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# Financial Management in the Cannabis Industry

## Innovative financial practices in the cannabis sector

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Financial management is essential in any business, but in the cannabis industry (in this article, cannabis denotes psychoactive cannabis, also known as marijuana), it's especially critical due to unique regulatory and operational complexities. Today, support for cannabis legalization in the U.S. has risen to over 68%, with both liberal and conservative states expanding recreational use and all states allowing hemp (non-psychoactive cannabis) cultivation. While hemp benefits from the 2018 Farm Bill's deregulation, cannabis remains tightly controlled at the federal level. Because of the Controlled Substances Act (CSA), access to banking, tax relief, and financial services remains complicated for recreational and medicinal cannabis businesses.

This article examines financial practices within the cannabis sector and is informed by survey research conducted across California's cannabis businesses in 2022 and 2023. Through analysis of financial strategies, regulatory challenges, and internal controls, we aim to provide insights into improving financial management practices within the industry. Our research also has implications for future federal tax policy reforms for the industry.

## Economic significance of cannabis

The cannabis industry is now a vital component of the U.S. economy, particularly in California, which boasts the nation's largest legal market valued at \$4.5 billion in 2023. California alone accounts for over 10% of the national cannabis industry, expected to reach \$44 billion this year. Cannabis sales contribute approximately \$1.1 billion annually in total tax revenue (excise and sales tax) and support over 83,000 jobs in California. However, regulatory and tax burdens, combined with a resilient black market, pose persistent financial challenges for the industry.

## The landscape

Federal regulations severely restrict cannabis businesses' access to traditional financial services and subject the industry to unfavorable tax treatment. For instance, cannabis firms must comply with IRS Section 280E, which disallows typical business deductions and results in higher effective tax rates. Estimates range between 40 to 80 percent in federal taxes for the industry when other businesses pay the flat 21% corporate tax rate. In 2024,

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an average of 27% of U.S. cannabis businesses surveyed reported being profitable, while 41% indicated they broke even, and 32% stated they were not profitable. These constraints push cannabis companies into cash-heavy operations, increasing their exposure to fraud and theft.

In contrast, hemp businesses have broader access to banking services and lower operational risks because the substance was partially deregulated under the 2018 Farm Bill. Hemp and cannabis are both varieties of the *Cannabis sativa* plant, but hemp, to be legal, must contain less than 0.3% THC, the primary psychoactive compound. In contrast, cannabis typically has THC levels in the 14% range for raw cannabis and 60% for concentrates though percentages can range higher. Hemp regulations present a potential model for cannabis should Congress elect to ease financial restrictions on the cannabis market.

Congressional committee proposals to reclassify cannabis as a less scrutinized Schedule III controlled substance under the Controlled Substances Act could significantly alter the financial landscape for cannabis businesses. Changes to IRC Section 280E could potentially reduce tax burdens, allowing cannabis businesses to deduct standard operating expenses like other industries. Reclassification could also improve access to banking and credit, as financial institutions may feel more secure in providing services to cannabis businesses. A Schedule III reclassification would be a substantial step but may still fall short of the comprehensive reforms needed to resolve financial inequities in the cannabis sector.

## Survey research findings

### Research methodology

Our research methodology involved a comprehensive online survey targeting California's cannabis business license holders registered with the California Department of Cannabis Control (DCC). In mid-2022, the DCC database had over 12,000 licenses, representing 8,700 unique individuals as some held multiple licenses, 54% designated for adult use. To capture a broad spectrum of insights, we surveyed a representative random sample of 1,125 business owners and achieved a 14% response rate from 155 owners. We then sent the survey to 2,048 unique license holders not previously selected, and received 111 additional responses, an 8% response rate. Groups were compared, and responses were similar enough to be combined. We distributed a third survey to all 76 registered hemp farmers in the Spring of 2023, receiving responses from 33 farmers, resulting in a 46% response rate.

The low response rate among cannabis businesses may stem from concerns about confidentiality and legal exposure, given the complex regulatory environment and the stigma associated with cannabis operations. Many business owners expressed fears that

sharing sensitive financial information, even anonymously, could lead to unintended consequences from regulators or divulge insights they perceive as giving away a strategic advantage.

During the survey and oral interviews, a representative sample of respondents provided information on financial challenges, the unlicensed market, internal control practices, and information about other unique obstacles faced by licensed cannabis businesses in a highly regulated environment.

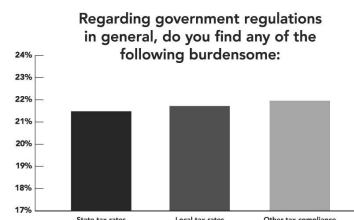
## Banking and cash management

Our study found that federal restrictions on banking for cannabis businesses force reliance on cash transactions, with over 53% of customer payments and 47% of vendor payments conducted in cash. This dependence increases risks of theft, fraud, and operational inefficiencies. National surveys contrast cannabis with other sectors, showing only 16% of transactions across all U.S. industries are cash-based. The Association of Certified Fraud Examiners (ACFE) notes that cash-heavy sectors are prone to skimming and revenue under-reporting, issues highlighting the unique vulnerability of cannabis businesses.

Limited banking access leads many cannabis businesses to use local credit unions, though these services are often costly and contain fees unique to cannabis businesses that hinder their growth. Federal policy reform could help cannabis businesses access traditional banking, potentially lowering costs, and risks. With access to federal banking privileges, the cannabis industry could reduce its reliance on cash, enhance security, and improve operational efficiency. Additionally, it could drive positive societal outcomes, such as increasing tax revenues and fostering economic growth.

## Tax compliance

Tax compliance is a critical issue for cannabis businesses, largely due to IRS Section 280E, which prohibits the deduction of ordinary business expenses. IRC Section 280E has had profound implications for cannabis businesses, as it disallows deductions for ordinary business expenses due to the classification of cannabis as a Schedule I (the same as heroin) controlled substance. This results in disproportionately high federal tax burdens, leaving many businesses struggling to achieve profitability. Cases such as *Californians Helping to Alleviate Medical Problems, Inc. v. Commissioner (CHAMP)* (2007) and *Harborside Health Center v. Commissioner* (2018) have reinforced the limitations imposed by Section 280E.



*Figure 1: Compliance challenges in the cannabis sector.*

At the state level, laws in jurisdictions like Colorado and California exacerbate these challenges by imposing separate cannabis-specific excise taxes. For example, California levies excise and cultivation taxes in addition to standard sales taxes, significantly increasing operational costs. Income tax laws in California and Colorado, as well as some others, allow business deductions that are prohibited under IRC Section 280E. As a result, tax returns in these states diverge from the federal return, creating additional complexity in the preparation of income tax filings and a more complex regulatory environment for cannabis businesses.

Due to the cash-intensive aspect of their operations, in interviews, 89% of respondents reported significant tax-related challenges creating complications for revenue tracking and increasing audit risks. As reflected in Figure 2, most respondents found state and local tax rates and other tax compliance to be among the top burdens of running their business. The IRS closely scrutinizes cash-intensive industries for underreporting, adding pressure to an already complex tax environment. To address these concerns, internal controls for tracking and verifying cash flows are essential for cannabis businesses.

## **Off-the-books labor and unlicensed competition**

Our survey results indicate that a substantial portion of respondents believe their competitors are still involved in the unlicensed cannabis market. Of the 194 respondents, the median estimate was that 70% of competitors were engaged in some form of unlicensed activity. Additionally, a significant number of respondents, 63%, believed that half or more of their competitors hired off-the-books labor, with 40 respondents indicating that all their competitors did so. The perception that a considerable portion of competitors are unlicensed is further supported by the estimate that 63% of participants thought at least half of their competitors operated without proper licensing. These findings suggest that illegal business practices, including unlicensed operations and off-the-books labor, remain prevalent in the cannabis industry, putting those in the licensed market at significant competitive disadvantage.

## **Technology and financial reporting**

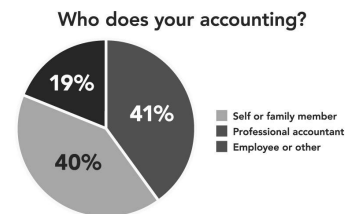
Our study found the cannabis sector underutilizes financial technology, with only 17% of businesses using accounting software primarily for compliance, payroll, and inventory management. In contrast, hemp businesses report higher adoption rates, with 67% using accounting software. As financial technology becomes more accessible, cannabis businesses could benefit from automated tracking of transactions, reducing cash dependency, and streamlining financial reporting to support transparency and regulatory adherence. Financial software could also help address audit risks by automating record-keeping and ensuring consistency in financial reporting. Expanding technology use within the cannabis industry would aid in establishing reliable controls, reducing fraud risk, and aligning with traditional business standards.

## Budgeting and long-term financial planning

Budgeting and long-term financial planning are crucial in cannabis, where cash flow can be unpredictable and operational costs high. Nearly 80% of our respondents rated budgeting as essential for handling these challenges. By integrating cash flow forecasts and aligning budgets with seasonal revenue variations, cannabis businesses can better manage expenses and meet obligations in volatile environments. Long-term financial planning helps hemp businesses prepare for these shifts, allocate resources efficiently, and sustain operations through economic cycles.

## Role of management accountants in addressing cannabis industry challenges

Management accountants could play a pivotal role in navigating the cannabis industry's unique financial and regulatory challenges. In an industry often constrained by limited access to banking, high tax rates, and cash-based operations, the demand for skilled financial management is evident. According to our research, 41% of cannabis businesses rely on informal accounting, often performed by the business owner or a family member, with only 40% seeking professional accounting support. This reliance on informal systems introduces significant risks and highlights a growing need for the expertise of management accountants, especially as 67% of businesses in the industry recognize financial management skills as crucial for operational success.



*Figure 2: Chart displaying who does the accounting to address industry challenges.*

Several accounting firms have developed specialized services tailored to the unique challenges faced by the cannabis industry. These firms, such as Green Growth CPAs, DOPE CFO, and the Canna CPAs, provide expertise in navigating complex regulatory frameworks, including compliance with IRC Section 280E and state-specific tax laws. Their services often include guidance on financial reporting, internal controls, cash management, and audit readiness, addressing critical operational and compliance issues for cannabis businesses operating within a largely cash-based system.

## Financial planning and analysis (FP&A)

FP&A is a core function of management accountants, and this skill could be particularly vital in an industry where over 50% of transactions are conducted in cash. Given the volatility in both regulatory costs and seasonal revenue patterns, cannabis businesses rely on robust financial projections to anticipate obligations and optimize cash flow. Management accountants in the cannabis industry would bring significant value through

their ability to analyze historical financial data, identify market trends, and create realistic budgets that account for both fixed and variable costs. These budgets are essential not only for day-to-day operations but also for long-term financial planning.

In the cannabis sector, accurate FP&A helps businesses prepare for substantial tax obligations, navigate fluctuating regulatory costs, and respond proactively to shifts in demand. For example, seasonal fluctuations can affect the availability and price of raw materials or influence customer purchasing behavior, impacting cash flow cycles. Management accountants could help cannabis businesses plan for these fluctuations, ensuring sufficient liquidity and working capital. Their insights also guide inventory management, resource allocation, and strategic investments, enabling businesses to withstand financial pressures and position themselves for growth.

## **Internal controls for financial security**

Internal controls are fundamental for maintaining financial security, particularly for cash-heavy industries like cannabis. Management accountants play a critical role in setting up an organization's system of internal controls. Without reliable banking services, cannabis businesses face heightened risks of theft, fraud, and revenue misreporting. Management accountants are experts in implementing critical safeguards—such as segregation of duties, regular reconciliations, and systematic cash tracking—that protect the business from potential financial misconduct. Effective internal controls mitigate the risks of theft, misappropriation, and regulatory penalties, all of which are prevalent threats in the industry.

Segregation of duties, a common internal control, ensures that no single individual has control over all aspects of a transaction, making it harder for fraudulent activities to go undetected. For example, a management accountant might assign separate roles for cash handling, recording transactions, and auditing financial records, thereby establishing a system of checks and balances. This structure is particularly beneficial for cannabis businesses, where cash-intensive transactions are more vulnerable to theft and fraud. Internal controls are also critical for compliance with complex tax regulations, as they enable accurate tracking and reporting of income, expenses, and inventory levels, reducing the risk of audit penalties.

## **Tax strategy and compliance**

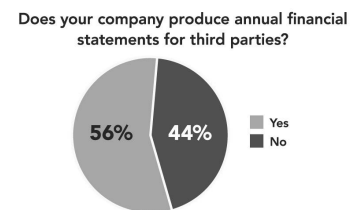
Tax compliance in the cannabis industry is challenging due to IRS Section 280E, which restricts cannabis businesses from deducting ordinary business expenses, effectively resulting in higher tax rates. Management accountants could develop tax strategies that help cannabis businesses reduce their taxable income within legal boundaries. Working

closely with tax professionals, management accountants might identify permissible deductions, credits, and other tax advantages to manage these burdens and maximize cash flow.

For example, one strategy might entail meticulously tracking costs associated with the cost of goods sold (COGS), as these are often the only deductions available under Section 280E. By allocating eligible expenses to COGS, management accountants could help the company potentially reduce its overall tax liability. In addition, accountants prepare detailed and transparent documentation to demonstrate compliance and support any tax deductions claimed. This documentation is crucial for audit readiness, as cannabis businesses are at higher risk for IRS scrutiny given their cash-based operations and strict tax regulations.

## Financial reporting and stakeholder communication

Consistent and transparent financial reporting is essential for maintaining credibility with stakeholders, including regulators, banks, and investors. Our research indicates that only 44% of businesses in the hemp industry produce annual financial statements, underscoring the need for more formalized financial reporting. Management accountants ensure that financial statements meet industry standards, accurately reflect business performance, and communicate critical financial information to stakeholders.



*Figure 3: Use of annual financial statements.*

Where investor confidence and regulatory compliance are key, management accountants can prepare reports highlighting key performance indicators (KPIs) and financial health metrics. These reports help build trust and transparency with stakeholders, which is essential for securing funding, attracting investment, and meeting regulatory expectations. For businesses looking to expand or seek external financing, detailed and reliable financial reports demonstrate the viability of the business and can open doors to potential partnerships or funding opportunities.

## Strategic decision-making

Management accountants can be vital contributors to cannabis business strategy, offering financial insights that support expansion plans, product diversification, and investment evaluations. In a market where regulatory landscapes are constantly shifting, aligning financial strategies with business goals is crucial for long-term success. These professionals can analyze financial data to provide strategic recommendations, enabling cannabis businesses to assess the feasibility of growth initiatives and respond to market opportunities.

In addition, management accountants support decision-making by conducting cost-benefit analyses and identifying areas for operational efficiency. They might evaluate potential acquisitions, mergers, or partnerships, assessing how such moves align with the company's financial goals and risk tolerance. As cannabis businesses grow, management accountants could provide crucial data and insights that support scaling operations responsibly, ensuring that expansion aligns with both financial and strategic objectives.

## Conclusion

Management accountants could play a crucial role in guiding cannabis businesses through complex financial and regulatory challenges. As the cannabis industry continues to mature and anticipates regulatory changes, such as expanded banking access and potential tax relief, accountants will be key in leveraging these reforms for business growth and profitability. By strengthening financial stability through strategic planning and internal controls, management accountants can support cannabis companies in navigating these regulatory pressures, fostering transparency, and positioning them for sustainable growth.

### About the authors

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