

CANNABIS COMPLIANCE BOARD STATE OF NEVADA



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To: Legislative Counsel Bureau, Director Nicholas Anthony

From: James Humm, Executive Director, Nevada Cannabis Compliance Board

Re: Audit Report – Nevada Cannabis Compliance Board and Nevada Department of Taxation

Date: March 29, 2024

Time Period: January 1, 2023 and December 31, 2023

Purpose

This report, required by NRS 678A.450(5), details certain audits performed in the previous year by the Nevada Cannabis Compliance Board (CCB) and the Nevada Department of Taxation (DoT). Specifically, the report includes the number of audits performed pursuant to NRS 678A.480, a summary of the findings of the audits, and the cost of each audit.

Background

The CCB is responsible for strictly regulating all persons, locations, practices, associations, and activities related to the operations of cannabis establishments in this state.

The DoT is responsible for the fair, efficient, and effective administration of tax programs for the State of Nevada in accordance with applicable statutes, regulations, and policies.

The CCB's Investigations Division is responsible for vetting potential licensees and affiliated owners, officers, and board members along with processing all transfer of interest requests (TOIs). As such, CCB investigators conduct regular financial and operational audits of licensees which include in-person interviews, thorough background and due diligence checks, and financial analysis. These investigations and reports allow CCB Board Members to make informed regulatory and licensing decisions regarding the 510 operational licenses that make up the state's privileged cannabis industry.¹

The DoT is responsible for conducting tax audits of all cannabis taxpayers. These audits are conducted by the Compliance Division. As of January 2024, the DoT oversees 119 adult-use cannabis cultivation facilities, 65 medical cannabis cultivation facilities, 100 adult-use cannabis retail stores, 40 medical cannabis dispensaries, 46 adult-use cannabis distributors, and 87 adult-use cannabis production facilities.

¹ Investigative audits detailed in this report are separate and distinct from routine audits conducted regularly by CCB audit agents. Routine audits focus on examining seed-to-sale reporting data and the analysis of monthly and quarterly inventory reported submitted to the CCB by all state licensees. Per Nevada Cannabis Compliance Regulations (NCCR) Regulation 5.075, the CCB Inspection/Audit division is required to perform a routine audit on each of Nevada's licensed establishments at least once annually. This results in the completion of approximately 700 additional routine audits each year.

Number of Investigative Audits – CCB

During the period of January 1, 2023, through December 31, 2023, the CCB conducted a total of 43 operational audits of licensees, all of which included financial audits of the accounts, funds, programs, activities, and functions of a licensee. In total the 43 TOI investigations resulted in the processing of 84 TOIs, impacting a total of 200 licenses.

Additionally, during the calendar year, the CCB conducted 17 Consumption Lounge (CL) Suitability investigations, all of which included financial audits of the accounts and funding, and proposed programs, activities, and functions of a licensee. In total, the 17 CL investigations resulted in the processing of 17 CL applications for licensure.

Lastly, the CCB conducted 18 Management Service Agreement (MSA) investigations, which includes a review of the operations between the licensee and the management company involved. Of the 18 MSA investigations, none included a financial audit. In total the MSA investigations impacted 50 licensees.

Summary of Findings – CCB

The CCB financial audits examined the financial and operational positions of each of the licensees for the last two reporting periods and included review of Income Statements and Balance Sheets, and included a ratio analysis of each licensee's liquidity, leverage, coverage, and profitability.

The operational and financial audits resulted in findings of 43 violations of the NRS and NCCR. Most violations discovered were related to TOIs completed without prior CCB approval, tax compliance issues, violations of fiduciary responsibility, and associations with unsuitable persons.

Cost of Audits – CCB

The average cost of each operational and financial audit completed by the CCB Investigations Division between January 1, 2023, and December 31, 2023, was \$8,507.04.

Number of Audits - DoT

During the period of January 1, 2023, through December 31, 2023, the DoT conducted a total of ten (10) cannabis audits. The audits included six (6) taxpayers who operated adult-use cannabis cultivation facilities and four (4) adult-use cannabis retail stores. The completed audits included two (2) entities that had an adult-use cannabis retail store and an adult-use cannabis cultivation facility. One of the entities has two (2) adult-use cannabis retail stores and three (3) adult-use cannabis cultivation facilities.

Summary of Findings - DoT

Common errors related to the cannabis tax deficiency was failure to pay a tax and/or accurately report the classification of product transfer (sales). Each classification has a different fair market value which led to cases of underreported taxes. For example, a taxpayer may report the sale of flower as popcorn bud which has a lower fair market value. Other errors occurred due to failure to file WMT returns and giveaways at one penny rate without reporting use tax.

Cost of Audits - DoT

Each tax audit took an average of 145.29 hours to complete at a cost of \$8,429.45 per audit or an aggregate of \$118,012.32. As a result of the audits, the DoT issued tax deficiency notices totaling \$1,700,232.92 which

includes cannabis taxes, sales and use tax, modified business tax, penalties, and interest. Of that amount, \$1,432,939.78 was billed for wholesale and retail cannabis for the Cultivators and a credit of (\$293,901.15) was issued for over reported retail cannabis tax for the Dispensaries. The total tax deficiency of \$1,139,308.63 is inclusive of all tax types to include penalty and interest. Currently, each taxpayer audited has either paid, petitioned, or has requested a hearing for the assessment with the DoT.

****Note:** The tax deficiencies noted above included adjustments from one audit that was petitioned for redetermination. The average hours and costs do include additional time to complete redeterminations, hearings, or adjustments to penalties and interest.**

Conclusion

To conclude, each agency has a critical role to play in its authority to ensure the cannabis industry remains strictly regulated and the appropriate amount of taxes due to the State are collected in a timely manner. To ensure that these efforts are strengthened by continued coordination and collaboration between the two agencies, the CCB and the DoT hold regular interagency working group meetings in addition to formalized biannual meetings to discuss cannabis licensee and taxpayer cases. This working group allows each agency to further refine its unique and specific role in order to maximize opportunities and efficiencies in state oversight of the cannabis industry.

Should you have any additional questions on the contents of this report, please feel free to contact me directly.

Sincere regards,



James Humm
Executive Director
Nevada Cannabis Compliance Board

CC: Adriana Guzmán Fralick, Chair