



Ontario  
Securities  
Commission

Commission des  
valeurs mobilières  
de l'Ontario

22<sup>nd</sup> Floor  
20 Queen Street West  
Toronto ON M5H 3S8

22e étage  
20, rue queen ouest  
Toronto ON M5H 3S8

---

**IN THE MATTER OF  
CRONOS GROUP INC. and WILLIAM HILSON**

**STATEMENT OF ALLEGATIONS**

(Subsections 127(1) and 127.1 of the *Securities Act*, RSO 1990 c S.5)

**A. OVERVIEW**

1. When public cannabis companies issue financial statements that do not provide accurate information about their financial performance and condition and fail to have adequate controls, they undermine confidence in Ontario's capital markets and leadership in the cannabis space.

2. Cronos Group Inc., an Ontario-based public cannabis company, is being held accountable for improperly recognizing \$7.6 million (US \$5.8 million) in revenue in its Q1, Q2 and Q3 2019 interim financial statements and for subsequently overstating virtually all of its U.S. goodwill and a significant portion of its U.S. intangible assets by a collective amount of \$234.9 million in its Q2 2021 interim financial statements.

3. Cronos restated its Q1, Q2 and Q3 2019 interim financial statements to correct the revenue recognition error upon determining that they had not been prepared in accordance with generally accepted accounting principles (**GAAP**). The Company again restated its interim financial statements, this time for Q2 2021, to correct its failure to recognize impairment charges for goodwill and intangible assets relating to the U.S. reporting unit. In both instances, Cronos reported related material weaknesses in internal control over financial reporting (**ICFR**).

4. William Hilson was Cronos' Chief Financial Officer and later its Chief Commercial Officer. In his role as Chief Commercial Officer, Hilson was involved in one of the 2019 transactions in which Cronos improperly recognized \$3 million in revenue. In Hilson's role and as a Chartered Professional Accountant, he understood the need for the transaction to be properly accounted for by Cronos in its interim financial statements. He failed to take appropriate steps to address the handling of revenue recognition issues for this transaction by Cronos.

## **B. FACTS**

### **(a) Cronos Uncovers Revenue Recognition Errors in Financial Reporting**

5. On February 24, 2020, Cronos Group Inc. (**Cronos** or the **Company**) publicly announced that it was delayed in completing its 2019 annual financial statements and that it would delay its 2019 fourth quarter and full-year earnings release and conference call.

6. Cronos is a licensed cannabis producer in Canada with international production and distribution. The Company is listed on the TSX (CRON) and NASDAQ (CRON) with a market capitalization of \$1.19 billion as of August 29, 2022. Cronos's brand portfolio includes Peace Naturals, Spinach and hemp-derived CBD brands, Lord Jones, Happy Dance and Peace+.

7. On March 2, 2020, Cronos disclosed that it filed a Form 12b-25 (Notification of Late Filing) with the U.S. Securities and Exchange Commission (**SEC**) for a 15-day extension of the due date to file its Form 10-K for the year ended December 31, 2019. The Company disclosed that it had been unable to complete its financial statements for fiscal 2019 due to a continuing review by the Audit Committee (the **Audit Committee**) of the Company's Board of Directors (the **Board**), with the assistance of outside counsel and forensic accountants, of several bulk resin purchases and sales of products through the wholesale channel (the **Transactions**) and the appropriateness of the recognition of revenue from the Transactions.

8. On March 17, 2020, Cronos filed a Material Change Report with the OSC and announced that, on the recommendation of its Audit Committee and after consultation with its auditors, its previously issued unaudited interim financial statements for the first, second and third quarters of 2019 would be restated and reissued and should no longer be relied upon.

9. The Company disclosed that its Audit Committee had been conducting a review of the Transactions and the restatement was being made to eliminate certain of these transactions. It announced that it would reduce revenue by \$2.5 million (US \$1.9 million) for the three months ended March 31, 2019, and by \$5.1 million (US \$3.9 million) for the three months ended September 30, 2019. The Company further disclosed that, in connection with the restatement, it anticipated that it would report one or more material weaknesses in ICFR when it filed its Form 10-K.

10. On March 30, 2020, the Company announced that the Audit Committee had completed its review of the Transactions and that the Board had determined, on the recommendation of the Audit

Committee and advice from its auditor, that the Company would restate its unaudited interim financial statements for the first, second and third quarters of 2019.

11. Cronos filed the restated interim financial statements on March 30, 2020.

12. The restated interim financial statements disclosed that the Audit Committee review had concluded that there were accounting errors in the previously issued interim financial statements for the first and third quarters of 2019 (Q1 2019 and Q3 2019, respectively). In particular, the Company reduced revenue for the three months ended March 31, 2019, by \$2.5 million (US \$1.9 million) and the three months ended September 30, 2019, by \$5.1 million (US \$3.9 million).

**(b) Q1 2019 Revenue Recognition Errors**

13. In the three months ended March 31, 2019, the revenue recognition error was due to one wholesale transaction that was inappropriately accounted for as revenue in the Company's originally issued interim financial statements for Q1 2019. The transaction involved the exchange of cannabis dry flower for cannabis resin, with a third party, in two simultaneous transactions entered into in contemplation of one another.

14. This transaction did not meet the criteria for revenue recognition in accordance with GAAP, in this case International Financial Reporting Standards (**IFRS**). The standard applicable to revenue recognition for the transaction was IFRS 15, *Revenue from Contracts with Customers*.

15. This transaction lacked commercial substance and therefore revenue should not have been recognized. As a result, Cronos had overstated revenue by approximately \$2.5 million (US \$1.9 million) on the Consolidated Statements of Operations and Comprehensive Income (Loss) in the original Q1 2019 interim financial statements.

**(c) Q3 2019 Revenue Recognition Errors**

(i) Wholesale Transaction

16. During the three months ended September 30, 2019, there was a similar wholesale transaction involving the exchange of cannabis dry flower for cannabis extracts in three simultaneous transactions which were entered into in contemplation of one another with the same third party.

17. This transaction did not meet the criteria for revenue recognition in accordance with GAAP, in this case IFRS. This transaction lacked commercial substance and therefore revenue should not

have been recognized. As a result, Cronos had overstated revenue by approximately \$2.1 million (US \$1.6 million) on the Consolidated Statements of Operations and Comprehensive Income (Loss) in the original interim financial statements for the three and nine months ended September 30, 2019.

(ii) Hilson's Role at Cronos and Further Q3 Transaction

18. Hilson is a Chartered Professional Accountant with a Master's of Science degree in clinical biochemistry. From about September 2016 until April 15, 2019, Hilson acted as CFO for Cronos. From April 15, 2019 to December 31, 2019, Hilson was Cronos' Chief Commercial Officer.

19. In July 2019, while Hilson was Cronos' Chief Commercial Officer, Cronos entered into an agreement with a third party titled "Contract Manufacturing Agreement" (**CMO Agreement**) governing the arrangements by which the third party was to provide manufacturing services to Cronos, specifically for the manufacture of vape cartridges. Under the CMO Agreement the biomass could be supplied by Cronos or sourced on its behalf. The CMO Agreement stipulated that Cronos retained title and ownership of the biomass at all times.

20. Hilson had input into the terms of the CMO Agreement and was aware of its terms. He made the CMO Agreement available to Cronos' accounting department for assessment of revenue recognition.

21. In the third quarter of 2019, Hilson played a significant role in a further wholesale transaction in which Cronos improperly recognized \$3 million in revenue. In that transaction, Cronos entered into a wholesale transaction to sell dried cannabis to the counterparty to the CMO Agreement (the **Q3 CMO Transaction**).

22. Hilson negotiated the Q3 CMO Transaction and its payment terms on behalf of Cronos.

23. Cronos' accounting department prepared its quarterly financial statements, which included the assessment of the Q3 CMO Transaction for revenue recognition purposes.

24. In his role as Chief Commercial Officer, Hilson was not required to certify or approve Cronos' quarterly financial statements. However, on November 8, 2019, Hilson signed an "Internal Control Certification" in connection with the quarterly financial statements and related reported information as of and for the three months ending September 30, 2019. Hilson confirmed in the signed certification that the interim financial statements were accurate and fairly presented in all

material respects Cronos' financial condition, results of operations, and cash flows as they related to his area of responsibility.

25. The Q3 CMO Transaction did not, in fact, meet the criteria for revenue recognition in accordance with applicable generally accepted accounting principles, in this case International Financial Reporting Standards (**IFRS**). The standard applicable to revenue recognition for the transaction was IFRS 15, *Revenue from Contracts with Customers*.

26. The Q3 Transaction did not meet the criteria for revenue recognition because it was deemed to be a consignment sale. As a result, Cronos had overstated revenue by approximately \$3 million, overstated cost of sales by approximately \$1.7 million, and overstated realized fair value adjustment on inventory by approximately \$3.3 million in its Consolidated Statements of Operations and Comprehensive Income (Loss), in the interim financial statements for the three and nine months ended September 30, 2019 (the **Q3 2019 Interim Financial Statements**).

27. Hilson failed to take appropriate steps to address the handling of revenue recognition issues for the Q3 CMO Transaction by Cronos, including by not ensuring that an analysis of revenue recognition in respect of the transaction had been prepared and considered by the Company prior to its completion of Q3 2019 Interim Financial Statements.

**(d) Material Weaknesses in ICFR: March 2020**

28. On March 30, 2020, the Company filed Amended and Restated Management's Discussion and Analysis of Financial Condition and Results of Operations (**MD&A**) for the first, second and third quarters of 2019.

29. Each of the MD&A for the first, second and third quarters of 2019 disclosed that as of the end of the reporting period, due to material weaknesses, ICFR was not effective to provide reasonable assurance regarding the reliability of financial reporting and the preparation of financial statements in accordance with applicable accounting standards.

30. A material weakness is a deficiency, or combination of deficiencies in ICFR, such that there is a reasonable possibility that a material misstatement of the Company's annual or interim financial statements will not be prevented or detected on a timely basis.

31. Cronos identified material weaknesses in the following areas:

- (a) *Segregation of Duties*: The Company did not maintain adequately designed controls on segregation of purchase and sale responsibilities to ensure accurate recognition of revenue in accordance with IFRS;
- (b) *Non-Routine Transactions*: The Company's controls were not effective to ensure that non-routine transactions, including deviations from contractually established sales terms, were authorized, communicated, identified, and evaluated for their potential effect on revenue recognition; and
- (c) *Risk Assessment*: The Company did not appropriately design controls to monitor and respond to changes in its business in relation to their transactions in the wholesale market.

32. Because of the segregation of duties and non-routine transaction deficiencies, the Company restated its interim financial statements in respect of the Transactions to correct the identified misstatements. While the risk assessment deficiency did not directly result in a misstatement, it was a contributing factor in the other material weaknesses described above.

33. Together, these deficiencies created a reasonable possibility that a material misstatement to the consolidated financial statements would not have been prevented or detected on a timely basis.

**(e) Cronos Uncovers Errors in Goodwill and Indefinite-Lived Tangible Assets**

34. On November 9, 2021, Cronos publicly announced that it had been unable to complete its interim financial statements for the three and nine months ended September 30, 2021 because its Audit Committee required additional time to evaluate goodwill and indefinite-lived intangible assets. Cronos also announced that it expected to record an impairment charge of not less than US \$220 million on goodwill and indefinite-lived intangible assets for the three and six months ended June 30, 2021.

35. On the same date, Cronos filed a Material Change Report with the OSC, in which it stated that on the recommendation of its Audit Committee and after consultation with its auditor, the Company would be required to restate its previously issued unaudited interim financial statements for the three and six month period ending June 30, 2021, and that those financial statements should no longer be relied upon. The Company also filed Forms 8-K and 12b-25 with both the OSC and the SEC.

36. On February 18, 2022, Cronos filed restated interim financial statements and an Amended and Restated MD&A for the three and six month period ending June 30, 2021 as the previously filed financial statements had not been prepared in accordance with GAAP, in this case US GAAP. Cronos disclosed that it had performed an interim impairment test on its U.S. reporting unit and the Lord Jones brand, as of June 30, 2021, to determine whether the carrying amount of the reporting unit and indefinite-lived intangible asset, the Lord Jones brand, exceeded their respective fair values. As a result of its analyses, the Company concluded that it should have recorded an impairment charge of US \$234.9 million on goodwill and indefinite-lived intangible assets related to its U.S. reporting unit.

**(f) Material Weaknesses in ICFR: February 2022**

37. On February 18, 2022, the Company disclosed that its ICFR was ineffective due to the existence of material weaknesses. The material weaknesses contributed to the failure to accurately recognize the value of its goodwill and indefinite-lived intangible assets. Specifically, the Company:

- (a) did not ensure that senior accounting personnel engaged consistently in appropriate professional conduct and conduct consistent with the Company's code of business conduct and ethics; and
- (b) lacked accounting personnel with appropriate level of knowledge and experience in US GAAP.

**C. BREACHES OF ONTARIO SECURITIES LAW AND CONDUCT CONTRARY TO THE PUBLIC INTEREST**

38. The following breaches of Ontario securities law and conduct contrary to the public interest are alleged:

- (a) Cronos failed to file interim financial statements prepared in accordance with applicable GAAP, contrary to s. 77 of the *Act*;
- (b) Cronos acted in a manner contrary to the public interest; and
- (c) Hilson acted in a manner contrary to the public interest.

**D. ORDER SOUGHT**

39. It is requested that the Tribunal make an order pursuant to subsection 127(1) and section 127.1 of the Act to approve the settlement agreements entered into by Cronos and Hilson with respect to the matters set out herein.

**DATED** at Toronto, Ontario, this 20<sup>th</sup> day of October, 2022.

**ONTARIO SECURITIES COMMISSION**

20 Queen Street West, 22<sup>nd</sup> Floor  
Toronto, ON M5H 3S8

**Rikin Morzaria**

Senior Litigation Counsel  
Enforcement Branch

Tel: 416-597-7236

[rmorzaria@osc.gov.on.ca](mailto:rmorzaria@osc.gov.on.ca)