

# Annual Financial Statements and You

An Educational Primer

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Certified Public Accountants

# Annual Financial Statement (AFS) Authority

Medical – Section 701 of MMFLA

By 30 days after the end of each state fiscal year, each licensee shall transmit to the board and to the municipality financial statements of the licensee's total operations

AU – Rule 20 of the Marihuana 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 MRA

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

Intent and History



# 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 on standards for attestation engagements
- AFS form report contains the required procedures and schedules for FY21
- 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 MRA by the deadline



# Licensee Notice and Responsibilities

- Licensee is notified by email and notice sent approximately 6 months in advance of the report due date. Due date is a hard and fast due date
- Email and notice sent to all licensee record contacts:
  - Entity
  - Person completing form
  - All supplemental individual and entities
- Licensee should review license record contacts and ensure that proper persons 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 MRA by the deadline



# 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





# 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
  - Timelines
    - When to engage





# AFS Form Report

Cover Sheet

Procedure 1 – Questionnaire

Procedure 2 – Revenue

Procedure 3 – Disbursements

Procedure 4 – Vendors

Procedure 5 – Payroll Tax

Procedure 6 – Ownership & Distributions

Procedure 7 – Licensing Agreements

Procedure 8 – Outsourced Services

Procedure 9 – Excise Tax

Procedure 10 – 1099 Independent Contractor

Procedure 11 – Sales Tax

# Procedure 1 Overview

- Procedure 1 is conducted collectively for all licenses held by an entity
  - Employee counts – part time, full time
  - Independent contractor counts
  - Compensation and other benefit plans
  - Banking and cash handling procedures
  - Real property lease agreements
    - Tested for adherence to terms





# Procedure 1 Best Practices and Common Exceptions

- Employee counts – counts provided by management
  - Utilize a system and rely on payroll records to quantify totals
- Independent contractor counts – counts provided by management
  - Utilize an accounting system that tracks payments to vendors receiving 1099s
  - Compare counts to filed 1099 forms in your reporting period and overarching 1096 forms
- Compensation and other benefit plans
  - Provide a thorough description of your benefit plans
  - Employee handbooks and onboarding materials, hiring materials
- Banking and cash handling procedures
  - Focus on internal controls and a good SOP



# Procedure 1 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
  - Most common exception on procedure 1 – rent is deferred, not paid, paid as cash is available, but all of these are inconsistent with the underlying agreement



# Procedure 1 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



# Procedure 2 Overview

- Duplicated for each license held
- Detail testing from METRC system through a Point-of-Sale (POS) (if applicable) and to underlying accounting ledgers
- Total revenue tie outs between METRC, POS (if applicable) and General Ledger
- METRC is a mandated system that is used as a baseline for evaluating licensee revenues



# Procedure 2 Best Practices and Common Exceptions

- Detail testing from METRC system through a POS system (if applicable) and to underlying accounting ledgers
  - Accurate general ledger postings are critical
  - Use invoicing module if available for cultivators, processors, secure transporters and safety compliance facilities
- Total revenue tie outs between METRC, POS (if applicable) and General Ledger
  - 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





# Procedure 2 Best Practices and Common Exceptions

- Common exceptions:
  - METRC doesn't match general ledger (cultivator, processor, provisioning center, retailer, microbusiness)
  - No METRC data (secure transporter, safety compliance)
  - Batch entries are not traceable into the ledger
  - Quantities are in METRC and invoices in different measurements (g vs. lb)
  - METRC amounts don't agree to invoices
  - Toll processing



# Procedure 2 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
- Secured transporters listed on a manifest but did not transport
- Incorrect license numbers referenced on manifest – Med vs. AU
- METRC errors
  - Wrong units – single vs multiples
  - Lack of record keeping/documentation to support transactions



# Procedure 3 Overview

- Duplicated for each license held
- Detail testing of disbursements/expenses
- Procedure includes evaluating vendors, description of expenses, periods of service
  - Traced to invoices and other types of corroborating support
- Observance of payment proof (clearance through a bank, credit card statement or cash log)



# Procedure 3 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
  - 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
  - No cash log
  - Support doesn't match disbursement amounts
  - Using multiple accounts, personal or business, to pay expenses



# Procedure 4 Overview

- Duplicated for each license held
- Listing of top vendors provided by management
- Similar in scoping and testing to procedure 3
  - Vendors
  - Descriptions
  - Periods of service





# Procedure 4 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
  - Maintain segregation for vendors and payments by Medical and Adult-Use (each report tests its own transactions) as this is one of the biggest issues for licensees when providing procedure 4 support
- Common exceptions
  - No support
  - Vendor list isn't complete or tagged appropriately
    - Inaccurate transaction amounts when compared to what is aggregated in the top list
  - Personal credit card company can not be a vendor



# Procedure 5 Overview

- Conducted collectively for all licenses held by an entity
- Payroll and employment testing
  - Directly employed personnel versus a PEO or staffing agency
- Tracing and comparing wage totals from filed 941 forms to underlying accounting ledger
- Tracing and comparing tax liability from filed 941 forms to underlying support
- Timely payments



# Procedure 5 Best Practices and Common Exceptions

- Documentation, documentation, documentation
  - Post payroll in a manner that allows tie out to payroll reporting
    - Gross wages v. Net wages
  - Allocating inventoriable wages? No problem
    - Post wages to an expense account and journal out the inventoriable portions for ease of tie out at AFS time
  - Payments – made timely, and support kept
  - If using a payroll processor – ensure that tax payment records are available to provide
- Common exceptions
  - Wages posted net (what comes out of the bank) versus gross
  - Wages not traceable in general ledger or mis-posted
  - Payments not made timely
  - Support not available for payments



# Procedure 6 Overview

- 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



# Procedure 6 Best Practices and Common Exceptions

- Obtain and follow legal documents (operating agreements, bylaws, etc.)
- Follow distribution procedures within legal agreements
- When onboarding investors, use procedure 6 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
- 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





# Procedure 7 Overview

- Conducted collectively for all licenses held by an entity
- What is a licensing agreement?
  - IP lease or royalty agreement
  - Branding agreements
- Listing of licensing agreements provided by management
  - These are approved by MRA as well
- Test agreements by tracing sales quantities from METRC to invoices or support
- Trace payments under the agreement to invoices or support



# Procedure 7 Best Practices and Common Exceptions

- Documentation, documentation, documentation
  - Invoices and support should be kept and archived
- Listing of all agreements should be maintained and readily available
- 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
- Common Exceptions:
  - Payment detail not traceable to support
  - METRC quantities don't agree to invoices
  - Payments made do not follow the licensing agreement as executed
  - A licensing agreement exists that management does not provide to the CPA, but MRA has a copy



# Procedure 7 Best Practices and Common Exceptions

- Licensing agreement reported has not been approved by MRA
- The 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



# Procedure 8 Overview

- Conducted collectively for all licenses held by an entity
- List of contracts for outsourced services provided by management
  - Management, consulting, accounting, anything that could normally be done “in-house” by an employee or owner
- Testing of transactions procedurally similar to procedure 3, 4, and 10
- Transactions traced to invoices, or other support



# Procedure 8 Best Practices and Common Exceptions

- Documentation, documentation, documentation
  - Retaining supporting documentation, invoices, receipts, etc. is critical
  - Refer to the contract and follow it; if exceptions are necessary, obtain agreement in writing
  - Tagging by vendor (or contract service provided) makes pulling accounting information much easier
  - Segregating amounts between Medical and Adult-Use
- Common exceptions
  - No support
  - Contract list isn't complete or tagged appropriately
    - Inaccurate transaction amounts when compared to what is aggregated in the top list
    - Every licensee reports these – if 95% of licensees list a contract with Ghost Management (for example) and you don't, but a Ghost Management transaction gets picked in procedure 3 or 4 – this presents a problem when reviewed by the MRA





# Procedure 8 Best Practices and Common Exceptions

- Management/Consulting/Service Company meets the definition of applicant.
- Receive more than 10% of gross or net profits during any full or partial calendar or fiscal year
- Exercises control over or participates in the management of the marihuana business
- Disbursements made are not in accordance with the payment terms of the agreement.
- New rule will require these agreements be reviewed and approved by MRA



# Procedure 9 Overview

- Conducted collectively for all licenses held by an entity
- What licenses are subject to excise tax?
  - Retailers and Microbusinesses – Adult Use only
- Trace METRC sales amounts to Point-of-Sale (POS) and to Treasury filed reports
- Trace payments made to total liability on Treasury filed reports



# Procedure 9 Best Practices and Common Exceptions

- Reconciliation from METRC to POS reports, and to filed excise tax reports
  - Reconciliations done in support of procedure 2 should come in handy here
- Payment support should be maintained
- Reports filed timely and accurately
  - No one wants to overpay taxes, but overpaying is better than underpaying
- Common Exceptions:
  - METRC, POS, and Treasury reports do not agree
  - Bundling of products and how non-THC product is taxed
  - Payments are not made or made timely
  - Non-payment of excise tax
  - Calculation accuracy issues



# Procedure 10 Overview

- Conducted collectively for all licenses held by an entity
- Independent contractor testing for those receiving a 1099-NEC
- Management provided list of 1099 recipients
- Procedurally, very similar to procedure 3, 4 and 8
- Traced payments to invoices or other support



# Procedure 10 Best Practices and Common Exceptions

- Documentation, documentation, documentation
  - Retain copies of invoices, payment remittances, etc.
- Agree information to 1099 forms and totals provided in the list to 1096 form
- Pay attention to reporting periods – a 1099 is calendar year while reporting periods may not be
  - Amounts should agree to the 1099 ONLY for 12/31 reporting period ends
- Common Exceptions:
  - No support
  - Inaccurate transaction amounts when compared to what is aggregated in the 1099 list
  - Independent contractor meets the definition of “applicant”





# Procedure 11 Overview

- Conducted collectively for all licenses held by an entity
- What licenses are subject to sales tax
  - Medical – Provisioning Centers
  - Adult Use – Retailers and Microbusinesses
- Trace METRC sales amounts to Point-of-Sale (POS) and to Treasury filed reports
- Trace payments made to total liability on Treasury filed reports



# Procedure 11 Best Practices and Common Exceptions

- Reconciliation from METRC to POS reports, and to filed sales tax reports
  - Reconciliations done in support of procedure 2 should come in handy here
  - Remember that **excise tax** is subject to sales tax, this will always be a reconciling item when a licensee has both Medical and Adult-Use licenses
- Payment support should be maintained
- Reports filed timely and accurately
  - No one wants to overpay taxes, but overpaying is better than underpaying
- Common Exceptions:
  - METRC, POS and Treasury reports do not agree
  - Bundling of products and how non-THC product is taxed
  - Sales tax percentage is incorrect
  - Payments are not made or made timely
  - Sales tax not paid on adult-use or medical sales
  - Sales tax not paid on excise tax



# Notice of Deficiency – What is it and What do we do with it?

- Notice of Deficiency (“NOD”) doesn’t mean you or your CPA did something incorrectly
- Opportunities to learn, get better with documentation, and provide explanation
- Amount of exceptions on the report do not necessarily indicate overall quality of report



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# 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
- I can't stress this enough: Documentation, Documentation, Documentation!



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# AFS Changes on the Horizon

- House Bill 4921 – If passed will allow the MRA to combine medical and adult-use reporting and set reporting schedules
- AFS FY 22 report revisions have been made based on Licensee and CPA workgroups and the related feedback from those workgroups held earlier this year



# Q & A

We'd like to provide some time to answer any questions that we can from the question submissions throughout this presentation



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