



# Accounting Best Practices

For Compliance,  
Financial Planning and Growth

**Cannabis Regulatory Agency  
Education Session**

May 16, 2024



# LEACIF

**Certified Public Accountant**

# About the Presenter and Firm

**Kareyna Miller, CPA, CRISC**

## LEACIF

**Kareyna Miller, CPA, CRISC** is a founding member of the MICPA Cannabis Industry Expert Panel, and has been working with businesses in Michigan's cannabis industry since 2017. Her industry experience is well rounded and includes both client service in the areas of accounting, tax, consulting, and assurance, as well as in firm management in organically growing and managing a practice servicing this unique niche.

**LEACIF** specializes in working with Michigan cannabis businesses for their accounting and business advisory needs, with focus primarily on providing fractional CFO and controller services to cultivators and processors, and their retail locations.



**LEACIF**  
Certified Public Accountant

**Innovate Your Expectations**  
Live Your Values | Define Your Control

# Disclaimer

The information provided herein is not and shall not be construed as tax, accounting, legal, regulatory or other professional advice or sufficient to satisfy any such requirements.

Attendees should consult tax, accounting, legal, regulatory or other professional advisor(s) for advice appropriate to their situations. This presentation is not sufficient to rely on and the information presented is not complete - many other matters affecting your business and tax structuring needs are also applicable.

**This presentation is for general purposes only. Please consult your CPA or tax advisor regarding your specific business.**

**Today's session will focus on the following topics:**



**LEACIF**

Certified Public Accountant

**Tips for an accounting system chart of accounts structure**

**Actionable accounting controls, including reconciliations and reviews**

**Inventory valuation and accounting methodologies under Internal Revenue Code 471**

**Tax matters to be aware of related to operating and other agreement type documents**

**Compliance related to accounting method changes for tax purposes**

# Why are we presenting these topics?



**LEACIF**

Certified Public Accountant

To help businesses in the industry better succeed



Awareness

Actionable Takeaways

# Accounting System



**LEACIF**  
Certified Public Accountant

Do you need **accounting software**?

The importance of having an **intentional** chart of accounts:

Support of accounting methodology

Financial and management reporting needs

Regulatory compliance requirements

Cash flow control and planning

# Chart of Accounts Structure



**LEACIF**  
Certified Public Accountant

First, determine the framework to be used:

Tax-Basis: **Cash vs. Accrual**

→ We are going to focus on tax basis applications in this session.

**GAAP**

Business activities

Other?

**Federal vs. State** differences



# Chart of Accounts Structure



**LEACIF**  
Certified Public Accountant

Structure should support accounting methodology.

- For example, if your cultivation facility is accounting for its inventory on a tax-basis following **US Treasury Regulation § 1.471-11**, consider designing your COA to reflect the **inventoriable cost categories** under this regulation.

Consider using account numbers and sub-accounts

- What are your business's financial and managerial reporting requirements?
- How much detail do you need/want?

# Chart of Accounts Structure



**LEACIF**  
Certified Public Accountant

Make sure account types and their classification support your accounting method



Should items be **expensed** or capitalized to **inventory asset accounts**?

Consider differences in federal vs. state tax rules, including compliance for state-level decoupling from **280E**, accounting for differences in Medical vs Adult Use activities, etc.

# Accounting Resources Available



**LEACIF**  
Certified Public Accountant

Chart of Accounts templates (.xlsx) available on our website!

**Disclaimer:** This chart of accounts template should be reviewed and tailored to your business's individual needs, including the addition and subtraction of accounts relevant to your activities and financial reporting requirements. This template may not be structured appropriately based on your entity's tax structure, regulatory requirements, other rules affecting your business, or accounting system requirements. Always consult with a qualified professional prior to relying on or using this template in your business. This template alone is not sufficient to support complete accounting and record keeping requirements. Use it at your own risk.

Sub accounts are accounts shown with parent accounts preceding the account name. For example "Inventory on Hand:Cultivation" indicates "Cultivation" is a sub account of "Inventory on Hand".

Account numbers must be updated based on your business's needs, and before attempting to use or upload this template to an accounting system.

The below format and descriptions are loosely formatted for a partnership tax structure. Account descriptions and placements within the chart of accounts should be updated accordingly.

Account #	Account	Type	Additional Notes
10XXX	Cash on hand	Bank	
101XXX	Cash on hand/Safe	Bank	
102XXX	Cash on Hand/Petty Cash	Bank	
110XX	Operating Checking	Bank	
110XX	Savings	Bank	
12XXX	Accounts Receivable (A/R)	Accounts Receivable	
101XXX	Undeposited Funds	Bank	
130XX	Inventory on hand	Other Current Assets	Clearing account.
1310XX	Inventory on Hand:Cultivation	Other Current Assets	
1311XX	Inventory on Hand:Cultivation:Cultivation Supplies	Other Current Assets	
1312XX	Inventory on Hand:Cultivation:Packaging Supplies	Other Current Assets	
1313XX	Inventory on Hand:Cultivation:Direct Labor	Other Current Assets	
1314XX	Inventory on Hand:Cultivation:Testing	Other Current Assets	
1315XX	Inventory on Hand:Cultivation:Repairs and Maintenance	Other Current Assets	
1316XX	Inventory on Hand:Cultivation:Environmental	Other Current Assets	
1317XX	Inventory on Hand:Cultivation:Other Direct Costs	Other Current Assets	
2110XX	Inventory on Hand:Cultivation:Overhead:Building Rent	Other Current Assets	
2210XX	Inventory on Hand:Cultivation:Overhead:Utilities	Other Current Assets	
2310XX	Inventory on Hand:Cultivation:Overhead:Security	Other Current Assets	

Available for:

Cultivators

Processors

Retailers



Check out:

<https://www.leacif.com/cannabis-accounting-resources>

# Chart of Accounts



**LEACIF**  
Certified Public Accountant

**Tip:** Review your existing chart of accounts structure against your accounting methodology. Common issues we see include:

→ For cultivators and processors, inventoriable costs categorized as expenses that may be disallowed by 280E

→ For operators following an **accrual accounting method**, inventory costs expensed directly to COGS

→ Asset accounts with negative balances

Unreconciled bank and cash balances

→ Incorrect accounting for **contributions, improvements, and other transactions** related to owners and related party entities

# Accounting Controls



**LEACIF**

Certified Public Accountant



Controls are important not only for compliance reasons, but also for business operators to timely catch errors and other discrepancies that can **impact their operations and reporting needs.**

# Accounting Controls



**LEACIF**

Certified Public Accountant

**METRC to General Ledger Reconciliation**

Cultivators and Processors vs Retailers

How to reconcile?

How often do you reconcile?

When to report an error/discrepancy to METRC?



# Accounting Controls



**LEACIF**

Certified Public Accountant



Accounting System Items to  
consider reviewing:

**Chart of accounts**

**Bank feed**

**Bank Reconciliations Adjustments**

**General Ledger**

**Accounts Payable and vendor transactions**

# Accounting Controls



**LEACIF**

Certified Public Accountant

Maintenance of Workpapers:

**1. Reconciliations**

**2. Ending inventory and cost of goods sold work papers**

**3. Overhead allocation work papers**

**4. Sales and MRE tax work papers**



# Accounting Controls



**LEACIF**  
Certified Public Accountant

Establish process for maintaining source documents

**Administrative Rule R 420.203**



**AFS support**

# Accounting Controls



**LEACIF**  
Certified Public Accountant

Other Tips to Consider:

Customer Credit Extension/Payment Terms Controls

→ **Written policy and controls**

→ **Process to review financial information for **payment terms****

Service Provider Due Diligence

# Accounting Controls



**LEACIF**  
Certified Public Accountant

Other Tips to Consider:

Data Security and Privacy Controls for Financial Information

- **Stored financial information security**
- Employee/Customer/Vendor transaction security
- **Retailer:** PCI compliance considerations
- **Tip:** Implement a Framework

# Inventory Accounting



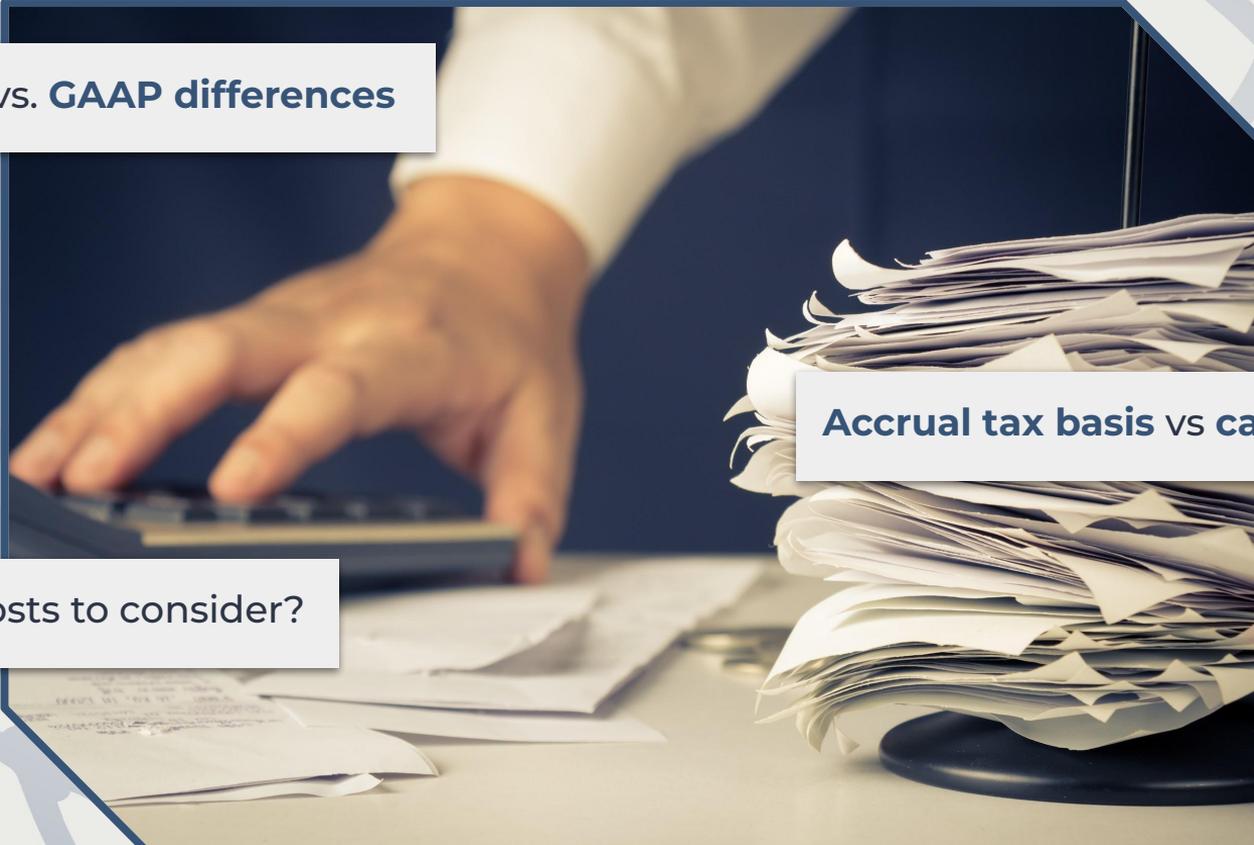
**LEACIF**

Certified Public Accountant

**General tax vs. GAAP differences**

**Accrual tax basis vs cash tax basis**

**What costs to consider?**



# Treasury Regulation §1.471-11

## Direct and Indirect Costs



**LEACIF**  
Certified Public Accountant

“Inventories of Manufacturers”

Accrual tax-basis method

Cultivators and processors, generally

Accounting for inventory and relation to cash flow

# Treasury Regulation §1.471-11

## Direct and Indirect Costs



**LEACIF**  
Certified Public Accountant

**Direct costs**

**Indirect Costs**

Includability of certain indirect production costs

Costs not included in inventoriable costs

Indirect production costs includible in inventoriable costs depending upon treatment in taxpayer's financial reports

# Direct Costs



**LEACIF**

Certified Public Accountant

**Direct material costs** include the cost of those materials which become an integral part of the specific product and those materials which are consumed in the ordinary course of manufacturing and can be identified or associated with particular units or groups of units of that product.

**Direct labor costs** include the cost of labor which can be identified or associated with particular units or groups of units of a specific product. [...] costs include such items as basic compensation, overtime pay, vacation and holiday pay, sick leave pay [...]

# Includability of certain indirect production costs



**LEACIF**  
Certified Public Accountant

Listed costs per § 1.471-11(c)(2)(i):

- Repair expenses
- Maintenance
- Utilities, such as heat, power and light
- Rent
- Indirect labor and production supervisory wages, [generally including similar costs as direct labor costs on earlier slide]
- Indirect materials and supplies
- Tools and equipment not capitalized
- Costs of quality control and inspection

*[..] Only to the extent such costs are incident to and necessary for production or manufacturing operations or processes.*

# Includability of certain indirect production costs



**LEACIF**  
Certified Public Accountant

**Indirect production costs** includible in inventoriable costs depending upon treatment in taxpayer's financial reports (listed costs per § 1.471-11(c)(2)(iii)):

- Taxes (generally, property taxes)
- Depreciation and depletion (Consider **book depreciation** only; tax based depreciation is generally **disallowed as a deduction**)
- Employee benefits
- Costs attributable to strikes, rework labor, scrap and spoilage
- Factory administrative expenses incident and necessary for the production process
- Officer salaries attributable to the production process
- Insurance costs incident and necessary to the production process

# Resource on our Website



**LEACIF**

Certified Public Accountant

If you would like to learn more tips on how to apply § 1.471-11 to your business, we have an additional presentation on our website:

This is for general purposes only. Please consult with a CPA or accountant who is knowledgeable of the tax regulations regarding your specific tax situation.



**Applying § 1.471-11 to the Cannabis Industry**

A practical approach for cannabis cultivators and processors

Michigan Association of CPAs

**Cannabis Summit**

December 12, 2023

**Check out:**

<https://www.leacif.com/recent-publications/applying471-11tocannabis>

# Retailers



**LEACIF**

Certified Public Accountant

Generally, two inventory regulations are applicable for accounting for inventory valuation

1.471-3 and 1.471-8

For most, applying a cost-based method to include inventory purchases and transport fees paid is appropriate



# IRC 471(c)



**LEACIF**  
Certified Public Accountant

Cash basis accounting method for accounting for inventory

New rule added with 2017 TCJA

→ Caveats

→ Change of accounting method compliance



# Agreements Tax Matters



**LEACIF**  
Certified Public Accountant

## 1. Operating Agreements

→ Understand **“Tax Matters”** Section

→ Ensure it supports your business intentions

## 2. Rental Agreements

→ **Real vs Personal Property**

→ **Deferred Rent Payments**

## 3. Related Party Transactions

# Federal vs. State Tax Matters



**LEACIF**

Certified Public Accountant



Michigan **partially decouples** from **280E** for Adult Use

→ How to account for this?

→ What might MI Treasury need to support?

Sales vs. MRE tax calculations

Other

# Other Tax Compliance Considerations



**LEACIF**  
Certified Public Accountant

Change of Accounting Method, Form 3115 (Federal)

→ When this may be necessary

What if 280E no longer applied in the future?

→ Potential **rescheduling of marijuana** from Schedule I to III under federal CSA



# Questions?

Feel free to ask questions at this time or email them to:

 [kareyna@leacif.com](mailto:kareyna@leacif.com)

 [leacif.com/cannabis](https://leacif.com/cannabis)

Check out our website and social media as well for more business and tax resources and accounting tips.



**@LEACIF**