

THE IMPACT OF MISSTATED ACCOUNTING DISCLOSURES ON A COMPANY'S EARNINGS: THE CASE OF AURORA CANNABIS INC.

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Headquartered in Edmonton (Canada), Aurora Cannabis Inc. was a vertically integrated and horizontally diversified company that produced and distributed medical cannabis and derivative products in Canada and internationally. In early 2020, Aurora announced a business transformation plan that promised to lower selling, general and administrative (SG&A) expenses and put the company on a sustainable long-term path. However, in September 2020, Aurora updated its fixed asset impairment charges and reported a surge in carrying value of inventory, resulting in a write-down of goodwill and intangible assets of approximately \$1.8 billion. It was on this news that Aurora's stock price fell by close to 12%. The company's investors filed class-action complaints that alleged that Aurora knowingly misstated its financials and thus violated the Securities Exchange Act of 1934. A law firm representing investors retained the expert witness services of a consulting company that specialized in class action lawsuits dealing with accounting and financial reporting issues. The legal team and the consultants faced a critical decision. Was there enough evidence of intentional wrongdoing and financial misreporting to pursue the lawsuit? This case integrates the issues of financial reporting, business law, shareholder value, and investor expectation management.

INTRODUCTION

In fall of 2020, Stephen Lawless found himself in a position he did not want to be in—he was a plaintiff in a lawsuit *Lawless v. Aurora Cannabis Inc.* He and similar investors alleged that Aurora knowingly misstated their financials and thus violated federal securities regulations. His lawyers retained the expert witness services of a consulting company that specialized in class action lawsuits dealing with accounting and financial reporting issues. Now preparing for the trial, Lawless's

lawyers and the consulting firm pored over Aurora's reporting materials made between February and September of 2020, particularly those pertaining to Sections 10(b) and 20(a) of the Securities Exchange Act of 1934 and Rule 10b-5. The legal team worked to prepare the case against Aurora's top financial officers—who under the Sarbanes-Oxley Act of 2002 were personally responsible for their firm's financial statements.

Aurora was headquartered in Edmonton, Canada. The company produced and distributed medical cannabis products worldwide as a vertically integrated and horizontally diversified company across various segments of the cannabis value chain (Class Action Complaint, US District Court of New Jersey). In early 2020, Aurora issued a press release announcing a business transformation plan to align the organization with the current market and regulatory conditions and to put the company on a sustainable path to achieve long-term growth. In its Form 6-K, Aurora management's discussion and analysis (MD&A) included a note regarding its organic growth and strategic acquisitions. However, only a few months later in September of 2020, Aurora issued another press release announcing an update of its business plan that reflected a projected a significant write-down of goodwill and intangible assets in the range of \$1.6 to \$1.8 billion. As a result, Aurora's stock price fell by 11.63% in September 2020 and it continued its downward trajectory after.

Lawless and the other plaintiffs alleged that Aurora made false and/or misleading statements and failed to disclose that it overpaid for previous acquisitions, experienced degradation in certain assets, misrepresented the success of its business transformation plan, and failed to be transparent with its investors on the significant goodwill and asset impairment charges.

THE INDUSTRY















First, the consulting firm familiarized itself with the fundamentals of the Canadian cannabis industry and its trends. The industry was complex due to its relative newness, brisk growth, web of regulations, and considerable uncertainty. Cannabis had for decades been considered a harmful drug and was included in the United Nations Single Convention on Narcotics Drugs of 1961 (United Nations, 2022). The Convention coordinated international action to limit the manufacture, trade, and distribution of drugs to medical and scientific purposes only. As party to the Convention, Canada had a very limited cannabis industry that basically consisted of medical patients growing their own cannabis plants or individuals growing plants for other medical patients. That changed with the Marihuana for Medical Purposes Regulations of 2013 (MMPR), which enabled the formation of companies dedicated to growing medical marijuana. The act treated cannabis as a narcotic pharmaceutical, meaning licensed producers could begin cultivating and selling

dried cannabis to prescription holders. Producers had to follow stringent guidelines for how they conducted business with the expectation that licensing would lead to better safety, quality, and dosing accuracy. Only a small percentage of applicants received licenses, and those licenses were for specific sites and products (Leung, 2017). Thus, single companies could hold multiple licenses. For example, in 2016 Aurora had licenses to cultivate dried plant and sell it, but it did not hold licenses to do other things such as produce oils.

The MMPR was replaced in 2016 with the Access to Cannabis for Medical Purposes Regulations (ACMPR), which kept the licensed producers framework while also allowing patients to grow their own plants again. The Act created an additional product market for licensed providers to sell cloned plants (cuttings taken from mother plants) and seeds to patients. The ACMPR also permitted the selling of cannabis oil in capsule or dosage form, but not marijuana-infused products or edibles. However, patients were permitted to alter fresh, dried, or oil cannabis to make their own edibles.

While continuing to serve the medical market, the Canadian cannabis industry had been preparing for the legalization of recreational marijuana—it was a key aspect of Canadian Prime Minister Justin Trudeau’s platform. The size of the recreational market was considerable, predicted to be about \$5 billion or up to \$22.6 billion with the inclusion of testing labs, security, paraphernalia, and other related markets (Koven, 2015). Legalization of recreational marijuana occurred in 2018 with the passage of The Cannabis Act (Guerra-Khan, 2019), making Canada the first major economy in the world to legalize adult use federally. The Act permitted adults to use and possess a certain amount of marijuana, expanded the types of cannabis products that could be sold, specified rules for production, distribution, and safety, and created new criminal offenses for the sale of marijuana to minors. Licenses were still required and were for specific classes of cannabis sold to either authorized distributors/retailers or to registered patients. For example, Figure 1 shows Aurora had five sites licensed in three provinces by 2021. Three sites were licensed for sales, processing, and cultivation while a fourth site was licensed to process and a fifth was licensed for medical sales. Aurora’s sites were licensed for plants/seeds, dried/fresh, extract, edible, and topical products.

FIGURE 1**Aurora's License Holders.**

Licence holder  	Province / territory  	Licence(s)  	Classes of cannabis the licence holder is authorized to sell		Client Care phone numbers for registered patients  	Date of initial licensing (year-month-day)  
			to provincially/territorially authorized distributors/retailers  	to registered patients  		
Aurora Cannabis Enterprises Inc. (10 th site)	ON	<ul style="list-style-type: none"> • Sale (Medical) • Processing • Cultivation 	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	1-855-4-RELEAF (473-5323)	2014-02-14
Aurora Cannabis Enterprises Inc. (11 th site)	ON	<ul style="list-style-type: none"> • Sale (Medical) • Processing • Cultivation 	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	1-855-4-RELEAF (473-5323)	2017-04-12
Aurora Cannabis Enterprises Inc. (3 rd site)	AB	<ul style="list-style-type: none"> • Sale (Medical) • Processing • Cultivation 	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	1-844-9AURORA (928-7672)	2018-01-26
Aurora Cannabis Enterprises Inc. (12 th Site)	ON	<ul style="list-style-type: none"> • Processing 	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	None	N/A	2020-11-13
Aurora Cannabis Enterprises Inc. (13 th site)	BC	<ul style="list-style-type: none"> • Sale (Medical) 	None	<ul style="list-style-type: none"> • Plants / Seeds • Dried / Fresh • Extracts • Edible • Topical 	1-844-9AURORA (928-7672)	2021-06-11

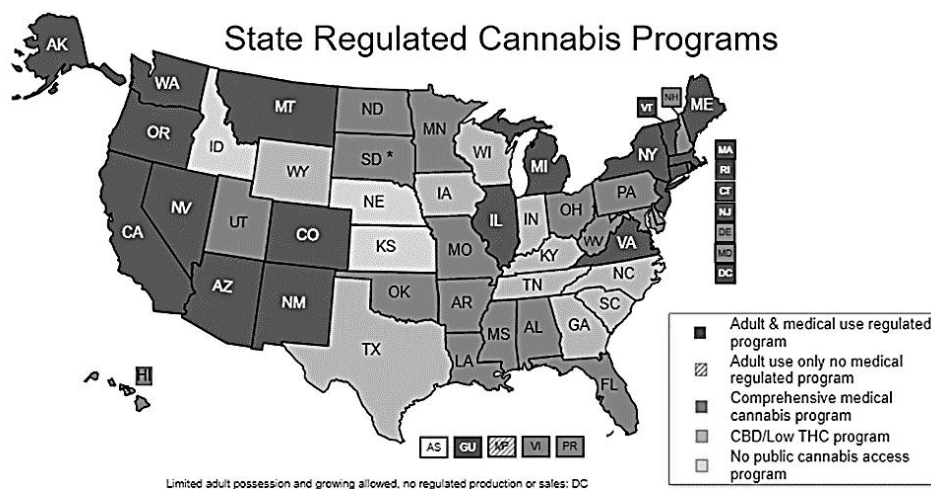
Source: Health Canada Cannabis License Holders (2022).

Given the licensing requirements and the stringent process to qualify, the Canadian cannabis industry was dominated by a few companies. Chief among them were Canopy Growth, OrganiGram, Aphria, and Aurora Cannabis. These companies enjoyed a rapidly growing market. In fact, the size of the Canadian cannabis market increased to \$2.6 billion in 2020, up more than double from \$1.2 billion in 2019 (Coulton, 2022). Approximately 58% of sales were dried cannabis, with 24% edibles and 17% extracts (Government of Canada, 2022). The production process for cannabis products was rather lengthy. It involved growing plants from seeds or clones, placing them in grow rooms for the plants to flower, harvesting, trimming, drying, curing, and packaging—a process that could take over six months (Leung, 2017). Despite legalization, both processing and selling continued to face substantial rules. For example, excise taxes as well as different provincial markups made the products more expensive for the producers and subsequently the retailers.

and consumers. Interestingly, cannabis was the only medicine in Canada subject to an excise tax (Coulton, 2022).

Most of the products produced by Canadian companies were sold domestically due to restrictions on trade by the UN Single Convention on Narcotic Drugs, but that dynamic was changing as additional countries and/or their territories legalized medical marijuana. Canada passed the Netherlands as the leading exporter of legal cannabis in 2020 while importing virtually none. To capture more of foreign markets, the Canadian companies were expanding operational capacities, acquiring companies in foreign countries to bypass trade rules, and developing strategic partnerships. The Canadian companies were also rapidly increasing sales to the United States due to multiple states legalizing medicinal and/or recreational marijuana (see Figure 2). The U.S. market was much larger than the Canadian market—the entire U.S. market was estimated to be at least 4 times the size of the Canadian market (Smith, 2018).

FIGURE 2
Legalization of Cannabis in the U.S.



Source: National Conference of State Legislatures (2022).

The key opportunity for the Canadian cannabis industry also happened to be its key threat: the United States and its changing political situation. As more U.S. states legalized marijuana and the federal government grew seemingly more likely to decriminalize marijuana, the opening of the entire U.S. market was a potentially huge opportunity for the Canadian producers. With their several year head start, the Canadian companies were well positioned with expertise, facilities, and capital—

they stood in a good position to leverage their first mover advantage to supply the U.S. market (PwC, 2018). However, U.S. companies, including behemoths such as pharmaceutical, tobacco, and alcohol companies, possessed the capital to enter the market, drive out competition, and ultimately expand into Canada if they chose to do so.

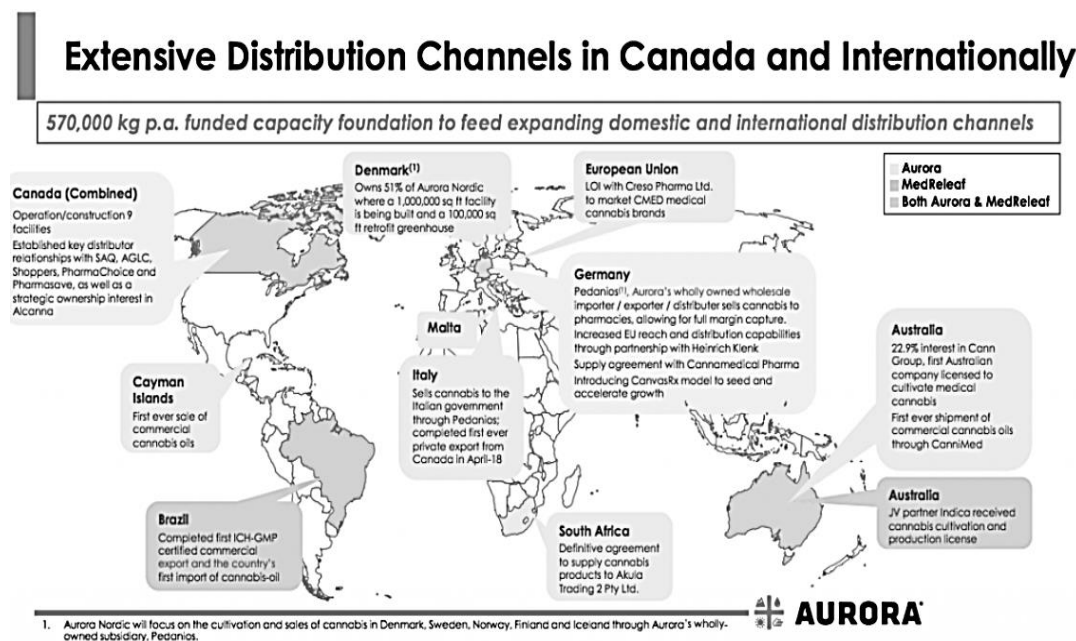
THE COMPANY PROFILE

Armed with the background information about the Canadian cannabis industry, the consulting team moved on to learn about the company itself. The information came from various publicly available sources, including Aurora's annual reports, earnings reports, and other company filings. Aurora Cannabis Inc. produced, distributed, and sold cannabis and cannabis derivative products in Canada and internationally. The company produced various strains of dried cannabis, cannabis oil and capsules, and topical kits for medical patients. It also sold vaporizers and consumable vaporizer accessories. Further, it provided patient counselling services; design and construction services; and cannabis analytical product testing services (Aurora, 2022).

The company's principal strategic business lines were focused on the production, distribution, and sale of medical and consumer cannabis products in Canada pursuant to the Cannabis Act. It also distributed wholesale medical cannabis in the European Union pursuant to the German Narcotic Drugs Act. Finally, it distributed and sold hemp-derived cannabidiol (CBD) products in the U.S. market. With the U.S. being the largest cannabis and CBD market, Aurora evaluated its alternatives to establishing an operating footprint in the U.S. In 2020, Aurora acquired Reliva, LLC, a Massachusetts-based company that specialized in the sale of CBD as an entry into the U.S. market. During the same year, the company also announced a business transformation plan "intended to better align the business financially with the current realities of the cannabis market in Canada while maintaining a sustainable platform for long-term growth" (Aurora, 2021). These actions included rationalizing selling, general and administrative expenses through a reduction in corporate and production staff. The company had also reduced and closed operations at four Canadian facilities.

FIGURE 3

Aurora's Distribution Channels.



Source: Aurora Investor Presentation (2018).

FINANCIAL DISCLOSURES

Aurora Cannabis Inc. (TSX: ACB) was a “foreign private issuer” as defined in Rule 3b-4 under the Securities Exchange Act of 1934 and was a Canadian issuer eligible to file its annual report on Form 40-F pursuant to the multi-jurisdictional disclosure system adopted by the SEC (Aurora, 2021).

Between 2017 and 2021, Aurora performed well and projected a positive outlook for earnings for the foreseeable future. In addition to enjoying the first-mover advantage, rapid capitalization on new opportunities, and a strong diversity of brands, the company was well known for its acquisition activities. Market analysts reported that acquisitions and deal-making were one of Aurora's defining characteristics. Aurora seemed to make more deals and larger deals compared to nearly any other company in cannabis (Seeking Alpha, 2018). However, during the third quarter of 2020, Aurora reported significant issues with impairment charges that investors alleged misled them, resulting in a legal complaint.

FIGURE 4

Aurora's Financials.

Income Statement					
For the Fiscal Period Ending (USD)					
	2017	2018	2019	2020	2021
Revenue	13.9	42.0	187.7	197.5	198.0
Other Revenue	-	-	-	-	-
Total Revenue	13.9	42.0	187.7	197.5	198.0
Cost Of Goods Sold	1.5	8.9	78.8	212.2	215.4
Gross Profit	12.4	33.1	108.9	(14.7)	(17.4)
Selling General & Admin Exp.	13.1	55.1	197.5	210.7	141.0
Stock-Based Compensation	5.8	28.5	81.8	43.5	16.3
R & D Exp.	0.2	1.3	11.3	19.1	9.2
Depreciation & Amort.	0.6	9.2	48.4	49.7	39.7
Other Operating Expense/(Income)	-	-	-	-	-
Other Operating Exp., Total	19.8	94.0	339.0	323.0	206.2
Operating Income	(7.4)	(60.9)	(230.2)	(337.7)	(223.6)
Interest Expense	(3.7)	(8.9)	(30.1)	(56.0)	(53.6)
Interest and Invest. Income	0.7	1.9	2.8	4.3	4.6
Net Interest Exp.	(3.1)	(7.0)	(27.3)	(51.6)	(49.0)
Income/(Loss) from Affiliates	-	(1.7)	(7.3)	(8.5)	(0.4)
Currency Exchange Gains (Loss)	(0.2)	(0.8)	(3.9)	(9.7)	(2.7)
Other Non-Operating Inc. (Exp.)	(1.6)	131.8	(17.6)	102.2	(1.8)
EBT Excl. Unusual Items	(12.2)	61.4	(286.3)	(305.2)	(277.5)
Restructuring Charges	-	-	-	(1.4)	(0.8)
Merger & Related Restruct. Charges	(1.2)	(11.9)	(13.2)	(4.8)	(4.6)
Impairment of Goodwill	-	-	(3.0)	(1,679.9)	(27.2)
Gain (Loss) On Sale Of Invest.	1.0	15.3	54.3	(46.4)	(1.0)
Gain (Loss) On Sale Of Assets	-	-	0.3	0.4	9.0
Asset Writedown	-	-	(3.9)	(294.0)	(236.7)
Legal Settlements	-	-	-	-	(37.3)
Other Unusual Items	(0.9)	(6.0)	(1.1)	(124.0)	11.4
EBT Incl. Unusual Items	(13.3)	58.8	(252.8)	(2,455.2)	(564.8)
Income Tax Expense	(3.3)	6.2	(22.9)	(60.5)	(5.1)
Earnings from Cont. Ops.	(10.0)	52.6	(229.9)	(2,394.8)	(559.7)
Earnings of Discontinued Ops.	-	-	0.1	(38.1)	(1.3)
Extraord. Item & Account. Change	-	-	-	-	-
Net Income to Company	(10.0)	52.6	(229.8)	(2,432.9)	(561.0)
Minority Int. in Earnings	-	2.1	5.4	19.6	1.2
Net Income	(10.0)	54.7	(224.4)	(2,413.3)	(559.9)

Source: Capital IQ (2022).

Allegations

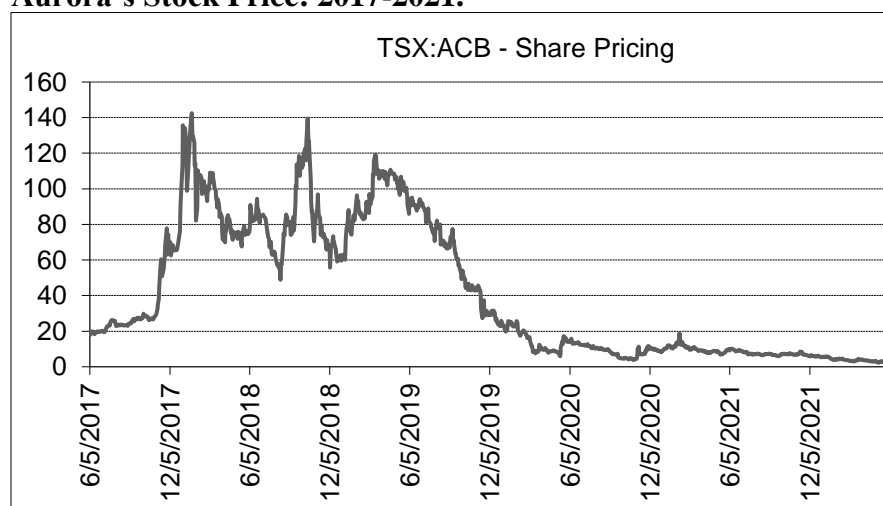
As discussed above, in February of 2020 Aurora issued a press release announcing its business transformation plan, which would result in significant decreases in selling, general & administrative (SG&A) expenses. In September 2020, the company issued another press release announcing an update of its business plan along with certain unaudited preliminary fiscal fourth quarter 2020 results.

The issue that precipitated the class action suit was Aurora's anticipated goodwill impairment charges in the fourth quarter of 2020. In early 2020, the company

recorded a \$762 million impairment charge to goodwill, a \$158.7 million impairment charge to definite life and indefinite life intangible assets, and a \$51.9 million impairment charge to property, plant and equipment. Later that year, the company suggested that it was still on track with its SG&A cost reductions, lowered capital expenditures, and reduced complexity across the organization. However, after only a few more months, Aurora noted a recorded \$7.4 million impairment charge associated with slower than expected sales and profitability. Additionally, the company recognized an impairment charge of \$28.2 million “to reflect current market values and \$9.6 million write-downs on one of the properties acquired as part of an earlier acquisition transaction.” Aurora updated its estimated fixed asset impairment charges up to \$90 million due to production facility rationalization and a charge of approximately \$140 million in the carrying value of certain inventory (Aurora, 2020). By September, Aurora indicated that approximately 40% of the expected inventory provision related to the non-cash IFRS fair value adjustment within inventory, which was projected to amount to a non-cash write-down of goodwill and intangible assets in the range of \$1.6 to \$1.8 billion. It was on this news that Aurora’s stock price fell 11.63% to close at \$7.52 per share on September 8, 2020, and it continued this downward trajectory thereafter. (see Figure 5).

FIGURE 5

Aurora’s Stock Price: 2017-2021.



Source: Capital IQ (2022).

The investors who filed the complaint alleged that during 2020 Aurora “made materially false and misleading statements regarding the company’s business, operational and compliance policies” (Class Action Complaint, 2020). Specifically, the investors claimed that: (i) Aurora had significantly overpaid for previous acquisitions and experienced degradation in certain assets, including its

production facilities and inventory; (ii) the purported “business transformation plan” failed to mitigate the foregoing issues; (iii) it was foreseeable that the company would record significant goodwill and asset impairment charges; and (iv) as a result, the company’s public statements were materially false and misleading at all relevant times (Class Action Complaint, 2020). The consulting firm was charged with investigating possible fraudulent financial reporting by Aurora between February and September of 2020. The consultants relied on Aurora’s publicly available information sources, earnings reports, and the MD&A materials to examine the validity of valuation assumptions made by Aurora and to determine whether a strong case could be made that violations took place.

Review of Aurora Information

A. Valuation of goodwill and indefinite life intangible assets

The consultants began their analysis by examining MD&A statements made by Aurora. During the second half of 2020, the goodwill and intangible asset balances of the company were reported at about \$1.34 billion, which included goodwill and intangibles related to the cannabis operating segment. Goodwill represented the excess of the purchase price paid for the acquisition of an entity over the fair value of the net tangible and intangible assets acquired. Aurora reported that it identified the assessment of the fair value of goodwill and intangible assets in the cannabis operating segment as “a critical audit matter” (Aurora, 2020). The company mentioned that it made several “critical assumptions and used a high degree of judgement to determine the fair market value, the recoverable amount, and the discount rate when simulating the valuation process.” (Aurora, 2020). Aurora assured its investors that it performed sensitivity analyses on the discount rates, and it believed that it did “an adequate job of making economic assumptions for estimating uncertain future values of the goodwill and recoverable amounts.” (Aurora, 2020). However, Aurora was not transparent about how it specifically computed the discount rates, what historical values and ranges were used, and whether comparable industry peers were utilized in the valuations.

B. Assessment of the cannabis inventory provision

Investors alleged that Aurora had significantly overpaid for previous acquisitions and experienced degradation in assets such as in production facilities and inventory. According to Aurora’s reports, inventory was valued at the lower of cost and net realizable value (NRV). The company used judgment in determining the NRV of inventory. When assessing NRV, Aurora considered the impact of average selling price per gram, inventory spoilage, inventory excess, age and damage (Aurora, 2021). Again, according to Aurora, the assessment of the cannabis inventory provision was a “critical audit matter” and required a high degree of subjectivity in economic assumptions.

According to the company's MD&A, inventories of harvested cannabis were transferred from biological assets to inventory at fair value less costs to sell at the point of harvest, which became the deemed cost (Figure 6). Historically, the company pro-rated this cost of inventory based on the total grams harvested, but in 2020 Aurora decided to measure it at NRV at point of harvest and deduct this value from the total deemed cost to record a net cost for the main product (see Note 9 in Appendix). Additionally, Aurora elected to change its accounting policy with respect to the allocation of production management staff salaries, previously charged to general administrative expense, and now charged to inventory and cost of sales. The company believed that "the revised policies provided more accurate and relevant financial information to users of the consolidated financial statements." (Aurora, 2021). However, Aurora did not explain why such changes were made during this time, and the consultants question the overall impact of these changes on the company's financials.

FIGURE 6
Financial Notes for Inventory Breakdown.

AURORA CANNABIS INC.

Notes to the Consolidated Financial Statements

Years ended June 30, 2020 and 2019

(Tabular amounts reflected in thousands of Canadian dollars, except share and per share amounts)

The following is a breakdown of inventory:

	June 30, 2020			June 30, 2019 ⁽¹⁾		
	Capitalized cost	Fair value adjustment	Carrying value	Capitalized cost	Fair value adjustment	Carrying value
	\$	\$	\$	\$	\$	\$
Harvested cannabis						
Work-in-process	29,737	16,708	46,445	30,518	31,386	61,904
Finished goods	11,826	1,735	13,561	8,529	5,007	13,536
	41,563	18,443	60,006	39,047	36,393	75,440
Extracted cannabis						
Work-in-process	21,608	4,995	26,603	4,536	1,356	5,892
Finished goods	15,758	1,396	17,154	7,563	1,224	8,787
	37,366	6,391	43,757	12,099	2,580	14,679
Hemp products						
Raw materials	929	—	929	4,508	—	4,508
Work-in-process	235	—	235	1,000	—	1,000
Finished goods	107	—	107	3,183	—	3,183
	1,271	—	1,271	8,691	—	8,691
Supplies and consumables	16,125	—	16,125	9,673	—	9,673
Merchandise and accessories	668	—	668	2,838	—	2,838
Ending Balance	96,993	24,834	121,827	72,348	38,973	111,321

Source: Aurora (2021).

NATURE OF THE CLASS ACTION

Lawless's law firm filed a class action complaint against Aurora alleging that the company and six of its officers engaged in securities fraud under the Securities

Exchange Act of 1934. The plaintiffs were investors who purchased company shares during the “class period” when they alleged certain misrepresentations and omissions were made in the company filings with the Securities and Exchange Commission (SEC). Alleged misleading statements included, among others, that: (1) demand for high quality cannabis was growing in Canada and abroad; (2) the company was confident that its rapidly increasing production capacity would result in revenue growth; and (3) the company was well positioned to achieve positive EBITDA in the last quarter of the current fiscal year. The plaintiffs claimed that the company made these and other statements in its SEC filings knowing they were false because the market was oversupplied, there were insufficient retail outlets, and there was a robust black market for the company’s products. Plaintiffs further claimed the misrepresentations had the effect of artificially inflating the market price of Aurora shares (*In re Aurora*). They concluded that the company and the six officers were liable for the decline in the value of Aurora shares and plaintiffs were misled into purchasing or holding the shares while the price was inflated.

The statutory bases for the complaint were Sections 10(b) and 20(a) of the Securities Exchange Act of 1934. Section 10(b) of the Act (15 U.S.C. § 78j) prohibited the use of any “manipulative or deceptive device or contrivance” in connection with the purchase or sale of stock. Section 20(a) (15 U.S.C. § 78t) provided for the joint and several liability of those who control or abet violators of the Act.

CONCLUSION

The accounting consulting firm hired by the legal team was asked to examine possible fraudulent financial reporting by Aurora between February and September of 2020 and provide the team with its recommendation. The consultants wanted to gather additional evidence on disclosures of assumptions used by Aurora regarding its fair value calculations. Was there enough evidence of intentional wrongdoing and financial misreporting to advise the law firm it should continue pursuit of the case? After reviewing the case and records, the consulting firm was prepared to share its recommendation about continued pursuit of the lawsuit with Lawless’s legal team.

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15 U.S.C. § 78t.

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APPENDIX A: TECHNICAL NOTE

Accounting Policy Regarding Inventory. Note 9 (Aurora, 2020).

The company defines inventory as all cannabis products after the point of harvest (“Cannabis Inventory”), hemp products, purchased finished goods for resale, consumable supplies and accessories. Cannabis Inventory includes harvested cannabis, trim, cannabis oils, capsules, edibles and vaporizers.

Inventories of harvested cannabis are transferred from biological assets at fair value less costs to sell at the point of harvest, which becomes the deemed cost. By-products, such as trim, are measured at their net-realizable-value (“NRV”) at point of harvest which is deducted from the total deemed cost to give a net cost for the primary product. Any subsequent post-harvest costs are capitalized to Cannabis Inventory to the extent that the cost is less than NRV. NRV for work-in-process (“WIP”) and finished Cannabis Inventory is determined by deducting estimated remaining conversion/completion costs and selling costs from the estimated sale price achievable in the ordinary course of business. Conversion and selling costs are determined using average cost. In the period that Cannabis Inventory is sold, the fair value portion of the deemed cost is recorded within changes in fair value of inventory sold line, and the cost of such Cannabis Inventory, including direct and indirect costs, are recorded within the cost of sales line on the statement of comprehensive loss. Products for resale, consumable supplies and accessories are initially recognized at cost and subsequently valued at the lower of cost and NRV. The company reviews these types of inventory for obsolescence, redundancy and slow turnover to ensure that they are written-down and reflected at NRV.

The company uses judgment in determining the NRV of inventory. When assessing NRV, the company considers the impact of price fluctuation, inventory spoilage, inventory excess, age and damage.