IAS 2 and IAS 41: Cannabis Accounting – Presentation

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Paragraph 12 of IAS 41 *Agriculture* states that "[a] biological asset shall be measured on initial recognition and at the end of each reporting period at its fair value less costs to sell, except for the case described in paragraph 30 where the fair value cannot be measured reliably."

Paragraph 40 of IAS 41 requires the disclosure of "the aggregate gain or loss arising during the current period on initial recognition of biological assets and agricultural produce and from the change in fair value less costs to sell [FVLCS] of biological assets." However, IAS 41 does not prescribe how these amounts should be presented in the Statement of Comprehensive Income.

The Group discussed the following fact pattern to highlight some of the considerations on how to present changes in FVLCS of the cannabis plants in the Statement of Comprehensive Income.

Fact Pattern

- During the year, an entity incurred subsequent expenditures of $500 on growing cannabis plants. These biological assets were measured at a FVLCS of $600.
- Of these biological assets, assets measuring $360 in FVLCS were harvested, reducing the remaining biological assets to $240 in FVLCS at the year-end reporting date.
- Assume no expenditures were incurred post-harvest to further process and convert the agricultural produce to finished goods inventory. During the same year, the entity sold inventory with a carrying value of $60 for $80.

Figure 1 below illustrates the fact pattern, assuming the entity established an accounting policy to either expense subsequent expenditures as incurred or capitalize the subsequent expenditures. Subsequent expenditures are costs incurred related to the biological transformation of the biological asset between the point of initial recognition and the point of harvest. Note: an entity's accounting policy in accounting for subsequent expenditures may affect the presentation of changes in FVLCS of biological assets.

Figure 1

	Expense Subsequent Expenditures			Capitalize Subsequent Expenditures		
	Biological Asset Continuity Debit / (Credit)	Inventory Continuity Debit / (Credit)	Profit or Loss Impact Debit / (Credit)	Biological Asset Continuity Debit / (Credit)	Inventory Continuity Debit / (Credit)	Profit or Loss Impact Debit / (Credit)
FVLCS, beginning of year	**$0**			**$0**		
Expenditures on growing cannabis			$500	$500		
Change in FVLCS on growing cannabis	$600		($600)	$100		($100)
Point of harvest	($360)	$360		($360)	$360	
Sale of cannabis – revenue			($80)			($80)
Sale of cannabis – cost		($60)	$60		($60)	$60
FVLCS, end of year	**$240**	**$300**		**$240**	**$300**	
Net Profit or Loss impact			**($120)**			**($120)**

Issue: How should the changes in the FVLCS of cannabis plants (i.e., biological assets) be presented in the Statement of Comprehensive Income?

Various approaches to presentation (see Figure 2)

Paragraph 85 of IAS 1 *Presentation of Financial Statements*, in part, requires an entity to present additional line items in the Statement of Comprehensive Income when such presentation is relevant to an understanding of the entity's financial performance. Paragraph 97 of IAS 1 requires that when items of income or expense are material, an entity shall disclose their nature and amount separately. Consequently, unrealized gains or losses resulting from the fair value changes of biological assets should be presented as a separate line item on the face of the Statement of Comprehensive Income. However, the question arises as to the most appropriate location to disclose these amounts. Illustrative Example 1 in IAS 41 illustrates a presentation approach based on the nature rather than function of expenses.

Figure 2 below, comprising Figures 2A to 2E, presents various presentation approaches based on the fact pattern. Each approach illustrates a presentation approach assuming subsequent expenditures are either expensed or capitalized.

- Figure 2A presents separately both the change in FVLCS of biological assets and the realized portion thereof on agricultural produce transferred to inventory and then sold. Figure 2A presents two gross profit subtotals – before and after the net unrealized changes in FVLCS of biological assets.
- Figure 2B does not separately present the realized portion of the FVLCS of agricultural produce in inventory that was sold, where an entity capitalizes subsequent expenditures. The gross profit subtotal presents a measure of gross profit that is consistent with the second gross profit measure in Figure 2A.

- Figure 2C presents the realized portion of the FVLCS of agricultural produce in inventory that was sold, together with the change in FVLCS of biological assets on a single line. This presentation approach shows the net unrealized change in FVLCS related to biological assets.

- Figure 2D is similar to Figure 2B, except that it draws a gross profit subtotal before changes in FVLCS of biological assets.

- Figure 2E shows the items within the Statement of Comprehensive Income based only on the nature of expenditures (rather than the function of expenditures). While this approach does not present either a cost of goods sold line item or gross profit subtotal, each line item faithfully represents the nature of what it purports to represent.

Figure 2

Figure 2A

Statement of Comprehensive Income (debit) / credit	Subsequent Expenditure Exp	Cap
Revenue	80	80
Production expenses	(500)	
Cost of sales other than FVLCS adjustments		(50)
Gross profit before FVLCS adjustments	(420)	30
Change in FVLCS of biological assets	600	100
Realized portion of change in FVLCS of biological assets on inventory sold	(60)	(10)
Gross profit including unrealized FVLCS adjustments	120	120
Net income/comprehensive income	**120**	**120**

Figure 2B

Statement of Comprehensive Income (debit) / credit	Subsequent Expenditure Exp	Cap
Revenue	80	80
Production expenses	(500)	
Realized portion of change in FVLCS on inventory sold	(60)	
Cost of sales including realized portion of change in FVLCS on inventory sold		(60)
Change in FVLCS of biological assets	600	100
Gross profit including unrealized FVLCS adjustments	120	120
Net income/comprehensive income	**120**	**120**

Figure 2C

Statement of Comprehensive Income (debit) / credit	Subsequent Expenditure Exp	Cap
Revenue	80	80
Production expenses	(500)	
Cost of sales other than FVLCS adjustments		(50)
Changes in FVLCS of biological assets less realized portion on inventory sold	540	90
Gross profit including unrealized FVLCS adjustments	120	120
Net income/comprehensive income	**120**	**120**

Figure 2D

Statement of Comprehensive Income (debit) / credit	Subsequent Expenditure Exp	Cap
Revenue	80	80
Production expenses	(500)	
Realized portion of change in FVLCS on inventory sold	(60)	
Cost of sales including realized portion of change in FVLCS on inventory sold		(60)
Gross profit before change in FVLCS of biological assets	(480)	20
Change in FVLCS of biological assets	600	100
Net income/comprehensive income	**120**	**120**

Figure 2E

Statement of Comprehensive Income (debit) / credit	Subsequent Expenditure Exp	Cap
Revenue	80	80
Change in FVLCS of biological assets	600	100
Production expenses	(500)	(500)
Change in biological assets - Costs capitalized		500
- Transfers to inventory	(360)	(360)
Change in inventory	300	300
Net income/comprehensive income	**120**	**120**

View A – All approaches in Figure 2 are acceptable.

Proponents of this view note that neither IAS 1 nor IAS 41 prescribe any specific presentation approaches, and that neither the detailed composition of cost of goods sold nor gross profit are explicitly defined in IFRS Standards. As a result, as long as entities are transparent and clear in terms of both their policy for either expensing or capitalizing subsequent expenditures, and where those subsequent expenditures and the changes in FVLCS of biological assets have been presented in the Statement of Comprehensive Income, any of the presentation alternatives in Figure 2 are acceptable.

View B – An entity must consider its specific circumstances and determine the most appropriate and relevant presentation.

Proponents of this view note that IAS 1 requires that management select the method for presentation of expenses that is reliable and more relevant because both the function of expense method and the nature of expense method may have merit for different types of entities.

In addition, whether an entity expenses or capitalizes subsequent expenditures may have a role in determining the appropriate presentation of gross profit subtotals. Proponents of this view think that if an entity has chosen to expense subsequent expenditures as incurred, then presenting a gross profit subtotal that includes expenditures related to items not yet sold would not be appropriate.

View C – This view is consistent with View B except that it is not appropriate to present a gross profit subtotal that includes unrealized changes in FVLCS of biological assets.

Proponents of this view see gross profit solely as a measure of realized margin over cost of goods sold. As such, proponents of this view agree with View B except that they think it is not appropriate to present gross profit including unrealized changes in FVLCS of biological assets.

The Group's Discussion

Group members had differing views on the appropriate presentation of unrealized gains and losses on changes in the FVLCS of biological assets, and the related effect of the entity's policy to capitalize or expense subsequent expenditures incurred on biological assets.

Several Group members supported View B because they agreed that it is important to consider what presentation approach provides financial statement users with the most relevant and reliable information. If an entity expenses subsequent expenditures as incurred, then presenting a gross profit subtotal that includes expenditures related to items not yet sold, as shown in Figures 2A and 2D, would be misleading.

A representative of the Canadian Securities Administrators (CSA) noted that this is an area in which there has been a lack of clarity in the markets. This CSA representative observed that View B and the presentation approach in Figure 2A are becoming more common in practice, and provides users of financial statements a greater disaggregation of items included in gross profit. This CSA representative also noted that this presentation approach provides more relevant and reliable information to investors when subsequent expenditures related to biological assets are capitalized, rather than expensed.

A few Group members supporting View B preferred the presentation approach in Figure 2B because they think that this approach results in a presentation of cost of goods sold and gross profit that is meaningful to users of financial statements. One Group member thought Figure 2D might also be reasonable if the thinking was that the change in fair value less cost to sell should be part of gross profit. However, this Group member held the view that a meaningful gross profit measure should be specific to the goods sold rather than including fair value changes for goods that are still in inventory.

Some Group members supported View C because they think it is not appropriate to present a measure representing gross profit including unrealized changes in FVLCS of biological assets, as shown in Figures 2A to 2C. A Group member observed that including unrealized gains and losses on changes in FVLCS would obfuscate underlying performance because it is so volatile.

Group members agreed that IAS 1 and IAS 41 do not prescribe any specific presentation for changes in the FVLCS of biological assets. Entities must consider the users of their financial statements and provide information that is sufficiently disaggregated and transparent to determine what is included and not included in the financial statement line items presented.

The Group's discussion highlighted the diversity in approaches to the presentation of gross profit when applying IAS 41, and the importance of transparency to financial statements users given the rapid growth of the industry. The Group recommended that the issue be discussed with the AcSB to determine whether it should be raised to the IASB or IFRS Interpretations Committee.

(For a full understanding of the discussions and views expressed, listen to the audio clip).