



British Columbia  
Securities Commission

# Reporting Issues in the Cannabis Industry

---

*CPAEF Symposium for Accounting Educators and Academics*  
May 24, 2019

Anita Cyr, Associate Chief Accountant





# This presentation

- **Background**
- **The accounting – IAS 41, IAS 2 and growing pains**
- **Results of disclosure review**
- **Non-GAAP measures – current and proposed**
- **What's next?**



**How did we get here?**





# Cannabis



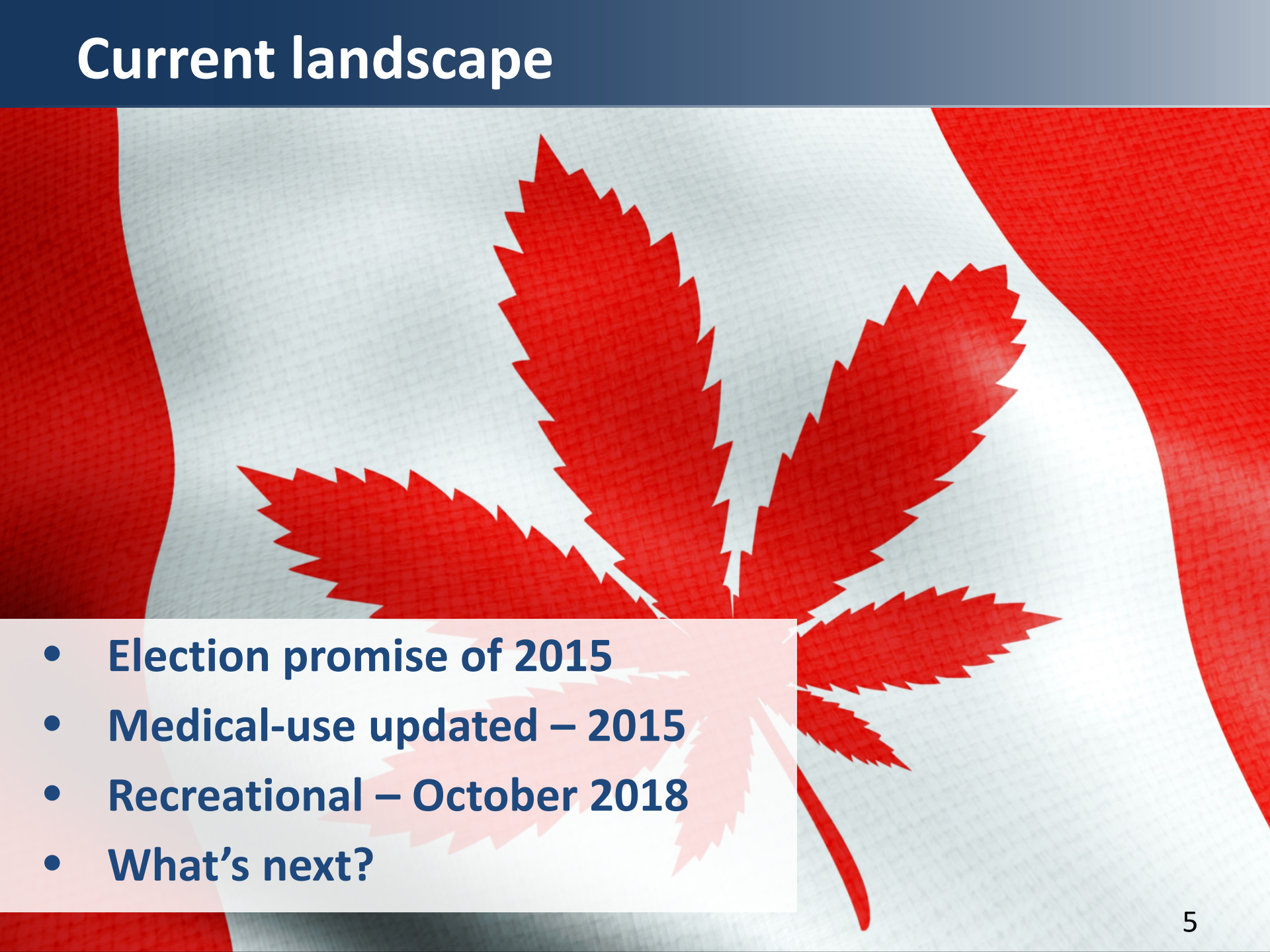
often  
though singular mod.  
florally  
often forming  
a 100 or more cor.



deepened less greenish  
of the center by  
the 10 or more seeds  
of 3  
by 1. Second  
by 1. All the. Acute  
le



# Current landscape

- 
- **Election promise of 2015**
  - **Medical-use updated – 2015**
  - **Recreational – October 2018**
  - **What's next?**



# Current landscape

- Number of issuers in the space is soaring
- High market cap
- How high will it go?





# The U.S. Effect





# The accounting



# The accounting

- Cannabis growers – recognize *biological assets* and *agricultural produce*
  - accounting and disclosure issues that are unique to this industry



# The accounting

- **IAS 41 Agricultural activity - *The management of biological transformation and harvest of biological assets for sale or for conversion into agricultural produce***



# The accounting: seed-to-sale

## IAS 41 - Agriculture

Biological transformation

Point of harvest



Biological Assets

Agricultural  
produce

*Recognise changes in fair value*

## IAS 2

Inventory



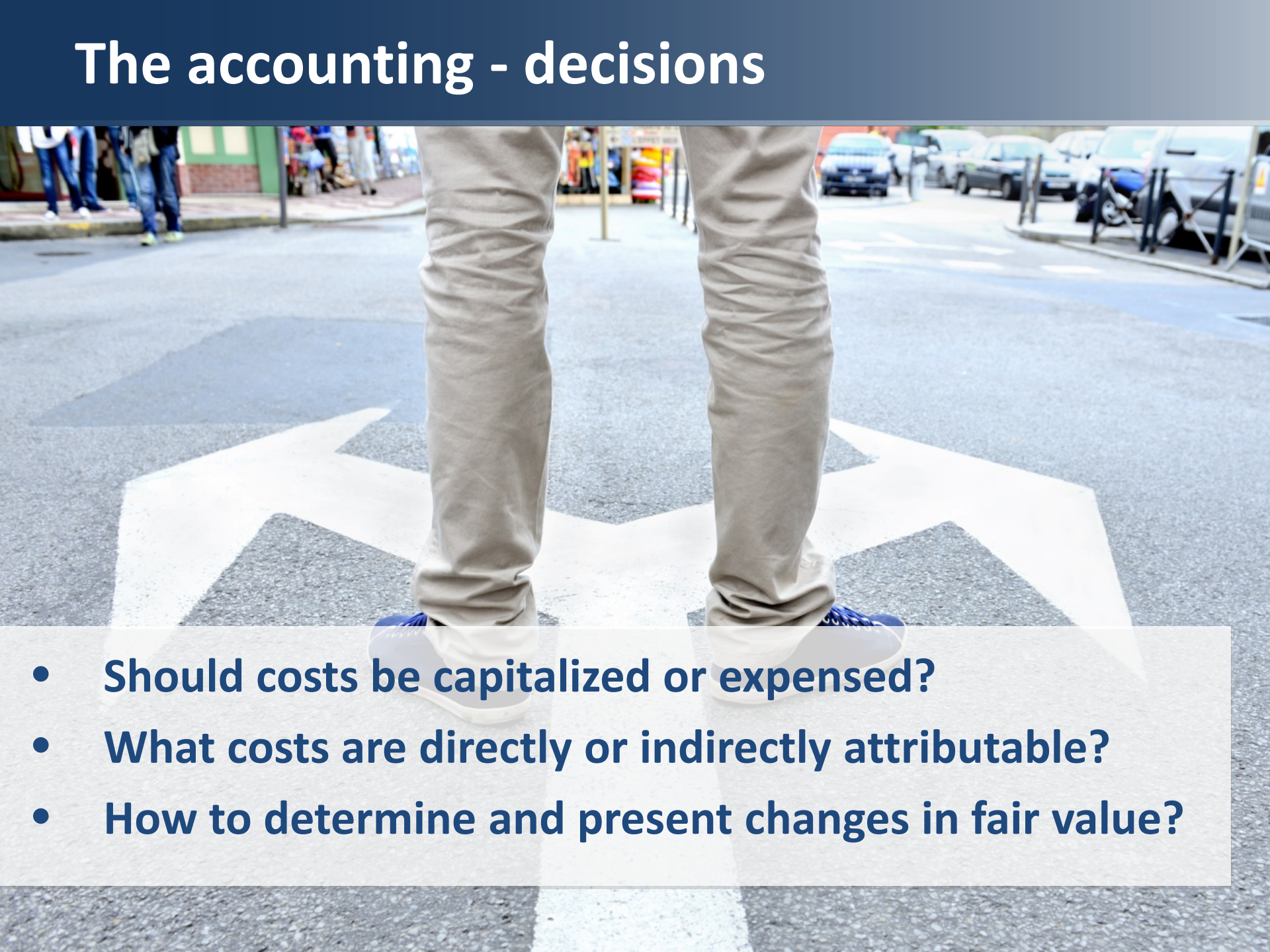
*Lower of cost or  
net realisable  
value*

# The accounting: summary of IAS 41

- Recognition of biological asset at fair value less costs to sell
- Subsequent measurement: fair value less costs to sell
  - Presumption is can measure fair value reliably
  - Can only rebut on initial recognition
- Upon harvest:  
Becomes agricultural produce (still IAS 41) or transfer into inventory (IAS 2)
  - Transferred at fair value less costs to sell



# The accounting - decisions

- 
- A photograph showing the lower legs and feet of a person standing on a white-painted crosswalk on a city street. The person is wearing light-colored trousers and blue sneakers. The background shows a busy street with cars, a motorcycle, and other pedestrians in the distance.
- Should costs be capitalized or expensed?
  - What costs are directly or indirectly attributable?
  - How to determine and present changes in fair value?

# Possible quirk...

(expressed in \$000's)	2018	2017
Revenue	\$80,000	\$40,000
Inventory production costs expensed to cost of sales	<u>40,000</u>	<u>15,000</u>
Gross Margin before the undernoted	40,000	25,000
FV changes in biological assets included in inventory sold	70,000	35,000
Unrealized gain on changes in FV of biological assets	(100,000)	(60,000)
Gross Margin	70,000	50,000



# The accounting – costs

- **Decisions and disclosures relating to costs incurred during biological transformation**
  - What costs are included in “Production costs” or “cost of goods sold”? Which costs are directly or indirectly attributable?
  - Are there other P&L line item costs are included in? For example, depreciation relating to equipment related to biological asset production
  - How to treat selling costs?
  - Are costs being capitalized or expensed?

# The accounting – costs incurred during biological transformation – expense vs. capitalize

	Expense Costs Incurred during Biological Transformation		Capitalize Costs Incurred during Biological Transformation	
	Biological Asset Continuity	Impact to P&L (Debit) / Credit	Biological Asset Continuity	Impact to P&L (Debit) / Credit
FVLCS, December 31, 2018	\$ 500		\$ 500	
Capitalized to biological assets			\$ 200	
Expensed		\$ (200)		
Change in fair value gain (loss) on growing cannabis	\$ 300	\$ 300	\$ 100	\$ 100
FVLCS March 31, 2019	\$ 800		\$ 800	
Net P&L Impact		\$ 100		\$ 100



# The accounting – costs incurred during biological transformation – expense vs. capitalize

- **What do the standard setters say?**
  - May 2018 CPA Canada article “... if we identify things that need to be done, the AcSB will move forward to have the right discussions and support the industry in asking for changes as needed”
  - Issue discussed at the AcSB IFRS Discussion Group June 2018 and subsequently by the AcSB
  - The topic has been submitted to the IFRS Interpretations Committee

# The accounting – presentation - more decisions

- **How to present changes in the FVLCS of biological assets in the statement of comprehensive income?**
  - Recall that changes may be impacted by accounting treatment of expenditures between the point of initial recognition of the biological asset and the point of harvest



# The accounting – presentation - more decisions

- Is P&L presented by nature or by function?
  - IAS 41 illustrative example -> by nature only
- Separate disclosure of unrealized vs. realized changes (on inventory sold) in FVLCS?
- Gross profit subtotal includes all costs of production for cannabis sold?
  - If expense costs incurred during biological transformation, may be misleading to use “gross profit” label

# The accounting – presentation example

Revenue	\$ 1,000,000
Cost of finished cannabis inventory sold	\$ (1,100,000)
Unrealized fair value gain on growth of biological assets	\$ <u>500,000</u>
Gross profit	\$ 400,000



# The accounting – presentation example

Revenue	\$ 1,000,000
Cost of finished cannabis inventory sold	<u>\$ (700,000)</u>
Gross profit, excluding fair value items	\$ 300,000
Realized fair value amounts included in inventory sold	\$ (400,000)
Unrealized fair value gain on growth of biological assets	<u>\$ 500,000</u>
Gross profit	\$ 400,000

# The accounting – fair value – disclosures

- **Valuation techniques and processes**
- **Description of inputs**
- **Level of the fair value hierarchy**
- **Sensitivity of the fair value measurement**
- **Any interrelationships between inputs**
- **Inputs**



# The accounting – fair value - more disclosures

- **Disclosure about the inputs:**
  - Price
  - Yield by plant
  - Wastage
  - Growing cycle length
  - Stage of growth
  - Spoilage
  - Post harvest costs



# The accounting - summary





# Other accounting issues

- **Consider complexity of transactions:**
  - “proprietary strains”?
  - RTOs -> U.S. companies cannot hold directly
  - Ancillary products/industries -> license gummies, for example

# Disclosure review – what did we look at?

- 
- ***CSA SN 51-357 Staff Review of Reporting Issuers in the Cannabis Industry***
  - **Reviewed 70 issuers – licensed producers, issuers with U.S. activities, other ancillary activities**



# Disclosure review – what did we find?

## Compliance

- Licensed producers – need to improve disclosure of impact of FV; accounting policies related to costs; non-GAAP measures
- Issuers with U.S. exposure – risk disclosure
- Other – unbalanced disclosure; forward-looking information (production); material contracts



# Non-GAAP and Other Financial Measures Disclosure

- Cash costs per gram appears to be most prevalent NGM
- Many reconciling items



# Proposed NI 52-112 *Non-GAAP and Other Financial Measures Disclosure*

- **The goal**
  - Issuers – clear requirements, reduced uncertainty
  - Investors – more transparency, more disclosure about the calculation and usefulness

# What's next?



- **Monitoring changes – new products, new markets, changes to Health Canada regulations**
- **Non-GAAP measures – new rule proposed 2018; currently considering comments**



# Questions

