

VIEWPOINTS: Applying IFRS Standards in the Cannabis Industry

CANNABIS STAGES OF GROWTH AND POST-HARVEST ACTIVITIES

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Cannabis Industry Task Force on IFRS® Standards

Chartered Professional Accountants of Canada (CPA Canada) created the Cannabis Industry Task Force on IFRS Standards (Task Force) to share views on IFRS Standards application issues of relevance to cannabis companies. The views of the Task Force are provided in a series of papers, entitled *Viewpoints*, available through free download. These *Viewpoints* are of particular interest to chief financial officers, controllers and auditors.

Purpose of This Viewpoint

This *Viewpoint* is the first in a series being developed by CPA Canada's [Cannabis Industry Task Force](#). In this *Viewpoint*, we provide an overview of the stages of growth of a cannabis plant and certain post-harvest activities. The application of IFRS Standards in the cannabis industry requires an understanding and careful assessment of these stages and activities which may vary, depending on the circumstances.

Background

International Accounting Standard (IAS) 41, *Agriculture*, prescribes the accounting treatment related to agricultural activity. The IAS 41 definition of "agricultural activity" is "the management by an entity of the biological transformation and harvest of biological assets for sale or for conversion into agricultural produce or into additional biological assets." The IAS 41 definition of "biological asset" is "a living animal or plant."

IAS 41 establishes the accounting treatment for cannabis plants during their *biological transformation* and for the initial measurement of agricultural produce at the point of harvest, but it does not deal with the processing of agricultural produce after harvest. "Harvest" is the detachment of produce from a biological asset or the cessation of a biological asset's life processes.

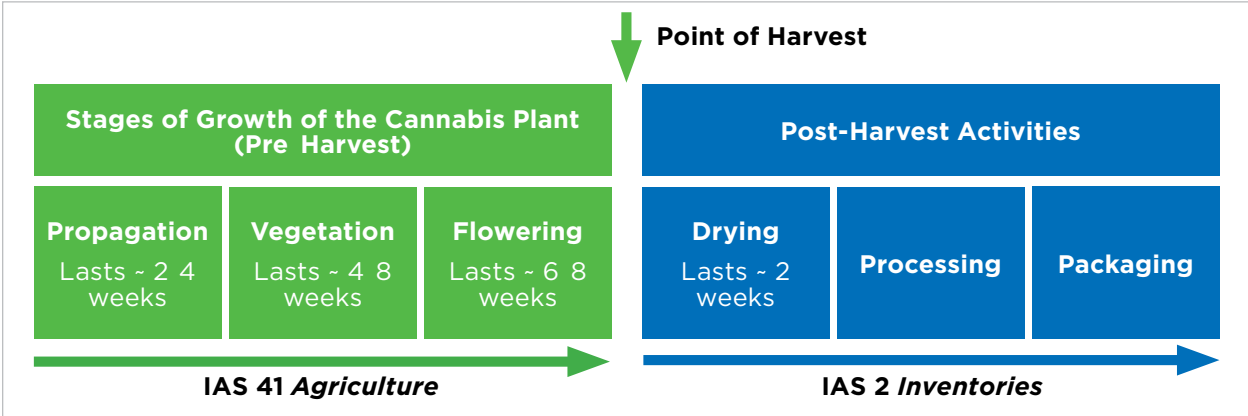
The agricultural produce of a cannabis plant is primarily the flower (bud) and trim (see below).

As per Paragraph 7 of IAS 41, biological transformation results in the following types of outcomes:

- (a) asset changes through (i) growth (an increase in quantity or improvement in quality of an animal or plant), (ii) degeneration (a decrease in the quantity or deterioration in quality of an animal or plant), or (iii) procreation (creation of additional living animals or plants); or
- (b) production of agricultural produce such as latex, tea leaf, wool, and milk.

Figure 1 below is a simplified illustration of the cannabis production process.

FIGURE 1: CANNABIS PRODUCTION: PRE-HARVEST TO POST-HARVEST



IAS 41 does not deal with processing of agricultural produce after harvest. IAS 2, *Inventories*, or another applicable IFRS Standard is applied at this point. Accordingly, the accounting for activities such as drying, processing and packaging of agricultural produce into, for example, oil, distillate, edibles, topicals or pre-rolls is not within the scope of IAS 41.

With the legalization of cannabis in various jurisdictions, there is greater focus on the application of IAS 41 and its fair value measurement basis. In particular, a lack of the commoditized pricing prevalent in some other agricultural crops has resulted in the need for complex fair value measurements in the cannabis sector, particularly when measuring the fair value less costs to sell (FVLCTS) of a cannabis plant during its growth stages.

Cannabis Production

Pre-Harvest Period

A cannabis plant yields a single harvest.

There are three major growth stages in the pre-harvest period:

1. propagation
2. vegetation
3. flowering

During the propagation stage, cannabis plants are germinated either using seeds or a cloning process involving cuttings from a mother plant. The propagation stage typically lasts two-to-four weeks. Mother plants are cannabis plants that are kept in a constant vegetative phase and are not transitioned to the flowering stage. The cuttings of the mother plants are used to form new plants from which the cannabis will be harvested. Mother plants often have a life cycle of less than one year.

The second major stage is the vegetation stage, which usually lasts four-to-eight weeks. During this phase, the plant is strengthening its stem as it continues to grow vertically and produce new leaves. The root system expands downwards in search of more water and food.

The final stage before harvest is the flowering stage. This is the stage where the buds are created, and it usually lasts between six-to-eight weeks.

Harvest

Harvest is the detachment of produce from a biological asset or the cessation of a biological asset's life processes. For a cannabis plant, harvesting involves removing the stem of the plant from its root and the cessation of the plant's life processes.

Post-Harvest Activities

A company's post-harvest activities can vary significantly. This will typically involve drying the detached parts of the plant, which can take approximately two weeks. During this phase, the leaves are removed and the buds (which form the primary produce of the cannabis plant) are separated. The leaves are separately harvested to create a by-product referred to as *trim*. Trim is commonly processed further into cannabis oils and other products. There will typically be additional quality control testing, processing and packaging done post-harvest.

Typical Production Costs

Typical pre-harvest costs

Examples include, but are not limited to:

- utilities (relating to cultivation rooms)
- direct labour costs and share-based payments (e.g., master grower and employees who work on different parts of the cultivation process)
- facility maintenance costs (relating to cultivation rooms)
- facility property taxes (relating to cultivation rooms)
- fertilizers
- seed and clone purchases
- sanitization
- chemicals
- production supplies
- depreciation and amortization of facilities and equipment, including right of use assets arising from leases

Typical post-harvest costs

Examples include, but are not limited to:

- utilities (relating to post-harvest rooms)
- direct labour costs and share-based payments (e.g., employees working on drying, cutting, packaging and other post-harvest-related activities)
- facility maintenance costs (relating to post-harvest rooms)
- facility property taxes (relating to post-harvest rooms)
- internal or external testing costs
- packaging supplies
- depreciation and amortization of facilities and equipment, including right of use assets arising from leases

Common Terms and Definitions

The following is a list of some common terms and definitions used in the cannabis industry:

Bud: Commonly used to refer to the dried, cured and consumable portions of the cannabis plant. The bud is the flower of the cannabis plant. The female bud contains the highest concentrations of cannabidiol (CBD) and tetrahydrocannabinol (THC) in the plant, especially THC.

Cannabidiol (CBD): Non-psychoactive compound found in cannabis plants.

Cannabinoids: The class of compounds found in cannabis that impact the endocannabinoid system in humans and animals. THC and CBD are the two most common cannabinoids.

Cuttings: Branches cut from a mother plant to germinate a new plant; may also be referred to as clones.

Edibles:¹ Ingestible products created from the further processing of cannabis oils into various goods, such as butter, baked goods, candies and other products.

Mother plant: A cannabis plant grown for the purpose of taking cuttings in order to grow more quantity of the same plant.

Oil: The result of separating cannabinoids and essential oils from cannabis plant material, such as trim or bud.

Strains: Brands of cannabis differentiated by their chemical mix and aroma (i.e., the amount of CBD and THC).

Tetrahydrocannabinol (THC): The compound within the cannabis plant which gives the main psychoactive effects.

Trim: By-product of the cannabis plant (typically leaves) used for extraction of oil.

Comments

Comments on this Viewpoint or suggestions for future Viewpoints should be emailed to ifrsviewpoints@cpacanada.ca.

For more information on IFRS, visit www.cpacanada.ca/ifrsguidance.

¹ On June 14, 2019, Health Canada finalized regulations for the production and sale of edible cannabis, cannabis extracts and cannabis topicals. The amended regulations came into force on October 17, 2019. For more information, please visit the Health Canada website: www.canada.ca/en/health-canada/news/2019/06/health-canada-finalizes-regulations-for-the-production-and-sale-of-edible-cannabis-cannabis-extracts-and-cannabis-topicals.html.

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