



CANNABIS

Marijuana and forensic accounting – high times for CPAs?

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CPAs in general practice are well-versed in the typical federal versus state issues when it comes to taxation. For those of us who practice in the forensic accounting world, we need to understand the differences in litigation matters in federal versus state courts. We also need to understand the differences in how damages are calculated in federal cases versus state cases as well as the differences that exist in the calculation of damages from state to state.

As if this is not enough to challenge our knowledge base, the concept of CPAs in general practice and forensic accountants working in the world of the cannabis industry takes the federal versus state issue to another level.

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The [Controlled Substances Act](#) (CSA) is a federal statute that regulates the manufacture and distribution of controlled substances, such as narcotics and depressants, among others. Under this act, drugs are categorized into five classifications, also known as schedules. This classification is based on their potential for abuse and status in international treaties. It also considers any medical benefits from such drugs. Generally speaking, drugs included in Schedule 1 are the most strictly regulated because they are deemed to have no medical value. The CSA provides examples of drugs and their classifications as follows:

- **Schedule 1:** Ecstasy, LSD and heroin. Marijuana is also considered a Schedule 1 drug, despite studies finding it to have medical uses.
- **Schedule 2:** Cocaine and methamphetamine.
- **Schedule 3:** Anabolic steroids, ketamine and testosterone.
- **Schedule 4:** Ambien, Xanax and Valium.
- **Schedule 5:** Lyrica and cough suppressants.

[Cole Memorandum](#)

The Cole Memorandum¹ was created in 2013 during the Obama administration by former Attorney General James M. Cole. It opposed the federal prosecution of state-regulated businesses in the cannabis industry. The memo encouraged law enforcement and prosecutors to focus on specific priorities related to cannabis, such as the following:²

- “Preventing the distribution of marijuana to minors;
- Preventing revenue from the sale of marijuana from going to criminal enterprises, gangs, and cartels;
- Preventing the diversion of marijuana from states where it is legal under state law in some form to other states;

- Preventing state-authorized marijuana activity from being used as a cover or pretext for the trafficking of other illegal drugs or other illegal activity;
- Preventing violence and the use of firearms in the cultivation and distribution of marijuana;
- Preventing drugged driving and the exacerbation of other adverse public health consequences associated with marijuana use;
- Preventing the growing of marijuana on public lands and the attendant public safety and environmental dangers posed by marijuana production on public lands; and
- Preventing marijuana possession or use on federal property.”

This memorandum was an attempt to close the gap between federal and state law regarding the legal use of cannabis. However, in January 2018, former Attorney General Jeff Sessions rescinded the Cole Memorandum and issued a memorandum indicating “a return to the rule of the law,” prohibiting the cultivation, distribution and possession of marijuana, consistent with the CSA of 1970.³ Although this creates uncertainty to the future of cannabis in state-regulated businesses, the [Joyce Amendment](#),⁴ formerly known as the Rohrabacher-Blumenauer Amendment and the [Rohrabacher-Farr Amendment](#), still is in effect. It prohibits the Department of Justice from using federal funds to interfere with, or prosecute, state-regulated medical marijuana businesses;⁵ however, it does not protect state-regulated recreational businesses or programs.

¹ “Guidance Regarding Marijuana Enforcement,” U.S. Department of Justice, August 29, 2013, www.justice.gov/iso/opa/resources/3052013829132756857467.pdf, accessed July 15, 2019.

² “BSA Expectations Regarding Marijuana-Related Business,” U.S. Treasury, Financial Crimes Enforcement Network, February 14, 2014, www.fincen.gov/resources/statutes-regulations/guidance/bsa-expectations-regarding-marijuana-related-businesses, accessed July 15, 2019.

³ “Justice Department Issues Memo on Marijuana Enforcement,” www.justice.gov/opa/pr/justice-department-issues-memo-marijuana-enforcement, accessed July 15, 2019.

⁴ “Powerful congressional panel puts medical marijuana protections in federal budget,” Marijuana Business Daily, May 17, 2018, <https://mjbizdaily.com/powerful-congressional-panel-puts-medical-marijuana-protections-in-federal-budget/>

⁵ “What Would Cannabis Legalization Look Like After the 2018 Midterm Election,” Cannabis Business Times, March 22, 2019, cannabisbusinesstimes.com/article/cannabis-legalization-post-midterm--elections/, accessed July 16, 2019.

State boards with issues, positions or guidance for CPAs

As of February 2019, 33 states and the District of Columbia⁶ have legalized medical marijuana in some capacity. Out of those states, the following 12 have issued positions or guidance for CPAs, as follows.⁷

Arizona – “... the Arizona Board of Accountancy has concluded that merely accepting an engagement to provide accounting services to a medical marijuana dispensary does not, on its face, constitute an act discreditable to the profession and it will not pursue independent disciplinary action against an Arizona CPA registrant based solely on such acceptance.”

Arkansas – “... the Board concludes that, in and of itself, the provision of professional services, as defined in ACA 17-12-103(a)(18), within states where the possession and distribution of medical marijuana has be [sic] legalized, and the client has been duly licensed or is in the process of licensure application does not constitute a lack of good moral character ... nor would the provisions of such services be considered an act discreditable to the profession ...”

Colorado – “It is the Board’s position that offering to perform or performing professional services for clients in the marijuana industry who are in compliance with Colorado Medical Marijuana Code and the Colorado Retail Marijuana Code is not in itself specifically prohibited by the Accountancy Act ...”

Connecticut – “... the Connecticut Board of Accountancy will not pursue independent disciplinary action against Connecticut CPAs or CPA firms who are operating within the bounds of state law.”

Florida – “... the provision of public accounting services, as defined in Section 473.302(8), FS, to marijuana-related businesses in states where marijuana-related businesses have been legalized, in the absence of a criminal conviction of the certified public accountant for the provision of those services, in and of itself does not constitute a lack of good moral character.”

Maryland – “... in light of the current state of Maryland and Federal law, the Board will take no regulatory action against a CPA or firm solely on the basis that the CPA or firm provides

services to a business involved in the sale or distribution of marijuana, provided that the business is operating legally under applicable state law.”

Massachusetts – “... the Board has determined that Massachusetts licensees and firms that elect to provide services to the marijuana industry legalized in any state in which the licensee practices will not face action by the Board based solely on the fact that the licensee or firm is providing such services. However, licensees are reminded that the federal government views such activity as a federal criminal offense. The Board’s position does not negate the possibility that disciplinary action may be taken by the Board should a licensee be found guilty of a federal criminal act.”

Michigan – “Federal law notwithstanding, it is the Department and Board’s position that a licensee offering to perform professional services for clients engaged in the medical marijuana industry who are otherwise in compliance with Michigan’s Medical Marijuana Act, Medical Marijuana Facilities Licensing Act, and associated administrative rules, or any other state where medical marijuana is legalized, is not in itself specifically prohibited by the provisions of Michigan’s Occupational Code (Act 299 of 1980, Article 7). Therefore, a licensee will not face any action by the Department or the Board based solely on the fact that the individual licensee or licensed firm provides professional services to a client engaged in the medical marijuana industry.”

Nevada – “... the Board has determined that Nevada licensees and firms that elect to provide services to the marijuana industry legalized in any state in which the licensee practices will not face action by the Board based solely on the fact that the licensee or firm is providing such services. However, licensees are reminded that the federal government views such activity as a federal criminal offense. The Board’s position does not negate the possibility that disciplinary action may be taken by the Board should a licensee be found guilty of a federal criminal act.”

New Mexico – “... the Board determined that this is a legal issue beyond its scope. Accordingly, it has declined to issue a letter permitting CPAs in New Mexico to conduct audits of medical cannabis producers, as it has no authority to do so. An individual licensee who is considering conducting such an audit should seek independent legal advice and might discuss his or her concerns with the United States Department of

⁶ “Medical Marijuana FAQs: What Providers Need to Know if Legal in Their State,” February 2019, leadingage.org/sites/default/files/Medical%20Marijuana%20FAQs_February%202019.pdf, accessed July 16, 2019.

⁷ “Providing services to businesses in the marijuana industry,” AICPA, NASBA, January 2019, aicpa.org/content/dam/aicpa/advocacy/state/downloadabledocuments/marijuana-state-board-positions.pdf, accessed July 16, 2019.

Justice and the Drug Enforcement Administration.”

Oregon – “... the Board has determined that Oregon licensees and firms that elect to provide services to the marijuana industry legalized in any state in which the licensee practices will not face action by the Board for violation of the State of Oregon Board of Accountancy’s Code of Professional Conduct, based solely on the fact that the licensee or firm is providing such services. However, all licensees should be reminded that any and all services provided are subject to the same professional standards, laws and rules applicable to all other services provided by the licensee.”

Washington – “... the Executive Director encourages individual CPAs and CPA firms providing (or desiring to provide) professional services to licensed commercial enterprises in this new and developing industry to diligently evaluate and address the potential risks and uncertainties associated with providing such services. The uncertainties of federal enforcement policy with respect to federal law further complicate a service provider’s initial and continuing client acceptance and engagement risk analyses.”

Marijuana business risks for CPAs

Although the directives the state boards provide have helped to guide CPAs regarding the ethical implications of accepting and providing services to these businesses, the reality is that medical marijuana is still classified as a Schedule 1 drug and, therefore, is subject to prosecution in accordance with the CSA. CPAs could be subject to federal racketeering and other federal laws for merely collecting fees for services rendered because marijuana businesses are still considered an illegal business under federal law.

This raises the question of professional liability insurance and how it applies regarding any claims involving a marijuana client. Although professional liability insurance does provide protection for claims of negligence in connection with services provided within a professional practice, most professional liability insurance policies do not cover criminal investigations and their accompanying penalties, such as fines or sanctions, among others. However, services a CPA renders in the normal course of business to a marijuana business effectively may be

covered within the professional liability insurance limitations. Practitioners should also be aware that restrictions exist. For those reasons, practitioners need to be familiar with their policy terms and conditions, as well as applicable laws, regulations and professional standards, and it is recommended that they consult with their carrier prior to commencement of services.

For additional information and review, the AICPA has published a white paper, [An Issue Brief on State Marijuana Laws and the CPA Profession](#),⁸ which is an additional source that can be used by CPAs regarding marijuana businesses and their effects within the CPA industry.

How can CPAs get to know the business?

With the growing number of businesses operating in the cannabis industry, it is imperative for CPAs to be well-educated regarding proper accounting procedures for these companies because it will ensure that they can offer appropriate support and guidance on industry best practices. CPAs who want to work in the cannabis industry must do their due diligence and become competent through education, research, and networking.

By conducting research and educating themselves on a regular basis regarding laws, regulations, and other important information, CPAs can stay current with the ever-changing cannabis industry. Multiple articles can be found through the AICPA and the *Journal of Accountancy*, among others, that can provide a reliable foundation of knowledge and information. CPAs interested in working in the cannabis industry should research and understand multiple areas, from farming to retail sales, and what potential major problems can arise. Other important areas to research include case law, such as *Alterman v. Commissioner*,⁹ which concluded that marijuana businesses are not entitled to any business expense deductions. These are all areas that can significantly affect cannabis business owners alike, and areas that CPAs need to be aware of.

In addition to research, another great tool that can prove to be invaluable is networking. Networking to develop connections is a great opportunity to acquire information and resources for a mutually beneficial relationship. You can start connecting with

⁸ “An issue brief on state marijuana laws and the CPA profession,” AICPA, Issued: July 24, 2015; Updated: January 14, 2019, www.aicpa.org/Advocacy/State/DownloadableDocuments/MarijuanaCPAsIssueBrief.pdf, accessed July 16, 2019.

⁹ Laurel Alterman and William A. Gibson, *Petitioners v. Commissioner of Internal Revenue*, Respondent, United States Tax Court, June 13, 2018, <https://www.ustaxcourt.gov/USTCInOP/OpinionViewer.aspx?ID=11671>.

others by joining and following LinkedIn and Facebook groups pertaining to the cannabis industry. Find out who the CEOs are, engage them, ask questions, and participate in discussions. Attend seminars and conferences to learn more about the industry, and be sure to connect with other attendees. Seminars and conferences are a great way to connect with others in the industry and formulate great business relationships.

Challenges for business valuation

Among the many challenges that already have been addressed regarding the cannabis industry and accounting, there is another area of concern that seems to be increasing among CPAs: How do you value a cannabis business? It appears many cannabis businesses are using the fair value model, which is the same model used in the agricultural industry. Although the agricultural industry seems like a comparable business model, in reality, it is not. Fair value accounting places a value on an asset for what it could be sold for based on current market values. This essentially places a value on the marijuana plant while it is still being grown, before it can be sold. As a result, the unrealized value of these plants can significantly increase the gross margin of a company without them ever selling one plant. Consequently, valuing the marijuana plants using this method does not take into consideration any other factors that could affect the ultimate sale of the product, such as economic factors, weather conditions, insects or other pathogens. In turn, this could lead to large write-offs and disgruntled investors.

With there being no history or clear guidance for valuing a cannabis business, these valuations are highly subjective and will range widely from business to business. Therefore, CPAs have to evaluate these businesses based on more than just the fair value of the plants. They need to look at adjusted net assets and projected cash flows, among other things. Furthermore, it would be appropriate for these businesses who do use fair value accounting to explain their results in their annual reports.

Potential fraud and other risks

Because of the dichotomy between federal and state laws, and more specifically, because cannabis is still considered illegal at the federal level, most traditional banks will not get involved with businesses in the industry. This has led to alternative markets for financing and handling of cash, which inherently brings increased risks of potential fraud and misuse.

In September 2018, the SEC issued an “Investor Alert: Marijuana Investments and Fraud.”¹⁰ This alert was intended to warn investors about the risks of investment fraud and market manipulation. The warnings from the SEC are not dissimilar from the red flags we see in any potentially suspect investment scheme: Look out for unlicensed or unregistered sellers, beware of guaranteed returns, and look out for unsolicited offers, which may come via social media, email, or phone calls.

The SEC further warns of being cautious when companies have had their stock suspended, when there are changes in the company name and false press releases. Again, these are not dissimilar to traditional company scams, but investors can often get caught up in a new trend, such as the dot-com boom, which lasted from about 1994 to 2000.

The American Bankers Association (ABA) has also issued its position on marijuana.¹¹ Specifically, although the ABA “takes no position on the moral issues raised by legalizing marijuana,” it notes that “the time has come for Congress and the regulatory agencies to provide greater legal clarity to banks operating in states where marijuana has been legalized for medical or adult use.” The ABA recognizes that banks face increasing risks as the marijuana industry grows.

The *Marijuana Business Daily* estimates the retail medical and recreational cannabis industry will reach revenues of \$12 billion by the end of 2019.¹² This increasing revenue and level of business continues to bring the problem of managing the finances, specifically, cash. Because of the aforementioned issues within the banking industry, most of the businesses in the industry still are cash-only operations. In some states, such as

¹⁰ “Investor Alert: Marijuana Investments and Fraud,” SEC, Sept. 5, 2018, [sec.gov/oiea/investor-alerts-and-bulletins/ia_marijuana](https://www.sec.gov/oiea/investor-alerts-and-bulletins/ia_marijuana), accessed July 16, 2019.

¹¹ “Marijuana and Banking,” American Bankers Association, [aba.com/advocacy/issues/pages/marijuana-banking.aspx?PF=1](https://www.aba.com/advocacy/issues/pages/marijuana-banking.aspx?PF=1), accessed July 16, 2019.

¹² “Exclusive: US retail marijuana sales on pace to rise 35% in 2019 and near \$30 billion by 2023,” *Marijuana Business Daily*, May 30, 2019, <https://mjbizdaily.com/exclusive-us-retail-marijuana-sales-on-pace-to-rise-35-in-2019-and-near-30-billion-by-2023/>, accessed July 16, 2019.

California¹³ and Colorado,¹⁴ there are movements to allow credit unions to accept deposits related to the cannabis industry, but there are still a lot of limitations and restrictions on exactly what business can be conducted.

This ultimately means that businesses are dealing in cash for all aspects of the business – they take cash in from customers, and they pay by cash for product from their wholesalers. They use cash to buy money orders. They pay employees in cash. They pay their bills in cash. As noted previously, although some credit unions have started to offer accounts to those in the industry, they tend to be non-interest-bearing checking accounts, and they certainly will not lend to the business for fear of repercussions at the federal level and the danger of seizure of collateral. As recently reported, “until federal law catches up to public sentiment, marijuana banking is unlikely to keep pace with the industry – the vetting is too expensive.”¹⁵

Opportunities for fraud prevention and investigation

Many businesses new to the cannabis industry are also new to, well, just being new. They may not know exactly how to run a business, which means keeping books and records, safeguarding their money and, at the most basic level, maintaining internal controls in their business. As stated throughout this article, cash is paramount in this industry. As fraud investigators, we all know what that means. Therefore, assisting with safeguarding cash also is paramount.

When cash is such a key element of a business, the risks of traditional schemes, such as skimming, are high. These companies will need help to reduce such risk. Similarly, we all know that reliance on cash can lead to complicit behavior and the risk of collusion with outsiders.

The traditional rules of safeguarding assets apply to this

industry as much as to any other. Internal controls, counting of cash (especially surprise cash counts), review of journal entries – these are all non-negotiable. We all know the red flags of fraud, and they all apply here. Whether it is mandatory vacation for accounting personnel or just understanding what each person does within the accounting function, these are all key to reduce the risk of loss.

Practice tips for the CPA

- Education, education and more education! This is an ever-changing industry. Many industry publications are available by subscription, such as the *Cannabis Industry Journal*¹⁶ and *Marijuana Business Magazine*.¹⁷ You should also be up to date with the position of your state board.
- Understand the law. Similar to state society pronouncements, you should know what the law is within your state. Talk to lawyers in your local area who are working with clients in this industry. Attend local chamber of commerce and other events, which focus on the state of the industry.
- Connect. Through social media sites such as LinkedIn, you will get to know who the players are in the industry. Connect with them and find out directly from them what the latest issues are.
- Discuss your practice with your professional liability insurance carrier and understand what services you may perform.
- Identify potential clients who may have a need for fraud prevention services and training for cash-intense businesses, among others.

¹³ “CA Senate votes to allow banks, credit unions to accept marijuana retailer deposits,” Marijuana Industry Daily, May 22, 2019, <https://mjbizdaily.com/california-senate-votes-allow-banks-credit-unions-accept-cannabis-retailer-deposits/>, accessed July 16, 2019.

¹⁴ “Cannabis Credit Union Gets Go-Ahead From Federal Reserve.” Leafly, HYPERLINK “file:///C:/Users/cfox/AppData/Local/Microsoft/Windows/INetCache/Content.Outlook/5MG3BDMZ/www.leafly.com/news/industry/cannabis-credit-union-gets-go-ahead-from-federal-reserve”www.leafly.com/news/industry/cannabis-credit-union-gets-go-ahead-from-federal-reserve, accessed July 16, 2019.

¹⁵ “Where Pot Entrepreneurs Go When the Banks Just Say No,” The New York Times Magazine, Jan. 4, 2018, nytimes.com/2018/01/04/magazine/where-pot-entrepreneurs-go-when-the-banks-just-say-no.html, accessed July 16, 2019.

¹⁶ See cannabisindustryjournal.com.

¹⁷ See mjbizmagazine.com.

Fraud news: fraud in the cannabis industry

Securities and Exchange Commission v. Bud Genius, Inc. and Aaron “Angel” Stanz¹⁸

Bud Genius Inc., a penny-stock medical marijuana testing company, and its CEO Aaron “Angel” Stanz, were charged with defrauding investors by issuing false and misleading statements regarding Bud Genius’ operations, financial condition and licensing agreements to make the company appear more profitable and valuable.

According to the facts of the case, it is alleged that Bud Genius published fraudulent financial statements that did not accurately represent their financial situation, sold billions of shares of unregistered stock offerings for more than \$540,000, and distributed press releases indicating a licensing agreement with comedian Tommy Chong to attract potential investors, knowing the licensing agreement was very unlikely.

“Without admitting or denying the Commission’s allegations, Stanz agreed to a judgment enjoining him from violating Sections 5(a), 5(c), 17(a)(1), and 17(a)(3) of the Securities Act of 1933 and Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, imposing five-year officer-director and penny stock bars, and ordering disgorgement and prejudgment interest of \$158,829. The settlements are subject to court approval.”

Securities and Exchange Commission v. Jerry Miller¹⁹

The SEC charged Jerry Miller, the principal of consulting firm Petrotech Oil and Gas Inc., with issuing false and misleading statements regarding a press release indicating that Petrotech had obtained a marijuana (medical and recreational) license from Colorado in connection with its newly founded marijuana business.

According to the facts of the case, a press release, allegedly written and published by Mr. Miller, was issued stating that

Petrotech had obtained a medical marijuana license from the state of Colorado and would be expanding its cannabis and hemp production by signing on six licensed growers in Colorado and three licensed growers in Washington. However, in actuality, Colorado had not issued any marijuana licenses to Petrotech, Mr. Miller, or either of Petrotech’s subsidiaries, LP.US Inc. or LP.US Management Group.

Mr. Miller is charged with “... violating Section 10(b) of the Securities Exchange Act of 1934 and Rule 10b-5 thereunder, and Section 20(b) of the Exchange Act, and seeks permanent injunctions, disgorgement of ill-gotten gains with prejudgment interest, a penalty, an officer and director bar, and a penny stock bar against Miller.” The SEC’s investigation is continuing.

Cannacea, LLC and Tisha Siler Matter²⁰

Tisha Siler, CEO of Cannacea, a northeast Portland pot dispensary, was charged with violating multiple state securities laws when attempting to circumvent the Oregon Health Authority’s Medical Marijuana Dispensary Program’s approval process to market to potential investors.

According to the facts of the case, Siler hired Green Rush Consulting LLC to create a pitch book and private placement memorandum (PPM) with the intention to solicit investors for Cannacea. In connection with preparing the PPM, Siler provided Green Rush with a forged document, purportedly from the Oregon Health Authority’s Medical Marijuana Dispensary Program, with fabricated statements, which were ultimately used in the PPM. According to the investigation of the PPM, it contained inaccuracies and fabrications, including that Oregon regulators pre-selected Siler to open pot dispensaries in Oregon, and they would “pre-approve” up to six medical cannabis dispensaries, ensuring effortless application processing. As a result, Siler received multiple investments ranging from \$50,000 to \$75,000 each.

Siler was found guilty in multiple violations and was fined \$40,000.

¹⁸ “SEC Charges Marijuana Company and its CEO With Fraud,” SEC, May 22, 2018, sec.gov/litigation/litreleases/2018/lr24148.htm.

¹⁹ Securities and Exchange Commission v. Jerry Miller, SEC, March 20, 2017, sec.gov/litigation/litreleases/2017/lr23782.htm.

²⁰ In the Matter of: Cannacea, LLC, and Tisha Siler, Respondents, State of Oregon, Department of Consumer and Business Services, Division of Financial Regulation, [media.oregonlive.com/marijuana/other/2016/07/29/Cannacea%20Notice%20Order.pdf](https://oregonlive.com/marijuana/other/2016/07/29/Cannacea%20Notice%20Order.pdf).