



HEXO (TSX:HEXO) Abruptly Changes Auditors: Should Investors Raise Eyebrows?

Description

HEXO Corp ([TSX:HEXO](#))(NYSE:HEXO) announced on Friday, February 7 that it had changed its auditors effective January 31, 2020, and this could raise some investor concerns, considering the cannabis firm was [recently “pressured” to restate its earnings](#).

The company has changed its auditors from MNP LLP to PricewaterhouseCoopers LLP, and there has been no statutorily required reportable events upon the change, so this could somehow be seen just as an ordinary change of service providers.

But things don't appear that simple to anyone closely following events at this company.

What we know

At an annual meeting of shareholders on January 20 this year, the company's shareholders voted to retain MNP LLP as the company's external audit services provider, only for the re-appointed firm, which had been doing business with the company for more than two years, to abruptly resign just 11 days later.

MNP had been appointed as an external audit services provider mid-year 2018, taking over from Deloitte LLP, which last provided a professional letter in November 2017.

The new service provider received 99.66% of shareholder votes in a January 2019 meeting, but it only garnered 86.6% of the votes in a similar meeting this year (and the trend was largely the same for its six re-elected directors this year, one of which resigned this month).

Shareholders were not as much in agreement in retaining the board and the auditor as they were in January last year, and we could reasonably blame the stock's dismal price performance in 2019, the revocation of an earlier bullish earnings guidance, declining revenues, and restructuring exercises that added new uncertainty about the future earnings performance for the marijuana operation.

Why the sudden auditor change?

This should be anybody's guess, but we can reasonably speculate given prior circumstances.

We know that the company recently restated its annual financial results for the fiscal year 2019 ending July 31, and its fiscal first-quarter 2020 results (for the quarter ending October 31, 2019) due to its auditor's disagreement with management's application of accounting standards regarding the treatment of deferred taxes at consolidation.

Management had decided to treat deferred taxes at each subsidiary separately, but the audit firm seems to have insisted that they be pooled together in consolidated results. The result was a much better restated earnings report for the year and a lower earnings deficit for this current fiscal year.

As [highlighted earlier](#), another earnings restatement had been done earlier concerning financial assets. The restatement of financial reports can be a significant source of embarrassment to any company, and investors can be tempted to think that the latest change has something to do with the recent clash.

After all, audit firms don't just resign and give up on lucrative business accounts, especially given the fact that MNP had just been given another year as service provider in a recent shareholder vote last month.

Foolish takeaway

Auditors bring some level of authenticity to a company's earnings results, and a company should ideally not retain a single firm for far too long, but the change from one such appointed service provider to another should usually be "more orderly" and preferably not through an abrupt resignation days after a reappointment.

The risk to any service corporate provider's job is that of failing to impress the client. Maybe the outgoing professional team should have been more proactive and advised the changes before the publication of results, but the recent clashes of opinion could have played a role in the professional hire's sudden departure.

If that was the case, will the new hire always be "more friendly" in the interpretation of international financial reporting standards than the outgoing one?

Happy investing, Fools.

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