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Annual Financial Statements

An Educational Primer

Presented by: Kaleb Grapp, CPA and Partner
& Jennifer Burkhart, CPA and Attest Manager



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CPAs and Advisors



Kaleb Grapp, CPA



Jennifer Burkhart, CPA

Grapp Lerash – Firm Profile

- Founded in 2018 by Kaleb Grapp & Aaron Lerash
- Full-service public accounting firm
- Headquartered in the Great Lakes Bay Region of Michigan, serving clients nationwide from coast to coast
- Involved in the cannabis industry since our inception
- Work with clients across each functional area of the cannabis supply chain

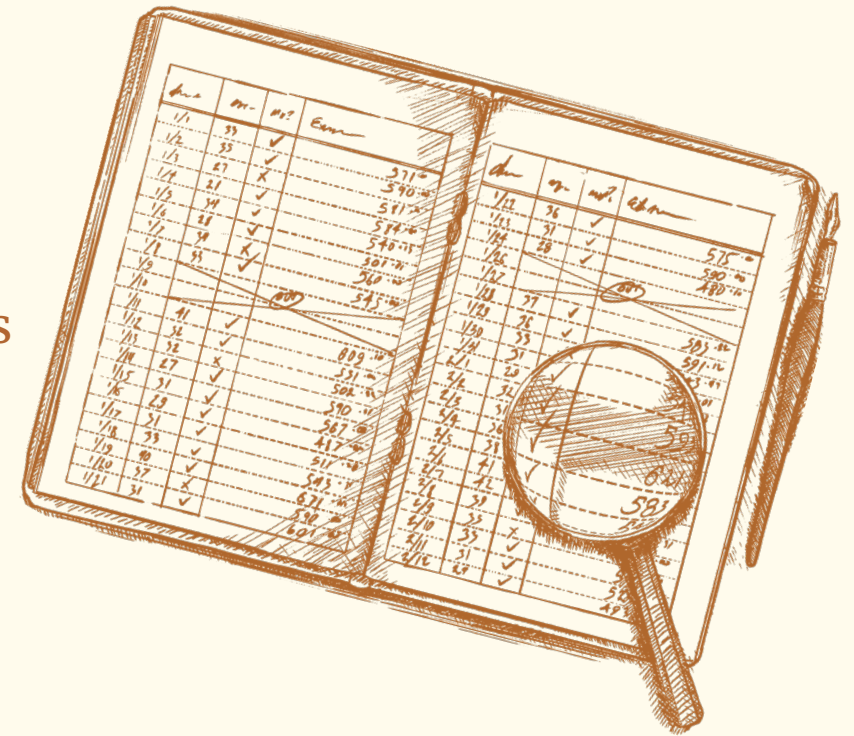


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Grapp Lerash AFS Work At-a-Glance

- Performing AFS Procedures since 2019
- Issued 200+ Reports
- Contributor to various Workgroups and Resource Groups, streamlining the AFS process
- Frequent presenters on Cannabis related Tax, Accounting, & AFS matters



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Annual Financial Statement (AFS) Authority

Medical – Section 701 of MMFLA

Public Act 119 of 2021, which took immediate effect on December 7, 2021, amended Section 701 of the MMFLA and now requires that licensees of medical marijuana facilities file a financial statement every three years, or a shorter time-period as determined by the CRA.

AU – Rule 20 of the Marijuana Licenses rules – R 420.20

The financial statements shall be reviewed by an independent certified public accountant in a manner and form prescribed by the CRA

The certified public accountant must be licensed or authorized to practice in this state under article 7 of the occupational code, 1980 PA, MCL 339.720 to 339.736



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AFS Preparation Requirements

- Report is an agreed-upon procedures engagement that must be conducted by an independent certified public accountant (CPA) and performed in accordance with statements of standards for attestation engagements
- AFS form report contains the required procedures and schedules for FY2x
 - Reporting Period will be a 12-month timeframe
- The CPA must communicate their findings in the report. No other report will be accepted
- The licensee is responsible for filing the report with the CRA via Accela by the deadline



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Licensee Notice and Responsibilities

- Licensee is notified by email and the first notice is sent approximately 6 months in advance of the report due date. Due date is a hard and fast due date.
- The First Notice Email is sent to the following contacts in Accela Citizen's Access portal (ACA):
 - Registered entity
 - Person who completed the online application (medical)
 - Person who completed the online application (adult-use)
 - OR person(s) listed on the most recent Contact Authorization Form
- Licensee should review license record contacts and ensure that proper individuals are identified as contacts and all contact information is up to date in Accela
- Ensure contact email boxes are being monitored
- Licensee should engage a CPA to complete the procedures immediately upon receiving notice
 - Don't assume someone else is doing it
- The licensee is responsible for filing the report with the CRA via Accela by the deadline



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Who Must File

- Every legal entity licensed must file an AFS
- Licensing under separate legal entities means separate complete AFS reports
- Multiple licenses held by one legal entity means one AFS report with some duplicate procedures required for each license held
- Separate but related legal entities sharing costs must allocate costs to each legal entity



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PRE-AFS Activities: Selecting an Independent CPA

- Key considerations when evaluating a CPA to engage for an AFS report:
 - Qualifications –
 - ✓ License status
 - ✓ Experience in the industry
 - **Quality Control**
 - ✓ Peer Review
 - Pass
 - Pass with deficiencies
 - Fail
 - Timeliness
 - When to engage



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Contact Authorization Form

- Must be filed with AFS Report
- Licensee authorizes the individuals listed to be contact persons that the CRA can discuss any and all information regarding the AFS
 - A licensee contact is **REQUIRED**
 - A CPA contact is **OPTIONAL**
- Form requires your Financial Compliance Record (FCR) Number



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AFS Report Form

Cover Sheet

Schedule of Total Revenue – (Grower, Processor)

Schedule of Total Revenue – (Retailer/Provisioning Center/Microbusiness)

Schedule of Total Revenue – (Safety Compliance Facility, Secure Transport)

Schedule of Expenditures – Lease Agreements

Schedule of Expenditures – Financing Agreements

Schedule of Expenditures – Management Agreements

Schedule of Expenditures – Licensing Agreements

Schedule of Expenditures – Service Vendors

Schedule of Expenditures – Other Vendors

Schedule of Distributions – Ownership

Schedule of Distributions – Employee

Schedule of Distributions – Other Persons

Schedule of Total Revenue – (Grower, Processor)

- Duplicate for each license type held
- Questionnaire
 - Cash Handling SOP
 - Revenue Reconciliation SOP
- Testing Total Revenue for Reporting Period from METRC through to the General Ledger

License #:	[insert license #]	
	Total Revenue per General Ledger	Discrepancy Amount \$
Total Revenue per METRC		-
Discrepancy Reason	Detailed Explanation	Amount
Contract Pricing		
Data Entry Errors		
Discounts		
Non-Marijuana Product		
Other		
Recalls		
Returns		
Timing		
Tolling Agreements		
Unit Price vs Total Sold		
Upload Errors		
Total		\$ -



Schedule of Total Revenue – (Grower, Processor) Best Practices and Common Exceptions

- Revenue amount in METRC differs from the Revenue amount in the General Ledger and isn't reconciled
 - Ensure that proper documentation is maintained to explain discrepancies
 - Written agreements between growers and processors when revenue is undetermined at transfer
- Products are listed on the same manifest but are for multiple receiving or originating facilities
- Products were returned after a manifest had been accepted
- Toll Processing
- METRC errors
 - Wrong units – single vs multiples
 - Lack of record keeping/documentation to support transactions



Schedule of Total Revenue – (Retailer/Provisioning Center/Microbusiness)

- Duplicate for each license type held
- Questionnaire
 - Cash Handling SOP
 - Revenue Reconciliation SOP
- Testing Total Revenue for Reporting Period from METRC through to the Point-of-Sale (POS)
- Testing Total Revenue for Reporting Period from METRC through to the General Ledger



Schedule of Total Revenue – (Retailer/Provisioning Center/Microbusiness)

- List each license with total revenue for the reporting period

License Number	Total Revenue per METRC	Total Revenue of Marijuana Products per Point of Sale (POS) System	Total Revenue of General Merchandise (Non-Marijuana Product) per Point of Sale (POS) System	Total Revenue per License per General Ledger

- Provide reconciliation with explanation(s) for discrepancies

Part 3 - Schedule of Total Revenue - License #1				
License #:	AU-R-000XXX			
Total Revenue per METRC	\$ 1,098,794.25	Total Revenue per General Ledger	\$ 1,133,655.95	Discrepancy Amount \$ 34,861.70
METRC to POS Reconciliation				
METRC	\$ 1,098,794.25			
POS	\$ 1,099,079.75			
Difference	\$ (285.50)	**Insert explanation here		
METRC to GL Reconciliation				
METRC	\$ 1,098,794.25			
GL	\$ 1,133,655.95			
Difference	\$ (34,861.70)	**Insert explanation here		
Results				
Please use this area to provide explanations for footnotes or items that need further clarification.				
**Insert further explanation here if necessary				

Schedule of Total Revenue – (Retailer/Provisioning Center/Microbusiness) Best Practices and Common Exceptions

- Detail testing from METRC system through a POS system and to underlying accounting ledgers
 - Accurate general ledger postings are critical
 - Reconciling between METRC, POS Systems and Ledgers should be done monthly, at a minimum, more frequently if possible
 - Understand why METRC and other systems may be different
 - Defined procedures for revenue cycle that are consistently applied and followed
 - Not expected to be exact, but should have an explanation within a reasonable amount



Schedule of Total Revenue – (Safety Compliance Facility, Secure Transport)

- Questionnaire
 - How are customers invoiced - monthly, per transaction, or otherwise
- Testing of Licensee's top revenue sources
 - For a licensee with an annual gross revenue between \$0 and \$500,000 for the reporting period: List the top 10 revenue sources based on total revenue received during the reporting period – 3 revenue sources will be tested
 - For a licensee with an annual gross revenue between \$500,001 and \$1,000,000 for the reporting period: List the top 10 revenue sources based on total revenue received during the reporting period – 5 revenue sources will be tested
 - For a licensee with an annual gross revenue greater than \$1,000,000 for the reporting period: List the top 20 revenue sources based on total revenue received during the reporting period – 10 revenue sources will be tested



Schedule of Total Revenue – (Safety Compliance Facility, Secure Transport) Best Practices and Common Exceptions

- Detail testing of invoice sent to payment(s) received

Part 4 - Schedule of Top Revenue Sources - Top Revenue Source #1				
Revenue Source:		#NAME?		
Payment Received Date	Invoice/Manifest #	Amount Received per Invoice	Amount Received per General Ledger	Notes

- Accurate general ledger postings are critical
- METRC manifests traceable to invoices
- Defined procedures for revenue cycle that are consistently applied and followed



Schedule of Expenditures – Lease Agreements

- Conducted collectively for all licenses held by an entity
- Real Property Lease Agreement(s)
 - Disclose relationship between Licensee and Lessor/Landlord
 - Common Ownership, Same Ownership, Parent/Subsidiary, Immediate Family Member(s), Unrelated Third-Party, Other
 - Note square footage of Leased Premise(s) if not in agreement
- Testing of amount due per agreement to total payments made during the reporting period
 - Reason for underpayment/overpayment
 - Agreement reached with Landlord if underpayment/overpayment
 - Formalized amended lease or other written document describing steps to rectify underpayment/overpayment



Schedule of Expenditures – Lease Agreements

Best Practices and Common Exceptions

- Real Property Lease Agreements
 - Obtain executed copies of ALL lease agreements
 - Follow the payment terms, consistency and accuracy
 - Ensure related party rents are reasonable
 - Real estate cap rates consistent with market and demographics
 - Tracking within an accounting system that clearly calls out rental expenses
 - Allocating inventoriable rents to COGS? No problem
 - Post your rent payments to one expense account and journal the inventoriable portion out for easy tie out at AFS time
 - If posted directly to Inventory - have a separate schedule to tie inventoriable & non-inventoriable payment
 - **Most common exception** – rent is deferred, not paid, paid as cash is available, but all of these are inconsistent with the underlying agreement



Schedule of Expenditures – Lease Agreements

Best Practices and Common Exceptions

- A lessor (of an updated lease agreement) meets the definition of applicant.
- Refer to R 420.1(1)(c)(ii)(C)
 - Lessor is not an applicant if:
 - Rent is reasonable
 - Fixed
 - Under bona fide lease or rental obligation
 - Unless the person exercises control over or participates in the management of the marihuana business
- Ownership of property held by undisclosed entity other than the licensee without arms length bona fide payment according to lease terms



Schedule of Expenditures – Financing Agreements

- Conducted collectively for all licenses held by an entity
- Loans, Promissory Notes, Debt Financing, Royalty Financing, Equity Financing, Debt Instruments, etc. with any individual or entity (excluding financial institutions or supplemental applicants)
- Testing of Agreement(s)
 - Formal written agreement
 - Payment Frequency
 - Monthly, Quarterly, Semi-Annually, Balloon Payment, Other
 - Disclose relationship between Lender & Licensee
 - Common Ownership, Same Ownership, Parent/Subsidiary, Immediate Family Member(s), Unrelated Third-Party, Other



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Schedule of Expenditures – Financing Agreements Best Practices and Common Exceptions

- Obtain executed copies of ALL agreements
- Follow the payment terms, consistency and accuracy
- Ensure related party re-payment schedule/plan is reasonable
- Tracking within an accounting system that clearly calls out deposits and repayments
- **Most common exception** – maturity date reached with no payment(s), paid as cash is available, prepayment(s) – but all of these are inconsistent with the underlying agreement



Schedule of Expenditures – Management Agreements

- Conducted collectively for all licenses held by an entity
- Understanding or contract between a licensee and another party for the provision of management or other services that would allow the other party to exercise control over or participate in the management of the licensee or to receive more than 10% of the gross profit from the licensee
- Testing of Agreement(s)
 - Formal written agreement
 - Disclose relationship between Lender & Licensee
 - Common Ownership, Same Ownership, Parent/Subsidiary, Immediate Family Member(s), Unrelated Third-Party, Other



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Schedule of Expenditures – Management Agreements Best Practices and Common Exceptions

- Obtain executed copies of ALL agreements
- Follow the payment terms, consistency and accuracy
- Ensure related party payment schedule/plan is reasonable
- Tracking within an accounting system that clearly calls out payments
- Common exceptions
 - No support
 - Contract isn't complete or payments are not related to agreement terms
 - Disbursements made are not in accordance with the payment terms of the agreement



Schedule of Expenditures – Licensing Agreements

- Conducted collectively for all licenses held by an entity
- What is a licensing agreement?
 - IP lease or royalty agreement
 - Branding agreements from Michigan or National brands
- Listing of licensing agreements provided by management
 - Must list CRA approval date as well
- Trace total payment made under the agreement during the reporting period



Schedule of Expenditures – Licensing Agreements Best Practices and Common Exceptions

- Documentation, documentation, documentation
 - Invoices and support should be kept and archived
- Obtain executed copies of ALL agreements
- Common Exceptions:
 - Payment detail not traceable to support
 - METRC amounts seem unreasonable for payment activity
 - Payments were not started or payments made do not follow the licensing agreement as executed
 - A licensing agreement exists that management provided to the CRA, but not to the CPA
 - A licensing agreement exists that management provided to the CPA, but not to the CRA



Schedule of Expenditures – Licensing Agreements Best Practices and Common Exceptions

- Common Exceptions (*cont.*):
 - Licensing agreement reported has not been approved by CRA
 - Licensor meets the definition of applicant
 - Disbursements are made not in accordance with the payment terms in the agreement
 - Payment directly to the licensor instead of licensee party to licensing agreement
- Reconciliation of licensing agreement transactions in METRC done monthly, at a minimum (more frequently, if possible)
 - Tagging METRC transactions with a unique identifier to provide for reconciliation ease



Schedule of Expenditures – Service Vendors

- Conducted collectively for all licenses held by an entity
- Refers to a party that provides a service and/or creates goods including, but not limited to: **safety compliance testing**, **secure transporter services**, consulting services, human resource management, supply chain management, supply chain financing (e.g., credit card fees, LeafLink Financial fees), accounting, customer services and/or support, marketing, bud trimming services, security, legal services, electricity, water, gas, sewer, garbage, telephone, and internet.
 - Service fees include, but are not limited to: annual fees, interest on unpaid balances, and service charges
- Detail testing of disbursements/expenses
- Listing of top vendors provided by management



Schedule of Expenditures – Service Vendors Best Practices and Common Exceptions

- Documentation, documentation, documentation
 - Keep vendor invoices, receipts, purchase orders and attach to each transaction
 - Vendor files or electronic files, some accounting systems allow for digital attaching of support
 - Maintain accounting system with vendor tags for ease of providing a top list
 - Bank statements, credit card statements and cash logs...oh my!
 - Keeping all statements and reconciling regularly will help support this procedure
 - Cash logs need to be meticulous and regularly reconciled
- Common exceptions:
 - No support or support doesn't match disbursement amounts
 - Vendor list isn't complete or tagged appropriately
 - Inaccurate transaction amounts when compared to what is aggregated in the top list
 - Using multiple accounts, personal or business, to pay expenses



Schedule of Expenditures – Other Vendors

- Conducted collectively for all licenses held by an entity
- Refers to any vendors receiving payment(s) from the licensee that has not been previously disclosed on the preceding vendor schedules including, but are not limited to: cannabis purchases, equipment purchases, packaging materials, purchases for materials used for growing or processing, etc. For purchases made through supply chain financing (i.e., credit cards), the underlying vendors must be identified and reported.
- Detail testing of disbursements/expenses
- Listing of top vendors provided by management



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Schedule of Expenditures – Other Vendors

Best Practices and Common Exceptions

- Documentation, documentation, documentation
 - Keep vendor invoices, receipts, purchase orders and attach to each transaction
 - Vendor files or electronic files, some accounting systems allow for digital attaching of support
 - Maintain accounting system with vendor tags for ease of providing a top list
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 - Cash logs need to be meticulous and regularly reconciled
- Common exceptions:
 - No support or support doesn't match disbursement amounts
 - Vendor list isn't complete or tagged appropriately
 - Inaccurate transaction amounts when compared to what is aggregated in the top list
 - Using multiple accounts, personal or business, to pay expenses



Schedule of Distributions - Ownership

- Conducted collectively for all licenses held by an entity
- Ownership and Distribution testing
- List owners of licensed entity
 - Looking through Relevant Passthrough Entities (“RPE”) to individual owners
 - Focus on supplemental applicants
- Trace distributions through to individual owners



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Schedule of Distributions – Ownership Best Practices and Common Exceptions

- Obtain and follow legal documents (operating agreements, bylaws, etc.)
- Follow distribution procedures within legal agreements
- When onboarding investors, use this procedure and look-through rules to establish best practices
- Different types of entities have different testing thresholds (5% v. 2.5%)
- Make sure to account for shareholder or partner loan transactions separately from equity accounts in accounting system



Schedule of Distributions – Ownership Best Practices and Common Exceptions

- Common Exceptions:
 - Legal documents are not followed (waterfall distributions, or distributions made not in accordance with percentages or terms)
 - Ownership has changed
 - RPEs are not traced through to individual
 - Odd or non-distribution transactions are recorded in equity accounts in general ledger



Schedule of Distributions - Employee

- Conducted collectively for all licenses held by an entity
- Test employee wages/salary against gross profit (Revenue less COGS)
 - If employee's wage/salary are more than 10% of gross profit, employee is listed with title and job description
- Test if bonuses are received during the reporting period
 - If employee's total bonus compensation is more than 25% of their total regular wages/salary for the reporting period, employee is listed with total amount of bonus paid
 - Be prepared to explain reason for bonus(es)
- Test if stock options are offered to employees
 - If yes, test if they were executed during the reporting period and gave the employee 10% direct or indirect ownership interest in the licensee
 - If yes, employee is listed with total percentage of ownership and date option was exercised



Schedule of Distributions – Employee Best Practices and Common Exceptions

- Employee Payroll – reports provided by management
 - Utilize a system and rely on payroll records to quantify totals
 - Pull reports by employee showing gross to net pay with pay items identifiable (regular/salary, bonus, commission, etc.)
- Compensation and other benefit plans
 - Provide a thorough description of your benefit & bonus plans
 - Employee handbooks and onboarding materials, hiring materials



Schedule of Distributions – Other Persons

- Conducted collectively for all licenses held by an entity
- Any other person(s) (*not previously identified on Schedule D1 – Ownership or D2 – Employee*) that received or has the right to receive more than 10% of the licensee's revenue (gross income) or profit (revenue less costs) during the reporting period
- Provide person's name, amount received, and date received
- Provide executed agreement or provide details of oral agreement



Notice of Deficiency (NOD) – What is it and What do we do with it?

- Notice of Deficiency (“NOD”) doesn’t mean you or your CPA did something incorrectly
- The NOD indicates items that require further clarification or were found to be deficient by the CRA
 - This document is sent to the authorized contacts provided on the Contact Authorization form
- Opportunities to learn, get better with documentation, and provide explanation
- Amount of exceptions on the report do not necessarily indicate overall quality of report



General Cannabis Accounting Best Practices

- Best practices should be implemented pre-licensure
- Maintain an accurate cash log of all cash transactions
- All transactions must include a vendor or customer
- Every disbursement is supported with receipts, vendor invoices, or purchase orders
- Every sale is supported with an invoice or POS report
- Break out sales in general ledger:
 - Adult Use vs. Medical
 - Cannabis vs. Non-Cannabis vs. Service Related
- Distributions to owners follows operating agreement or bylaws, without question
- Documentation, Documentation, Documentation!



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General Cannabis Accounting Best Practices - continued

- Consult a CPA early and often
- Research and fully utilize software that is complimentary to your operation
- Consider data backup options to insure against loss of electronic information
- Keep segregation between business and personal transactions – it can be tempting to run personal items through a solely owned business, but it is never a good idea
- Be cognizant of the AFS process and how arduous it can be – good accounting practices will make this much easier
- We can't stress this enough: Documentation, Documentation, Documentation!



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AFS Changes on the Horizon

AFS report revisions are expected for the
FY25 reporting periods



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Q & A

What questions do you have?

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