

It's Illegal! – Marijuana Related Businesses and the Accounting Profession

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Recent legislation has resulted in legalized marijuana in more than half of the US states, with more expected. The industry is increasingly turning to CPA's for assistance with tax compliance and their abundance of cash. Professionals need to be aware that no Federal protection exists for recreational marijuana and that Federal laws like RICO and Money Laundering pose tremendous risks to all aspect of the marijuana industry. Professional ethics have important implications for CPAs, exposure to investigations and related sanctions can occur directly, and indirectly through criminal or regulatory investigations of clients.

INTRODUCTION

CPA's and other professionals are facing increased demand for services from the marijuana industry due to states' legalization of recreational usage. CPA's, and attorneys are especially at risk for providing these services due to both its illegality and professional standards. Under Federal law marijuana is a schedule 1 illegal drug. (21 U.S.Code§812(c) Schedule I (c)10) As a result of this listing, individuals engaged directly or indirectly in the marijuana industry are in violation of federal law and are subject to criminal prosecution. Further, there is a prima facie case that the individual has violated professional ethical standards as well by virtue of committing a federal crime. However, thirty one states, the District of Columbia, Guam and Puerto Rico have legalized marijuana for either medical or recreational usage. (NCSL, 2018) This chasm between federal and state law has arisen largely through voter initiatives at the state level that began in 2012 with Colorado Amendment 64 and Washington Initiative 502 regarding the legalization of marijuana for recreational use. Currently, there exists a delicate truce at the federal level allowing the marijuana industry to exist contingent on U.S. Attorney prosecutorial discretion and the federal budget.

We examine this conflict in the context of providing professional services to the marijuana industry, specifically addressing the legal, professional and reputational risks that professionals face by providing services to this emerging industry. It is important to note that the economic scale of the marijuana industry is substantial, and growing. In 2016 the impact in Colorado alone was estimated to exceed \$1.3 billion. (Huddleston, 2016) With Vermont approving recreational usage beginning July 1, 2018, recreational marijuana use is now legal in nine states and the District of Columbia. Marijuana usage is currently legal in some form in forty six of the fifty states. (NCSL, 2018)

Our paper provides guidance for professional accountants interested in expansion of professional services to the marijuana industry. As we identify, providing professional services to marijuana clients is a minefield that could result in being charged with violation of a federal crime(s). CPA's especially need to be mindful of these pitfalls despite/in the face of extremely lucrative fees that can be earned. We discuss issues related to the violation of federal laws, and CPA professional ethics, we also identify several important practical considerations that must be evaluated both initially and continuously following the decision to provide services. Finally, consideration must be given to the fact that professional services might have to be discontinued immediately to established (cannabis) clients if the federal non-enforcement policy changes, as well as the reputational impacts from existing and potential clients and the larger professional community (for providing services to an illegal enterprise).

LEGAL ISSUES

Since "An Issue Brief on State Marijuana Laws and the CPA Profession" was first issued by the AICPA in July 2015, and updated in January 2016, several new rulings, regulations and mandates as they relate to the legal marijuana industry have come out and accounting professionals need to be wary of the legal ramifications of accepting business from any marijuana related businesses.

Up until January 4, 2018, when Attorney General Jeff Sessions issued his "Marijuana Enforcement Memorandum" (2018 Sessions Memo) the legal marijuana industry and those providing attendant services found comfort, although misplaced, in what have become known as the 'Cole Memos'. Additional protections were also believed to be provided by the issuance of the 2014 Department of Treasury FinCen Guidance Memorandum "BSA Expectations Regarding Marijuana-Related Businesses" and the 2014 passage of the Rohrabacher-Farr amendment ("Rohrabacher amendment"). The combination of these directives and law, along with the ongoing passage of State legislation legalizing marijuana has led to an unprecedented growth in marijuana related businesses. (Borchardt, Jan. 2017)

The first semblance of prosecutorial protection the marijuana industry received was the Department of Justice memorandum from then Deputy Attorney General James Cole which was issued in 2013. The 2013 Cole Memo set forth guidance to US Attorneys around the country with respect to prosecuting marijuana related cases under the Federal Controlled Substances Act. The memo set forth eight priorities:

- 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.

The 2013 Cole Memo has been mistakenly perceived as a form of legal authority with respect to protecting individuals involved in the marijuana industry from federal prosecution. However, the 2013 Cole Memo specifically did not prevent U.S. attorneys from prosecuting marijuana related cases. The memo clearly stated that it did "not alter in any way the Department's authority to enforce federal law, including federal laws relating to marijuana, regardless of state law." The 2013 Cole Memo simply gave guidance as to where U.S. attorneys should focus their resources in relation to marijuana related prosecutions. Although the 2013 Cole Memo did not prohibit the prosecution of legal marijuana cases, it appears to have had a modest impact, as federal drug prosecutions declined after the issuance of the memo. (Gramlich, 2017)

While the 2013 Cole Memo addressed solely the marijuana industry itself, Deputy Attorney General Cole issued a subsequent memo on February 14, 2014 (concurrently with the Department of Treasury FinCen Guidance Memorandum) addressing the institutions which deal with finances derived from the marijuana industry. The 2014 Cole Memo and the concurrent FinCen Guidance Memo reiterated the eight priorities set out above. The memos, while again specifically stating that the marijuana industry is illegal under Federal law, gave direction to financial institutions in handling money derived from these illegal operations. First and foremost was that any institution accepting funds from anyone associated with the marijuana industry must file a Suspicious Activity Report (SAR).

The FinCen Guidance Memo specifically requires “a financial institution to file a SAR on any activity involving a marijuana related business, including those duly licensed under state law.” Financial institutions receiving funds from a marijuana related business must file either a ‘Marijuana Limited SAR’ or a ‘Marijuana Priority SAR’. The difference between the two is pretty straight forward: if the institution suspects that their customer is violating any one of the eight priorities of the 2013 Cole Memo then a Marijuana Priority SAR must be filed; if no violation of the 2013 Cole Memo is suspected the institution must file a Marijuana Limited SAR if they “know, suspect or have reason to suspect that a transaction conducted or attempted by, at, or through the financial institution involves funds derived from illegal activity.” (Department of Treasury, 2014) The FinCen memo then clarifies that funds derived from illegal activity include any financial transactions involving funds from a marijuana-related business. What should be cause for concern for accountants who decide to take on a marijuana industry client, is that they themselves can be considered a ‘marijuana related business’ and subject to SAR reporting. The term “marijuana related business” has not been legally defined, and because of this the interpretation is left open to the financial institutions themselves. (ACAMS, 2016)

The final piece of the prosecution protection puzzle came in the form of the Rohrabacher amendment which was designed to protect medical marijuana businesses from DOJ prosecutions. The Rohrabacher amendment amended the *Commerce, Justice, Science, and Related Agencies Appropriations Act, 2015* (H.Amdt.748 to H.R.4660) to prevent the DOJ from spending any federally allocated funds on prosecuting crimes related to the medical marijuana industry in States where it has been legalized under state law. Despite the inclusion of the Rohrabacher amendment in the 2015 Appropriations Act, the DOJ narrowly interpreted the amendment as meaning that the DOJ could not prosecute ‘States’ for allowing businesses associated with medical marijuana to conduct business. The DOJ did not interpret the Rohrabacher amendment as preventing them from prosecuting the marijuana businesses. Despite the Cole Memos and the Rohrabacher amendment, the DOJ proceeded to prosecute medical marijuana businesses in states where they were operating legally under state law. The issue remained highly debated and largely unresolved until the Federal 9th Circuit issued it’s ruling in *United States v. McIntosh* in August of 2016.

The *McIntosh* case was a consolidation of 10 different federal criminal prosecutions involving medical marijuana defendants (six from California and four from Washington). The Ninth Circuit ultimately concluded that the Rohrabacher amendment was intended to limit the use of federal funds to prosecute individuals and not just States. However, in footnote 5 of the decision, Judge O’Scannlain issued a warning:

“To be clear, § 542 does not provide immunity from prosecution for federal marijuana offenses. The CSA prohibits the manufacture, distribution, and possession of marijuana. Anyone in any state who possesses, distributes, or manufactures marijuana for medical or recreational purposes (or attempts or conspires to do so) is committing a federal crime. The federal government can prosecute such offenses for up to five years after they occur.

Congress currently restricts the government from spending certain funds to prosecute certain individuals. But Congress could restore funding tomorrow, a year from now, or four years from now, and the government could then prosecute individuals who committed offenses while the government lacked funding. Moreover, a new president

will be elected soon, and a new administration could shift enforcement priorities to place greater emphasis on prosecuting marijuana offenses.

Nor does any state law “legalize” possession, distribution, or manufacture of marijuana. Under the Supremacy Clause of the Constitution, state laws cannot permit what federal law prohibits. Thus, while the CSA remains in effect, states cannot actually authorize the manufacture, distribution, or possession of marijuana. Such activity remains prohibited by federal law.”

Judge O’Scannlain’s warning about a new President being elected soon (referring to the then November 2016 Presidential election) and the possibility of a new administration shifting enforcement priorities proved prophetic. On January 4, 2018, Attorney General Sessions issued his memorandum on “Marijuana Enforcement”.

The 2018 Sessions Memo, along with Judge O’Scannlain’s warning, should give accounting professionals serious pause when considering taking on or continuing to provide services to the marijuana industry. The 2018 Sessions Memo rescinded all prior DOJ memorandums which previously addressed marijuana enforcement, dating all the way back to the first memo by Deputy Attorney General David Ogden in 2009. While the 2018 Sessions did not provide any explicit guidance as to marijuana enforcement beyond directing U.S. Attorney’s to exercise prosecutorial discretion, it did open the door for prosecutions of marijuana business which are non-medically related, as they are not protected by the Rohrabacher amendment and no longer have the protection of the eight priorities set out in the 2013 Cole Memo.

As a response to people seeking clarity as a result of the confusion created by the 2018 Sessions Memo, Andrew E. Lelling, U.S. Attorney for the District of Massachusetts, issued a statement on January 8, 2018.

“I cannot, however, provide assurances that certain categories of participants in the state-level marijuana trade will be immune from federal prosecution...Deciding, in advance, to immunize a certain category of actors from federal prosecution would be to effectively amend the laws Congress has already passed, and that I will not do...This is a straightforward rule of law issue. Congress has unambiguously made it a federal crime to cultivate, distribute and/or possess marijuana.” (Lelling, 2018)

This uncertainty brings with it the potential for serious legal liability. Over the past several years the marijuana industry and their attendant services have largely relied on the 2013 Cole Memo as protection against prosecution. What has largely been overlooked is a memorandum authored by Deputy Attorney General Cole in 2011. The 2011 Cole Memo had a decidedly different tone than the one that followed two years later, and in light of the 2018 Session Memo could provide a glimpse of where the DOJ may be heading with respect to federal marijuana prosecutions.

“Persons who are in the business of cultivating, selling or distributing marijuana, and those who knowingly facilitate such activities, are in violation of the Controlled Substances Act, regardless of state law...State laws or local ordinances are not a defense...Those who engage in transactions involving the proceeds of such activity may also be in violation of federal money laundering statutes and other federal financial laws.” (Cole, 2011)

The laws that Deputy Attorney General Cole was referring to are the Money Laundering (18 U.S. Code § 1956) and RICO (18 U.S. Code Ch. 96) statutes which provide federal criminal liability for persons who are financially associated with illegal businesses.

While a detailed look at Money Laundering and RICO laws is beyond the scope of this article, it is important to note that providing services to any marijuana related business, that is not exclusively

medical, creates serious legal liability both criminally and civilly. While potential criminal liability should be fairly clear given the 2018 Sessions Memo, the 2011 Cole Memo and Judge O'Scannlain's warning, civil liability under RICO may not.

RICO provides not only criminal but civil liability. In fact, civil RICO liability in this realm should be a major concern for accounting professionals. (Wright, 2014) While Accountants are not individually required to file a SAR if dealing with clients in the marijuana industry those dealing directly with financial institutions on behalf of their clients could face RICO liability if they do not fully disclose information to the financial institution and the institution suffers a loss as a result. Transactions with financial institutions conducted by an accountant on behalf of a marijuana related business need to be fully disclosed so the institution can fulfill its SAR obligations and avoid potential liability and losses. (Wright, 2014, p.990)

Medical marijuana protections are holding on by a thread because the Rohrabacher amendment is at risk with every new budget (Borchardt, Sept. 2017) and recreational marijuana related businesses have no protection from federal prosecution and will not have any protection anytime soon. In March 2018 an amendment introduced by Colorado Congressman Jared Polis, which attempted to protect recreational marijuana business from federal prosecution, was voted down by the US House Rules Committee.

As of today, there are tenuous protections for medical marijuana related businesses and there is no protection at all for businesses associated with recreational marijuana.

PROFESSIONAL ETHICS

Based on the previous discussion regarding the (federal) criminality of the marijuana industry, it is tenuous at best to argue that providing services to the marijuana industry does not violate professional standards. While arguments could be made based on various ethical theories that federal law is wrong or unjust, these would be superfluous, and likely unsuccessful. By very definition, committing a (federal) crime constitutes an ethical violation. Given this postulate the objective for professionals is parallel to the legal quandary, avoiding enforcement of an ethics violation/breach. It is important to note that the accountancy community is strongly divided on the issue of states' legalization of marijuana and the majority of this community is reticent about providing services to the marijuana industry. This fact at least partially explains the difficulty many marijuana entrepreneurs face trying to obtain accounting services. Then it is of note that professional ethics are strongly influenced, or at least in part defined by the accounting community.

If providing services to the marijuana industry violates professional ethics why haven't CPA's or other professionals faced ethics sanctions to date? This is an important question that, in our opinion, parallels (relates to) the lack of enforcement at the federal level, reflecting the changing perceptions regarding the marijuana industry by accountants and other professionals. So, similar to the federal versus state dichotomy regarding criminal penalties, there has not been a broad enforcement of ethics violations in states where marijuana has been legalized in some fashion.

Despite this, CPAs and other professionals could see selective enforcement, or enforcement when public policy warrants to support public interest priorities (2013 Cole Memo) or when states need to enforce local regulations.

At the national level, the AICPA released a memo concerning the provision of services to marijuana businesses. The AICPA was careful to point out that it did not represent an official position on this matter, but rather shared that several state boards where marijuana has been decriminalized have indicated they would not pursue enforcement actions solely on the basis that a licensee had provided services. (AICPA 2015)

It is notable that state boards of accountancy that have weighed on the issue of providing services to the marijuana industry have prefaced their opinions that no ethics actions would be taken so long as the businesses operated in compliance with applicable state laws. And this is the crux of the issue. CPAs must be extremely vigilant monitoring both their own behavior as well as their clients to ensure that they do not violate applicable laws, and thus trigger a related ethics investigation. But these violations would be

secondary to a violation of federal laws addressed earlier, and certainly could provide a basis for an ethics investigation.

The AICPA's ethical principles and related ethics rules emanate from the central goal of protecting the public interest. And this is consistent with the Cole Memo's goal regarding enforcement/prosecution priorities that relate to public welfare. The major concern for CPAs and other professionals engaged in providing services is what happens when there are violations of the regulations that currently provide the safe harbor from enforcement.

As mentioned previously, virtually all of the non-enforcement of federal law applies to the medical marijuana industry. The recreational marijuana industry has not been afforded these "deferrals" from federal prosecution. So CPAs should take special note of this fact when evaluating whether or not to provide services to marijuana clients.

An in-depth discussion of potential ethics violations/issues begins with an identification of areas where potential violations of ethics may occur. Our analysis identifies the following areas where ethical considerations would be paramount when providing services to the marijuana industry: integrity & objectivity, compliance with professional standards (including professional competency) and acts discreditable. (AICPA 2014)

An alleged ethical lapse could involve any or all of these ethical standards/rules and would likely depend on the severity of the infraction as well as the degree of knowledge or constructive knowledge that the CPA possessed, or should have possessed. For example, the failure of a client to be in full compliance with state regulations could trigger an ethics investigation concerning the CPAs involvement that could escalate from a lack of integrity or objectivity to a discreditable act depending on the severity of the violation, and the accountant's imputed responsibilities for the violation. We think this standard of performance is unique to the marijuana industry, and is why CPAs need to be cognizant that they may be subjected to enforcement actions due to actions by their client that they may have had little or no direct knowledge about but they should have.

Integrity & objectivity requires CPA's to always do the right thing, whether or not these behaviors will ever come to public light. These would obviously include engagement in questionable practices or activities, especially criminal activities, as well as less obvious violations such as failing to detect a material weakness in cash or inventory management that led to a violation. Due to the broad nature of this principle, it could be cited along with just about any other alleged violation.

Compliance with professional standards is also a fairly general requirement that requires CPAs to follow professional guidance in the provision of any services when such guidance exists, like IRS circular 230 which governs tax preparation and would also include lesser known bank regulations like bank secrecy act requirements. CPAs need to be vigilant regarding not just their own activities but also the activities of their marijuana clients. This includes, among other things: money laundering whether intentional or unknowingly, illegal wire transfers, interstate commerce, as well as compliance with state and local marijuana regulations, on top of any additional professional guidance provided by state boards or other authoritative sources.

Acts Discreditable are usually defined by state boards and include a number of violations including willful tax violations. However, with the marijuana industry, the list of possible infractions expands considerably related to the areas discussed above. The alleged violation would escalate dependent on the severity of the infraction(s), and whether the CPA assisted, had knowledge or should have had knowledge/constructive knowledge of any violation(s) of federal or state laws or regulations.

Because CPAs are presumed experts in accounting and finance, regulators, and the profession will likely impose high standards upon professionals who provide services to marijuana clients. Professional standards require CPAs serving the marijuana industry to ensure all federal regulations, including taxation and banking, are complied with because defenses predicated on lack of knowledge or ignorance would be risky and will likely be unsuccessful for limiting attribution for violations.

Given the challenges that the marijuana industry faces regarding access to banking services and differential taxation regulations, it is especially crucial that the CPA not unknowingly provide any assistance, or allow clients to subvert laws and regulations such as money laundering and mail or wire

fraud (transferring funds across states). This parallels the standards imposed on the banking industry that places additional burdens to monitor client activities to ensure that they are compliant with both state and federal regulations. Thus, how does a CPA avoid violation of this ethics principle when providing professional services? CPA's engaged in the marijuana industry must thoroughly vet and monitor their clients, as well as their own behaviors to avoid engaging in any questionable practices. This includes actual or constructive knowledge of violations by their marijuana clients.

This monitoring requirement places substantially higher responsibilities concerning professional skepticism of client activities relative to your clients operating in other legal industries. At a minimum CPAs need to undertake significant monitoring measures to ensure that their marijuana clients are not violating priority areas identified by the Cole Memo, state and local regulations, and by closely adhering to guidance provided by their State professional accountancy board to avoid potential enforcement actions.

CPAs must be vigilant and mindful to avoid assisting or allowing clients to commit illegal activities like illegal wire transfers, structuring or other violations of banking regulations. CPAs must be mindful of these requirements before providing services because they may be held accountable as if they did or should have known them.

We argue that providing services to marijuana clients requires significantly greater transparency, and trust regarding all aspects of the marijuana business to ensure compliance with all applicable regulations. CPA are unlikely to find relief in claiming ignorance regarding alleged violations, and thus must be proactive and vigilant in the monitoring and guidance provided to clients. An analogy of this different level of responsibility is the difference between providing negative assurance versus positive assurance regarding some assertion.

CPAs will need to perform an extensive analysis of client activities to ensure they are in fact not in violation of applicable laws and regulations. For example, if a marijuana client has weak controls over the tracking of product or cash, the CPA must take measures to identify these weaknesses and address them, even if the client does not request them, or realize their value. The burden is on the CPA to ensure their client's compliance or risk professional and/or legal sanctions. This standard raises the bar concerning whether a CPA has the requisite competency and/or expertise to provide services requested or required by clients.

Aside from the legal and professional ethical considerations mentioned there are some important practical implications that CPAs need to carefully evaluate before accepting marijuana industry clients. Because of current federal regulations it is crucial, as mentioned earlier, that CPAs and their marijuana clients maintain a high level of transparency and trust. CPAs must use extreme caution to avoid being gamed or deceived by their clients. This requires a careful vetting of all clients and extensive on-going monitoring activities, which imposes significantly higher costs. Clients must be willing to pay these higher costs of performing services. Further is strongly recommended at all services must be provided under formal engagement agreements that clearly and fully specify each parties' responsibilities. These disclosures should clearly delineate what services the CPA is providing and not providing. Explicit consideration must be given to the greater compliance costs in making the decision to provide services. These costs are significant and increasing in the context of a multi-person practice.

Another important consideration that warrants consideration is that, if the current federal policy changes, the marijuana industry could suddenly face enforcement of the federal laws. Accordingly, CPAs need to have an exit strategy and this must be thoroughly and formally communicated to clients. Recall that individuals are still subject to federal prosecution for a period of up to five years.

Finally, there are significant reputational considerations that should be considered and carefully evaluated by CPAs in connection with providing services to the marijuana industry. Marijuana is a very public regulated industry so your association will most likely become very public. For example, how will other clients, and the larger professional community, react to the decision to provide services? What are the reputational and economic consequences associated with having to suddenly terminate services to clients if federal attitude toward enforcement changes? This would likely impose significant costs on both you and your marijuana clients, and affect your professional reputation.

In conclusion, the marijuana industry is an especially risky bedfellow, particularly the recreational part of the industry. The level of responsibility for both the CPA and clients' actions is extremely high and must be constantly monitored. Further, the current lack of federal enforcement could change virtually overnight, and thus charges could be brought for professional services provided over the previous five years. CPAs could face a morass of legal and ethical charges that would be costly to defend against. Further, there is a possible stigmatism by the professional and business community against CPAs who venture into this industry. Finally, CPAs take pride and satisfaction from providing quality services to their clients. Having to suddenly discontinue providing those services would be detrimental to both the client and the CPA firm.

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