the proportion of costs on a new-born animal. Besides the baby there is a new production of milk, a manure or a slurry. All costs must therefore be split between these items. Determination of the percentage ratio is also problematic. This leads to the fact that the valuation of new-born animal in livestock production often has a low explanatory power. Since it is difficult to separate the costs incurred for the baby and mother the valuation at the replacement cost is often used. But even the determination of the replacement cost is not without problems. The sale is usually carried out after weaning, so the market price for a new-born animal does not exist. Thus, it is adjusted the price of the baby after weaning. (Kouřilová & Drábková 2009, I)
Calculation formula contains many items and it is not always easy to determine the amount of the costs attributable to the animal.

**Classification of assets in plant production**

In the long-term assets under Perennial crops are posted only fruit trees and shrubs on a certain area, and permanent vegetation vineyards and hop gardens without bearing structures. Of course, the period of use must be taken into account.

The problem with plant assets is a discrepancy between the calendar and the marketing year. Many farms in the Czech Republic does not use the possibility to set an accounting period as the marketing year, although it would be more appropriate in many cases. (Dvořáková D., 2012)

Purchased permanent crop is valued at the purchase price. Permanent crop planted by entity is valued at own cost. The value of the valuation increases by costs incurred in growing the crop until fertility. Permanent vegetation is depreciated after the period of fertility and other following associated costs are accounted in costs of that period. If an entity acquires vegetation by land acquisition, the purchase amount must be divided between land and permanent crops. Depreciation is similar to other long-term assets and is determined according to the expected useful life of the stand.

Accounting treatment of the forests is very specific. The forest itself is not recorded in the accounts on the assets side separately. If the forest is acquired by purchase, it is recorded in the price of land, if the entity for out the forest itself, costs go up in consumption in the current period and the forest is not registered at all. Newy there is the obligation to disclose the information about forests, if an entity owns, has the right or competence to manage 10 ha of forest land in the notes to the financial statements. (Dvořáková D., 2012)

**Calculation of crop production**

The calculation is used by valuing of crop production as well as of livestock production. Direct production costs and a portion of production overheads are include into the value. The problem with the calculation of costs crop production occurs in the associated production when determining the cost to the individual types of output.

The main problem with the calculation of own costs of crop production is the cost of fertilizer, particularly by fertilizing with organic fertilizers. The problem arises already by the evaluation of these fertilizers, which is subject of the calculation in livestock production. Another problem is the fact that not only the current crops but the whole crop rotation is fertilized. (Dvořáková D., 2012)

**3.2 Approach to the problem of agriculture in the context of international accounting standards**

The international accounting standard IAS 41 – Agriculture solves some of the above problems. The subject of the IAS 41 are biological assets and agricultural produce at the point of harvest and state subsidies provided in connection with agricultural activities.

**Valuation**

Except the definitions of basic terms there is provided information that the biological assets are measured at fair value reduced by estimated costs to sell in the time at recognizing assets and each balance sheet date. The same is the award of agricultural production at the point of harvest, which represents the cost of acquisition, for example, for the application of IAS 2 - Inventories. (IAS 41 - Agriculture)

Standard sets out exactly how to determine fair value under many different conditions. By valuation at fair value the valuation of property can be not only reduced but also increased, in Czech conditions it is not possible. Conditions for the valuation at the fair value are consolidated by IFRS 13- Valuation at fair value since 2013. Biological assets measured at fair value must be required to revalue each balance sheet date, they are not depreciated and there is no need to test them for impairment. (IFRS 13 - Fair Value Measurement)

Unfortunately, the land used for agriculture or intangible assets linked to agriculture such as preferential limits or quotas are not subjects of the IAS 41.

The combined assets are also distinguished in international accounting standards when the biological asset is associated with land and the fair value of the biological asset is not separately determined in the market. The firm may use a combined valuation of assets for their valuation, which is reduced by the fair value of the land and the value of land improvements. (Dvořáková D., 2012)
Biological assets can be valued at historical cost but only when a small part biological transformation was carried out since the valuation of biological assets at historical prices or the impact of this transformation on price is not significant. This can be used only if the price determined by the market for a particular asset is not available and determination of the fair value by estimation is unreliable. The asset is then valued at costs reduced by accumulated amortization and impairment losses. If the fair value of the asset exists in future, the asset is revalued at the fair value and kept at fair value until its disposal. The transition from fair value to the valuation at the costs is impossible. (IAS 41 - Agriculture)

Subsidies

The IAS 41 also deals with subsidies for the acquisition of biological assets, which are valued at fair value. The international accounting standards distinguish two kinds of subsidies provided to agriculture - conditional and unconditional. An unconditional subsidy is recognized as revenue at the time of admission. The conditional subsidy is recognized as revenue after the fulfilment of certain conditions. (IAS 41 - Agriculture)

Classification

This standard sets out what a biological asset is. These are animals or plants that are the subjects or the means of agricultural activity of the company. For their reporting the same conditions as for other assets are set, as such that the company controls the asset (there is no need to own it), that the future economic benefits associated with the asset will flow to the company and that asset can be measured reliably. These terms are defined in the Framework.

Advantages and disadvantages

Historical prices – their advantage is the robustness, relatively easy feasibility and also reduction of the possibility of subjective affecting of the valuation. The disadvantage is the link to the past, when the valuation of an asset may not answer the real value for some time. For many assets occurs evaluation conversely.

Fair value - the biggest disadvantage of appreciation in fair value is the ability to influence the reported values. Market prices are often volatile and may be seasonal in nature. Market prices of biological assets and agricultural products are affected by the subsidy policy of the state.

The mandatory disclosures should partially reduce the impact of the disadvantages of appreciation in fair value. It must include methods of determining the fair value of each group of biological assets and agricultural production. Causes of changes in the carrying amount of assets must be reported in disclosures. These information must be divided into profit or loss resulting from the change in fair, into changes resulting from the sale or acquisition, into increasing as a result of the business combination and income and expenses incurred due to unfavourable climatic conditions, disease states and others natural factors.

For assets measured at the costs basis, there must be disclosed further information. To the main information belong the description of the biological assets; the explanation why the fair value is not used; the description of the methods of depreciation.

The posting of subsidies to income does not affect the fair value of the acquired biological assets. The real value is not distorted.

3.3 The comparison and the recommendations for the Czech practice

The distribution to mature and immature, to the consumable and fruiting cannot be found in the Czech concept. The scope of obligatory disclosures in our conditions is minimal. The information obligatory disclosed in accordance with IAS 41 are not even detectable from Czech accounting system. It is easier to determine the financial situation of the company from the information disclosed in accordance with international accounting standards.

There is a big difference in the valuation. In terms of Czech legislation the valuation is based on historical cost. Purchased assets are valued at purchasing price, the own production assets at the amount of the incurred costs. In some situations, it is possible to use valuation at the replacement cost. In contrast, the International Accounting Standards require the valuation at fair value and the revaluation to each balance sheet date. The valuation at fair value more reflects the true value of the asset and thus it is more consistent with the principle of true and fair view of reality. On the other hand there is the problem with her findings and relevance the fair value. There is also a greater risk
of affecting the value of the awards. The problem with finding and conclusive evidence also occurs in the calculations, which are used for measurements in both animal and crop production in the Czech Republic.

The posting of subsidies received for acquisition of fixed asset is recognized as income according to international accounting standards, it does not diminish the value of the asset. There is no distortion of its value and thus it gives a truer picture of the company's assets. Implementation of the same posting to the Czech accounting practice could be conditioned on depreciation treatments. The depreciation of assets acquired through grants should not be posted as costs.

The differences between these two systems are summarized in the following Table 1.

Table 1 Comparison of Czech and international accounting legislation in the field of agriculture

<table>
<thead>
<tr>
<th>AREA</th>
<th>CZECH LEGISLATION</th>
<th>IFRS</th>
</tr>
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<tbody>
<tr>
<td>Measurement – purchased assets</td>
<td>Purchasing price</td>
<td>Fair value, (costs)</td>
</tr>
<tr>
<td>Measurement of assets from own production</td>
<td>Own costs (replacement costs)</td>
<td>Fair value, (costs)</td>
</tr>
</tbody>
</table>
| Classification            | • The setting the limits for the classification of assets as fixed assets  
                            • The distribution to the crop and the livestock production  
                            • The distribution to the long-term and short-term assets  
                            • The forest is not recognized in assets                    | • The valuation is not restricted (even babies are the biological assets  
                            • The main distribution to consumable and fruiting assets  
                            • The distribution to mature and immature within this groups |
| Subsidies for the acquisition of assets | reduce the value of assets | are posted as income         |
| The mandatory disclosures  | • The methods of valuation of all types of assets  
                            • The amount of subsidies for purchased assets                  | • The method of determination the fair value (where the expert opinion was used)  
                            • Causes of changes in the value of each separately reported group of biological assets (distributed by the various causes)  
                            • For assets valued at costs there must be their description, the reason for non-use of fair value, the band in which high probable the fair value is |

Source: Own processing

In the Czech accounting legislation, there would be possible to introduce some changes. The abolition of border of valuation for inclusion in long-term assets would lead to keeping all biological assets, which are not owned for sale, in the same group. This would lead to a more faithful representation of the assets. Further applicable measures is offered for representation of forests in the Czech accounting. The value of forest is included in the value of the land (not affect the value of assets), but the separate display would serve as a truer picture of the assets of the farm. The reason for reducing of the valuation of the asset, for which a subsidy was awarded, is to avoid depreciation of the subsidy.

Very problematic seems to be the valuation. Setting their own costs is complicated and there are not active markets with most just born animals, where their fair value could be determined. A legislative change in this area is therefore a question of a longer time horizon with a lot of discussions about what is better.

4 Conclusions

Czech accounting legislation is devoted to general accounting principles and practices. It does not address individual fields and their specifics in detail, giving rise to discrepancies between businesses and it may also lead to a distortion of true and fair view, which is one of the main accounting principles. At the level of international accounting standards, there is the IAS 41 - Agriculture that is trying to cover specific areas of agricultural activity. There is set the classification of biological assets, the valuation and disclosure requirements. This standard attends to subsidies for agricultural activity. Along with the obligation to disclose much information related to agricultural activity and biological assets this concept leads to a more faithful representation of assets and liabilities of the company. Of course, in addition to positive, problematic areas can also be found in the legislation. For example, the valuation
at the fair value carries a higher risk of affecting the value by management, than the valuation according to Czech accounting legislation at the purchased price that is clearly established. Taking into account all possibilities, their advantages and disadvantages there should be created a new accounting standard for enterprises engaged in agricultural activities in the Czech Republic. This extension of legislation would unite the carrying values of companies and increase the faithfulness of the financial statements and their explanatory power.

Already in the previous works there were relatively large differences, for example by a different classification of dairy cows in inventory and fixed assets. Due to the depreciation there is the difference in profit or loss in the amount of CZK 6,000 per one piece of the animal. In other materials these problems will be illustrated on the cases. There will be assessed the results achieved in the Czech accounting system, in accordance with IFRS or US GAAP. There will be evaluated their impact on the indicators of the financial analysis, or estimate the level of the risk of objectivity of the data collected.

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