Advisor alert

The Canadian Accounting Standards Board released new ASPE Section 3041 *Agriculture.* How will your enterprise's financial statements be impacted?

June 2020

Part 2 of 4: Recognition and Measurement of Agricultural Inventories

Overview

The Canadian Accounting Standards Board recently released new Section 3041 *Agriculture* which sets out principles for the recognition, measurement and disclosure of biological assets and the harvested product of biological assets which are held by an agricultural producer. The new guidance is expected to be transformational for many agricultural producers that prepare financial statements in accordance with Accounting Standards for Private Enterprises (ASPE) or Accounting Standards for Not for Profit Organizations (ASNPO). Grant Thornton LLP has released a series of publications which explain some of the new guidance contained in Section 3041 and provide practical insights and examples to help financial statement preparers and users evaluate the impact on an enterprise's financial statements.

This publication, which is the second in the series, looks at the recognition and measurement of agricultural inventories. The other publications in this series address the following topics:

- Part 1: Scope and Key Definitions
- Part 3: Recognition and Measurement of Productive Biological Assets; and
- Part 4: Presentation, Disclosure and Transition Requirements.

Readers are encouraged to read the publications in order. Furthermore, enterprises that expect to be impacted by this standard should also refer to the original text of Section 3041 to assess and understand the implications for their specific situation.

Agricultural inventories – recognition

Items of agricultural inventory are recognized when they meet: 1) the definition of an asset and 2) the recognition criteria outlined in Section 1000 *Financial Statement Concepts* (for enterprises applying ASPE) or Section 1001 *Financial Statement Concepts for Not-for-Profit Organizations* (for enterprises applying ASNPO). Professional judgment may be required in certain circumstances to determine when the asset should be recognized. For example, an agricultural producer will need to apply judgement to determine when to recognize an unborn animal on its balance sheet (e.g., at the time of conception, when the unborn animal reaches a certain gestation, at the time of birth).

Agricultural inventories – measurement

There are two models that can be used to measure agricultural inventories:

1 net realizable value or

2 cost.

An agricultural producer must apply its accounting policy choice consistently to all agricultural inventories that have a similar nature and use.

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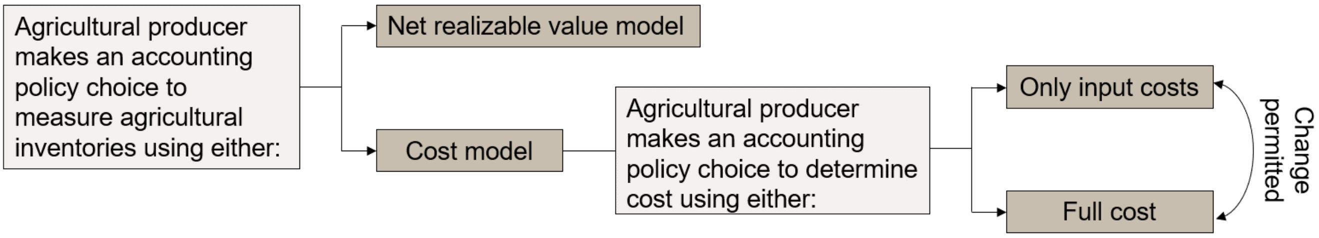
This diagram illustrates the accounting policy choice:

Diagram 1: Making an accounting policy choice

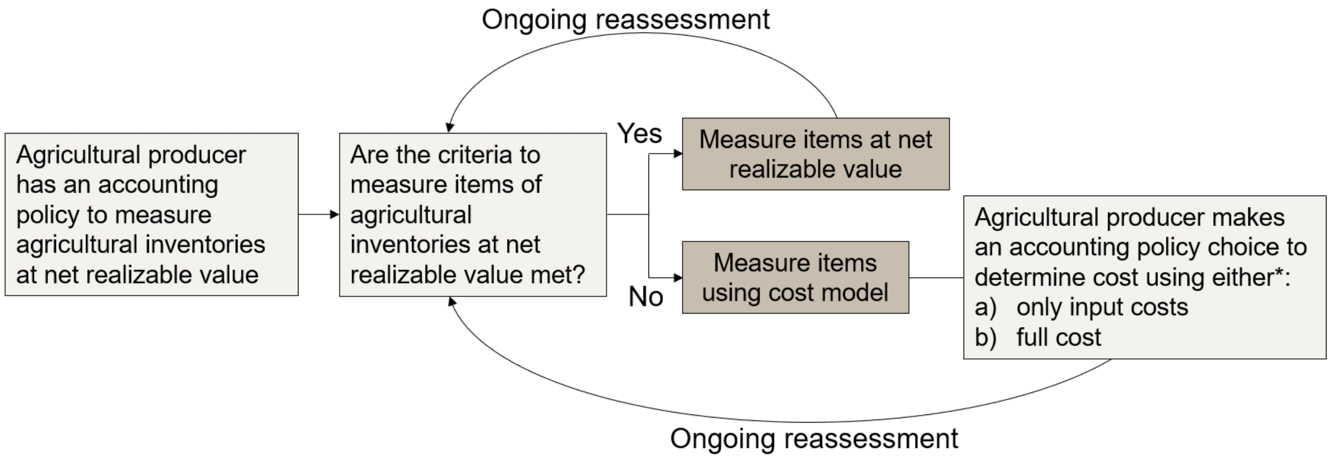


Regardless of which method is used to account for agricultural inventory, the agricultural producer will recognize the carrying amount of the agricultural inventories as an expense in the period in which it is sold. Furthermore, any costs incurred in the production of agricultural inventory which are excluded from the cost (e.g., abnormal amounts of wasted material/labour, administrative overhead, selling costs) are expensed in the period incurred.

Net realizable value model

This diagram depicts how the net realizable value model is applied:

Diagram 2: Applying Net Realizable Value



**Same method must be used to determine cost for all items that are of a similar nature and use*

An agricultural producer that chooses to use the net realizable value model would measure its agricultural inventories at net realizable value only when the product:

- has a reliable, readily determinable and realizable market price;
- has reliably measurable and predictable costs of disposal; **and**
- is available for immediate delivery.

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Until such time that all of these conditions are met, the agricultural producer will measure the items of agricultural inventory using the cost model. An example of a type of agricultural inventory that might meet all three conditions is harvested wheat that is available for immediately delivery.

As outlined in Diagram 2, items of agricultural inventory are measured at net realizable value at each period end unless/until there is a change in circumstances which causes the conditions for measurement at net realizable value to no longer be met. If at any time the conditions cease to be met, the current carrying amount of the inventory would become its deemed cost and it would be measured using the cost model until the conditions to measure at net realizable value are met again.

All changes in the carrying amount of agricultural inventories resulting from changes in net realizable value are recognized in net income in the period they arise. For example, if the net realizable value of the agricultural inventory increases from one period end to the next, the agricultural producer will recognize a gain in net income for the period.

Cost model

Agricultural inventories measured using the cost model are measured at either: 1) only input cost or 2) full cost.

The cost of agricultural inventories measured at **only input cost** includes the:

- cost of direct materials (e.g., purchase price, import duties and other taxes, transport, handling, and other costs directly attributable to the acquisition of materials and services used in the development and harvest of biological assets); and
- cost of direct labour, but only to the extent that the cost of the direct labour is readily determinable and can be directly related to the items of agricultural inventories produced.

Alternatively, the cost of agricultural inventories measured at **full cost** includes:

- all input costs (direct materials and direct labour); and
- a systematic allocation of fixed and variable agricultural production overheads and all other costs incurred in the development and harvest of biological assets.

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Example

Entity A raises both cattle and chickens for consumption. The farm is owner-managed, meaning the farmer who owns the enterprise also does the majority of the work on the farm.

Two labourers were hired to assist with shipping the animals throughout the year. The labourers, who are paid hourly, only work on the days that animals are shipped. Entity A accounts for the animals in groups (i.e., groups that were purchased/bred at approximately the same time and will be sold at approximately the same time).

The cost of each group of animals would include the following:

	Full cost method	**Only input costs method**
Cost of direct materials (e.g., feed, cost of purchase (if applicable))	✓	✓
Allocation of the farmer's direct labour hours (i.e., the cost associated with the time spent by the farmer tending to that particular group of animals)	✓	? only if the farmer tracks time spent tending to each group of animals
Cost of the hired labour when that group of animals is shipped	✓	✓
Allocation of direct and indirect overhead (e.g., depreciation of farm equipment)	✓	✕
Interest costs (i.e., if the development of the animals takes a substantial period of time)	? only if Entity A's accounting policy is to capitalize interest costs	✕

Practical insight

Historically, enterprises had to develop methodologies for allocating indirect costs to agricultural inventories. The option available in Section 3041 to use only input costs is expected to reduce the cost and effort associated with measuring agricultural inventories at cost. Enterprises that choose to measure agricultural inventories at full cost will likely incur a one-time cost to establish a methodology to allocate overhead costs. However, the methodology developed could continue to be applied in subsequent years for little additional cost.

Agricultural inventories carried at cost will be subsequently measured at the lower of cost and net realizable value.

Next steps

Although Section 3041 is not yet effective, agricultural producers should start to consider how the impending changes will impact their financial statements prepared in accordance with ASPE or ASNPO. Enterprises will need to determine which accounting policy to apply and design or procure a system to track the cost of items of agricultural inventories, if applicable. Additionally, enterprises should consider how the new guidance will impact their financial statements prepared in accordance with ASPE or ASNPO, and financial covenants, debt agreements and/or other key metrics. If the enterprise will be affected, talking to the users of the financial statements early will help to avoid last minute surprises. Some banking agreements may need to be revised or waivers need to be obtained if the new guidance will/may create violations.

For further information please refer to the other publications in this series:

- Part 1: Scope and Key Definitions;
- Part 3: Recognition and Measurement of Productive Biological Assets; and
- Part 4: Presentation, Disclosure and Transition Requirements.

How can Grant Thornton Help?

At Grant Thornton, our advisors are up-to-date with new Section 3041 and can help enterprises interpret the new guidance, assess the impact on their financial statements prepared in accordance with ASPE or ASNPO and determine what information the enterprise needs to gather in advance of applying the new standard for the first time.